

H M A S O T E[®]

2014 Annual Report
Our 105th 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.

44[®] SoundBarrier[®]

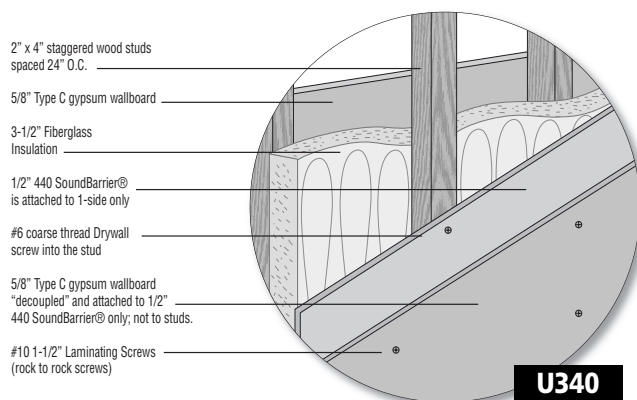
International Building Code (IBC) Calls for minimum Sound Transmission Class (STC) and Insulation Impact Class (IIC) Ratings of 50 • **UL[®]-listed wall and floor assemblies** • **ICC-ES ESR-1374**

Less Material, Less Labor, Better Results!

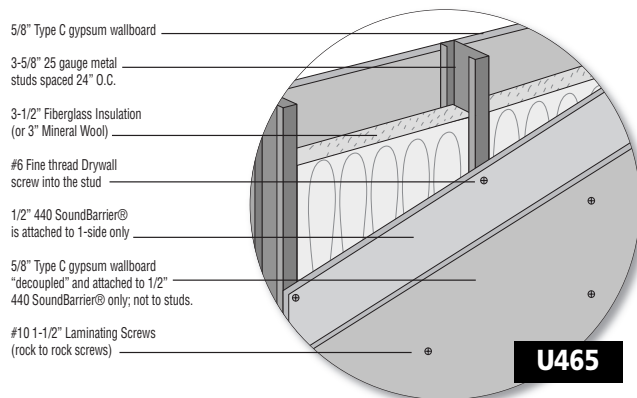
Superior Sound Control For Both
Metal and Wood Stud Walls In:

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

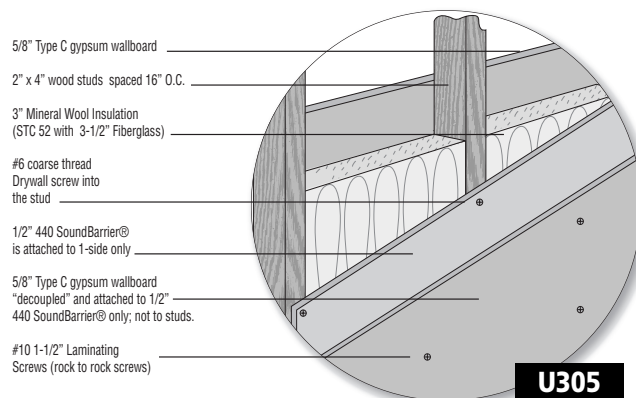
STC 53



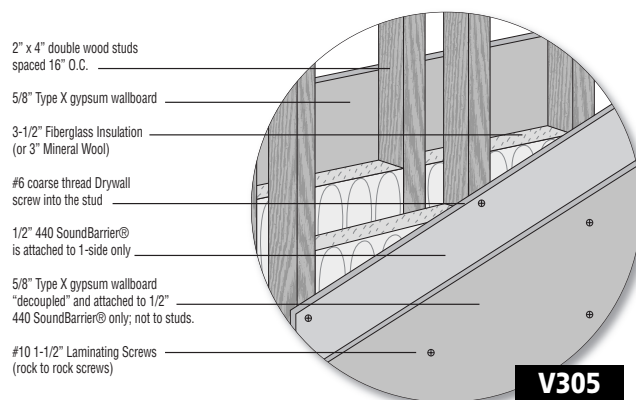
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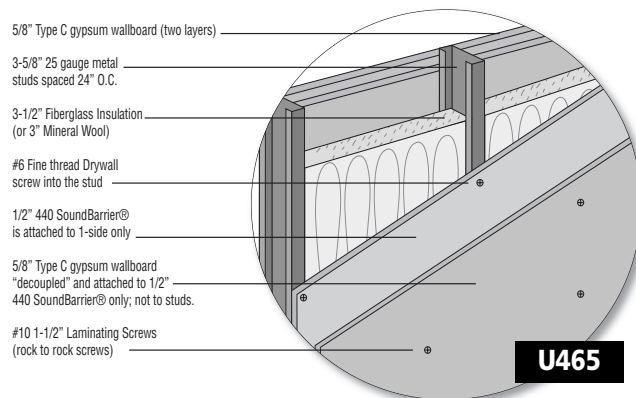
STC 53



STC 60



STC 58



HOMASOTE[®]

Sensible. Sound.
Solutions.



www.homasote.com

To Shareholders and Employees

Herewith is presented the Annual Report of your Company for the year ended December 31, 2014.

2014 was another year of moving forward, but with a few hiccups along the way. We continue to closely manage our business to enhance our liquidity position.

Projects

Throughout the year, we made significant investment into our building structure and will continue to upgrade our facility going forward. Unfortunately the outstanding projects from last year, preheating of the Coe Dryer air and monitoring of energy use within the plant, have not been completed. While we had made much progress toward both ends, due to extended negotiations with our insurance carrier that covered the two outages in 2014, we were not able to finish an upgrade and repair to the substation/transformer which directly relates to both programs. We hope to have these projects completed by late spring 2016.

Sales

On the sales end, our sales force continues to make inroads with the use of our flagship product, 440 SoundBarrier, in walls and floors for sound control. Sales for hotel, apartment and condo markets are key targeted areas. Domestic sales of our protection board to glass customers have not lost steam, but the strong dollar has hurt some of the export business, both in the Middle East and Asia. The forecast for multi-family construction looks bright for our 440 SoundBarrier products. This should also carry over to our glass protection board products.

During the year 2014, we unknowingly experienced intermittent interruption of our chemical feed process which resulted in some warranty claims and a large volume recall of finished product in 2015. We are able to use most of the recalled material for alternate products with little resultant loss. This problem was first identified in June 2015 and has continued into the second half of 2015.

Year In Review

Millboard division sales results were as follows: millboard products, including our flagship 440 SoundBarrier and Homex expansion joint and forming boards decreased 1% and 2%, respectively. Nova pre-finished interior panels decreased by 15%. Decking product sales decreased by 6%. Industrial (Pakline Division) sales increased by 1% for 2014.

Net sales for 2014 were \$20,410,058 versus 2013 sales of \$20,713,544, a decrease of \$303,486 or 1.5%. Net income for the year was \$631,772, resulting in diluted earnings per common share of \$1.77. The 2013 net income was \$770,809. Working capital was \$(3.8) million, a decline of \$0.1 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

	2014	2013	2012	2011	2010
Net sales.....	\$ 20,410,058	\$ 20,713,544	\$ 19,529,396	\$ 19,283,283	\$ 18,117,531
Depreciation and amortization..	\$ 790,167	\$ 727,585	\$ 786,131	\$ 797,174	\$ 931,012
Net income (loss).....	\$ 631,772	\$ 770,809	\$ 824,508	\$ (944,737)	\$ (1,193,566)
Common shares outstanding (weighted average):					
Basic.....	356,007	354,707	353,441	351,732	349,032
Diluted	357,132	356,732	356,532	351,732	349,032
Net earnings (loss) per common share:					
Basic.....	\$ 1.78	\$ 2.17	\$ 2.33	\$ (2.69)	\$ (3.42)
Diluted	\$ 1.77	\$ 2.16	\$ 2.31	\$ (2.69)	\$ (3.42)
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	\$ (3,764,184)	\$ (3,674,045)	\$ (1,808,224)	\$ (3,057,749)	\$ (2,464,536)
Working capital ratio5:1	.5:1	.7:1	.5:1	.5:1
Capital expenditures.....	\$ 532,035	\$ 2,243,964	\$ 4,496,945	\$ 256,948	\$ 280,905
Total assets.....	\$ 12,393,983	\$ 12,063,435	\$ 11,177,633	\$ 6,320,228	\$ 6,807,477
Long-term debt, excluding current portion	\$ 4,316,236	\$ 5,246,706	\$ 6,129,686	\$ 1,800,000	\$ 1,800,000
Stockholders' equity	\$ (3,897,190)	\$ (3,149,662)	\$ (5,252,931)	\$ (5,804,190)	\$ (3,584,219)
Common shares outstanding....	357,099	355,799	354,499	353,199	351,599
Per share book value of common stock	\$ (10.91)	\$ (8.85)	\$ (14.82)	\$ (16.43)	\$ (10.19)

Two Year Dividend and Stock Price Comparison

CASH DIVIDENDS

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

Quarter	2014	2013
First.....	\$ 0.00	\$ 0.00
Second	0.00	0.00
Third	0.00	0.00
Fourth	0.00	0.00
	<u>\$ 0.00</u>	<u>\$ 0.00</u>

STOCK PRICES

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

Quarter	2014		2013	
	High	Low	High	Low
First.....	\$ 4.10	\$ 2.25	\$ 4.25	\$ 2.50
Second	\$ 4.50	\$ 2.50	\$ 4.80	\$ 3.00
Third	\$ 6.10	\$ 2.81	\$ 4.80	\$ 3.00
Fourth	\$14.00	\$ 4.25	\$ 7.00	\$ 3.50

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

The number of Stockholders of record of the Company at December 31, 2014 and 2013 is 158 and 166, respectively.

Profile

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

Statements of Operations

Years Ended December 31

	2014	2013	2012
Net sales.....	\$20,410,058	\$20,713,544	\$19,529,396
Cost of sales.....	14,795,784	14,960,652	13,729,479
Gross profit.....	5,614,274	5,752,892	5,799,917
Selling, general and administrative expenses	4,420,035	4,414,652	4,533,940
Operating income	1,194,239	1,338,240	1,265,977
Other income (expense):			
Interest expense	(576,326)	(591,143)	(466,341)
Other income	13,859	23,712	24,872
Income before income tax expense.....	631,772	770,809	824,508
Income tax expense	—	—	—
Net income	\$ 631,772	\$ 770,809	\$ 824,508
Net earnings per common share:			
Basic	\$ 1.78	\$ 2.17	\$ 2.33
Diluted	\$ 1.77	\$ 2.16	\$ 2.31
Weighted average common shares outstanding:			
Basic.....	356,007	354,707	353,441
Diluted	357,132	356,732	356,532

See accompanying notes to financial statements.

Statements of Comprehensive (Loss) Income

Years Ended December 31

	2014	2013	2012
Net income	\$ 631,772	\$ 770,809	\$ 824,508
Other comprehensive (loss) income:			
Net actuarial (loss) gain of retirement benefit plans:			
Unrealized (loss) gain arising during the period	(1,295,410)	1,284,982	(287,638)
Amortization of actuarial (loss) gain.....	(86,404)	45,242	13,605
Total other comprehensive (loss) income.....	(1,381,814)	1,330,224	(274,033)
Comprehensive (loss) income	\$ (750,042)	\$ 2,101,033	\$ 550,475

See accompanying notes to financial statements.

Balance Sheets**December 31**

Assets	2014	2013
Current Assets:		
Cash and cash equivalents	\$ 38,093	\$ 38,827
Accounts receivable (net of allowance for doubtful accounts of \$46,000 in 2014 and 2013)	1,457,970	1,623,440
Inventories	1,550,772	1,325,150
Deferred income taxes	30,762	22,163
Prepaid expenses and other current assets	657,720	137,057
Total Current Assets	\$ 3,735,317	\$ 3,146,637
Property, plant and equipment, net	8,633,859	8,864,929
Other assets	24,807	51,869
Total Assets	<u>\$12,393,983</u>	<u>\$12,063,435</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Short-term debt.....	\$ 1,950,356	\$ 2,161,342
Current portion of long-term debt	930,470	882,980
Accounts payable	3,912,152	3,153,550
Accrued expenses	557,523	469,810
Current portion of obligations under benefit plans.....	149,000	153,000
Total Current Liabilities	\$ 7,499,501	\$ 6,820,682
Long-term debt	4,316,236	5,246,706
Deferred income taxes	30,762	22,163
Obligations under benefit plans	3,476,548	2,542,698
Other liabilities	968,126	580,848
Total Liabilities	16,291,173	15,213,097
Commitments and Contingencies		
Stockholders' Equity:		
Common stock, par value \$0.20 per share; Authorized 1,500,000 shares; Issued 872,595 shares in 2014 and 872,195 shares in 2013	174,519	174,439
Additional paid-in capital.....	947,829	945,395
Retained earnings	5,420,216	4,788,444
Accumulated other comprehensive loss	(2,928,925)	(1,547,111)
	3,613,639	4,361,167
Less cost of common shares in treasury, 515,196 shares in 2014 and 2013	7,510,829	7,510,829
Total Stockholders' Equity.....	(3,897,190)	(3,149,662)
Total Liabilities and Stockholders' Equity	<u>\$12,393,983</u>	<u>\$12,063,435</u>

See accompanying notes to financial statements.

Statements of Changes in Stockholders' Equity

Years Ended December 31

	COMMON STOCK SHARES	PAR VALUE	ADDITIONAL PAID IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	TREASURY STOCK	TOTAL STOCKHOLDERS' EQUITY
Balances at January 1, 2012.....	357,199	\$ 174,479	\$ 942,335	\$ 3,193,127	\$ (2,603,302)	\$ (7,510,829)	\$ (5,804,190)
Net income.....				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 loss.....							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)
Net income				631,772			631,772
Net change in unrecognized retirement benefit plans.....					(1,381,814)		(1,381,814)
Other comprehensive income.....							(750,042)
Share based compensation.....	400	80	2,434				2,514
Balances at December 31, 2014.....	<u>357,399</u>	<u>\$ 174,519</u>	<u>\$ 947,829</u>	<u>\$ 5,420,216</u>	<u>\$ (2,928,925)</u>	<u>\$ (7,510,829)</u>	<u>\$ (3,897,190)</u>

See accompanying notes to financial statements.

Statements of Cash Flows

Years Ended December 31

	2014	2013	2012
Cash flows from operating activities:			
Net income	\$ 631,772	\$ 770,809	\$ 824,508
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization.....	790,167	727,585	786,131
Bad debt expense.....	—	12,500	18,697
Share based compensation expense	2,514	2,236	784
Amortization of retirement plans prior service cost and actuarial gain and loss	(86,404)	45,242	13,605
Changes in assets and liabilities:			
Decrease (increase) in accounts receivable, net....	165,470	(248,851)	(114,294)
(Increase) decrease in inventories	(225,622)	288,687	(417,401)
(Increase) decrease in prepaid expenses and other current assets	(520,663)	51,558	(23,532)
Increase in other assets	—	—	(67,500)
Increase (decrease) in accounts payable.....	758,602	462,288	(1,017,036)
Increase (decrease) in accrued expenses.....	87,713	(169,153)	333,837
Decrease in other current liabilities	—	(151,528)	(201,000)
Decrease in obligations under benefit plans	(365,560)	(260,021)	(70,786)
Increase in other liabilities	387,278	47,435	65,039
Net cash from operating activities	1,625,267	1,578,787	131,052
Cash flows from investing activities:			
Capital expenditures.....	(532,035)	(2,243,964)	(1,029,093)
Net cash used in investing activities.....	(532,035)	(2,243,964)	(1,029,093)
Cash flows from financing activities:			
Net (repayment of) proceeds from issuance of short-term debt	(210,986)	348,145	561,238
Net (repayment of) proceeds from issuance of long-term debt	(882,980)	(197,488)	861,834
Net cash (used in) provided by financing	(1,093,966)	150,657	1,423,072
Net (decrease) increase in cash and cash equivalents	(734)	(514,520)	525,031
Cash and cash equivalents at beginning of year.....	38,827	553,347	28,316
Cash and cash equivalents at end of year	\$ 38,093	\$ 38,827	\$ 553,347
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest.....	\$ 576,326	\$ 591,143	\$ 466,341
Noncash investing and financing activities			
Equipment purchased through financing	\$ —	\$ —	\$ 3,467,852

See accompanying notes to financial statements.

Notes to Financial Statements

December 31, 2014, 2013 and 2012

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 2014 were distributed as follows: Building material wholesalers and contractors, approximately 56%; industrial manufacturers, approximately 44%; in 2013 building material wholesalers and contractors, approximately 57%; industrial manufacturers, approximately 43% and in 2012, 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 ninety days 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, 2014 and 2013.

	2014	2013
Balance at January 1	\$ 12,000	\$ 94,095
Accruals and adjustments for product warranties issued during the period ...	45,097	(14,063)
Settlements made during the period.....	(29,097)	(68,032)
Balance at December 31 ...	<u>\$ 28,000</u>	<u>\$ 12,000</u>

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

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

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

The Company's customers are located throughout the United States of America. Additionally, export sales, 54% to Canada and the balance to other countries, accounted for approximately 4%, 6% and 5%, in the years ended December 31, 2014, 2013 and 2012, respectively, of the Company's sales. One customer accounted for 12% of the Company's sales in 2014, 10% in 2013 and 11% in 2012. Additionally, one customer accounted for 10% of the accounts receivable balance at December 31, 2014 and 12% at December 31, 2013.

ACCOUNTS RECEIVABLE: The Company records accounts receivable at net realizable value. This value includes an appropriate allowance for uncollectible

Notes to Financial Statements continued

December 31, 2014, 2013 and 2012

Note 1—Summary of Significant Accounting Policies (continued)

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.

Refer to Note 7 (Post Employment Benefit Plans).

SHARE-BASED COMPENSATION COSTS: The Company has an incentive plan (the "2008 Stock Plan") which rewards "key persons", as defined, with restricted shares of Common Stock. Shares awarded vest in four equal annual installments based on the date of grant. The cost of these awards is determined using the market price of the shares on the date of grant. Compensation expense is recognized over the requisite vesting period

and adjusted for actual forfeitures before vesting. On December 13, 2010 the 2008 Stock Plan was amended and restated (the "Amended Stock Plan"). Shares awarded to employees under the Amended Stock Plan vest in five equal annual installments based on the date of grant. Other provisions of the stock award incentive plan continue substantially unchanged.

Refer to Note 8 (Share-based Compensation).

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

The Company has adopted accounting guidance related to accounting for uncertainty in income taxes. Under the "more-likely-than-not" threshold guidelines, the Company believes no significant uncertain tax positions exist, either individually or in the aggregate, that would give rise to the non-recognition of an existing tax benefit. As of December 31, 2014, 2013 and 2012, 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.

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.

Notes to Financial Statements continued

December 31, 2014, 2013 and 2012

Note 1—Summary of Significant Accounting Policies (continued)

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 May 2014, FASB issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"), requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. In August 2015, the FASB issued ASU 2015-14, *Revenue from Contracts with Customers (Topic 606) – Deferral of the Effective Date* ("ASU 2015-14"), which defers the effective date of ASU 2014-09 by one year. The updated standard will be effective for annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016. The updated standard will be effective for the Company for the year ending December 31, 2019. The Company has not yet selected a transition method and is currently evaluating the effect that the updated standard will have on the financial statements.

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern* ("ASU 2014-15"). ASU 2014-15 explicitly requires management

to evaluate, at each annual or interim reporting period, whether there are conditions or events that exist which raise substantial doubt about an entity's ability to continue as a going concern and to provide related disclosures. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and annual and interim periods thereafter, with early adoption permitted. The Company is currently evaluating the impact of adopting this new standard on its financial statement disclosures.

In April 2015, the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs* ("ASU 2015-03"). ASU 2015-03 requires that debt issuance costs related to a debt liability be reported on the balance sheet as a direct deduction from the debt liability and will no longer be recorded as a separate asset. ASU 2015-03 is effective for fiscal years beginning after December 15, 2015, and for interim periods within fiscal years beginning after December 15, 2016. Early adoption is permitted. ASU 2015-03 will be effective for the Company for the year ending December 31, 2016. The Company is currently evaluating the impact of adopting this new standard on its financial statements and related disclosures.

In July 2015, the FASB issued ASU 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory* ("ASU 2015-11"). Historically U.S. GAAP required entities to measure inventory at the lower of cost or market. When measuring inventory, "market" could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. ASU 2015-11 does not apply to inventory measured using the last-in, first-out method or the retail inventory method. The ASU applies to all other inventory, which includes inventory measured using the first-in, first-out method or the average cost method. Inventory within the scope of ASU 2015-11 now is required to be measured at the lower of cost and net realizable value. Net realizable value is defined as "the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation." For public business entities, ASU 2015-11 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. For all other entities, the ASU is effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. ASU 2015-11 will be effective for the Company for the year ending December 31, 2017. The Company is currently evaluating the impact of adopting this new standard on its financial statements and related disclosures.

Notes to Financial Statements continued

December 31, 2014, 2013 and 2012

Note 2 – INVENTORIES

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

	2014	2013
Finished goods	\$ 1,021,806	\$ 846,905
Work in process.....	8,461	12,964
Raw materials.....	520,505	465,281
	<u>\$ 1,550,772</u>	<u>\$1,325,150</u>

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

Note 3 – PROPERTY, PLANT AND EQUIPMENT

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

	2014	2013	Estimated Useful Lives
Land.....	\$ 591,492	\$ 591,492	
Buildings and additions.....	11,549,159	11,476,609	10-50 years
Machinery and equipment	32,821,912	32,494,441	3-20 years
Office equipment	1,484,552	1,444,552	3-10 years
Automotive equipment.....	310,985	249,755	3-5 years
Cogeneration system.....	3,606,248	3,575,464	20 years
	<u>50,364,348</u>	<u>49,832,313</u>	
Less accumulated depreciation	<u>41,730,489</u>	<u>40,967,384</u>	
	<u>\$ 8,633,859</u>	<u>\$ 8,864,929</u>	

Depreciation expense was \$763,105, \$695,857 and \$719,578 for the years ended December 31, 2014, 2013 and 2012, 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 2014, 2013 and 2012 the Company satisfied the minimum EBITDA covenant as amended.

On December 14, 2012, the Company and the Lender entered into a Second Amendment to the 2010 Agreement (the “2012 Agreement”) to extend the term of the

Notes to Financial Statements continued

December 31, 2014, 2013 and 2012

Note 4 – DEBT (continued)

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 on December 14, 2015 equal to the then-outstanding and unpaid principal and interest amount. As of December 31, 2014, the outstanding balance under the 2012 Term Loan, including current portion, was \$2,350,000. 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, 2014, \$1,950,356 was outstanding and \$549,644 was the unused credit under the 2012 Revolving Credit Facility. The unused credit was limited to \$221,090, based on eligible receivables and inventory as of December 31, 2014. Interest on each loan is payable monthly at the greatest of (a) the Lender’s prime rate (3.25% at December 31, 2014) 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 May 21, 2015, the Company and the Lender (ACF Finco I LP and successor-in-interest to Keltic Financial Partners II, LP) entered into a Third Amendment to the 2010 Agreement to extend the term of the credit facilities for a period of three (3) years from December 14, 2015 to December 14, 2018 and to increase the amount of the outstanding principal balance of the term loan by

\$1,000,000 to a total of \$3,166,667. The 2012 Term Loan, as extended, is payable in 42 equal installments of \$45,833.33 commencing on June 1, 2015 and one installment on December 14, 2018 equal to the then outstanding and unpaid principal and interest amount. All other provisions of the 2012 Agreement continue as stipulated.

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, 2014, the outstanding principal under the Agreement, including current portion, was \$2,896,706.

The balance of long-term debt, including current portion, outstanding at December 31, 2014 and 2013 was \$5,246,706 and \$6,129,686 respectively. Aggregate maturities of long-term debt as of December 31, 2014 are as follows: \$930,470 in 2015, \$1,002,104 in 2016, \$1,030,314 in 2017, \$1,255,680 in 2018 and \$1,028,138 thereafter.

Total interest costs incurred during 2014, 2013 and 2012 were \$576,326, \$591,143 and \$466,341, respectively.

Note 5 – ACCRUED EXPENSES

Accrued expenses as of December 31, 2014 and 2013 consist of the following:

	2014	2013
Commissions	\$ 48,509	\$ 42,991
Payroll	69,234	32,167
Warranty claims	28,000	12,000
Maintenance Cogen	175,537	140,674
Other	236,243	241,978
	<u>\$557,523</u>	<u>\$469,810</u>

Notes to Financial Statements continued

December 31, 2014, 2013 and 2012

Note 6 – INCOME TAXES

During 2014, 2013 and 2012, the Company had 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:

	2014	2013	2012
Computed “expected” tax expense (benefit) ...	\$ 220,720	\$ 262,075	\$ 287,256
Change in valuation allowance.....	(494,612)	(237,135)	(21,408)
Other.....	273,892	(24,940)	(265,848)
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

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:

	2014	2013
Deferred tax assets:		
Accounts receivable, due to allowance for doubtful accounts	\$ 14,378	\$ 14,378
Inventories, due primarily to cost capitalization ..	89,389	82,630
Other liabilities, principally due to supplemental pension and postretirement costs.....	608,558	732,363
Nondeductible accrued expenses	60,961	46,582
Net operating loss carryforwards – federal and state.....	4,203,745	4,415,785
Alternative minimum tax credit.....	26,182	26,182
Total deferred tax assets	5,003,213	5,317,920
Less valuation allowance.....	3,709,254	4,203,866
Net deferred tax assets	<u>1,293,959</u>	<u>1,114,054</u>
Deferred tax liabilities:		
Fixed assets, due to accelerated depreciation	963,632	840,437
Other assets, due to pension costs	330,327	273,617
Total deferred tax liabilities	1,293,959	1,114,054
Net deferred tax assets	<u>\$ —</u>	<u>\$ —</u>

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, 2014. 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, 2014 was a decrease of \$494,612. The net change in the total valuation allowance for the year ended December 31, 2013 was a decrease of \$237,135. In addition, at December 31, 2014, the Company has net operating loss carryforwards for federal and state income tax purposes of approximately \$11,783,000 and \$3,481,000 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 2015 for state tax purposes.

Notes to Financial Statements continued

December 31, 2014, 2013 and 2012

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 \$230,000 to the Pension Plan in 2015. 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, 2014 and 2013, 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 at December 31, 2014 and 2013) 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, 2015, \$121,000, 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, 2014 and 2013, 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, 2014, 2013 and 2012

Note 7 – POST EMPLOYMENT BENEFIT PLANS (continued)

	Pension Plan		Supplemental Plan		Postretirement Benefits	
	2014	2013	2014	2013	2014	2013
Change in benefit obligation						
Benefit obligation at beginning of year	\$ 9,018,403	\$ 9,590,749	\$ 805,642	\$ 868,752	\$ 243,239	\$ 271,173
Service cost	—	—	—	—	1,590	1,881
Interest cost	468,453	450,776	42,273	40,716	12,308	12,253
Actuarial (gain) loss	1,128,354	(519,641)	92,363	26,836	26,785	(10,589)
Benefits paid	(500,938)	(503,481)	(128,263)	(130,662)	(29,902)	(31,479)
Benefit obligation at end of year	<u>10,114,272</u>	<u>9,018,403</u>	<u>812,015</u>	<u>805,642</u>	<u>254,020</u>	<u>243,239</u>
Accumulated benefit obligation at end of year	<u>10,114,272</u>	<u>9,018,403</u>	<u>812,015</u>	<u>805,642</u>	<u>—</u>	<u>—</u>
Change in plan assets						
Fair value of plan assets at beginning of year	7,371,585	6,489,972	—	—	—	—
Actual return on plan assets	597,465	1,345,697	—	—	—	—
Employer contributions	214,680	153,462	128,263	130,662	29,902	31,479
Administrative expenses	(128,034)	(114,065)	—	—	—	—
Benefits paid	(500,938)	(503,481)	(128,263)	(130,662)	(29,902)	(31,479)
Fair value of plan assets at end of year	<u>7,554,758</u>	<u>7,371,585</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Funded status						
Benefit obligation in excess of plan assets	<u>\$ (2,559,514)</u>	<u>\$ (1,646,818)</u>	<u>\$ (812,015)</u>	<u>\$ (805,642)</u>	<u>\$ (254,020)</u>	<u>\$ (243,239)</u>
Amounts recognized in balance sheets						
Current benefit liability	\$ —	\$ —	\$ (121,000)	\$ (122,000)	\$ (28,000)	\$ (31,000)
Non-current benefit liability	<u>(2,559,514)</u>	<u>(1,646,818)</u>	<u>(691,015)</u>	<u>(683,642)</u>	<u>(226,020)</u>	<u>(212,239)</u>
Net liability recognized	<u>\$ (2,559,514)</u>	<u>\$ (1,646,818)</u>	<u>\$ (812,015)</u>	<u>\$ (805,642)</u>	<u>\$ (254,020)</u>	<u>\$ (243,239)</u>
Unrecognized prior service credit	\$ —	\$ —	\$ —	\$ —	\$ 123,650	\$ 285,558
Unrecognized actuarial (loss) gain	<u>(3,386,571)</u>	<u>(2,331,890)</u>	<u>(48,329)</u>	<u>43,604</u>	<u>382,325</u>	<u>455,617</u>
Accumulated other comprehensive (loss) income	<u>\$ (3,386,571)</u>	<u>\$ (2,331,890)</u>	<u>\$ (48,329)</u>	<u>\$ 43,604</u>	<u>\$ 505,975</u>	<u>\$ 741,175</u>

The total amount included in Accumulated Other Comprehensive Loss (“AOCI”) relating to the Company’s retirement plans at December 31, 2014 and 2013 was \$2,928,925 and \$1,547,111, respectively. The estimated amounts of prior service credit and actuarial net (loss) gain included in AOCI as of December 31, 2014 and expected to be amortized into net periodic benefit cost in 2015, are \$(226,000) for the defined benefit plan, \$(8,000) for the supplemental plan and \$163,252 for the postretirement plan.

Notes to Financial Statements continued

December 31, 2014, 2013 and 2012

Note 7 – POST EMPLOYMENT BENEFIT PLANS (continued)

	Pension Plan			Supplemental Plan		
	2014	2013	2012	2014	2013	2012
Components of net periodic benefit cost:						
Service cost.....	\$ 91,351	\$ 83,040	\$ 72,950	\$ —	\$ —	\$ —
Interest cost.....	468,453	450,776	465,578	42,273	40,716	43,619
Expected return on plan assets.....	(608,690)	(533,084)	(505,389)	—	—	—
Amortization of prior service cost.....	—	—	11,909	—	—	—
Recognized actuarial loss (gain)	121,581	257,707	228,767	430	(3,074)	(22,543)
Net periodic benefit cost.....	<u>\$ 72,695</u>	<u>\$ 258,439</u>	<u>\$ 273,815</u>	<u>\$ 42,703</u>	<u>\$ 37,642</u>	<u>\$ 21,076</u>

Postretirement Benefits			
	2014	2013	2012
Service cost.....	\$ 1,590	\$ 1,881	\$ 2,064
Interest cost.....	12,308	12,253	13,734
Expected return on plan assets.....	—	—	—
Amortization of prior service cost.....	(161,908)	(161,908)	(161,908)
Recognized actuarial gain	(46,507)	(47,483)	(42,620)
Net periodic benefit cost.....	<u>\$ (194,517)</u>	<u>\$ (195,257)</u>	<u>\$ (188,730)</u>

	Pension Benefits			Postretirement Benefits		
	2014	2013	2012	2014	2013	2012
Assumptions:						
Weighted-Average Assumptions used to determine net periodic benefit cost for years ended December 31:						
Discount rate	5.40%	4.80%	5.30%	5.40%	4.80%	5.30%
Expected long-term return on plan assets..	8.50%	8.50%	8.50%	N/A	N/A	N/A

	Pension Benefits		Postretirement Benefits	
	2014	2013	2014	2013
Weighted-Average Assumptions used to determine benefit obligations at December 31:				
Discount rate	4.33%	5.40%	4.33%	5.40%

Notes to Financial Statements continued

December 31, 2014, 2013 and 2012

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 2014. 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 2014 and 2013, and the target allocation for 2015, by asset category, are as follows:

	Target Allocation	Percentage of the Plan Assets at end of year	
	2015	2014	2013
Equity Mutual Funds	70%	69%	73%
Debt Mutual Funds	30%	28%	26%
Cash and Cash Equivalents	0%	3%	1%
	<u>100%</u>	<u>100%</u>	<u>100%</u>

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, 2014

Plan Assets

	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 192,504	—	—	\$ 192,504
Equity mutual funds	5,211,918	—	—	5,211,918
Debt mutual funds	2,150,336	—	—	2,150,336
Fair value of plan assets	<u>\$ 7,554,758</u>	<u>—</u>	<u>—</u>	<u>\$ 7,554,758</u>

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	<u>\$ 7,371,585</u>	<u>—</u>	<u>—</u>	<u>\$ 7,371,585</u>

Notes to Financial Statements continued

December 31, 2014, 2013 and 2012

Note 7 – POST EMPLOYMENT BENEFIT PLANS (continued)

Benefit Payments

The following table summarizes expected benefit payments from pension and postretirement plans through 2024. Actual benefit payments may differ from expected benefit payments.

	<u>Pension Benefit</u>	<u>Supplemental Plan</u>	<u>Postretirement Benefits</u>
2015	\$ 575,000	\$ 121,000	\$ 28,000
2016	575,000	111,000	27,000
2017	577,000	102,000	25,000
2018	583,000	94,000	23,000
2019	577,000	86,000	21,000
2020-24	3,249,000	324,000	84,000

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 2014, 2013 and 2012.

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 26,400 shares, net of cancellations, remain available as of December 31, 2014 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, 2014, 2013 and 2012

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 of stock to each of four non-employee members of the Board of Directors. All shares granted were from authorized but unissued Common Stock.

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

On September 9, 2014, the Board of Directors, on the recommendation of the Compensation Committee, resolved to grant 100 fully paid and non-assessable shares of stock to each of four non-employee members of the Board of Directors. All shares granted were from authorized but unissued Common Stock.

The total fair value of shares vested and compensation incurred pursuant to the Amended 2008 Plan and 2008 Stock Plan in 2014, 2013 and 2012 was \$2,514, \$2,236 and \$784, respectively. As of December 31, 2014 there was \$168 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 2014, 2013 or 2012.

Note 10 – COMMITMENTS AND CONTINGENCIES

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

The Company leases certain office, manufacturing equipment and vehicles under operating leases that expire at various dates. Payments under these leases were \$77,212 in 2014. Lease payments subsequent to December 31, 2014 are as follows: 2015, \$65,077; 2016, \$43,454; 2017, \$42,347; 2018, \$42,347 and 2019, \$10,587.

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.

Notes to Financial Statements continued

December 31, 2014, 2013 and 2012

Note 10 – COMMITMENTS AND CONTINGENCIES (continued)

On June 17, 2008, the insurance carrier and the Company signed an Interim Asbestos Claims Administration Agreement (the "Agreement") that defines how the parties will share past and future defense and indemnity costs from asbestos claims. The Agreement provided for a settlement of \$172,638 covering all prior costs. The Company further agreed to pay 6% of ongoing defense costs. The Company's agreed upon share of future indemnity costs varies from 0% to 10.49%, based on the claimant's date of first exposure. The Company incurred \$62,206 of such costs for the year ended December 31, 2014. The amount of such costs payable in the future is not determinable as of December 31, 2014. As of December 31, 2014 the Company recognized a provision of \$70,000 in its financial statements.

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

Note 11 – SUBSEQUENT EVENTS

The Company assessed events occurring subsequent to December 31, 2014 through November 6, 2015 for potential recognition and disclosure in the financial statements. There were seven 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 November 6, 2015.

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 2015 winter shutdown at the approximate cost of \$300,000.

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. On August 2, 2014 the Company experienced another breakdown of the switchgear equipment. Cogeneration is not possible until permanent repairs and/or replacement is completed. Due to extended negotiations with the insurance carrier, the Company was not able to finalize plans to replace the substation/transformer. A substantial amount of the claim, totaling \$499,780 and included in the Prepaid expenses and other current assets in the Company's December 31, 2014 Balance Sheet, has been paid in the first and second quarters of 2015. However, there are still significant matters to be resolved. The Company anticipates that final replacement of the equipment will be completed by late spring 2016. The approximate cost of the project is \$860,000, to be financed in part by additional debt.

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. Due to the above referenced substation/transformer replacement, the Company anticipates completion of this project by the second quarter of 2016.

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 2016. The cost of such design changes has not been determined.

Notes to Financial Statements continued

December 31, 2014, 2013 and 2012

Note 11 – SUBSEQUENT EVENTS (continued)

The Company has rebuilt its small hydropulper and is still in the process of completing the project. The anticipated cost to complete is \$75,000. This restoration provides the Company with a back-up to the main hydropulper and the smaller size meets the Company's production needs with reduced energy consumption.

The Company unknowingly experienced intermittent interruption of the biocide chemical feed process which resulted in warranty claims and a large volume recall of finished product in 2015. The result of the interruption is the formation of harmless bacteria, volatile fatty acids, ("VFAs"), which when exposed to heat and humidity, emit a distasteful gas odor. The biocide, although they are droplets, cause the VFAs to shrink during production and inhibit the production of the distasteful gas. VFAs are commonly found in wood fiber and are very common to paper mills. The Company is able to use most of the recalled material for alternate products with little resultant loss. This problem was first identified in June of 2015 and has continued into the second half of 2015. The amount of warranty claims and related costs is approximately \$350,000 and will be reflected in the financial statements of the Company in the second half of 2015.

On May 21, 2015, the Company and the Lender (ACF Finco I LP and successor-in-interest to Keltic Financial Partners II, LP) entered into a Third Amendment to the 2010 Agreement to extend the term of the credit facilities for a period of three (3) years from December 14, 2015 to December 14, 2018 and to increase the amount of the outstanding principal balance of the term loan by \$1,000,000 to a total of \$3,166,667. The Term Loan, as extended, is payable in 42 equal installments of \$45,833.33 commencing on June 1, 2015 and one installment on December 14, 2018 equal to the then outstanding and unpaid principal and interest amount. All other provisions of the 2012 Agreement continue as stipulated.

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, 2014 and 2013, and the related statements of income, comprehensive (loss) income, changes in stockholders' equity and cash flows for each of the three years ended December 31, 2014, and the related notes to the financial statement.

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 audits 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, 2014 and 2013, and the results of its operations and its cash flows for each of the three years ended December 31, 2014 in accordance with accounting principles generally accepted in the United States of America.

Mercaderes, P C
Certified Public Accountants

Hamilton, New Jersey
November 6, 2015

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, interest rates, inflation, costs of energy, weather, strikes, international unrest, terrorist acts and other factors;
- competitive, regulatory and market conditions, such as changes in choices regarding building materials by architects and builders and packing products by industrial firms;
- the performance of new products and the continued acceptance of current products in the marketplace; and
- the execution of strategic initiatives and alliances.

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 2014-2013

Net sales decreased in 2014 by \$303,486 or 1.5% to \$20,410,058 from \$20,713,544 in 2013. 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 2014 decreased by \$380,625 or 3% to \$11,551,572 from \$11,932,197 in 2013. The decrease in sales is reflective of mixed results across the division as follows: the largest product line, millboard products decreased 2%; the Homex product line sales volume decreased 1%; the Nova pre-finished panels product line saw a sales volume decrease of 15%; while Decking product sales decreased by 6%.

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 2014 increased by \$77,139 or almost 1% to \$8,858,486 from \$8,781,347 in 2013.

Gross profit as a percentage of sales decreased to 27.5% in 2014 from 27.8% in 2013. The relatively lower level of gross profit in 2014 as compared to 2013, is due primarily to a 16% increase in the cost of natural gas, from an average cost of \$5.63 per dekatherm in 2013 to \$6.51 per dekatherm in 2014 that was offset in part by a 20% decrease in the amount of gas consumed. The increase in the cost of natural gas between 2013 and 2014 based on 203,946 dekatherms purchased was \$179,472. Also contributing to the lower gross profit was an increase in the cost of paper of 2% from an average of \$134.00 per ton in 2013 to \$137.00 per ton in 2014, based on 19,565 tons purchased. The effect on cost of sales was a decrease of \$59,000. Offsetting some of the decrease in gross profit was a reduction in maintenance expense for machinery and equipment, building and forklifts of \$171,000 and machine rental of \$75,000, partially offset by increases in waste disposal and depreciation of \$116,000.

Selling, general and administrative expenses increased \$5,383 from \$4,414,652 in 2013 to \$4,420,035 in 2014, and as a percentage of sales were 21.7% in 2014 as compared to 21.3% in 2013. The year-over-year increase in Selling general and administrative expenses is due in part to increases in customer claims expense, agents' commissions, professional fees and architectural presentations, as offset by decreases in advertising costs, employee benefits, the cost of the Company's retirement plans, insurance and debt related expense.

Interest expense on debt decreased to \$576,326 in 2014 from \$591,143 in 2013. The decrease is due primarily to the relatively lower level of borrowed funds resulting from repayments of the Term Loan and debt incurred in connection with the purchase of the Cogen System.

In 2014, 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 2014 was \$631,772 as compared to net income of \$770,809 in 2013.

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 de-

creased \$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.

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 2014 and 2013.

Working capital was \$(3.8) million at December 31, 2014, as compared to \$(3.7) million at December 31, 2013, a decline of \$0.1 million. The decrease was due primarily to increased accounts payable balances of \$0.8 million resulting largely from the purchase of capital equipment and repairs of building roof structures and equipment, offset in part by an increase of \$0.5 million in Prepaid expenses and other current assets, attributable to an insurance claim receivable and also to an increase in inventories of \$0.2 million.

Capital expenditures for new and improved facilities and equipment, which are financed primarily through internally generated funds and debt were \$0.5 million in 2014, \$2.2 million in 2013 and \$4.5 million in 2012. The Company has estimated capital expenditures for 2015 in the amount of \$1.0 million to implement switchgear equipment replacement and other improvement projects.

Cash flows used in financing activities were \$1.1 million in 2014 as compared to cash flows provided by financing activities of \$0.2 million in 2013. The decrease in long-term debt in 2014 is due primarily to the contractual obligation of repaying the Term Loan in monthly installments and repayments due under the Promissory Note payable to Caterpillar Financial Services Corporation.

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

Disclosures About Contractual Obligations and Commercial Commitments:

	Cash Payments Due by Period				
	Total	Within Year 1	2-3 Years	4-5 Years	After 5 Years
Short-term debt.....	\$ 1,950,356	\$ 1,950,356	\$ —	\$ —	\$ —
Long-term debt (includes current portion).....	5,246,706	930,470	2,032,418	2,283,818	—
Operating leases	203,812	65,077	85,801	52,934	—
	<u>\$ 7,400,874</u>	<u>\$ 2,945,903</u>	<u>\$ 2,118,219</u>	<u>\$ 2,336,752</u>	<u>—</u>

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 \$77,212 in 2014. Lease payments subsequent to December 31, 2014 are as follows: 2015, \$65,077; 2016, \$43,454; 2017, \$42,347; 2018, \$42,347 and 2019, \$10,587.

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 2014, 2013 and 2012 the Company satisfied the minimum EBITDA covenant as amended.

On December 14, 2012, the Company and the 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 on December 14, 2015 equal to the then-outstanding and unpaid principal and interest amount. As of December 31, 2014, the outstanding balance under the 2012 Term Loan, including current portion, was \$2,350,000. 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, 2014, \$1,950,356 was outstanding and \$549,644 was the unused credit under the 2012 Revolving Credit Facility. The unused credit was limited to \$221,090, based on eligible receivables and inventory as of December 31, 2014. Interest on each loan is payable monthly at the greatest of (a) the Lender's prime rate (3.25% at December 31, 2014) 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 May 21, 2015, the Company and the Lender (ACF Finco I LP and successor-in-interest to Keltic Financial Partners II, LP) entered into a Third Amendment to the 2010 Agreement to extend the term of the credit facilities for a period of three (3) years from December 14, 2015 to December 14, 2018 and to increase the amount of the outstanding principal balance of the term loan by \$1,000,000 to a total of \$3,166,667. The 2012 Term Loan, as extended, is payable in 42 equal installments of \$45,833.33 commencing on June 1, 2015 and one installment on December 14, 2018 equal to the then outstanding and unpaid principal and interest amount. All other provisions of the 2012 Agreement continue as stipulated.

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, 2014, the outstanding principal under the Agreement, including current portion, was \$2,896,706.

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 2014 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 2015. 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, 2014 and 2013, 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 operat-

ing 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, 2014. 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.

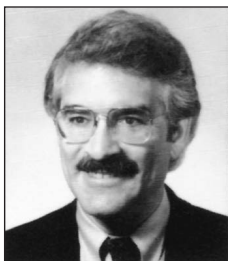
Summarized (unaudited) quarterly financial data of the Company for years 2014 and 2013 are as follows:

	(in thousands of dollars except per share data)								
	2014					2013			
	First	Second	Third	Fourth		First	Second	Third	Fourth
Net sales	\$ 4,831	\$ 5,641	\$ 4,726	\$ 5,212		\$ 5,048	\$ 5,552	\$ 4,881	\$ 5,233
Gross profit	\$ 1,225	\$ 1,613	\$ 1,225	\$ 1,551		\$ 1,170	\$ 1,702	\$ 1,344	\$ 1,537
Net (loss) earnings	\$ (75)	\$ 297	\$ (69)	\$ 479		\$ (184)	\$ 366	\$ 108	\$ 48
Net (loss) earnings per common share:									
Basic	\$ (0.21)	\$ 0.83	\$ (0.19)	\$ 1.35		\$ (0.52)	\$ 1.03	\$ 0.31	\$ 1.35
Diluted	\$ (0.21)	\$ 0.83	\$ (0.19)	\$ 1.34		\$ (0.52)	\$ 1.03	\$ 0.30	\$ 1.35

Valuation and Qualifying Accounts for years 2014, 2013 and 2012:

	Balance at Beginning of Year	Additions Charged to Profit and Loss	Accounts Written Off	Balance at End of Year
Year Ended December 31, 2014 Allowance for doubtful accounts	\$ 46,000	\$ —	\$ —	\$ 46,000
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

Board of Directors



Michael R. Flicker
Attorney at Law



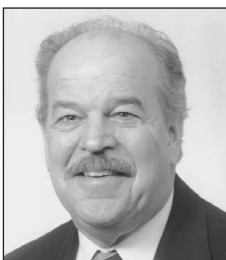
Warren L. Flicker
Chairman of the Board,
Chief Executive Officer



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

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Common Stock Traded

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Independent Auditors

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