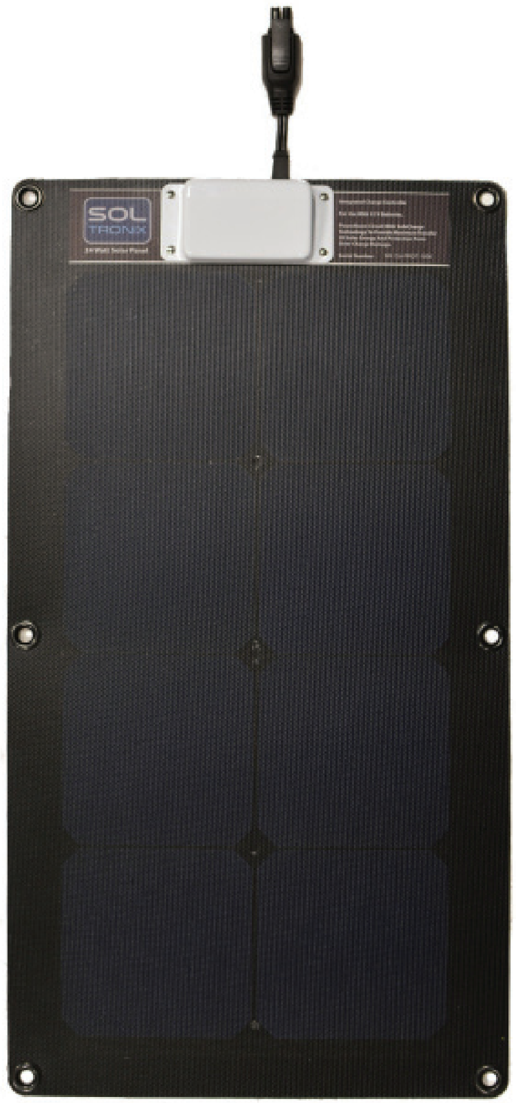
PowerFilm® SOLAR

MADE IN THE USA



New Semi-Flexible Crystalline Silicon Products

2017 Annual Report

PowerFilm, Inc.

2017 Annual Report

Highlights for Fiscal Year 2017

- Revenue of $3.3 million for the year ended December 31, 2017 (2016: $6.1 million).
- Net Loss after tax of $5.0 million for the year ended December 31, 2017 (2016: loss of $2.8 million). An asset impairment loss of $1.8 million for outdated equipment increased the net loss.
- On December 31, 2017, the Company had $4.6 million in cash, cash equivalents, and certificates of deposit (2016: $6.7 million).
- There is no long-term debt on the balance sheet.
- Gross margin for the year ended December 31, 2017 was (18.5%) (2016: 10.6%).
- To improve product margins and profitability by reducing fixed costs, a major cost restructuring was completed to reflect current and future anticipated reductions in revenue.
- There was an increased focus on the addition of semi-flexible crystalline silicon products to the product line, which was a radical departure from the Company's amorphous silicon-only strategy that had been in place since the founding of the Company in 1988.
- Internet of Things (IoT) applications, including asset tracking, remains a fresh growth opportunity for the intermediate term.

Chairman and CEO's Statement

As reported in prior annual reports, a combination of global trends and events over the past several years has resulted in a perfect storm of challenges for PowerFilm:

- The commodification of crystalline silicon photovoltaic (PV) material due to Asian imports significantly reduced the size of the niche for amorphous silicon, our core PV product.
- Budget sequestration resulted in a significant drop in military spending which historically has driven over 70 percent of our revenues.
- The drop in global oil prices greatly curtailed oil exploration, a traditionally strong secondary market for PowerFilm.

Thus, we experienced a drop in revenues from over $11.6 million as recently as 2011 to under $3.3 million in 2017.

We implemented a significant reduction in our cost structure mid-year in 2017. This painful, but necessary, adjustment was handled ethically and professionally. The effort resulted in a monthly savings of roughly $100K, and will be completed within the next couple of months as we consolidate all of our operations into a single facility.

No doubt our history of disciplined cost management helped us outlast almost all other domestically produced PV producers. That is of little solace and alone cannot be extrapolated to ensure our future survival. At best, cost containment buys us time.

In short, we need to identify more sources of revenue that value the unique benefits that PowerFilm's products, manufacturing capabilities, and people provide. Example efforts during 2017 include:

- Defocusing on consumer markets in favor of those where lives or livelihoods depend on the unique advantages of amorphous silicon PV (lightweight, portability, flexibility, durability, and performance under low light conditions) and/or improved reliability provided by PowerFilm's quality processes.
- Expanding our product range with semi flexible crystalline silicon PV for outdoor applications in the 25-100 W range where lower cost outweighs some of the advantages of amorphous silicon.
- Retargeting marketing efforts towards product developers and entrepreneurs, emphasizing our best-in-class ability to provide engineering guidance and prototypes for solar-based, power supply system solutions.
- Restarting our revenue-generating contract research engine.

On a positive note, asset tracking and providing power for industrial Internet of Things (IoT) sensor applications are real, emerging opportunities. The ultimate size of both opportunities remains to be seen.

We hope that raising the federal budget caps for military spending for fiscal years 2018-19 and the recent rise in oil prices will provide some semblance of the "old normal," but we aren't planning on it.

We continue to focus on what we can control. We are developing a sales culture that proactively "hunts" for new opportunities and can also quickly and effectively vet the inquiries that find us. Ultimately, bringing more of those opportunities to profitable products is essential for our future.

Rick Brimeyer
Chairman

Frank R. Jeffrey
CEO

Operational Review

Sales and Marketing

PowerFilm develops, manufactures, markets, and sells a full and diversified line of solar products for the
custom OEM, government and military, and select specialty consumer markets. The Company sells both solar modules to other businesses, as well as finished solar panels and power system products ready out-of-the-box for end-users.

Semi-Flexible Crystalline Silicon Product: Soltronix Crystalline Solutions

In 2017 there was an increased focus on the addition of semi-flexible crystalline silicon products to the product line, which was a radical departure from the Company's amorphous silicon-only strategy that had been in place since the founding of the Company in 1988. These products are currently marketed and sold under the Soltronix brand name.

The new Soltronix products combine high-efficiency crystalline silicon solar cells, custom semi-flexible panel designs and proprietary PowerBoost charge controllers to deliver as much power as possible to targeted applications.

Power for Internet of Things (IoT) Applications

PowerFilm continues to pursue opportunities for powering IoT applications, both indoors and outdoors. The market opportunity is large, broad, unstructured, and still in its early years. The sales cycle for custom panels into this emerging market space is not short and can be more than a year from initial prototyping to volume production. The Company is developing partnerships with Bluetooth communications hardware manufacturers. Development kits have been designed and are available for purchase to aid in expediting customer education on solar integration and prototyping.

Original Equipment Manufacturer (OEM) Custom Panels

The Company engineers and supplies custom solar panels optimized to meet the specific power needs of diverse OEM customers in a wide array of applications.

The core OEM products are available in a variety of voltage configurations, current configurations, and form factors. The core solar panels are encapsulated in different materials depending upon the application need. The encapsulated solar panels are bonded to and integrated with a broad range of materials and power systems. PowerFilm's ability to custom engineer integrated products and total power solutions is a strong source of competitive advantage in the industry. Each prospective custom product inquiry is evaluated for market and technical viability, volume, margin, and total value to the Company.

The solar recharging asset tracking application market, for both railroad cars and semi trailers, continues to be an important target market for growth.

Government and Military

PowerFilm develops and sells ruggedized lightweight “Made in USA” solar products for the military and government market, in a variety of configurations. Also, the new Soltronix ruggedized semi-flexible crystalline silicon panels offer the military an alternative product for solar power.

Shipments continue to long-term military and government customers. It remains an open question whether the increase in US Department of Defense spending will result in an increase in purchases of solar products and related systems.

Specialty Consumer Products and Markets

PowerFilm has specialty products for the Marine, RV, and Golf Car markets.

LightSaver Consumer Products

After gaining the benefit of some initial experience in the market, the focus now is on the highly differentiated LightSaver Max product for larger portable and remote charging needs. PowerFilm has decided not to pursue actively the other smaller products in the LightSaver line given the consumer market’s extreme sensitivity to price over other PowerFilm differentiating factors.

PowerFilm continues to sell its longstanding foldable and rollable solar chargers for the consumer market.

Custom Engineering

PowerFilm custom engineers products for customers with diverse power needs in a variety of application markets. The custom engineering takes many forms, ranging from variation of form factor to encapsulation, to fastening, to electrical termination, and connection. In some cases the PowerFilm engineering group works with customers to optimize the overall power system: solar panel power generation, power storage, and application power use. As a result, the Company is able to provide customers with differentiated optimized solutions that are not generically available in the market.

In addition to our capability of customizing OEM solar panels, we also engineer total power systems for select applications. This is an area where PowerFilm has a competitive edge versus other companies, especially those solar companies with generic commodity products.

Manufacturing Operations

To improve product margins and profitability by reducing fixed costs, a major cost restructuring was completed to reflect the current and future anticipated reduction in revenues in the middle of 2017 given low production volume demand. In 2017 much progress was made on the building consolidation project. The target is to have the move to the newer Building 2 facility complete by the middle of 2018.

<u>Research and Development (R&D)</u>
R&D continues its work on further development of and improvements to PowerFilm's IoT/Low Light technology.

Financial Review

Financial Results
Revenue of $3,255,783 was realized for the year ended December 31, 2017, compared with $6,084,972 for the year ended December 31, 2016. The decrease in 2017 over 2016 was attributable to a $1,870,750 decrease in product sales revenue and a $958,439 decrease in development contract revenue.

Gross Margin for the year ended December 31, 2017 was (18.5%), compared with 10.6% for the year ended December 31, 2016. The net loss was $(4,985,211) for the year ended December 31, 2017, compared with a net loss of $(2,807,637) for the year ended December 31, 2016. An asset impairment loss of $(1.8) million for outdated equipment increased the net loss.

The Company's balance sheet at December 31, 2017 includes cash and cash equivalents of $967,825, short-term certificates of deposit of $3,657,038, and no long-term certificates of deposit. These accounts total $4,624,863 at December 31, 2017, compared to a total of $6,735,024 at December 31, 2016, including long-term certificates of deposit of $780,130.

The Company has no long-term debt.

Interest and dividend income for the year ended December 31, 2017 was $53,699, compared to $103,191 for the previous year. The Company's policy is to place its cash and certificates of deposit with high credit quality financial institutions in order to limit the amount of credit exposure. Although globally interest rates still are at a low level, the Company seeks investments in higher yielding certificates of deposit to get the maximum yields for highly secure investments.

Accounts Reviewed
The financial information in this announcement is from the Company's reviewed accounts for the year ended December 31, 2017.

The information presented herein has been prepared on the basis of current accounting principles generally accepted in the United States of America (US GAAP).

Outlook
The outlook for 2018 will be challenging until additional profitable sales revenue is realized.

From a macro perspective, the overall U.S. economy strengthened in 2017 and now in 2018 is the strongest it has been since 2008 with clear GDP growth and low unemployment. Although interest rates are increasing incrementally, they remain at historically low levels.

A potential global trade war that includes solar products further stokes the unpredictability of the solar industry's future in the U.S. The rules have not yet been set; the situation remains highly dynamic.

China's continued commitment to dominate the solar industry globally has a pronounced ongoing downward impact on solar panel and module prices, and margins, in the U.S. and other markets.

The FY2018 U.S. Department of Defense appropriation (October 1, 2017 to September 30, 2018) is an increase of approximately 10% over the enacted FY2017 level, with Research, Development, Test, and Evaluation increased 22%. It remains an open question how much of that will be spent on solar products and systems, and what share of that PowerFilm will capture.

New people in management and their strategic business plan have been in place for roughly one year. Their fresh approach is expected to move PowerFilm forward to achieve positive cash flow, then positive net income, and ultimately increased company value.

PowerFilm has a broad product line (excluding panels for large power arrays, rooftops, and building integrated) and is pushing its range of products. Ongoing internal analysis of each product in the months ahead—including market size, market traction at price point, and margin durability--will decide if the Company now truly has the product lineup that can be the foundation for sustained positive results.

The year 2018 marks the 30th anniversary of the founding of PowerFilm by physicists and solar industry innovators Frank Jeffrey and Derrick Grimmer. Much progress has been made. Much has been experienced. Much more is expected and anticipated.

The next couple years will be pivotal for the future of the Company.

Forward-looking Statements

This release includes forward-looking statements which are based on certain assumptions and reflect management's current expectations as contemplated under the Safe Harbor provisions of the US Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations. Some of these factors include: uncertainty as to whether our strategies, partnerships and business plans will yield the expected benefits; general global economic conditions; general industry and market conditions and growth rates; increasing competition; the ability to identify, develop and achieve commercial success for new products, services and technologies; changes in technology; changes in laws and regulations, including government incentive programs; intellectual property rights; our ability to secure and maintain strategic relationships, including key supply relationships; the availability and cost of capital; the availability of, and our ability to retain, key personnel; and the failure of the Company to effectively integrate acquisitions. Additional factors are discussed in our public disclosure materials from time to time. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

PowerFilm, Inc. and Subsidiary

Consolidated Financial Report
(Reviewed)
December 31, 2017

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RSM

Contents

RSM US LLP

Independent Accountant's Review Report

Board of Directors and Stockholders
PowerFilm, Inc. and Subsidiary

We have reviewed the accompanying consolidated financial statements of PowerFilm, Inc. and Subsidiary (the Company), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, the related consolidated statements of operations, comprehensive loss, stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements). A review includes primarily applying analytical procedures to management's financial data and making inquiries of management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, we do not express such an opinion.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Accountant's Responsibility
Our responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants. Those standards require us to perform procedures to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. We believe that the results of our procedures provide a reasonable basis for our conclusion.

Accountant's Conclusion
Based on our reviews, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

RSM US LLP

Des Moines, Iowa
May 16, 2018

PowerFilm, Inc. and Subsidiary

Consolidated Balance Sheets
December 31, 2017 and 2016
See Independent Accountant's Review Report

	2017	2016
Assets		
Current assets:		
Cash and cash equivalents	**$ 967,825**	$ 4,112,317
Short-term certificates of deposit	**3,657,038**	1,842,577
Accounts receivable, less allowance for doubtful accounts, 2017 and 2016 $13,545	**259,060**	366,994
Inventories	**2,425,690**	2,702,439
Prepaid expenses and other assets	**103,522**	157,620
Income tax receivable	**19,785**	30,603
Total current assets	**7,432,920**	9,212,550
Long-term certificates of deposit	**-**	780,130
Property and equipment, net	**9,380,811**	12,033,793
Other assets	**31,082**	33,482
	$ 16,844,813	$ 22,059,955
Liabilities and Stockholders' Equity		
Current liabilities:		
Trade accounts payable	**$ 67,644**	$ 69,453
Other payables and accrued expenses	**375,369**	619,897
Total current liabilities	**443,013**	689,350
Commitments		
Stockholders' equity:		
Common stock	**381,687**	381,687
Additional paid-in capital	**32,744,422**	32,736,279
Retained deficit	**(16,270,399)**	(11,285,188)
Treasury stock, at cost	**(453,910)**	(462,173)
Total stockholders' equity	**16,401,800**	21,370,605
	$ 16,844,813	$ 22,059,955

See notes to consolidated financial statements.

PowerFilm, Inc. and Subsidiary

Consolidated Statements of Operations
Years Ended December 31, 2017 and 2016
See Independent Accountant's Review Report

	2017	2016
Operating revenues:		
Sales	**$ 3,249,943**	$ 5,120,693
Development contracts	**5,840**	964,279
	3,255,783	6,084,972
Cost of revenues	**3,858,876**	5,441,584
Gross profit (loss)	**(603,093)**	643,388
Operating expenses:		
Research and development	**1,101,315**	1,310,648
Selling, general and administrative	**1,521,573**	1,826,660
Asset impairment loss	**1,839,392**	-
	4,462,280	3,137,308
Operating loss	**(5,065,373)**	(2,493,920)
Other income (expense):		
Interest income	**53,699**	103,191
Interest expense	**-**	(581,794)
Other	**6,678**	(4,476)
	60,377	(483,079)
Loss before income tax benefit	**(5,004,996)**	(2,976,999)
Income tax benefit	**(19,785)**	(169,362)
Net loss	**$ (4,985,211)**	$ (2,807,637)

See notes to consolidated financial statements.

PowerFilm, Inc. and Subsidiary

Consolidated Statements of Comprehensive Loss
Years Ended December 31, 2017 and 2016
See Independent Accountant's Review Report

	2017	2016
Net loss	**$ (4,985,211)**	$ (2,807,637)
Other comprehensive income (expense):		
Unrealized derivative gain arising during the period before income tax expense	**-**	442,682
Income tax expense	**-**	(130,123)
Comprehensive loss	**$ (4,985,211)**	$ (2,495,078)

See notes to consolidated financial statements.

PowerFilm, Inc. and Subsidiary

Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2017 and 2016
See Independent Accountant's Review Report

	Common Stock	Additional Paid-In Capital	Retained Deficit	Treasury Stock	Accumulated Other Comprehensive Loss	Total Equity
Balance, December 31, 2015	$ 381,687	$ 32,748,004	$ (8,477,551)	$ (476,545)	$ (312,559)	$ 23,863,036
Net loss	-	-	(2,807,637)	-	-	(2,807,637)
Unrealized derivative gain, net of tax expense of $130,123	-	-	-	-	312,559	312,559
Restricted shares issued	-	(14,280)	-	14,875	-	595
Restricted shares forfeited to treasury shares	-	503	-	(503)	-	-
Restricted shares repurchased	-	(42)	-	-	-	(42)
Stock-based compensation expense	-	2,094	-	-	-	2,094
Balance, December 31, 2016	381,687	32,736,279	(11,285,188)	(462,173)	-	21,370,605
Net loss	-	-	(4,985,211)	-	-	(4,985,211)
Restricted shares issued	-	(14,400)	-	15,000	-	600
Restricted shares forfeited to treasury shares	-	6,737	-	(6,737)	-	-
Restricted shares repurchased	-	(273)	-	-	-	(273)
Stock-based compensation expense	-	16,079	-	-	-	16,079
Balance, December 31, 2017	**$ 381,687**	**$ 32,744,422**	**$ (16,270,399)**	**$ (453,910)**	**$ -**	**$ 16,401,800**

See notes to consolidated financial statements.

PowerFilm, Inc. and Subsidiary

Consolidated Statements of Cash Flows
Years Ended December 31, 2017 and 2016
See Independent Accountant's Review Report

	2017	2016
Cash flows from operating activities:		
Net loss	**$ (4,985,211)**	$ (2,807,637)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	**1,135,743**	1,290,096
(Gain) loss on disposal of equipment	**(450)**	13,702
Asset impairment loss	**1,839,392**	-
Stock-based compensation expense	**16,079**	2,052
Interest expense recognized upon elimination of interest rate swap	**-**	390,000
Deferred income taxes	**-**	(130,123)
Changes in working capital components:		
Accounts receivable	**107,934**	616,787
Inventories	**276,749**	461,533
Prepaid expenses and other assets	**54,098**	(8,817)
Income tax receivable	**10,818**	(25,226)
Trade accounts payable	**(1,809)**	(226,189)
Other payables and accrued expenses	**(244,528)**	271,348
Net cash used in operating activities	**(1,791,185)**	(152,474)
Cash flows from investing activities:		
Purchase of property and equipment	**(319,753)**	(431,453)
Proceeds from sale of property and equipment	**450**	5,657
Proceeds from calls of restricted securities held-to-maturity	**-**	1,000,000
Proceeds from maturities of certificates of deposits	**780,130**	4,676,106
Purchase of certificates of deposits	**(1,814,461)**	-
Net cash provided by (used by) investing activities	**(1,353,634)**	5,250,310
Cash flows from financing activities:		
Principal payments on long-term debt	**-**	(3,125,000)
Payment made to unwind the interest rate swap	**-**	(390,000)
Proceeds from issuance of restricted shares	**327**	595
Net cash provided by (used in) financing activities	**327**	(3,514,405)
Net increase (decrease) in cash and cash equivalents	**(3,144,492)**	1,583,431
Cash and cash equivalents:		
Beginning	**4,112,317**	2,528,886
Ending	**$ 967,825**	$ 4,112,317

(Continued)

PowerFilm, Inc. and Subsidiary

Consolidated Statements of Cash Flows (Continued)
Years Ended December 31, 2017 and 2016
See Independent Accountant's Review Report

	2017	2016
Supplemental disclosure of cash flow information:		
Cash payments (refunds received) for:		
Interest, net of capitalized	$ -	$ 108,836
Income taxes	$ (30,603)	$ 16,590
Supplemental schedule of noncash investing and financing activities:		
Gain on interest rate swap agreement	$ -	$ 442,682
Restricted shares awarded from treasury shares, net of forfeitures	$ 8,263	$ 14,372

See notes to consolidated financial statements.

Note 1. Summary of Significant Accounting Policies

Nature of business: PowerFilm, Inc. was incorporated on October 13, 1988, for the purpose of research and development of thin film technologies. PowerFilm, Inc.'s focus is now the use of such developed technologies to manufacture solar modules. PowerFilm, Inc. sells its solar modules throughout the world and continues to enter into research contracts to further develop the thin film technology for use in the manufacturing of solar cells. Phicot, Inc. was incorporated as a subsidiary during 2008 for the purpose of conducting further research and development under certain research contracts. The Phicot, Inc. related contracts expired during 2012 and the entity has not had any activities since the contract expiration.

Principles of consolidation: The consolidated financial statements include the accounts of PowerFilm, Inc. and its 92 percent owned subsidiary, Phicot, Inc. (collectively, the Company). All intercompany balances and transactions have been eliminated in consolidation.

Use of estimates: The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents: The Company considers all cash accounts and all highly liquid investments with an original maturity of three months or less to be cash equivalents. At December 31, 2017 and 2016, approximately none and $127,000, respectively, of cash is denominated in a foreign currency. During the year ended December 31, 2016, approximately $28,000 of foreign currency loss was recognized in other income on the consolidated statements of operations and none for December 31, 2017.

Certificates of deposit: Certificates of deposit not meeting the definition of a cash equivalent are classified as current or long-term based on remaining months to maturity as of December 31, 2017 and 2016. As of December 31, 2017, all certificates of deposit are in United States banks, are recorded at cost and mature from January 2018 through November 2018. Interest income on these certificates is recorded on the accrual basis.

Accounts receivable: Accounts receivable are carried at original invoice amount less an estimate for doubtful receivables based on a review of outstanding amounts. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Accounts receivable are written off when deemed uncollectible. Recoveries of accounts receivable previously written off are recorded when received.

Inventories: Inventories are stated at the lower of cost or net realizable value, with cost determined on the first-in, first-out (FIFO) basis.

Property and equipment: Property and equipment is recorded at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the related assets. During 2017 and 2016, the Company capitalized interest totaling approximately none and $50,000, respectively, related to construction in progress. Construction in progress is not depreciated until items are complete and placed in service.

Note 1. Summary of Significant Accounting Policies (Continued)

Long-lived assets: The Company evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted future cash flows expected to result from the use and eventual disposition of the asset are less than the carrying amount of the asset, an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value. An impairment loss of approximately $1,839,000 and none was recognized during the years ended December 31, 2017 and 2016, respectively.

Revenue recognition: Revenue from product sales is recognized upon shipment of the product to the customer. Revenue from development contracts is recognized as services are performed. Shipping and handling charges to customers are included in operating revenue. Shipping and handling costs incurred by the Company are included in cost of revenues.

Foreign sales: Sales to customers located in foreign countries (primarily Norway and India) totaled approximately $446,000 and $1,146,000 for the years ended December 31, 2017 and 2016, respectively.

Concentration of credit risk: The Company's financial instruments that are subject to concentrations of credit risk consist primarily of cash, certificates of deposit and accounts receivable. The Company's policy is to place its cash and certificates of deposit with high credit quality financial institutions in order to limit the amount of credit exposure. The Company maintains cash in bank accounts and certificates of deposit that at times may exceed federally insured limits. The Company has not experienced any losses in such accounts.

Stock-based compensation: Compensation cost for all stock-based awards is measured at fair value on the date of grant and is recognized as compensation expense over the requisite service period for awards expected to vest. The Company's consolidated statements of operations include stock-based compensation expense of approximately $16,100 and $2,100 for the years ended December 31, 2017 and 2016, respectively.

Income taxes: Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The Company follows the accounting standard on accounting for uncertainty in income taxes, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, the Company may recognize the tax benefit from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement. The guidance on accounting for uncertainty in income taxes also addresses de-recognition, classification, interest and penalties on income taxes. The Company has evaluated their material tax positions and determined no effects on the financial statements related to uncertainty to income taxes.

Note 1. Summary of Significant Accounting Policies (Continued)

Derivative financial instruments: During the year ended December 31, 2016, the Company had an interest rate swap derivative in order to manage the interest rate exposure on a portion of its long-term debt. The swap was accounted for as a cash flow hedge under Accounting Standards Update (ASU) No. 2014-03. Accordingly, changes in the carrying value were recognized in equity as a gain or loss to accumulated other comprehensive income or loss. The Company had elected under ASU 2014-03 to measure the swap at settlement value. During the year ended December 31, 2016, the Company terminated its interest rate swap due to debt payoff, resulting in a realized loss of $390,000 which is reported in interest expense on the consolidated statement of operations.

Accumulated other comprehensive loss: Accumulated other comprehensive loss consisted of the effective portion of net gains or losses on the derivative instrument designated as a qualifying cash flow hedge.

Recent accounting pronouncements: In May 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606),* requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. In August of 2015, the FASB issued ASU No. 2015-14, which defers the effective date of ASU 2014-09 one year making it effective for annual reporting periods beginning after December 15, 2018. The Company has not yet selected a transition method and is currently evaluating the effect that the updated standard will have on the consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The guidance in this update supersedes the requirements in ASC Topic 840, Leases. The update will require business entities to recognize lease assets and liabilities on the balance sheet and to disclose key information about leasing arrangements. A lessee would recognize a liability to make lease payments and a right-of-use asset representing its right to use the leased asset for the lease term. This update will be effective for annual periods beginning after December 15, 2019, and is to be applied on a modified retrospective basis. The Company is currently assessing the impact that this guidance will have on its consolidated financial statements.

Note 2. Inventories

Inventories were composed of the following at December 31:

	2017	2016
Raw materials	$ 748,940	$ 777,795
Work in process	1,068,532	1,265,247
Finished products	608,218	659,397
	$ 2,425,690	$ 2,702,439

Note 3. Property and Equipment

Property and equipment consisted of the following at December 31, 2017 and 2016:

	2017	2016
Land	$ 972,432	$ 972,432
Building and improvements	5,059,825	5,059,825
Machinery and equipment	12,068,686	12,886,143
Leasehold improvements	272,276	272,276
Construction in progress	2,343,571	3,695,546
	20,716,790	22,886,222
Less accumulated depreciation	(11,335,979)	(10,852,429)
	$ 9,380,811	$ 12,033,793

Note 4. Revenue Bonds Payable

During the year ended December 31, 2016, the Company paid in full a $3,125,000 tax exempt industrial revenue bond issued by the Iowa Finance Authority. Interest expense recognized on outstanding revenue bond borrowings during the year ended December 31, 2016, totaled approximately $99,000.

Note 5. Income Taxes

Approximate income tax benefit consists of the following for the years ended December 31, 2017 and 2016:

	2017	2016
Current benefit	$ (20,000)	$ (39,000)
Deferred expense	-	(130,000)
	$ (20,000)	$ (169,000)

Approximate income tax benefit differs from the amount expected by applying the statutory federal tax rate to loss before taxes as a result of the following:

	2017	2016
Tax benefit at the statutory tax rate	$ (1,702,000)	$ (1,012,000)
Increase in tax resulting from:		
Tax credit carryforward	(61,000)	(78,000)
Refundable state tax credit	(20,000)	(31,000)
Change in effective tax rate (A)	2,011,000	-
Change in valuation allowance	(287,000)	912,000
Other, net	39,000	40,000
Tax benefit at effective tax rate	$ (20,000)	$ (169,000)

Note 5. Income Taxes (Continued)

(A) On December 22, 2017, the Tax Cuts and Jobs Act (the Act) was signed into law. The Act includes numerous changes in existing tax law, including a permanent reduction in the federal corporate income tax rate to 21 percent. The rate reduction takes effect on January 1, 2018. As a result of the reduction of the federal corporate income tax rates, the Company's deferred tax assets and liabilities were revalued. The effect on deferred tax assets and liabilities of the change in tax rate is recognized in income in the period of enactment of the bill (December 22, 2017). The corporate rate reduction component resulted in an additional income tax expense and corresponding reduction of the net deferred tax asset of approximately $2,011,000 in 2017 related to the revaluation of its deferred tax assets and liabilities. This expense only impacted the valuation allowance and thus there was no impact on income or loss from continuing operations.

The tax effects of significant items comprising the Company's net deferred tax assets (liabilities) as of December 31, 2017 and 2016, is as follows:

	2017	2016
Deferred tax assets:		
Accrued expenses	$ 29,000	$ 63,000
Tax credit carryforward	455,000	395,000
Net operating loss carryforward	3,478,000	4,407,000
Other	10,000	13,000
	3,972,000	4,878,000
Less valuation allowance	(3,739,000)	(4,026,000)
	233,000	852,000
Deferred tax liabilities:		
Property and equipment	(198,000)	(817,000)
Other	(35,000)	(35,000)
	(233,000)	(852,000)
Net deferred tax assets	$ -	$ -

As of December 31, 2017 and 2016, the Company has recorded a valuation allowance against its net deferred tax assets due to the uncertainty of future utilization.

As of December 31, 2017, the Company has unused net operating loss carryforwards of approximately $16,400,000 which expire beginning in 2030 through 2037.

Note 6. Related Party Lease

The Company leases its offices and manufacturing facility from a stockholder. The lease was renewed in 2016 to extend the maturity to December 31, 2020, with monthly lease payments of $7,500. Future rental commitments are $90,000 for each of the years ended December 31, 2018, 2019 and 2020. Rent expense under this lease totaled $90,000 for each of the years ended December 31, 2017 and 2016. Rent expense was offset by approximately $47,000 of sublease income during each of the years ended December 31, 2017 and 2016.

Note 7. 401(k) Plan

The Company has a 401(k) profit sharing plan which covers substantially all employees of the Company. The Company may make annual contributions to the plan at the discretion of the Board of Directors. The Company contributed approximately $185,000 and $240,000 during the years ended December 31, 2017 and 2016, respectively.

Note 8. Major Customers

The Company considers a customer which accounts for 10 percent or more of sales to be a major customer. There were no major customers for the year ended December 31, 2017. Sales for the year ended December 31, 2016, include sales to the following major customers, together with the approximate accounts receivable due from those customers.

	2016	
	Net Sales	Accounts Receivable
Customer A	16%	$ 36,000
Customer B	15	17,000
Customer C	13	-

Note 9. Components of Common Stock

Information regarding components of $0.01 par value common stock at December 31, 2017 and 2016, is as follows:

	Authorized Shares	Issued Shares	Outstanding Shares
2017	60,000,000	38,168,779	36,306,964
2016	60,000,000	38,168,779	36,274,264

The Company issued 60,000 and 59,500 shares of restricted stock out of treasury shares during the years ended December 31, 2017 and 2016, respectively. An additional 27,300 and 4,200 shares previously issued under the restricted stock plans discussed in Note 9 were forfeited during 2017 and 2016, respectively, prior to vesting. Per the terms of the restricted stock plan, these shares are to be held in treasury and are available for future grant under the plans.

Note 10. Stock-Based Compensation

The Company's Board of Directors adopted the 2012 Restricted Stock Plan (2012 Plan) during May 2012, the 2013 Restricted Stock Plan (2013 Plan) during January 2014, and the 2016 Restricted Stock Plan (2016 Plan) during June 2016. Under these plans, restricted shares may be granted to any full-time employee of the Company, except officers and directors. Common shares issued under the plans may not be sold or otherwise transferred until restrictions have lapsed. During the vesting period, participants have voting rights and receive dividends on the restricted shares. The 2012 Plan, 2013 Plan and 2016 Plan authorized a total of 61,500, 38,000 and 167,500 shares, respectively, to be available for grant. Awards that are forfeited prior to vesting are held in treasury. At December 31, 2017 and December 31, 2016, there were 81,000 and 114,000, respectively, shares remaining available for future grant under these plans.

The fair value of restricted stock awards, based on the fair value of the Company's common stock on the date of grant, is being amortized as compensation expense on a straight-line basis over the period the restrictions lapse. Compensation expense related to restricted share awards totaling approximately $16,100 and $2,100 is included in selling, general and administrative expenses on the consolidated statement of operations for the years ended December 31, 2017 and 2016, respectively. As of December 31, 2017, unrecognized compensation cost for restricted stock totaled approximately $12,800 which is expected to be recognized over a weighted average remaining period of approximately 2.9 years.

Note 11. Subsequent Events

Subsequent events have been evaluated for potential recognition and disclosure through May 16, 2018, the date the financial statements were issued. Through that date, there were no events requiring recognition or disclosure.