

IKONICS CORP
Form 10-Q
August 14, 2009

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**U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

(Mark One)

☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended June 30, 2009**

or

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Transition Period From _____ to _____.**

**Commission file number 000-25727
IKONICS CORPORATION**

(Exact name of registrant as specified in its charter)

Minnesota

41-0730027

(State or other jurisdiction of
incorporation or organization)

(I.R.S. employer
identification no.)

4832 Grand Avenue
Duluth, Minnesota

55807

(Address of principal executive offices)

(Zip code)

(218) 628-2217

Issuer's telephone number
Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.)

Yes ☐ No ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practical date: Common Stock, \$.10 par value 1,967,057 shares outstanding as of August 7, 2009.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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Large accelerated
filer o

Accelerated filer o

Non-accelerated filer o
(Do not check if a smaller reporting
company)

Smaller reporting
company b

IKONICS Corporation
QUARTERLY REPORT ON FORM 10-Q

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	June 30 2009 (unaudited)	December 31 2008
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 882,023	\$ 901,738
Short term investments	600,000	
Trade receivables, less allowance of \$88,000 in 2009 and \$56,000 in 2008	2,055,030	2,077,158
Inventory	2,018,486	2,109,164
Deposits, prepaid expenses and other assets	99,358	192,201
Income tax refund receivable	37,246	185,869
Deferred income taxes	96,000	96,000
 Total current assets	 5,788,143	 5,562,130
 PROPERTY, PLANT, AND EQUIPMENT, at cost:		
Land and building	5,913,458	5,928,275
Machinery and equipment	2,477,156	2,430,857
Office equipment	763,595	763,595
Vehicles	241,905	241,905
	9,396,114	9,364,632
Less accumulated depreciation	(3,967,017)	(3,762,569)
	5,429,097	5,602,063
 INTANGIBLE ASSETS, less accumulated amortization of \$297,950 in 2009 and \$270,325 in 2008	 367,092	 403,285
 INVESTMENTS IN NON-MARKETABLE EQUITY SECURITIES	 918,951	 918,951
	\$ 12,503,283	\$ 12,486,429
 LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable		
Trade	\$ 433,232	\$ 344,783

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Construction		120,000
Accrued compensation	281,043	335,126
Other accrued liabilities	90,933	109,880
Total current liabilities	805,208	909,789
DEFERRED INCOME TAXES	178,000	143,000
Total liabilities	983,208	1,052,789
STOCKHOLDERS' EQUITY:		
Preferred stock, par value \$.10 per share; authorized 250,000 shares; issued none		
Common stock, par value \$.10 per share; authorized 4,750,000 shares; issued and outstanding 1,967,057 shares in 2009 and 1,993,983 in 2008	196,706	199,398
Additional paid-in capital	2,185,036	2,202,888
Retained earnings	9,138,333	9,031,354
Total stockholders' equity	11,520,075	11,433,640
	\$ 12,503,283	\$ 12,486,429

See notes to condensed financial statements.

Table of Contents**IKONICS CORPORATION
CONDENSED STATEMENTS OF OPERATIONS (Unaudited)**

	Three Months Ended June 30		Six Months Ended June 30	
	2009	2008	2009	2008
NET SALES	\$ 3,786,501	\$ 4,330,059	\$ 7,349,713	\$ 8,110,907
COST OF GOODS SOLD	2,329,999	2,468,468	4,487,897	4,620,261
GROSS PROFIT	1,456,502	1,861,591	2,861,816	3,490,646
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	1,095,839	1,154,850	2,317,420	2,521,930
RESEARCH AND DEVELOPMENT EXPENSES	155,993	167,855	323,276	382,710
INCOME FROM OPERATIONS	204,670	538,886	221,120	586,006
GAIN ON SALE OF NON-MARKETABLE EQUITY SECURITIES	9,631		29,762	
INTEREST INCOME	2,050	23,697	2,120	67,372
INCOME BEFORE INCOME TAXES	216,351	562,583	253,002	653,378
INCOME TAX EXPENSE	69,603	204,146	53,119	189,303
NET INCOME	\$ 146,748	\$ 358,437	\$ 199,883	\$ 464,075
EARNINGS PER COMMON SHARE:				
Basic	\$ 0.07	\$ 0.17	\$ 0.10	\$ 0.22
Diluted	\$ 0.07	\$ 0.17	\$ 0.10	\$ 0.22
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING :				
Basic	1,971,938	2,076,828	1,980,532	2,064,216

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Diluted	1,973,514	2,080,617	1,981,677	2,068,292
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See notes to condensed financial statements.

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CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)**

	Six Months Ended June 30	
	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 199,883	\$ 464,075
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	214,318	142,205
Amortization	27,625	26,855
Excess tax benefit from share-based payment arrangement		(39,319)
Tax benefit from stock option exercise		4,388
Stock based compensation	10,396	8,028
Loss (gain) on sale of equipment and vehicles	13,582	(1,725)
Loss on intangible asset abandonment	12,700	
Gain on sale of non-marketable equity securities	(29,762)	
Deferred income taxes	35,000	
Changes in working capital components:		
Trade receivables	22,128	(149,431)
Inventory	90,678	368,073
Deposits, prepaid expenses and other assets	92,843	(195,524)
Income tax refund receivable	148,623	
Accounts payable	(31,551)	94,054
Accrued liabilities	(73,030)	(41,694)
Income taxes payable		36,166
Net cash provided by operating activities	733,433	716,151
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(72,934)	(829,950)
Proceeds from sale of equipment and vehicles	18,000	8,500
Purchase of intangibles	(4,132)	(33,130)
Purchase of short-term investments	(600,000)	
Proceeds on sale of short-term investments		3,550,000
Proceeds from sale of non-marketable equity securities	29,762	
Net cash provided by (used in) investing activities	(629,304)	2,695,420
CASH FLOWS FROM FINANCING ACTIVITIES:		
Excess tax benefit from share-based payment arrangement		39,319
Repurchase of common stock	(123,844)	
Proceeds from exercise of stock options		106,712
Net cash provided by (used in) financing activities	(123,844)	146,031

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NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(19,715)	3,557,602
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	901,738	1,230,020
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 882,023	\$ 4,787,622
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for income taxes, net of refunds received	\$ (106,514)	\$ 191,644
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Construction payables incurred for building expansion	\$	\$ 390,424

See notes to condensed financial statements.

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IKONICS CORPORATION
NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The balance sheet of IKONICS Corporation (the Company) as of June 30, 2009, and the related statements of operations for the three and six months ended June 30, 2009 and 2008, and cash flows for the six months ended June 30, 2009 and 2008, have been prepared without being audited.

In the opinion of management, these statements reflect all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of IKONICS Corporation as of June 30, 2009, and the results of operations and cash flows for all periods presented.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted. Therefore, these statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

The results of operations for interim periods are not necessarily indicative of results that will be realized for the full fiscal year.

2. Short Term Investments

The Company's \$600,000 of short-term investment is comprised of fully insured certificates of deposit with maturities ranging from seven to twelve months and interest rates ranging from 1.9% to 2.3%.

3. Inventory

The major components of inventory are as follows:

	June 30, 2009	Dec 31, 2008
Raw materials	\$ 1,403,753	\$ 1,447,063
Work-in-progress	270,216	324,361
Finished goods	1,234,158	1,194,148
Reduction to LIFO cost	(889,641)	(856,408)
 Total Inventory	 \$ 2,018,486	 \$ 2,109,164

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IKONICS CORPORATION
NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited)

4. Earnings Per Common Share (EPS)

Basic EPS is calculated using net income divided by the weighted average of common shares outstanding. Diluted EPS is similar to Basic EPS except that the weighted average number of common shares outstanding is increased to include the number of additional common shares that would have been outstanding if the potential dilutive common shares, such as those shares subject to options, had been issued.

Shares used in the calculation of diluted EPS are summarized below:

	Three Months Ended	
	June 30, 2009	June 30, 2008
Weighted average common shares outstanding	1,971,938	2,076,828
Dilutive effect of stock options	1,576	3,789
Weighted average common and common equivalent shares outstanding	1,973,514	2,080,617

	Six Months Ended	
	June 30, 2009	June 30, 2008
Weighted average common shares outstanding	1,980,532	2,064,216
Dilutive effect of stock options	1,145	4,076
Weighted average common and common equivalent shares outstanding	1,981,677	2,068,292

5. Stock-based Compensation

The Company has a stock incentive plan for the issuance of up to 442,750 shares of common stock including the 100,000 additional shares approved by the shareholders at the April 24, 2009 annual meeting. The plan provides for granting eligible participants stock options or other stock awards, as described by the plan, at option prices ranging from 85% to 110% of fair market value at date of grant. Options granted expire up to seven years after the date of grant. Such options generally become exercisable over a one to three year period. A total of 127,423 shares of common stock are reserved for additional grants of options under the plan at June 30, 2009.

The Company charged compensation cost of \$6,600 against income for the three months ended June 30, 2009 compared to \$4,700 for the three months ended June 30, and 2008. For the first six months of 2009, the Company charged compensation cost of approximately \$10,400 against income compared to approximately \$8,000 for the same period in 2008. As of June 30, 2009 there was approximately \$67,000 of unrecognized compensation cost related to unvested share-based compensation awards granted. That cost is expected to be recognized over the next three years.

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There were no excess tax benefits recognized during the three or six month period ended June 30, 2009. For the six months ended June 30, 2008, \$39,319 of excess tax benefits were reported as operating and financing cash flows. The Company's APIC pool totaled \$111,029 at June 30, 2009 and December 31, 2008.

Proceeds from the exercise of stock options were \$106,712 for the six months ended June 30, 2008. There were no options exercised during the six months ended June 30, 2009.

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IKONICS CORPORATION
NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited)

The fair value of options granted during the six months ended June 30, 2009 and 2008 were estimated using the Black-Scholes option pricing model with the following assumptions:

	2009	2008
Dividend yield	0%	0%
Expected volatility	47.2%	55.0%
Expected life of option	Five Years	Five Years
Risk-free interest rate	2.0%	3.0%
Fair value of each option on grant date	\$2.10	\$4.05

There were 21,750 options and 5,000 options granted during the six months ended June 30, 2009 and 2008, respectively.

Stock option activity during the six months ended June 30, 2009 was as follows:

	Shares	Weighted Average Exercise Price
Outstanding at beginning of period	26,250	\$6.69
Granted	21,750	5.00
Exercised		
Expired and forfeited	(2,500)	6.14
Outstanding at June 30, 2009	45,500	5.91
Exercisable at June 30, 2009	15,916	6.40

The aggregate intrinsic value of all options outstanding and for those exercisable at June 30, 2009 was \$9,000 and \$6,000, respectively.

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IKONICS CORPORATION
NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited)

6. Segment Information

The Company's reportable segments are strategic business units that offer different products and have varied customer bases. There are three reportable segments: Domestic, Export, and IKONICS Imaging. Domestic sells screen printing film, emulsions, and inkjet receptive film to distributors located in the United States and Canada. IKONICS Imaging sells photo resistant film, art supplies, glass, metal medium and related abrasive etching equipment to end user customers located in the United States and Canada. It is also entering the market for etched ceramics, glass and silicon wafers; and is developing and selling proprietary inkjet technology. Export sells primarily the same products as Domestic and IKONICS Imaging to foreign customers. The accounting policies applied to determine the segment information are the same as those described in the summary of significant accounting policies included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

Management evaluates the performance of each segment based on the components of divisional income, and with the exception of trade receivables, does not allocate assets and liabilities to segments. Financial information with respect to the reportable segments follows:

For the three months ended June 30, 2009:

	Domestic	Export	IKONICS Imaging	Other	Total
Net sales	\$ 1,705,462	\$ 1,169,869	\$ 911,170	\$	\$ 3,786,501
Cost of goods sold	912,497	928,447	489,055		2,329,999
Gross profit	792,965	241,422	422,115		1,456,502
Selling, general and administrative*	233,341	116,309	292,619	453,570	1,095,839
Research and development*				155,993	155,993
Income (loss) from operations	\$ 559,624	\$ 125,113	\$ 129,496	\$ (609,563)	\$ 204,670

For the three months ended June 30, 2008:

	Domestic	Export	IKONICS Imaging	Other	Total
Net sales	\$ 1,799,163	\$ 1,350,783	\$ 1,180,113	\$	\$ 4,330,059
Cost of goods sold	963,903	908,520	596,045		2,468,468
Gross profit	835,260	442,263	584,068		1,861,591
Selling, general and administrative*	295,068	89,605	326,841	443,336	1,154,850
Research and development*				167,855	167,855
Income (loss) from operations	\$ 540,192	\$ 352,658	\$ 257,227	\$ (611,191)	\$ 538,886

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IKONICS CORPORATION
NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited)

For the six months ended June 30, 2009:

	Domestic	Export	IKONICS Imaging	Other	Total
Net sales	\$ 3,353,332	\$ 2,123,473	\$ 1,872,908	\$	\$ 7,349,713
Cost of goods sold	1,796,024	1,643,136	1,048,737		4,487,897
Gross profit	1,557,308	480,337	824,171		2,861,816
Selling, general and administrative*	505,528	255,622	584,527	971,743	2,317,420
Research and development*				323,276	323,276
Income (loss) from operations	\$ 1,051,780	\$ 224,715	\$ 239,644	\$ (1,295,019)	\$ 221,120

For the six months ended June 30, 2008:

	Domestic	Export	IKONICS Imaging	Other	Total
Net sales	\$ 3,191,389	\$ 2,579,728	\$ 2,339,790	\$	\$ 8,110,907
Cost of goods sold	1,747,858	1,715,346	1,157,057		4,620,261
Gross profit	1,443,531	864,382	1,182,733		3,490,646
Selling, general and administrative*	586,752	201,503	676,039	1,057,636	2,521,930
Research and development*				382,710	382,710
Income (loss) from operations	\$ 856,779	\$ 662,879	\$ 506,694	\$ (1,440,346)	\$ 586,006

* The Company does not allocate all general and administrative expenses or any research and development expenses to its operating segments for internal reporting.

Trade receivables by segment as of June 30, 2009 and December 31, 2008 were as follows:

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	June 30, 2009	Dec 31, 2008
Domestic	\$ 974,358	\$ 957,617
Export	806,439	874,068
IKONICS Imaging	317,680	276,718
Other, net of allowances	(43,447)	(31,245)
 Total	 \$ 2,055,030	 \$ 2,077,158

7. Sale of Non-Marketable Equity Securities

The Company received and realized a gain of \$29,762 during the first six months of 2009 related to the 2007 sale of its equity investment in Apprise Technologies, Inc (Apprise). The Company realized a gain of approximately \$55,000 on the \$253,000 cash payment received in 2007. During 2008 the Company received an additional \$25,000 related to the Apprise sale.

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IKONICS CORPORATION
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(Unaudited)

8. Income Taxes

The Company accounts for its uncertain tax positions under the provisions of Financial Standards Accounting Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). During the first quarter of 2009 and 2008, the statute of limitations for the relevant taxing authority to examine and challenge the tax position for open years expired, resulting in decreases in income tax expense of \$21,000 for the first six months of 2009 and \$44,000 for the first six months of 2008. As of June 30, 2009, the liability for unrecognized tax benefits totaled \$27,000 compared to a liability of \$48,000 as of June 30, 2008. The liability for unrecognized tax benefits is included in other accrued liabilities.

The Company is subject to taxation in the United States and various states. The material jurisdictions that are subject to examination by tax authorities primarily include Minnesota and the United States, for tax years 2006, 2007, and 2008.

It has been the Company's policy to recognize interest and penalties related to uncertain tax positions in income tax expense. The Company had accrued approximately \$6,000 of interest related to uncertain tax positions at June 30, 2009. The unrecognized tax benefits at June 30, 2009 relate to taxation of foreign export sales.

A reconciliation of the beginning and ending amounts of unrecognized tax benefit for the first six months of 2009 is as follows:

Balance at December 31, 2008	\$ 48,000
Expiration of the statute of limitations for the assessment of taxes	(21,000)
Balance at June 30, 2009	\$ 27,000

The balance of unrecognized tax benefits at June 30, 2009, if reversed, would decrease the provision for income taxes and increase net income by the same amount and reduce the Company's effective tax rate. The Company expects its unrecognized tax benefit to be reduced by approximately \$27,000 during the next twelve months as a result of the expiration of the statutes of limitations for the assessment of taxes.

9. Subsequent Events

In May 2009, the FASB issued and the Company adopted SFAS No. 165, *Subsequent Events* (SFAS 165). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financials statements are issued or are available to be issued. SFAS 165 requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether the date represents the date the financial statements were issued or were available to be issued. SFAS 165 was effective for the Company's quarter ending June 30, 2009. Accordingly, the Company evaluated subsequent events for recognition and disclosure through August 14, 2009. The evaluation resulted in no impact to the interim consolidated financial statements.

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IKONICS CORPORATION

The information presented below in Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended. Such statements are subject to risks and uncertainties, including those discussed under Factors that May Affect Future Results below, that could cause actual results to differ materially from those projected. Because actual results may differ, readers are cautioned not to place undue reliance on these forward-looking statements. Certain forward-looking statements are indicated by italics.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following management's discussion and analysis focuses on those factors that had a material effect on the Company's financial results of operations during the second quarter of 2009, the six months ended June 30, 2009 and the same periods of 2008. It should be read in connection with the Company's unaudited financial statements and notes thereto included in this Form 10-Q and the Company's audited financial statements, including related notes, and Management's Discussion and Analysis of Financials Condition and Results of Operations contained in the Company's 2008 Annual Report on Form 10-K.

Factors that May Affect Future Results

The possibility that the Company may need to record an adjustment reducing the value of its investment in imaging Technology international (iTi) This investment is periodically assessed for an other-than-temporary impairment and recorded at the lower of cost or market value and is currently recorded at \$919,000, which represents approximately 8% of outstanding shares of iTi. In assessing whether a decline has occurred in the fair value of this investment, the Company may consider a number of factors, including, any recent transactions in iTi equity securities occurring at lower valuations than past transactions, uncertainty or failures in iTi's technology or business strategies, and declines in iTi's financial condition, results of operations and ability to achieve its forecasted results without reasonable prospects for improvement. An occurrence of any of these factors may cause the Company to record an adjustment lowering the value of this investment. iTi is in the early stages of developing its business and, as a result, this investment is highly speculative.

The Company's expectation that its effective tax rate will return to 35% to 36% of pretax income for the remainder of 2009 compared to effective tax rate of 21% recorded in the first six month of 2009 The effective tax rate for the final six months of 2009 may be affected by changes in federal and state tax law, unanticipated changes in the Company's financial position or the Company's operating activities and/or management decisions could increase or decrease its effective tax rate.

The Company's belief that the quality of its receivables is high and that strong internal controls are in place to maintain proper collections This belief may be impacted by domestic economic conditions, by economic, political, regulatory or social conditions in foreign markets, or by the failure of the Company to properly implement or maintain internal controls.

The belief that the Company's current financial resources, cash generated from operations and the Company's capacity for debt and/or equity financing will be sufficient to fund current and anticipated business operations and capital expenditures. The belief that the Company's low debt levels and available line of credit make it unlikely that a decrease in product demand would impair the Company's ability to fund operations Changes in anticipated operating results, credit availability, equity market conditions or the Company's debt levels may further enhance or inhibit the Company's ability to maintain or raise appropriate levels of cash.

The Company's expectation that it will obtain a new line of credit similar to its current line of credit when the current line of credit expires This expectation may be impacted by factors such as changes

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in capital markets, general economic conditions, the Company's financial results and condition, and the Company's anticipated need for capital to fund business operations and capital expenditures.

The Company's expectations as to the level and use of planned capital expenditures and that capital expenditures will be funded with cash on hand and cash generated from operating activities This expectation may be affected by changes in the Company's anticipated capital expenditure requirements resulting from unforeseen required maintenance, repairs, or capital asset additions. The funding of planned or unforeseen expenditures may also be affected by changes in anticipated operating results resulting from decreased sales, lack of acceptance of new products or increased operating expenses or by other unexpected events affecting the Company's financial position.

The Company's belief that its vulnerability to foreign currency fluctuations and general economic conditions in foreign countries is not significant This belief may be impacted by economic, political and social conditions in foreign markets, changes in regulatory and competitive conditions, a change in the amount or geographic focus of the Company's international sales, or changes in purchase or sales terms.

The Company's plans to continue to invest in research and development efforts, expedite internal product development and invest in technological alliances, as well as the expected focus and results of such investments These plans and expectations may be impacted by general market conditions, unanticipated changes in expenses or sales, delays in the development of new products, technological advances, the ability to find suitable and willing technology partners or other changes in competitive or market conditions.

The Company's efforts to grow its international business These efforts may be impacted by economic, political and social conditions in current and anticipated foreign markets, regulatory conditions in such markets, unanticipated changes in expenses or sales, changes in competitive conditions or other barriers to entry or expansion.

The Company's belief as to future activities that may be undertaken to expand the Company's business Actual activities undertaken may be impacted by general market conditions, competitive conditions in the Company's industry, unanticipated changes in the Company's financial position, lack of acceptance of new products or the inability to identify attractive acquisition targets or other business opportunities.

Critical Accounting Estimates

The Company prepares its financial statements in conformity with accounting principles generally accepted in the United States of America. Therefore, the Company is required to make certain estimates, judgments and assumptions that the Company believes are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. The accounting estimates, which IKONICS believes are the most critical to aid in fully understanding and evaluating its reported financial results, include the following:

Trade Receivables. The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history and the customer's current credit worthiness, as determined by review of the current credit information. The Company continuously monitors collections and payments from its customers and maintains a provision for estimated credit losses based upon historical experience and any specific customer collection issues that have been identified. While such credit losses have historically been within expectations and the provisions established, the Company cannot guarantee that it will continue to experience the same collection history that has occurred in the past. The general payment terms are net 30-45 days for domestic customers and net 30-90 days for foreign customers

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Inventory. Inventory is valued at the lower of cost or market value using the last in, first out (LIFO) method. The Company monitors its inventory for obsolescence and records reductions in cost when required.

Income Taxes. At June 30, 2009, the Company had net current deferred tax assets of \$96,000 and net noncurrent deferred tax liabilities of \$178,000. The deferred tax assets and liabilities result primarily from temporary differences in property and equipment, accrued expenses, and inventory reserves. The Company has determined that it is more likely than not that the deferred tax asset will be realized and that a valuation allowance for such assets is not currently required. The Company accounts for its uncertain tax positions under FIN 48 and the related liability of \$27,000 as of June 30, 2009 will be adjusted as the statute of limitations expires or these positions are reassessed.

Investments in Non-Marketable Equity Securities. Investments in non-marketable equity securities consist of a \$919,000 investment in imaging Technology international (iTi). The Company accounts for this investment by the cost method because iTi 's common stock is unlisted and the criteria for using the equity method of accounting are not satisfied. Under the cost method, the investment is assessed for other-than-temporary impairment and recorded at the lower of cost or market value which requires significant judgment since there are no readily available market values for this investment. In assessing the fair value of this investment the Company considers recent equity transactions that iTi has entered into, the status of iTi 's technology and strategies in place to achieve its objectives, as well as iTi 's financial condition, results of operations, and ability to achieve its forecasted results. To the extent there are changes in the assessment, an adjustment may need to be recorded to reduce this investment

Revenue Recognition. The Company recognizes revenue on sales of products when title passes which can occur at the time of shipment or when the goods arrive at the customer location. Freight billed to customers is included in sales. Shipping costs are included in cost of goods sold.

Results of Operations

Quarter Ended June 30, 2009 Compared to Quarter Ended June 30, 2008

Sales. The Company realized a 12.6% sales decrease during the second quarter of 2009 with sales of \$3.8 million, compared to \$4.3 million in sales during the same period in 2008. IKONICS Imaging sales for the second quarter of 2009 were down 22.8% versus the second quarter of 2008 as film, glass and equipment shipments all fell short of 2008 levels for the same period due to softer demand in the awards and recognition market. Export sales were also lower by 13.4% during the second quarter of 2009 versus the same period in 2008 due to lower European shipments. Domestic incurred a 5.2% decrease in second quarter of 2009 shipments as both film and emulsion shipments were slightly lower during the period.

Gross Profit. Gross profit was \$1.5 million, or 38.5% of sales, in the second quarter of 2009 compared to \$1.9 million, or 43.0% of sales, for the same period in 2008. IKONICS Imaging gross profit percentage decreased to 46.3% during the second quarter of 2009 compared to 49.5% in the second quarter of 2008. The IKONICS Imaging gross profit percentage was unfavorably impacted by additional manufacturing expenses related to startup and development of new business initiatives discussed below in Future Outlook as well as higher raw material costs and lower volumes. Export gross profit percentage decreased from 32.7% in the second quarter of 2008 to 20.6% in the second quarter of 2009 due to higher raw material prices and lower sales volumes. The Domestic Chromaline gross profit percentage of 46.5% was consistent with the same period in 2008.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were \$1.1 million, or 28.9% of sales, in the second quarter of 2009, and \$1.2 million, or 26.7% of sales, for the same period in 2008. The decrease reflects lower personnel, travel, and advertising expenses.

Research and Development Expenses. Research and development expenses during the second quarter of 2009 were \$156,000, or 4.1% of sales, versus \$168,000, or 3.9% of sales, for the same period in 2008. The decrease is due to lower personnel cost.

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Gain on Sale of Non-Marketable Equity Securities. The Company realized a gain of \$9,600 in the second quarter of 2009 on the sale of its investment in the common and preferred stock of Apprise Technologies, Inc. The original sale took place during 2007. An additional \$20,100 was received in the first quarter of 2009. The total final payment of \$29,800 received in 2009 was related to a portion of the original sales price that was placed in escrow at the time of the sale for indemnification obligations as part of the agreement between Apprise and its purchaser.

Interest Income. The Company earned \$2,000 of interest income in the second quarter of 2009. During the second quarter of 2008 interest income was \$24,000. The interest income decrease from the prior year's period is due to lower investment balances in the second quarter of 2009 resulting from the Company's use of cash to finance construction of its new facility and the repurchase of a portion of the Company's stock. A large portion of the interest earned is related to interest received from the Company's short-term investments. The Company's \$600,000 of short-term investments are comprised of fully insured certificates of deposit with maturities ranging from seven to twelve months. The Company's cash is also maintained in an insured checking account that does not provide for interest. Instead, the account earns credits which offset banking fees.

Income Taxes. For the second quarter of 2009, the Company realized income tax expense of \$70,000, or an effective rate of 32.2% versus \$204,000, or an effective rate of 36.3% for the second quarter of 2008. The 2009 second quarter decrease is related to 2009 research and development tax credits which were not available during the second quarter of 2008. The 2008 research and development tax credits were not available until later in 2008 due to the timing of legislation.

Six Months Ended June 30, 2009 Compared to the Six Months Ended June 30, 2008

Sales. The Company's sales decreased 9.4% during the first six months of 2009 to \$7.4 million versus sales of \$8.1 million during the first six months of 2008. IKONICS Imaging realized a 20.0% sales decrease during the first half of 2009 over the same period in 2008 as sales to the awards and recognition markets continue to be negatively impacted by the slow economy. Export shipments were also down 17.7% for the first six months of 2009 as the global economic slowdown has dampened shipments to Europe. Partially offsetting these sales shortfalls, Domestic Chromaline shipments increased 5.1% during the first six months of 2009 over the same period in 2008 due to increased private label film shipments.

Gross Profit. Gross profit for the first six months of 2009 was \$2.9 million, or 38.9% of sales compared to \$3.5 million, or 43.0% of sales, for the same period in 2008. IKONICS Imaging gross profit percentage decreased from 50.5% in the first six months of 2008 to 44.0% in the first six months of 2009. The IKONICS Imaging gross profit percentage was unfavorably impacted by additional manufacturing expenses related to startup and development of new business initiatives discussed below in *Future Outlook* as well as higher raw material costs and lower volumes. The Export's gross profit percentage for the first six months of 2009 was 22.6% compared to 33.5% during the first six months of 2008. Export's gross profit has been unfavorably affected by higher raw material prices and lower sales volumes. Domestic's gross profit percentage benefited from a more favorable sales mix as it improved from 45.2% in the first six months of 2008 to 46.4% in the first six months of 2009.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased to \$2.3 million, or 31.5% of sales, in the first six months of 2009, from \$2.5 million, or 31.1% of sales, for the same period in 2008. The first six months of 2009 reflect lower salaries, travel, advertising and trade show expenses.

Research and Development Expenses. Research and development expenses during the first half of 2009 were \$323,000, or 4.4% of sales, versus \$383,000, or 4.7% of sales, for the same period in 2008. The decrease is mainly due to lower production trial and personnel expenses.

Gain on Sale of Non-Marketable Equity Securities. The Company realized a gain of \$29,800 during the first six months of 2009 on the sale of its investment in the common and preferred stock of Apprise Technologies, Inc. The original sale took place during 2007. The final \$29,800 received in the first six months of 2009 was related to a portion of the original sales price that was placed in escrow at the time of the sale for indemnification obligations as part of the agreement between Apprise and its purchaser.

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Interest Income. The Company earned \$2,000 of interest income during the first six months of 2009. During the first six months of 2008 interest income was \$67,000. The interest income decrease from the prior year's period is due to lower investment balances in 2009 resulting from the Company's use of cash to finance construction of its new facility and the repurchase of a portion of the Company's stock. A large portion of the interest earned is related to interest received from the Company's short-term investments. The Company's \$600,000 of short-term investments are comprised of fully insured certificates of deposit with maturities ranging from seven to twelve months. The Company's cash is also maintained in an insured checking account that does not provide for interest. Instead, the account earns credits which offset banking fees.

Income Taxes. During the first six months of 2009, the Company realized an income tax expense of \$53,000, or an effective rate of 21.0%, compared to income tax expense of \$189,000, or an effective rate of 29.0%, for the same period in 2008. The effective tax rate for the first six months of 2009 was significantly impacted by derecognizing a liability of \$21,000 for unrecognized tax benefits in accordance with FIN 48 relating to a tax year where the statute of limitations expired during the first quarter and the benefits of the domestic manufacturing deduction, research and development tax credits, and state income taxes. The 2008 first six month effective tax rate was significantly impacted by derecognizing a liability of \$44,000 for unrecognized tax benefits relating to a tax year where the statute of limitations expired during the first quarter, and the benefits of the domestic manufacturing deduction, tax exempt interest, and state income taxes. The Company expects that for the remainder of 2009, the Company will record income taxes at an effective tax rate of 35% to 36%.

Liquidity and Capital Resources

The Company has financed its operations principally with funds generated from operations. These funds have been sufficient to cover the Company's normal operating expenditures, annual capital requirements, and research and development expenditures.

Cash and cash equivalents were \$882,000 and \$4,788,000 at June 30, 2009 and 2008, respectively. The Company generated \$733,000 in cash from operating activities during the six months ended June 30, 2009, compared to generating \$716,000 of cash from operating activities during the same period in 2008. Cash provided by operating activities is primarily the result of net income adjusted for non-cash depreciation, amortization, gain on sale of nonmarketable equity securities, deferred taxes, and certain changes in working capital components discussed in the following paragraph.

During the first six months of 2009, trade receivables decreased by \$22,000. The decrease in receivables was driven by lower sales volumes. The Company believes that the quality of its receivables is high and that strong internal controls are in place to maintain proper collections. Inventory levels decreased \$91,000 due to lower raw material levels as the Company is managing its inventory to match sales volumes. Deposits, prepaid expenses and other assets decreased \$93,000 as a result of the Company prepaying for equipment at the end of 2008 which was received in 2009. Income tax refund receivable decreased \$149,000 due to the Company receiving its 2008 income tax refund. Accounts payable decreased \$32,000 due to the timing of payments to and purchases from vendors and payments made to contractors associated with the new building. Accrued liabilities decreased \$73,000, reflecting the timing of compensation payments.

During the first six months of 2009, investing activities used \$629,000. The Company invested \$600,000 in fully insured certificates on deposits. Purchases of property and equipment were \$73,000, mainly for new equipment to support the Company's new business initiatives and research activities. Also during the first six months of 2009, the Company incurred \$4,000 in patent application costs that the Company records as an asset and amortizes upon successful completion of the application process. The Company received proceeds of approximately \$30,000 in the first six months of 2009 on the 2007 sale of its investment in the common and preferred stock of Apprise Technologies, Inc.

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For the first six months of 2008, investing activities provided \$2,695,000 to the Company. The Company sold \$3,550,000 of short-term investments during 2008 at no gain or loss. These proceeds were partially offset by \$830,000 of property and construction costs related the Company's new facility which was completed in 2008. The \$830,000 also includes the final \$95,000 payment on the Company's industrial digital inkjet machine. The Company incurred \$33,000 in patent application costs during the first six months of 2008.

The Company used \$124,000 in financing activities during the first six months of 2009 to repurchase 26,926 shares of its own stock. During the first six months of 2008 the Company received \$146,000 from financing activities. The Company received \$107,000 from the issuance of 35,872 shares of common stock upon the exercise of stock options during the first six months of 2008. The Company also realized \$39,000 during the first six months of 2008 related to the excess tax benefits resulting from the exercise of stock options.

A bank line of credit exists providing for borrowings of up to \$1,250,000. Outstanding debt under this line of credit is collateralized by trade receivables and inventory and bears interest at 2.0 percentage points over the 30-day LIBOR rate. The Company did not utilize this line of credit during the first six months of 2009 and there were no borrowings outstanding as of June 30, 2009. The line of credit was also not utilized during first six months of 2008, and there were no borrowings outstanding under this line as of June 30, 2008. The line of credit expires on October 30, 2009, at which time the Company expects to renew the line of credit under similar terms.

The Company believes that current financial resources, its line of credit, cash generated from operations and the Company's capacity for debt and/or equity financing will be sufficient to fund current and anticipated business operations. The Company also believes that its low debt levels and available line of credit make it unlikely that a decrease in demand for the Company's products would impair the Company's ability to fund operations.

Capital Expenditures

Through June 30, 2009, the Company had \$73,000 in capital expenditures. Capital expenditures during the first six months of 2009 were mainly for new equipment to support the Company's new business initiatives and research activities. The Company plans for other capital expenditures during 2009 to include ongoing manufacturing equipment upgrades, as well as development equipment to modernize the capabilities and processes of the Company's research and development laboratory to improve measurement and quality control processes. Capital expenditures are expected to be approximately \$125,000 for the remaining six months of the year and will be funded with cash generated from operating activities.

International Activity

The Company markets its products to numerous countries in North America, Europe, Latin America, Asia and other parts of the world. Foreign sales were approximately 29% of total sales during the first six months of 2009 compared to 32% of sales during the same period in 2008. Lower volumes in Europe negatively impacted 2009 first half sales volumes. Fluctuations of certain foreign currencies have not significantly impacted the Company's operations because the Company's foreign sales are not concentrated in any one region of the world. The Company believes its vulnerability to uncertainties due to foreign currency fluctuations and general economic conditions in foreign countries is not significant.

The Company's foreign transactions are primarily negotiated, invoiced and paid in U.S. dollars, while a portion is transacted in Euros. IKONICS has not implemented an economic hedging strategy to reduce the risk of foreign currency translation exposures, which management does not believe to be significant based on the scope and geographic diversity of the Company's foreign operations as of June 30, 2009. Furthermore, the impact of foreign exchange on the Company's balance sheet and operating results was not material in either 2009 or 2008.

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Future Outlook

IKONICS has spent on average over 4% of its sales dollars for the past few years in research and development and in addition has made capital expenditures related to its digital technology program. The Company plans to maintain its efforts in this area and expedite internal product development as well as form technological alliances with outside experts to ensure commercialization of new product opportunities.

The Company achieved commercial acceptance of several new business initiatives, including its photo-machining process, sound deadening technology, digital texturing and IKONICS Industrial Solutions, which creates custom products to meet the needs of specific users. The Company anticipates that these new business initiatives will contribute an increasing amount of the Company's sales in the later part of 2009. The Company's anticipated sales from these new initiatives for 2009 includes sales of an improved sound-deadening product that is expected to expand the Company's customer base and sales of the Company's next-generation DTX printer, which is planned to be available for sale in the second half of 2009.

In addition to its traditional emphasis on domestic markets, the Company will continue efforts to grow its business internationally by attempting to develop new markets and expand market share where it has already established a presence.

Other future activities undertaken to expand the Company's business may include acquisitions, building improvements, equipment additions, new product development and marketing opportunities.

Recent Accounting Pronouncements

SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS 157 does not require any new fair value measurements. SFAS 157 was adopted by the Company on January 1, 2008 for financial assets and liabilities and on January 1, 2009 for nonfinancial assets. The Company's only financial instruments measured at fair value on a recurring basis were its auction rate securities, which were sold during the second quarter of 2008 at cost. The Company's nonfinancial assets include property, plant and equipment and intangible assets comprised of patents and non-competes. SFAS 157 affects how the fair value of these assets is determined when determining if the assets are impaired. None of the Company's non-financial assets were considered to be impaired as of June 30, 2009. Accordingly, the adoption of SFAS 157 for financial and nonfinancial assets had no impact on the Company's financial condition or results of operations through the second quarter of 2009.

In December 2007, the FASB issued SFAS No. 141 (Revised), Business Combinations (SFAS 141(R)). SFAS 141(R) establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The Company adopted SFAS 141(R) on January 1, 2009. The adoption of SFAS 141(R) had no impact on the Company's current financial condition or results of operations, as the Company did not enter into any business combinations.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements (SFAS 160). SFAS 160 requires all entities to report minority interests in subsidiaries as equity in the consolidated financial statements, and requires that transactions between entities and noncontrolling interests be treated as equity. The Company adopted SFAS 160 on January 1, 2009. The adoption of SFAS 160 had no impact on the Company's financial condition or results of operations.

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In May 2009, the FASB issued and the Company adopted SFAS No. 165, Subsequent Events (SFAS 165). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financials statements are issued or are available to be issued. SFAS 165 requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, that is, whether the date represents the date the financial statements were issued or were available to be issued. SFAS 165 was effective for the Company's quarter ended June 30, 2009.

In June 2009, the FASB issued SFAS No. 168 The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting (SFAS 168). SFAS 168 represents the last numbered standard to be issued by FASB under the old (pre-Codification) numbering system, and amends the GAAP hierarchy established under SFAS 162. On July 1, 2009 the FASB launched FASB's new Codification which will supersede all existing non-SEC accounting and reporting standards. SFAS 168 is effective in the first interim and annual periods ending after September 15, 2009. This pronouncement will have no effect on our current references to GAAP which will be replaced with references to the applicable codification paragraphs beginning with our financial statements for the quarter ended September 30, 2009.

Off Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

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ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

Not applicable

ITEM 4. Controls and Procedures

As of the end of the period covered by this report, the Company conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of the Company's disclosure control and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the

Exchange Act)). Based on this evaluation, the principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

There was no change in the Company's internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and Rule 15d-15(d) of the Exchange Act that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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None

ITEM 1A. Risk Factors

Not applicable

ITEM 2. Unregistered Sales of Equity Securities and Use of ProceedsThe Company repurchased shares as indicated in the table below during the second quarter of 2009⁽¹⁾:

	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under The Plans or Programs
April 1, 2009 through April 30, 2009				
May 1, 2009 through May 31, 2009	10,599	\$ 5.15	10,599	35,231
June 1, 2009 through June 30, 2009				

(1) In prior years, the Company's board of directors had authorized the repurchase of 150,000 shares of common stock. In August 2008, the Company's Board of Directors approved the repurchase of an additional 100,000 shares of common stock bringing the total shares eligible for repurchase to 250,000. A total of 204,170 shares have been repurchased

under this
program
including
10,599 shares
repurchased
during the
second quarter
of 2009. The
plan allows for
an additional
35,231 shares to
be repurchased.

ITEM 3. Defaults upon Senior Securities

Not applicable

ITEM 4. Submission of Matters to a Vote of Security Holders

The Company's Annual Meeting was held on April 24, 2009. The shareholders took the following actions:

The shareholders elected seven directors to hold office until the next annual meeting of shareholders. The shareholders present in person or by proxy cast the following numbers of votes in connection with the election of directors, resulting in the election of all nominees:

	Votes for (at least)	Votes Withheld (no more than)
Charles H. Andresen	1,746,753	53,418
Lockwood Carlson	1,746,753	53,418
David O. Harris	1,746,753	53,418
Gerald W. Simonson	1,746,753	53,418
William C. Ulland	1,746,753	53,418
Rondi Erickson	1,746,753	53,418
H. Leigh Severance	1,746,753	53,418

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The shareholders elected to amend the Company's 1995 Stock Incentive Plan principally by extending the expiration date from February 22, 2014 to February 18, 2019, and by reserving 100,000 additional shares of Common Stock for future awards. The shareholders present in person or by proxy cast the following numbers of votes in connection with the amendments to the 1995 Stock Incentive Plan, resulting in the approval of all amendments:

Votes For	Votes Against	Abstain
1,095,470	42,789	4,490

ITEM 5. Other Information

None

ITEM 6. Exhibits

The following exhibits are filed as part of this Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2009:

Exhibit	Description
3.1	Restated Articles of Incorporation of Company, as amended. ¹
3.2	By-Laws of the Company, as amended. ²
10	IKONICS Corporation 1995 Stock Incentive Plan, as amended. ³
31.1	Rule 13a-14(a)/15d-14(a) Certifications of CEO
31.2	Rule 13a-14(a)/15d-14(a) Certifications of CFO
32	Section 1350 Certifications

Copies of Exhibits will be furnished upon request and payment of the Company's reasonable expenses in furnishing the Exhibits.

1 Incorporated by reference to the like numbered Exhibit to the Company's Registration Statement on Form 10-SB (File No. 000-25727).

2 Incorporated by reference to the like numbered Exhibit to the Company's Current Report on Form 8-K filed with the Commission on February 22,

2007 (File
No. 000-25727).

- 3 Incorporated by
reference to the
like numbered
Exhibit to the
Company's
Registration
Statement on
Form S-8 filed
with the
Commission on
August 14, 2009
(File
No. 000-25727).

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IKONICS CORPORATION
SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

IKONICS CORPORATION

DATE: August 14, 2009

By: /s/ Jon Gerlach
Jon Gerlach,
Chief Financial Officer, and
Vice President of Finance

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INDEX TO EXHIBITS

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3.2	By-Laws of the Company, as amended	Incorporated by reference
10	IKONICS Corporation 1995 Stock Incentive Plan, as amended	Incorporated by reference
31.1	Rule 13a-14(a)/15d-14(a) Certifications of CEO	Filed Electronically
31.2	Rule 13a-14(a)/15d-14(a) Certifications of CFO	Filed Electronically
32	Section 1350 Certifications	Filed Electronically