HOMASOTE®

2013 Annual Report
Our 104th Year

About Us

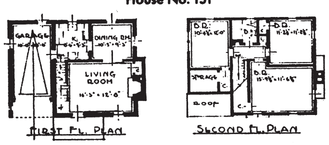
Homasote Company is America's leading green building products manufacturer. All our base products are manufactured from Homasote board which is made from 98% recycled paper fiber (high post-consumer content). The remaining 2% is comprised of environmentally-friendly materials that give our products their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

We categorize our served markets into two sales divisions. The larger is our millboard division that supplies a variety of products including sound insulation in walls and floors (440 SoundBarrier, ComfortBase), roof decking (Easy-Ply, FireStall), floor decking (Four-Way Floor Deck), concrete joint filler and forming board (Homex), finished interior panels (NovaCork, DesignWall, Burlap Panels), and ice arena coverings (Ice Deck).

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

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

House No. 151



ONE ORDER COVERS EVERYTHING

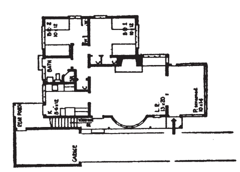
Once you approve the plan, we give you a price which covers everything—including all details of excavation, heating, plumbing and decorating.

WHAT IS HOMASOTE?

A very important feature of your Precision-Built home is the fact that it will be doubly insulated with Homasote—the oldest and strongest insulating and building board on the market. This means a home that is cooler in Summer, warmer in Winter, costing less to heat. Homasote's large sheets permit whole wall sections—up to 14'—without a joint. Homasote will not crack or split, has no knots or defects, takes paint perfectly, allows quick, dry construction.

We urge you to get the full details. You will incur no obligation. Come in or phone today. There will be no high-pressure salesmanship!

House No. 160



ONE PRICE COVERS EVERYTHING

A 7-room home—with full basement and complete in every detail—can now be yours for as low as \$4500. Precision-Built methods make big savings in construction costs. And—every Precision-Built house is eligible for an FHA Mortgage.

Each home is doubly insulated—attractive and economical to own—a home built for comfortable living. Although the cost is low, nowhere is quality sacrificed. We use only the best in both construction and materials. Yet, you do not wait 90 days; these houses are ready for occupancy within 30 days—at a cost that is less than for other houses of equal size and quality.

We can show you many attractive plans and pictures—from which to make a selection. Or—we can help you work out with an architect, a plan for a home entirely of your own design. The house can be of any size or type. The bigger the house, the greater the savings.

1939 Advertisements

440 SoundBarrier®

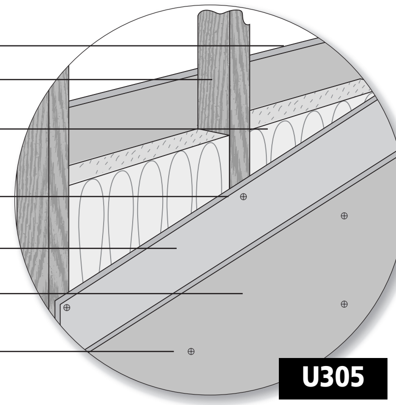
International Building Code (IBC) Calls for minimum Sound Transmission Class (STC) and Insulation Impact Class (IIC) Ratings of 50 • **UL®-listed wall and floor assemblies • ICC-ES ESR-1374**

Less Material, Less Labor, Better Results!

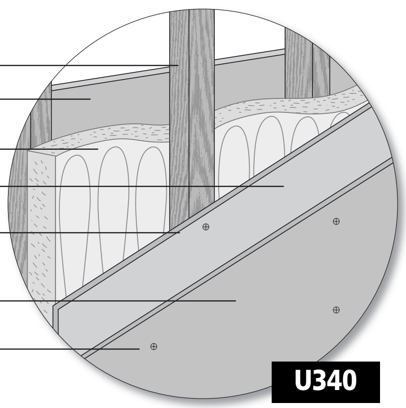
Superior Sound Control For Both Metal and Wood Stud Walls In:

- Multi-family residential
- Home theatres
- Hotels
- Dormitories

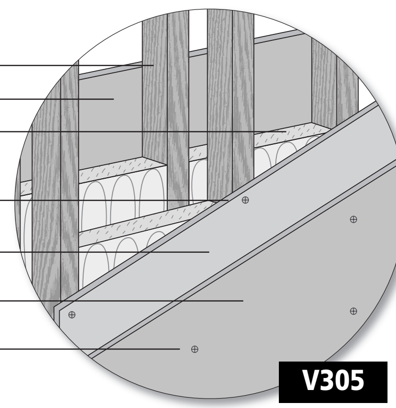
STC 53



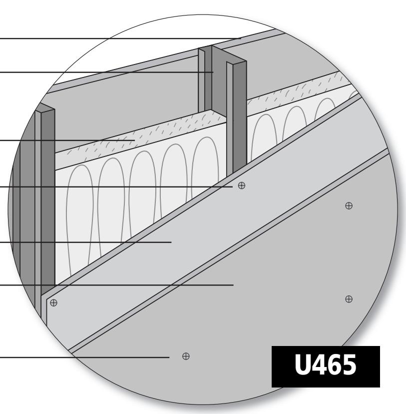
STC 53



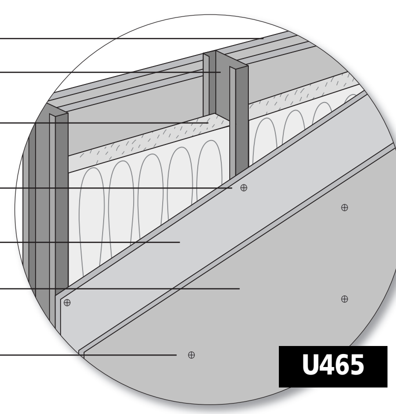
STC 60



STC 55



STC 58



HOMASOTE®

Sensible. Sound. Solutions.

MADE IN THE USA SINCE 1909 · CHPS COLLABORATIVE FOR HIGH PERFORMANCE SCHOOLS MEMBER · MEMBER ICC · FSC www.fsc.org FSC® C102908 The mark of responsible forestry

www.homasote.com

To Shareholders and Employees

Herewith is presented the Annual Report of your Company for the year ended December 31, 2013.

Sales

As of this writing several major sales accomplishments have set our Company on an exciting path. Our focus on multi-family construction started slowly in the Mid-Atlantic states but is starting to spread into the Northeast. Several builders will start using our ½" 440 SoundBarrier product in walls between units and should open up other avenues for our products.

The sales force and distribution market are still being tweaked with the addition of an installer distributor. We've also added an individual to service our Home Depot outlets. This addition will allow our salesmen more time to call on architects and contractors.

On a sad note, Thomas Wanders, our Director of Sales & Marketing, passed away during the 1st quarter of 2014. Tom will be greatly missed. His position will be filled with a combined effort by Greg O'Driscoll, Director of Sales & Marketing, and Christine Lemonick, Manager – Sales Operations, as we revamp the top end of the department.

Projects

Most of the capital improvements instituted in the latter half of 2012 have been completed at this time. The outstanding issues are the preheating of the Coe Dryer air and monitoring of energy use throughout the plant. The monitoring system has been installed and should be up and running shortly. This will enable us to see the energy produced and consumed by our Co-Generation Facility and the energy consumed by individual machines.

Year In Review

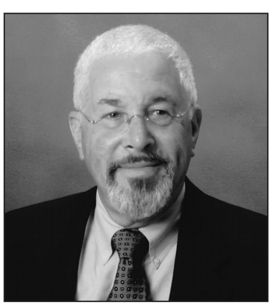
Millboard division sales results were as follows: millboard products, including our flagship 440 SoundBarrier, increased by 14%. Homex expansion joint and forming boards increased 5%. Nova pre-finished interior panels decreased by 14%. Decking product sales decreased by 22%. Industrial (Pakline Division) sales increased by 3% for 2013.

Net sales for 2013 were $20,713,544 versus 2012 sales of $19,529,396, an increase of $1,184,148 or 6%. Net income for the year was $770,809, resulting in diluted earnings per common share of $2.16. The 2012 net income was $824,508. Working capital was $(3.7) million, a decline of $1.9 million from the previous year.

We wish to acknowledge and express our appreciation for the many years of loyal effort and cooperation given to Homasote Company by our retirees.

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

Homasote Management Team



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

Ronald D. Fasano
Chief Financial Officer

Peter Tindall
Vice President,
Operations

Five Year Highlights

	2013	2012	2011	2010	2009
Net sales	$ 20,713,544	$ 19,529,396	$ 19,283,283	$ 18,117,531	$ 15,460,239
Depreciation and amortization	$ 727,585	$ 786,131	$ 797,174	$ 931,012	$ 1,023,264
Net income (loss)	$ 770,809	$ 824,508	$ (944,737)	$ (1,193,566)	$ (1,409,690)
Common shares outstanding (weighted average):					
Basic	354,707	353,441	351,732	349,032	348,799
Diluted	356,732	356,532	351,732	349,032	348,799
Net earnings (loss) per common share:					
Basic	$ 2.17	$ 2.33	$ (2.69)	$ (3.42)	$ (4.04)
Diluted	$ 2.16	$ 2.31	$ (2.69)	$ (3.42)	$ (4.04)
Dividends-declared and paid	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Dividends per share	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Working capital	$ (3,674,045)	$ (1,808,224)	$ (3,057,749)	$ (2,464,536)	$ (2,604,158)
Working capital ratio	.5:1	.7:1	.5:1	.5:1	.5:1
Capital expenditures	$ 2,243,964	$ 4,496,945	$ 256,948	$ 280,905	$ 115,176
Total assets	$ 12,063,435	$ 11,177,633	$ 6,320,228	$ 6,807,477	$ 7,141,333
Long-term debt, excluding current portion	$ 5,246,706	$ 6,129,686	$ 1,800,000	$ 1,800,000	$ 1,360,000
Stockholders' equity	$ (3,149,662)	$ (5,252,931)	$ (5,804,190)	$ (3,584,219)	$ (2,262,795)
Common shares outstanding	355,799	354,499	353,199	351,599	348,799
Per share book value of common stock	$ (8.85)	$ (14.82)	$ (16.43)	$ (10.19)	$ (6.49)

Two Year Dividend and Stock Price Comparison

CASH DIVIDENDS

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

Quarter	2013	2012
First	$ 0.00	$ 0.00
Second	0.00	0.00
Third	0.00	0.00
Fourth	0.00	0.00
	$ 0.00	$ 0.00

STOCK PRICES

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

	2013		2012	
Quarter	High	Low	High	Low
First	$ 4.25	$ 2.50	$ 0.56	$ 0.51
Second	$ 4.80	$ 3.00	$ 0.51	$ 0.51
Third	$ 4.80	$ 3.00	$ 2.49	$ 0.51
Fourth	$ 7.00	$ 3.50	$ 3.25	$ 1.21

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

The number of Stockholders of record of the Company at December 31, 2013 and 2012 is 166. In 2003 the Company filed with the Securities and Exchange Commission to deregister the Homasote Common Stock.

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

Statements of Operations

Years Ended December 31

	2013	2012	2011
Net sales	$20,713,544	$19,529,396	$19,283,283
Cost of sales	14,960,652	13,729,479	15,603,316
Gross profit	5,752,892	5,799,917	3,679,967
Selling, general and administrative expenses	4,414,652	4,533,940	4,356,802
Operating income (loss)	1,338,240	1,265,977	(676,835)
Other income (expense):			
Interest expense	(591,143)	(466,341)	(307,013)
Other income	23,712	24,872	39,111
Income (loss) before income tax expense	770,809	824,508	(944,737)
Income tax expense	—	—	—
Net income (loss)	$ 770,809	$ 824,508	$ (944,737)
Net earnings (loss) per common share:			
Basic	$ 2.17	$ 2.33	$ (2.69)
Diluted	$ 2.16	$ 2.31	$ (2.69)
Weighted average common shares outstanding:			
Basic	354,707	353,441	351,732
Diluted	356,732	356,532	351,732

See accompanying notes to financial statements.

Statements of Comprehensive Income (Loss)

Years Ended December 31

	2013	2012	2011
Net income (loss)	$ 770,809	$ 824,508	$ (944,737)
Other comprehensive income (loss):			
Net actuarial gain (loss) of retirement benefit plans:			
Unrealized gain (loss) arising during the period	1,284,982	(287,638)	(1,197,888)
Amortization of actuarial gain (loss)	45,242	13,605	(77,994)
Total other comprehensive income (loss)	1,330,224	(274,033)	(1,275,882)
Comprehensive income (loss)	$ 2,101,033	$ 550,475	$ (2,220,619)

See accompanying notes to financial statements.

Balance Sheets
December 31

	2013		2012	
Assets				
Current Assets:				
Cash and cash equivalents	$ 38,827		$ 553,347	
Accounts receivable (net of allowance for doubtful accounts of $46,000 in 2013 and 2012)	1,623,440		1,387,089	
Inventories	1,325,150		1,613,837	
Deferred income taxes	22,163		34,326	
Prepaid expenses and other current assets	137,057		188,615	
Total Current Assets		$ 3,146,637		$ 3,777,214
Property, plant and equipment, net		8,864,929		7,316,822
Other assets		51,869		83,597
Total Assets		$12,063,435		$11,177,633
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current Liabilities:				
Short-term debt	$ 2,161,342		$ 1,813,197	
Current portion of long-term debt	882,980		197,488	
Accounts payable	3,153,550		2,691,262	
Accrued expenses	469,810		638,963	
Other current liabilities	–		151,528	
Current portion of obligations under benefit plans	153,000		93,000	
Total Current Liabilities		$ 6,820,682		$ 5,585,438
Long-term debt		5,246,706		6,129,686
Deferred income taxes		22,163		34,326
Obligations under benefit plans		2,542,698		4,147,701
Other liabilities		580,848		533,413
Total Liabilities		15,213,097		16,430,564
Commitments and Contingencies				
Stockholders' Equity:				
Common stock, par value $0.20 per share; Authorized 1,500,000 shares; Issued 872,195 shares in 2013 and 871,795 shares in 2012	174,439		174,359	
Additional paid-in capital	945,395		943,239	
Retained earnings	4,788,444		4,017,635	
Accumulated other comprehensive loss	(1,547,111)		(2,877,335)	
	4,361,167		2,257,898	
Less cost of common shares in treasury, 515,196 shares in 2013 and 2012	7,510,829		7,510,829	
Total Stockholders' Equity		(3,149,662)		(5,252,931)
Total Liabilities and Stockholders' Equity		$12,063,435		$11,177,633

See accompanying notes to financial statements.

Statements of Changes in Stockholders' Equity

Years Ended December 31

	COMMON STOCK SHARES	COMMON STOCK PAR VALUE	ADDITIONAL PAID IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	TREASURY STOCK	TOTAL STOCKHOLDERS' EQUITY
Balances at January 1, 2011	354,799	$ 173,999	$ 942,167	$ 4,137,864	$ (1,327,420)	$ (7,510,829)	$ (3,584,219)
Net loss				(944,737)			(944,737)
Net change in unrecognized retirement benefit plans					(1,275,882)		(1,275,882)
Other comprehensive loss							(2,220,619)
Share based compensation	2,400	480	168				648
Balances at December 31, 2011	357,199	174,479	942,335	3,193,127	(2,603,302)	(7,510,829)	(5,804,190)
Net loss				824,508			824,508
Net change in unrecognized retirement benefit plans					(274,033)		(274,033)
Other comprehensive loss							550,475
Share based compensation	(600)	(120)	904				784
Balances at December 31, 2012	356,599	174,359	943,239	4,017,635	(2,877,335)	(7,510,829)	$ (5,252,931)
Net income				770,809			770,809
Net change in unrecognized retirement benefit plans					1,330,224		1,330,224
Other comprehensive income							2,101,033
Share based compensation	400	80	2,156				2,236
Balances at December 31, 2013	356,999	$ 174,439	$ 945,395	$ 4,788,444	$ (1,547,111)	$ (7,510,829)	$ (3,149,662)

See accompanying notes to financial statements.

1939 Advertisement

Statements of Cash Flows

Years Ended December 31

	2013	2012	2011
Cash flows from operating activities:			
Net income (loss)	$ 770,809	$ 824,508	$ (944,737)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	727,585	786,131	797,174
Bad debt expense	12,500	18,697	42,891
Share based compensation expense	2,236	784	648
Amortization of retirement plans prior service cost and actuarial gain and loss	45,242	13,605	(77,994)
Changes in assets and liabilities:			
(Increase) decrease in accounts receivable, net	(248,851)	(114,294)	238,803
Decrease (increase) in inventories	288,687	(417,401)	(226,623)
Decrease (increase) in prepaid expenses and other current assets	51,558	(23,532)	(97,276)
Increase in other assets	–	(67,500)	–
Increase (decrease) in accounts payable.	462,288	(1,017,036)	735,251
(Decrease) increase in accrued expenses	(169,153)	333,837	(33,361)
(Decrease) increase in other current liabilities	(151,528)	(201,000)	107,500
(Decrease) increase in obligations under benefit plans	(260,021)	(70,786)	33,940
Increase (decrease) in other liabilities	47,435	65,039	(139,108)
Net cash from operating activities	1,578,787	131,052	437,108
Cash flows from investing activities:			
Capital expenditures	(2,243,964)	(1,029,093)	(256,948)
Net cash from investing activities	(2,243,964)	(1,029,093)	(256,948)
Cash flows from financing activities:			
Net proceeds from issuance (repayment) of short-term debt	348,145	561,238	(162,200)
Net (repayment of) proceeds from issuance of long-term debt	(197,488)	861,834	–
Net cash from financing activities	150,657	1,423,072	(162,200)
Net (decrease) increase in cash and cash equivalents	(514,520)	525,031	17,960
Cash and cash equivalents at beginning of year	553,347	28,316	10,356
Cash and cash equivalents at end of year	$ 38,827	$ 553,347	$ 28,316
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	$ 591,143	$ 466,341	$ 307,013
Noncash investing and financing activities			
Equipment purchased through financing	$ –	$ 3,467,852	$ –

See accompanying notes to financial statements.

Notes to Financial Statements

December 31, 2013, 2012 and 2011

Note 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS: Homasote Company is in the business of manufacturing wood fiberboard products used in a variety of building material applications including sound insulation, thermal insulation, floor and roof decking and interior tack panels. The Company also manufactures an industrial packaging product line consisting primarily of glass, paper and metal separators. Sales in 2013 were distributed as follows: Building material wholesalers and contractors, approximately 57%; industrial manufacturers, approximately 43%; and in 2012 and 2011, building material wholesalers and contractors, approximately 56%; industrial manufacturers, approximately 44%. The Company's primary basic raw material, post-consumer newsprint, is generally readily available from various regional suppliers.

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

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

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

PRODUCT WARRANTIES: Product warranty costs are accrued when the covered products are delivered to the customer. Product warranty expense is recognized based on the terms of the product warranty and the related estimated costs, considering historical claims expense. Accrued warranty costs are reduced as these costs are incurred and as the warranty period expires. The table presents the changes in the Company's accrual for product warranties, which is included in accrued expenses, for the years ended December 31, 2013 and 2012.

	2013	2012
Balance at January 1........	$ 94,095	$ 9,000
Accruals and adjustments for product warranties issued during the period ...	(14,063)	153,932
Settlements made during the period..............	(68,032)	(68,837)
Balance at December 31 ...	$ 12,000	$ 94,095

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

NET EARNINGS (LOSS) PER SHARE: Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 260, *Earnings Per Share,* requires presentation of basic earnings per share and diluted earnings per share. Basic earnings (loss) per share is computed by dividing income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share gives effect to all dilutive potential common shares outstanding during the period. These potentially dilutive securities are not included in the calculation of loss per share for the year ended December 31, 2011, because the Company incurred a loss during such period and thus their effect would have been anti-dilutive. Accordingly, basic and diluted loss per share is the same for the year ended December 31, 2011.

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

The Company's customers are located throughout the United States of America. Additionally, export sales, 43% to Canada and the balance to other countries, accounted for approximately 6%, 5% and 4%, in the years ended December 31, 2013, 2012 and 2011, respectively, of the

Notes to Financial Statements continued

December 31, 2013, 2012 and 2011

Note 1—Summary of Significant Accounting Policies (continued)

Company's sales. One customer accounted for 10% of the Company's sales in 2013 and 11% in both 2012 and 2011. Additionally, one customer accounted for 12% of the accounts receivable balance at December 31, 2013 and 14% at December 31, 2012. No customer represented 10% or more of the accounts receivable balance at December 31, 2011.

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

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

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

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

Refer to Note 8 (Share-based Compensation).

INCOME TAXES: In accordance with FASB ASC 740, income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets are reduced by a valuation allowance when in the opinion of management, it is more likely than not, that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled.

The Company has adopted accounting guidance related to accounting for uncertainty in income taxes. Under the "more-likely-than-not" threshold guidelines, the Company believes no significant uncertain tax positions exist, either individually or in the aggregate, that would give rise to the non-recognition of an existing tax benefit. As of December 31, 2013, 2012 and 2011, the Company had no material unrecognized tax benefits or accrued interest and penalties. The Company's policy is to account for interest as a component of Interest expense and penalties as a component of Selling, general and administrative expense.

Notes to Financial Statements continued

December 31, 2013, 2012 and 2011

Note 1—Summary of Significant Accounting Policies (continued)

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

USE OF ESTIMATES: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Areas in which the Company makes such estimates include inventory valuation, the valuation of long-lived assets, accounts receivable, deferred tax assets and pension and postretirement benefits, among others. Actual results could differ from those estimates.

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

RECENT ACCOUNTING PRONOUNCEMENTS: In February 2013, the FASB issued Accounting Standards Update ("ASU") 2013-02, *Reporting of Amounts Reclassified out of Accumulated Comprehensive Income,* ("ASU 2013-02") which amended prior reporting requirements with respect to comprehensive income by requiring additional disclosures about the amounts reclassified out of accumulated other comprehensive loss by component. ASU 2013-02 became effective for reporting periods after December 15, 2012. The adoption of ASU 2013-02 did not have a material impact on the Company's financial position, results of operations or cash flows.

On May 28, 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"). ASU 2014-09 provides a robust framework for addressing revenue recognition issues and, upon its effective date, replaces almost all existing revenue recognition guidance, including industry-specific guidance, in current U.S. generally accepted accounting principles. ASU 2014-09 is effective beginning with the calendar year ended December 31, 2018. The Company has not yet assessed the impact ASU 2014-09 will have on its financial position, results of operations or cash flows when adopted.

Note 2 – INVENTORIES

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

	2013	2012
Finished goods	$ 846,905	$1,230,443
Work in process	12,964	13,135
Raw materials	465,281	370,259
	$ 1,325,150	$1,613,837

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

Notes to Financial Statements continued

December 31, 2013, 2012 and 2011

Note 3 – PROPERTY, PLANT AND EQUIPMENT

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

	2013	2012	Estimated Useful Lives
Land	$ 591,492	$ 591,492	
Buildings and additions	11,476,609	9,839,018	10-50 years
Machinery and equipment	32,494,441	32,040,125	3-20 years
Office equipment	1,444,552	1,444,552	3-10 years
Automotive equipment	249,755	205,310	3-5 years
Cogeneration system	3,575,464	3,467,852	20 years
	49,832,313	47,588,349	
Less accumulated depreciation	40,967,384	40,271,527	
	$ 8,864,929	$ 7,316,822	

Depreciation expense was $695,857, $719,578 and $739,669 for the years ended December 31, 2013, 2012 and 2011, respectively.

Note 4 – DEBT

On April 30, 2010, the Company entered into a Credit Facilities Agreement (the “2010 Agreement”) with Keltic Financial Partners II, LP (the “Lender”). The 2010 Agreement, which had an original expiration date of April 30, 2013, was comprised of a term loan (the “2010 Term Loan”) and a revolving credit facility (the “2010 Revolving Credit Facility”). The 2010 Term Loan, in the amount of $1,800,000, was due and payable on the expiration date of the 2010 Agreement. Under the 2010 Revolving Credit Facility, the Company could borrow up to specified percentages of eligible receivables and inventory (inventory limited to $500,000), as defined, in an aggregate amount not to exceed $2,000,000. Interest on each loan was payable monthly at the greatest of (A) The Lender’s prime rate, as defined, plus 3.25%, (B) the LIBOR Rate, as defined, plus 5.75%, and (C) 6.50%. The 2010 Agreement further provided for an annual facility fee in the amount of $38,000 payable in equal monthly installments, a monthly collateral management fee of $1,500, a commitment and closing fee of $76,000 paid at loan origination and certain other expenses of the Lender. The 2010 Agreement contains financial and other covenants including minimum EBITDA and limitations on other indebtedness, capital expenditures and dividends, all as defined. Loans and advances under the 2010 Agreement are collateralized by substantially all of the Company’s assets, including real property.

On April 7, 2011, effective December 31, 2010, the Lender, at the request of the Company, issued the First Amendment to the 2010 Agreement (the “First Amendment”) amending the EBITDA and capital expenditures covenants contained in the 2010 Agreement. For the measurement periods in 2013, 2012 and 2011 the Company satisfied the minimum EBITDA covenant as amended.

On December 14, 2012, the Company and Lender entered into a second amendment to the 2010 Agreement (the “2012 Agreement”) to extend the term of the 2010 Agreement, as amended by the First Amendment. The 2012 Agreement, which has an expiration date of December 14, 2015, is comprised of a term loan (the “2012 Term Loan”), and a revolving credit facility (the “2012 Revolving Credit Facility”). The 2012 Term Loan, in the amount of $2,900,000, satisfied the existing term loan and is to be repaid in 24 equal monthly installments of $45,833.33 commencing on January 1, 2014 and in one installment equal to the then-outstanding and unpaid principal amount of the 2012 Term Loan on December 14, 2015. Under the 2012 Revolving Credit Facility, the Company may borrow up to a specified percentage of eligible receivables and inventory as defined, in an aggregate amount not to exceed $2,500,000. As of December 31, 2013, $2,161,342 was outstanding and $338,658 was the unused credit under the 2012 Revolving Credit Facility. The unused credit was limited to $184,127, based on eligible receivables and inventory as of December 31, 2013. Interest on each loan is payable monthly at the greatest of (a) the Lender’s prime rate (3.25% at December 31, 2013) plus 2.75%, (b) the LIBOR rate, as defined, plus 5.25%, or (c) 6.00%. The

Notes to Financial Statements continued

December 31, 2013, 2012 and 2011

Note 4 – DEBT (continued)

2012 Agreement further provides for an annual facility fee in the amount of $54,000 payable in equal monthly installments, a monthly collateral management fee of $1,500 and a closing fee of $67,500 paid at the loan settlement.

On July 6, 2012, the Company and Caterpillar Financial Services Corporation ("Caterpillar") agreed to terminate an operating lease arrangement for an on-site cogeneration system to supply substantially all of the Company's electricity requirements and thermal energy for the pulping process. Caterpillar agreed to refinance the remaining balance outstanding under the lease, subject to the terms and conditions of the Security Agreement and Promissory Note (the "Agreement"). The Agreement provides for payment of the principal amount of $3,467,852 over a term of seven years commencing August 1, 2012 with interest on the outstanding principal at 5.9% per annum. Principal and interest are payable in unequal monthly installments in accordance with an amortized payment schedule, with a final payment due on August 1, 2019. As of December 31, 2013, the total outstanding principal under the Agreement was $2,682,980.

The balance of long-term debt, including current portion, outstanding at December 31, 2013 and 2012 was $6,129,686 and $6,327,174 respectively. Aggregate maturities of long-term debt as of December 31, 2013 are as follows: $882,980 in 2014, $2,776,303 in 2015, $452,104 in 2016, $480,314 in 2017 and $1,537,985 thereafter.

Total interest costs incurred during 2013, 2012 and 2011 were $591,143, $466,341 and $307,013, respectively.

Note 5 – ACCRUED EXPENSES

Accrued expenses as of December 31, 2013 and 2012 consist of the following:

	2013	2012
Commissions	$ 42,991	$ 59,459
Payroll	32,167	65,403
Warranty claims	12,000	94,095
Insurance claim deductible	–	100,000
Maintenance Cogen	140,674	25,395
Other	241,978	294,611
	$469,810	$638,963

Note 6 – INCOME TAXES

During 2013, 2012 and 2011, the Company has no current tax expense (benefit) as a result of current losses incurred or utilization of net operating loss carryforwards coupled with a change in the deferred tax valuation allowance which was equal to the change in deferred tax assets and liabilities.

The actual income tax expense (benefit) differs from the amounts computed by applying the U.S. federal income tax rate of 34% to loss before income tax expense (benefit) as a result of the following:

	2013	2012	2011
Computed "expected" tax expense (benefit) ...	$ 262,075	$ 287,256	$ (321,210)
Change in valuation allowance.......................	(237,135)	(21,408)	262,262
Other...	24,940	265,848	58,948
	$ –	$ –	$ –

Notes to Financial Statements continued

December 31, 2013, 2012 and 2011

Note 6 – INCOME TAXES (continued)

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

	2013	2012
Deferred tax assets:		
Accounts receivable, due to allowance for doubtful accounts	$ 14,378	$ 14,378
Inventories, due primarily to cost capitalization	82,630	88,283
Other liabilities, principally due to supplemental pension and postretirement costs	732,363	860,074
Nondeductible accrued expenses	46,582	75,377
Net operating loss carryforwards – federal and state	4,415,785	4,763,676
Alternative minimum tax credit	26,182	26,182
Total deferred tax assets	5,317,920	5,827,970
Less valuation allowance	4,203,866	4,441,001
Net deferred tax assets	1,114,054	1,386,969
Deferred tax liabilities:		
Fixed assets, due to accelerated depreciation	840,437	1,071,423
Other assets, due to pension costs	273,617	315,546
Total deferred tax liabilities	1,114,054	1,386,969
Net deferred tax assets	$ –	$ –

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon this assessment, management believes it is more likely than not that the Company will realize the benefits of these deductible differences, net of existing valuation allowances at December 31, 2013. The amount of net deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced.

The net change in the total valuation allowance for the year ended December 31, 2013 was a decrease of $237,135. The net change in the total valuation allowance for the year ended December 31, 2012 was a decrease of $21,408. In addition, at December 31, 2013, the Company has net operating loss carryforwards for federal and state income tax purposes of approximately $11,760,000 and $7,029,000, respectively, which are available to reduce future income taxes, if any. The net operating loss carryforwards will begin to expire in year 2019 for federal and 2014 for state tax purposes.

Notes to Financial Statements continued

December 31, 2013, 2012 and 2011

Note 7 – POST EMPLOYMENT BENEFIT PLANS

The Company has a noncontributory defined benefit retirement plan (the "Pension Plan") covering all eligible employees. Benefits under the Pension Plan are calculated at a rate of $23.00 per month per year of service, as defined. The Company's funding policy for the Pension Plan is to contribute amounts sufficient to meet minimum funding requirements set forth in U.S. employee benefit and tax laws. The Company expects to contribute approximately $265,000 to the Pension Plan in 2014. On December 17, 2009 the Board of Directors of the Company resolved that employees hired on or subsequent to April 1, 2010 are not eligible to enter the Pension Plan. On December 2, 2011 the Board of Directors of the Company resolved that the Pension Plan be amended to discontinue benefit accruals effective March 1, 2012.

A supplemental non-contributory plan (the "Supplemental Plan") covering certain key employees of the Company provides retirement benefits based upon the employee's compensation, as defined, during the highest five of the last ten consecutive years preceding retirement. The Company's policy for funding the Supplemental Plan is to contribute amounts determined at the discretion of management. As of December 31, 2013 and 2012, the plan was unfunded. On May 11, 2005 the Board of Directors of the Company resolved to terminate the Supplemental Plan for all current employees not already receiving benefits. The termination was recognized as a curtailment gain in 2005. Additionally, as of June 1, 2005, the benefit payments of retired participants were reduced to 50% of their actuarially determined benefit. The payment of the balance of such benefits was deferred and recorded as an other liability ($512,578 and $463,580 at December 31, 2013 and 2012, respectively) until such time as the Board of Directors determined that it was prudent to either reinstate the full monthly payment as it accrues and/or to begin paying the deferred portion. On September 16, 2013 the Board of Directors of the Company resolved to reinstate, as of October 1, 2013, the full monthly payment of such benefits as earned. The estimated amount of such benefits payable for the year ended December 31, 2014, $122,000, is reflected in current liabilities on the balance sheet of the Company.

The Company also provides a portion of certain health care benefits for eligible retired employees who have reached the age of 65. Partial benefits are provided to eligible early retirees who have reached the age of 62. Employees hired on or subsequent to January 1, 2005 are not eligible for retiree health benefits. The Company's policy is to fund the cost of health care benefits for retirees in amounts determined at the discretion of management. As of December 31, 2013 and 2012, the plan was unfunded. Effective July 1, 2005 the Company reduced its contribution to the postretirement benefit plan for all current and future retirees by 50% of the portion paid by the Company prior to such date.

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

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

Notes to Financial Statements continued

December 31, 2013, 2012 and 2011

Note 7 – POST EMPLOYMENT BENEFIT PLANS (continued)

	Pension Plan 2013	Pension Plan 2012	Supplemental Plan 2013	Supplemental Plan 2012	Postretirement Benefits 2013	Postretirement Benefits 2012
Change in benefit obligation						
Benefit obligation at beginning of year	$ 9,590,749	$ 9,130,983	$ 868,752	$ 854,294	$ 271,173	$ 275,570
Service cost	–	–	–	–	1,881	2,064
Interest cost	450,776	465,578	40,716	43,619	12,253	13,734
Actuarial (gain) loss	(519,641)	502,956	26,836	100,915	(10,589)	13,071
Benefits paid	(503,481)	(508,768)	(130,662)	(130,076)	(31,479)	(33,266)
Benefit obligation at end of year	9,018,403	9,590,749	805,642	868,752	243,239	271,173
Accumulated benefit obligation at end of year	9,018,403	9,590,749	805,642	868,752	–	–
Change in plan assets						
Fair value of plan assets at beginning of year	6,489,972	6,236,997	–	–	–	–
Actual return on plan assets	1,345,697	867,283	–	–	–	–
Employer contributions	153,462	–	130,662	130,076	31,479	33,266
Administrative expenses	(114,065)	(105,540)	–	–	–	–
Benefits paid	(503,481)	(508,768)	(130,662)	(130,076)	(31,479)	(33,266)
Fair value of plan assets at end of year	7,371,585	6,489,972	–	–	–	–
Funded status						
Funded status	(1,646,818)	(3,100,777)	(805,642)	(868,752)	(243,239)	(271,172)
Unrecognized prior service cost	–	–	–	–	(285,558)	(447,467)
Unrecognized actuarial loss (gain)	2,331,890	3,890,826	(43,604)	(73,514)	(455,617)	(492,511)
Prepaid (accrued) pension cost	$ 685,072	$ 790,049	$ (849,246)	$ (942,266)	$ (984,414)	$ (1,211,150)
Amounts recognized in balance sheets						
Accrued benefit plan cost	$ (1,646,818)	$ (3,100,777)	–	–	–	–
Current benefit liability	–	–	(122,000)	(61,000)	(31,000)	(32,000)
Non-current benefit liability	–	–	(683,642)	(807,752)	(212,239)	(239,173)
Accumulated other comprehensive loss (income)	2,331,890	3,890,826	(43,604)	(73,514)	(741,175)	(939,977)
Net amount recognized	$ 685,072	$ 790,049	$ (849,246)	$ (942,266)	$ (984,414)	$ (1,211,150)

The total amount included in Accumulated Other Comprehensive Income (Loss) ("AOCI") relating to the Company's retirement plans at December 31, 2013 and 2012 was $1,547,111 and $2,877,335, respectively. The estimated amounts of prior service cost and actuarial net loss (gain) included in AOCI as of December 31, 2013 and expected to be amortized into net periodic benefit cost in 2014, are $133,000 for the defined benefit plan, $(7,000) for the supplemental plan and $(208,000) for the postretirement plan.

Notes to Financial Statements continued

December 31, 2013, 2012 and 2011

Note 7 – POST EMPLOYMENT BENEFIT PLANS (continued)

	Pension Plan 2013	Pension Plan 2012	Pension Plan 2011	Supplemental Plan 2013	Supplemental Plan 2012	Supplemental Plan 2011
Components of net periodic benefit cost:						
Service cost	$ 83,040	$ 72,950	$ 187,072	$ –	$ –	$ –
Interest cost	450,776	465,578	478,232	40,716	43,619	45,873
Expected return on plan assets	(533,084)	(505,389)	(550,241)	–	–	–
Amortization of prior service cost	–	11,909	29,534	–	–	–
Recognized actuarial loss (gain)	257,707	228,767	148,721	(3,074)	(22,543)	(49,598)
Net periodic benefit cost	$ 258,439	$ 273,815	$ 293,318	$ 37,642	$ 21,076	$ (3,725)

	Postretirement Benefits 2013	Postretirement Benefits 2012	Postretirement Benefits 2011
Service cost.	$ 1,881	$ 2,064	$ 8,107
Interest cost	12,253	13,734	23,516
Expected return on plan assets	–	–	–
Amortization of prior service cost	(161,908)	(161,908)	(161,908)
Recognized actuarial gain	(47,483)	(42,620)	(44,743)
Net periodic benefit cost	$ (195,257)	$ (188,730)	$ (175,028)

	Pension Benefits 2013	Pension Benefits 2012	Pension Benefits 2011	Postretirement Benefits 2013	Postretirement Benefits 2012	Postretirement Benefits 2011
Assumptions:						
Weighted-Average Assumptions used to determine net periodic benefit cost for years ended December 31:						
Discount rate	4.80%	5.30%	6.00%	4.80%	5.30%	6.00%
Expected long-term return on plan assets	8.50%	8.50%	8.50%	N/A	N/A	N/A

	Pension Benefits 2013	Pension Benefits 2012	Postretirement Benefits 2013	Postretirement Benefits 2012
Weighted-Average Assumptions used to determine benefit obligations at December 31:				
Discount rate	5.40%	4.80%	5.40%	4.80%

Note 7 – POST EMPLOYMENT BENEFIT PLANS (continued)

Assumed Health Care Cost Trend

For measurement purposes, no health care cost trend rate of increase was assumed for 2013. The Company monthly-paid benefit for each participant is fixed at the amount as of January 1, 2003 and further adjusted as of July 1, 2005 as discussed above.

Plan Assets

The asset allocation for the Pension Plan at the end of 2013 and 2012, and the target allocation for 2014, by asset category, are as follows:

	Target Allocation	Percentage of the Plan Assets at end of year	
	2014	2013	2012
Equity Mutual Funds	70%	73%	73%
Debt Mutual Funds	30%	26%	26%
Cash and Cash Equivalents	0%	1%	1%
	100%	100%	100%

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

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

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

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

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

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

December 31, 2013

Plan Assets	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 43,024	–	–	$ 43,024
Equity mutual funds	5,409,166	–	–	5,409,166
Debt mutual funds	1,919,395	–	–	1,919,395
Fair value of plan assets	$ 7,371,585	–	–	$ 7,371,585

December 31, 2012

Plan Assets	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 46,806	–	–	$ 46,806
Equity mutual funds	4,729,655	–	–	4,729,655
Debt mutual funds	1,713,511	–	–	1,713,511
Fair value of plan assets	$ 6,489,972	–	–	$ 6,489,972

Notes to Financial Statements continued

December 31, 2013, 2012 and 2011

Note 7 – POST EMPLOYMENT BENEFIT PLANS (continued)

Benefit Payments

The following table summarizes expected benefit payments from pension and postretirement plans through 2023. Actual benefit payments may differ from expected benefit payments.

	Pension Benefit	Supplemental Plan	Postretirement Benefits
2014	$ 563,000	$ 122,000	$ 31,000
2015	565,000	113,000	29,000
2016	566,000	104,000	27,000
2017	567,000	97,000	25,000
2018	573,000	89,000	23,000
2019-23	3,000,000	341,000	87,000

Savings Plan

The Company has a voluntary savings plan (the "Savings Plan") for which all employees are eligible. The Savings Plan provides for the Company to contribute a minimum of $0.25 for every dollar contributed by employees, up to 4% of their compensation, as defined. On March 25, 2009 the Board of Directors resolved to suspend the Company contributions as of April 1, 2009. A restoration date has not been determined. The Savings Plan qualifies and meets the requirements under Section 401(k) of the Internal Revenue Code. Company contributions charged to operations under this Plan amounted to $0 in 2013, 2012 and 2011.

Note 8 – SHARE-BASED COMPENSATION

On October 24, 2008, the Board adopted the 2008 Stock Incentive Plan (the "2008 Stock Plan"). No stock was awarded in 2010 or 2009 under the 2008 Stock Plan. On December 13, 2010, the 2008 Stock Plan was amended and restated (the "Amended 2008 Plan"). The Amended 2008 Plan authorizes the issuance of restricted stock to "key persons" including officers, employees, directors and consultants to provide an incentive to enter and remain in the service of the Company, enhance the long-term performance of the Company and acquire a proprietary interest in the success of the Company. An aggregate of 35,000 shares of the Company's stock is available for issuance under the Amended 2008 Plan and a total of 26,800 shares remain available as of December 31, 2013 for future grants of stock.

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

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

On December 13, 2010 the Board of Directors, on the recommendation of the Compensation Committee, resolved to grant 1,000 fully paid and non-assessable shares of stock to each of four employee officers of the Company. The shares vest in five equal annual installments based on the date of grant. Additionally, on such date, 500 fully paid and non-assessable shares were granted to each of four non-employee members of the Board of Directors. All shares granted were from authorized but unissued Common Stock.

Notes to Financial Statements continued

December 31, 2013, 2012 and 2011

Note 8 – SHARE-BASED COMPENSATION (continued)

On December 2, 2011 the Board of Directors, on the recommendation of the Compensation Committee, resolved to grant 500 fully paid and non-assessable shares of stock to each of four employee officers of the Company. The shares vest in five equal annual installments based on the date of grant. Additionally, on such date, 100 fully paid and non-assessable shares were granted to each of four non-employee members of the Board of Directors. All shares granted were from authorized but unissued Common Stock.

On August 9, 2012, the Board of Directors, on the recommendation of the Compensation Committee, resolved to grant 100 fully paid and non-assessable shares to each of four non-employee members of the Board of Directors. All shares granted were from authorized but unissued Common Stock.

On September 16, 2013, the Board of Directors, on the recommendation of the Compensation Committee, resolved to grant 100 fully paid and non-assessable shares to each of four non-employee members of the Board of Directors. All shares granted were from authorized but unissued Common Stock.

The total fair value of shares vested and compensation incurred pursuant to the Amended 2008 Plan and 2008 Stock Plan in 2013, 2012 and 2011 was $2,236, $784 and $648, respectively. As of December 31, 2013 there was $486 of unrecognized compensation cost related to non-vested share-based compensation under the Amended 2008 Plan.

Note 9 – TREASURY STOCK

The Company has a policy offering directors, officers and employees the option to purchase reacquired shares of Homasote Company common stock on the date acquired and at the purchase price paid by the Company. No shares were acquired or sold in 2013, 2012 or 2011.

Note 10 – COMMITMENTS AND CONTINGENCIES

The Company was a party to a purchase contract with the Mercer County Improvement Authority (“MCIA”) that expired at the end of 2009, as extended, to acquire the Company’s basic raw material, post-consumer newsprint. On July 18, 2011 the Company signed an agreement for a Stipulation of Settlement (the “Settlement”) with MCIA. The Settlement amicably resolved certain differences between the parties regarding quality and balance owed and dismissed a pending lawsuit in exchange for fulfillment of the terms set forth in the Settlement with MCIA. Under the terms of the Settlement, the Company agreed to pay MCIA the sum of $446,028 in a series of unequal monthly payments from July 29, 2011 through August 30, 2013. Such amount had been recorded as accounts payable in the books of the Company as of December 31, 2009 and was partially in dispute through the date of the Settlement. As of December 31, 2012, the remaining amount due MCIA of $151,528 was reflected on the balance sheet of the Company as an other current liability which amount was paid by the Company during 2013.

The Company was a party to an operating lease arrangement (the “Lease”) for an on-site cogeneration system (the “Cogen System”) to supply substantially all of the Company’s electricity requirements and thermal energy for the pulping process. The Lease term (the “Term”) was ten (10) years with a monthly rental of $50,856, later reduced to $48,471. Payments under the Lease commenced in January 2005. The Lease granted the Company the option to purchase the Cogen System from the lessor at the end of the Term for the fair market price of the Cogen System, as defined under the Lease, provided that the Company had met its obligations under the Lease.

In connection with certain operational problems with the Cogen System and resultant downtime, on August 20, 2009 the Company and Caterpillar Financial Services Corporation (“Caterpillar”) entered into a forbearance agreement for the purpose of allowing the Company and Caterpillar the opportunity, with all reasonable efforts, to market, sell or otherwise dispose of the Cogen System. Caterpillar also agreed to reduce the monthly rent to $20,000. The forbearance agreement had a termination date of April 30, 2010. As of April 30, 2010, Caterpillar verbally agreed to allow the forbearance agreement, together with the monthly rentals of $20,000, to continue until a resolution of the

Notes to Financial Statements continued

Note 10 – COMMITMENTS AND CONTINGENCIES (continued)

Company's efforts to market, sell or otherwise dispose of the Cogen System had been completed. Pending such resolution, there were no payments under the Lease in 2012.

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

On June 23, 2011 the Company signed a letter of intent and exclusivity agreement with an energy company to conduct a feasibility study (the "Study") to determine the optimal method to integrate the cogeneration plant, boiler plant, process energy loads and facility space conditioning loads of the Company. In January 2012, the Study was completed and presented to the Company. The Study concluded that a maximum estimated capital investment of $1.7 million dollars, providing for construction in two phases, would yield an estimated annual savings of $0.8 million dollars based on natural gas cost of $8.40 per dekatherm and electric cost of $0.12 per kilowatt-hour. Industry analysts project that natural gas delivered cost will stay below $5.00 per dekatherm for approximately five years. This projected drop in the total cost of natural gas would increase the annual savings estimated by the Study. The review of the Study was completed by the Company in March 2012 and it was concluded that the return on investment was significant enough to initiate an engineering study for design, implementation and operation of the integrated cogeneration plant, process energy loads and facility space conditioning loads of the Company (the "System"). A consultant was chosen to provide guidance and advice on the proper design of the System to fit the Company's long term plan to reduce the cost of both natural gas and electricity consumption. With the design of the System completed, the Company commenced the selection of the vendors of the equipment to be purchased and the installation of the System. The cost of the System was funded primarily from additional funding provided by the Company's lender on December 14, 2012.

On October 29, 2012 in connection with Super Storm Sandy, the Company sustained significant roof damage to various areas of the building. The related repair costs for the affected areas is $264,662 for which an insurance claim was submitted to the Company's insurance carrier for payment under the Company's Property and Casualty insurance policy. Payment of the claim under the policy was subject to a $100,000 deductible amount for covered property. Such amount was accrued at December 31, 2012 and is included in the Balance Sheet of the Company under Accrued Expenses. The storm related roof repairs were substantially completed as of December 31, 2013.

The Company leases certain office, manufacturing equipment and vehicles under operating leases that expire at various dates. Payments under these leases were $118,004 in 2013. Lease payments subsequent to December 31, 2013 are as follows: 2014, $68,461, 2015, $20,738 and 2016, $1,107.

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

On June 17, 2008, the insurance carrier and the Company signed an Interim Asbestos Claims Administration Agreement (the "Agreement") that defines how the parties will share past and future defense and indemnity costs from asbestos claims. As of December 31, 2007, the Company recognized in its financial statements a provision of $142,000. Such amount represented a significant portion of the final aggregate provision in the agreement of $172,638, for all prior costs. The settlement was paid in twenty-four equal monthly amounts commencing July 1,

Notes to Financial Statements continued

December 31, 2013, 2012 and 2011

Note 10 – COMMITMENTS AND CONTINGENCIES (continued)

2008. The Company further agreed to pay 6% of ongoing defense costs. The Company's agreed upon share of future indemnity costs varies from 0% to 10.49%, based on the claimant's date of first exposure. The Company incurred $65,359 of such costs for the year ended December 31, 2013. The amount of such costs payable in the future is not determinable as of December 31, 2013.

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

Note 11 – SUBSEQUENT EVENTS

The Company assessed events occurring subsequent to December 31, 2013 through July 23, 2014 for potential recognition and disclosure in the financial statements. There were six events that require such disclosure. Other than the events described below, there were no events that have occurred that would require adjustment to or disclosure in the financial statements, which were issued on July 23, 2014.

The Company plans to install a heat exchanger to pre-heat the Coe dryer's combustion air stream, utilizing excess thermal energy generated by the Cogen System in the board drying process. Projected completion date of this System component was August 2013. However, due to engineering design changes, the planned completion date is in the fourth quarter of 2014. The cost of such design changes has not been determined.

The Company continues to repair and refurbish the many roof areas damaged by Super Storm Sandy. This project will continue into the fourth quarter of 2014.

The Company is rebuilding a small hydrapulper and will restore it to service in the third quarter of 2014 at a projected cost of $415,000. This restoration provides the Company with a back-up to the main hydrapulper and the smaller size meets the Company's production needs with reduced energy consumption.

The Company has chosen a vendor for a monitoring system which will allow for effective management of energy consumption when using the Cogen System. The monitoring system will allow the Company to measure electric usage in response to market conditions. It will measure the optimal time to either produce electricity through the Cogen System or purchase the commodity from a public utility company. As of May 25, 2014 the vendor has completed the installation of the hardware and software necessary to proceed with the completion of the web-based monitoring system scheduled for the third quarter of 2014.

The Company intends to replace the first unit press platen which has been corroded, pitted and unstable, adversely affecting product quality. Temporary repairs were made in 2009, and again in 2013, with only marginal success. To sustain operations and maintain product quality, replacement is now the only viable alternative. The project is planned for 2014 winter shutdown at the approximate cost of $500,000.

On April 30, 2014 the Company experienced a high voltage breakdown in its 4160V switchgear. This equipment was supplying electric power to the facility and the Cogen System. A temporary bypass was put in place to supply power to the plant; however, cogeneration is not possible until permanent repairs are completed. A claim is in the process of being submitted to an insurance company and a public adjuster has been contracted to assist with this claim. Final estimates for repair or rebuild have not been received.

Independent Auditors' Report

The Board of Directors and Shareholders of **Homasote Company:**

Report on the Financial Statements

We have audited the accompanying financial statements of Homasote Company (the "Company") which comprise the balance sheet as of December 31, 2013 and 2012, and the related statements of operations, comprehensive income (loss), changes in stockholders' equity and cash flows for each of the three years ended December 31, 2013, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Homasote Company as of December 31, 2013 and 2012, and the results of its operations and its cash flows for each of the three years ended December 31, 2013 in accordance with accounting principles generally accepted in the United States of America.

Mercadien, P.C.
Certified Public Accountants

Hamilton, New Jersey
July 23, 2014

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

General

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

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

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

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

Results of Operations 2013-2012

Net sales increased in 2013 by $1,184,148 or 6% to $20,713,544 from $19,529,396 in 2012. The Company operates two sales divisions, Millboard and Industrial. The Company's millboard division serves several markets including the construction and renovation of multi-family dwellings, commercial office buildings, educational facilities, single-family dwellings and retail establishments. The primary channel of distribution is through a "two-step" model wherein wholesale distributors sell the Company's products to dealers that typically specialize in lumber and other forestry products. The economic downturn and other external factors affecting the construction industry continued to present challenges for our business. The Millboard product line is led by 440 SoundBarrier, followed by Homex expansion joint and NovaCork cork board. Net sales for the millboard division in 2013 increased by $895,935 or 8% to $11,932,197 from $11,036,262 in 2012. The increase in sales is reflective of mixed results across the division as follows: the largest product line, millboard products increased 14%; the Homex product line sales volume increased 5%; the Nova pre-finished panels product line saw a sales volume decrease of 14%; while Decking product sales decreased by 22%.

The Company's industrial (Pakline) division provides sustainable packaging solutions for users in three main manufacturing and finishing sectors: glass, paper and steel. Additionally, the division provides a variety of products to end-users as varied as appliance manufacturers and office furniture makers. Net sales for the industrial division in 2013 increased by $288,213 or 3.4% to $8,781,347 from $8,493,134 in 2012.

Gross profit as a percentage of sales decreased to 27.8% in 2013 from 29.7% in 2012. The relatively lower level of gross profit in 2013 as compared to 2012, is due primarily to a 26% increase in the cost of natural gas, from an average cost of $4.47 per dekatherm in 2012 to $5.63 per dekatherm in 2013 and a 16% increase in the amount of gas consumed. The increase in the cost of natural gas between 2012 and 2013 based on 245,061 dekatherms purchased was $438,000. Also contributing to the lower gross profit were higher labor costs, due in part to a wage increase and parts and repair costs in the pulping, making and Cogen areas. Offsetting some of the decrease in gross profit was a reduction in the cost of purchased electricity of $244,000 due to the use of the Cogen. Additionally a decrease in the cost of paper of 3.6% from an average of $139.00 per ton in 2012 to $134.00 per ton in 2013, based on 19,451 tons purchased, was $44,000.

Selling, general and administrative expenses decreased $119,288 from $4,533,940 in 2012 to $4,414,652 in 2013, and as a percentage of sales were 21.3% in 2013 as compared to 23.2% in 2012. The year-over-year decrease in Selling general and administrative expenses is due in part to decreases in customer claims expense, agents' commissions, sound testing expense, debt related expense, asbestos claims and defense costs, professional fees and bad debt expense, as offset by increases in advertising costs, salaries and wages, employee benefits, bonuses, utilities and insurance.

Interest expense on debt increased to $591,143 in 2013 from $466,341 in 2012. The increase is due to the combination of the relatively higher level of borrowed funds available from the Term Loan and Revolving Credit Facility and interest incurred in connection with the purchase of the Cogen System.

In 2013, other income consists primarily of the sale of scrap metal from the dismantling of obsolete and fully depreciated equipment sold to brokers.

As a result of the foregoing, net income in 2013 was $770,809 as compared to net income of $824,508 in 2012.

Results of Operations 2012-2011

Net sales increased in 2012 by $246,113 or 1.3% to $19,529,396 from $19,283,283 in 2011. The Company operates two sales divisions, Millboard and Industrial. The Company's millboard division serves several markets including the construction and renovation of multi-family dwellings, commercial office buildings, educational facilities, single-family dwellings and retail establishments. The primary channel of distribution is through a "two-step" model wherein wholesale distributors sell the Company's products to dealers that typically specialize in lumber and other forestry products. The economic downturn and other external factors affecting the construction industry continued to present challenges for our business. The Millboard product line is led by 440 SoundBarrier, followed by Homex expansion joint and NovaCork cork board. Net sales for the millboard division in 2012 increased by $204,645 or 1.9% to $11,036,262 from $10,831,617 in 2011. The increase in sales is reflective of mixed results across the division as follows: the largest product line, millboard products was stable as compared to 2011; the Homex product line sales volume increased 20%; the Nova pre-finished panels product line saw a sales volume increase of 2%; while Decking product sales decreased by 16%.

The Company's industrial division provides sustainable packaging solutions for users in three main manufacturing and finishing sectors: glass, paper and steel. Additionally, the division provides a variety of products to end-users as varied as appliance manufacturers and office furniture makers. Net sales for the industrial division in 2012 increased by $41,468 or 0.5% to $8,493,134 from $8,451,666 in 2011.

Gross profit as a percentage of sales increased to 29.7% in 2012 from 19.1% in 2011. The relatively higher level of gross profit in 2012 as compared to 2011, is due primarily to a 46% reduction in the cost of natural gas, from an average cost of $8.26 per dekatherm in 2011 to $4.47 per dekatherm in 2012. The decrease in the cost of natural gas between 2011 and 2012 based on 211,039 dekatherms purchased was $865,000.

Additionally a decrease in the cost of paper of 20% from an average of $173.00 per ton in 2011 to $139.00 per ton in 2012, based on 19,134 tons purchased, was $873,000.

The above positive factors were offset by uninsured boiler rental expenses of $181,000 due to the failure of the Company's main boiler in January 2012. The Company determined not to replace the main boiler which resulted in a longer than expected rental period of a temporary boiler.

Additionally there were expenses of $150,000 incurred due to insurance claim deductibles; a $100,000 deductible was a result of damage caused by Super Storm Sandy and a $50,000 deductible in connection with the boiler failure described above.

Selling, general and administrative expenses increased $177,138 from $4,356,802 in 2011 to $4,533,940 in 2012, and as a percentage of sales were 23.2% in 2012 as compared to 22.6% in 2011. The year-over-year increase in Selling, general and administrative expenses is due in part to increases in advertising, promotional and related sales expenses, agent commissions and product warranty expenses, partially offset by decreases in salaries, wages and related costs, energy expense, depreciation and building maintenance expense.

Interest expense on debt increased to $466,341 in 2012 from $307,013 in 2011. The increase is due to the combination of the level of borrowed funds available with the new Term Loan and Revolving Credit Facility and interest incurred in connection with the purchase of the Cogen System.

In 2012, other income consists primarily of scrap metal from the dismantling of obsolete and fully depreciated equipment sold to brokers.

As a result of the foregoing, net income in 2012 was $824,508 as compared to net loss of $944,737 in 2011.

Liquidity and Capital Resources

Cash flows from operating activities and bank borrowings are the primary sources of liquidity. Net cash provided by operating activities amounted to $1.6 million in 2013, compared to $0.1 million in 2012.

Working capital was $(3.7) million at December 31, 2013, as compared to $(1.8) million at December 31, 2012, a decline of $1.9 million. The decrease was due primarily to decreased cash balances of $0.5 million and increased accounts payable balances of $0.5 million resulting largely from the purchase of capital equipment and repairs of building roof structures and equipment. Contributing to the decline in working capital was an increase of $0.7 million in the current portion of long-term debt in accordance with the terms of the loans.

Capital expenditures for new and improved facilities and equipment, which are financed primarily through internally generated funds and debt were $2.2 million in 2013, $4.5 million in 2012 and $0.3 million in 2011. The Company has estimated capital expenditures for 2014 in the amount of $0.8 million to implement manufacturing equipment replacement and improvement projects.

Cash flows provided by financing activities were $0.2 million in 2013 and $1.4 million in 2012. The increase in short-term debt in 2013 is due primarily to the increased level of borrowing in the Revolving Credit Facility to partially fund the new and improved facilities and equipment.

On April 30, 2010, the Company entered into a Credit Facilities Agreement (the "2010 Agreement") with Keltic Financial Partners II, LP (the "Lender"). The 2010 Agreement, which had an original expiration date of

Disclosures About Contractual Obligations and Commercial Commitments:

	Cash Payments Due by Period				
	Total	Within Year 1	2-3 Years	4-5 Years	After 5 Years
Short-term debt	$ 2,161,342	$ 2,161,342	$ –	$ –	$ –
Long-term debt (includes current portion)	6,129,686	882,980	3,228,407	990,160	1,028,139
Operating leases	90,306	68,461	21,845	–	–
	$ 8,381,334	$ 3,112,783	$ 3,250,252	$ 990,160	$ 1,028,139

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

The Company leases certain office, manufacturing equipment and vehicles under operating leases that expire at various dates. Payments under these leases were $118,004 in 2013. Lease payments subsequent to December 31, 2013 are as follows: 2014, $68,461, 2015, $20,738 and 2016, $1,107.

April 30, 2013, was comprised of a term loan (the "2010 Term Loan") and a revolving credit facility (the "2010 Revolving Credit Facility"). The 2010 Term Loan, in the amount of $1,800,000, was due and payable on the expiration date of the 2010 Agreement. Under the 2010 Revolving Credit Facility, the Company could borrow up to specified percentages of eligible receivables and inventory (inventory limited to $500,000), as defined, in an aggregate amount not to exceed $2,000,000. Interest on each loan was payable monthly at the greatest of (A) The Lender's prime rate, as defined, plus 3.25%, (B) the LIBOR Rate, as defined, plus 5.75%, and (C) 6.50%. The 2010 Agreement further provided for an annual facility fee in the amount of $38,000 payable in equal monthly installments, a monthly collateral management fee of $1,500, a commitment and closing fee of $76,000 paid at loan origination and certain other expenses of the Lender. The 2010 Agreement contains financial and other covenants including minimum EBITDA and limitations on other indebtedness, capital expenditures and dividends, all as defined. Loans and advances under the 2010 Agreement are collateralized by substantially all of the Company's assets, including real property.

On April 7, 2011, effective December 31, 2010, the Lender, at the request of the Company, issued the First Amendment to the 2010 Agreement (the "First Amendment") amending the EBITDA and capital expenditures covenants contained in the 2010 Agreement. For the measurement periods in 2013, 2012 and 2011 the Company satisfied the minimum EBITDA covenant as amended.

On December 14, 2012, the Company and Lender entered into a second amendment to the 2010 Agreement (the "2012 Agreement") to extend the term of the 2010 Agreement, as amended by the First Amendment. The 2012 Agreement, which has an expiration date of December 14, 2015, is comprised of a term loan (the "2012 Term Loan"), and a revolving credit facility (the "2012 Revolving Credit Facility"). The 2012 Term Loan, in the amount of $2,900,000, satisfied the existing term loan and is to be repaid in 24 equal monthly installments of $45,833.33 commencing on January 1, 2014 and in one installment equal to the then-outstanding and unpaid principal amount of the 2012 Term Loan on December 14, 2015. Under the 2012 Revolving Credit Facility, the Company may borrow up to a specified percentage of eligible receivables and inventory as defined, in an aggregate amount not to exceed $2,500,000. As of December 31, 2013, $2,161,342 was outstanding and $338,658 was the unused credit under the 2012 Revolving Credit Facility. The unused credit was limited to $184,127, based on eligible receivables and inventory as of December 31, 2013. Interest on each loan is payable monthly at the greatest of (a) the Lender's prime rate (3.25% at December 31, 2013) plus 2.75%, (b) the LIBOR rate, as defined, plus 5.25%, or (c) 6.00%. The 2012 Agreement further provides for an annual facility fee in the amount of $54,000 payable in equal monthly installments, a monthly collateral management fee of $1,500 and a closing fee of $67,500 paid at the loan settlement.

On July 6, 2012, the Company and Caterpillar Financial Services Corporation ("Caterpillar") agreed to terminate an operating lease arrangement for an on-site cogeneration system to supply substantially all of the Company's electricity requirements and thermal energy for the pulping process. Caterpillar agreed to refinance the remaining balance outstanding under the lease, subject to the terms and conditions of the Security Agreement and Promissory Note (the "Agreement"). The Agreement provides for payment of the principal amount of $3,467,852 over a term of seven years commencing August 1, 2012 with interest on the outstanding principal at 5.9% per annum. Principal and interest are payable in unequal monthly installments in accordance with an amortized payment schedule, with a final payment due on August 1, 2019. As of December 31, 2013, the total outstanding principal under the Agreement was $2,682,980.

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

Critical Accounting Policies

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

The significant accounting policies are described in Note 1 of the Notes to Financial Statements included in the Company's 2013 Annual Report. Not all of these significant accounting policies require management to make difficult, subjective or complex judgments or estimates. However, management considers the following policies to have the potential for the most significant impact on the financial statements.

Pension and Other Postretirement Benefits

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

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

The Company's funding policy for the Pension Plan is to contribute amounts sufficient to meet minimum funding requirements set forth in U.S. employee benefit and tax laws. The Company expects to make cash contributions to the Pension Plan as required in 2014. The Company's policy for funding the Supplemental Plan and Postretirement Benefit Plan is to contribute benefits in amounts as determined at the discretion of management. As of December 31, 2013 and 2012, these Plans were unfunded.

Inventories

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

Long-Lived Assets

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

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

Deferred Income Tax

A majority of the deferred tax assets, which have been recorded by the Company, represent net operating loss carryforwards. A valuation allowance has been recorded for certain capital losses and other deferred tax assets. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon this assessment, management believes it is more likely than not that the Company will realize the benefits of these deductible differences, net of existing valuation allowances at December 31, 2013. The amount of net deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced.

Accounts Receivable

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

Inflation and Economy

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

Summarized (unaudited) quarterly financial data of the Company for years 2013 and 2012 are as follows:

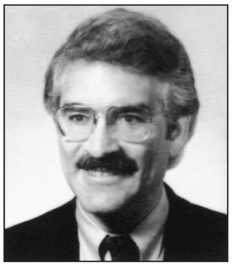
(in thousands of dollars except per share data)

	2013				2012			
	First	Second	Third	Fourth	First	Second	Third	Fourth
Net sales	$ 5,048	$ 5,552	$ 4,881	$ 5,233	$ 5,038	$ 5,185	$ 4,636	$ 4,670
Gross profit	$ 1,170	$ 1,702	$ 1,344	$ 1,537	$ 1,572	$ 1,593	$ 1,408	$ 1,227
Net (loss) earnings	$ (184)	$ 366	$ 108	$ 481	$ 377	$ 342	$ 120	$ (14)
Net (loss) earnings per common share:								
Basic	$ (0.52)	$ 1.03	$ 0.31	$ 1.35	$ 1.06	$ 0.97	$ 0.34	$ (0.04)
Diluted	$ (0.52)	$ 1.03	$ 0.30	$ 1.35	$ 1.05	$ 0.96	$ 0.34	$ (0.04)

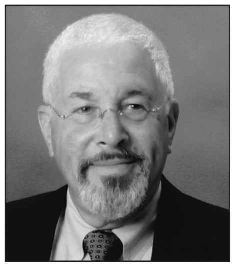
Valuation and Qualifying Accounts for years 2013, 2012 and 2011:

	Balance at Beginning of Year	Additions Charged to Profit and Loss	Accounts Written Off	Balance at End of Year
Year Ended December 31, 2013				
Allowance for doubtful accounts	$ 46,000	$ 12,500	$ 12,500	$ 46,000
Year Ended December 31, 2012				
Allowance for doubtful accounts	$ 46,000	$ 18,697	$ 18,697	$ 46,000
Year Ended December 31, 2011				
Allowance for doubtful accounts	$ 46,000	$ 42,891	$ 42,891	$ 46,000

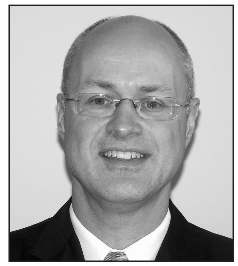
Board of Directors



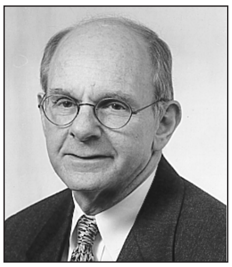
Michael R. Flicker
Attorney at Law



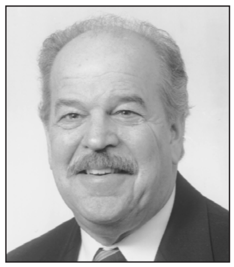
Warren L. Flicker
Chairman of the Board,
Chief Executive Officer



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



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



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

Other Officers

Ronald D. Fasano
Chief Financial Officer
& Treasurer

Peter Tindall
Vice President,
Operations

Jennifer D. Bartkovich
Corporate Secretary

Corporate Offices:
Homasote Company
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