



bringing unique imaging solutions
to the people of the world



IKONMetal Brass



Thru-Holes on Silicon Wafer



Deep Etching on Alumina



UPC Identification on Graphite



Acquired December 2006

CORPORATE PROFILE

2006 Net Sales	.....	\$14,888,912
Earnings per common share (diluted)	.....	\$.055
Founded	.....	1952
Employees	.....	70
NASDAQ Symbol	.....	.IKNX

IKONICS
CORPORATION

I am pleased to report sales and earnings for the year 2006. Net sales increased by 7% to \$14,889,000 and earnings by 24% to \$1,124,000 or \$0.55 per diluted share. We remain financially very sound, with a strong balance sheet.

In addition to a positive financial year we have laid the foundation for future growth.

At the end of 2006 we acquired the image mate™ brand of screen print products from Franklin International. The products and distributor base complement our domestic and export screen print products, with a number of opportunities for cross fertilization and a dual brand marketing strategy. For 2006, Franklin's image mate estimated sales were \$600,000.

During 2006, we spent considerable effort bringing our abrasive etching technology to the industrial ceramics and electronic wafer markets. This effort is based on proprietary products (including our DuPont licensed RapidMask™ film), designed to meet specific industrial needs. Although this is a longer sales cycle than we are accustomed to and 2006 has been a learning year, we believe we now have significant business opportunities in sight. I anticipate this effort will be a contributor to future growth.

Also, during the year we increased our investment in Imaging Technology International, recognized leaders in industrial digital inkjet technology. We have made the development of inkjettable fluids and fluid receptive substrates a priority for our R&D effort and capital expenditures. We have established a digital inkjet lab in Duluth and have made progress toward the commercialization of an advanced digital technology.

Finally, in the second half of 2006, we improved the production process for IKONMetal™, and the product is being sold to both the signage and award/trophy markets. Our IKONBraille™ product has encountered similar production issues; but I believe we are well on our way to solving them.

I anticipate that 2007 will be another successful year for IKONICS, with our core businesses continuing to grow and our new initiatives bringing increased revenues and profits while diversifying our customer base. I do, however, expect that compliance costs associated with Sarbanes Oxley Rule 404 will be a drag on earnings.

For the Board of the Directors



William C. Ulland
Chairman, President and CEO



BILL ULLAND
CHAIRMAN, PRESIDENT & CEO

The preceding letter contains statements regarding future financial results, new products, the success of acquisitions and other matters that involve risks and uncertainties. The Company's actual results could differ materially as a result of domestic and global economic conditions, competitive market conditions, acceptance of new products, the ability to identify, complete and successfully integrate suitable acquisitions, as well as the other factors described elsewhere in this Annual Report and in the Company's most recent Form 10-KSB and most recent Form 10-QSB on file with the SEC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following management discussion and analysis focuses on those factors that had a material effect on the Company's financial results of operations and financial condition during 2006 and 2005 and should be read in connection with the Company's audited financial statements and notes thereto for the years ended December 31, 2006 and 2005.

Factors that May Affect Future Results

Certain statements made in this Annual Report on Form 10-KSB, including those summarized below, are forward-looking statements within the meaning of the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended, that involve risks and uncertainties, and actual results may differ. Factors that could cause actual results to differ include those identified below.

The Company's belief that costs related to Section 404 of the Sarbanes-Oxley Act of 2002 should be higher in 2007—This belief may be impacted by changes in law or regulation affecting the timing of the Company's required compliance with Section 404 or unanticipated barriers to such compliance resulting from the Company's internal controls or third party influences.

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 capital expenditures will be funded with 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 or repairs. The funding of planned or unforeseen expenditures may also be affected by changes in anticipated operating results resulting from decreased sales or increased operating expenses.

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.

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5-Year History	Back Cover

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 or the inability to identify attractive acquisition targets or other business opportunities.

CRITICAL ACCOUNTING POLICIES

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 policies which IKONICS believes are the most critical to aid in fully understanding and evaluating its reported financial results include the following:

Accounts Receivable

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 60-90 days for foreign customers.

Inventory

Inventories are 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.

Deferred Tax Assets

At December 31, 2006, the Company had approximately \$145,000 of net deferred tax assets. The deferred tax assets result primarily from temporary differences in accrued expenses, inventory reserves, intangible assets and property and equipment. The Company has recorded a \$27,000 valuation allowance to reserve for items that more likely than not will not be realized. The Company has determined that it is more likely than not that the remaining deferred tax assets will be realized and that an additional valuation allowance for such assets is not currently required.

Revenue Recognition

The Company recognizes revenue on products when title passes which is usually upon shipment. Freight billed to customers is included in sales. Shipping costs are included in cost of goods sold.

RESULTS OF OPERATIONS

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Sales

The Company's net sales increased 6.6% to \$14.9 million in 2006, compared to net sales of \$14.0 million in 2005. Sales increases were realized in both international and domestic markets. International shipments grew 10.1% mainly due to increased film shipments to Asia. The 5.1% domestic sales increase was driven by both higher film and glass shipments.

Cost of Goods Sold

Cost of goods sold was \$8.2 million, or 55.0% of sales, in 2006 and \$7.7 million, or 55.5% of sales, in 2005. The decrease in the cost of sales as a percentage of sales during 2006 reflects a more favorable product mix partially offset by rising raw material and transportation costs.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased to \$4.5 million, or 30.2% of sales, in 2006 from \$4.4 million, or 31.3% of sales, in 2005. The 2006 increase was due to \$140,000 of additional trade show and advertising expenses. Salary, insurance and pension costs also increased by \$100,000. These cost increases were partially offset by a \$80,000 decrease in travel costs and a \$20,000 decrease in depreciation. The Company also incurred \$40,000 in additional expenses related to Sarbanes-Oxley compliance in 2005 as compared to 2006. The Company anticipates that Sarbanes-Oxley compliance expenses will increase by \$60,000 in 2007 as compared to 2006.

Research and Development Expenses

Research and development expenses were \$742,000, or 5.0% of sales, in 2006 compared to \$642,000, or 4.6% of sales, in 2005. The increase is due to an increase in spending on new product development, production trials, and additional research and development staff.

Interest Income

Interest income increased to \$115,000 for 2006, compared to \$58,000 for 2005. The increase was primarily due to increased interest rates and a larger average cash balance during the year.

Income Taxes

The income tax provision differs from the expected tax expense primarily due to the benefits of the foreign sales exclusion, state income taxes and federal tax credits for research and development. Income tax expense in 2006 was \$466,000, or an effective rate of 29.3%. Income tax expense for 2005 was \$348,000, or an effective rate of 27.7%. The lower effective rate for 2005 was partially due to a study performed by the Company during 2005 related to its research and development activities resulting in tax credits totaling \$15,000. The Company also realized a larger benefit in 2005 related to the foreign sales exclusion.

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 \$3,428,000 and \$3,412,000 at December 31, 2006 and 2005, respectively. The Company generated \$1,076,000 in cash from operating activities during 2006 compared to \$980,000 of cash generated from operating activities during 2005. Cash provided by operating activities is primarily the result of net income adjusted for non cash depreciation, amortization, stock based compensation, deferred taxes, and certain changes in working capital components discussed in the following paragraph.

During 2006, trade receivables increased by \$274,000. The increase in receivables is primarily related to higher sales. 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 increased by \$34,000 due to higher raw material and finished goods inventory stock. Accounts payable decreased by \$150,000, reflecting the timing of payments to suppliers. Income taxes payable increased by \$74,000 as a result of the timing of estimated 2006 tax payments compared to the calculated 2006 tax liability.

The Company used \$1,283,000 and \$423,000 in cash for investing activities during 2006 and 2005, respectively. During 2006, the Company invested \$538,000 in imaging Technology international Corporation ("iTi") to acquire 69,166 common shares. The Company owns 105,662 shares of iTi which represents 7% of the total outstanding common shares of iTi. iTi is a leader in the development of industrial production systems based on inkjet technology and the Company believes iTi's expertise fits strategically with the Company's expertise in developing substrates for inkjet printing and the Company's plans to develop proprietary industrial inkjet technologies. On December 29, 2006, the Company acquired the image mate™ line of screen printing products from Franklin International for \$533,000. Unaudited image mate sales in 2006 were estimated to be \$600,000. The acquisition included inventory, equipment, deposits under an agreement to purchase key raw materials from Franklin International and an agreement not to compete. The Company made \$274,000 of property and equipment purchases during 2006. The purchases were comprised of plant and research equipment to improve efficiency and safety, reduce operating costs and update facilities, and two automobiles. The Company also incurred \$28,000 in patent application costs that it recorded as an asset and amortizes upon successful completion of the application process. The Company received \$84,000 during 2006 from the sale of marketable securities and \$6,000 from the sale of an automobile.

During 2005, the Company invested \$253,000 in iTi to acquire 36,496 common shares and warrants to purchase an additional 33,333 common shares of iTi. The Company made \$211,000 of property and equipment purchases during 2005 and \$12,000 in patent application costs. The Company received \$43,000 during 2005 from the sale of marketable securities and \$11,000 from the sale of automobiles.

The Company realized \$223,000 in cash from financing activities during 2006 compared to \$117,000 received in 2005. During 2006, the Company received \$186,000 for the issuance of 48,324 shares of common stock issued upon the exercise of stock options compared to \$233,000 received during 2005 for 57,491 shares of common stock issued upon the exercise of stock options. The Company also realized a \$37,000 cash benefit during 2006 related to the excess tax benefit from the exercise of stock options. The Company repurchased 25,499 shares of its common stock at a cost of \$116,000 during 2005.

A bank line of credit provides for borrowings of up to \$1,250,000. Borrowings under this line of credit are collateralized by accounts receivable and inventory and bear interest at 2.00 percentage points over the 30 day LIBOR rate. The Company did not utilize this line of credit during the year and there were no borrowings outstanding as of December 31, 2006. The line of credit was also not utilized during 2005 and there were no borrowings outstanding under this line as of December 31, 2005.

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

The Company spent \$274,000 on capital expenditures during 2006. This spending included plant and research equipment upgrades to improve efficiency and safety, reduce operating costs, update facilities and vehicles.

Plans for capital expenditures include ongoing manufacturing equipment upgrades, development equipment to modernize the capabilities and processes of IKONICS' laboratory, research and development to improve measurement and quality control processes and vehicles. These commitments are expected to be funded with cash generated from operating activities.

International Activity

The Company markets its products to numerous countries in all regions of the world including North America, Europe, Latin America, and Asia. Foreign sales were approximately 30.4% of total sales during 2006 and 29.4% of total sales in 2005. Foreign sales in 2006 reflect increased shipments to Asia. Fluctuations in 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 December 31, 2006.

Future Outlook

IKONICS has invested on average over 4% of its sales dollars for the past few years in research and development. 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.

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 expanding market share where it has already established a presence.

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

Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and tran-

sition. FIN 48 will be effective for the Company beginning in fiscal 2007. The Company does not expect this interpretation will have a material effect on its financial statements and related disclosures.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ("SFAS 157"). 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 is effective for the Company beginning in fiscal year 2008. The Company is evaluating the statement to determine the effect on its financial statements and related disclosures.

MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY SECURITIES

The Company's Common Stock is traded on the Nasdaq Capital Market under the symbol IKNX. The following table sets forth, for the fiscal quarters indicated, the high and low bid prices for the Company's Common Stock as reported on the Nasdaq Capital Market for the periods indicated. The quotations reflect inter-dealer prices without retail mark-up, mark-down or commission, and may not represent actual transactions.

Fiscal Year Ended December 31, 2006:	High	Low
First Quarter	\$8.33	\$6.26
Second Quarter	10.47	7.06
Third Quarter	8.97	7.15
Fourth Quarter	8.60	7.02
Fiscal Year Ended December 31, 2005:	High	Low
First Quarter	\$7.35	\$5.51
Second Quarter	7.00	4.20
Third Quarter	6.99	4.95
Fourth Quarter	8.99	5.78

As of February 28, 2007, the Company had approximately 654 shareholders. The Company has never declared or paid any dividends on its Common Stock.

The Company did not purchase shares of its equity securities during 2006. A total of 50,007 shares of Common Stock may yet be purchased under the repurchase program approved by the Company's Board of Directors in February 2005.

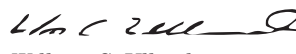
MANAGEMENT'S REPORT

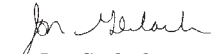
The financial statements of IKONICS Corporation have been prepared by company management who are responsible for their content. These statements have been prepared in accordance with accounting principles generally accepted in the United States of America and, where appropriate, reflect estimates based on judgements of management.

IKONICS maintains a system of internal controls. Our system provides reasonable assurance that assets are protected, transactions are appropriately reported, and established procedures are followed.

The financial statements have been audited by McGladrey & Pullen LLP, an independent registered public accounting firm.

The Audit Committee of the Board of Directors, comprised of outside directors, meets periodically with the independent auditors and management to discuss the company's internal accounting controls and financial reporting matters. Our independent public accounting firm has unrestricted access to the Audit Committee, without management present, to discuss the results of their audit, the adequacy of internal accounting controls, and the quality of financial reports.


William C. Ulland
Chairman, President & CEO


Jon Gerlach
Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

*Stockholders and Board of Directors
IKONICS Corporation
Duluth, Minnesota*

We have audited the balance sheets of IKONICS Corporation as of December 31, 2006 and 2005, and the related statements of operations, stockholders' equity and comprehensive income and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of IKONICS Corporation as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the financial statements, effective January 1, 2006 the Company adopted Statement of Financial Accounting Standards No. 123 (Revised 2004), "Shared-Based Payment."

/s/ McGladrey & Pullen, LLP
Duluth, Minnesota
March 21, 2007

BALANCE SHEETS: DECEMBER 31, 2006 & 2005

ASSETS	2006	2005
Current Assets:		
Cash and cash equivalents	\$3,428,186	\$3,412,072
Marketable securities	—	84,875
Trade receivables, less allowance for doubtful accounts of \$50,000 (Note 10)	1,976,893	1,702,608
Inventories (Notes 1 and 10)	2,494,876	2,364,056
Deposits, prepaid expenses and other assets (Note 3)	232,255	65,747
Deferred income taxes (Note 2)	<u>97,000</u>	<u>99,000</u>
Total current assets	<u>8,229,210</u>	<u>7,728,358</u>
Property, Plant, and Equipment, at cost:		
Land and building	1,500,271	1,479,824
Machinery and equipment	2,396,867	2,531,734
Office equipment	817,406	1,280,149
Vehicles	<u>203,816</u>	<u>174,803</u>
	4,918,360	5,466,510
Less accumulated depreciation	<u>3,926,440</u>	<u>4,514,945</u>
	<u>991,920</u>	<u>951,565</u>
Intangible Assets , less accumulated amortization of \$159,351 in 2006 and \$134,642 in 2005 (Notes 3 and 4)	485,421	279,086
Deferred Income Taxes (Note 2)	48,000	61,000
Investments in Non-Marketable Equity Securities (Note 1)	<u>988,910</u>	<u>450,790</u>
	<u>\$10,743,461</u>	<u>\$9,470,799</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$288,449	\$438,597
Accrued compensation	324,082	279,042
Other accrued expenses	172,381	217,912
Income taxes payable	<u>94,450</u>	<u>56,743</u>
Total current liabilities	<u>879,362</u>	<u>992,294</u>
Commitments and Contingencies (Note 4)		
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 2,010,861 shares in 2006 and 1,962,537 shares in 2005	201,086	196,254
Additional paid-in capital	1,979,012	1,721,119
Retained earnings	7,684,001	6,560,236
Accumulated other comprehensive income	—	896
Total stockholders' equity	<u>9,864,099</u>	<u>8,478,505</u>
	<u>\$10,743,461</u>	<u>\$9,470,799</u>

See notes to financial statements.

STATEMENTS OF OPERATIONS: YEARS ENDED DECEMBER 31, 2006 & 2005

	2006	2005
Net Sales (Note 6)	\$14,888,912	\$13,971,217
Costs and Expenses:		
Cost of goods sold	8,181,814	7,748,707
Selling, general and administrative	4,490,381	4,383,144
Research and development	742,406	641,622
	<u>13,414,601</u>	<u>12,773,473</u>
Income from Operations	1,474,311	1,197,744
Interest Income	<u>115,454</u>	<u>58,425</u>
Income Before Income Taxes	1,589,765	1,256,169
Federal and State Income Taxes (Note 2)	<u>466,000</u>	<u>348,000</u>
Net Income	<u>\$1,123,765</u>	<u>\$908,169</u>
Earnings Per Common Share:		
Basic	<u>\$0.56</u>	<u>\$ 0.47</u>
Diluted	<u>\$0.55</u>	<u>\$0.46</u>
Weighted Average Common Shares:		
Basic	<u>2,000,017</u>	<u>1,944,330</u>
Diluted	<u>2,027,916</u>	<u>1,986,885</u>

See notes to financial statements.

STATEMENTS OF STOCKHOLDERS' EQUITY & COMPREHENSIVE INCOME: YEARS ENDED DECEMBER 31, 2006 & 2005

	Common Stock	Additional	Retained	Accumulated	Total	
	Shares	Paid-in	Earnings	Other	Stock-	
	Amount	Capital	Income (Loss)	holders'	Equity	
Balance at December 31, 2004	1,930,545	\$193,055	\$1,477,815	\$5,745,662	\$(2,316)	\$7,414,216
Net income	-	-	-	908,169	-	908,169
Unrealized gain on available-for-sale securities	-	-	-	-	3,212	<u>3,212</u>
Total comprehensive income	-	-	-	-	-	911,381
Exercise of stock options	57,491	5,749	227,042	-	-	232,791
Common stock repurchased	(25,499)	(2,550)	(19,519)	(93,595)	-	(115,664)
Tax benefit resulting from stock option exercises	-	-	<u>35,781</u>	-	-	<u>35,781</u>
Balance at December 31, 2005	1,962,537	196,254	1,721,119	6,560,236	896	8,478,505
Net income	-	-	-	1,123,765	-	1,123,765
Unrealized loss on available-for-sale securities	-	-	-	-	(896)	<u>(896)</u>
Total comprehensive income	-	-	-	-	-	1,122,869
Exercise of stock options	48,324	4,832	181,503	-	-	186,335
Tax benefit resulting from stock option exercises	-	-	14,055	-	-	14,055
Stock based compensation and related tax benefit	-	-	<u>62,335</u>	-	-	<u>62,335</u>
Balance at December 31, 2006	<u>2,010,861</u>	<u>\$201,086</u>	<u>\$1,979,012</u>	<u>\$7,684,001</u>	<u>\$ -</u>	<u>\$9,864,099</u>

See notes to financial statements.

STATEMENTS OF CASH FLOWS: YEARS ENDED DECEMBER 31, 2006 & 2005

	2006	2005
Cash Flows from Operating Activities:		
Net income	\$1,123,765	\$908,169
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	242,833	269,549
Amortization	24,710	24,914
Excess tax benefit from share-based payment arrangement	(36,712)	-
Tax benefit from stock option exercise	14,055	35,781
Stock based compensation	25,623	-
(Gain) Loss on sale of vehicles	(640)	7,992
Deferred income taxes	15,000	48,000
Changes in working capital components, net of effects of business acquisition:		
Trade receivables	(274,285)	(59,704)
Inventories	34,101	(162,774)
Prepaid expenses and other assets	(16,508)	(8,402)
Accounts payable	(150,148)	(97,794)
Accrued expenses	(491)	(12,258)
Income taxes payable	74,419	26,574
Net cash provided by operating activities	<u>1,075,722</u>	<u>980,047</u>
Cash Flows from Investing Activities:		
Purchases of property and equipment	(273,548)	(211,276)
Proceeds on sale of vehicles	6,000	11,000
Business acquisition (Note 3)	(532,921)	-
Purchase of intangibles	(28,045)	(11,651)
Purchase of non-marketable equity securities	(538,120)	(253,330)
Proceeds from sale of marketable securities	83,979	42,695
Net cash used in investing activities	<u>(1,282,655)</u>	<u>(422,562)</u>
Cash Flows from Financing Activities:		
Excess tax benefit from share-based payment arrangement	36,712	-
Proceeds from exercise of stock options	186,335	232,791
Redemption of common stock	-	(115,664)
Net cash provided by financing activities	<u>223,047</u>	<u>117,127</u>
Net Increase in Cash and Cash Equivalents	16,114	674,612
Cash and Cash Equivalents at Beginning of Year	<u>3,412,072</u>	<u>2,737,460</u>
Cash and Cash Equivalents at End of Year	<u>\$3,428,186</u>	<u>\$3,412,072</u>
Supplemental Disclosure of Cash Flow Information		
Cash paid for income taxes	<u>\$362,526</u>	<u>\$237,645</u>

See notes to financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business and Foreign Sales

IKONICS Corporation (the Company) develops and manufactures high-quality photochemical imaging systems for sale primarily to a wide range of printers and decorators of surfaces. Customers' applications are primarily screen printing and abrasive etching. The Company's principal markets are throughout the United States. In addition, the Company sells to Western Europe, Latin America, Asia, and other parts of the world. The Company extends credit to its customers, all on an unsecured basis, on terms that it establishes for individual customers.

Foreign sales approximated 30.4% of total sales in 2006 and 29.4% of total sales in 2005. Thirty-nine percent and forty-four percent, respectively, of the Company's accounts receivable at December 31, 2006 and 2005 are due from foreign customers. The foreign receivables are composed primarily of open credit arrangements with terms ranging from 45 to 90 days. No single customer represented greater than 10% of net sales in 2006 or in 2005.

A summary of the Company's significant accounting policies follows:

Cash Equivalents

The Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash equivalents consist of putable variable rate municipal bonds backed by a letter of credit and money market funds in which the carrying value of both types of instruments approximate market value because of the short maturity of these instruments.

Marketable Securities

Marketable securities were classified as available-for-sale and consist primarily of municipal revenue bonds that were held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity, or changes in the availability or yield of alternative investments. These securities were carried at fair market value with changes in fair value, net of tax, recorded in other comprehensive income. There were no marketable securities at December 31, 2006.

Trade Receivables

Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on an on-going basis. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history, and current economic conditions. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received. Accounts are considered past due if payment is not received according to agreed-upon terms.

Inventories

Inventories are stated at the lower of cost or market using the last-in, first-out (LIFO) method. If the first-in, first-out cost method had been used, inventories would have been approximately \$535,000 and \$509,000 higher than reported at December 31, 2006 and 2005, respectively. The major components of inventories are as follows:

	2006	2005
Raw materials	\$1,577,165	\$1,483,881
Work-in-progress	225,033	212,254
Finished goods	1,227,806	1,176,647
Reduction to LIFO cost	(535,128)	(508,726)
Total inventories	<u>\$2,494,876</u>	<u>\$2,364,056</u>

Depreciation

Depreciation of property, plant and equipment is computed using the straight-line method over the following estimated useful lives:

	Years
Building	15-40
Machinery and equipment	5-10
Office equipment	3-10
Vehicles	3

Intangible Assets

Intangible assets consist primarily of patents, licenses and covenants not to compete arising from business combinations. Intangible assets are amortized on a straight-line basis over their estimated useful lives or agreement terms. Remaining estimated useful lives on intangible assets range from 5 to 14 years. Intangible assets with finite lives are assessed for impairment whenever events or circumstances indicate the carrying value may not be fully recoverable by comparing the carrying value of the intangibles to their future undiscounted cash flows. To the extent there is impairment, analysis is performed based on several criteria, including, but not limited to, revenue trends, discounted operating cash flows and other operating factors to determine the impairment amount.

Investments in Non-Marketable Equity Securities

Investments in non-marketable equity securities consist of a \$791,450 investment in Imaging Technology International ("iTi"). The Company acquired an additional 69,166 common shares of iTi during 2006. The Company currently owns 105,662 common shares of iTi which represents 7% of the total outstanding common shares of iTi. iTi is a leader in the development of industrial production systems based on inkjet technology and the Company believes iTi's expertise fits strategically with the Company's expertise in developing substrates for inkjet printing and its plan to develop proprietary industrial inkjet technology. The Company has a \$197,460 equity investment in Apprise Technologies, Inc. As of December 31, 2006, the Company's ownership of Apprise's common and preferred stock represented approximately 4.95% of the outstanding shares of Apprise. The Company accounts for these investments by the cost method because the common stock of each corporation is unlisted and the criteria for using the equity method of accounting are not satisfied. The Company reviews these investments for impairment annually and writes them down whenever the recorded amount exceeds estimated fair market value. During February 2007, Apprise was acquired by Eco Lab Incorporated for cash. The Company realized a gain of approximately \$55,000 on the first payment from the transaction. The Company also expects to receive an additional \$40,000 in 2008 at which time an additional gain will be recognized. Cash received in February 2007 was \$253,000.

Fair Value of Financial Instruments

The carrying amounts of financial instruments, including cash, cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximate fair value due to the short maturity of these instruments. The carrying value of the non-marketable equity securities approximated their estimated fair value based on management's knowledge of recent sales prices of the non-marketable equity securities.

Revenue Recognition

The Company recognizes revenue on sales of products when title passes which is usually upon shipment. Freight billed to customers is included in sales. Shipping costs are included in cost of goods sold.

Deferred Taxes

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

Comprehensive Income

The Company's comprehensive income consists of net income and net unrealized holding gains and losses on marketable securities, net of taxes.

Earnings Per Common Share (EPS)

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

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

	2006	2005
Weighted average common shares outstanding	2,000,017	1,944,330
Dilutive effect of stock options	<u>27,899</u>	<u>42,555</u>
Weighted average common and common equivalent shares outstanding	<u>2,027,916</u>	<u>1,986,885</u>

Options to purchase 88,222 and 130,285 shares of common stock were outstanding as of December 31, 2006 and 2005, respectively.

Employee Stock Plan

Effective January 1, 2006, the Company adopted Financial Accounting Standards Board Statement No. 123 (revised 2004), "Share-Based Payment," (FAS 123(R)) using the modified-prospective-transition method. Prior to the adoption of FAS 123(R), we accounted for stock option grants under APB Opinion No. 25, "Accounting for Stock Issued to Employees" (the intrinsic value method), and accordingly recognized no compensation expense for stock option grants.

Under the modified-prospective-transition method, FAS 123(R) applies to new awards and to awards that were outstanding on January 1, 2006 that are subsequently modified, repurchased, or cancelled. Under this method compensation cost in 2006 includes cost for options granted prior to but not vested as of December 31, 2005, and options granted in 2006. Prior periods were not restated to reflect the impact of adopting the new standard.

The adoption of FAS 123(R) lowered net income by approximately \$25,600 for the year ended December 31, 2006, compared to accounting for share-based compensation under APB No. 25. The Company has elected the alternative (short-cut) method for calculating the pool of excess tax benefits (APIC Pool) available to absorb tax shortages recognized subsequent to the adoption of FAS 123(R). The Company's calculation of the APIC windfall at January 1, 2006 was \$3,000.

The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of FAS 123(R) during the period prior to its effective date. For the purposes of this pro forma disclosure, the value of the options is estimated using a Black-Scholes option-pricing model and amortized to expense over the vesting periods of the options.

Year Ended December 31, 2005

Net income:	
As reported	\$908,169
Deduct total stock-based employee compensation expense determined under fair value based method for all awards	<u>21,214</u>
Pro forma	<u>\$886,955</u>
Basic earnings per common share:	
As reported	\$0.47
Pro forma	\$0.46
Diluted earnings per common share:	
As reported	\$0.46
Pro forma	\$0.45

As of December 31, 2006, there was approximately \$36,000 of unrecognized compensation cost related to unvested share-based compensation awards granted. That cost is expected to be recognized over the next three years.

The Company receives a tax deduction for certain stock option exercises during the period in which the options are exercised, generally for the excess of the prices at which the option shares are sold over the exercise price of the options. Prior to the adoption of FAS 123(R), the Company reported all tax benefits relating to the exercise of stock options as operating cash flows in our statement of cash flows. In accordance with FAS 123(R), for the year ended December 31, 2006, we began reporting the excess tax benefits from the exercise of stock options as a reduction of operating and an increase in financing cash flows. For the year ended December 31, 2006, \$36,712 of excess tax benefits were reported in the statement of cash flows.

Use of Estimates

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

Foreign Currency Translation

Foreign currency transactions and translation adjustments did not have a significant effect on the Statements of Stockholders' Equity and Comprehensive Income and Cash Flows for 2006 and 2005.

2. INCOME TAXES

Income tax expense for the years ended December 31, 2006 and 2005 consists of the following:

	<u>2006</u>	<u>2005</u>
Current:		
Federal	\$401,000	\$262,000
State	<u>50,000</u>	<u>38,000</u>
	451,000	300,000
Deferred	<u>15,000</u>	<u>48,000</u>
	<u>\$466,000</u>	<u>\$348,000</u>

The expected provision for income taxes, computed by applying the U.S. federal income tax rate of 35% in 2006 and 2005 to income before taxes, is reconciled to income tax expense as follows:

	<u>2006</u>	<u>2005</u>
Expected provision for federal income taxes	\$556,400	\$439,700
State income taxes, net of federal benefit	36,300	25,700
Extraterritorial income exclusion ..	(49,400)	(64,700)
Domestic manufacturers deduction ..	(11,100)	-
Non-deductible meals and entertainment	16,400	13,600
Tax-exempt interest	(39,000)	(18,100)
R&D Credit	(13,600)	(29,000)
Other	<u>(30,000)</u>	<u>(19,200)</u>
	<u>\$466,000</u>	<u>\$348,000</u>

Deferred tax assets consist of the following as of December 31, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Property and equipment and other assets	\$38,000	\$40,000
Accrued vacation	19,000	14,000
Other accrued expenses	49,000	47,000
Inventories	12,000	20,000
Allowance for doubtful accounts ...	18,000	18,000
Allowance for sales returns	7,000	7,000
Intangible assets	10,000	21,000
Capital loss carryforward	<u>27,000</u>	<u>27,000</u>
	180,000	194,000
Less valuation allowance	<u>(27,000)</u>	<u>(27,000)</u>
	153,000	167,000
Deferred tax liabilities:		
Prepaid expenses	<u>8,000</u>	<u>7,000</u>
	<u>\$145,000</u>	<u>\$160,000</u>

4. INTANGIBLE ASSETS

Intangible assets consist primarily of patents, licenses and covenants not to compete arising from business combinations. Intangible assets are amortized on a straight-line basis over their estimated useful lives or terms of their agreement, whichever is shorter. During 2005, application costs for two patents with total capitalized costs of \$30,341 were expensed as it was determined that these projects had no future value. No impairment adjustments to intangible assets were made during the year ended December 31, 2006.

Intangible assets at December 31, 2006 and 2005 consist of the following:

	<u>December 31, 2006</u>		<u>December 31, 2005</u>		
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization	
Amortized intangible assets:					
Patents	\$241,773	\$(81,022)	\$213,728	\$(71,102)	
Licenses	100,000	(35,000)	100,000	(26,875)	
Non-compete agreement	<u>303,000</u>	<u>(43,330)</u>	<u>100,000</u>	<u>(36,664)</u>	
	<u>\$644,773</u>	<u>\$(159,352)</u>	<u>\$413,728</u>	<u>\$(134,642)</u>	
Aggregate amortization expense:			2006	2005	
For the year ended December 31			\$24,710	\$24,914	
Estimated amortization expense for the year ended December 31:					
2007	\$53,710	2009	\$53,710	2011	\$53,710
2008	\$53,710	2010	\$53,710		

In connection with the license agreements, the Company has agreed to pay royalties ranging from 3% to 5% on the future sales of products subject to the agreements. The Company incurred \$119,000 of expense under these agreements during 2006, and \$108,000 during 2005.

5. RETIREMENT PLAN

The Company has established a salary deferral plan under Section 401(k) of the Internal Revenue Code. Such deferrals accumulate on a tax-deferred basis until the employee withdraws the funds. The Company contributes 5% of each eligible employee's compensation. Total retirement expense for the years ended December 31, 2006 and 2005 was approximately \$163,000 and \$150,000, respectively.

The deferred tax amounts described above have been included in the accompanying balance sheet as of December 31, 2006 and 2005 as follows:

	<u>2006</u>	<u>2005</u>
Current assets	\$97,000	\$99,000
Noncurrent assets	<u>48,000</u>	<u>61,000</u>
	<u>\$145,000</u>	<u>\$160,000</u>

3. PURCHASE OF ASSETS

On December 29, 2006, the Company acquired certain assets of Franklin International Inc. (Franklin) related to the image mate™ line of screen printing products. The acquisition was accounted for under the purchase method of accounting. Accordingly, the assets acquired were recorded at their fair market value. The assets acquired include lab equipment, raw materials and finished goods inventory, and a non-compete agreement with Franklin. The costs allocated to the non-compete agreement will be amortized on a straight-line basis over its seven year term. In connection with the acquisition, the Company entered into an agreement to prepay for inventory purchases from Franklin, which are expected to be utilized over three years.

The fair market value of the assets acquired resulted in the following purchase price allocation:

Cash price paid for assets	\$528,921
Acquisition costs incurred	<u>4,000</u>
Total purchase price	<u>\$532,921</u>

Purchase Price Allocation

Inventory	\$164,921
Deposit for inventory purchases	150,000
Equipment	15,000
Noncompete agreement	<u>203,000</u>
	<u>\$532,921</u>

If the acquisition had occurred on January 1, 2005, the unaudited pro forma impact on revenues would have been to increase revenues by approximately \$600,000 for each of the years ended December 31, 2005 and 2006. The unaudited proforma net income and earnings per common share would not have been significant to the amounts reported in the Company's financial statements for such years.

6. SEGMENT INFORMATION

The Company's reportable segments are strategic business units that offer different products and have a varied customer base. There are three reportable segments: Domestic, Export, and IKONICS Imaging. Domestic sells screen printing film, emulsions, and inkjet receptive film which is sold to distributors located in the United States. 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. 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.

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

For the year ended December 31, 2006	Domestic	Export**	IKONICS Imaging	Other	Total
Net sales	\$5,777,987	\$4,531,605	\$4,579,320	\$ -	\$14,888,912
Cost of good sold	3,803,598	2,955,011	2,143,205	-	8,181,814
Selling, general and administrative*	965,695	395,619	1,479,464	1,649,603	4,490,381
Accounts receivable	842,144	780,599	384,748	(30,598)	1,976,893
For the year ended December 31, 2005	Domestic	Export**	IKONICS Imaging	Other	Total
Net sales	\$5,512,880	\$4,115,198	\$4,343,139	\$ -	\$13,971,217
Cost of good sold	3,071,175	2,669,605	2,007,927	-	7,748,707
Selling, general and administrative*	935,424	445,852	1,381,117	1,620,751	4,383,144
Accounts receivable	696,615	748,002	290,305	(32,314)	1,702,608

*The company does not allocate all general and administrative expenses to its operating segments for internal reporting.

**In 2006 and 2005, the Company marketed its products in various countries throughout the world. The Company is exposed to the risk of changes in social, political, and economic conditions inherent in foreign operations, and the Company's results of operations are affected by fluctuations in foreign currency exchange rates. No single foreign country accounted for more than 10% of the Company's net sales for 2006 and 2005.

30.4% and 29.4%, respectively, of the Company's net sales at December 31, 2006 and 2005 are from foreign customers.

7. STOCK OPTIONS

During 1995, the Company, with the approval of its shareholders, adopted a stock incentive plan for the issuance of up to 57,750 shares of common stock. In 1999, the Company, with the approval of its shareholders, increased the number of shares reserved for issuance under this plan to 305,250 shares and, in 2004, increased the number of shares reserved for issuance under this plan to 342,750 shares. 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 55,673 shares of common stock are reserved for additional grants of options under the plan at December 31, 2006.

Under the plan, the Company charged compensation cost of \$25,623 against income and recognized a total income tax benefit in the income statement of \$26,482 for 2006. No compensation cost or income tax benefit was recognized in the income statement for share-based compensation in 2005.

The fair value of share-based payment awards was estimated using the Black-Scholes option pricing model with the following assumptions:

	2006	2005
Dividend yield	0.0%	0.0%
Expected volatility	60.6 - 63.0%	63.2%
Expected life of option	five years	five years
Risk-free interest rate	4.8-5.0%	3.9%

A summary of the status of the Company's stock option plan as of December 31, 2006 and changes during the year then ended is presented below:

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at January 1, 2006	130,285	\$3.27		
Granted	7,250	8.03		
Exercised	(48,324)	3.86		
Expired and forfeited	(989)	4.50		
Outstanding at December 31, 2006	<u>88,222</u>	<u>3.33</u>	<u>1.55</u>	<u>\$392,710</u>
Vested or expected to vest at December 31, 2006	<u>87,722</u>	<u>3.33</u>	<u>1.55</u>	<u>\$392,710</u>
Exercisable at December 31, 2006	<u>73,888</u>	<u>\$2.75</u>	<u>1.12</u>	<u>\$370,356</u>

The weighted-average grant-date fair value of options granted was \$4.58 and \$2.44 for the years ended December 31, 2006 and 2005, respectively. The total intrinsic value of options exercised was \$227,175 and \$109,345 for the years ended December 31, 2006 and 2005, respectively.

The following table summarizes information about stock options outstanding at December 31, 2006:

Range of Exercise Price	Options Outstanding			Options Exercisable	
	Number Outstanding at December 31, 2006	Weighted-Average Remaining Contractual Life (years)	Weighted-Average Exercise Price	Number Exercisable at December 31, 2006	Weighted-Average Exercise Price
\$2.00 - 2.99	58,222	0.89	\$2.44	58,222	\$2.44
3.00 - 3.99	11,250	1.59	3.36	11,250	3.36
4.00 - 4.99	9,250	3.32	4.32	2,916	4.32
7.00 - 7.99	<u>9,500</u>	<u>3.79</u>	<u>7.79</u>	<u>1,500</u>	<u>7.01</u>
	<u>88,222</u>	<u>1.55</u>	<u>\$3.33</u>	<u>73,888</u>	<u>\$2.75</u>

8. CONCENTRATION OF CREDIT RISK

The Company maintains its cash balances primarily in one financial institution. As of December 31, 2006, the balance exceeded the Federal Deposit Insurance Corporation coverage. The Company reduces its exposure to credit risk by maintaining such balances with financial institutions that have high credit ratings.

Accounts receivable are financial instruments that also expose the Company to concentration of credit risk. The large number of customers comprising the Company's customer base and their dispersion across different geographic areas limits such exposure. In addition, the Company routinely assesses the financial strength of its customers and maintains an allowance for doubtful accounts that management believes will adequately provide for credit losses. Concentration of credit risk with respect to trade receivables is not significant. No one customer accounted for more than 10% of total receivables as of December 31, 2006.

9. LEASE EXPENSE

The Company leases buildings on a month-to-month basis and equipment as needed. Total rental expense for all equipment and building operating leases was \$21,000 in 2006 and \$30,000 in 2005. On February 1, 2007 the Company entered into a one year lease agreement for additional warehouse space at a cost of \$5,750 per month or \$69,000 per year.

10. LINE OF CREDIT

The Company has a \$1,250,000 bank line of credit that provides for working capital financing. This line of credit is subject to annual renewal on each May 1, is collateralized by trade receivables and inventory, and bears interest at 2.00 percentage points over 30-day LIBOR. There were no outstanding borrowings under this line of credit at December 31, 2006 and 2005.

11. ACCOUNTING PRONOUNCEMENTS

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 will be effective for the Company beginning in fiscal 2007. Management does not expect this interpretation will have material effect on the Company's our financial statements and related disclosures.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ("SFAS 157"). 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 is effective for the Company beginning in fiscal year 2008. Management is evaluating the statement to determine the effect, if any, on the financial statements and related disclosures.

BOARD OF DIRECTORS



Charles H. Andresen
Attorney
Andresen &
Butterworth P.A.
Duluth, MN
Director Since 1979



Rondi Erickson
Co-Owner
Nokomis Restaurant
Duluth, MN
Director Since 2000



David O. Harris
President
David O. Harris, Inc.
Minneapolis, MN
Director Since 1965



H. Leigh Severance
President
Severance Capital
Management
Denver, CO
Director Since 2000



Gerald W. Simonson
President
Omnetics Connector
Corporation
Minneapolis, MN
Director Since 1978



William C. Ulland
*Chairman, President
& CEO*
IKONICS Corporation
Duluth, MN
Director Since 1972

OFFICERS



Robert D. Banks
*Vice President,
International*



Toshifumi Komatsu
*Vice President,
Technology*



Jon Gerlach
*Vice President,
Finance, CFO*



Claude Piguet
*Executive
Vice President*



Parnell Thill
*Vice President,
Marketing*



William C. Ulland
*Chairman, President
& CEO*

ADDITIONAL FINANCIAL INFORMATION

Stockholders of record automatically receive quarterly earnings information, and street name holders may do so upon written request. For a copy of the Form 10-KSB, as filed with the Securities and Exchange Commission, and other financial information available at no charge to stockholders, please contact:

Jon Gerlach, *Chief Financial Officer*
IKONICS Corporation
4832 Grand Avenue
Duluth, MN 55807
Phone: 218-628-2217
E-mail: jgerlach@ikonics.com

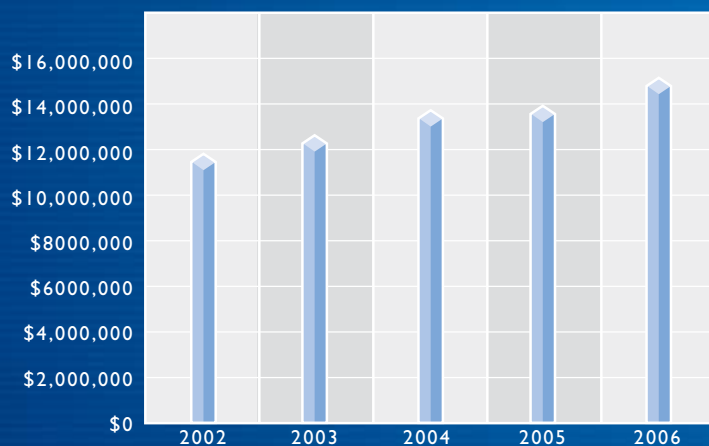
ANNUAL MEETING

The Company's annual meeting will be held April 26, 2007 at 1:00 p.m. at the Kitchi Gammi Club, 831 East Superior Street, Duluth, MN.

FIVE-YEAR HISTORY	2002	2003	2004	2005	2006
Net Sales	\$11,797,279	\$12,105,127	\$13,682,449	\$13,971,217	\$14,888,912
Pretax Income	\$460,817	\$632,416	\$1,031,351	\$1,256,169	\$1,589,765
Net Income	\$359,817	\$503,416	\$758,351	\$908,169	\$1,123,765
Net Cash Provided by Operations	\$249,117	\$1,400,756	\$1,261,855	\$980,047	\$1,075,722
Return on Sales	3.0%	4.2%	5.5%	6.5%	7.5%
Return on Assets	5.6%	7.0%	8.9%	9.6%	10.5%
Return on Avg. Stockholders' Equity	6.3%	8.2%	11.0%	11.4%	12.3%
Debt to Equity	9.3%	13.0%	14.5%	11.7%	8.9%
Diluted EPS	\$0.19	\$0.27	\$0.38	\$0.46	\$0.55
Stock price: High	\$3.40	\$5.56	\$8.30	\$8.99	\$10.47
Low	\$1.90	\$2.03	\$4.48	\$4.20	\$6.26
Close	\$2.20	\$4.20	\$7.35	\$6.35	\$7.53
Weighted Average Shares Outstanding	1,878,030	1,872,190	1,906,771	1,944,330	2,000,017
Weighted Average Shares & Equivalent	1,879,213	1,895,106	1,982,814	1,986,885	2,027,916
Total Assets	\$6,412,159	\$7,194,684	\$8,489,988	\$9,470,799	\$10,743,461
Total Liabilities	\$545,496	\$826,334	\$1,075,772	\$992,294	\$879,362
Total Stockholders' Equity	\$5,866,663	\$6,368,350	\$7,414,216	\$8,478,505	\$9,864,099
Capital Spending	\$250,366	\$244,573	\$270,089	\$211,276	\$273,548

Share & per share amounts have been adjusted for the 2004 three-for-two stock split. All share and per share information presented has been adjusted as if the stock split occurred on the earliest date presented.

NET SALES 2002-2006



NET INCOME 2002-2006

