HOMASOTE®

2018 Annual Report
Our 109th Year

About Us

Homasote Company is America's leading green building products manufacturer. Most of our base products are manufactured from Homasote® board which is made from 98% recycled paper fiber. The remaining 2% is comprised of environmentally-friendly materials that give our products their strength, water resistance and mold/mildew resistance. They contain no added urea formaldehyde, phenolics or resins to outgas.

We categorize our served markets into two sales divisions. The larger is our millboard division that supplies a variety of products including sound insulation in walls and floors (440 SOUNDBARRIER®), roof decking (HOMASOTE EASY-PLY®, FIRESTALL®), floor decking (HOMASOTE 4-WAY® floor decking), concrete expansion joint and forming board (HOMEX®), and finished interior panels (NovaCork, DesignWall, PINnacle™ panels).

Our industrial division is the smaller of the two sales divisions and serves the glass, metal and paper industries with a variety of shapes and coated strips for product separation and breakage reduction, along with custom designed packaging that protects customers' products during interplant transport (PAK-LINE®, STAPLE-SAFE®). Homasote products are used in everything from finished caskets to blocking for refrigerator doors during shipping.

Whether you need sound control for a home theatre installation or a joint filler for your driveway that contains no harmful bituminous material, you can count on Homasote to deliver time tested performance while keeping an eye on the planet. Homasote, Sensible. Sound. Solutions.

To Shareholders and Employees

Herewith is presented the Annual Report of your Company for the year ended December 31, 2018.

As 2018 drew to a close we were pleased to do so on continued solid ground. This was a year in which we made strides in streamlining our production of basic board and further the cost cutting programs we had already started. Our overall cash flow and balance sheet continues to improve as we increased our gross profit to 32.6% while our sales were just slightly below our 2017 number. We saw a decrease in sales starting in the fourth quarter and attribute that to weather conditions throughout the country along with fires on the west coast.

Accomplishments & Projects Completed through 2018 were:

- Installation of 2nd pulping exhaust fan
- Replacement of #10 chest
- Rebuilding of Ultra screen

Major Projects started in 2019:

- Design / Install new paper chute for backup pulper
- New switch gear and restart of Cogen facility
- Demo of old boiler house
- New banders for Homex cutting line
- Rebuild and replace 2 RAM cylinders – first unit press
- Replace 2 cyclones
- Rebuild 2nd Ultra screen
- Examine and possibly rebuild Ultra sorter
- Add extra side hill screen

Year In Review

Millboard sales results were as follows: millboard products, including our flagship 440 SoundBarrier, decreased by 7%. Homex expansion joint and forming boards increased 1%. Nova pre-finished interior panels increased by 19%. Industrial (Pak-Line Division) sales increased by 3%.

Net sales for 2018 were $20,620,354 versus 2017 sales of $20,643,785, a decrease of $23,431. Net income for the year was $997,849, resulting in diluted earnings per common share of $2.77. The 2017 net income was $1,396,773. Working capital was $(4.4) million, a decline of $1.0 million from the previous year.

We wish to acknowledge and express our appreciation for the many years of loyal effort and cooperation given to Homasote Company by our 2018 retiree, Mr. Ed Flynn.

We wish to thank our loyal shareholders, employees, directors, officers, customers and suppliers for their continued support and we value each of you.

Homasote Management Team

Warren L. Flicker
Chairman of the Board,
Chief Executive Officer

Ronald D. Fasano
Chief Financial Officer
& Treasurer

Peter Tindall
Vice President,
Operations

Homasote Company

Five Year Highlights

	2018	2017	2016	2015	2014
Net sales	$ 20,620,354	$ 20,643,785	$ 20,867,302	$ 19,409,538	$ 20,410,058
Depreciation	$ 938,656	$ 896,902	$ 836,108	$ 790,650	$ 763,105
Net income	$ 997,849	$ 1,396,773	$ 524,527	$ 234,651	$ 631,772
Common shares outstanding (weighted average):					
Basic	359,744	359,411	358,656	357,587	356,407
Diluted	360,319	359,976	359,666	357,582	357,132
Net earnings per common share:					
Basic	$ 2.77	$ 3.89	$ 1.46	$ 0.66	$ 1.77
Diluted	$ 2.77	$ 3.88	$ 1.46	$ 0.66	$ 1.77
Dividends – declared and paid	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Dividends per share	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Working capital	$ (4,426,344)	$ (3,422,907)	$ (4,139,607)	$ (3,913,866)	$ (3,784,006)
Working capital ratio	.4:1	.5:1	.4:1	.4:1	.5:1
Capital expenditures	$ 647,258	$ 536,389	$ 714,836	$ 824,710	$ 532,035
Total assets	$ 10,990,886	$ 11,438,525	$ 11,588,444	$ 11,863,314	$ 12,369,176
Long-term debt, excluding current portion	$ 181,088	$ 2,384,483	$ 3,514,355	$ 4,436,026	$ 4,391,043
Stockholders' equity	$ (1,458,356)	$ (2,280,302)	$ (3,906,188)	$ (4,578,184)	$ (3,897,190)
Common shares outstanding	$ 360,619	$ 360,219	359,999	359,599	357,399
Per share book value of common stock	$ (4.04)	$ (6.33)	$ (10.85)	$ (12.73)	$ (10.90)

Two Year Dividend and Stock Price Comparison

CASH DIVIDENDS

Quarterly cash dividends for the last two years were as follows:

Quarter	2018	2017
First	$ 0.00	$ 0.00
Second	0.00	0.00
Third	0.00	0.00
Fourth	0.00	0.00
	$ 0.00	$ 0.00

STOCK PRICES

Quarterly stock prices for the Company's common stock for the last two years were as follows:

	2018		2017	
Quarter	High	Low	High	Low
First	$10.25	$ 7.45	$ 4.10	$ 3.25
Second	$ 9.00	$ 7.26	$ 4.10	$ 3.41
Third	$12.04	$ 6.27	$ 3.99	$ 1.96
Fourth	$11.83	$ 8.79	$ 8.00	$ 2.79

The common stock of the Company is traded over-the-counter.

The number of Stockholders of record of the Company at December 31, 2018 is 155 and 2017 is 161.

Profile Homasote Company manufactures building and industrial products used in various construction and manufacturing industries.

Statements of Income

Years Ended December 31

	2018	2017	2016
Net sales	$ 20,620,354	$ 20,643,785	$ 20,867,302
Cost of sales	13,893,238	14,073,754	14,609,963
Gross profit	6,727,116	6,570,031	6,257,339
Selling, general and administrative expenses	4,823,626	4,597,427	4,976,192
Operating income	1,903,490	1,972,604	1,281,147
Other income (expense):			
Interest expense	(492,169)	(539,636)	(562,205)
Other (expense) income	(328,906)	151,184	4,586
NPBC – other components	(84,566)	(187,379)	(199,001)
Income before income tax expense	1,005,060	1,396,773	524,527
Income tax expense	—	—	—
Net income	$ 997,849	$ 1,396,773	$ 524,527
Net earnings per common share:			
Basic	$ 2.77	$ 3.89	$ 1.46
Diluted	$ 2.77	$ 3.88	$ 1.46
Weighted average common shares outstanding:			
Basic	359,744	359,011	358,656
Diluted.	360,319	359,976	359,666

See accompanying notes to financial statements.

Statements of Comprehensive (Loss) Income

Years Ended December 31

	2018	2017	2016
Net income	$ 997,849	$ 1,396,773	$ 524,527
Other comprehensive (loss) income:			
Net actuarial (loss) gain of retirement benefit plans:			
Unrealized loss arising during the period	(439,447)	(45,823)	(109,187)
Amortization of actuarial gain	258,037	270,869	253,826
Total other comprehensive (loss) income	(181,410)	225,046	144,639
Comprehensive income	$ 816,439	$ 1,621,819	$ 669,166

See accompanying notes to financial statements.

Homasote Company

Balance Sheets

December 31

ASSETS	**2018**		**2017**	
Current Assets:				
Cash and cash equivalents	$ 156,059		$ 50,642	
Accounts receivable (net of allowance for doubtful accounts of $46,000 in 2018 and 2017)	1,422,163		1,599,268	
Inventories	1,168,206		1,339,414	
Prepaid expenses and other current assets	318,984		243,380	
Total Current Assets		$ 3,065,412		$ 3,232,704
Property, plant and equipment, net		7,894,736		8,186,134
Deferred income taxes		30,738		19,687
Total Assets		$ 10,990,886		$ 11,438,525
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current Liabilities:				
Short-term debt, net of unamortized issuance cost of $0 in 2018 and $11,412 in 2017	$ 1,898,917		$ 1,933,405	
Current portion of long-term debt	2,305,109		1,145,722	
Accounts payable.	2,429,692		3,023,959	
Accrued expenses	759,038		453,525	
Current portion of obligations under benefit plans	99,000		99,000	
Total Current Liabilities		$ 7,491,756		$ 6,655,611
Long-term debt, net of unamortized issuance cost of $0 in 2018 and $14,454 in 2017		181,088		2,384,483
Deferred income taxes		30,738		19,687
Obligations under benefit plans		3,901,124		3,814,510
Other liabilities		844,536		844,536
Total Liabilities		12,449,242		13,718,827
Commitments and Contingencies				
Stockholders' Equity:				
Common stock, par value $0.20 per share; Authorized 1,500,000 shares; Issued 875,815 shares in 2018 and 875,415 shares in 2017	175,163		175,119	
Additional paid-in capital	962,987		957,524	
Retained earnings	8,574,016		7,576,167	
Accumulated other comprehensive loss	(3,659,693)		(3,478,283)	
	6,052,473		5,230,527	
Less cost of common shares in treasury, 515,196 shares in 2018 and 2017	7,510,829		7,510,829	
Total Stockholders' Equity.		(1,458,356)		(2,280,302)
Total Liabilities and Stockholders' Equity		$10,990,886		$ 11,438,525

See accompanying notes to financial statements.

Homasote Company

Statements of Changes in Stockholders' Equity

Years Ended December 31

	COMMON STOCK SHARES	COMMON STOCK PAR VALUE	ADDITIONAL PAID IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME	TREASURY STOCK	TOTAL STOCKHOLDERS' EQUITY
Balances at January 1, 2016	359,599	$174,959	$950,787	$5,654,867	$(3,847,968)	$(7,510,829)	$(4,578,184)
Net income				524,527			524,527
Net change in unrecognized retirement benefit plans					144,639		144,639
Other comprehensive income							669,166
Issuance of restricted stock, vested and non-vested	400	80	(80)				
Share based compensation			2,830				2,830
Balances at December 31, 2016	359,999	175,039	953,537	6,179,394	(3,703,329)	(7,510,829)	(3,906,188)
Net income				1,396,773			1,396,773
Net change in unrecognized retirement benefit plans					225,046		225,046
Other comprehensive income							1,621,819
*Issuance of restricted stock, vested and non-vested	220	80	(80)				
Share based compensation			4,067				4,067
Balances at December 31, 2017	360,219	175,119	957,524	7,576,167	(3,478,283)	(7,510,829)	(2,280,302)
Net income				997,849			997,849
Net change in unrecognized retirement benefit plans					(181,410)		(181,410)
Other comprehensive income							816,439
*Issuance of restricted stock, vested and non-vested	400	44	(44)				
Share based compensation			5,507				5,507
Balances at December 31, 2018	360,619	$175,163	$962,987	$8,574,016	$(3,659,693)	$(7,510,829)	$(1,458,356)

*Par Value balance reflects corrected 2017 entry.

See accompanying notes to financial statements.

Homasote Company

Statements of Cash Flows

Years Ended December 31

	2018	2017	2016
Cash flows from operating activities:			
Net income	$ 997,849	$ 1,396,773	$ 524,527
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	938,656	896,902	836,108
Bad debt expense	—	—	(51,857)
Share based compensation expense	5,507	4,067	2,830
Amortization of retirement plans actuarial gain and loss	258,037	270,869	253,826
Changes in assets and liabilities:			
Decrease (increase) in accounts receivable, net	177,105	(46,372)	(413,159)
Decrease (increase) in inventories	171,208	(119,713)	618,314
Increase in prepaid expenses and other current assets	(75,604)	(52,595)	(12,499)
(Decrease) increase in accounts payable	(594,267)	(557,464)	200,109
Increase (decrease) in accrued expenses	305,513	(86,919)	(43,892)
Decrease in obligations under benefit plans	(352,832)	(207,650)	(187,609)
Decrease in other liabilities	—	—	(34,916)
Net cash provided by operating activities	1,831,172	1,497,898	1,691,782
Cash flows from investing activities:			
Capital expenditures	(647,258)	(536,389)	(714,836)
Net cash used in investing activities	(647,258)	(536,389)	(714,836)
Cash flows from financing activities:			
Net (repayment of) proceeds from issuance of short-term debt	(45,900)	142,694	(136,186)
Net repayment of long-term debt	(1,058,463)	(1,117,826)	(866,201)
Debt issuance costs, net	25,866	28,219	23,398
Net cash used in financing activities	(1,078,497)	(946,913)	(978,989)
Net increase (decrease) in cash and cash equivalents	105,417	14,596	(2,043)
Cash and cash equivalents at beginning of year	50,642	36,046	38,089
Cash and cash equivalents at end of year	$ 156,059	$ 50,642	$ 36,046
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	$ 466,303	$ 511,419	$ 538,807

See accompanying notes to financial statements.

Notes to Financial Statements

December 31, 2018, 2017 and 2016

Note 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS: Homasote Company is in the business of manufacturing wood fiberboard products used in a variety of building material applications including sound insulation, thermal insulation, floor and roof decking and interior tack panels. The Company also manufactures an industrial packaging product line consisting primarily of glass, paper and metal separators. Sales in 2018 were distributed as follows: Building material wholesalers and contractors, approximately 57%; industrial manufacturers, approximately 43% and in 2017, building material wholesalers and contractors, approximately 59%; industrial manufacturers, approximately 41% and in 2016, building material wholesalers and contractors, approximately 58%; industrial manufacturers, approximately 42%. The Company's primary basic raw material, post-consumer wastepaper, is generally readily available from various regional suppliers.

CASH AND CASH EQUIVALENTS: The Company considers all highly liquid debt instruments purchased with a maturity of ninety days or less to be cash equivalents.

INVENTORY VALUATION: Inventories are valued at the lower of cost (first-in, first-out) or net realizable value.

PROPERTY, PLANT AND EQUIPMENT: Property, plant and equipment are stated at cost. Depreciation of property, plant and equipment is computed using the straight-line and various accelerated methods at rates adequate to depreciate the cost of applicable assets over their expected useful lives. Maintenance and repairs are charged to operations as incurred. Alterations and major overhauls which extend the lives or increase the capacity of plant assets are capitalized. The cost of assets retired or otherwise disposed of and the accumulated depreciation thereon is removed from the accounts with any gain or loss realized upon sale or disposal charged or credited to operations.

PRODUCT WARRANTIES: Product warranty costs are accrued when the covered products are delivered to the customer. Product warranty expense is recognized based on the terms of the product warranty and the related estimated costs, considering historical claims expense. Accrued warranty costs are reduced as these costs are incurred and as the warranty period expires. The table presents the changes in the Company's accrual for product warranties, which is included in accrued expenses, for the years ended December 31, 2018 and 2017.

	2018	2017
Balance at January 1	$ 25,000	$ 89,471
Accruals and adjustments for product warranties issued during the period	14,922	80,460
Settlements made during the period	(14,922)	(144,931)
Balance at December 31	$ 25,000	$ 25,000

REVENUE RECOGNITION: Revenue from product sales is recognized when the related goods are shipped and title and risk of loss pass to the buyer. The Company generally has no obligations after the product is shipped except for routine and customary warranties. Consequently, the point at which the Company recognizes revenue is subject to very little judgment and subjectivity.

NET EARNINGS PER SHARE: Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 260, *Earnings Per Share*, requires presentation of basic earnings per share and diluted earnings per share. Basic earnings per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share gives effect to all dilutive potential common shares outstanding during the period.

BUSINESS AND CREDIT CONCENTRATIONS: Sales of the Company's products are dependent upon the economic conditions of the housing and manufacturing industries. Changes in these industries may significantly affect management's estimates and the Company's performance.

The Company's customers are located throughout the United States of America. Additionally, export sales, 38% to Canada and the balance to other countries, accounted for approximately 4%, 3% and 4% of the Company's sales in the years ended December 31, 2018, 2017 and 2016, respectively. One customer accounted for 11%, 13% and 11% of the Company's sales in 2018, 2017 and 2016, respectively. Additionally, one customer accounted for 7% of accounts receivable at December 31, 2018 and 2017.

Note 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

ACCOUNTS RECEIVABLE: The Company records accounts receivable at net realizable value. This value includes an appropriate allowance for uncollectible accounts to reflect any loss anticipated on the accounts receivable balances. The Company calculates this allowance based on the history of write-offs, level of past-due accounts based on the contractual terms of the receivables, and the Company's relationships with and economic status of its customers.

FAIR VALUE OF FINANCIAL INSTRUMENTS: Cash and cash equivalents, trade accounts receivable, trade accounts payable and accrued expenses are reflected in the financial statements at carrying value, which approximates fair value due to the short-term nature of these instruments. The carrying value of the Company's borrowings approximates their fair value based on the current rates available to the Company for similar instruments.

PENSIONS AND OTHER POSTRETIREMENT PLANS: The Company has a non-contributory pension plan covering substantially all of its employees who meet age and service requirements. Employees hired subsequent to April 1, 2010 are not eligible to enter the pension plan. Effective March 1, 2012 the pension plan was amended to discontinue benefit accruals. Additionally, a supplemental non-contributory plan, curtailed for active employees in 2005, covers certain retired key employees of the Company. The Company also provides certain health care benefits, discontinued for new employees hired on or after January 1, 2005, to retired employees. The Company records annual expenses relating to its pension benefit and postretirement plans based on calculations which include various actuarial assumptions, including discount rates, assumed asset rates of return and turnover rates. The Company reviews its actuarial assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends. The effects of the gains, losses, and prior service costs and credits are amortized over future service periods. In accordance with FASB ASC 715, the funding status, or projected benefit obligation less plan assets, if any, for each plan, is reflected in the Company's balance sheet.

Refer to Note 7 (Post Employment Benefit Plans).

SHARE-BASED COMPENSATION COSTS: The Company has an incentive plan (the "2008 Stock Plan") which rewards "key persons", as defined, with restricted shares of Common Stock. Shares awarded vest in four equal annual installments based on the date of grant. The cost of these awards is determined using the market price of the shares on the date of grant. Compensation expense is recognized over the requisite vesting period and adjusted for actual forfeitures before vesting. On December 13, 2010 the 2008 Stock Plan was amended and restated (the "Amended Stock Plan"). Shares awarded to employees under the Amended Stock Plan vest in five equal annual installments based on the date of grant. Other provisions of the stock award incentive plan continue substantially unchanged.

Refer to Note 8 (Share-based Compensation).

INCOME TAXES: In accordance with FASB ASC 740, income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. 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 measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled.

The Company has adopted accounting guidance related to accounting for uncertainty in income taxes. Under the "more-likely-than-not" threshold guidelines, the Company believes no significant uncertain tax positions exist, either individually or in the aggregate, that would give rise to the non-recognition of an existing tax benefit. As of December 31, 2018, 2017 and 2016, the Company had no material unrecognized tax benefits or accrued interest and penalties. The Company's policy is to account for interest as a component of interest expense and penalties as a component of Selling, general and administrative expense.

Note 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

IMPAIRMENT OF LONG-LIVED ASSETS: Long lived assets, such as property, plant and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset, which is generally based on discounted cash flows.

USE OF ESTIMATES: The preparation of 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. Areas in which the Company makes such estimates include inventory valuation, the valuation of long-lived assets, accounts receivable, deferred tax assets and pension and postretirement benefits, among others. Actual results could differ from those estimates.

RECLASSIFICATIONS: Certain financial statement amounts reported in prior periods have been reclassified to conform with the current year presentation. The reclassifications did not impact the Company's net income or net income per share.

RECENT ACCOUNTING PRONOUNCEMENTS: In May 2014, the FASB issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"), 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 replaces most existing revenue recognition guidance in U.S. GAAP and permits the use of either a full retrospective or retrospective with cumulative effect transition method. In August 2015, the FASB issued ASU 2015-14, *Revenue from Contracts with Customers (Topic 606) – Deferral of the Effective Date* ("ASU 2015-14"), which defers the effective date of ASU 2014-09 by one year. The updated standard is effective for annual reporting periods beginning after December 15, 2017, and interim periods within that reporting period. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016. The updated standard was effective for the Company for the year ended December 31, 2018. The adoption of this standard did not have a material effect on the Company's financial statements and related disclosures.

In July 2015, the FASB issued ASU 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory* ("ASU 2015-11"). Historically U.S. GAAP required entities to measure inventory at the lower of cost or market. When measuring inventory, "market" could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. ASU 2015-11 does not apply to inventory measured using the last-in, first-out method or the retail inventory method. The ASU applies to all other inventory, which includes inventory measured using the first-in, first-out method or the average cost method. Inventory within the scope of ASU 2015-11 now is required to be measured at the lower of cost and net realizable value. Net realizable value is defined as "the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation." ASU 2015-11 is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2016. ASU 2015-11 was effective for the Company for the year ended December 31, 2017, the standard was adopted with no material effect on its financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, Leases ("ASU 2016-02"), revising accounting guidance for the recognition, measurement, presentation and disclosure of leasing arrangements. The update requires the recognition of a right of use asset and lease liability for those leases currently classified as operating leases while also refining the definition of a lease. In addition, lessees will be required to disclose key information about the amount, timing and uncertainty of cash

Note 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

flows arising from leasing arrangements. ASU 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018, and will be effective for the Company for the year ending December 31, 2019. As originally released, ASU 2016-02 required application at the beginning of the earliest comparative period presented at the time of adoption. In July 2018, the FASB issued further guidance providing the option to instead apply the provisions of ASU 2016-02 at the effective date, without adjusting the comparative periods presented. The Company expects to apply the provisions of the updated guidance at the effective date, without adjusting the comparative periods presented. The Company is currently evaluating the impact of adopting this new standard on its financial statements and related disclosures.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments* ("ASU 2016-15"). ASU 2016-15 addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice and affects all entities required to present a statement of cash flows under Topic 230. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The ASU was effective for the Company on January 1, 2018, the standard was adopted with no material effect on its financial statements and related disclosures.

In March 2017, the FASB issued ASU 2017-07, *Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Postretirement Benefit Cost* ("ASU 2017-07"). ASU 2017-07 requires that the service cost component of net periodic pension and postretirement benefit cost be reported in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period, and the other components of net benefit cost be reported separately from the service cost component and below operating income. The standard also allows only the service cost component to be eligible for capitalization when applicable. ASU 2017-07 is effective for public entities for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted. The standard is to be applied retrospectively for the presentation of net benefit cost in the income statement and prospectively for the capitalization of the service cost component of net benefit cost, as applicable. The Company adopted ASU 2017-07 on January 1, 2018 on a retrospective basis. As permitted by the new guidance, the Company used the amounts disclosed in Note 7, Post Employment Benefit Plans, for the prior comparative periods as the basis for applying the retrospective reclassifications. Only the service cost component of pension and postretirement benefit costs is included in Operating Income. For the years ending December 31, 2017 and 2016, the Company reclassified $187,379 and $199,001, respectively, of non-service related Net Periodic Benefit Cost from Selling, general and administrative expense to a new line item, NPBC-other components, in Other income (expense). Adoption of this guidance had no effect on the Net income, Net earnings per common share or Statement of cash flows of the Company.

In May 2017, the FASB issued ASU 2017-09, *Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting* ("ASU 2017-09"), clarifying when a change to the terms or conditions of a stock-based payment award must be accounted for as a modification. This guidance requires modification accounting if the fair value, vesting condition or the classification of the award is not the same immediately before and after a change to the terms and conditions of the award. ASU 2017-09 was effective for the Company on January 1, 2018, the standard was adopted on a prospective basis and did not impact the Company's financial statements and related disclosures.

In August 2018, the FASB issued ASU 2018-14, *Compensation-Retirement Benefits-Defined Benefit Plans-General (Topic 715): Disclosure Framework-Changes to the Disclosure Requirements for Defined Benefit Plans* ("ASU 2018-14"). This guidance removes certain disclosures that are not considered cost beneficial, clarifies certain required disclosures and requires certain additional disclosures. ASU 2018-14 is effective for the Company on a retrospective basis for the year ending December 31, 2020, with early adoption permitted. The adoption of this standard is not expected to have a material effect on the Company's financial statements and related disclosures.

Note 2 – INVENTORIES

The following are the major classes of inventories as of December 31:

	2018	2017
Finished goods	$ 735,224	$ 837,812
Work in process	14,723	13,256
Raw materials	418,259	488,346
	$ 1,168,206	$ 1,339,414

Inventories include the cost of materials, labor and manufacturing overhead.

Note 3 – PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following at December 31:

	2018	2017	Estimated Useful Lives
Land	$ 591,491	$ 591,492	
Buildings and additions	11,943,115	11,793,489	10-50 years
Machinery and equipment	34,836,176	34,408,543	3-20 years
Office equipment	1,500,832	1,500,832	3-10 years
Automotive equipment	601,868	531,868	3-5 years
Cogeneration system	3,614,059	3,614,059	20 years
	53,087,541	52,440,283	
Less accumulated depreciation	45,192,805	44,254,149	
	$ 7,894,736	$ 8,186,134	

Depreciation expense was $938,656, $896,902 and $836,108 for the years ended December 31, 2018, 2017 and 2016, respectively.

Note 4 – DEBT

On May 21, 2015, the Company amended and extended its Credit Facilities Agreement (the "Agreement") with ACF Finco I LP, successor-in-interest to Keltic Financial Partners II, LP (the "Lender"). The Agreement is comprised of a term loan (the "Term Loan") and a revolving credit facility (the "Revolving Credit Facility"). The Term Loan, in the amount of $3,166,667 is payable in 42 equal installments of $45,833.33 commencing on June 1, 2015 and in one installment on December 14, 2018 equal to the then outstanding and unpaid principal and interest amount. As of December 31, 2018 and 2017, the outstanding balances under the Agreement, including current portion, were $1,195,833 and $1,745,833, respectively. Under the Revolving Credit Facility, the Company can borrow up to specified percentages of eligible receivables and inventory, as defined, in an aggregate amount not to exceed $2,500,000. As of December 31, 2018 and 2017, the outstanding amount was $1,898,917 and $1,944,817, respectively. As of December 31, 2018 and 2017, the unused credit under the Revolving Credit Facility was $601,083 and $555,183, respectively. The unused credit was limited to $62,112, based on eligible receivables and inventory as of December 31, 2018. Interest on each loan is payable monthly at the greatest of (a) the Lender's prime rate, as defined (5.50% at December 31, 2018) plus 2.75%, (b) the LIBOR Rate, as defined, plus 5.25%, or (c) 6.00%. The Agreement further provides for an annual facility fee in the amount of $56,667 payable in equal monthly installments, a monthly collateral management fee of $1,500 and a closing fee of $62,370 paid at the loan settlement and certain other expenses of the Lender. The Agreement contains financial and other covenants including minimum EBITDA and limitations on other indebtedness, capital expenditures and dividends. For the measurement periods in 2018 and 2017 all covenants were satisfied by the Company. Loans and advances under the Agreement are collateralized by substantially all of the Company's assets, including real property.

On July 6, 2012, the Company and Caterpillar Financial Services Corporation ("Caterpillar") agreed to terminate an operating lease arrangement for an on-site cogeneration system to supply substantially all of the Company's electricity requirements and thermal energy for the pulping process. Caterpillar agreed to refinance the remaining balance outstanding under the lease, subject to the terms and conditions of the Security Agreement and Promissory Note (the "Caterpillar Agreement"). The Caterpillar Agreement provides for payment of the principal amount of $3,467,852 over a term of seven years commencing August 1, 2012 with interest on the outstanding principal at 5.9% per annum. Principal and interest are payable in unequal monthly installments in accordance with an amortized payment schedule, with a final payment due on August 1, 2019. As of December 31, 2018, the outstanding principal under the Caterpillar Agreement, including current portion, was $1,029,195.

From July 2013 through December 2018 the Company executed purchase agreements with two lenders covering eleven vehicles with original costs ranging between $33,269 to $49,633. Principal and interest are payable in monthly installments ranging between $521 and $847 over periods of sixty to seventy-two months with interest rates ranging between 1.9% to 7.14%. Final payments are due between July 2019 and January 2025. As of December 31, 2018, outstanding amounts due under the loans, including current portion, were $257,772.

In February 2015, the Company purchased a 2014 Kubota wheel loader. The Company secured a purchase agreement with Kubota Credit Corporation USA for the payment of $62,656 over a term of four years commencing March 12, 2015 with 0% interest per annum. Principal is payable in equal monthly installments of $1,305.34 per month, with a final payment due in February 2019. As of December 31, 2018, the outstanding amount, including current portion, was $2,611.

The balance of long-term debt, including current portion, out¬standing at December 31, 2018 and 2017 was $2,486,197 and $3,544,659, respectively. Aggregate maturities of long-term debt as of December 31, 2018 are as follows: $2,305,109 in 2019, $67,418 in 2020, $49,141 in 2021, $31,964 in 2022, $15,752 in 2023 and $16,813 thereafter.

Total interest costs incurred during 2018, 2017 and 2016 were $466,303, $511,419 and $538,807, respectively.

Subsequent to year end the Company's debt was refinanced as disclosed in Note 11.

Note 5 – ACCRUED EXPENSES

Accrued expenses as of December 31, 2018 and 2017 consist of the following:

	2018	2017
Commissions	$ 48,607	$ 42,067
Payroll	84,713	66,096
Warranty claims	25,000	25,000
Maintenance CoGen	46,135	100,000
Professional Fees	107,000	104,000
Environmental	356,384	—
Other	91,199	116,362
	$ 759,038	$ 453,525

Note 6 – INCOME TAXES

During 2018, 2017 and 2016, the Company had no current tax expense as a result of current losses incurred or utilization of net operating loss carryforwards coupled with a change in the deferred tax valuation allowance which was equal to the change in deferred tax assets and liabilities.

The actual income tax expense differs from the amounts computed by applying the U.S. federal income tax rate of 21% for the year ended December 31, 2018 and 34% for the years ended December 31, 2017 and 2016 to income before income tax expense as a result of the following:

	2018	2017	2016
Computed "expected" tax expense	$ 206,650	$ 471,473	$ 178,672
Change in valuation allowance	(1,594,943)	(331,036)	(310,486)
Other	1,388,293	(140,437)	131,814
	$ —	$ —	$ —

The tax effect of temporary differences that give rise to significant portions of the deferred tax assets and liabilities at December 31 are presented below:

	2018	2017
Deferred tax assets:		
Accounts receivable, due to allowance for doubtful accounts	$ 10,120	$ 10,120
Inventories, due primarily to cost capitalization	52,739	56,348
Other liabilities, principally due to supplemental pension and postretirement costs	265,515	292,814
Nondeductible accrued expenses	127,624	27,444
Net operating loss carryforwards – federal and state	2,031,099	3,752,902
Alternative minimum tax credit	7,360	7,360
Total deferred tax assets	2,394,277	4,146,988
Less valuation allowance	1,482,116	3,077,059
Net deferred tax assets	1,012,341	1,069,929
Deferred tax liabilities:		
Fixed assets, due to accelerated depreciation	842,521	899,458
Other assets, due to pension costs	169,820	170,471
Total deferred tax liabilities	1,012,341	1,069,929
Net deferred tax assets	$ —	$ —

Note 6 – INCOME TAXES (continued)

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon this assessment, management believes it is more likely than not that the Company will realize the benefits of these deductible differences, net of existing valuation allowances at December 31, 2018. The amount of net deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced.

The net change in the total valuation allowance for the year ended December 31, 2018 was a decrease of $1,594,943. The net change in the total valuation allowance for the year ended December 31, 2017 was a decrease of $331,036. In addition, at December 31, 2018, the Company has net operating loss carryforwards for federal and state income tax purposes of approximately $9,502,000 and $500,000, respectively, which are available to reduce future income taxes, if any. The net operating loss carryforwards will begin to expire in year 2019 for federal and 2029 for state tax purposes.

Note 7 – POST EMPLOYMENT BENEFIT PLANS

The Company has a noncontributory defined benefit retirement plan (the "Pension Plan") covering all eligible employees. Benefits under the Pension Plan are calculated at a rate of $23.00 per month per year of service, as defined. The Company's funding policy for the Pension Plan is to contribute amounts sufficient to meet minimum funding requirements set forth in U.S. employee benefit and tax laws. The Company expects to contribute approximately $294,000 to the Pension Plan in 2019. On December 17, 2009 the Board of Directors of the Company resolved that employees hired on or subsequent to April 1, 2010 are not eligible to enter the Pension Plan. On December 2, 2011 the Board of Directors of the Company resolved that the Pension Plan be amended to discontinue benefit accruals effective March 1, 2012.

A supplemental non-contributory plan (the "Supplemental Plan") covering certain key employees of the Company provides retirement benefits based upon the employee's compensation, as defined, during the highest five of the last ten consecutive years preceding retirement. The Company's policy for funding the Supplemental Plan is to contribute amounts determined at the discretion of management. As of December 31, 2018 and 2017, the plan was unfunded. On May 11, 2005 the Board of Directors of the Company resolved to terminate the Supplemental Plan for all current employees not already receiving benefits. The termination was recognized as a curtailment gain in 2005. Additionally, as of June 1, 2005, the benefit payments of retired participants were reduced to 50% of their actuarially determined benefit. The payment of the balance of such benefits was deferred and included as an other liability ($512,578 at December 31, 2018 and 2017) until such time as the Board of Directors determined that it was prudent to either reinstate the full monthly payment as it accrues and/or to begin paying the deferred portion. On September 16, 2013 the Board of Directors of the Company resolved to reinstate, as of October 1, 2013, the full monthly payment of such benefits as earned. The estimated amount of such benefits payable for the year ended December 31, 2019, $80,000, is included in current liabilities on the balance sheet of the Company.

The Company also provides a portion of certain health care benefits for eligible retired employees and their spouses who have reached the age of 65. Partial benefits are provided to eligible early retirees who have reached the age of 62. Employees hired on or subsequent to January 1, 2005 are not eligible for retiree health benefits. The Company's policy is to fund the cost of health care benefits for retirees in amounts determined at the discretion of management. As of December 31, 2018 and 2017, the plan was unfunded. Effective July 1, 2005 the Company reduced its contribution to the postretirement benefit plan for all current and future retirees by 50% of the portion paid by the Company prior to such date. On November 10, 2017 the Board of Directors of the Company resolved to allow eligible retirees and their spouses hired after January 1, 2005 to elect participation in the plan, but be required to contribute 100% of the cost.

The Company uses a December 31 measurement date for the pension and other postretirement benefit plans. Year-end asset and obligation amounts are disclosed as of the plan measurement dates.

The following tables set forth the Company's defined benefit, supplemental pension and postretirement benefit plans' benefit obligations, fair value of assets, funded status and other information:

Note 7 – POST EMPLOYMENT BENEFIT PLANS (continued)

	Pension Plan		Supplemental Plan		Postretirement Benefits	
	2018	2017	2018	2017	2018	2017
Change in benefit obligation						
Benefit obligation at beginning of year	$10,934,032	$10,346,339	$ 508,166	$ 646,820	$ 187,094	$ 198,725
Service cost	—	—	—	—	1,834	1,739
Interest cost	435,849	468,225	19,638	23,876	7,267	8,631
Actuarial (gain) loss	(640,833)	674,868	5,721	(75,374)	(6,440)	155
Benefits paid	(559,053)	(555,400)	(70,188)	(87,156)	(19,565)	(22,156)
Benefit obligation at end of year	10,169,995	10,934,032	463,337	508,166	170,190	187,094
Accumulated benefit obligation at end of year	10,169,995	10,934,032	463,337	508,166	—	—
Change in plan assets						
Fair value of plan assets at beginning of year	7,715,782	7,116,547	—	—	—	—
Actual return on plan assets	(411,320)	1,182,641	—	—	—	—
Employer contributions	264,082	168,393	70,188	87,156	19,565	22,156
Administrative expenses	(206,094)	(196,399)	—	—	—	—
Benefits paid	(559,053)	(555,400)	(70,188)	(87,156)	(19,565)	(22,156)
Fair value of plan assets at end of year	6,803,397	7,715,782	—	—	—	—
Funded status						
Benefit obligation in excess of plan assets	$ (3,366,598)	$ (3,218,250)	$ (463,337)	$ (508,166)	$ (170,190)	$ (187,094)
Amounts recognized in balance sheets						
Current benefit liability	$ —	$ —	$ (80,000)	$ (81,000)	$ (19,000)	$ (18,000)
Non-current benefit liability	(3,366,598)	(3,218,250)	(383,337)	(427,166)	(151,190)	(169,094)
Net liability recognized	$ (3,366,598)	$ (3,218,250)	$ (463,337)	$ (508,166)	$ (170,190)	$ (187,094)
Unrecognized actuarial loss (gain)	3,970,725	3,824,694	(32,994)	(42,546)	(278,038)	(303,865)
Accumulated other comprehensive loss (income)	$ 3,970,725	$ 3,824,694	$ (32,994)	$ (42,546)	$ (278,038)	$ (303,865)

The total amount included in Accumulated Other Comprehensive Loss ("AOCI") relating to the Company's retirement plans at December 31, 2018 and 2017 was $3,659,693 and $3,478,283, respectively. The estimated amounts of actuarial net loss (gain) included in AOCI as of December 31, 2018 and expected to be amortized into net periodic benefit cost in 2019, are $355,656 for the defined benefit plan, $(5,293) for the supplemental plan and $(30,468) for the postretirement plan.

Notes to Financial Statements (continued)

Note 7 – POST EMPLOYMENT BENEFIT PLANS (continued)

	Pension Plan			Supplemental Plan		
	2018	2017	2016	2018	2017	2016
Components of net periodic benefit cost:						
Service cost	$ 172,640	$ 151,806	$ 141,597	$ —	$ —	$ —
Interest cost	435,849	468,225	485,767	19,638	23,876	31,982
Expected return on plan assets	(636,225)	(584,222)	(582,409)	—	—	—
Recognized actuarial loss (gain)	294,135	311,686	284,996	(3,831)	(7,526)	3,017
Net periodic benefit cost	$ 266,399	$ 347,495	$ 329,951	$ 15,807	$ 16,350	$ 34,999

	Postretirement Benefits		
	2018	2017	2016
Components of net periodic benefit cost:			
Service cost.	$ 1,834	$ 1,739	$ 1,738
Interest cost	7,267	8,631	9,835
Expected return on plan assets	—	—	—
Recognized actuarial gain	(32,267)	(33,291)	(34,187)
Net periodic benefit cost	$ (23,166)	$ (22,921)	$ (22,614)

Service cost is recorded in Selling, general and administrative expense. All other components of Net periodic benefit costs are recorded in Other income (expense). See Note 1 for information on the adoption of ASU 2017-07.

	Pension Benefits			Postretirement Benefits		
	2018	2017	2016	2018	2017	2016
Assumptions:						
Weighted-Average Assumptions used to determine net periodic benefit cost for years ended December 31:						
Discount rate	4.10%	4.60%	4.93%	4.10%	4.60%	4.93%
Expected long-term return on plan assets	8.50%	8.50%	8.50%	N/A	N/A	N/A

	Pension Benefits		Postretirement Benefits	
	2018	2017	2018	2017
Weighted-Average Assumptions used to determine benefit obligations at December 31:				
Discount rate	4.60%	4.10%	4.60%	4.10%

Note 7 – POST EMPLOYMENT BENEFIT PLANS (continued)

Assumed Health Care Cost Trend

For measurement purposes, no health care cost trend rate of increase was assumed for 2018. The Company's monthly-paid benefit for each participant is fixed at the amount as of January 1, 2003 and further adjusted as of July 1, 2005 as discussed above.

Plan Assets

The asset allocation for the Pension Plan at the end of 2018 and 2017, and the target allocation for 2019, by asset category, are as follows:

	Target Allocation 2019	Percentage of the Plan Assets at end of year 2018	2017
Equity Mutual Funds	70%	68%	70%
Debt Mutual Funds	30%	32%	30%
Cash and Cash Equivalents	0%	0%	0%
	100%	100%	100%

The target asset allocations reflect the investment strategy of the outside Custodian and Asset Manager of the plan assets appointed by the Pension Plan Committee of the Board of Directors, and the current funded status, within an appropriate level of risk. No equity investments within plan assets include Homasote Company common stock. The expected long-term rate of return on plan assets reflects the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the projected benefit obligation.

FASB ASC 820 10, *Fair Value Measurements and Disclosures,* establishes a framework and provides guidance on measuring the fair value of assets in a pension plan and how an employer should disclose the same. The framework establishes a fair value hierarchy that prioritizes the inputs to the valuation techniques used to measure fair value. The three levels of fair value hierarchy are described as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Note 7 – POST EMPLOYMENT BENEFIT PLANS (continued)

The following table sets forth by level, within the fair value hierarchy, the Pension Plan assets at fair value as of the dates indicated.

	December 31, 2018			
Plan Assets	**Level 1**	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	$ 44,732	—	—	$ 44,732
Equity mutual funds	4,604,826	—	—	4,604,826
Debt mutual funds	2,153,839	—	—	2,153,839
Fair value of plan assets	$ 6,803,397	—	—	$ 6,803,397

	December 31, 2017			
Plan Assets	**Level 1**	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	$ 33,537	—	—	$ 33,537
Equity mutual funds	5,383,493	—	—	5,383,493
Debt mutual funds	2,298,752	—	—	2,298,752
Fair value of plan assets	$ 7,715,782	—	—	$ 7,715,782

Benefit Payments

The following table summarizes expected benefit payments from pension and postretirement plans through 2028. Actual benefit payments may differ from expected benefit payments.

	Pension Benefit	Supplemental Plan	Postretirement Benefits
2019	$ 603,000	$ 80,000	$ 19,000
2020	603,000	72,000	17,000
2021	649,000	65,000	16,000
2022	692,000	58,000	15,000
2023	696,000	51,000	14,000
2024-28	3,549,000	176,000	57,000

Savings Plan

The Company has a voluntary savings plan (the “Savings Plan”) for which all employees are eligible. The Savings Plan had provided for the Company to contribute a minimum of $0.25 for every dollar contributed by employees, up to 4% of their compensation, as defined. Effective October 1, 2018, the Board of Directors resolved to increase the Company contribution to a minimum of $.50 for every dollar contributed by employees, up to 4% of their compensation, as defined. The Savings Plan qualifies and meets the requirements under Section 401(k) of the Internal Revenue Code. Company contributions charged to operations under this Plan amounted to $43,285 in 2018, $30,415 in 2017 and $31,596 in 2016.

Notes to Financial Statements (continued)

Note 8 – SHARE-BASED COMPENSATION

On October 24, 2008, the Board adopted the 2008 Stock Incentive Plan (the "2008 Stock Plan"). No stock was awarded in 2010 or 2009 under the 2008 Stock Plan. On December 13, 2010, the 2008 Stock Plan was amended and restated (the "Amended 2008 Plan"). The Amended 2008 Plan authorizes the issuance of restricted stock to "key persons" including officers, employees, directors and consultants to provide an incentive to enter and remain in the service of the Company, enhance the long-term performance of the Company and acquire a proprietary interest in the success of the Company. An aggregate of 35,000 shares of the Company's stock is available for issuance under the Amended 2008 Plan and a total of 23,180 shares, net of cancellations, remain available as of December 31, 2018 for future grants of stock.

The Amended 2008 Plan is administered by a Compensation Committee selected by the Board and consisting of not less than two non-employee directors. The Compensation Committee may amend or modify the Amended 2008 Plan and take all action necessary to administer it without prior Board approval.

Stock available for issuance under the Amended 2008 Plan may be from unissued Common Stock, issued Common Stock held in the Company's treasury or stock acquired by the Company for the purposes of the Amended 2008 Plan. Shares issued under the Amended 2008 Plan are subject to certain restrictions including continued service to the Company, non-transferability and repurchase rights, as defined, and such other restrictions as may be determined at the time of grant. A maximum of 3,500 shares of Common Stock may be granted annually to any key person under the Amended 2008 Plan. Shares awarded to employees under the Amended 2008 Plan vest in five equal annual installments based on the date of grant. The cost of these awards is determined using the market price of the shares on the date of grant. Compensation expense is recognized over the requisite vesting period into Selling, general and administrative expense and paid-in surplus and adjusted for actual forfeitures before vesting.

On December 2, 2015 the Board of Directors, on the recommendation of the Compensation Committee, resolved to grant 300 fully paid and non-assessable shares of stock to each of six employees of the Company. The shares vest in five equal annual installments based on the date of grant. In 2017, 180 non-vested shares of said grant were forfeited when an employee did not continue in service. Additionally, on such date, 100 fully paid and non-assessable shares were granted to each of four non-employee members of the Board of Directors. All shares granted were from authorized but unissued Common Stock.

On November 1, 2016, the Board of Directors, on the recommendation of the Compensation Committee, resolved to grant 100 fully paid and non-assessable shares of stock to each of four non-employee members of the Board of Directors. All shares granted were from authorized but unissued Common Stock.

On November 10, 2017, the Board of Directors, on the recommendation of the Compensation Committee, resolved to grant 100 fully paid and non-assessable shares of stock to each of four non-employee members of the Board of Directors. All shares granted were from authorized but unissued Common Stock.

On October 2, 2018, the Board of Directors, on the recommendation of the Compensation Committee, resolved to grant 100 fully paid and non-assessable shares of stock to each of four non-employee members of the Board of Directors. All shares granted were from authorized but unissued Common Stock.

The total fair value of shares vested and compensation incurred pursuant to the Amended 2008 Plan in 2018, 2017 and 2016 was $5,507, $4,067 and $2,830, respectively. As of December 31, 2018 there was $1,275 of unrecognized compensation cost related to non-vested share-based compensation under the Amended 2008 Plan.

Note 9 – TREASURY STOCK

The Company has a policy offering directors, officers and employees the option to purchase reacquired shares of Homasote Company common stock on the date acquired and at the purchase price paid by the Company. No shares were acquired or sold in 2018, 2017 or 2016.

Note 10 – COMMITMENTS AND CONTINGENCIES

On July 6, 2012, following resolution of certain operational problems with a cogeneration system ("Cogen System"), the Company successfully completed negotiations with Caterpillar to terminate an operating lease arrangement and purchase the Cogen System. Caterpillar agreed to refinance the remaining balance outstanding under the lease of $3,467,852 for a term of seven years, payable in a series of unequal monthly payments, commencing August 1, 2012 with interest at the rate of 5.9% per annum. A final payment is due on August 1, 2019 equal to the sum of the outstanding principal plus any accrued interest due.

The Company leases certain office, manufacturing equipment and vehicles under operating leases that expire at various dates. Payments under these leases were $99,773 in 2018. Lease payments subsequent to December 31, 2018 are as follows: 2019, $43,667, 2020, $27,147, and 2021, $8,077.

The Company is a defendant in various asbestos litigation matters. The Company is being defended in these matters by its insurance carrier, who paid all prior defense and indemnity costs as of June 16, 2008. Although the Company believes that the limits of these policies are more than sufficient to cover these claims, the Company has been requested by its insurance carrier to pay a portion of the defense and indemnity costs for claims which occurred, in whole or in part, prior to 1965. The Company has worked to locate coverage for those periods, but has not been able to do so. The Company continues to investigate the merits of these claims, and intends to defend them vigorously.

On June 17, 2008, the insurance carrier and the Company signed an Interim Asbestos Claims Administration Agreement (the "Agreement") that defines how the parties will share past and future defense and indemnity costs from asbestos claims. The Agreement provided for a settlement of $172,638 covering all prior costs. The Company further agreed to pay 6% of ongoing defense costs. The Company's agreed upon share of future indemnity costs varies from 0% to 10.49%, based on the claimant's date of first exposure. The Company incurred $52,100 of such costs for the year ended December 31, 2018. The amount of such costs payable in the future is not determinable as of December 31, 2018. As of December 31, 2018 the Company recognized a provision of $18,000 in its financial statements.

During the normal course of business, the Company is from time to time involved in various claims and legal actions. In the opinion of management, uninsured losses, if any, resulting from the ultimate resolution of these matters will not have a material adverse effect on the Company's financial position, results of operations or liquidity.

Notes to Financial Statements (continued)

December 31, 2018, 2017 and 2016

Note 11 – SUBSEQUENT EVENTS

The Company assessed events occurring subsequent to December 31, 2018 through August 20, 2019 for potential recognition and disclosure in the financial statements. There were five events that require such disclosure. Other than the events described below, there were no events that have occurred that would require adjustment to or disclosure in the financial statements, which were issued on August 20, 2019.

On April 30, 2014 the Company experienced a high voltage breakdown in its 4160V switchgear. This equipment was supplying electric power to the facility and the Cogen System. A temporary bypass was put in place to supply power to the plant. On August 2, 2014 the Company experienced another breakdown of the switchgear equipment. Cogeneration is not possible until permanent repairs and/or replacement is completed. Due to extended negotiations with the insurance carrier, the Company was not able to finalize plans to replace the substation/transformer. There are still significant matters to be resolved. The approximate cost of the project is $1,200,000, to be financed in part by additional debt. The amount of $332,000 of such cost, resulting from insurance proceeds received by the Company to date, is reflected in Other liabilities in the December 31, 2018 Balance Sheet included in the Company's financial statements. The Company anticipates that final replacement of the equipment will be completed by late 2020.

The Company plans to install a heat exchanger to pre-heat the Coe dryer's combustion air stream, utilizing excess thermal energy generated by the Cogen System in the board drying process. Projected completion date of this System component was August 2013. However, due to engineering design changes, the planned completion date is in late 2020. The cost of such design changes has not been determined.

The Company plans to address needed roof repairs in the facility over the engineering shop, the electric shop and machine shop. The ongoing project began in late 2017. The cost for the repairs in 2018 was approximately $150,000. The Company anticipates approximately $450,000 of additional roof repairs through 2019.

During August 2019, the Company refinanced and paid off all of its outstanding debt with a bank. The new debt agreements provide for a revolving line of credit, commercial mortgage and equipment financing. The one year $3,000,000 revolving line of credit bears interest at LIBOR plus two hundred seventy-five (275) basis points. The Company may borrow on the line at a percentage of its inventory and outstanding account receivable, which also collateralize the line of credit. The $2,180,000 commercial mortgage has a fifteen (15) year repayment term and bears interest at LIBOR plus two hundred seventy-five (275) basis points. The Company also entered into a swap agreement related to the commercial mortgage. The mortgage is collateralized by the building and other assets of the Company. The equipment financing allows the Company to borrow up to $1,200,000 over a twelve (12) month period, which at the end of the twelve-month period will convert to a seven year term loan bearing interest at LIBOR plus two hundred seventy-five (275) basis points. The equipment financing is collateralized by the equipment it relates to.

Subsequent to year end, while the Company was working through its debt financing as referenced above, it became aware of an oil spill that previously occurred which requires remediation. Based on a professional environmental study that was conducted, the Company accrued a liability of $356,385 in the balance sheet at December 31, 2018. The Company is currently working with its environmental engineers and the New Jersey Department of Environmental Protection to perform the remediation.

Independent Auditors' Report

To the Board of Directors and Shareholders of **Homasote Company:**

Report on the Financial Statements

We have audited the accompanying financial statements of Homasote Company (the "Company") which comprise the balance sheets as of December 31, 2018 and 2017, and the related statements of income, comprehensive income, changes in stockholders' equity and cash flows for each of the three years ended December 31, 2018, and the related notes to the financial statements.

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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Homasote Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years ended December 31, 2018 in accordance with accounting principles generally accepted in the United States of America.

Mercadien, P.C.
Certified Public Accountants

Hamilton, New Jersey
August 20, 2019

Management's Discussion and Analysis of Financial Condition and Results of Operations

General

This Annual Report, including our Letter to Shareholders and Employees and this Management's Discussion and Analysis and accompanying materials, may include forward-looking statements about the future that are necessarily subject to various risks and uncertainties. These statements are based on the beliefs and assumptions of management and on information currently available to management. These forward-looking statements are identified by words such as "believe", "estimate", "expect", "anticipate", "plan", "potential", "continue" and other similar expressions.

Factors that could cause future results to differ materially from those expressed in or implied by the forward-looking statements or historical results include the impact or outcome of:

- events or conditions that affect the building and manufacturing industries in general and the Company in particular, such as general economic conditions, employment levels, interest rates, inflation, costs of energy, weather, strikes, international unrest, terrorist acts and other factors;
- competitive, regulatory and market conditions, such as changes in choices regarding building materials by architects and builders and packing products by industrial firms;
- the performance of new products and the continued acceptance of current products in the marketplace; and
- the execution of strategic initiatives and alliances.
- other important factors disclosed previously and from time to time in the Company's Annual Report and other material.

Although the ultimate impact of the above and other factors are uncertain, these and other factors may cause future operating results to differ materially from results or outcomes we currently seek or expect. Therefore, the reader is cautioned not to rely on these forward-looking statements. The Company disclaims any intent or obligation to update these forward-looking statements.

Results of Operations 2018-2017

Net sales were relatively constant with a slight decrease in 2018 by $23,431 to $20,620,354 from $20,643,785 in 2017. The Company operates two sales divisions, Millboard and Industrial. The Company's millboard division serves several markets including the construction and renovation of multi-family dwellings, commercial office buildings, educational facilities, single-family dwellings and retail establishments. The primary channel of distribution is through a "two-step" model wherein wholesale distributors sell the Company's products to dealers that typically specialize in lumber and other forestry products. The millboard product line is led by 440 Sound-Barrier, followed by Homex expansion joint and NovaCork cork board. Net sales for the millboard division in 2018 decreased by $278,462 or 2% to $11,960,240 from $12,238,702 in 2017. The decrease in sales is reflective of the results across the division as follows: the largest product line, millboard products decreased 7%; the Homex product line sales volume increased 1%; the Nova pre-finished panels product line saw a sales volume increase of 19%; while decking product sales decreased by 7%.

The Company's industrial (Pak-Line) division provides sustainable packaging solutions for users in three main manufacturing and finishing sectors: glass, paper and steel. Additionally, the division provides a variety of products to end-users as varied as appliance manufacturers and office furniture makers. Net sales for the industrial division in 2018 increased by $255,031 or 3% to $8,660,114 from $8,405,083 in 2017.

Gross profit as a percentage of sales was 32.6% in 2018 and 31.7% in 2017. There was a 8.1% decrease in board production from 2018 as compared to 2017. Variances in the Company's energy and paper costs contributed to the increased gross profit level. There was a 19% increase in the cost of natural gas, from an average cost of $4.12 per dekatherm in 2017 to $4.89 per dekatherm in 2018. The increase in the cost of natural gas between 2018 and 2017 based on 184,408 dekatherms purchased was $141,994. Partially offsetting the energy costs was a decrease in the cost of paper of 28% from an average of $146 per ton in 2017 to $105 per ton in 2018, based on 19,167 tons purchased. The effect on cost of sales was a decrease of $733,371 in overall paper costs.

Selling, general and administrative expenses increased $226,199 from $4,597,427 in 2017 to $4,823,626 in 2018, and as a percentage of sales were 23.4% in 2018 as compared to 22.3% in 2017. The increase in selling, general and administrative expenses is due primarily to increases in employee benefits and advertising costs. Such increases were partially offset by decreased agent commissions and customer claim costs.

Interest expense on debt decreased to $492,169 in 2018 from $539,638 in 2017. The decrease is due primarily to the relatively lower level of borrowed funds resulting from repayments of debt incurred in connection with the purchase of the Cogen System.

In 2018, other expense consists primarily of an extraordinary item based on a professional environmental study conducted during the Company's debt refinancing efforts resulted in the Company having to accrue a liability for environmental remediation amounting to $356,385. The expense is positively offset by the sale of scrap metal from the dismantling of obsolete and fully depreciated equipment sold to brokers.

As a result of the foregoing, net income in 2018 was $997,849 as compared to net income of $1,396,773 in 2017.

Results of Operations 2017-2016

Net sales decreased in 2017 by $223,517 or 1% to $20,643,785 from $20,867,302 in 2016. The Company operates two sales divisions, Millboard and Industrial. The Company's millboard division serves several markets including the construction and renovation of multi-family dwellings, commercial office buildings, educational facilities, single-family dwellings and retail establishments. The primary channel of distribution is through a "two-step" model wherein wholesale distributors sell the Company's products to dealers that typically specialize in lumber and other forestry products. The millboard product line is led by 440 SoundBarrier, followed by Homex expansion joint and NovaCork cork board. Net sales for the millboard division in 2017 increased by $96,801 or 1% to $12,238,702 from $12,141,901 in 2016. The increase in sales is reflective of the results across the division as follows: the largest product line, millboard products increased 4%; the Homex product line sales volume increased 1%; the Nova pre-finished panels product line saw a sales volume decrease of 17%; while decking product sales decreased by 56%.

The Company's industrial (Pak-Line) division provides sustainable packaging solutions for users in three main manufacturing and finishing sectors: glass, paper and steel. Additionally, the division provides a variety of products to end-users as varied as appliance manufacturers and office furniture makers. Net sales for the industrial division in 2017 decreased by $320,318 or 4% to $8,405,083 from $8,725,401 in 2016.

Gross profit as a percentage of sales was 31.7% in 2017 and 30% in 2016. Production efficiency contributed to increased gross profit resulting in a 5.5% increase in board production from 2017 as compared to 2016. Variances in the Company's energy and paper costs have also contributed to the increased gross profit level. There was an 18% reduction in the cost of natural gas, from an average cost of $4.99 per dekatherm in 2016 to $4.12 per dekatherm in 2017. The decrease in the cost of natural gas between 2017 and 2016 based on 193,946 dekatherms purchased was $168,733. Partially offsetting the energy gains was an increase in the cost of paper of 5% from an average of $139 per ton in 2016 to $146 per ton in 2017, based on 18,811 tons purchased. The effect on cost of sales was an increase of $326,797 in overall paper costs.

Selling, general and administrative expenses decreased $378,765 from $4,976,192 in 2016 to $4,597,427 in 2017, and as a percentage of sales were 22.3% in 2017 as compared to 23.8% in 2016. The decrease in selling, general and administrative expenses is due primarily to reductions in labor count and related expenses, advertising, payroll services and customer claim costs. Such decreases were partially offset by increased agent commissions, healthcare costs, professional fees and asbestos litigation costs.

Interest expense on debt decreased to $539,636 in 2017 from $562,205 in 2016. The decrease is due primarily to the relatively lower level of borrowed funds resulting from repayments of debt incurred in connection with the purchase of the Cogen System.

In 2017, other income consists primarily of the sale of scrap metal from the dismantling of obsolete and fully depreciated equipment sold to brokers. Additionally, an extraordinary item was received in the amount of $141,740 as a result of a class action suit from the Dow Settlement fund in the Urethane Antitrust Litigation – Polyether Polyol Case.

As a result of the foregoing, net income in 2017 was $1,396,773 as compared to net income of $524,527 in 2016.

Disclosures About Contractual Obligations and Commercial Commitments:

	Cash Payments Due by Period				
	Total	Within Year 1	2-3 Years	4-5 Years	After 5 Years
Short-term debt	$ 1,898,917	$ 1,898,917	$ —	$ —	$ —
Long-term debt (includes current portion)	2,486,197	2,305,109	116,559	47,716	16,813
Operating leases	78,891	43,667	35,224	—	—
	$ 4,464,005	$ 4,247,693	$ 151,783	$ 47,716	$ 16,813

In addition to the aforementioned contractual obligations and commercial commitments, the Company has certain benefit plan obligations (see Note 7 of the Company's financial statements) the timing of which is presently unknown and is contingent upon the retirement dates of the respective participants.

The Company leases certain office, manufacturing equipment and vehicles under operating leases that expire at various dates. Payments under these leases were $99,773 in 2018. Lease payments subsequent to December 31, 2018 are as follows: 2019, $43,667; 2020, $27,147; 2021, $8,077.

Liquidity and Capital Resources

Cash flows from operating activities and bank borrowings are the primary sources of liquidity. Net cash provided by operating activities amounted to $1.8 million in 2018 and $1.5 million in 2017.

Working capital was $(4.4) million at December 31, 2018, as compared to $(3.4) million at December 31, 2017, a decline of $1.0 million. Reduced working capital is due primarily to a decrease in inventory and a decrease level of accounts receivable of $0.3 million and an increased level of the current portion of long-term debt of $1.1 million and a increase level of accrued expenses of $0.3 million offset by a lower level of accounts payable of $0.6 million.

Capital expenditures for new and improved facilities and equipment, which are financed primarily through internally generated funds and debt, were $0.6 million in 2018 and $0.5 million in 2017. The Company estimated capital expenditures for 2019 in the amount of $2.0 million for continued projects.

Cash flows used in financing activities were $1.1 million in 2018 and $1.0 million in 2017. The decrease in long-term debt in 2018 is due primarily to debt repayment. Refer to Note 4 (Debt) for explanation.

Management believes that cash flows from operations, coupled with its credit facilities, are adequate for the Company to meet its future obligations.

Critical Accounting Policies

Management is required to make certain estimates and assumptions during the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America. These estimates and assumptions impact the reported amount of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the financial statements. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the financial statements in the period they are determined to be necessary. Actual results could differ from those estimates.

The significant accounting policies are described in Note 1 of the Notes to Financial Statements included in the Company's 2018 Annual Report. Not all of these significant accounting policies require management to make difficult, subjective or complex judgments or estimates. However, management considers the following policies to have the potential for the most significant impact on the financial statements.

Pension and Other Postretirement Benefits

The costs and obligations of the Company's pension and retiree medical plans are calculated using many assumptions to estimate the benefit that the employee earns while working, the amount of which cannot be completely determined until the benefit payments cease. The most significant assumptions, as presented in Post Employment Benefit Plans (Note 7 of the Notes to Financial Statements), include discount rate, expected return on plan assets and mortality rates. The selection of assumptions is based on historical trends and known economic and market conditions at the time of valuation. Actual results may differ substantially from these assumptions. These differences may significantly impact future pension or retiree medical expenses.

Annual pension and retiree expense is principally the sum of five components: 1) value of benefits earned by employees for working during the year; 2) increase in liability from interest; 3) administrative expenses (Pension Plan only); less 4) expected return on plan assets (Pension Plan only); and 5) other gains and losses as described below. The expected return on plan assets is calculated by applying an assumed long-term rate of return to the fair value of plan assets. In any given year, actual returns can differ significantly from the expected return. Differences between the actual and expected return on plan assets are combined with gains or losses resulting from the revaluation of plan liabilities. Plan liabilities are revalued annually, based on updated assumptions and information about the individuals covered by the plan. The combined gain or loss, together with prior service costs or credits, are recognized in AOCI in accordance with ASC 715 (see Note 7 of the Notes to Financial Statements) and generally expensed evenly over the remaining years that employees are expected to work.

The Company's funding policy for the Pension Plan is to contribute amounts sufficient to meet minimum funding requirements set forth in U.S. employee benefit and tax laws. The Company expects to make cash contributions to the Pension Plan as required in 2019. The Company's policy for funding the Supplemental Plan and Postretirement Benefit Plan is to contribute benefits in amounts as determined at the discretion of management. As of December 31, 2018 and 2017, these Plans were unfunded.

Inventories

Inventories are valued at the lower of cost, (first-in, first-out) or net realizable value and have been reduced by an allowance for excess and obsolete inventories. The estimate is based on management's review of inventories on hand compared to estimated future usage and sales. Cost includes material, labor and manufacturing overhead.

Long-Lived Assets

Long-lived assets, such as property, plant and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

The Company does not have any goodwill or identifiable intangible assets.

Deferred Income Tax

A majority of the deferred tax assets, which have been recorded by the Company, represent net operating loss carry-forwards. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon this assessment, management believes it is more likely than not that the Company will realize the benefits of these deductible differences, net of existing valuation allowances at December 31, 2018. The amount of net deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced.

Accounts Receivable

The Company estimates an allowance for doubtful accounts after considering the collectability of balances due, the credit worthiness of the customer and its current level of business with the customer. Actual results could differ from these estimates.

Inflation and Economy

The Company will continue to maintain a policy of constantly monitoring such factors as product demand and costs, and will adjust prices as these factors and the economic conditions warrant.

Summarized (unaudited) quarterly financial data of the Company for years 2018 and 2017 are as follows:

(in thousands of dollars except per share data)

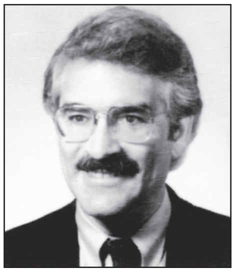
	2018				2017			
	First	Second	Third	Fourth	First	Second	Third	Fourth
Net sales	$ 4,955	$ 5,687	$ 5,021	$ 4,958	$ 5,101	$ 5,826	$ 5,205	$ 4,512
Gross profit	$ 1,669	$ 2,224	$ 1,714	$ 1,120	$ 1,634	$ 1,980	$ 1,654	$ 1,302
Net earnings (loss)	$ 271	$ 807	$ 311	$ (391)	$ 228	$ 527	$ 345	$ 297
Net earnings (loss) per common share:								
Basic	$ 0.75	$ 2.24	$ 0.87	$ (1.09)	$ 0.63	$ 1.47	$ 0.96	$ 0.83
Diluted	$ 0.75	$ 2.24	$ 0.86	$ (1.08)	$ 0.63	$ 1.46	$ 0.96	$ 0.83

Valuation and Qualifying Accounts for years 2018, 2017 and 2016:

	Balance at Beginning of Year	Additions Charged to Profit and Loss	Accounts Written Off	Balance at End of Year
Year Ended December 31, 2018				
Allowance for doubtful accounts	$ 46,000	$ —	$ —	$ 46,000
Year Ended December 31, 2017				
Allowance for doubtful accounts	$ 46,000	$ —	$ —	$ 46,000
Year Ended December 31, 2016				
Allowance for doubtful accounts	$ 107,857	$ (51,857)	$ 10,000	$ 46,000

Homasote Company

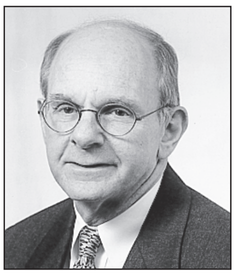
Board of Directors



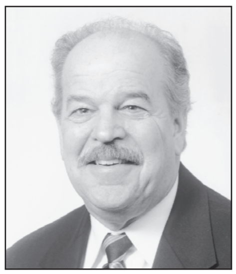
Michael R. Flicker
Attorney at Law

Warren L. Flicker
Chairman of the Board,
Chief Executive Officer

John P. Outerbridge
Vice President,
Carlson Wagonlit
Harvey's Travel



James M. Reiser
Retiree, Former Chief
Financial Officer,
Homasote Company



Norman Sharlin
Retired, Former President,
& Chief Operating Officer,
Sharlin Lite Corp.

Other Officers

Ronald D. Fasano
Chief Financial Officer
& Treasurer

Peter Tindall
Vice President,
Operations

Jennifer D. Bartkovich
Corporate Secretary
& Assistant Treasurer

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