

ENERGY AND ENVIRONMENTAL SERVICES, INC.

FINANCIAL STATEMENTS

December 31, 2017 and 2016

Together With Accountant's Compilation Report

C O N T E N T S

ACCOUNTANT'S COMPILATION REPORT	Page 1
FINANCIAL STATEMENTS	
Consolidated Balance Sheets	2
Consolidated Statements of Income	3
Consolidated Statements of Stockholders' Equity	4
Consolidated Statements of Cash Flows	5 - 6
Consolidated Footnotes to Financial Statements	7- 12

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Accountants' Compilation Report

ENERGY AND ENVIRONMENTAL SERVICES, INC.
Board of Directors:

Management is responsible for the accompanying financial statements of Energy and Environmental, Inc., which comprise the consolidated balance sheets as of December 31, 2017 and 2016 and the related consolidated statements of income for the years ended December 31, 2017 and 2016 and the consolidated statements of changes in cash flows for the years ended December 31, 2017 and 2016, in accordance with principles generally accepted in the United States of America. We have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. We did not audit or review the financial statements nor were we required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, we do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

Leslie G. Pettitt, PC

ENERGY AND ENVIRONMENTAL SERVICES, INC.
CONSOLIDATED BALANCE SHEETS

	December 31, <u>2017</u>	December 31, <u>2016</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 3,651,400	\$ 2,679,700
Accounts receivable - trade	588,400	380,500
Accounts receivable - other	27,400	30,900
Inventory	1,145,100	1,720,700
Deferred tax assets	558,500	1,762,400
Prepaid expenses	27,300	-
	<hr/>	<hr/>
Total current assets	5,998,100	6,574,200
	<hr/>	<hr/>
Property, plant and equipment (net of accumulated depreciation of \$1,339,600 and \$1,265,500 at December 31, 2017 and 2016, respectively)	3,085,300	4,815,000
Equity investments	3,200	-
Goodwill	130,000	149,900
	<hr/>	<hr/>
Total assets	<u>\$ 9,216,600</u>	<u>\$ 11,539,100</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 287,600	\$ 1,500
Payroll liabilities	35,100	44,400
Stock repurchase payable	25,000	-
Deferred tax liabilities	117,800	215,500
Current portion of long-term debt	62,700	75,000
Other taxes	2,000	800
	<hr/>	<hr/>
Total current liabilities	530,200	337,200
Long-Term Notes - less current portion	167,900	254,100
Stockholders' Equity		
Preferred stock, \$0.0001 par value, 20,000,000 shares authorized, no shares issued and outstanding December 31, 2017 and 2016, respectively	-	-
Common stock, \$0.00001 par value, 100,000,000 shares authorized 47,727,644 and 47,947,644 shares issued and outstanding at December 31, 2017 and 2016, respectively	500	500
Additional paid in capital	490,500	485,000
Retained earnings	8,027,500	10,462,300
	<hr/>	<hr/>
Total Stockholder's Equity	8,518,500	10,947,800
	<hr/>	<hr/>
Total Liabilities and Stockholders' Equity	<u>\$ 9,216,600</u>	<u>\$ 11,539,100</u>

See Accountants' Compilation Report

ENERGY AND ENVIRONMENTAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	December 31, <u>2017</u>	December 31, <u>2016</u>
Sales revenues	\$ 3,803,800	\$ 1,967,300
Cost of goods sold	<u>971,900</u>	<u>1,083,000</u>
Gross profit	<u>2,831,900</u>	<u>884,300</u>
Operating expenses		
Selling general and administrative expenses	3,956,800	3,771,500
Depreciation and amortization	<u>341,500</u>	<u>371,300</u>
Total operating expenses	<u>4,298,300</u>	<u>4,142,800</u>
(Loss) from operations	<u>(1,466,400)</u>	<u>(3,258,500)</u>
Other income (expense)		
Other revenues	80,200	43,800
Impairment of assets	(743,000)	-
Loss on sale of assets	(241,200)	-
Interest and finance costs	<u>(15,400)</u>	<u>(3,700)</u>
(Loss) from operations before income tax	(2,385,800)	(3,218,400)
Benefit (provision) for income tax		
Current income tax benefit	436,600	1,185,400
Deferred income tax provision	<u>(485,600)</u>	<u>(65,000)</u>
	(49,000)	1,120,400
Net (loss)	<u>\$ (2,434,800)</u>	<u>\$ (2,098,000)</u>
Earnings per share	<u>\$ (0.05)</u>	<u>\$ (0.04)</u>
Weighted average shares outstanding	<u>47,941,014</u>	<u>47,947,644</u>

See Accountants' Compilation Report

ENERGY AND ENVIRONMENTAL SERVICES, INC.
CONSOLIDATED STATEMENTS CHANGES IN STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	Common Stock		Preferred Stock		Additional Paid-In Capital	Retained Earnings	Total Stockholders' Equity
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>			
Balance, December 31, 2015	47,947,644	\$ 500	-	\$ -	\$ 47,500	\$ 12,560,300	\$ 12,608,300
Contribution of net assets	-	-	-	-	437,500	-	437,500
Net (loss)	-	-	-	-	-	(2,098,000)	(2,098,000)
Balance, December 31, 2016	<u>47,947,644</u>	<u>500</u>	<u>-</u>	<u>-</u>	<u>485,000</u>	<u>10,462,300</u>	<u>10,947,800</u>
Contribution of net assets	-	-	-	-	115,500	-	115,500
Buy back of stock	(220,000)	-	-	-	(110,000)	-	(110,000)
Net (loss)	-	-	-	-	-	(2,434,800)	(2,434,800)
Balance, December 31, 2017	<u><u>47,727,644</u></u>	<u><u>\$ 500</u></u>	<u><u>-</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 490,500</u></u>	<u><u>\$ 8,027,500</u></u>	<u><u>\$ 8,518,500</u></u>

See Accountants' Compilation Report

ENERGY AND ENVIRONMENTAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

	December 31, <u>2017</u>	December 31, <u>2016</u>
Cash flows from operating activities		
Net loss	\$ (2,434,800)	\$ (2,098,000)
Adjustments to reconcile net (loss) to net cash provided by operating activities		
Depreciation and amortization	341,500	371,300
Write off of bad debts	127,600	-
Inventory impairment	723,100	-
Goodwill impairment	19,900	-
Loss on sale of assets	241,200	-
Earnings from equity method investment	(1,200)	-
Net changes in current assets and liabilities		
Accounts Receivable	(335,500)	520,000
Accounts receivable - related parties	-	(150,500)
Accounts receivable - other	3,500	(400)
Inventory	(147,500)	664,800
Deferred tax assets	1,203,900	(505,000)
Prepaid expenses	(27,300)	-
Accounts payable	286,100	(83,200)
Payroll liabilities	(9,300)	23,300
Other taxes	1,200	-
Deferred taxes	<u>(97,700)</u>	<u>65,000</u>
Net cash (used in)/provided by operations	(105,300)	(1,192,700)
Cash flows from investing activities		
Sale of property, plant and equipment	1,382,800	-
Purchases of property, plant and equipment	(120,300)	(44,600)
Investment in equity method investment	<u>(2,000)</u>	<u>-</u>
Net cash (used in) investing activities	1,260,500	(44,600)
Cash flows from financing activities		
Payments on notes payable	(98,500)	(18,300)
Buy back of stock	(85,000)	-
Contribution of net assets by shareholder	<u>-</u>	<u>116,200</u>
Net cash provided by financing activities	<u>(183,500)</u>	<u>97,900</u>
Net increase/(decrease) in cash	971,700	(1,139,400)

See Accountants' Compilation Report

ENERGY AND ENVIRONMENTAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016
(Continued)

	December 31, <u>2017</u>	December 31, <u>2016</u>
Cash and cash equivalents, beginning of year	<u>2,679,700</u>	<u>3,819,100</u>
Cash and cash equivalents, end of year	<u><u>\$ 3,651,400</u></u>	<u><u>\$ 2,679,700</u></u>
Supplemental disclosures of cash flow informations:		
Cash paid during the year for:		
Interest	<u><u>\$ 15,400</u></u>	<u><u>\$ 3,700</u></u>
Taxes	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>

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ENERGY & ENVIRONMENTAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2017 AND 2016

1. NATURE OF OPERATIONS

Energy and Environmental Services, Inc. (the “Company”) was originally incorporated as Energas Resources, Inc in 1989 in British Columbia, Canada as a public company listed on the Vancouver Stock Exchange. In 2001, the Company registered as a Delaware corporation becoming a United States domestic corporation. In 2002, its registration statement filed with the Securities and Exchange Commission became effective and its stock was traded on the Over the Counter Bulletin Board market. On November 1, 2011, the Company voluntarily delisted from the Over the Counter Bulletin Board market and qualified its shares to trade on the OTC pink current information market.

On January 25, 2012, the name of the Company was changed to Enerlabs, Inc. On March 23, 2015, the Company redomiciled the company from Delaware and registered as a Colorado corporation. On October 24, 2016, the Company signed a share exchange with Melvin Smith, the sole shareholder of Energy & Environmental Services, Inc. (“EES”), in which Smith exchanged his EES shares for 32 million shares of the Company. EES became the operating subsidiary of Enerlabs. On December 5, 2016, the name of the Company was changed to Energy and Environmental Services, Inc.

For accounting purposes, the share exchange has been accounted for as a reverse acquisition under the purchase method. Accordingly, the Company and its subsidiary, EES, are treated as the continuing entity for accounting purposes. For comparative purposes, the common shares outstanding reported in the related financial statements have been retroactively applied to January 1, 2015, and consistently applied throughout all periods, to present the recapitalization and the related stock split.

The Company, headquartered in Oklahoma City, manufactures specialized liquid and solid chemicals used primarily in the oil and gas industry and high-tech specialized protective coatings for oil and gas and other industrial applications. It also has products under development using enzyme technologies for animal feed supplements and odor solutions. The Company’s operations are maintained and occur through its wholly-owned subsidiaries: EES, Enduro-Bond Manufacturing Company, LLC (“EMC”), and EcoZyme System Technologies, LLC (“EST”). These subsidiaries were formed in the state of Oklahoma.

On October 21, 2016, the Company sold all of the outstanding shares, and associated debts, of its subsidiaries AT Gas Gathering Systems, Inc., Energas Corp. and Energas Pipeline, Inc. to George G. Shaw, former majority shareholder of the Company.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation - The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, EES, EMC and EST. All significant inter-company items have been eliminated in consolidation.

Use of estimates in the preparation of financial statements - The preparation of 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.

Cash and Cash Equivalents – The Company considers all highly liquid debt instruments purchased with a maturity period of three months or less to be cash equivalents. The carrying amounts reported in the accompanying consolidated balance sheets for cash and cash equivalents approximate their fair value.

Accounts Receivable – Management periodically assesses the collectability of the Company’s accounts receivable and notes receivable. Accounts determined to be uncollectible are charged to operations when that determination is made.

Inventories – Inventories are stated at the lower of cost or market. Cost is determined using the weighted average method.

Cost of inventories comprises all costs of purchases, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Costs of conversion of inventories include fixed and variable production overheads, taking into account the stage of completion.

Intangible Assets and Amortization – Intangible assets represent software and closing costs acquired by the Company and are stated at cost less amortization and impairment, if any. Amortization of software and closing costs is calculated on the straight-line method, based on the period over which the software is licenses or the length of the note from closing on the building.

Goodwill - Goodwill represents the excess of cost over fair value of assets acquired. Goodwill is not subject to amortization but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired, as required by ASC Topic 350, “Intangibles - Goodwill and Other”.

Revenue recognition - Revenue from the sale of goods and services is recognized on the transfer of risks and rewards of ownership, which generally coincides with the time when the goods are delivered to customers and the title has passed and services have been rendered.

Long-lived assets - The Company reviews its long-lived assets for impairment whenever changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For purposes of evaluating the recoverability of long-lived assets, the recoverability test is performed using estimated undiscounted net cash flows to be generated by the asset.

Property, Plant and Equipment - Equipment is recorded at cost and depreciated on the straight-line basis over the following periods:

Computer equipment	3-5 years
Truck	5 years
Office equipment	5-7 years
Buildings and improvements	7-39 years

Earnings per share - Basic net income (loss) per common share is computed by dividing net earnings (loss) applicable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net earnings (loss) per common share is determined using the weighted average number of common shares outstanding during the period, adjusted for the dilutive effect of common stock equivalents, consisting of shares that might be issued upon exercise of common stock options. In periods where losses are reported, the weighted average number of common shares outstanding excludes common stock equivalents, because their exclusion would be anti-dilutive.

Concentration of credit risk – The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant risk.

Trade receivables consist of uncollateralized customer obligations due under normal trade terms. Management believes all trade receivables to be fully collectible at December 31, 2017 and 2016.

Financial Instruments – The carrying value of current assets and liabilities reasonably approximates their fair value due to their short maturity periods.

Income taxes - The Company uses the asset/liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The Company's policy is to classify the penalties and interest associated with uncertain tax positions, if required, as a component of its income tax provision.

Retirement Benefit Costs – The Company maintains defined contribution 410(k) retirement plans in two subsidiaries EES and EMC.

For the years ended December 31, 2017 and 2016, the Company's pension cost charged to the statements of income under the plans amounted to none and \$8,700, respectively.

Reclassifications – Certain prior period amounts have been reclassified to conform to current period presentation.

New Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). ASU 2016-02 requires lessees to recognize all leases, including operating leases, on the balance sheet as a lease asset or lease liability, unless the lease is a short-term lease. ASU 2016-02 also requires additional disclosures regarding leasing arrangements. ASU 2016-02 is effective for interim periods and fiscal years beginning after December 15, 2018, and early application is permitted. The adoption of ASU 2016-02 is not expected to have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued Accounting Standards Update ("ASU") 2017-04, Intangibles – Goodwill and Other. ASU 2017-04 simplifies the subsequent measurement of goodwill by removing the second step of the two-step impairment test. The amendment requires an entity to perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The amendment should be applied on a prospective basis. ASU 2017-04 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The adoption of ASU 2017-04 is not expected to have a material impact on the Company's consolidated financial statements.

In February 2018, the Financial Accounting Standards Board (FASB) issued ASU 2018-02, Income Statement - Reporting Comprehensive Income, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (Topic 220), which amended its standard on comprehensive income to provide an option for an entity to reclassify the stranded tax effects of the Act that was passed in December of 2017 from accumulated other comprehensive income (AOCI) directly to retained earnings. The stranded tax effects result from the remeasurement of deferred tax assets and liabilities which were originally recorded in comprehensive income but whose remeasurement is reflected in the income statement. This is a one-time amendment applicable only to the changes resulting from the Act. The standard will be effective for us on January 1, 2019, and may be reflected retroactively to any period in which the impacts of the Act are recognized. The standard permits early adoption for any financial statements that have not been released as of the date of the revised standard. The overall financial impact of adopting this standard is unknown at this time.

Other recently issued accounting pronouncements did not or are not believed by management to have a material impact on the Company's present or future financial statements.

3. RELATED PARTY TRANSACTIONS

In 2017, the Company paid \$11,600 as sales commissions to a distributor partially owned and controlled by a director of the Company. During the same period, the distributor purchased \$29,000 of coatings products from the Company for resale. The sales commissions and resale discounts were comparable to commissions paid and discounts afforded to third party distributors.

The sole shareholder of EES at September 30, 2016, contributed the net assets of P&M, LLC, Enduro and Chem, LLC, MJN, LLC, LVS, LLC to EES on September 30, 2016. As per guidance the book value net assets of the entities as of the date of contribution was recorded in EES with an offset to contributed capital.

On September 30, 2016, the sole shareholder of EMC transferred 100% of the outstanding capital to EES. As per guidance, due to common control of both entities EMC was consolidated into the Company at book value as of the date of contribution with the offset to contributed capital.

During the year ended December 31, 2016, the Company paid \$288,200 to related parties for rent and lease payments. In 2016, the related party contributed the properties to the Company and the rents ceased.

4. INVENTORIES

ASC 330-10-35, "Adjustments to Lower of Cost or Market", requires us to reduce the carrying value of inventory when there is evidence that the utility of goods will be less than cost, whether due to physical deterioration, obsolescence, changes in price levels or other causes.

As of December 31, 2017 and 2016, inventories consisted of the following:

	December 31, 2017	December 31, 2016
At cost:		
Raw materials	\$ 766,500	\$ 1,471,300
Blends	37,100	39,200
Finished goods	341,500	210,200
	<u>\$ 1,145,100</u>	<u>\$ 1,720,700</u>

During the year ended December 31, 2017, the Company impaired inventory in the amount \$723,100 that was obsolete or no longer marketable.

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment, stated at cost less accumulated depreciation, consisted of the following:

	December 31, 2017	December 31, 2016
Buildings	\$ 1,930,000	\$ 3,214,500
Improvements	1,030,600	1,361,000
Equipment	734,000	639,200
Vehicles and transportation equipment	365,400	517,000
Furniture and fixtures	275,500	262,400

Software and closing costs	89,500	90,200
	4,425,000	6,084,300
Less: Accumulated depreciation	(1,339,700)	(1,269,300)
	<u>\$ 3,085,300</u>	<u>\$ 4,815,000</u>

6. Long-Term Notes - Less Current Portion

	December 31, 2017	December 31, 2016
Bank loan dated October 30, 2013 due October 30, 2023 with an interest rate of 4.25%	\$ 28,600	\$ 255,000
Bank loan dated August 29, 2013, due September 1, 2018 with an interest rate of 4.25%	202,000	74,100
	230,600	329,100
Less current portion of notes payable	(62,700)	(75,000)
	<u>\$ 167,900</u>	<u>\$ 254,100</u>

7. SALE OF BUILDING

In December 2017, the Company completed the sale of the Oklahoma City office building for \$1,325,000 less closing costs of \$16,300. A loss of \$278,500 is included in the income statements for the year ended December 31, 2017.

8. SHARE REPURCHASE

In December 2017, the Company repurchased 220,000 shares of the Company's common stock at \$0.50 per share for a total purchase amount of \$110,000. As of December 31, 2017, \$25,000 of the total purchase had not yet been made and is included in Stock Repurchase Payable in the financial statements.

9. INCOME TAXES

The Company records income taxes using the liability method. Under this method, deferred tax assets and liabilities are computed for the expected future impact of temporary differences between the financial statement and income tax bases of assets and liabilities using current income tax rates and for the expected future tax benefit to be derived from tax loss and tax credit carryforwards. ASC 740 provides detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in the financial statements. Tax positions must meet a "more-likely-than-not" recognition threshold before a benefit is recognized in the financial statements.

A reconciliation of the provision (benefit) for income taxes with the amounts determined by applying the U.S. federal income tax rate to income before income taxes is as follows:

	Year Ended December 31,	
	2017	2016
Computed at the federal statutory rate of 34%	\$ (371,100)	\$ (1,094,000)
State tax (benefit) at statutory rates	(65,500)	(193,100)
Use of prior year net operating losses and return adjustments	485,300	-

Depreciation differences	<u>(97,700)</u>	<u>101,700</u>
Income tax (Benefit)	<u>\$ (49,000)</u>	<u>\$ (1,185,400)</u>

Significant components of the Company's deferred tax assets and liabilities are as follows:

	<u>As of December 31,</u>	
	<u>2017</u>	<u>2016</u>
Deferred tax assets – Net Operating Loss Carryforwards	<u>\$ 558,500</u>	<u>\$ -</u>
Deferred tax liabilities – depreciation and amortization	<u>\$ (117,800)</u>	<u>\$ (215,500)</u>

The Company is subject to examination in the U.S. federal and state tax jurisdiction of the 2014 to 2017 tax years. There are not current examinations of the Company's prior tax returns. The penalty and interest charges on the delinquent returns is estimated to be minimal due to net operating losses incurred in each year of operations.

No penalty and interest on any tax positions have been computed and the Company does not anticipate there will be a charge in the uncertain tax position in the next 12 months.

10. EARNINGS PER SHARE

Accounting guidance requires a reconciliation of the numerator and denominator of the basic and diluted earnings per share (EPS) computations.

The following reconciles the components of the EPS computation for the years ended December 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Basic and Diluted (loss) per share computation		
Numerator:		
Net loss	\$ (2,385,800)	\$ (2,098,000)
Denominator:		
Weighted average common shares outstanding	47,941,014	47,947,644
Basic (loss) per share	\$ (0.05)	\$ (0.04)

11. LEASES

The Company leases office and warehouse space under leases expiring during 2018. The future lease payments required under the lease in the next year are \$63,845. Total rent expense for the years ended December 31, 2017 and 2016, was \$59,174 and \$229,555, respectively.

12. CONTINGENCIES

In the normal course of its operations, the Company may, from time to time, be named in legal actions seeking monetary damages. While the outcome of these matters cannot be estimated with certainty, management does not expect, based upon consultation with legal counsel, that they will have a material effect on the Company's business or financial condition or results of operations.