Energy and Environmental Services, Inc.

2018 Annual Report

Disclosure Regarding Forward-Looking Statements and Cautionary Statements

This Annual Report contains forward-looking statements about our growth strategies, anticipated trends in our business and our future results of operations. In addition, the words "believe", "may", "could", "will", "when", "estimate", "continue", "anticipate", "intend", "expect" and similar expressions, as they relate to us, our business or our industry, are intended to identify forward-looking statements. These forward-looking statements are based largely on our expectations and are subject to a number of risks and uncertainties, many of which are beyond our control. Actual results could differ materially from these forward-looking statements as a result of, among other things:

- Our plans and objectives for future operations
- Existing cash flows being adequate to fund future operational needs
- Outcomes of future product development, the amount of research and development costs, and our success in commercialization plans and timing
- The competitive nature of our business and market conditions with respect to products and pricing
- Future plans related to budgets, capital requirements, market share growth, and anticipated capital projects and obligations
- Other assumptions described in this Annual Report underlying such forward-looking statements

Although we believe that the expectations included in these forward-looking statements are reasonable, these forward-looking statements are subject to certain events, risks, assumptions, and uncertainties, including those discussed below and in the "Risk Factors" section in our Annual Report. These statements involve known and unknown risks, uncertainties and other important factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements.

TABLE OF CONTENTS

BUSINESS AND PROPERTIES

Our Background

Energy and Environmental Services, Inc. ("*We*") manufacture specialized liquid and solid chemicals used primarily in the oil and gas industry and high-tech specialized protective coatings for oil and gas and other industrial applications. We also have products under development using enzyme technologies for animal feed supplements, organic fertilizers, and odor solutions. We are headquartered in Edmond, Oklahoma.

In November 2016, we undertook a share exchange in which Melvin B. Smith, the principal and sole shareholder of Energy & Environmental Services, Inc., an Oklahoma corporation ("*EES*"), exchanged his shares for 32 million shares of EnerLabs, Inc., a Colorado corporation ("*Enerlabs*"). As a result, Smith owned approximately 66.7% of the outstanding Enerlabs shares, the former Enerlabs shareholders owned the balance, and EES became a wholly-owned subsidiary of Enerlabs. Enerlabs was originally incorporated in British Columbia, Canada, in 1989, domesticated in Delaware in 2001, and domesticated in Colorado in 2015. After the share exchange transaction, Enerlabs changed its name to Energy and Environmental Services, Inc. EES was incorporated in 1991. The information presented in this Annual Report reflects the operations and activity of EES unless otherwise indicated.

We have entered into a letter of intent to acquire Patriot Chemicals & Services LLC ("*Patriot*"). Patriot markets chemicals used in oil and gas drilling and production, including chemicals manufactured by us. Patriot has two locations in Oklahoma and one in Kansas. It had 2018 revenues of approximately $4.6 million. The parties have not executed a definitive agreement. We offer no assurances if or when the acquisition may be completed.

Our stock is traded in the OTC Markets Pink Open Market under the symbol EESE. We qualify through the Alternative Reporting Standard by making filings, including unaudited annual and quarterly, GAAP-based financial statements, publicly available through the OTC Disclosure & News Service.

Our Business Segments

Oilfield Chemicals. We offer a full line of hydraulic fracking additives and acid additives to oilfield well service companies. We also offer a complete line of wholesale products and services to downhole production chemical companies. Our chemicals include acid inhibitors, scale inhibitors, corrosion inhibitors, packer fluid inhibitors, paraffin dispersant compounds; H_2S scavengers, biocides, water treating compounds, demulsifiers, emulsion breakers, non-emulsifiers, frac foamers, clay stabilizers, liquid KCL substitute, cross linkers, wetting agents/surfactants, friction reducers, anti-sludge agents, mutual solvents, silt suspenders, iron sequestrants, iron control, complete acid gel systems, xylene/acid emulsifiers, and HCl acid retarders. We produce and market these products under our Enduro-Tech® name. Our wholesale products and services include custom chemical blending, toll blending, and private labeling.

We also offer a proprietary solid chemical technology that allow us to provide most of our liquid chemical products in solid form. Solid chemicals offer the advantages of easier handling and extended protection due to a slow release and a higher rate of activity. Additionally, these solid chemicals are compatible with frac fluids and oppositely charged molecules found in downhole and other well site environments. Our solid chemical applications can be batch treated down-hole or added to frac stimulation processes. We sell our solid form chemicals under our Enduro-Tech® name and provide wholesale products and services including custom and toll blending, private labeling and pelletizing. In 2019, we shall include application services of our solid chemical in the frac stimulation processes.

We provide chemical testing and analysis in our laboratory. We have a fleet of five trucks, including two semi-tractor trailers, and five trailers, for on-location deliveries. While most of our chemicals are sold to oilfield users, we also sell and service water treatment and other industrial users.

Powdered Coatings. Under the Enduro-Bond® trademark, we offer a process that applies a protective, anti-corrosion coating to metal products. The powdered coating is baked on in high-temperature ovens and produces a smooth 1- to 2-millimeter protective coating to all areas of metal parts without compromising threads or connective tolerances. Applied to ductile iron or carbon steel, the coating will enable these metals to perform like stainless steel in corrosive environments. The coating is also stable in high heat and protects against impact and abrasion. Our services include electrostatic coating, valve servicing, testing, disassembly and reassembly, and grit blasting. In 2018 we added a 32-foot oven, which gives us the ability to coat 30-foot sections of pipe. We market four product lines – Enduro-Bond, Enduro-Bond PLUS, Enduro-Bond DuraShield, and Enduro-Bond ULTRA-Shield – to end users in oil and gas, industrial, pharmaceutical manufacturing, pipeline transmission, waste water (municipalities), refineries, and automotive fields. We have a two-truck fleet for pick up and deliveries.

Products in Development – Enzymes and Probiotics. We have several products in development that relate to our work with enzymes and probiotics.

- *Fertilizer Blending Facility*. In June 2018, we started building a facility to produce a natural organic liquid fertilizer for Natures Formula. Bio-Sure Grow is an all-natural organic humus and manure extract that is put through a proprietary process to suspend the micro nutrients, which becomes a natural quick response formulation of nitrogen, potassium and phosphorus. The product is OMRI-certified for organic farming. Our pilot tests generated solid production gains in a variety of crops, including cotton, alfalfa, corn and soybeans. The product pricing is competitive with non-organic fertilizers. We are market ready and anticipate sales beginning in the second quarter.

- *Probiotic Feed Supplements for Livestock.* We have developed a proprietary blend of probiotic microorganisms and other organic ingredients that are combined to produce a fermented feed grade product to supplement the animal diet. We call our feed supplement BioBlend™. Modern animal feeds are generally composed of plant material, such as cereals and vegetable proteins, which cannot be fully digested and utilized. The microorganisms produce beneficial enzymes that increase the digestibility of these feeds, which improves feed-to-gain ratios for cattle, pigs, horses and other ruminant and monogastric animals. The probiotics can also enhance the biome in the animal's gut, which improves animal health. In our early tests, cattle have reached target weights in a significantly shorter amount of time, and with fewer health issues in comparison to control groups using currently accepted feeding regimens. Our supplement has also improved meat grade in cattle and milk quality in dairy cows. We recently completed a trial with a land grant university, which studied the effectiveness of adding BioBlend™

to livestock feeding programs. The published study indicated a significant weight gain for animals receiving our probiotic feed supplement.

- *Odor Elimination*. We are developing a line of odor elimination products for home and industrial use. These "ecologically" compatible products eliminate odors by breaking the chemical bond at a molecular level that forms to create the malodors. The malodors are eliminated, not just masked or deodorized. The products are a non-toxic and biodegradable liquid that combines microorganisms and a formulation of natural plant extracts. Expected home uses include the removal of pet odors, urine and bacteria smells in carpet, and foul garbage bins. Industrial applications could include sewage facilities, feed lots, locker rooms and other environment where foul odors might exist. We are currently testing the product in livestock lagoons, livestock confinements, and other similar environments.

- *Farrowing Product*. We have developed a neonatal farrowing aid, which is a unique blend of natural minerals and healing salts. It interacts with the amniotic fluid and the skin of the neonatal piglets to ease the birth cycle, facilitate umbilical cord drying and healing, provide traction on the birthing mat, and speed the time from birth to suckling. When applied to the underside of the gilt or sow, it will assist in a more rapid and even colostrum/milk distribution. In birthing piglets, excess moisture in consort with pathogens and mold poses significant health risks, while ammonia, sulfide and putrefaction are some of the leading causes of respiratory and scours problems. The product absorbs moisture, reduces the risk of pathogenic bacteria, provides a blanket of exothermic natural warming, and captures a variety of malic odors targeting ammonia/sulfur in pens and holding areas. Our initial tests indicate that the product performs much better than comparable farrowing products. All ingredients are GRAS listed under 21 CFR Part 82. To develop demand, we have distributed the product to pork producing operations, participants in show-pig arenas, and a land-grant university.

- *Hydrogen Sulfide Removal*. Hydrogen sulfide (H_2S) is a life-threatening, corrosive and flammable gas that may be encountered in the drilling for and production of oil and gas. The detection and monitoring of H_2S is essential for oil and gas operators. The gas's corrosive properties can require costly special production equipment, such as stainless steel tubing. We are working on an organic treatment system for the removal of H_2S in oil and gas production. Under our system, the H_2S bond is cleaved enzymatically allowing the operator to utilize a treatment system that is less expensive and non-toxic as compared to current industry removal methods. Our laboratory tests have shown that this compound can break-up and render the potentially fatal H_2S gas harmless. Independent field trials have been inconclusive, and we are undecided about whether to continue product development.

Business Segments by Revenue. The following table shows the revenues attributable to each business segment:

	Year Ended Dec. 31,			
	2017		**2018**	
Oilfield Chemicals				
• Enduro-Tech® liquid	$ 1,090,826	28.7%	$ 3,526,567	49.0%
• Enduro-Tech® solid	1,933,110	50.8%	3,099,487	43.0%
Enduro-Bond® Coatings	501,143	13.2%	570,125	7.9%
Other	278,721	7.3%	5,121	0.1%
Total Sales	$ 3,803,800	100.0%	$ 7,201,300	100.0%

Possible Merger with Patriot. In December 2018, we entered into a letter of intent with Patriot Chemicals & Services LLC ("*Patriot*"), in which we would acquire Patriot in its merger with a wholly-owned subsidiary. The merger consideration would consist of a combination of $300,000 in cash, $300,000 in three-year notes, and 2.0 million shares of our common stock. The consideration also includes earnouts in each of year one and year two of 1.0 million additional shares of common stock. The earnouts would be achieved if Patriot realizes earnings before interest, taxes, depreciation and amortization of $620,000 in year one and $930,000 in year two. The merger consideration is subject to adjustments for changes in working capital and assumes, among other things, that Patriot's non-current liabilities will be capped at a specified level (but including current liabilities incurred in the ordinary course of business).

We believe the merger will expand our sales to the oil and gas industry and increase revenues. On a pro forma basis assuming the consummation of the merger with Patriot, we anticipate that our annual consolidated revenues will increase by approximately $3.6 million after intercompany eliminations.

Patriot markets chemicals used in oil and gas drilling and production. It has facilities in Southern Oklahoma, Northeastern Oklahoma, and Southeast Kansas. Patriot covers the states of Kansas and Oklahoma and parts of Texas. We produce some of the chemicals sold by Patriot.

The above description of terms is based on our understandings of the letter of intent. The parties have not executed a definitive agreement and the merger terms – including the amount of merger consideration – may change depending on the results of negotiations. There is no assurance that we will consummate the merger or other acquisition of Patriot.

Our Business Strategy

We anticipate continued growth in our core business; Enduro-Tech liquid and solid chemicals and Enduro-Bond protective coatings. These core products are our foundation. They are field tested and proven successful. We will attempt to increase market share through potential mergers and acquisitions as well as organic growth in our core product lines. We have made capital investments at our Snyder, Texas facility. This investment will give us a liquid and solid chemical manufacturing plant to service the Permian basin more efficiently. We believe we will see a significant reduction in freight cost, increase in market share, and shorter lead times for our customers. We have also made capital investments in work trucks, gooseneck trailers and solid chemical pumps for application of chemical treatments at the wellsite. We anticipate growth in Enduro-Bond protective coating product sales through potential mergers and acquisitions, organic growth through our authorized manufacturer representatives, our operational 32-foot oven which gives us the ability to coat 30-foot pipe, and from the continued growth of Vortex coated pump barrel joint venture. We made additional capital investments in our farm and ranch segment. We built a fertilizer plant on our property in Edmond, Oklahoma, which is currently producing OMRI-certified liquid fertilizer. We have the capacity to produce 20,000 gallons per month. We expect several products to reach market later this year through our toll manufacturing and marketing agreement with Natures Formula LLC.

We strive to make innovative products that meet our customers' needs. We also believe that diversity in our product lines is important. Our belief in diversity is shown by microbial lines of products under development. In all these efforts, we adhere to certain core values: customer service to build loyalty, respect for our employees, integrity in our working relationships, accountability to our customers, shareholders, employees and community.

Our Facilities

We conduct our operations in six facilities in Oklahoma and Texas. Our offices are located in a 16,000-square foot building at 6300 Boucher Drive, Edmond, Oklahoma, which is also where our primary research and development occurs. Our oilfield chemical plant is housed in a 27,500-square foot building located at 6701 Boucher Drive, Edmond, Oklahoma. Our Enduro-Bond® coating operations are mostly done in a 30,000-square foot facility located at 1728 Frisco Avenue in Chickasha, Oklahoma. We own these buildings as well as an 80,000-square foot chemical warehouse in Snyder, Texas, and a 2-acre lot on Boucher Drive, Edmond, Oklahoma.

In 2018, we closed the Troup, Texas facility, and moved these operations to a leased 10,000 square foot building at 6388 Boucher Drive, Edmond, Oklahoma, where we cultivate the enzymes and probiotics used on our microbial product lines. We also lease a 1,000-square foot warehouse at 7210 N. Santa Fe Avenue in Oklahoma City, where we manufacture Enduro-Bond® protective coatings products.

Our offices were formerly in a two-story office building located at 6300 Northwest Expressway, Oklahoma City, Oklahoma, which we sold in December 2017.

Marketing

We market our Enduro-Tech® chemical products on a pre-packaged basis to end users and also offer custom chemical blending, toll manufacturing and private label packaging. The bulk of our chemical sales is handled through an internal sales staff of five employees, who are located in Oklahoma and Texas. Our Enduro-Bond® protective coating product line is distributed through authorized manufacturer representatives with over 45 agents in 23 states: the Northeast region (Illinois, Indiana, Kentucky, West Virginia, Michigan, Ohio and Pennsylvania), the Southeast region (Mississippi, Louisiana and Arkansas), the South region (Oklahoma and Texas), the Southwest region (West Texas/Permian Basin and New Mexico), the Midwest region (Kansas, Colorado and Utah), and the Western region (Arizona, California, Nevada and Idaho).

In 2018, we entered into a toll manufacturing agreement with Natures Formula, under which we will produce products under the Natures Formula label. Our Bio-Sure Grow, the natural organic liquid fertilizer, is the first product to be produced and sold under this agreement. We believe we can duplicate existing products in Natures Formula's product line and add new products utilizing our facility and our enzyme and microbe capabilities. Natures Formula is a Texas-based producer and marketer of organic fertilizer and probiotic and health aids for horses and other livestock.

Research and Development

Our expertise for many years has been in the development of effective and innovative products. Our research and development apply to existing product lines and products under development. The odor removal products are ready to market, but we must determine the packaging, labeling, tradenames and manner of distribution, especially for retail sales. We expect to produce the probiotic livestock feed supplement for Natures Treat. We had research and development expenses of $178,829 in 2017 and expenses of $161,961 in 2018.

Major Customers

In 2018, we had four customers that accounted for 59% of our total net sales. In 2017, we had four customers that accounted for 50% of our total net sales.

Trademarks and Patents

We have obtained trademark registrations for Enduro-Tech®, Enduro-Bond® and Bio-Blend®. We also have trademark registrations for Molecule Design, TherMel-Kem, TMB-2, Terra Secure, and Odor Knot. Our customers' recognition and association of our brands and trademarks with quality are important elements of our operating strategy.

Environmental, Health and Safety Matters

Our operations are subject to extensive federal, state and local laws and regulations relating to the protection of the environment and human health and to safety, including those pertaining to chemical manufacture and distribution, waste generation, storage and disposal, the health of our employees and the safety of our facilities. Applicable environmental laws include the Federal Clean Air Act, the Water Pollution Control Act (also known as the Clean Water Act, the Resource Conservation and Recovery Act, the Comprehensive Environmental Response, Compensation and Liability Act, and the Toxic Substances Control Act. We are subject to the Occupational Safety and Health Act ("*OSHA*"), and comparable state statutes, the purpose of which are to protect the health and safety of workers. We also are subject to OSHA Process Safety Management regulations, which are designed to prevent or minimize the consequences of catastrophic releases of toxic, reactive, flammable or explosive chemicals. We also are subject to EPA Chemical Accident Prevention Provisions, known as the Risk Management Plan requirements, which are designed to prevent the accidental release of toxic, reactive, flammable or explosive materials.

Our Bio-Blend™ animal feed supplement is subject to regulation by the Federal Food and Drug Administration ("*FDA*"), which is the primary Federal regulatory agency responsible for ensuring the safety of animal feed. The FDA manages this responsibility under its Animal Feed Safety System, which cover all stages of feed production and use. Typical feed ingredients, such as forages, grains, most minerals and vitamins, and the probiotic microorganisms and other organic ingredients that we make, are generally recognized as safe as sources of nutrients and do not require premarket approval.

Governmental authorities have the power to enforce compliance with their regulations, and violators may be subject to civil, criminal and administrative penalties, injunctions or both. Our facilities are inspected periodically, and we may be subject to further regulatory inspections, future requests for investigation or assertions of liability relating to OSHA and other regulatory compliance. We devote significant financial resources to ensure compliance with safety and environmental laws. See "*Risk Factors*".

Competition

Our bulk Enduro-Tech® oilfield chemical products face strong competition from other suppliers, many of whom have substantially greater financial and other resources than we do. To the extent we are engaged in private labelling or toll manufacturing, our operations will experience indirect competition from the competitors of our customers, since we rely on our customers to market and sell finished goods that incorporate our components or products. Our Enduro-Bond® protective coating products materials compete in a more limited market, but still face substantial competition including competition from the manufacturers of stainless steel products, the use of which are prevalent in corrosive environments. Transportation costs especially impact our Enduro-Bond® lines, since we are often coating metal items that are large and heavy and expensive to transport. Based on our experience developing products for a variety of customers, we believe that potential customers will continue to be product-specific in nature, with the decision for each product being driven primarily by the performance needs of the application and, secondarily, by cost considerations.

Legal Proceedings

We are not party to any material legal or administrative proceedings.

Employees

As of March 27, 2019, we employed 22 people on a full-time basis and no people on a part-time basis. We also use temporary workers on an "as needed" basis. None of our employees are covered under collective bargaining contracts, and we believe our employee relationships are good.

RISK FACTORS

Risks Relating Generally to Our Operations and Industry

The industries in which we operate are competitive. This competition may affect our market share or prevent us from raising prices as our costs increase, making it difficult for us to maintain existing business and win new business.

We operate in competitive markets. Many of our competitors have substantially greater financial and technical resources than we do. Additionally, new competitors may enter our markets. We may be required to reduce prices if our competitors reduce prices, or due to any other downward pressure on prices for our products and services, which could have an adverse effect on us. With the volatility in the oil and gas industry, our customers have requested price decreases and maintaining or raising prices has been difficult over the past several years and may continue in the near future. Competition in our Enduro-Tech® and Enduro-Bond® lines is based on several factors, including price, freight economics, product quality and technical support. If we are unable to compete successfully, our financial condition and results of operations could be adversely affected.

The industries that we compete in are subject to economic downturns.

While we market our products in other industries, the bulk of our sales is in the oil and gas industry. An economic downturn in the oil and gas industry could have a material adverse impact on sales of our Enduro-Tech® and Enduro-Bond® products, which account for 92% of our revenues.

A significant portion of our revenue and operating income are concentrated in a relatively small number of customers.

We derive a significant portion of our revenues and operating income from sales of products to a relatively small number of customers. As a result, the loss of one or more of these customers, or a material reduction of demand from any of those customers, could adversely affect our revenues and operating income.

We are dependent on a limited number of suppliers for certain key materials, the loss of any one of which could have a material adverse effect on our financial condition and results of operations.

We depend on a limited number of suppliers for certain key materials needed for our Enduro-Bond® protective coatings products. Those suppliers are subject to a variety of operational and commercial constraints that can adversely impact our supply. If we were to lose suppliers for key materials, we might have difficulty securing a replacement supplier at reasonable cost, and no assurance can be given that such loss would not have a material adverse effect on our financial condition and results of operations.

Increases in the price of our primary raw materials may decrease our profitability and adversely affect our liquidity, cash flow, financial condition and results of operations.

The prices we pay for raw materials in our businesses may increase significantly, and we may not always be able to pass those increases through to our customers fully and timely. In the future, we may be unable to pass on increases in our raw material costs, and raw material price increases may erode the profitability of our products by reducing our gross profit. Price increases for raw materials may also increase our working capital needs, which could adversely affect our liquidity and cash flow. For these reasons, we cannot assure you that raw material cost increases in our businesses would not have a material adverse effect on our financial condition and results of operations.

We are subject to extensive health and safety and environmental laws and regulations and may incur costs that have a material adverse effect on our financial condition because of violations of or liabilities under such regulations.

Like other companies involved in chemical manufacturing, our operations and properties are subject to extensive and stringent Federal, state and local health and safety and environmental regulations, including those concerning, among other things:

- The safety of our machinery and workplaces
- Employee training and compliance programs
- The marketing, sale, use and registration of our chemical products
- The treatment, storage and disposal of waste by-products
- The emission of substances into the air
- Other matters relating to environmental protection and various health and safety matters

The OSHA, EPA and other Federal and state agencies may promulgate regulations that could have a material adverse impact on our operations. These health and safety and environmental regulations may require permits for certain types of operations, require the installation of expensive equipment, place restrictions upon operations or impose substantial liability for operating activities. We expend substantial funds to comply with governmental regulations. We have incurred, and expect to continue to incur, significant costs to comply with environmental and health and safety laws or to address liabilities for our facilities. Federal and state governmental authorities may seek fines and penalties, as well as injunctive relief, for violation of the various laws and governmental regulations, and could, among other things, impose liability on us for a failure to comply.

Our use of hazardous materials exposes us to potential liabilities.

Our manufacturing and distribution of chemical products involves the controlled use of hazardous materials. Our operations, therefore, are subject to various associated risks, including chemical spills, discharges or releases of toxic or hazardous substances or gases, fires, mechanical failure, storage facility leaks and similar events. Our suppliers are subject to similar risks that may adversely impact the availability of raw materials. While we adapt our manufacturing and distribution processes to the environmental control standards of regulatory authorities, we cannot completely eliminate the risk of accidental contamination or injury from hazardous or regulated materials, including injury of our employees, individuals who handle our products or goods treated with our products, or others who claim to have been exposed to our products, nor can we completely eliminate the unanticipated interruption or suspension of operations at our facilities due to such events. We may be held liable for significant damages or fines in the event of contamination or injury, and such assessed damages or fines could have a material adverse effect on our financial performance and results of operations.

Risks Specific to Us

We have incurred significant losses in the past. If we incur significant losses in the future, we will experience negative cash flow which may hamper current operations and prevent us from sustaining or expanding our business.

We have been in existence for over 25 years and have relied, historically, upon cash from operations to fund all the cash requirements of our business. In 2017, we had revenues of $3,803,800 and an operating loss of $1,466,400. In 2018, our revenues improved to $7,201,300, which generated net operating income of $39,300. Our cash and cash equivalents at December 31, 2017 and 2018, were $3,651,400 and $2,332,000, respectively. Our cash position decreased $1,319,400 in 2018. Our current cash and cash equivalents, accounts receivable and inventory continue to provide some cushion to absorb future losses and cash demands. Still, we cannot maintain these trends indefinitely and need stronger revenues and better product margins to strengthen profitability. If we do not sustain or increase profitability, our business will be adversely affected and our stock price will decline.

We are pursuing new product lines and services, which will take time and money to determine their value. Whether these new products will return our investment is uncertain.

We are pursuing new product lines with enzyme and probiotics work. Our products for odor elimination, livestock feed, and H_2S removal are all in the development stage. There is no guarantee that these new product lines will be successful in the marketplace. We use our best efforts to research and forecast future profitability of any new product line, however, any new endeavor has underlying risks that known and unknown. The success of any new product is also dependent on product performance, customer demand, market stability, existing barriers to entry, and other factors of product introduction.

The market for our shares is limited and inefficient. Our shareholders face the risks of illiquidity and price volatility.

Our shares trade in the OTC Markets Pink Open Market, which is an electronic dealer network for companies adhering to its alternative reporting standard. Under this standard, we are not required to provide audited financial statements and the level of disclosure is less than that required of a company registered under the Securities Exchange Act of 1934, as amended (the "*Exchange Act*"), or whose shares trade on exchanges, such as the New York Stock Exchange or NASDAQ. Due to its lower reporting standards, this market is more speculative and lacks the volumes and efficiencies of the exchanges. In addition, we are subject to the penny stock rules of the Securities and Exchange Commission ("*SEC*"), which place further limitations on the trading of our shares. The trading volume in our shares is limited, and we do not anticipate an active trading market for our shares until and unless we become a reporting company under the Exchange Act. You may be unable to sell your shares when you wish to sell them or at a price that you consider attractive or satisfactory. The lack of an active market may also adversely affect our ability to raise capital by selling securities, or impair our ability to make acquisitions using our shares as consideration.

Dependence on Key Personnel

Our success is dependent on the services of key members of our senior management. The loss of one or more of these individuals could have a material adverse effect on our operations and business prospects. Furthermore, we must continue to hire highly qualified individuals, including financial, sales and operations personnel. There can be no assurance that we will be able to attract and retain qualified personnel.

MARKET FOR OUR COMMON STOCK, RELATED SHAREHOLDER MATTERS AND OUR PURCHASES OF EQUITY SECURITIES

Market Information. Our common stock is quoted on the OTC Markets Pink Open Market under the symbol "EESE".

The following table sets forth the high and low bid quotations per share of our common stock as reported on by OTC Markets for the periods indicated. The high and low bid quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions. The closing price at March 27, 2019, was $0.25 per share with daily volume averaging 8,380 shares over the prior 30 days.

Fiscal Year 2018		**High**		**Low**
First Quarter	$	0.59	$	0.31
Second Quarter	$	0.48	$	0.22
Third Quarter	$	0.37	$	0.20
Fourth Quarter	$	0.35	$	0.16

Fiscal Year 2017		**High**		**Low**
First Quarter	$	1.50	$	0.60
Second Quarter	$	1.35	$	0.40
Third Quarter	$	1.00	$	0.40
Fourth Quarter	$	0.70	$	0.39

Holders. As of March 27, 2019, there were approximately 196 shareholders of record of our common shares.

Dividend Policy. We have not paid any dividends on our common shares and do not anticipate that dividends will be paid at any time in the immediate future.

Recent Sales of Unregistered Securities. The following is a list of our shares of common stock issued by us for cash or as stock compensation to consultants during the period from January 1, 2016 through December 31, 2018, which were not registered under the Securities Act:

Name of Purchaser	**Issue Date**	**Shares**	**Consideration**
George Shaw	10/21/16	3,803,955	$649,906(1)
Scott Shaw	10/21/16	71,218	$12,168(1)
Vicki Webb	10/21/16	255,287	$43,616(1)
At Gas Gathering Systems, Inc.	10/21/16	1,300	debt assumption(2)
Energas Corp.	10/21/16	1,000	debt assumption(2)
Melvin Smith Rev. Trust	11/03/16	32,000,000	share exchange(3)

(1) These shares were issued in settlement of debt owed to the purchaser.

(2) These purchasers received shares in exchange for assuming debt owed by us.

(3) These shares were issued in exchange for the Trust's shares of Energy & Environmental Services, Inc. See "*Business and Properties – Our Background*".

Our Purchases of Common Stock. In December 2017, we offered a stock buyback program to our employees excluding the executive officers. The program provided our employees with liquidity that was otherwise unavailable in the market. Under the program, employees could elect to sell up to 10,000 shares at $.50 per share. The program ended at year end. We purchased a total 220,000 shares for $110,000 ($.50 per share). As of December 31, 2018, our employees (excluding executive officers) held approximately 5,655,000 shares.

Securities Authorized for Issuance under Equity Compensation Plans. In December 2018, we granted 625,000 shares of restricted stock to employees and outside directors under out Equity Incentive Plan. Other information concerning our equity compensation plans is incorporated by reference from information contained under the section "Equity Compensation Plans" in our Proxy Statement for the 2019 Annual Meeting of Shareholders.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion is intended to assist in understanding our financial condition and results of operations. Our Financial Statements and Notes thereto contain detailed information that should be referred to in conjunction with the following discussion. See "*Financial Statements*".

Summary of Significant Accounting Policies

Our financial statements reflect the selection and application of accounting policies that require us to make significant estimates and assumptions. The Footnote 1 to our Financial Statements describe some of the more critical judgment areas in the application of accounting policies that currently affect our financial condition and results of operations.

Results of Operations

Our sales revenues continued to climb in 2018 to $7,201,300 from $3,803,800 in 2017, which is an increase of $3,397,500 or 89%. Our oilfield chemical lines represent 92% of our sales revenue. Although oil prices stalled in parts of 2018, as the industry anticipated excess supply, our chemical sales to the industry increased. We attribute the increase to our marketing efforts in the frac and stimulation products as well as production chemical lines. A more aggressive approach in pricing lead to increase in market share in the Permian basin and the Stack play in northern Oklahoma. The pricing strategy lowered our margins, which was reflected in higher proportionate cost of sales, which were 52% of sales ($3,776,800) in 2018 versus 26% of sales ($971,900) in 2017.

We realized net income from operations of $39,300 in 2018 versus net loss from operations of $(1,466,400) for 2017. Net income 2018 was $127,700 versus a net loss of $(2,434,800) for 2017. The net income in 2018 was attributed to increase in gross profit while decreasing overall expenses. The net loss in 2017 was increased generally by a write-down of obsolete inventory of $(743,000) and a loss on the sale of our office building of $(241,200). The net income per share was $0.00 in 2018 compared to $(0.05) in 2017.

Our general and administrative expense decreased from $3,956,800 in 2017 to $3,110,000 in 2018. We anticipate that general and administrative expense may increase slightly as revenues increase. In light of cost-cutting measures, we do not expect that general and administrative expense will increase proportionately with growth in revenue.

Liquidity and Capital Resources

Our primary source of capital historically has been cash flow from operations. We have had limited borrowings in recent years and have not sold shares to generate capital. Our balance sheet remains strong, despite the losses incurred in last couple of years. At December 31, 2018, we had working capital of $4,988,100 versus $5,467,900 for 2017. Cash used in operating activities during 2018 was $813,200 versus $105,300 used in 2017. The negative cash flow was primarily due to large increases in our accounts receivable ($1,069,900) and an increase in inventory ($484,500). The receivables include a $597,002 note receivable, which we took in payment of account from a customer in 2018. We invested $417,900 in 2018, most of which paid for the relocation of our enzymes and probiotics cultivation facility to Edmond, Oklahoma, the addition of solid chemical manufacturing equipment, improvements to our Snyder Texas location, and the purchase and installation of a 32-foot oven and pipe coating equipment in our coating facility, which significantly increases our production capacity.

Our 2017 cash was aided by $1,260,500 realized from the sale of our office building. We had a net decrease in cash of $1,319,400 in 2018, compared to a net increase of $971,700 in 2017.

We have one note payable of $167,300 at December 31, 2018, which is the purchase mortgage on a Chickasha property. If we were to need additional funds, alternative capital resources are readily available to us, including bank borrowings.

Outlook

We just completed our most successful year since 2014. We have a strong balance sheet with $2,332,000 of cash and cash equivalents and working capital of $4,988,100 at December 31, 2018. Our revenues increased nearly 90% from 2017 to 2018, all of which resulted from internal growth. We expect that future revenue growth will come less from internal growth and more from strategic acquisitions. These acquisitions can increase market share, lower costs and better utilize our capacities. We have reduced general and administrative expense, but must work on improving margins. We anticipate more production in our powdered coatings and farm and ranch segments in 2019. Our board of directors will continue to guide us to take the necessary actions to enhance performance, increase value for our shareholders, and position us for long-term success.

MANAGEMENT AND OWNERSHIP OF THE COMPANY

The information relating to Directors and Executive Officers; Corporate Governance, Executive Compensation, Stock Ownership of Management and Certain Shareholders, and Related Transactions is presented in our proxy statement, which is being mailed to shareholders on or about April 17, 2019, and is available on our website at https://eesokc.com/investors/.

Leslie G. Pettitt, P.C.

Certified Public Accountant

4603 N College Ave

Bethany, Oklahoma 73008

(405) 833-7458 Fax (888) 748-6813

email: lgpettitt@hotmail.com

March 25, 2019

Accountants' Compilation Report

ENERGY AND ENVIRONMENTAL SERVICES, INC.

Board of Directors:

Management is responsible for the accompanying financial statements of Energy and Environmental, Inc., which comprise the consolidated balance sheets as of December 31, 2018 and 2017 and the related consolidated statements of income for the years ended December 31, 2018 and 2017 and the consolidated statements of changes in cash flows for the years ended December 31, 2018 and 2017, in accordance with principles generally accepted in the United States of America. We have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. We did not audit or review the financial statements nor were we required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, we do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

Leslie G. Pettitt, PC

ENERGY AND ENVIRONMENTAL SERVICES, INC.

CONSOLIDATED BALANCE SHEETS

	December 31, 2018	December 31, 2017
ASSETS		
Current assets		
Cash and cash equivalents	$ 2,332,000	$ 3,651,400
Accounts receivable - trade	1,061,100	588,400
Accounts receivable - other	-	27,400
Current portion of notes receivable	143,300	-
Inventory	1,629,600	1,145,100
Deferred tax assets	341,600	558,500
Prepaid expenses	125,800	27,300
Total current assets	5,633,400	5,998,100
Property, plant and equipment (net of accumulated depreciation of $1,623,300 and $1,339,600 at December 31, 2018 and 2017, respectively)	3,204,600	3,085,300
Notes receivable	453,900	-
Equity investments	27,300	3,200
Goodwill	130,000	130,000
Total assets	$ 9,449,200	$ 9,216,600
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 240,700	$ 287,600
Other current liabilities	130,600	35,100
Stock repurchase payable	-	25,000
Deferred tax liabilities	79,500	117,800
Current portion of long-term debt	43,600	62,700
Other taxes	78,700	2,000
Total current liabilities	573,100	530,200
Long-Term Notes - less current portion	123,700	167,900
Stockholders' Equity		
Preferred stock, $0.00001 par value, 20,000,000 shares authorized, no shares issued and outstanding December 31, 2018 and 2017, respectively	-	-
Common stock, $0.00001 par value, 100,000,000 shares authorized 48,352,644 and 47,727,644 shares issued and outstanding at December 31, 2018 and 2017, respectively	500	500
Additional paid in capital	596,700	490,500
Retained earnings	8,155,200	8,027,500
Total Stockholder's Equity	8,752,400	8,518,500
Total Liabilities and Stockholders' Equity	$ 9,449,200	$ 9,216,600

See Accountants' Compilation Report

ENERGY AND ENVIRONMENTAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Sales revenues	$ 7,201,300	$ 3,803,800
Cost of goods sold	3,776,800	971,900
Gross profit	3,424,500	2,831,900
Operating expenses		
Selling general and administrative expenses	3,110,000	3,956,800
Depreciation and amortization	275,200	341,500
Total operating expenses	3,385,200	4,298,300
Income (loss) from operations	39,300	(1,466,400)
Other income (expense)		
Other revenues	81,500	80,200
Impairment of assets	-	(743,000)
Loss on sale of assets	-	(241,200)
Interest and finance costs	(10,000)	(15,400)
Income (loss) from operations before income tax	110,800	(2,385,800)
Benefit (provision) for income tax		
Current income tax benefit	-	436,600
Deferred income tax benefit (provision)	16,900	(485,600)
	16,900	(49,000)
Net income (loss)	$ 127,700	$ (2,434,800)
Earnings (loss) per share	$ -	$ (0.05)
Weighted average shares outstanding	47,736,206	47,941,014

See Accountants' Compilation Report

ENERGY AND ENVIRONMENTAL SERVICES, INC.
CONSOLIDATED STATEMENTS CHANGES IN STOCKHOLDERS' EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2018 AND 2017

	Common Stock		Preferred Stock		Additional Paid-In	Retained	Total Stockholders'
	Shares	Amount	Shares	Amount	Capital	Earnings	Equity
Balance, December 31, 2016	47,947,644	$ 500	-	$ -	$ 485,000	$ 10,462,300	$ 10,947,800
Contribution of net assets	-	-	-	-	115,500	-	115,500
Buy back of stock	(220,000)	-	-	-	(110,000)	-	(110,000)
Net (loss)	-	-	-	-	-	(2,434,800)	(2,434,800)
Balance, December 31, 2017	47,727,644	500	-	-	490,500	8,027,500	8,518,500
Stock based compensation	625,000	-	-	-	$ 106,200	-	106,200
Net income	-	-	-	-	-	127,700	127,700
Balance, December 31, 2018	48,352,644	$ 500	-	$ -	$ 596,700	$ 8,155,200	$ 8,752,400

See Accountants' Compilation Report

ENERGY AND ENVIRONMENTAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Cash flows from operating activities		
Net income (loss)	$ 127,700	$ (2,434,800)
Adjustments to reconcile net (loss) to net cash provided by operating activities		
Depreciation and amortization	275,200	341,500
Write off of bad debts	-	127,600
Inventory impairment	-	723,100
Goodwill impairment	-	19,900
Loss on sale of assets	-	241,200
Stock based compensation	34,000	
Earnings from equity method investment	(9,100)	(1,200)
Net changes in current assets and liabilites		
Accounts Receivable	(1,069,900)	(335,500)
Accounts receivable - other	27,400	3,500
Inventory	(484,500)	(147,500)
Deferred tax assets	178,600	1,203,900
Prepaid expenses	(26,300)	(27,300)
Accounts payable	(46,900)	286,100
Other current liabilities	103,900	(9,300)
Other taxes	76,700	1,200
Deferred taxes	-	(97,700)
Net cash used in operations	(813,200)	(105,300)
Cash flows from investing activities		
Sale of property, plant and equipment	-	1,382,800
Purchases of property, plant and equipment	(402,900)	(120,300)
Investment in equity method investment	(15,000)	(2,000)
Net cash (used in) provided by investing activities	(417,900)	1,260,500
Cash flows from financing activities		
Payments on notes payable	(63,300)	(98,500)
Buy back of stock	(25,000)	(85,000)
Net cash used in financing activities	(88,300)	(183,500)
Net (decrease) increase in cash	(1,319,400)	971,700

See Accountants' Compilation Report

ENERGY AND ENVIRONMENTAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017
(Continued)

	2018	2017
Cash and cash equivalents, beginning of period	3,651,400	2,679,700
Cash and cash equivalents, end of period	$ 2,332,000	$ 3,651,400
Supplemental disclosures of cash flow informations:		
Cash paid during the year for:		
Interst	$ 10,000	$ 15,400
Taxes	$ -	$ -

See Accountants' Compilation Report

ENERGY & ENVIRONMENTAL SERVICES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

1. NATURE OF OPERATIONS

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

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

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

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

2. SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

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

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

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

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

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

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

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

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

Stock-based compensation - The Company accounts for stock-based compensation under the provisions of the Financial Accounting Standards Board (the "FASB") Accounting Standards Codification ("ASC") — 718 Compensation — Stock Compensation. The guidance under ASC 718 requires companies to estimate the fair value of the stock-based compensation awards on the date of grant for employees and directors and record expense over the related service periods, which are generally the vesting period of the equity awards. Awards for consultants are accounted for under ASC 505-50 — Equity Based Payments to Non-Employees. Compensation expense is recognized over the period during which services are rendered by such consultants and non-employees until completed. At the end of each financial reporting period prior to completion of the service, the fair value of these awards is remeasured using the then-current fair value of the Company's common stock and updated assumption inputs in the Black-Scholes-Merton option-pricing model ("BSM").

The Company estimates the fair value of stock-based option awards to its employees and directors using the BSM. The BSM requires the input of subjective assumptions, including the expected stock price volatility, the calculation of expected term, forfeitures and the fair value of the underlying common stock on the date of grant, among other inputs. The risk-free interest rate was determined from the implied yields for zero-coupon U.S. government issues with a remaining term approximating the expected life of the options or warrants. Dividends on common stock are assumed to be zero for the BSM valuation of the stock options. The expected term of stock options granted is based on vesting periods and the contractual life of the options. Expected volatilities are based on comparable companies' historical volatility, which management believes represents the most accurate basis for estimating expected future volatility under the current conditions. The Company accounts for forfeitures as they occur.

The value of the shares of the Company's common stock underlying its stock-based awards is determined by using the closing stock price on the date of grant for the fair value of the common stock.

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

Trade receivables consist of uncollateralized customer obligations due under normal trade terms. Management believes all trade receivables to be fully collectible at December 31, 2018 and 2017.

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

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

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

For the years ended December 31, 2018 and 2017, there was no pension cost charged to the statements of income under the plans.

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

New Accounting Pronouncements

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

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

In June 2018, the FASB issued ASU 2018-07, Compensation — Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting, which simplifies the accounting for nonemployee share-based payment transactions. The amendments specify that Topic 718 applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in a grantor's own operations by issuing share-based payment awards. ASU 2018-07 will be effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years with early adoption permitted (but no sooner than the adoption of Topic 606). The adoption of ASU 2018-07 is not expected to have a material impact on the Company's consolidated financial statements.

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

3. RELATED PARTY TRANSACTIONS

In 2018 and 2017, the Company paid $19,100 and $11,600 as sales commissions to a distributor partially owned and controlled by a director of the Company. During the same period, the distributor purchased $76,900 and $29,000 of coatings products from the Company for resale. The sales commissions and resale discounts were comparable to commissions paid and discounts afforded to third party distributors.

4. INVENTORIES

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

As of December 31, 2018 and 2017, inventories consisted of the following:

	December 31, 2018	December 31, 2017
At cost:		
Raw materials	$ 1,463,400	$ 766,500
Blends	33,800	37,100
Finished goods	132,400	341,500
	$ 1,629,600	$ 1,145,100

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

5. PROPERTY, PLANT AND EQUIPMENT

As of December 31, 2018 and 2017, property, plant and equipment, stated at cost less accumulated depreciation, consisted of the following:

	December 31, 2018	December 31, 2017
Buildings	$ 1,930,000	$ 1,930,000
Improvements	1,066,300	1,030,600
Equipment	1,002,600	734,000
Vehicles and transportation equipment	437,600	365,400
Furniture and fixtures	275,500	275,500
Software and closing costs	115,900	89,500
	4,827,900	4,425,000
Less: Accumulated depreciation	(1,623,300)	(1,339,700)
	$ 3,204,600	$ 3,085,300

6. NOTES RECEIVABLE

In December 2018, the Company transferred $597,200 from the accounts receivable of a customer to a note receivable due in 48 monthly installments at 3% interest. The current portion of the note receivable is $143,300.

7. LONG-TERM NOTES - LESS CURRENT PORTION

	December 31, 2018	December 31, 2017
Bank loan dated October 30, 2013 due October 30, 2023 with an interest rate of 4.25%	$ 400	$ 28,600
Bank loan dated August 29, 2013, due September 1, 2018 with an interest rate of 4.25%	166,900	202,000
	167,300	230,600
Less current portion of notes payable	(43,600)	(62,700)
	$ 123,700	$ 167,900

8. SALE OF BUILDING

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

9. SHARE REPURCHASE

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

10. SHARE-BASED PAYMENT AWARDS

The Company's board of directors and stockholders approved the EES 2018 Equity Incentive Plan in June 2018 (the "2018 Plan"), which authorized the issuance of up to 5,000,000 shares of the Company's common stock. The Company has granted restricted stock awards under the 2018 Plan as detailed in the tables below. There were 4,375,000 shares available for future issuance under the 2018 Plan as of December 31, 2018.

Restricted Stock Awards	Number of Shares
Unvested as of December 31, 2017	-
Issued	625,000
Vested	(199,998
Forfeited/Cancelled	-
Unvested as of December 31, 2018	425,002

The weighted average grant date value of the restricted stock award issued was $0.17 during the period ended December 31, 2018. The fair value of the restricted stock awards vested during the year ended December 31, 2018 was $34,000.

11. INCOME TAXES

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

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

	Year Ended December 31,	
	2018	**2017**
Computed at the federal statutory rate	$ 30,400	$ (371,100)
State tax (benefit) at statutory rates	8,700	(65,500)
Use of prior year net operating losses and return adjustments	600	485,300
Depreciation differences	(22,800)	(97,700)
Income tax (Benefit)	$ 16,900	$ (49,000)

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

	As of December 31,	
	2018	2017
Deferred tax assets – Net Operating Loss Carryforwards	$ 341,600	$ 558,500
Deferred tax liabilities – depreciation and amortization	$ (78,700)	$ (117,800)

The Company is subject to examination in the U.S. federal and state tax jurisdiction of the 2015 to 2018 tax years. There are not current examinations of the Company's prior tax returns. The penalty and interest charges on the delinquent returns is estimated to be minimal due to net operating losses incurred in each year of operations.

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

12. EARNINGS PER SHARE

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

The following reconciles the components of the EPS computation for the years ended December 31, 2018 and 2017:

	2018	2017
Basic and Diluted (loss) per share computation		
Numerator:		
Net income (loss)	$ 127,700	$ (2,385,800)
Denominator:		
Weighted average common shares outstanding	47,730,384	47,941,014
Basic (loss) per share	$ 0.00	$ (0.05)

13. LEASES

The Company leases office and warehouse space under month to month leases. Total rent expense for the years ended December 31, 2018 and 2017, was $86,500 and $59,200, respectively.

14. COMMITMENTS

In December 2018, we entered into a letter of intent with Patriot Chemicals & Services LLC ("*Patriot*"), in which we would acquire Patriot in its merger with a wholly-owned subsidiary. The merger consideration would consist of a combination of $300,000 in cash, $300,000 in three-year notes, and 2.0 million shares of our common stock. The consideration also includes earnouts in each of year one and year two of 1.0 million additional shares of common stock. The earnouts would be achieved if Patriot realizes earnings before interest, taxes, depreciation and amortization of $620,000 in year one and $930,000 in year two. The merger consideration is subject to adjustments for changes in working capital and assumes, among other things, that Patriot’s non-current liabilities will be capped at a specified level (but including current liabilities incurred in the ordinary course of business).

The above description of terms is based on our understandings of the letter of intent. The parties have not executed a definitive agreement and the merger terms – including the amount of merger consideration – may change depending on the results of negotiations. There is no assurance that we will consummate the merger or other acquisition of Patriot.

15. CONTINGENCIES

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