

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **2001-08-03** | Period of Report: **2001-06-30**  
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FILER

**HEADWATERS INC**

CIK: **1003344** | IRS No.: **870547337** | State of Incorporation: **DE** | Fiscal Year End: **0930**  
Type: **10-Q** | Act: **34** | File No.: **000-27808** | Film No.: **1696985**  
SIC: **6794** Patent owners & lessors

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2001

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-27808

HEADWATERS INCORPORATED

-----  
(Exact name of registrant as specified in its charter)

Delaware

87-0547337

-----  
(State or other jurisdiction of  
incorporation or organization)

-----  
(I.R.S. Employer  
Identification No.)

11778 South Election Road, Suite 210  
Draper, Utah

84020

-----  
(Address of principal executive offices)

-----  
(Zip Code)

(801) 984-9400

-----  
(Registrant's telephone number, including area code)

Not applicable

-----  
(Former name, former address and former fiscal year,  
if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports  
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of  
1934 during the preceding 12 months (or for such shorter period that the  
registrant was required to file such reports), and (2) has been subject to such  
filing requirements for the past 90 days. Yes  No

The number of shares outstanding of the Registrant's common stock as of July 31,  
2001 was 23,475,902.

HEADWATERS INCORPORATED

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Forward Looking Statements

Statements in this Form 10-Q, including those concerning the Registrant's expectations regarding its business, and certain of the information presented in this report, constitute forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. As such, actual results may vary materially from such expectations. For a discussion of the factors that could cause actual results to differ from expectations, please see the caption entitled "Forward Looking Statements" in Part I, Item 2 hereof. There can be no assurance that the Registrant's results of operations will not be adversely affected by such factors. Registrant undertakes no obligation to revise or publicly release the results of any revision to these forward looking statements. Readers are cautioned not to place undue reliance on these forward looking statements, which reflect management's opinion only as of the date hereof.

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ITEM 1. FINANCIAL STATEMENTS (Unaudited)  
<TABLE>  
<CAPTION>

HEADWATERS INCORPORATED AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(Unaudited)

(thousands of dollars)	September 30, 2000	June 30, 2001
ASSETS		
<S>	<C>	<C>
Current assets:		
Cash and cash equivalents	\$ 983	\$ 218
Short-term investments	6,973	5,207
Trade receivables, net	7,298	6,542
Short-term notes and accrued interest receivable	2,530	1,180
Other current assets	387	401
Total current assets	18,171	13,548
Property, plant and equipment, net of accumulated depreciation	552	631
Other assets:		
Notes and accrued interest receivable	6,598	8,716
Equity investments, net	3,259	4,210
Deferred income taxes	3,000	3,000
Intangible assets, net of accumulated amortization	1,221	1,094
Other assets	640	1,175
Total other assets	14,718	18,195

(continued)

The accompanying notes are an integral part of the consolidated financial statements.

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## HEADWATERS INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS, continued  
(Unaudited)

(thousands of dollars and shares)	September 30, 2000	June 30, 2001
-----		
LIABILITIES AND STOCKHOLDERS' EQUITY		
<S>	<C>	<C>
Current liabilities:		
Accounts payable	\$ 698	\$ 1,025
Accrued personnel costs	2,254	1,681
Other accrued liabilities	3,786	3,140
Short-term borrowings	208	612
	-----	-----
Total current liabilities	6,946	6,458
	-----	-----
Long-term liabilities:		
Notes payable, non-current	5,055	149
Other long-term liabilities	180	149
Deferred revenue	10,513	7,187
	-----	-----
Total long-term liabilities	15,748	7,485
	-----	-----
Total liabilities	22,694	13,943
	-----	-----
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock, \$0.001 par value; authorized 10,000 shares, issued and outstanding 17 shares at September 30, 2000 and 0 shares at June 30, 2001	1	--
Common stock, \$0.001 par value; authorized 50,000 shares, issued and outstanding 23,341 shares at September 30, 2000 (including 214 shares held in treasury) and 23,472 shares at June 30, 2001 (including 568 shares held in treasury)	23	23
Capital in excess of par value	82,659	78,521
Accumulated deficit	(70,221)	(55,978)
Other, primarily treasury stock	(1,715)	(4,135)
	-----	-----
Total stockholders' equity	10,747	18,431
	-----	-----
Total liabilities and stockholders' equity	\$33,441	\$32,374
	=====	=====

&lt;/TABLE&gt;

The accompanying notes are an integral part of the consolidated financial statements.

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## HEADWATERS INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)

(thousands of dollars, except per-share data)	Three Months Ended June 30,		Nine months Ended June 30,	
	2000	2001	2000	2001
-----				
<S>	<C>	<C>	<C>	<C>
Revenue:				
License fees	\$ 3,591	\$ 4,336	\$12,424	\$15,770
Chemical sales	2,709	5,777	5,945	15,432
Gains on sale of facilities	8,527	--	13,868	--
Gains on non-recurring transactions	--	--	1,079	--
Other	173	586	633	1,566

Total revenue	15,000	10,699	33,949	32,768
Operating costs and expenses:				
Cost of chemical	1,860	3,610	4,088	9,889
Cost of operations	1,006	489	3,488	2,446
Selling, general and administrative	1,215	730	3,112	3,828
Asset write-offs and other non-recurring charges	2,111	--	13,973	--
Loss on sale of facilities, net	--	--	598	--
Total operating costs and expenses	6,192	4,829	25,259	16,163
Operating income	8,808	5,870	8,690	16,605
Other income (expense):				
Interest and investment income	324	170	1,434	511
Interest expense	(951)	(33)	(4,716)	(179)
Other, net	78	(1,033)	62	(1,859)
Total other income (expense), net	(549)	(896)	(3,220)	(1,527)
Income before income taxes and extraordinary item	8,259	4,974	5,470	15,078
Income tax benefit (expense)	--	(18)	3,000	(140)
Income before extraordinary item	8,259	4,956	8,470	14,938
Extraordinary loss on early extinguishment of debt	(6,037)	--	(7,860)	--
Net income	\$ 2,222	\$ 4,956	\$ 610	\$14,938
Basic net income per common share	\$ .09	\$ .22	\$ .01	\$ .65
Diluted net income per common share	\$ .09	\$ .20	\$ .01	\$ .61

</TABLE>

The accompanying notes are an integral part of the consolidated financial statements.

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HEADWATERS INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY  
For the Nine Months Ended June 30, 2001  
(Unaudited)

(thousands of dollars and shares)	Convertible Preferred Stock		Common Stock		Capital in excess of par value	Accumulated deficit	Other		
	Shares	Amount	Shares	Amount			Related party note receivable collateralized by common stock	Deferred compensation from stock options	Common stock held in treasury
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Balances at September 30, 2000	17	\$1	23,341	\$23	\$82,659	\$ (70,221)	\$ (466)	\$ (515)	\$ (734)
Exercise of stock options			255	--	383				
Write-up of related party note receivable to collateral value							(541)		
Cancellation of related party note receivable and transfer of collateral shares to treasury stock							1,007		(1,007)
Amortization of deferred compensation from stock options									

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Purchase of treasury stock, at cost									(2,968)
Treasury stock transferred to employee stock purchase plan									70
Cancellation of treasury stock	(762)	--	(2,753)						2,753
Net income						9,982			
Balances at March 31, 2001	17	1	22,834	23	80,289	(60,239)	--	(469)	(1,886)
Common stock issued on conversion of convertible preferred stock	(17)	(1)	443	--	--				
Preferred stock dividends redeemed for cash						(695)			
Exercise of stock options and warrants			553	--	1,325				
Amortization of deferred compensation from stock options								24	
Purchase of treasury stock, at cost									(4,915)
Treasury stock transferred to employee stock purchase plan									18
Cancellation of treasury stock			(357)	--	(3,093)				3,093
Net income						4,956			
Balances at June 30, 2001	--	\$ --	23,473	\$23	\$78,521	\$(55,978)	\$ --	\$(445)	\$(3,690)

</TABLE>

The accompanying notes are an integral  
part of the consolidated financial statements.

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<TABLE>  
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HEADWATERS INCORPORATED AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

(thousands of dollars)	Nine months Ended June 30,	
	2000	2001
<S>	<C>	<C>
Cash flows from operating activities:		
Net income	\$ 610	\$14,938
Adjustments to reconcile net income to net cash provided by operating activities:		
Recognition of deferred revenue	(490)	(1,739)
Depreciation and amortization	912	196
Deferred income tax benefit	(3,000)	--
Losses in equity investments, write-offs and provisions for unrealizable investments	--	1,428
Write-down of notes receivable and related accrued interest	--	1,025
Net gains on sale of facilities and disposition of equipment	(13,355)	(42)
Amortization of deferred compensation from stock options	683	70
Interest expense related to amortization of debt discount and debt issuance costs	2,990	57
Write-down (write-up) of related party note receivable	82	(541)
Gains on non-recurring transactions	(1,079)	--
Asset write-offs and other non-recurring charges	11,680	--
Extraordinary loss on early extinguishment of debt	7,860	--
Other changes in operating assets and liabilities	3,762	(1,444)
Net cash provided by operating activities	10,655	13,948
Cash flows from investing activities:		
Net proceeds from sale of short-term investments	--	1,766
Investments in and loans to non-affiliated companies	(450)	(4,562)
Proceeds from sale of facilities and equipment	34,579	42
Purchase of facilities held for sale and equipment	(551)	(148)
Net increase in other assets	(75)	(527)

Decrease in restricted assets	589	--
Net cash provided by (used in) investing activities	34,092	(3,429)
Cash flows from financing activities:		
Net proceeds from issuance of notes payable and warrants and other borrowings	6,980	8,148
Payments on notes payable, including redemption premiums, and other borrowings	(41,754)	(12,650)
Purchase of common stock for the treasury, net of employee stock purchases	(32)	(7,795)
Proceeds from exercise of options and warrants	421	1,708
Preferred stock dividends	(297)	(695)
Net proceeds from issuance of common stock and warrants	5,254	--
Preferred stock redemption	(4,454)	--
Net cash used in financing activities	(33,882)	(11,284)
Net increase (decrease) in cash and cash equivalents	10,865	(765)
Cash and cash equivalents, beginning of period	461	983
Cash and cash equivalents, end of period	\$11,326	\$ 218
Supplemental schedule of non-cash investing and financing activities:		
Cancellation of treasury stock	\$ --	\$(5,846)
Common stock issued on conversion of convertible preferred stock and in payment of dividends	1,634	3,100
Cancellation of related party notes receivable and the common stock collateralizing the notes	6,164	--
Common stock issued on conversion of convertible debt and related accrued interest	3,104	--
Reclassification of redeemable convertible preferred stock to convertible preferred stock	2,710	--

</TABLE>

The accompanying notes are an integral part of the consolidated financial statements.

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#### HEADWATERS INCORPORATED AND SUBSIDIARIES

#### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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#### 1. Nature of Operations and Basis of Presentation

Headwaters Incorporated and its Subsidiaries' primary business is to commercialize its chemical technologies used to produce alternative fuel from coal derivatives and to develop and deploy related technologies. Currently, Headwaters has licensed its technology to the owners of 28 alternative fuel facilities which are operating at various levels of production in eight states. During the fiscal year ended September 30, 2000, Headwaters began evaluating and pursuing investment alternatives. Headwaters invested excess cash in high-grade government backed securities and made several equity investments in and loans to unrelated high-risk entities. Headwaters does not currently intend to make any significant additional equity investments or loans to any new unrelated entities. Headwaters is interested in possible strategic acquisitions of operating entities that would be synergistic to Headwaters' current operations.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission for quarterly reports on Form 10-Q. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All adjustments except the items described in Note 5 consist of normal recurring adjustments. The results of operations for the three- and nine-month periods ended June 30, 2001 are not necessarily indicative of the results to be expected for the full fiscal 2001 year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. It is suggested that these financial statements be read in conjunction with the consolidated financial statements and notes thereto included in Headwaters' Annual Report on Form 10-K for the year ended September 30, 2000 and in Headwaters' Quarterly Reports on Form 10-Q for the quarters ended December 31, 2000 and March 31, 2001. Certain prior period amounts have been reclassified to conform with the current periods' presentation. The reclassifications had no effect on net income or total

assets.

## 2. Equity Transactions

During the quarter ended June 30, 2001, Headwaters completed several equity transactions, including the following.

**Treasury Stock** - During the quarter ended June 30, 2001, Headwaters continued acquiring shares of its common stock in connection with the stock repurchase program announced in May 2000 and expanded in June 2001. The program, as revised, authorizes Headwaters to purchase stock in the open market or through negotiated block transactions up to an aggregate of 20% of the outstanding common stock, 3,000,000 shares of common stock, or \$15,000,000, whichever is greater. During the quarter ended June 30, 2001, Headwaters purchased approximately 455,000 shares for approximately \$4,915,000. Also during the quarter, approximately 357,000 shares of treasury stock were cancelled.

**Common Stock Options** - During the quarter ended June 30, 2001, options and warrants for the purchase of approximately 553,000 shares of common stock were exercised for cash proceeds of approximately \$1,325,000.

**Convertible Preferred Stock** - In May 2001, all of the remaining outstanding shares of preferred stock, consisting of 3,000 shares of Series A and 14,310 shares of Series B, were converted into a total of approximately 443,000 shares of common stock (representing a conversion price of \$7.00 per common share). Headwaters redeemed the accrued but undeclared dividends of approximately \$695,000 for cash rather than allowing conversion into common stock.

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### HEADWATERS INCORPORATED AND SUBSIDIARIES

#### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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## 3. Notes Payable and Other Borrowings

<TABLE>

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Notes payable and other borrowings consisted of the following:

(thousands of dollars)	September 30, 2000	June 30, 2001
-----	-----	-----
<S>	<C>	<C>
Short-term borrowings from an investment company, bearing interest at a floating rate (4.7% as of June 30, 2001), collateralized by investments with the investment company with a carrying value of approximately \$5,175,000.	\$ --	\$509
Note payable to a bank, bearing interest at prime plus 2%, repaid with proceeds from a long-term line of credit with this bank obtained in October 2000.	3,000	--
Note payable to a corporation bearing interest at 6%, repaid in October 2000 with funds obtained from a long-term bank line of credit obtained in October 2000.	1,838	--
Other	425	252
	-----	-----
Less: current portion	5,263 (208)	761 (612)
	-----	-----
Total non-current	\$5,055	\$149
	=====	=====

</TABLE>

The weighted-average interest rate on the above obligations was 9.7% at September 30, 2000 and 7.5% at June 30, 2001.

## 4. Basic and Diluted Earnings per Share

<TABLE>

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(thousands of dollars and shares, except per-share data)	Three Months Ended June 30, 2000	June 30, 2001	Nine Months Ended June 30, 2000	June 30, 2001
-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>
Numerator:				
Income before extraordinary item	\$8,259	\$4,956	\$8,470	\$14,938
Extraordinary item	(6,037)	--	(7,860)	--
	-----	-----	-----	-----
Net income	2,222	4,956	610	14,938
Preferred stock dividends	(66)	(19)	(331)	(113)
Imputed preferred stock dividends	--	--	(58)	--
	-----	-----	-----	-----



Numerator for basic earnings per share -- net income attributable to common stockholders	2,156	4,937	221	14,825
Effect of dilutive securities - preferred stock dividends	19	19	92	113
<hr/>				
Numerator for diluted earnings per share -- net income attributable to common stockholders after assumed conversions	\$2,175	\$4,956	\$313	\$14,938
<hr/>				
Denominator:				
Denominator for basic earnings per share -- weighted-average shares outstanding	22,988	22,730	18,208	22,723
Effect of dilutive securities:				
Shares issuable upon exercise of options and warrants	226	2,220	188	1,445
Shares issuable upon conversion of preferred stock	1,052	187	3,020	357
<hr/>				
Total dilutive potential shares	1,278	2,407	3,208	1,802
<hr/>				
Denominator for diluted earnings per share -- weighted-average shares outstanding after assumed exercises and conversions	24,266	25,137	21,416	24,525
<hr/>				
Basic net income per share:				
Income before extraordinary item	\$ .35	\$ .22	\$ .44	\$ .65
Extraordinary item	(.26)	--	(.43)	--
<hr/>				
Net income per common share	\$ .09	\$ .22	\$ .01	\$ .65
<hr/>				
Diluted net income per share:				
Income before extraordinary item	\$ .34	\$ .20	\$ .38	\$ .61
Extraordinary item	(.25)	--	(.37)	--
<hr/>				
Net income per common share	\$ .09	\$ .20	\$ .01	\$ .61
<hr/>				

</TABLE>

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#### HEADWATERS INCORPORATED AND SUBSIDIARIES

##### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

During the nine months ended June 30, 2000, Headwaters' potentially dilutive securities consisted of options and warrants for the purchase of common stock, convertible debt and convertible preferred stock, many of which were anti-dilutive and were therefore omitted in the calculation of diluted earnings per share. For all other periods presented, certain potentially dilutive securities, primarily options and warrants, were anti-dilutive and were also omitted in the calculation of diluted earnings per share. The amount of anti-dilutive securities not considered in the diluted earnings per share calculation totaled approximately 5,100,000 shares and 700,000 shares for the three months ended June 30, 2000 and 2001, respectively, and approximately 8,200,000 shares and 1,600,000 shares for the nine months ended June 30, 2000 and 2001, respectively.

#### 5. Non-recurring Items

In December 1999, Headwaters sold one of the three remaining alternative fuel facilities it owned at that time. In January 2000, Headwaters sold another alternative fuel facility and an option to acquire a licensee facility, and in April 2000, Headwaters sold its remaining owned facility. During the nine months ended June 30, 2000, Headwaters reported net gains on all facility sale transactions of approximately \$13,270,000. Also during the nine months ended June 30, 2000, Headwaters recorded non-recurring gains of approximately \$1,079,000 related to the satisfaction of a contingent contract liability and a gain recognized on a note receivable transaction.

In the June 2000 quarter, Headwaters recorded non-recurring asset write-offs and employee severance charges totaling approximately \$2,111,000. In addition, during the six months ended March 31, 2000, Headwaters recorded impairment charges and other non-recurring employee severance and settlement charges totaling approximately \$11,862,000. The impairment charges related primarily to assets located at the Price, Utah site and consisted of a write-down to net realizable value of certain plant and equipment which remained on the site and became idle when a facility was sold, plus a write-off of an intangible asset which was no longer considered recoverable due to the relocation of a licensee facility. Approximately \$11,680,000 of the total impairment charges in the nine months ended June 30, 2000 did not involve the use of cash.

During the nine months ended June 30, 2000, Headwaters redeemed two series of convertible debt. Early prepayment costs totaling approximately \$7,860,000 were recognized as an extraordinary item as a result of the redemption consideration paid plus the acceleration of amortization of the unamortized debt discount and debt issuance costs in excess of the debt carrying value.

There were no non-recurring gains or losses recorded during the quarter or nine months ended June 30, 2001.

#### 6. Income Taxes

In the quarter ended June 30, 2001, Headwaters incurred \$18,000 of state income tax expense. In addition, in the six months ended March 31, 2001, Headwaters reported \$100,000 of federal alternative minimum tax expense and \$22,000 of state income tax expense. There was no income tax expense for the quarter ended June 30, 2000; however, Headwaters reported an income tax benefit of \$3,000,000, consisting of the recognition of a portion of its deferred tax asset, in the nine-month period ended June 30, 2000. Headwaters believes it is more likely than not that this portion of the total deferred tax asset will be realized as a result of income to be recognized from the amortization in subsequent periods of deferred revenue currently recorded in the consolidated balance sheet.

As of June 30, 2001, Headwaters has net operating loss carryforwards of approximately \$31,500,000 which can be used to offset future taxable income. Headwaters has not recognized any additional deferred tax asset related to these net operating loss carryforwards due to various factors, including its short history of profitability, the significant variability of licensee production levels, and other uncertainties related to the future recoverability of a potential tax asset.

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### HEADWATERS INCORPORATED AND SUBSIDIARIES

#### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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#### 7. Hydrocarbon Technologies, Inc. Acquisition

In May 2001, Headwaters announced it had signed definitive agreements to acquire Hydrocarbon Technologies, Inc. ("HTI"), a New Jersey-based company that has technologies related to heavy oil, clean coal and other alternative energy processes. The purchase price will be comprised of approximately \$14,500,000 of stock (80%) and cash (20%), plus the assumption of approximately \$1,500,000 of HTI debt. Fifty percent of the purchase price is contingent upon HTI accomplishing certain financial milestones over the next two years as it further commercializes its technologies. The acquisition is expected to be consummated during August 2001. As of July 31, 2001, Headwaters has loaned HTI \$600,000 and incurred approximately \$500,000 in costs in connection with the acquisition.

#### 8. Commitments and Contingencies

Commitments and contingencies, consisting of legal and contractual matters, as of June 30, 2001 not disclosed elsewhere, are as follows:

Adtech. In October 1998, Headwaters entered into a technology purchase agreement with James G. Davidson and Adtech, Inc. The transaction transferred certain patent and royalty rights to Headwaters related to an alternative fuel technology invented by Davidson. In September 2000, Headwaters received a summons and complaint from the United States District Court for the Western District of Tennessee filed by Adtech, Inc. against Davidson and Headwaters. In the action certain purported officers and directors of Adtech allege that the technology purchase transaction was an unauthorized corporate action and that Davidson and Headwaters conspired together to effect the transfer. The complaint asserts related causes of action in fraud, conversion, patent infringement, conspiracy and unfair competition seeking unspecified money damages to be proven at trial, accounting, disgorgement, rescission of contracts, punitive damages, and other relief. Headwaters denies these allegations and is asking the court to dismiss the action. Because the litigation is at an early stage and resolution is uncertain, legal counsel cannot express an opinion as to the ultimate amount, if any, of Headwaters' liability.

Levy and Klein. In March 1999, Headwaters sold convertible preferred stock, warrants, and a convertible promissory note to OZ Master Fund, Ltd. In September 2000, Headwaters received a summons and complaint from the United States District Court for the Southern District of New York filed by Mark Levy against OZ Master Fund and related entities ("OZ") and Headwaters. In January 2001, Headwaters received a summons and complaint from the same court filed by Terry Klein against OZ and Headwaters making the same

claims. The parties in the two cases agreed to consolidate. In the actions, purported shareholders of Headwaters allege that OZ violated section 16(b) of the Securities Exchange Act of 1934 by converting preferred stock into Headwaters common stock and then selling the same within a six month period, and further, that Headwaters' redemption of the preferred stock and the note constituted a sale of common stock for which OZ is liable under section 16(b). The complaints seek on behalf of Headwaters from OZ unspecified money damages to be proven at trial, attorney fees, and other relief. In July 2001, the case was dismissed by the District Court; however, the ruling can be appealed. Because final resolution is uncertain, legal counsel cannot express an opinion as to the ultimate amount, if any, that might be recovered.

AJG. In December 1996, Headwaters entered into a technology license and proprietary chemical sale agreement with AJG Financial Services, Inc. The agreement called for AJG to pay royalties and to purchase proprietary chemical material from Headwaters. In October 2000, Headwaters filed a complaint in the Fourth District Court for the State of Utah against AJG alleging that it has failed to make payments and to perform other obligations under the agreement. Headwaters asserts claims including breach of contract, declaratory judgment, unjust enrichment, and for an accounting and seeks money damages in the amount of \$750,000 plus other damages to be proven at trial, as well as other relief. AJG has answered the complaint denying Headwaters' claims and asserting counter-claims based upon allegations of misrepresentation and breach. AJG seeks unspecified compensatory damages as well as punitive damages. Headwaters denies the allegations of AJG's counter-claims. In May 2001, Headwaters filed a separate complaint against AJG alleging that AJG's counterclaims in the first action breached a previous settlement agreement between the parties. AJG answered the complaint denying Headwaters' claims. Because the litigation is at an early stage and resolution is uncertain, legal counsel cannot express an opinion as to the ultimate amount of recovery or liability.

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#### HEADWATERS INCORPORATED AND SUBSIDIARIES

#### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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Nalco. In October 2000, Headwaters filed a complaint in the United States District Court for the District of Utah against Nalco Chemical Company ("Nalco"). Headwaters alleges that Nalco, by its sale and marketing of materials for use in creating alternative fuel, breached a non-disclosure agreement, misappropriated trade secrets, and violated patent rights of Headwaters. Headwaters seeks by its complaint injunctive relief and damages to be proven at trial. Nalco filed an answer denying the allegations in the complaint and asserting counter-claims alleging patent invalidity. Headwaters denies the counter-claims; however, if Nalco prevails on its counter-claims, the result could have a material adverse effect on Headwaters' business. Because the litigation is at an early stage and resolution is uncertain, legal counsel cannot express an opinion as to the ultimate amount, if any, that might be recovered by Headwaters.

Headwaters is also involved in other legal proceedings that have arisen in the normal course of business. Management believes that in cases involving claims against Headwaters, many of the claims are without merit and in all cases intends to vigorously prosecute or defend its position. Management does not believe that the outcome of these cases will have a significant effect upon the operations or the financial position of Headwaters; however, it is possible that a change in management's estimates of probable liability could occur and the change could be significant.

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#### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the accompanying unaudited consolidated financial statements and notes thereto.

Three Months Ended June 30, 2001 Compared to Three Months Ended June 30, 2000

The information set forth below compares Headwaters' operating results for the three months ended June 30, 2001 ("2001") with operating results for the three months ended June 30, 2000 ("2000").

Revenue. Total revenue for 2001 decreased by \$4,301,000 to \$10,699,000 as compared to \$15,000,000 for 2000. However, there was \$8,527,000 of non-recurring gains on sale of facilities included in revenue for 2000. There was no

non-recurring revenue in 2001. The major components of revenue are discussed in the sections below.

**License Fees.** During 2001, Headwaters recognized license fees totaling \$4,336,000 while \$3,591,000 of license fees were recognized during 2000. The license fees in 2001 consisted of recurring earned license fees or royalty payments of \$4,060,000 and deferred revenue amortization of \$276,000. License fees in 2000 consisted of recurring license fees of \$3,562,000 and deferred revenue amortization of \$230,000, reduced by a one-time adjustment of \$201,000. Deferred revenue consists primarily of initial license fees paid by licensees and is being amortized on a straight-line basis over the period covered by Headwaters' license agreements with the related licensees.

Recurring earned license fees or royalty payments are due quarterly based upon alternative fuel sold by licensees. The 2000 earned license fees included \$2,400,000 related to a single licensee that owns four facilities. This licensee significantly reduced its production and sale of alternative fuel in 2001 and is not currently operating the four facilities, resulting in a decline in earned license fees in 2001 as compared to 2000. This licensee continues to pursue the sale of its four facilities and following the sale, possible relocation and ramp-up of the facilities, Headwaters expects to receive increased license fee revenues from these facilities in the future. The ultimate consummation and timing of these events however can not be predicted.

There was an increase of more than \$2,500,000 in earned license fees from all other licensees in 2001 over 2000 (due to increased alternative fuel sales by those licensees), including approximately \$557,000 from a licensee that recently relocated and began operating its facility. Headwaters expects license fees from its licensees to increase in future years as additional facilities not currently operating or not operating at normal levels begin to operate at expected levels, and as certain other licensees begin paying license fees that in prior periods were not yet contractually due. Headwaters expects fluctuations in future periods in individual licensee alternative fuel sales with corresponding fluctuations in Headwaters' license fees due to feedstock availability and other licensee operational issues, marketing issues, the ability of licensees to utilize the income tax credits earned from the sale of alternative fuel and other factors, many of which are beyond the direct control of Headwaters. Headwaters also expects fluctuations in aggregate license fee revenue. However, at the current time, Headwaters expects its annual license fee revenue for the current fiscal year to be higher than for fiscal 2000 and that this trend will continue in future fiscal years.

**Chemical Sales.** Headwaters provides chemical reagent to its licensees either at a fixed price or at Headwaters' cost plus a contracted markup. Headwaters purchases the chemical materials under a long-term contract with a large chemical company. Chemical sales during 2001 were \$5,777,000 with a corresponding direct cost of \$3,610,000. Chemical sales during 2000 were \$2,709,000 with a corresponding direct cost of \$1,860,000. The increase in chemical sales in 2001 over 2000 was due to increased alternative fuel production by Headwaters' licensees.

**Gains on Non-recurring Transactions.** In 2000, Headwaters sold an alternative fuel facility and recognized a gain of \$1,227,000. Also, \$6,500,000 of contingent sales proceeds related to the January 2000 sale of a facility and sale of an option to acquire a facility were received and recognized as revenue. Finally, Headwaters received approximately \$3,777,000 of contingent sales proceeds related to the sale of a facility in August 1999, of which \$800,000 was recognized as revenue in 2000 and the balance deferred. There were no facility sales or non-recurring gains recorded in 2001.

**Cost of Operations.** These costs decreased by \$517,000 to \$489,000 in 2001 from \$1,006,000 in 2000, primarily as a result of the resolution of certain contingent liabilities for amounts less than previously recorded.

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**Selling, General and Administrative Expenses.** These expenses decreased \$485,000 to \$730,000 during 2001 from \$1,215,000 for 2000. The decrease in 2001 was due to a decrease in compensation-related costs of approximately \$472,000 and the resolution of certain contingent liabilities for \$175,000 less than previously recorded. These decreases were partially offset by an increase in professional services expenses of approximately \$206,000, with a net decrease in all other cost categories of approximately \$44,000. The increase in professional services expenses was due primarily to legal costs associated with the current legal actions Headwaters is involved in.

**Asset Write-offs and Other Non-recurring Charges.** In 2000, Headwaters recorded non-recurring asset write-offs and employee severance charges totaling approximately \$2,111,000. There were no similar charges in 2001.

**Other Income and Expense.** During 2001, Headwaters reported net other expenses of \$896,000 compared to net expenses of \$549,000 for 2000. This increase of \$347,000 relates primarily to an increase of \$1,040,000 in equity and debt investment-related losses and a decrease of \$154,000 in interest income, reduced

by a decrease in interest expense of \$918,000.

Beginning in June 2000, Headwaters made debt and equity investments in several less than 50%-owned affiliates. Allowances are provided on a case-by-case basis when management first determines that the investment has been impaired. Gains on these same investments cannot be recognized until realized, which normally occurs at a much later date. During 2001, the write-offs of debt investments totaled approximately \$660,000. The equity in losses of investees accounted for using the equity method, including amortization of the investment amount in excess of Headwaters' portion of one investee's net equity, totaled approximately \$380,000. There were no such expenses in 2000.

The decrease in interest income from 2000 to 2001 primarily related to a decrease in average cash and investment balances in 2001 as compared to 2000 and a decrease in the interest rate, effective in May 2000, on a \$6,500,000 note receivable from a licensee. Interest expense decreased in 2001 primarily due to the reduction in borrowings from 2000 to 2001.

Income Taxes. In 2001, Headwaters incurred \$18,000 of state income tax expense. There was no income tax expense recognized in 2000. As of June 30, 2001, Headwaters has net operating loss carryforwards of approximately \$31,500,000 which can be used to offset future taxable income. Headwaters has not recognized the deferred tax asset related to these net operating loss carryforwards due to various factors, including its short history of profitability, the significant variability of licensee production levels and other uncertainties related to the future recoverability of a potential tax asset.

Extraordinary Item. In 2000, Headwaters redeemed all of its convertible debt issued in March 1999. The loss recognized as a result of the redemption consideration paid plus the acceleration of amortization of the unamortized debt discount and debt issuance costs totaled approximately \$6,037,000. This loss is reflected as an extraordinary item in the 2000 consolidated statement of income.

Net Income. For 2001, net income of \$4,956,000 increased by \$2,734,000 from net income of \$2,222,000 in 2000 as a result of the factors described above.

Nine months Ended June 30, 2001 Compared to Nine months Ended June 30, 2000

The information set forth below compares Headwaters' operating results for the nine months ended June 30, 2001 ("2001") with operating results for the nine months ended June 30, 2000 ("2000").

Revenue. Total revenue for 2001 decreased by \$1,181,000 to \$32,768,000 as compared to \$33,949,000 for 2000. There was \$13,868,000 of non-recurring gains on sale of facilities and \$1,079,000 of other non-recurring revenue in 2000. There was no non-recurring revenue recorded in 2001. The major components of revenue are discussed in the sections below.

License Fees. During 2001, Headwaters recognized license fees totaling \$15,770,000 while \$12,424,000 of license fees were recognized during 2000. The license fees in 2001 consisted of recurring earned license fees or royalty payments of \$14,031,000 and deferred revenue amortization of \$1,739,000. License fees in 2000 consisted of recurring license fees of \$11,934,000 and deferred revenue amortization of \$691,000, reduced by a one-time adjustment of \$201,000.

The 2000 earned license fees included \$8,980,000 related to a single licensee that owns four facilities. This licensee did not report and pay certain prior period royalty obligations to Headwaters timely, resulting in some "catch-up" revenue recognition in 2000 for royalties relating to periods other than the nine-month period ended June 30, 2000. This licensee significantly reduced its production and sale of alternative fuel in 2001 and is not currently operating the four facilities, resulting in a decline in earned license fees from the licensee of approximately \$5,285,000 in 2001 as compared to 2000.

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There was an increase of approximately \$7,382,000 in earned license fees from all other licensees in 2001 over 2000 (due to increased alternative fuel sales by those licensees), including approximately \$557,000 from a licensee that recently relocated and began operating its facility.

Chemical Sales. Chemical sales during 2001 were \$15,432,000 with a corresponding direct cost of \$9,889,000. Chemical sales during 2000 were \$5,945,000 with a corresponding direct cost of \$4,088,000. The increase in chemical sales in 2001 over 2000 was due to increased alternative fuel production by Headwaters' licensees. Currently, Headwaters expects its chemical sales revenue from all licensees for the remainder of the fiscal year ending September 30, 2001 to be higher than the amounts reported for the comparable period in the fiscal year ended September 30, 2000. Headwaters expects the gross profit margin for the fiscal 2001 year to be comparable to the profit margin reported in the nine month period ended June 30, 2001.

Gains on Non-recurring Transactions. In December 1999, Headwaters sold one of the three remaining alternative fuel facilities it owned at that time and

reported a gain of approximately \$5,341,000. In April 2000, Headwaters sold a alternative fuel facility and recognized a gain of \$1,227,000. Also, \$6,500,000 of contingent sales proceeds related to a January 2000 sale of a facility and sale of an option to acquire a facility were received and recognized as revenue. Finally, Headwaters received approximately \$3,777,000 of contingent sales proceeds related to the sale of a facility in August 1999, of which \$800,000 was recognized as revenue and the balance deferred. Also in 2000, Headwaters recorded other non-recurring gains of approximately \$1,079,000 related to the satisfaction of a contingent contract liability and a gain recognized on a note receivable transaction. There were no facility sales or non-recurring gains recorded in 2001.

Cost of Operations. These costs decreased by \$1,042,000 to \$2,446,000 in 2001 from \$3,488,000 in 2000. The decrease was primarily attributable to the sale of owned facilities in 2000 and the resolution of certain contingent liabilities for amounts less than previously recorded, partially offset by increased personnel costs in 2001. During 2001, Headwaters incurred lower operating expenses in connection with the continued refinement and implementation of the alternative fuel process associated with licensee-owned facilities. Also, in 2001 there were no operating costs associated with the three facilities owned by Headwaters which were sold in December 1999 through April 2000. In 2000, cost of operations included labor and operating expenses at the owned alternative fuel facilities and the wash plant located in Utah. There were no such costs in 2001.

Selling, General and Administrative Expenses. These expenses increased \$716,000 to \$3,828,000 during 2001 from \$3,112,000 for 2000. The increase in 2001 was due primarily to an increase in professional services expenses of approximately \$928,000 and an increase in compensation-related costs of approximately \$98,000. These increases were partially offset by the resolution of certain contingent liabilities for \$175,000 less previously recorded, with a net decrease in all other cost categories of approximately \$135,000. The increase in professional services expenses was due primarily to legal costs associated with the current legal actions Headwaters is involved in.

Asset Write-offs and Other Non-recurring Charges. In 2000, Headwaters recorded asset impairments and write-offs and other non-recurring employee severance and settlement charges totaling approximately \$13,973,000. The impairment charges related primarily to assets located at the Price, Utah site and consisted of a write-down to net realizable value of certain plant and equipment which remained on the site and became idle when a facility was sold, plus a write-off of an intangible asset which was no longer considered recoverable due to the relocation of a licensee facility. In addition to the sales of facilities on which gains were recognized, Headwaters sold an alternative fuel facility and an option to acquire a licensee facility in January 2000 and reported a combined loss on these transactions of approximately \$598,000. There were no similar non-recurring charges recorded in 2001

Other Income and Expense. During 2001, Headwaters reported net other expenses of \$1,527,000 compared to net expenses of \$3,220,000 for 2000. This decrease of \$1,693,000 relates primarily to a decrease of \$4,537,000 in interest expense and an increase in the mark-to-market adjustment of the carrying value of a related party note receivable of \$623,000, partially offset by an increase of \$2,454,000 in equity and debt investment-related losses and a decrease of \$923,000 in interest income. Interest expense decreased in 2001 primarily due to the reduction in borrowings from 2000 to 2001.

During 1996, Headwaters sold certain construction companies and received as consideration a \$5,000,000 note receivable. The note was "marked to market" each quarter based upon the market value of Headwaters' common stock held as collateral and was reflected in the consolidated balance sheet at the underlying value of this collateral, \$466,000 at September 30, 2000. In January 2001, Headwaters accepted as full satisfaction of the note receivable the shares of Headwaters' stock collateralizing the note and a new note receivable which has been fully reserved. This resulted in recognition of a gain in 2001 of approximately \$541,000 representing the increase in value of the collateral from September 30, 2000 to the date the collateral was surrendered in

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payment of the note. The corresponding adjustment in 2000 resulted in a write-down of \$82,000 for a net change in other income and expense of \$623,000 in 2001 compared to 2000.

During 2001, the write-offs of debt investments totaled approximately \$1,025,000. The write-offs and equity in losses of investees accounted for using the equity method, including amortization of the investment amount in excess of Headwaters' portion of one investee's net equity, totaled approximately \$1,429,000. There were no such expenses in 2000. The decrease in interest income from 2000 to 2001 primarily related to a decrease in interest from the related party note receivable discussed above from \$515,000 in 2000 to \$0 in 2001 and a decrease in the interest rate, effective in May 2000, on a \$6,500,000 note receivable from a licensee.

Income Taxes. In 2001, Headwaters incurred \$40,000 of state income tax expense

and \$100,000 of federal alternative minimum tax expense. In 2000, Headwaters reported an income tax benefit of \$3,000,000, consisting of the recognition of a portion of its deferred tax asset. Headwaters believes it is more likely than not that this portion of the total deferred tax asset will be realized as a result of income to be recognized from the amortization in subsequent periods of deferred revenue currently recorded in the consolidated balance sheet.

Extraordinary Item. In 2000, Headwaters redeemed two series of convertible debt. Early prepayment costs totaling approximately \$7,860,000 were recognized as an extraordinary item as a result of the redemption consideration paid plus the acceleration of amortization of the unamortized debt discount and debt issuance costs in excess of the debt carrying value.

Net Income. For 2001, net income of \$14,938,000 increased by \$14,328,000 from net income of \$610,000 in 2000 as a result of the factors described above.

#### Liquidity and Capital Resources

Net cash provided by operating activities during 2001 was \$13,948,000 compared to \$10,655,000 during 2000. Most of the cash flow from operating activities in 2001 was attributable to net income of \$14,938,000. During 2001, investing activities consisted primarily of investments in and loans to non-affiliated companies of approximately \$4,562,000 and financing activities consisted primarily of proceeds from borrowings of approximately \$8,148,000, repayments of borrowings of approximately \$12,650,000 and the purchase of treasury stock, net of transfers to Headwaters' Employee Stock Purchase Plan, for approximately \$7,795,000.

In 2001, Headwaters' primary investing activity consisted of investments in and loans to non-affiliated companies. As of June 30, 2001, Headwaters owns from 1% to 33% of the voting securities of four non-public high-risk investee companies. The carrying value of current investments ranges from \$66,000 to \$1,819,000 each. Headwaters has no future commitments and does not currently expect to make any significant additional investments in any similar entities. As of June 30, 2001, Headwaters also had notes receivable with a total net carrying value of approximately \$3,299,000, representing primarily loans to private, emerging growth companies. These loans generally bridge the period between seed funding and the close of first and second rounds of equity financing. Most of these notes receivable range from \$200,000 to \$278,000 each and have original terms of three to four months, although many of these loans have been extended for successive three- to four-month periods. Headwaters also has one additional long-term loan for \$2,000,000 to a longer-established private company. Headwaters does not currently intend to make any additional equity investments or loans, but could incur losses if the investments are not recoverable or the loans are not repaid. Headwaters has no current plans to construct additional alternative fuel facilities or to incur significant costs to acquire property, plant and equipment, but is interested in possible strategic acquisitions of entities that would be synergistic to Headwaters' current operations. Any future acquisitions could be funded using Headwaters stock, cash or a combination of stock and cash.

As described in Note 2 to the consolidated financial statements, Headwaters continued acquiring shares of its common stock during 2001, in connection with its stock purchase program. The program authorizes Headwaters to purchase stock in the open market or through negotiated block transactions. Purchases under the plan are at the discretion of Headwaters' management. During 2001, Headwaters purchased approximately 1,358,000 shares for approximately \$7,795,000. Headwaters continually evaluates financial alternatives to the stock repurchase program and future purchases are subject to market conditions and available cash.

Headwaters' working capital decreased from approximately \$11,225,000 at September 30, 2000 to approximately \$7,090,000 as of June 30, 2001. The primary reasons for this change were the use of cash for the repayment of long-term debt, for investments in and loans to non-affiliated companies and for purchases of treasury stock. Cash from operations funded most of these cash requirements. Headwaters also expects its operations to produce positive cash flows in future periods. In addition to cash

provided by operating activities, Headwaters has an arrangement with an investment company under which Headwaters can borrow up to 90% of the value of the total portfolio of Headwaters' short-term investments with that investment company, which investments collateralize any outstanding borrowings. Under this arrangement, maximum borrowings during 2001 were approximately \$3,252,000 of which approximately \$509,000 was outstanding as of June 30, 2001.

Headwaters also has borrowing capability under a revolving line of credit with a bank which expires in October 2002. Borrowings under the line of credit bear interest at prime plus .75% (7.5% at June 30, 2001) and are limited to the lesser of \$10,000,000 or the "borrowing base," as defined. Maximum borrowings under the line of credit during 2001 were approximately \$4,896,000. The borrowing base was approximately \$7,500,000 at June 30, 2001 and there were no

borrowings under the line at June 30, 2001. Headwaters believes it will have sufficient cash reserves to meet its obligations during fiscal 2001, and also believes it has the ability to raise additional debt and equity capital from other sources if necessary.

Income Taxes. As of June 30, 2001, Headwaters has net operating loss carryforwards of approximately \$31,500,000 which can be used to offset future taxable income. Headwaters has not recognized the deferred tax asset related to these net operating loss carryforwards due to various factors, including its short history of profitability, the significant variability of licensee production levels and other uncertainties related to the future recoverability of a potential tax asset. During the remainder of fiscal 2001 and in fiscal 2002, Headwaters expects to pay some alternative minimum taxes and a minimal amount of state income taxes in certain states where net operating loss carryforwards aren't available. However, because of existing net operating loss carryforwards for federal purposes and in most states where Headwaters does business, Headwaters does not currently expect to pay significant amounts of regular income taxes during fiscal 2001 or during most or all of fiscal 2002.

#### Hydrocarbon Technologies, Inc. Acquisition

In May 2001, Headwaters announced it had signed definitive agreements to acquire Hydrocarbon Technologies, Inc. ("HTI"), a New Jersey-based company that has technologies related to heavy oil, clean coal and other alternative energy processes. The purchase price will be comprised of approximately \$14,500,000 of stock (80%) and cash (20%), plus the assumption of approximately \$1,500,000 of HTI debt. Fifty percent of the purchase price is contingent upon HTI accomplishing certain financial milestones over the next two years as it further commercializes its technologies. The acquisition is expected to be consummated during August 2001. As of July 31, 2001, Headwaters has loaned HTI \$600,000 and incurred approximately \$500,000 in costs in connection with the acquisition.

#### Other

The Financial Accounting Standards Board recently issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangibles." Headwaters has not yet reviewed this statement to determine what effect it might have on Headwaters in future periods.

#### Forward Looking Statements

Statements in this Management's Discussion and Analysis regarding Headwaters' expectations as to the operation of facilities utilizing Headwaters' technologies, the marketing of products, the receipt of licensing fees, royalties, and product sales revenues, the development, commercialization and financing of non-alternative fuel technologies and other strategic business opportunities and acquisitions and other information about Headwaters that is not purely historical by nature, including those statements regarding Headwaters' future business plans, the operation of facilities, the availability of feedstocks, the marketability of the alternative fuel and the financial viability of the facilities, constitute forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Although Headwaters believes that its expectations are based on reasonable assumptions within the bounds of its knowledge of its business and operations, there can be no assurance that actual results will not differ materially from its expectations. In addition to matters affecting the alternative fuel industry or the economy generally, factors which could cause actual results to differ from expectations stated in these forward looking statements include, among others, the following:

- (1) Operating issues for licensed facilities including feedstock availability, moisture content, Btu content, correct application of chemical reagent, achieving significant chemical change, operability of equipment, production capacity, product durability, resistance to water absorption, overall costs of operations and other commercial factors surrounding the use of Headwaters' technologies.
- (2) Marketing issues relating to market acceptance of products manufactured using Headwaters' technologies.

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- (3) Securing of suitable facility sites, including permits and raw materials, for relocation and operation of facilities and product sales.
- (4) The market acceptance of products manufactured with Headwaters' technologies in the face of competition from traditional products.
- (5) Dependence on licensees to successfully implement Headwaters' chemical technologies and to make license and other payments to Headwaters.
- (6) Maintenance of placed-in-service and other requirements under Section 29 of the tax code by alternative fuel manufacturing facilities.
- (7) Changes in governmental regulations or failure to comply with existing regulations that may result in reduction or shutdown of operations of licensee facilities.
- (8) The continued availability of tax credits to licensees under the tax code and each licensee's ability to use tax credits.



- (9) The commercial feasibility of Headwaters' alternative fuel technologies upon the expiration of tax credits.
- (10) Ability to meet financial commitments under existing contractual arrangements.
- (11) Ability to meet non-financial commitments under existing contractual arrangements.
- (12) Ability to commercialize non-alternative fuel technologies which have only been tested in the laboratory and not in full-scale operations.
- (13) Ability to commercialize the technology of others and to implement new business plans which are at an early stage of investigation and investment and which will require significant time, management, and capital investment.
- (14) Success in the face of competition by others producing alternative fuel and other products.
- (15) Sufficiency of intellectual property protections.
- (16) Satisfactory resolution of disputes in litigation.

PART II -- OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See "ITEM 3: LEGAL PROCEEDINGS" in Headwaters' Annual Report on Form 10-K for the year ended September 30, 2000 for descriptions of current legal proceedings. With respect to all of those matters except NEICO/Earthco and Levy, there have been no material changes since that report was filed. NEICO, Earthco and Headwaters have settled their disputes and on November 30, 2000 the District Court entered an order of dismissal with prejudice as to all parties. With respect to Levy, an additional claimant has been added to the case and the consolidated case was dismissed by the District Court, as described in Note 7 to the consolidated financial statements.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

Recent Sales of Unregistered Securities

Other than the issuance of 103,833 shares of restricted common stock issued upon exercise of options, there have been no securities issued by Headwaters within the past fiscal quarter without registration under the Securities Act of 1933, as amended. Headwaters has five effective registration statements filed on Form S-3 and three effective registration statements filed on Form S-8. One or more of these registration statements have registered all of the other securities issued during the quarter, which consisted solely of the issuance of common stock upon exercise of options and warrants and conversion of convertible preferred stock, as described in Note 2 to the consolidated financial statements.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) The following exhibits are included herein:

- 10.72 Agreement and Plan of Reorganization between Headwaters and Hydrocarbon Technologies, Inc. dated May 2, 2001
- 10.72.1 Share Exchange Agreement between Headwaters and Hydrocarbon Technologies, Inc. dated May 2, 2001
- 99.2 Amended 2000 Employee Stock Purchase Plan

(b) There were no reports filed on Form 8-K during the quarter ended June 30, 2001.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HEADWATERS INCORPORATED

Date: August 3, 2001

By: /s/ Kirk A. Benson

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Kirk A. Benson, Chief Executive Officer  
and Principal Executive Officer

Date: August 3, 2001

By: /s/ Steven G. Stewart

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Steven G. Stewart, Chief Financial Officer  
and Principal Financial Officer

AGREEMENT AND PLAN OF REORGANIZATION

THIS AGREEMENT AND PLAN OF REORGANIZATION (the "Agreement") is made and entered into effective as of May 2, 2001, by and among HEADWATERS INCORPORATED, a Delaware corporation ("Headwaters"), HEADWATERS SUB CORPORATION, a New Jersey corporation and a wholly owned subsidiary of Headwaters ("Merger Sub"), HYDROCARBON TECHNOLOGIES, INC., a New Jersey corporation ("HTI"), and Alfred G. Comolli, Lap-Keung (Theo) Lee, Ph.D., David L. Tanner, and Michael Kelley (the "HTI Founders").

RECITALS

A. Upon the terms and subject to the conditions of this Agreement and in accordance with the applicable provisions of the laws of the State of New Jersey ("New Jersey Law"), Headwaters and HTI will enter into a business combination transaction pursuant to which Merger Sub will acquire in excess of ninety percent (90%) of the outstanding capital stock of HTI and immediately thereafter Merger Sub will merge with and into HTI (the "Merger").

B. As a condition and inducement to Headwaters' willingness to enter into this Agreement, certain shareholders of HTI have agreed, and certain other shareholders of HTI are expected to agree, to transfer in aggregate in excess of ninety percent (90%) of the outstanding shares of HTI Common Stock to Merger Sub in exchange for shares of Headwaters Common Stock and cash, on the terms and subject to the conditions set forth in the Share Exchange Agreement (the "Exchange Agreement"), in substantially the form attached hereto as Exhibit A (the "Exchange"). (The Merger, the Exchange, and the other transactions contemplated herein and in the Exchange Agreement, taken together, are referred to herein as the "Transaction.") Merger Sub, as owner of such shares of HTI Common Stock following the Exchange, shall vote for or consent to the Merger.

C. The Boards of Directors of Headwaters and Merger Sub (i) have determined that the Exchange and the Merger are in the best interests of Headwaters, its stockholders, and Merger Sub and (ii) have approved this Agreement, the Exchange Agreement, and the Transaction;

D. The Board of Directors of HTI (i) has determined that the Exchange and the Merger are in the best interests of HTI and its stockholders, (ii) has approved this Agreement, the Exchange Agreement, and the Transaction, and (iii) has determined to recommend that certain stockholders of HTI (the "HTI Stockholders") enter into the Exchange Agreement.

E. Headwaters, Merger Sub, HTI, and the HTI Founders desire to make certain representations and warranties and other agreements in connection with the Merger and the Transaction.

NOW, THEREFORE, in consideration of the premises and of the mutual agreements herein contained, the parties hereto do hereby agree as follows:

ARTICLE I  
THE MERGER

1.1 The Merger. At the Effective Time (as defined in Section 1.2) and subject to and upon the terms and conditions of this Agreement and the applicable provisions of New Jersey Law, Merger Sub shall be merged with and into HTI, the separate corporate existence of Merger Sub shall cease, and HTI shall continue as the surviving corporation. (HTI as the surviving corporation after the Merger is hereinafter sometimes referred to as the "Surviving Corporation.")

1.2 Effective Time; Closing. Subject to the provisions of this Agreement, the parties hereto shall cause the Merger to be consummated by filing a Certificate of Merger, substantially in the form of Exhibit B hereto (the "Certificate of Merger"), with the Secretary of State of the State of New Jersey, in accordance with the relevant provisions of New Jersey Law (the time of such filing (or such later time as may be agreed in writing by the parties and specified in the Certificate of Merger) being the "Effective Time") as soon as practicable on or after the Closing Date (as herein defined). Unless the context otherwise requires, the term "Agreement" as used herein refers collectively to this Agreement and the Certificate of Merger. The closing of the Merger (the "Closing"), along with the closing of the Exchange, shall take place at the offices of HTI or Headwaters, at a time and date to be specified by the parties, which shall be no later than the second business day after the satisfaction or waiver of the conditions set forth in Articles V and VI, or at such other time, date, and location as the parties hereto agree in writing (the "Closing Date").

1.3 Effect of the Merger. At the Effective Time, the effect of the Merger shall be as provided in this Agreement and the applicable provisions of New Jersey Law. Without limiting the generality of the foregoing, and subject thereto, at the Effective Time all the property, rights, privileges, powers, and franchises of HTI and Merger Sub shall vest in the Surviving Corporation, and all debts, liabilities, and duties of HTI and Merger Sub shall become the debts, liabilities, and duties of the Surviving Corporation.

1.4 Certificate of Incorporation; Bylaws.

(a) At the Effective Time, the Certificate of Incorporation of Merger Sub, in the form attached hereto as Exhibit C, as in effect immediately prior to the Effective Time, shall be the Certificate of Incorporation of the Surviving Corporation until thereafter amended as provided by law and such Certificate of Incorporation; provided, however, that at the Effective Time the Certificate of Incorporation of the Surviving Corporation shall be amended so that the name of the Surviving Corporation shall be Hydrocarbon Technologies, Inc.

(b) The Bylaws of HTI, as in effect immediately prior to the Effective Time, shall be, at the Effective Time, the Bylaws of the Surviving Corporation until thereafter amended.

1.5 Directors. The persons listed on Schedule 1.5 hereto shall be the directors of the Surviving Corporation, from and after the Effective Time, until their respective successors are duly elected or appointed and qualified.

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#### 1.6 Effect on Capital Stock.

(a) Definitions. For purposes of this Agreement:

(i) Exchanged Shares shall mean all shares of HTI Common Stock to be exchanged pursuant to the Exchange Agreement.

(ii) Merger Shares shall mean all Outstanding Shares other than the Exchanged Shares.

(iii) Fully Diluted Number shall mean the aggregate of (i) the number of Exchanged Shares, plus (ii) the number of Merger Shares, plus (iii) the number of shares of HTI Common Stock underlying all vested and unvested HTI Stock Options (as defined below) outstanding as of the Effective Time.

(iv) Headwaters Common Stock shall mean the common stock, \$0.01 par value per share, of Headwaters.

(v) HTI Common Stock shall mean the common stock, \$.01 par value per share, of HTI.

(vi) Option Exchange Ratio shall mean (A) \$14,468,750 divided by the Fully Diluted Number, and divided by the Signing Price.

(vii) Signing Price shall mean \$8.702.

(viii) Outstanding Shares shall mean all shares of HTI Common Stock outstanding immediately prior to the Closing under the Exchange Agreement.

(ix) Transaction Consideration shall mean the aggregate of the Merger Consideration (as defined herein) and the Exchange Consideration (as defined in the Exchange Agreement).

(b) Merger Consideration. The aggregate consideration for the Merger Shares (the "Merger Consideration") shall consist of cash in the amount of (A) \$14,468,750, divided by (B) the Fully Diluted Number, multiplied by (C) the number of Merger Shares.

(c) Conversion of Merger Shares. Immediately prior to the Closing, the Exchange Agreement shall be consummated. At the Effective Time, by virtue of the Merger, and without any action on the part of Merger Sub, HTI, or the holders of any shares of the Common Stock of HTI, each share of HTI Common Stock issued and outstanding immediately prior to the Effective Time that is not owned by Headwaters or Merger Sub, and all rights to accrued dividends in respect thereof (other than any shares of HTI Common Stock to be canceled pursuant to Section 1.6(d) and any Dissenting Shares (as defined in and to the extent provided in Section 1.7)), will be canceled and extinguished and automatically converted into the right to receive in cash the aggregate consideration (rounded to the nearest cent) per Merger Share in the amount of (A) the Merger Consideration plus

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the aggregate exercise price of any vested HTI Stock Options exercised between the date hereof and the Effective Time, divided by (B) the number of Merger Shares.

(d) Cancellation of Headwaters-Owned Stock. Any shares of HTI Common Stock held in the treasury of HTI or owned by Merger Sub or Headwaters immediately prior to the Effective Time, including the Exchanged Shares, shall be canceled and extinguished without any conversion thereof except for the consideration described in the Exchange Agreement.

(e) Stock Options. At the Effective Time, all options to purchase HTI Common Stock ("HTI Stock Options") then outstanding under HTI's Stock Option Plan (the "HTI Stock Option Plan") shall be exchanged by Headwaters for options to acquire Headwaters Common Stock under Headwaters' option plan registered on Form S-8 ("Substitute Options") and shall have, and be subject to, the same vesting and expiration terms as set forth in the HTI Stock Option Plan and/or any agreements pursuant to which such HTI Stock Options were granted as in effect immediately prior to the Effective Time, except that (A) each Substitute Option shall be exercisable for that number of whole shares of Headwaters Common Stock equal to the number of shares underlying such HTI Stock Option immediately prior to the Effective Time, multiplied by the Option Exchange Ratio and rounded to the nearest whole number of shares of Headwaters Common Stock and (B) the price at which each such Substitute Option is exercisable shall be divided by the Option Exchange Ratio and rounded to the nearest cent. Headwaters shall have reserved at the Effective Time a sufficient number of shares of Headwaters Common Stock for issuance upon exercise of the assumed HTI Stock Options.

(f) Capital Stock of Merger Sub. Each share of Common Stock, \$.01 par value, of Merger Sub (the "Merger Sub Common Stock") issued and outstanding immediately prior to the Effective Time shall be converted into and exchanged for one validly issued, fully paid, and nonassessable share of Common Stock, \$.01 par value, of the Surviving Corporation. Each certificate of shares of Merger Sub Common Stock shall continue to evidence ownership of such share of

### 1.7 Dissenting Shares.

(a) Notwithstanding any provision of this Agreement to the contrary, the shares of any holder of HTI Common Stock who has demanded and perfected appraisal rights for such shares in accordance with New Jersey Law, to the extent applicable, and who, as of the Effective Time, has not effectively withdrawn or lost such appraisal rights ("Dissenting Shares") shall not be converted into, or represent a right to receive, the Merger Consideration pursuant to Section 1.6, but the holder thereof shall only be entitled to such rights as are granted by New Jersey Law.

(b) Notwithstanding the foregoing, if any holder of shares of HTI Common Stock who demands appraisal of such shares under New Jersey Law shall effectively withdraw or lose (for failure to perfect or otherwise) the right to appraisal, then, as of the later of the Effective Time or the occurrence of such event, such holder's shares shall automatically be converted into and represent only the right to receive the Merger Consideration pursuant to Section 1.6 hereof, without interest thereon, upon surrender of the certificate representing such shares of HTI Common Stock in the

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manner provided in Section 1.8 hereof (or, in the case of a lost, stolen, or destroyed certificate, upon delivery of an affidavit (and bond, if required) in the manner provided in Section 1.10 hereof).

(c) HTI shall give Headwaters (i) prompt notice of any written demands for appraisal of any shares of HTI Common Stock, withdrawals of such demands, and any other instruments served pursuant to New Jersey Law and received by HTI which relate to any such demand for appraisal and (ii) the opportunity to participate in all negotiations and proceedings which take place prior to the Effective Time with respect to demands for appraisal under New Jersey Law. HTI shall not, except with the prior written consent of Headwaters or as may be required by applicable law, voluntarily make any payment with respect to any demands for appraisal of HTI Common Stock or offer to settle or settle any such demands. Any payments made in respect of Dissenting Shares shall be made by HTI.

### 1.8 Surrender of Certificates.

(a) Exchange Procedures. Promptly after the Effective Time, Headwaters shall mail to each holder of record (as of the Effective Time) of a certificate or certificates (the "Certificates") which immediately prior to the Effective Time represented outstanding shares of HTI Common Stock whose shares were converted into the right to receive the Merger Consideration pursuant to Section 1.6, (i) a letter of transmittal (which shall specify that delivery shall be effected, and risk of loss and title to the Certificates shall pass, only upon delivery of the Certificates to Headwaters, and which shall be in such

form and have such other provisions as Headwaters may reasonably specify) ("Letter of Transmittal") and (ii) instructions for use in effecting the surrender of the Certificates in exchange for the Merger Consideration pursuant to Section 1.6. Upon surrender of Certificates for cancellation to Headwaters, together with the Letter of Transmittal, duly completed and validly executed in accordance with the instructions thereto, the holders of such Certificates shall be entitled to receive in exchange therefor the Merger Consideration pursuant to Section 1.6, and the Certificates so surrendered shall forthwith be canceled. Until so surrendered, each outstanding Certificate will be deemed from and after the Effective Time, for all corporate purposes, to evidence the right to receive the Merger Consideration set forth in Section 1.6.

(b) No Liability. Notwithstanding anything to the contrary in this Section 1.8, neither Headwaters, the Surviving Corporation, nor any party hereto shall be liable to a holder of shares of HTI Common Stock for any amount properly paid to a public official pursuant to any applicable abandoned property, escheat, or similar law.

1.9 No Further Ownership Rights in HTI Common Stock. All Merger Consideration paid upon the surrender of shares of HTI Common Stock in accordance with the terms hereof shall be deemed to have been paid in full satisfaction of all rights pertaining to such Merger Shares, and there shall be no further registration of transfers on the records of the Surviving Corporation of shares of HTI Common Stock which were outstanding immediately prior to the Effective Time. If, after the Effective Time, Certificates are presented to the Surviving Corporation for any reason, they shall be canceled and exchanged as provided in this Article I.

1.10 Lost, Stolen, or Destroyed Certificates. In the event any Certificates shall have been lost, stolen, or destroyed, Headwaters shall pay the Merger Consideration in exchange for such lost,

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stolen, or destroyed Certificates upon the making of an affidavit of that fact by the holder thereof; provided, however, that Headwaters may, in its discretion and as a condition precedent to the issuance thereof, require the owner of such lost, stolen, or destroyed Certificates to deliver a bond in such sum as it may reasonably direct as indemnity against any claim that may be made against Headwaters, HTI, or the Surviving Corporation with respect to the Certificates alleged to have been lost, stolen, or destroyed.

1.11 Taking of Necessary Action; Further Action. If, at any time after the Effective Time, any further action is necessary or desirable to carry out the purposes of this Agreement and to vest the Surviving Corporation with full right, title, and possession to all assets, property, rights, privileges, powers, and franchises of HTI and Merger Sub, the officers and directors of HTI and Merger Sub are fully authorized in the name of their respective corporations or otherwise to take, and will take, all such lawful and necessary action, so long as such action is consistent with this Agreement. This provision shall be a



continuing obligation of the HTI Founders and the officers and directors of HTI and shall survive the Effective Time.

1.12 Tax Treatment. The parties intend that the Transaction will be a reorganization within the meaning of Section 368 of the Internal Revenue Code, as amended (the "Code") and hereby adopt this Agreement, in conjunction with the Exchange Agreement, as a "plan of reorganization" within the meaning of Sections 1.368-2(g) and 1.368-3(a) of the regulations promulgated under the Code (the "Treasury Regulations").

## ARTICLE II REPRESENTATIONS AND WARRANTIES OF HTI

HTI hereby makes the representations and warranties to Headwaters and Merger Sub contained in this Article II, except as set forth in the disclosure letter previously delivered by HTI to Headwaters dated on or before the date hereof and certified by a duly authorized officer of HTI (the "HTI Disclosure Letter"). As used herein, where a statement is made "to the knowledge" of HTI or a statement is made that HTI "knows" a particular fact or circumstance, such knowledge shall include the actual knowledge after reasonable inquiry of the HTI Founders and directors of HTI.

2.1 Organization of HTI. HTI is a corporation duly organized, validly existing, and in good standing under the laws of the jurisdiction of its incorporation, has the corporate power to own, lease, and operate its property and to carry on its business as now being conducted, and is duly qualified to do business and in good standing as a foreign corporation in each jurisdiction in which the character of the properties owned or held under lease or license or the nature of the business conducted by it requires such qualification, except where the failure to be so qualified would not have a material adverse effect on the business, assets (including intangible assets), financial condition, or results of operations (a "Material Adverse Effect") of HTI. The subsidiaries of HTI are as listed on Section 2.1 of the HTI Disclosure Letter; HTI owns all of the capital stock or equity of such entities. HTI has delivered true and correct copies of the Certificate of Incorporation and Bylaws of HTI, as amended to date, to counsel for Headwaters.

2.2 HTI Capital Structure. The authorized capital stock of HTI consists of 10,000,000 shares of HTI Common Stock, of which there are 1,599,611 shares issued and

outstanding as of the date hereof, and no shares of Preferred Stock are authorized, issued, or outstanding. All outstanding shares of HTI Common Stock are duly authorized, validly issued, fully paid, and non-assessable and are not subject to preemptive rights created by statute, the Certificate of Incorporation or Bylaws of HTI, or any agreement or document to which HTI is a party or by which it is bound. As of the date that is one day prior to the date hereof, HTI had reserved an aggregate of 489,500 shares of Common Stock, net of

exercises, for issuance to employees, consultants, and non-employee directors pursuant to the HTI Stock Option Plan, under which options are outstanding for an aggregate of 152,000 shares. Through the date hereof, HTI has issued no employee offer letters agreeing to issue HTI Stock Options for shares of HTI Common Stock. All shares of HTI Common Stock subject to issuance as aforesaid, upon issuance on the terms and conditions specified in the instruments pursuant to which they are issuable, would be duly authorized, validly issued, fully paid, and nonassessable. Section 2.2 of the HTI Disclosure Letter sets forth a list of all owners of HTI Common Stock and the number of shares held, all repurchases of HTI Common Stock (including the date of repurchase) and each outstanding HTI Stock Option, the name of the holder of such option, the number of shares subject to such option, the exercise price of such option, the number of shares as to which such option will have vested at such date and whether the exercisability of such option will be accelerated in any way by the transactions contemplated by this Agreement or for any other reason, and indicates the extent of acceleration, if any, and such list is true, correct, and complete in all material respects.

2.3 Obligations With Respect to Common Stock. Except as set forth in Sections 2.2 or 2.3 of the HTI Disclosure Letter, there are no options, warrants, equity securities, partnership interests, or similar ownership interests, calls, rights (including preemptive rights) of any class of HTI, or any securities exchangeable or convertible into or exercisable for such equity securities, partnership interests, or similar ownership interests issued, reserved for issuance, or outstanding. Except as set forth in Section 2.3 of the HTI Disclosure Letter, there are no commitments or agreements of any character to which HTI is a party or by which HTI is bound obligating HTI to issue, deliver, or sell, or cause to be issued, delivered, or sold, or repurchase, redeem, or otherwise acquire, or cause the repurchase, redemption, or acquisition, of any options, warrants, equity securities, partnership interests, or similar ownership interests, calls, rights (including preemptive rights) of HTI or obligating HTI to grant, extend, accelerate the vesting of, or enter into any such option, warrant, equity security, partnership interests, or similar ownership interests, call, right, commitment, or agreement. Except as set forth in Section 2.3 of the HTI Disclosure Letter, there are no registration rights, and to the knowledge of HTI, except as set forth herein, there are no voting trusts, proxies, or other agreements or understandings, with respect to any equity security, partnership interests, or similar ownership interests of any class of HTI.

#### 2.4 Authority.

(a) HTI has all requisite corporate power and authority to enter into this Agreement and to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement and the consummation of the transactions contemplated hereby and thereby, have been duly authorized by all necessary corporate action on the part of HTI, subject only to the approval of this Agreement by HTI's stockholders (unless Merger Sub, after consummation of the Exchange, satisfies the ownership requirements of Section 14A:10-5.1 of the New Jersey Business Corporations Act (the "Act") for a merger of a subsidiary corporation without shareholder

approval, in which case the only approval shall be that of Merger Sub) and the filing and recordation of the Certificate of Merger pursuant to New Jersey Law. If the Merger does not qualify for treatment under Section 14A:10-5.1 of the Act, a vote of the holders of at least a majority of the outstanding shares of the HTI Common Stock is required for HTI's stockholders to approve and adopt this Agreement and to approve the Merger. This Agreement has been duly executed and delivered by HTI and the HTI Founders and, assuming the due authorization, execution, and delivery by Headwaters and Merger Sub, constitutes the valid and binding obligations of HTI and the HTI Founders, enforceable in accordance with its terms, except as enforceability may be limited by bankruptcy and other similar laws and general principles of equity. The execution and delivery of this Agreement and the Exchange Agreement by HTI and the HTI Founders do not, and the performance of this Agreement and the Exchange Agreement by HTI and the HTI Founders will not, (i) conflict with or violate the Certificate of Incorporation or Bylaws of HTI, (ii) subject to compliance with the requirements set forth in Section 2.4(b) below, conflict with or violate any law, rule, regulation, order, judgment, or decree applicable to the HTI Founders or HTI, or by which the HTI Founders or HTI, or any of their respective properties, is bound or affected, or (iii) result in any breach of or constitute a default (or an event that with notice or lapse of time or both would become a default) under, or impair HTI's rights or alter the rights or obligations of any third party under, or give to others any rights of termination, amendment, acceleration, or cancellation of, or result in the creation of a lien or encumbrance on any of the properties or assets of HTI pursuant to, any note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise, or other instrument or obligation to which HTI is a party or by which HTI or its properties are bound or affected, except, with respect to clauses (ii) and (iii), for any such conflicts, violations, defaults, or other occurrences that would not have a Material Adverse Effect on HTI. Section 2.4 of the HTI Disclosure Letter lists all consents, waivers, and approvals under any of HTI's agreements, contracts, licenses, or leases required to be obtained in connection with the consummation of the transactions contemplated hereby.

(b) No consent, approval, order, or authorization of, or registration, declaration, or filing with any court, administrative agency, or commission or other governmental authority or instrumentality ("Governmental Entity") is required by or with respect to HTI or the HTI Founders in connection with the execution and delivery of this Agreement or the Exchange Agreement, or the consummation of the transactions contemplated hereby and thereby, except for (i) the filing of the Agreement of Merger with the Secretary of State of the State of New Jersey, and (ii) such other consents, authorizations, filings, approvals, and registrations which, if not obtained or made, would not have a Material Adverse Effect on HTI or have a material adverse effect on the ability of the parties to consummate the Merger.

## 2.5 HTI Financial Statements.

(a) HTI has delivered to Headwaters certain consolidated financial statements of HTI and its subsidiaries as follows: (i) the audited balance sheets as of June 30, 2000, December 31, 1999, and December 31, 1998, and the related audited statements of operations, stockholders' equity and cash flows for the years ended as of December 31, 1999 and 1998, and the six months ended as of June 30, 2000, and the notes thereto; (ii) the unaudited quarterly financial data for the quarterly periods ended as of September 30, 2000, and December 31, 2000, and (iii) the unaudited balance sheets as of December 31, 2000, and February 28, 2001, and the statement of operations,

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stockholders' equity and cash flows for the one-year period ended December 31, 2000 (collectively, the "HTI Financials"). Each of the HTI Financials (i) was prepared in accordance with generally accepted accounting principles ("GAAP"), applied on a consistent basis throughout the periods involved (except as may be indicated in the notes thereto) and (ii) fairly presented the financial position of HTI as at the respective dates thereof and the results of its operations and cash flows for the periods indicated, except for the absence of notes for the unaudited interim financial statements and that the unaudited interim financial statements were or are subject to normal and recurring year-end adjustments which were not, or are not expected to be, material in amount. The balance sheet of HTI as of December 31, 2000 is hereinafter referred to as the "HTI Balance Sheet." Except as disclosed in the HTI Financials, HTI does not have any liabilities, debts, or obligations of any kind or description (absolute, accrued, contingent, or otherwise) of a nature required to be disclosed on a balance sheet or in the related notes to the financial statements prepared in accordance with GAAP which are, individually or in the aggregate, material to the business, results of operations, or financial condition of HTI, except (i) as and to the extent reflected or reserved against in the HTI Balance Sheet, or (ii) incurred since the date of the HTI Balance Sheet in the ordinary course of business consistent with past practices.

2.6 Absence of Certain Changes or Events. Since the date of the HTI Balance Sheet, there has not been: (i) any event that has had or would reasonably be expected to have a Material Adverse Effect on HTI, or (ii) any material change by HTI in its accounting methods, principles, or practices, except as required by concurrent changes in GAAP, nor has HTI entered into any contracts, leases, orders, or other commitments other than in the ordinary course of business.

## 2.7 Taxes.

(a) Definition of Taxes. For the purposes of this Agreement, "Tax" or "Taxes" refers to any and all federal, state, local and foreign taxes, assessments and other governmental charges, duties, impositions and liabilities relating to taxes, including taxes based upon or measured by gross receipts, income, profits, sales, use and occupation, and value added, ad valorem, transfer, franchise, withholding, payroll, recapture, employment, excise and property taxes, together with all interest, penalties and additions imposed with

respect to such amounts and any obligations under any agreements or arrangements with any other person with respect to such amounts and including any liability for taxes of a predecessor entity.

(b) All federal, state, local and foreign returns, estimates, information statements and reports ("Returns") relating to Taxes required to be filed with any tax authority by or on behalf of the HTI with respect to any taxable period ending on or before the Closing Date if due on or before the Closing Date (i) have been or will be filed on or before the applicable due date (including any extensions of such due date if properly obtained), and (ii) have been, or will be when filed, prepared in all material respects in compliance with all applicable legal requirements. All amounts shown on the Tax Returns to be due on or before the Closing Date have been or will be paid on or before the Closing Date.

(c) HTI's financial statements fully accrue all actual and contingent liabilities for Taxes with respect to all periods through the dates thereof in accordance with GAAP. HTI will

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establish, in the ordinary course of business and consistent with its past practices, reserves adequate for the payment of all Taxes for the period from the date of this Agreement through the Closing Date.

(d) Since inception, no Tax Return of HTI has been examined or audited by any applicable tax authority. No extension or waiver (other than the normal extension occurring by reason of an extension of time to file a Return) of the limitation period applicable to any such Returns has been granted (by HTI or any other person on behalf of HTI), and no such extension or waiver has been requested from HTI.

(e) No claim or legal proceeding is pending or, to the best of the knowledge of HTI, has been threatened against or with respect to HTI in respect of any material Tax. There are no unsatisfied liabilities for material Taxes (including liabilities for interest, additions to tax and penalties thereon and related expenses) with respect to any notice of deficiency or similar document received by HTI with respect to any material Tax (other than liabilities for Taxes asserted under any such notice of deficiency or similar document which are being contested in good faith by HTI and with respect to which adequate reserves for payment have been established). There are no liens for material Taxes upon any of the assets of HTI except liens for current Taxes not yet due and payable. HTI has not entered into or become bound by any agreement or consent pursuant to Section 341(f) of the Code. HTI has not been and, to the knowledge of HTI, will not be, required to include any adjustment in taxable income for any tax period (or portion thereof) pursuant to Section 481 or 263A of the Code or any comparable provision under state or foreign Tax laws as a result of transactions or events occurring, or accounting methods employed, prior to the Closing. HTI has neither made an election, nor is required, to treat any of its assets as owned by another person pursuant to the provision of

Section 168(f) of the Code or as tax-exempt bond financed property or tax-exempt use property within the meaning of Section 168 of the Code. HTI has not acquired and does not own any assets that directly or indirectly secure any debt the interest on which is tax exempt under Section 103(a) of the Code.

(f) There is no agreement, plan, arrangement, or other Contract covering any employee or independent contractor or former employee or independent contractor of HTI that, considered individually or considered collectively with any other such agreement, will or could reasonably be expected to give rise directly or indirectly to the payment of any amount that would not be deductible pursuant to Section 280G or Section 162 of the Code. HTI is not, nor has it ever been, a party to or bound by any tax indemnity agreement, tax sharing agreement, tax allocation agreement, or similar agreement. HTI has never been a member of a consolidated, combined, or unitary group. HTI has no interest in nor is it subject to any joint venture, partnership, or other arrangement or contract which is treated as a partnership for federal income tax purposes. HTI has no liability for Taxes of any Person other than HTI under Section 1.1502-6 of the Treasury Regulations (or any similar provision of state, local, or foreign law), as a transferee or successor, by contract or otherwise. HTI is not and has not been a United States real property holding corporation within the meaning of Section 897(c)(2) of the Code during the applicable period specified in Section 897(c)(1)(A)(ii) of the Code.

(g) There is currently no limitation on the utilization of the net operating losses, built-in losses, capital losses, Tax credits, or other similar items of HTI under Sections 382, 383, and 384 of the Code and Section 1502 of the Code and under the Treasury Regulations promulgated

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thereunder. HTI has not taken any action not in accordance with past practice that would have the effect of deferring a measure of Tax (including but not limited to income, sales, gross receipts, or payroll) from a period (or portion thereof) ending on or prior to the Closing to a period (or portion thereof) beginning after the Closing. No material item of income or gain of HTI reported or to be reported for financial reporting purposes in any pre-Closing period is required to be included in taxable income in a post-Closing period. HTI has never been a party to any transaction intended to qualify under Section 355 of the Code. The total adjusted tax basis of HTI's assets equals or exceeds the sum of HTI's liabilities.

## 2.8 Intellectual Property.

(a) Section 2.8(a) of the HTI Disclosure Letter contains a true and complete list of all patents, trademarks, trade names, service marks, and copyrights, and registrations thereof and applications (including provisional applications) therefor (including all trademarks and service marks that HTI has used with the intent of creating or benefiting from any common law rights relating to such marks), used in the business of HTI, and lists any proceedings or actions pending as of the date hereof before any court or

tribunal (including the United States Patent and Trademark Office or equivalent authority anywhere in the world) related to such intellectual property.

(b) Except as set forth in Section 2.8(b) of the HTI Disclosure Letter, HTI owns, or has the right to use, sell, or license all intellectual property (including the patents, trademarks, trade names, service marks, copyrights, and registrations thereof and applications therefor described in Section 2.8(a) of the HTI Disclosure Letter) necessary or required for the conduct of its business as currently conducted (such intellectual property and the rights thereto are collectively referred to herein as the "HTI IP Rights"), and HTI has delivered or will deliver to Headwaters prior to the Effective Time certificates of originality with respect to the HTI IP Rights in form and substance reasonably satisfactory to Headwaters. HTI (i) owns exclusively all trademarks, service marks, and trade names used by it in connection with the operation or conduct of the business of HTI, including the sale of any products or technology or the provision of any services by HTI; provided, however, that HTI may use trademarks, service marks, and trade names of third parties which are licensed to HTI or are in the public domain, and (ii) owns exclusively, and has good title to, each copyrighted work that is an HTI product and each other work of authorship that HTI otherwise purports to own.

(c) To the extent that any HTI intellectual property has been developed or created by any person other than HTI, HTI has a written agreement with such person with respect thereto and has either (i) obtained ownership of, and is the exclusive owner of, all such intellectual property by operation of law or by valid assignment of any such rights or (ii) has obtained a license under or to such intellectual property.

(d) Except pursuant to agreements described in Section 2.8(d) of the HTI Disclosure Letter, HTI has not transferred ownership of or granted any license of or other right to use or authorized the retention of any rights to use any intellectual property that is or was HTI IP, to any other Person.

(e) The HTI IP constitutes all the intellectual property used in and/or necessary to the conduct of HTI's business as it currently is conducted, including the design, development,

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distribution, marketing, manufacture, use, import, license, and sale of the products, technology, and services of HTI (including products, technology, or services currently under development).

(f) Section 2.8(f) of the HTI Disclosure Letter lists all contracts and licenses (including all inbound licenses) to which HTI is a party with respect to any intellectual property. No person other than HTI has ownership rights to improvements made by HTI in intellectual property that has been licensed to HTI.

(g) Section 2.8(g) of the HTI Disclosure Letter lists all

contracts, licenses, and agreements between HTI and any other person wherein or whereby HTI has agreed to, or assumed, any obligation or duty to warrant, indemnify, reimburse, hold harmless, guaranty, or otherwise assume or incur any obligation or liability or provide a right of rescission with respect to the infringement or misappropriation by HTI or such other person of the intellectual property of any person other than HTI.

(h) The operation of the business of HTI as currently conducted, including HTI's design, development, use, import, manufacture, and sale of the products, technology, or services (including products, technology, or services currently under development) of HTI (the "HTI Technology") does not (i) with respect to the HTI Technology underlying HTI's contracts and proposed contracts with Shenhua Group Corporation described in Sections 2.8 and 2.16 of the HTI Disclosure Letter and with PetroChina described in Section 2.16 of the HTI Disclosure Letter (the "Shenhua/PetroChina Agreements") infringe or misappropriate the intellectual property of any person, and with respect to all other HTI Technology, with the knowledge of HTI, infringe or misappropriate the intellectual property of any person, (ii) violate any term or provision of any license or contract concerning such intellectual property (including any provision required by or imposed pursuant to 35 U.S.C. ss.ss. 200-212 in any license or contract to which HTI is a party requiring that products be manufactured substantially in the United States ("Made-in-America Requirements")), (iii) with respect to the HTI Technology underlying the Shenhua/PetroChina Agreements, violate the rights of any person (including rights to privacy or publicity) and with respect to all other HTI Technology, with the knowledge of HTI, violate the rights of any person (including rights to privacy or publicity), or (iv) constitute unfair competition or an unfair trade practice under any law, and HTI has not received notice from any person claiming that such operation or any act, product, technology, or service (including products, technology, or services currently under development) of HTI infringes or misappropriates the intellectual property of any person or constitutes unfair competition or trade practices under any law, including notice of third party patent or other intellectual property rights from a potential licensor of such rights.

(i) Each item of HTI IP is valid and subsisting, and all necessary registration, maintenance, renewal fees, annuity fees, and taxes in connection with such HTI IP have been paid and all necessary documents and certificates in connection with such HTI IP have been filed with the relevant patent, copyright, trademark, or other authorities in the United States or foreign jurisdictions, as the case may be, for the purposes of maintaining such HTI IP. Section 2.8(i)(1) of the HTI Disclosure Letter lists all actions that must be taken by HTI within ninety (90) days from the date hereof, including the payment of any registration, maintenance, renewal fees, annuity fees, and taxes or the filing of any documents, applications, or certificates for the purposes of maintaining, perfecting, or preserving or renewing any HTI IP. Except as set forth in Section 2.8(i)(2) of the HTI



Disclosure Letter, HTI has registered the copyright with the U.S. Copyright Office for the latest version of each product or technology of HTI that constitutes or includes a copyrightable work. In each case in which HTI has acquired ownership of any intellectual property rights from any person, HTI has obtained a valid and enforceable assignment sufficient to irrevocably transfer all rights in such intellectual property (including the right to seek past and future damages with respect to such intellectual property) to HTI and, to the maximum extent provided for by and required to protect HTI's ownership rights in and to such intellectual property in accordance with applicable laws, HTI has recorded each such assignment of HTI IP with the relevant governmental or regulatory authority, including the PTO and the U.S. Copyright Office.

(j) There are no contracts or licenses between HTI and any other person with respect to HTI intellectual property under which there is any dispute (or, to HTI's knowledge, facts that may reasonably lead to a dispute) known to HTI regarding the scope of such contract or license, or performance under such contract or license, including with respect to any payments to be made or received by HTI thereunder.

(k) To the knowledge of HTI, no person is infringing or misappropriating any HTI IP.

(l) HTI has taken all commercially reasonable steps to protect its rights in confidential information and trade secrets of HTI or provided by any other person to HTI subject to a duty of confidentiality. Without limiting the generality of the foregoing, HTI has, and enforces, a policy requiring each employee, and each consultant and independent contractor with access to confidential information, to execute proprietary information, confidentiality, and invention and copyright assignment agreements substantially in the form set forth in Section 2.8(l) of the HTI Disclosure Letter, and each current and former employee, consultant, and independent contractor of HTI has executed such an agreement and copies of all such agreements have been provided or made available to Headwaters for review.

(m) No HTI IP or product, technology, or service of HTI is subject to any order, action, or proceeding, or "march in" rights, that restricts, or that is reasonably expected to restrict in any manner, the use, transfer, or licensing of any HTI IP by HTI or that may affect the validity, use, or enforceability of such HTI IP.

(n) No (i) product, technology, service, or publication of HTI, (ii) material published or distributed by HTI, or (iii) conduct or statement of HTI constitutes obscene material, a defamatory statement, or material, false advertising, or otherwise violates any law.

(o) Neither this Agreement nor any transactions contemplated by this Agreement will result in Headwaters granting any rights or licenses with respect to the intellectual property of Headwaters or HTI to any person pursuant to any contract to which HTI is a party or by which any of its assets and properties are bound.

(p) Section 2.8(p) of the HTI Disclosure Letter sets forth a list of (x) all software which HTI has licensed from any third party which is used by HTI in its products or otherwise in its business (other than standard off-the-shelf software) and (y) a list of all "freeware" and "shareware"

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incorporated into any product now or heretofore shipped by HTI. HTI has all rights necessary to the use of such software, "freeware", and "shareware."

(q) HTI's products comply in all material respects with all applicable standards and with the feature specifications and performance standards set forth in HTI's product data sheets. There are no outstanding claims (or facts that may reasonably lead to a claim) for breach of warranties by HTI in connection with the foregoing. All product performance comparisons heretofore furnished by HTI to customers or Headwaters are accurate in all material respects as of the dates so furnished (except that, in the case of product performance comparisons made as of a specified earlier date, such comparisons shall be accurate as of such specified earlier date, and, in the case of product performance comparisons superseded by a subsequent product performance comparison furnished to the customer before the customer's acquisition of a license on the product covered by the superseded comparison, the superseding comparison shall be accurate in all material respects and the superseded comparison shall be disregarded).

(r) HTI has taken all reasonably necessary and appropriate steps to protect and preserve ownership of HTI IP. HTI has secured valid written assignments from all consultants and employees who contributed to the creation or development of the HTI IP. In the event that the consultant is concurrently employed by HTI and a third party, HTI has taken additional steps to ensure that any HTI IP developed by such a consultant does not belong to the third party or conflict with the third party's employment agreement; such steps include ensuring that all research and development work performed by such a consultant are performed only on HTI's facilities and only using HTI's resources, except as set forth in Section 2.8(r) of the HTI Disclosure Letter.

(s) HTI is in timely compliance in all material respects with the performance milestones set forth in its agreement with Lyondell Chemical Company described in Section 2.8(a) of the HTI Disclosure Letter.

(t) HTI is in compliance in all material respects with the terms of the Institut Francais du Petrole ("IFP") agreement described in Section 2.8(a) of the HTI Disclosure Letter and has not to date used any of IFP's technology.

## 2.9 Compliance; Permits.

(a) HTI is not in conflict with, or in default or violation of, (i) any law, rule, regulation, order, judgment or decree applicable to HTI

or by which HTI or any of its properties is bound or affected (except for such conflicts, defaults and violations which are not, individually or in the aggregate, material to the operation of the business of HTI), or (ii) any note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise or other instrument or obligation to which HTI is a party or by which HTI or any of its properties is bound or affected. To the knowledge of HTI, no investigation or review by any governmental or regulatory body or authority is pending or threatened against HTI, nor has any governmental or regulatory body or authority indicated an intention to conduct the same.

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(b) HTI holds all permits, licenses, variances, exemptions, orders and approvals from governmental authorities which are material to the operation of the business of HTI (collectively, the "HTI Permits"). HTI is in compliance with the terms of HTI Permits.

2.10 Litigation. There is no action, suit, proceeding, claim, arbitration or investigation pending, or as to which HTI has received any notice of assertion, nor, to HTI's knowledge, is there a threatened action, suit, proceeding, claim, arbitration or investigation against HTI, including any such action, suit, proceeding, claim, arbitration or investigation that in any manner challenges or seeks to prevent, enjoin, alter or delay any of the transactions contemplated by this Agreement.

2.11 Brokers' and Finders' Fees. HTI has not incurred, nor will it incur, directly or indirectly, any liability for brokerage or finders' fees or agents' commissions or any similar charges in connection with this Agreement or any transaction contemplated hereby.

2.12 Employee Matters and Benefit Plans.

(a) Definitions. With the exception of the definition of "Affiliate" set forth in Section 2.12(a)(i) below (which definition shall apply only to this Section 2.12), for purposes of this Agreement, the following terms shall have the meanings set forth below:

(i) "Affiliate" shall mean any other person or entity under common control with HTI within the meaning of Section 414(b), (c), (m) or (o) of the Code and the regulations issued thereunder;

(ii) "HTI Employee Plan" shall mean any plan, program, policy, practice, contract, agreement or other arrangement providing for compensation, severance, termination pay, deferred compensation, performance compensation, stock or stock-related compensation, fringe benefits or other employee benefits or remuneration of any kind, whether written or unwritten or otherwise, funded or unfunded, including without limitation, each "employee benefit plan," within the meaning of Section 3(3) of ERISA which is or has been maintained, contributed to, or required to be contributed to, by HTI or any Affiliate for the benefit of any HTI Employee, or with respect to which HTI or

any Affiliate has or may have any liability or obligation;

(iii) "COBRA" shall mean the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended;

(iv) "DOL" shall mean the Department of Labor;

(v) "HTI Employee" shall mean any current or former employee, consultant or director of HTI or any Affiliate;

(vi) "HTI Employee Agreement" shall mean each management, employment, severance, consulting, relocation, repatriation, expatriation, visas, work permit or other agreement or contract or arrangement between HTI or any Affiliate and any HTI Employee;

(vii) "ERISA" shall mean the Employee Retirement Income Security Act of 1974, as amended;

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(viii) "FMLA" shall mean the Family Medical Leave Act of 1993, as amended;

(ix) "HTI International Employee Plan" shall mean each HTI Employee Plan that has been adopted or maintained by HTI or any Affiliate, whether informally or formally, or with respect to which HTI or any Affiliate will or may have any liability, for the benefit of HTI Employees who perform services outside the United States;

(x) "IRS" shall mean the Internal Revenue Service;

(xi) "HTI Multiemployer Plan" shall mean any "HTI Pension Plan" (as defined below) which is a "multiemployer plan," as defined in Section 3(37) of ERISA;

(xii) "PBGC" shall mean the Pension Benefit Guaranty Corporation; and

(xiii) "HTI Pension Plan" shall mean each HTI Employee Plan which is an "employee pension benefit plan," within the meaning of Section 3(2) of ERISA.

(b) Schedule. Section 2.12(b) of the HTI Disclosure Letter contains an accurate and complete list of each HTI Employee Plan and each HTI Employee Agreement under each HTI Employee Plan. HTI does not have any plan or commitment to establish any new HTI Employee Plan or HTI Employee Agreement, to modify any HTI Employee Plan or HTI Employee Agreement (except to the extent required by law or to conform any such HTI Employee Plan or HTI Employee Agreement to the requirements of any applicable law, in each case as previously disclosed to Headwaters in writing, or as required by this Agreement or in the

ordinary course of business), or to enter into any HTI Employee Plan or HTI Employee Agreement.

(c) Documents. HTI has made available to Headwaters: (i) correct and complete copies of all documents embodying each HTI Employee Plan and each HTI Employee Agreement including (without limitation) all amendments thereto and all related trust documents; (ii) the most recent annual actuarial valuations, if any, prepared for each HTI Employee Plan; (iii) the three (3) most recent annual reports (Form Series 5500 and all schedules and financial statements attached thereto), if any, required under ERISA or the Code in connection with each HTI Employee Plan; (iv) if the HTI Employee Plan is funded, the most recently required and completed annual and periodic accounting of HTI Employee Plan assets; (v) the most recent summary plan description together with the summary(ies) of material modifications thereto, if any, required under ERISA with respect to each HTI Employee Plan; (vi) all IRS determination, opinion, notification and advisory letters, and all applications and correspondence to or from the IRS or the DOL with respect to any such application or letter; (vii) all material written agreements and contracts relating to each HTI Employee Plan, including, but not limited to, administrative service agreements, group annuity contracts and group insurance contracts; (viii) all written communications material to any HTI Employee or HTI Employees relating to any HTI Employee Plan and any proposed HTI Employee Plans, in each case, relating to any amendments, terminations, establishments, increases or decreases in benefits, acceleration of payments or vesting schedules or other events which would result in any material liability to HTI; (ix) all correspondence to or from any governmental agency relating to any HTI Employee Plan; (x) all COBRA forms and related notices; (xi) all policies pertaining to

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fiduciary liability insurance covering the fiduciaries for each HTI Employee Plan; and (xii) all discrimination tests for each HTI Employee Plan for the most recent plan year.

(d) Employee Plan Compliance. Except as set forth in Section 2.12(d) of the HTI Disclosure Letter, (i) HTI has performed in all material respects all obligations required to be performed by it under, is not in default or violation of, and has no knowledge of any default or violation by any other party to each HTI Employee Plan, and each HTI Employee Plan has been established and maintained in all material respects in accordance with its terms and in compliance in all material respects with all applicable laws, statutes, orders, rules and regulations, including but not limited to ERISA or the Code; (ii) each HTI Employee Plan intended to qualify under Section 401(a) of the Code and each trust intended to qualify under Section 501(a) of the Code has either received a favorable determination, opinion, notification or advisory letter from the IRS with respect to each such Plan as to its qualified status under the Code, including all amendments to the Code effected by the Tax Reform Act of 1986 and subsequent legislation, or has remaining a period of time under applicable Treasury Regulations or IRS pronouncements in which to apply for such a letter and make any amendments necessary to obtain a favorable determination as to the

qualified status of each such HTI Employee Plan; (iii) to HTI's knowledge, no "prohibited transaction," within the meaning of Section 4975 of the Code or Sections 406 and 407 of ERISA, and not otherwise exempt under Section 408 of ERISA, has occurred with respect to any HTI Employee Plan; (iv) there are no actions, suits or claims pending, or, to the knowledge of HTI, threatened or reasonably anticipated (other than routine claims for benefits) against any HTI Employee Plan or against the assets of any HTI Employee Plan; (v) each HTI Employee Plan can be amended, terminated or otherwise discontinued after the Effective Time in accordance with its terms, without liability to the Headwaters, Merger Sub, the Surviving Corporation, HTI or any of its Affiliates (other than ordinary administration expenses or full vesting of any employer contributions to any HTI Employee Plan intended to qualify under Section 401(a) of the Code); (vi) there are no audits, inquiries or proceedings pending or, to the knowledge of HTI or any Affiliates, threatened by the IRS or DOL with respect to any HTI Employee Plan; and (vii) neither HTI nor any Affiliate is subject to any penalty or tax with respect to any HTI Employee Plan under Section 502(i) of ERISA or Sections 4975 through 4980 of the Code.

(e) HTI Pension Plan. Neither HTI nor any Affiliate has ever maintained, established, sponsored, participated in, or contributed to any HTI Pension Plan that is subject to Title IV of ERISA or Section 412 of the Code.

(f) HTI Multiemployer Plans. At no time has HTI or any Affiliate contributed to or been required to contribute to any HTI Multiemployer Plan.

(g) No Post-Employment Obligations. No HTI Employee Plan provides, or reflects or represents any liability to provide, retiree life insurance, retiree health or other retiree employee welfare benefits to any person for any reason, except as may be required by COBRA or other applicable statute, and HTI has never represented, promised or contracted (whether in oral or written form) to any HTI Employee (either individually or to HTI Employees as a group) or any other person that such HTI Employee(s) or other person would be provided with retiree life insurance, retiree health or other retiree employee welfare benefit, except to the extent required by statute.

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(h) COBRA. Neither HTI nor any Affiliate has, prior to the Effective Time and in any material respect, violated any of the health care continuation requirements of COBRA, the requirements of FMLA or any similar provisions of state law applicable to its HTI Employees.

(i) Effect of Transaction.

(i) Except as set forth in the Disclosure Letter, the execution of this Agreement and the consummation of the transactions contemplated hereby will not (either alone or upon the occurrence of any additional or subsequent events) constitute an event under any HTI Employee Plan, HTI Employee Agreement, trust or loan that will or may result in any

payment (whether of severance pay or otherwise), acceleration, forgiveness of indebtedness, vesting, distribution, increase in benefits or obligation to fund benefits with respect to any HTI Employee.

(ii) Except as set forth in the Disclosure Letter, no payment or benefit which will or may be made by HTI or its Affiliates with respect to any HTI Employee as a result of the transactions contemplated by this Agreement will be characterized as a "parachute payment," within the meaning of Section 280G(b)(2) of the Code (but without regard to clause (ii) thereof).

(j) HTI International Employee Plan. Neither HTI nor any Affiliate has ever maintained, established, sponsored, participated in, or contributed to, any HTI International Employee Plan.

2.13 Absence of Liens and Encumbrances; Condition of Equipment. Set forth in Section 2.13 of the HTI Disclosure Letter are a complete and correct list and summary description of all fixed assets, machinery, equipment, vehicles and other tangible assets owned or used by HTI at the date of this Agreement. HTI has the exclusive right to use all such assets, subject, in the case of leased property, to continuing obligations under leases therefor. HTI has good and valid title to, or, in the case of leased properties and assets, valid leasehold interests in, all of its material tangible properties and assets, real, personal and mixed, used in its business, free and clear of any liens or encumbrances except as reflected in the HTI Financials and except for liens for taxes not yet due and payable.

#### 2.14 Environmental Matters.

(a) Hazardous Material. Except as set forth in Section 2.14 of the HTI Disclosure Letter, no underground storage tanks and no amount of any substance that has been designated by any Governmental Entity or by applicable federal, state, or local statute, ordinance, or regulation to be radioactive, toxic, hazardous, or otherwise a danger to health or the environment, including, without limitation, PCBs, asbestos, petroleum, urea-formaldehyde, and all substances listed as hazardous substances pursuant to the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended, or listed as hazardous wastes pursuant to the Resource Conservation and Recovery Act of 1976, as amended, and the regulations promulgated pursuant to said laws (a "Hazardous Material"), but excluding office and janitorial supplies, are present, as a result of HTI's actions, or, to HTI's knowledge, as a result of a third party's actions or otherwise, in, on, or under any property, including the land and the improvements, ground water, and surface water thereof, that HTI has at any time owned, operated, occupied, or leased.

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(b) Hazardous Materials Activities. Neither HTI nor any HTI officer or employee on its behalf has transported, sold, distributed, stored, treated, processed, used, manufactured, generated, disposed of, released, or exposed its employees, others, or the environment to Hazardous Materials or any

product containing a Hazardous Material (collectively "Hazardous Materials Activities") except in compliance with all applicable treaties, federal, state, and local statutes, ordinances, regulations, or judicial and administrative orders (collectively, "Environmental Laws") in effect prior to or as of the date hereof.

(c) Permits. HTI currently holds all environmental approvals, permits, licenses, clearances and consents (the "HTI Environmental Permits") required for the conduct of HTI's Hazardous Materials Activities, the use and occupancy of its property, and other businesses of HTI as such activities and businesses are currently being conducted and is in compliance with all terms and conditions of all HTI Environmental Permits.

(d) Environmental Liabilities. Except as set forth in Section 2.14 of the HTI Disclosure Letter, HTI is not subject to and has not received notice of any past, pending, or, to HTI's knowledge, threatened claim, demand, action, judicial or administrative proceeding, notice of noncompliance, notice of violation, consent order, or consent agreement (collectively, "Environmental Claims") under any Environmental Law from any enforcement entity or third party, concerning any HTI Environmental Permit, Hazardous Material, or Hazardous Materials Activity of HTI, any property that HTI has at any time owned, operated, occupied, or leased, or any facility or location to which Hazardous Materials generated by HTI have been transported for disposal. HTI is not aware of any fact or circumstance that could involve HTI in any Environmental Claim or impose upon HTI any liability that would have a Material Adverse Effect on HTI.

2.15 Labor Matters. To HTI's knowledge, there are no activities or proceedings of any labor union to organize any employees of HTI and there are no strikes, or material slowdowns, work stoppages or lockouts, or threats thereof by or with respect to any employees of HTI. HTI is and has been in compliance with all applicable laws regarding employment practices, terms and conditions of employment, and wages and hours (including, without limitation, ERISA, WARN or any similar state or local law), except for any noncompliance that would not have a Material Adverse Effect on HTI. HTI has not received any notice from any of its employees that any employee is terminating his or her employment with HTI, nor, to the best of HTI's knowledge, does any employee intend to terminate his or her employment with HTI as a result of the transactions contemplated hereby.

2.16 Agreements, Contracts, and Commitments. Set forth in Section 2.16 of the HTI Disclosure Letter are a complete and correct list and summary description of all material contracts, agreements, orders, leases, licenses and other commitments (each a "HTI Contract") of HTI at the date of this Agreement. Except as set forth in the HTI Disclosure Letter, HTI is not a party to nor is bound by:

(a) any collective bargaining agreements;

(b) any bonus, deferred compensation, severance, incentive compensation, pension, profit-sharing, or retirement plans, or any other employee benefit plans or arrangements;



(c) any employment or consulting agreement, contract, or commitment with any officer- or director-level employee, or member of HTI's Board of Directors;

(d) any agreement or plan, including, without limitation, any stock option plan, stock appreciation right plan, or stock purchase plan, any of the benefits of which will be increased, or the vesting of benefits of which will be accelerated, by the occurrence of any of the transactions contemplated by this Agreement or the value of any of the benefits of which will be calculated on the basis of any of the transactions contemplated by this Agreement;

(e) any agreement of indemnification or guaranty not entered into in the ordinary course of business other than indemnification agreements between HTI and any of its officers or directors;

(f) any agreement, contract, or commitment containing any covenant limiting the freedom of HTI to engage in any line of business or compete with any person;

(g) any agreement, contract, or commitment relating to capital expenditures and involving future obligations in excess of \$10,000 and not cancelable without penalty;

(h) any agreement, contract, or commitment currently in force relating to the disposition or acquisition of assets not in the ordinary course of business or any ownership interest in any corporation, partnership, joint venture, or other business enterprise;

(i) any mortgages, indentures, loans, or credit agreements, security agreements, or other agreements or instruments relating to the borrowing of money or extension of credit;

(j) any joint marketing or development agreement (excluding agreements with resellers, value added resellers, or independent software vendors entered into in the ordinary course of business that do not permit such resellers or vendors to modify HTI's software products);

(k) any distribution agreement (identifying any that contain exclusivity provisions); or

(l) any other agreement, contract, or commitment which involves payment by HTI under any such agreement, contract or commitment of \$100,000 or more individually and is not cancelable without penalty within thirty (30) days.

Neither HTI, nor to HTI's knowledge any other party to a HTI Contract,

has breached, violated, or defaulted under, or received notice that it has breached, violated, or defaulted under, any of the material terms or conditions of any of such HTI Contracts in such a manner as would permit any other party to cancel or terminate any such HTI Contract, or would permit any other party to seek damages.

2.17 Employees; Change of Control Payments. Set forth in Section 2.17 of the HTI Disclosure Letter is a complete list of the current employees of HTI, including a complete and correct compensation schedule for all employees and a complete and correct list and summary description of benefits for the key employees of HTI. Except as set forth in Section 2.17 of the HTI

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Disclosure Letter, there are no employment contracts with any personnel. Section 2.17 of the HTI Disclosure Letter sets forth each plan or agreement pursuant to which any amounts may become payable (whether currently or in the future) to current or former officers, directors and employees of HTI as a result of or in connection with the Merger.

2.18 Restrictions on Business Activities. There is no agreement (noncompete or otherwise), judgment, injunction, order, or decree to which HTI is a party or otherwise binding upon HTI which has or reasonably would be expected to have the effect of prohibiting or impairing any business practice of HTI, any acquisition of property (tangible or intangible) by HTI, or the conduct of business by HTI. Without limiting the foregoing, HTI has not entered into any agreement under which HTI is restricted from selling, licensing, or otherwise distributing any of its products to any class of customers, in any geographic area, during any period of time, or in any segment of the market.

2.19 Title to Properties; Absence of Liens and Encumbrances.

(a) Schedule 2.19(a) of the HTI Disclosure Letter sets forth the location, years of ownership, and former owners (to the extent known) of all real property owned by HTI, either currently or in the past.

(b) Section 2.19(b) of the HTI Disclosure Letter sets forth a list of all real property currently leased by HTI, the name of the lessor, and the date of the lease and each amendment thereto. All such current leases are in full force and effect, are valid and effective in accordance with their respective terms, and there is not, under any of such leases, any material existing default or event of default (or event which with notice or lapse of time, or both, would constitute a material default).

(c) HTI has good and valid title to, or, in the case of leased properties and assets, valid leasehold interests in, all of its tangible properties and assets, real, personal, and mixed, used or held for use in its business, free and clear of any liens, pledges, charges, claims, security interests, or other encumbrances of any sort except as reflected in HTI's Financials or in Section 2.19(b) of the HTI Disclosure Letter and except for

liens for Taxes not yet due and payable and such imperfections of title and encumbrances, if any, which are not material in character, amount, or extent, and which do not materially detract from the value, or materially interfere with the present use, of the property subject thereto or affected thereby.

2.20 Board Approval. The Board of Directors of HTI has, as of the date of this Agreement, determined (i) that the Transaction is fair to, and in the best interests of, HTI and all of its stockholders, and (ii) to recommend that the stockholders of HTI approve and adopt this Agreement and approve the Merger.

2.21 Insurance. Section 2.21 of the HTI Disclosure Letter sets forth all insurance policies held by HTI for the two years prior to the Effective Time. During the past five years HTI has not experienced any uninsured losses in respect of public liability, product liability, and worker compensation claims. All insurance policies are duly in force as of the date of this Agreement. No

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notice has been received by HTI regarding the cancellation, non-renewal, or increased premiums due with respect to any insurance policy.

2.22 Warranties. HTI has heretofore furnished or made available to Headwaters or its counsel for its review copies of all written warranties covering the products of HTI currently in effect. HTI has not experienced any warranty claims which have affected the consolidated net income of HTI by more than \$10,000 in any one fiscal year.

2.23 Minute Books. The minute books of HTI made available to counsel for Headwaters are the only minute books of HTI and contain a reasonably accurate summary, in all material respects, of all meetings of directors (and committees thereof) and stockholders or actions by written consent since the time of incorporation of HTI.

2.24 Business Plan. The projections set forth in the Business Plan were prepared in good faith based on conclusions and assumptions that, to the knowledge of HIT, are reasonable as of the date hereof.

2.25 No Material Misrepresentations. Neither this Agreement nor any certificate, exhibit, schedule, or other information furnished by or on behalf of HTI pursuant to this Agreement contains any untrue statement of material fact or, when this Agreement and such certificates, schedules, and other information are taken in their entirety, contains any untrue statement of a material fact or omits to state a material fact necessary to make the statements contained therein not misleading as of the date hereof.

ARTICLE III  
REPRESENTATIONS AND WARRANTIES OF HEADWATERS  
AND MERGER SUB

Headwaters and Merger Sub represent and warrant to HTI, except as set

forth in the disclosure letter supplied by Headwaters to HTI on or before the date hereof and certified by a duly authorized officer of Headwaters (the "Headwaters Disclosure Letter"), as follows:

3.1 Organization of Headwaters. Each of Headwaters and Merger Sub is a corporation duly organized, validly existing, and in good standing under the laws of the jurisdiction of its incorporation, has the corporate power to own, lease, and operate its property and to carry on its business as now being conducted, and is duly qualified to do business and is in good standing as a foreign corporation in each jurisdiction in which the failure to be so qualified would have a Material Adverse Effect on the business, assets (including intangible assets), financial condition, or results of operations of Headwaters and its subsidiaries taken as a whole.

### 3.2 Authority.

(a) Each of Headwaters and Merger Sub has all requisite corporate power and authority to enter into this Agreement and to consummate the transactions contemplated hereby. The execution and delivery of this Agreement and the consummation of the transactions contemplated hereby have been duly authorized by all necessary corporate action on the part of Headwaters and, in the case of this Agreement, Merger Sub, subject only to the filing and recordation of the Certificate

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of Merger pursuant to New Jersey Law. This Agreement has been duly executed and delivered by each of Headwaters and Merger Sub, and, assuming the due authorization, execution, and delivery by HTI, constitutes valid and binding obligations of Headwaters and Merger Sub, enforceable in accordance with its terms, except as enforceability may be limited by bankruptcy and other similar laws and general principles of equity. The execution and delivery of this Agreement by each of Headwaters and Merger Sub do not, and the performance of this Agreement by each of Headwaters and Merger Sub will not, (i) conflict with or violate the Certificate of Incorporation or Bylaws of Headwaters or the Certificate of Incorporation or Bylaws of Merger Sub or the equivalent organizational documents of any of Headwaters' other subsidiaries, (ii) conflict with or violate any law, rule, regulation, order, judgment, or decree applicable to Headwaters or any of its subsidiaries (including Merger Sub) or by which its or any of their respective properties is bound or affected pursuant to, any note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise, or other instrument or obligation to which Headwaters or any of its subsidiaries (including Merger Sub) is a party or by which Headwaters or any of its subsidiaries or its or any of their respective properties are bound or affected, except, with respect to clause (ii), for the consent of Zion's First National Bank and any such conflicts, violations, defaults, or other occurrences that would not have a Material Adverse Effect on Headwaters and its subsidiaries taken as a whole. The Headwaters Disclosure Letter lists all consents, waivers, and approvals under any of Headwaters' or any of its subsidiaries' agreements, contracts, licenses, or leases required to be obtained in connection with the

consummation of the transactions contemplated hereby which, if not obtained, would have a Material Adverse Effect on Headwaters and its subsidiaries taken as a whole or have a material adverse effect on the ability of the parties to consummate the Merger.

(b) No consent, approval, order or authorization of, or registration, declaration, or filing with any Governmental Entity is required by or with respect to Headwaters or Merger Sub in connection with the execution and delivery of this Agreement and the Exchange Agreement or the consummation of the Transaction, except for

(i) the filing of the Certificate of Merger with the Secretary of State of the State of New Jersey;

(ii) the filing with the Securities and Exchange Commission (the "SEC") of the Form D (as hereinafter defined) and any required state filings related to the Exchange and such reports under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as may be required in connection with this Agreement and the transactions contemplated hereby; and

(iii) such other consents, authorizations, filings, approvals, and registrations which, if not obtained or made, would not have a Material Adverse Effect on Headwaters and its subsidiaries taken as a whole or have a material adverse effect on the ability of the parties to consummate the Merger.

3.3 No Material Misrepresentations. Neither this Agreement nor the Headwaters Disclosure Letter contains any untrue statement of material fact or, when this Agreement and the Headwaters Disclosure Letter are taken in their entirety, contains any untrue statement of a material fact or omits to state a material fact necessary to make the statements contained therein not misleading as of the date hereof.

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3.4 Available Funds. Headwaters and Merger Sub collectively have sufficient capital available to consummate the transactions contemplated by this Agreement and is not relying on obtaining additional financing in connection with such transactions.

3.5 Merger Sub. Merger Sub is a wholly-owned subsidiary of Headwaters that was formed to effect the transactions contemplated by this Agreement. As of the date of this Agreement, Merger Sub has no business, operations, assets, or liabilities other than those arising from its formation and pursuant to this Agreement.

3.6 SEC Documents. Headwaters has filed all required reports, schedules, forms, statements, and other documents with the SEC since October 1, 1999 (collectively, and in each case including all exhibits and schedules thereto and documents incorporated by reference therein, the "Headwaters SEC

Documents"). As of their respective dates, the Headwaters SEC Documents complied in all material respects with the requirements of the Securities Act of 1933, as amended (the "Securities Act") or the Exchange Act, as the case may be, and the rules and regulations of the SEC promulgated thereunder applicable to such Headwaters SEC Documents. As of their respective dates, none of the Headwaters SEC Documents (including any and all financial statements therein) contained any untrue statement of a material fact or failed to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. The consolidated financial statements of Headwaters included in the Headwaters SEC Documents comply as to form in all material respects with applicable accounting requirements and the published rules and regulations of the SEC with respect thereto, have been prepared in accordance with GAAP (except, in the case of unaudited consolidated quarterly statements, as permitted by Form 10-Q of the SEC) applied on a consistent basis during the period involved (except as may be indicated in the notes thereto), and present fairly, in all material respects, the consolidated financial position of Headwaters and its subsidiaries at the respective dates thereof and the consolidated results of operations and cash flows for the periods specified (subject, in the case of unaudited quarterly statements, to normal year-end audit adjustments). Except as reflected or reserved against in the Headwaters Financial Statements or otherwise disclosed in the Headwaters Disclosure Letter, Headwaters and its subsidiaries have no material liabilities or other obligations (including contingent liabilities and obligations) except, (i) since the date of the most recent audited balance sheet included in the Headwaters Financial Statements, liabilities and obligations incurred in the ordinary course of business or (ii) that would not be required to be reflected or reserved against in the consolidated balance sheet of Headwaters and its subsidiaries prepared in accordance with GAAP.

3.7 Absence of Certain Changes or Events. Except as disclosed in the Headwaters SEC Documents, or in the Headwaters Disclosure Letter, since the date of the most recent audited balance sheet included in the Headwaters SEC Documents, there is not and has not been (a) any material adverse change to Headwaters, or (b) any condition, event, or occurrence that could reasonably be expected to prevent or materially delay Headwaters from consummating the transactions contemplated by this Agreement; provided that, for purposes of this Section 3.7, a change in the price of Headwaters Common Stock shall not be deemed to constitute a "material adverse change."

#### ARTICLE IV ADDITIONAL AGREEMENTS

4.1 Conduct of Business. During the period from the date of this Agreement and continuing until the earlier of the termination of this Agreement pursuant to its terms or the Effective Time, HTI agrees, except as provided in Section 4.1 of the HTI Disclosure Letter, or to the extent that Headwaters shall otherwise consent in writing, to carry on its business diligently and in

accordance with good commercial past practice and to carry on its business in the usual, regular, and ordinary course, in substantially the same manner as heretofore conducted and in compliance with all applicable laws and regulations, to pay its debts and taxes when due subject to good faith disputes over such debts or taxes, to pay or perform other material obligations when due, and use its commercially reasonable efforts consistent with past practices and policies to preserve intact its present business organization, keep available the services of its present officers and employees, and preserve its relationships with customers, suppliers, distributors, licensors, licensees, and others with which it has business dealings. In addition, HTI will promptly notify Headwaters of any material event involving its business or operations. No information or knowledge obtained in any investigation will affect or be deemed to modify any representation or warranty contained herein or the conditions to the obligations of the parties to consummate the Merger and the Exchange.

In addition, except as permitted by the terms of this Agreement, and except as provided in Section 4.1 of the HTI Disclosure Letter, without the prior written consent of Headwaters, HTI shall not do any of the following:

(a) Waive any stock repurchase rights; accelerate, amend, or change the period of exercisability of options or restricted stock; or re-price options granted under any employee, consultant, or director stock plans, or authorize cash payments in exchange for any options granted under any of such plans;

(b) Enter into any material partnership arrangements, joint development agreements, strategic alliances, agreements to create standards, or agreements with "Standards" bodies;

(c) Grant any severance or termination pay to any officer or employee except payments in amounts consistent with policies and past practices or pursuant to written agreements outstanding, or policies existing, on the date hereof and as previously disclosed in writing to Headwaters; or adopt any new severance plan;

(d) Transfer or license to any person or entity or otherwise extend, amend, or modify in any material respect any rights to the HTI IP Rights, other than in the ordinary course of business, or enter into grants to future patent rights, other than in the ordinary course of business;

(e) Declare or pay any dividends on or make any other distributions (whether in cash, stock, or property) in respect of any capital stock, or split, combine, or reclassify any capital stock or issue or authorize the issuance of any other securities in respect of, in lieu of, or in substitution for any capital stock;

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(f) Repurchase or otherwise acquire, directly or indirectly, any shares of capital stock except pursuant to rights of repurchase of any such

shares under any employee, consultant, or director stock plan or agreement existing on the date hereof;

(g) Issue, deliver, sell, authorize, or propose the issuance, delivery, or sale of any shares of capital stock or any securities convertible into shares of capital stock, or subscriptions, rights, warrants, or options to acquire any shares of capital stock or any securities convertible into shares of capital stock, or enter into other agreements or commitments of any character obligating it to issue any such shares or convertible securities, other than shares of HTI Common Stock issued pursuant to the exercise of stock options outstanding as of the date of this Agreement.

(h) Cause, permit, or propose any amendments to any charter document or bylaw (or similar governing instruments of any subsidiaries);

(i) Acquire or agree to acquire by merging or consolidating with, or by purchasing any equity interest in or a material portion of the assets of, or by any other manner, any business or any corporation, partnership interest, association, or other business organization or division thereof, or otherwise acquire or agree to acquire any assets which are material, individually or in the aggregate, to the business of HTI, or enter into any joint ventures, strategic partnerships or alliances;

(j) Buy, sell, lease, license, encumber, or otherwise dispose of or acquire any properties or assets which are material, individually or in the aggregate, to the business of HTI or which exceed \$100,000 in the aggregate;

(k) Incur any indebtedness for borrowed money (other than ordinary course trade payables) or guarantee any such indebtedness or issue or sell any debt securities or warrants or rights to acquire debt securities of HTI, or guarantee any debt securities of others;

(l) Adopt or amend any employee benefit or employee stock purchase or employee option plan, or enter into any employment contract, pay any bonus or special remuneration to any director or employee, or increase the salaries or wage rates of its officers or employees, or change in any material respect any management policies or procedures;

(m) Pay, discharge, or satisfy any claim, liability, or obligation (absolute, accrued, asserted or unasserted, contingent, or otherwise), other than the payment, discharge, or satisfaction in the ordinary course of business;

(n) Make any grant of exclusive rights to any third party; or

(o) Agree in writing or otherwise to take any of the actions described in Section 4.1(a) through (n) above.

4.2 Information Statement. Headwaters will prepare, with the cooperation of HTI, the Information Statement to be sent to the HTI Stockholders to solicit agreement to the terms of the Exchange Agreement and related



documents. Insofar as the Information Statement contains information pertaining to Headwaters, at the time of its mailing to the HTI Stockholders and at the

time of the execution and closing of the Exchange Agreement, the Information Statement will contain no untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they are made, not misleading, and Headwaters will advise HTI in writing if, prior to the execution and closing of the Exchange Agreement, it shall obtain knowledge of any facts that would make it necessary to supplement or amend the Information Statement to comply with applicable laws. Information provided by HTI for inclusion in the Information Statement, at the time of its mailing to the HTI Stockholders and at the time of the execution and closing of the Exchange Agreement, will contain no untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they are made, not misleading, and Headwaters will advise HTI in writing if, prior to the execution and closing of the Exchange Agreement, it shall obtain knowledge of any facts that would make it necessary to supplement or amend the Information Statement to comply with applicable laws. The Board of Directors of HTI, subject to the directors' fiduciary duties, will recommend that the Stockholders approve and adopt the Exchange Agreement and the Transaction.

4.3 Access to Information; Confidentiality. Subject to the Confidentiality Agreement between the parties, each party will afford the other party and its accountants, counsel, and other representatives full access to the properties, books, records, and personnel of the other party and full cooperation, during the period prior to the Effective Time, to obtain all information concerning the business, including the status of product development efforts, properties, results of operations, and personnel of such party, and to determine the accuracy of each party's representations and warranties, as the other party may reasonably request. No information or knowledge obtained in any investigation pursuant to this Section 4.3 will affect or be deemed to modify any representation or warranty contained herein or the conditions to the obligations of the parties to consummate the Merger. The parties acknowledge that HTI and Headwaters have previously executed the Confidentiality Agreement, which Confidentiality Agreement will continue in full force and effect in accordance with its terms. HTI shall cooperate with Headwaters and its auditors in determining whether any restatement of HTI's financials is necessary or appropriate prior to the Closing.

4.4 No Solicitation. From and after the date of this Agreement until the earlier of the Effective Time or termination of this Agreement pursuant to its terms, HTI shall not, and will instruct its respective directors, officers, employees, representatives, agents, and affiliates not to, directly or indirectly, (i) solicit or knowingly encourage submission of any proposals or offers by any person, entity, or group (other than Headwaters and its affiliates, agents, and representatives), or (ii) participate in any discussions

or negotiations with, or disclose any non-public information concerning HTI to, or afford any access to the properties, books or records of HTI to, or otherwise assist or facilitate, or enter into any agreement or understanding with, any person, entity or group (other than Headwaters and its affiliates, agents and representatives), in connection with any Acquisition Proposal with respect to HTI. For the purposes of this Agreement, an "Acquisition Proposal" with respect to HTI means any proposal or offer relating to (i) any merger, consolidation, sale of substantial assets or similar transactions involving HTI (other than sales of assets or inventory in the ordinary course of business or permitted under the terms of this Agreement), (ii) sale of 10% or more of the outstanding shares of capital stock of HTI (including without limitation by way of a tender offer or an exchange offer), (iii) the acquisition by any person of beneficial ownership or a right to acquire beneficial ownership of, or the formation of any "group" (as defined under

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Section 13(d) of the Exchange Act and the rules and regulations thereunder) which beneficially owns, or has the right to acquire beneficial ownership of, 10% or more of the then outstanding shares of capital stock of HTI; or (iv) any public announcement of a proposal, plan or intention to do any of the foregoing or any agreement to engage in any of the foregoing. HTI will immediately cease any and all existing activities, discussions or negotiations with any parties conducted heretofore with respect to any of the foregoing. HTI will (i) notify Headwaters as promptly as practicable if any inquiry or proposal is made or any information or access is requested in writing in connection with an Acquisition Proposal or potential Acquisition Proposal and (ii) as promptly as practicable provide Headwaters with a copy of any such inquiry, proposal or Acquisition Proposal (or a detailed summary thereof if such inquiry, proposal or Acquisition Proposal is not in writing). In addition, subject to the other provisions of this Section 4.4, from and after the date of this Agreement until the earlier of the Effective Time and termination of this Agreement pursuant to its terms, HTI will not, and will instruct its respective directors, officers, employees, representatives, investment bankers, agents and affiliates not to, directly or indirectly, make or authorize any public statement, recommendation or solicitation in support of any Acquisition Proposal made by any person, entity or group (other than Headwaters).

4.5 Legal Requirements. Each of Headwaters, Merger Sub, and HTI will take all reasonable actions necessary or desirable to comply promptly with all legal requirements which may be imposed on them with respect to the consummation of the transactions contemplated by this Agreement and the Exchange Agreement (including furnishing all information required in connection with approvals of or filings with any Governmental Entity, and prompt resolution of any litigation prompted hereby) and will promptly cooperate with and furnish information to any party hereto necessary in connection with any such requirements imposed upon any of them or their respective subsidiaries in connection with the consummation of the transactions contemplated by this Agreement and the Exchange Agreement.

4.6 Third Party Consents. As soon as practicable following the date

hereof, HTI and Headwaters will each use reasonable commercial efforts to obtain all consents, waivers, and approvals under any of its agreements, contracts, licenses, or leases required to be obtained in connection with the consummation of the transactions contemplated hereby.

4.7 Notification of Certain Matters. Subject to the terms and provisions of the Confidentiality Agreement, each party will give prompt notice to the other parties of the occurrence, or failure to occur, of any event, which occurrence or failure to occur would be reasonably likely to cause (a) any representation or warranty contained in this Agreement to be untrue or inaccurate in any material respect at any time from the date of this Agreement to the Effective Time, or (b) any material failure of such party, as the case may be, or of any officer, director, employee, or agent thereof, to comply with or satisfy any covenant, condition, or agreement to be complied with or satisfied by it under this Agreement. Notwithstanding the above, the delivery of any notice pursuant to this section will not limit or otherwise affect the remedies available hereunder to the party receiving such notice.

4.8 Commercially Reasonable Efforts and Further Assurances. Merger Sub, as the owner of the HTI Common Stock immediately following the Exchange, will cause the Merger to be effected in accordance with the terms and conditions hereto. Subject to the respective rights and

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obligations of Headwaters and HTI under this Agreement, each of the parties to this Agreement and the Exchange Agreement will use its commercially reasonable efforts to effectuate the Exchange, the Merger, and the other transactions contemplated hereby and to fulfill and cause to be fulfilled the conditions to closing under this Agreement and the Exchange Agreement. Each party hereto, at the reasonable request of another party hereto, will execute and deliver such other instruments and do and perform such other acts and things as may be necessary or desirable for effecting completely the consummation of the transactions contemplated hereby.

4.9 HTI Employee Matters.

(a) Headwaters agrees to continue the employment with the Surviving Corporation of all HTI employees at the same salary as was in existence immediately prior to the Effective Time; provided, however, that this provision shall not be interpreted to limit Headwaters' ability to terminate or change the nature of its or the Surviving Corporation's employment relationship with any such HTI employee after the Effective Time. Headwaters agrees to permit such employees of the Surviving Corporation to participate in the Headwaters employee benefit plans and to give them years of service credit for purposes of such plans based on each employee's service with HTI prior to the Effective Time. The parties agree that this Section 4.9(a) is not intended to create any third party beneficiary right in any employee.

(b) Headwaters agrees to guarantee as of the Effective Time

the obligations of HTI pursuant to the employment agreements listed in Schedule 4.10.

(c) HTI shall terminate its bonus policy (provided that such termination and transition to Headwaters' bonus plan satisfy applicable Department of Energy requirements), Employee Stock Purchase Plan and any stock option plans effective at or prior to the Closing.

4.10 Board Representation. Headwaters will cause two designees of the Representative to be appointed to the Board of Directors of Headwaters as of the Effective Date, one for a term that shall end on March 31, 2004, and the other for a term that shall end on March 31, 2003. If, at any time prior to March 31, 2004, the Board of Directors of Headwaters has an executive or similar committee, the Board of Directors shall appoint one of the Board designees of the Representative to such committee for a term expiring not earlier than the term specified above.

4.11 Directors and Officers of the Surviving Corporation. Headwaters shall cause the initial board of directors of the Surviving Corporation to consist of six designees of the Representative and two representatives of Headwaters; provided, however, that Headwaters will retain the power to elect and remove directors from the board of directors of the Surviving Corporation. Headwaters will also continue the employment of all officers of HTI, as of the Closing Date, in their present capacities in the Business Unit, and will cause the board of directors of the Surviving Corporation to remove such officers only with the approval of a majority vote of the Headwaters Board that includes the approval of both of the Representative's designees thereto.

4.12 Cooperation Concerning License Agreements. HTI will consult with Headwaters in the negotiation and execution of the Shenhua and PetroChina license agreements, and will agree to any commercially reasonable requests of Headwaters (that would not significantly impact the ability

of HTI to meet the Milestones) concerning the terms, and timing of the execution, of these agreements. HTI will provide to Headwaters promptly all information relating to the progress of negotiations.

4.13 Treatment of Merger as a Qualifying Reorganization. Each of HTI and Headwaters shall (a) treat the Merger as a reorganization under Section 368 of the Code, (b) report the Merger and all related transactions consistently therewith in any and all Tax Returns filed by it, (c) take all such actions as may be reasonably required to cause the Merger to be treated as a qualifying reorganization, and (d) take no action which could disqualify the Merger from reorganization status under Section 368 of the Code. Neither HTI nor Headwaters, as of the date of this Agreement and on the Closing Date, know of any reason that the Transaction may not qualify as a reorganization within the meaning of Section 368 of the Code.

4.14 Non-Compete Agreements. Each of Alfred G. Comolli, Lap-Keung (Theo) Lee, Ph.D., and David L. Tanner hereby agrees that, as of the Effective Time, (i) the non-competition provision in his employment agreement with HTI described in Section 2.17 of the HTI Disclosure Letter shall continue in effect until the later of two years after the Closing Date or one year after the termination of his employment with Headwaters or any subsidiary thereof, including the Surviving Corporation, and (ii) the scope of the non-competition provision set forth in the respective employment agreements shall be extended to include, in addition to the business of HTI, the business activities of Headwaters or of any Headwaters subsidiary in which the employee materially participated as an officer, director or employee of Headwaters, the Business Unit or any other Headwaters subsidiary.

#### 4.15 Tax Matters

(a) Tax Returns. Headwaters shall cause HTI to prepare and file all Tax Returns required to be filed by or with respect to HTI for all periods ending on or prior to the Closing Date which are filed on or after the Closing Date and for all periods which begin prior to the Closing Date and end after the Closing Date. Headwaters shall timely pay or cause to be timely paid the Taxes attributable to such Tax periods, subject only to Headwaters' rights under Section 8.1 of this Agreement to the extent that the payment of such Taxes represents an item described therein. The stockholders of HTI shall not bear any responsibility for the Taxes of HTI attributable to such periods except as provided in Section 8.1 hereof.

(b) Cooperation and Access to Information. Provided that the rights under this paragraph (b) lapse on the expiration of the Indemnity period, the parties to this Agreement shall cooperate as and to the extent reasonably requested by any other party hereto, in connection with (i) the filing of Tax Returns pursuant to this Agreement and any audit, litigation, or other proceeding with respect to Taxes, and (ii) complying with Section 6043 of the Code and all Treasury Regulations promulgated thereunder. Such cooperation shall include the retention and (upon another party's request) the provision of records and information which are reasonably relevant to any such Tax Return, audit, litigation, or other proceeding and making employees available on a mutually convenient basis to provide additional information and explanation of any material provided hereunder.

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(c) Retention of Books and Records. Provided that the rights under this paragraph (c) lapse on the expiration of the Indemnity period, the parties to this Agreement agree (i) to retain all books and records with respect to Tax matters pertinent to HTI relating to any taxable period beginning before the Closing Date until the expiration of the statute of limitations of the respective taxable periods, and (ii) to give the other parties to this Agreement reasonable written notice prior to transferring, destroying, or discarding any such books and records and, if a party so requests, Headwaters, HTI, or the HTI Stockholders, as the case may be, shall allow the other party to take possession

of such books and records.

(d) Treatment of Indemnity Payment as Purchase Price Adjustment. In the case of any claim for indemnity under this Agreement based on Taxes determined to be payable by HTI or a successor thereto, the indemnity obligation shall be considered to be a purchase price adjustment under this Agreement and the Exchange Agreement.

4.16 Bridge Loan. If the Closing does not occur within thirty (30) days of the date hereof, Headwaters shall make available to HTI a bridge loan, in the amount of up to two hundred thousand dollars (\$200,000), with a maturity date of one year following the date hereof, bearing the same interest rate as would be applicable at such time pursuant to HTI's loan agreements with Yardville National Bank described in Section 6.8 hereto, and containing other terms and conditions reasonably agreeable to Headwaters. Such bridge loan would be secured by a perfected security interest immediately subordinate to any Permitted Lien. For purposes of this Section 4.16, a Permitted Lien is any security interest encumbering HTI assets in existence as of the date hereof. HTI's entry into any bridge loan agreement is subject to obtaining the consent of Yardville National Bank; HTI will make commercially reasonable efforts to obtain such consent.

#### 4.17 Environmental Issues.

(a) HTI shall use its reasonable best efforts to obtain written confirmation from the New Jersey Department of Environmental Protection (the "NJDEP") reasonably satisfactory to Headwaters that no further action need be taken regarding environmental remediation of the real property owned by HTI.

(b) The parties hereto acknowledge that the Transaction may be subject to the requirements of the New Jersey Industrial Site Recovery Act, N.J.S.A. 13:1K-6, et seq., and the regulations promulgated pursuant thereto ("ISRA"). To permit completion of the Transaction, HTI shall use its reasonable best efforts to comply with ISRA by seeking to obtain from the NJDEP (a) one of the following, at HTI's option and discretion, regarding HTI's wholly-owned subsidiary, Chemsampco: (i) a Letter of Non-applicability; (ii) approval of a Negative Declaration; (iii) approval of a Remediation-in-Process or other form of waiver; or (iv) execution of a Remediation Agreement, as such terms are used in ISRA; and (b) a Letter of Non-applicability regarding HTI (each of the items set forth in (a) (i) through (iv) and (b) being referred to as an "ISRA Approval"). If remediation pursuant to one or more Remediation Agreements is required by the NJDEP, then HTI shall be responsible for implementing such Remediation Agreements and satisfying all other requirements under ISRA, including but not limited to providing a remediation funding source and obtaining a no further action letter from the NJDEP evidencing full compliance with ISRA. If HTI enters into a Remediation Agreement with the NJDEP to allow closing of the

Transaction to occur, subject to the provisions of Section 6.10 of this

Agreement, all of the costs of such remediation, if any, shall constitute a claim for indemnification under this Agreement or under the Exchange Agreement (regardless of any representations or warranties or exceptions thereto set forth in this Agreement) and such claim may be paid from the Escrow Account or Contingent Payment in accordance with the terms of the Exchange Agreement. If any indemnification is paid to Headwaters from the Escrow Account or from Contingent Payments related to ISRA compliance, including costs of remediation, then to the extent of such indemnification the Representative shall be assigned any rights, claims, entitlements or choses in action which Headwaters, ITI or the Surviving Corporation may have against any third parties, including the New Jersey Spill Compensation Fund, who or which may be liable for such costs, whether in whole or in part.

ARTICLE V  
CONDITIONS TO OBLIGATIONS OF HEADWATERS AND MERGER SUB

The obligations of Headwaters and Merger Sub hereunder are subject to the satisfaction, or waiver thereof by Headwaters, of the following conditions:

5.1 Stockholder Approval. This Agreement and the Merger shall have been approved and adopted by the HTI Stockholders by the requisite vote (if any) under applicable law and HTI's Certificate of Incorporation.

5.2 No Actions or Proceedings. No judgment, writ, order, injunction, award, or decree of or by any Governmental Entity shall have been issued that would, and no action or proceeding shall have been instituted by or before any Governmental Entity seeking to, enjoin or prevent the consummation of the transactions contemplated hereby. Notwithstanding the generality of the foregoing, no person shall have (i) commenced, or shall have notified either HTI or Headwaters that it intends to commence, an action or proceeding or (ii) provided HTI or Headwaters with notice, in either case which allege(s) that any of the intellectual property presently embodied, or proposed to be embodied, in HTI's products or design environments infringes or otherwise violates the intellectual property rights of such person, is available for licensing from a potential licensor providing the notice, or otherwise alleges that HTI does not otherwise own or have the right to exploit such intellectual property.

5.3 Representations and Warranties. The representations and warranties of HTI shall be true and correct in all material respects at the Effective Time, with the same effect as though such representations and warranties had been made on and as of such date, except for changes which, in the aggregate, would not have a material adverse effect on the financial condition, properties, business, prospects, or results of operations of HTI, and each and all of the agreements of HTI to be performed or complied with in all material respects pursuant to the terms of this Agreement shall have been duly performed and complied with.

5.4 No Material Adverse Effect. No event shall have occurred since the date of this Agreement that has had or would reasonably be expected to have a Material Adverse Effect on HTI.

5.5 Exchange Agreement. The transactions contemplated by the Exchange Agreement shall have closed prior to the Closing, and HTI Stockholders shall have agreed, pursuant to the Exchange Agreement, to exchange at least ninety percent (90%) of the Outstanding Shares.

5.6 Opinion of Counsel. There shall be delivered to Headwaters on the Closing Date of the Merger an opinion or opinions of counsel to HTI, dated the Closing Date of the Merger and satisfactory in form and substance to Headwaters and its counsel, in substantially the form of Exhibit D hereto.

5.7 Non-Compete and Affiliate Agreements. HTI, Headwaters, and each of James G. Conklin, Bruce Pelrine, and Peizheng Zhou, Ph.D. (the "Key Employees") shall have entered into agreements not-to-compete (the "Non-Compete Agreements") substantially in the form of Exhibit E hereto. The directors and executive officers of HTI, and shareholder reasonably deemed to be an affiliate of HTI shall have entered into Affiliate Agreements, substantially in the form of Exhibit F hereto with Headwaters.

5.8 Employment. The Key Employees of HTI shall continue to be employed by HTI at the Closing (and shall not have given any notice or other indication that they will not continue to be willing to be employed by the Surviving Corporation following the Closing). At least ninety percent (90%) of the employees of HTI employed as of this date, including the Key Employees, shall continue to be employed by HTI at the Closing (and shall not have given any notice or other indication that they will not continue to be willing to be employed by the Surviving Corporation following the Closing). Arrangements satisfactory to Headwaters shall have been made to effect the assignment to the Surviving Corporation of all intellectual property created by HTI's founders, employees, and consultants (other than intellectual property created for a prior employer), and to obtain their full cooperation to complete and prosecute all appropriate U.S. and foreign patent filings related thereto.

5.9 Compliance Certificate. HTI shall have delivered to Headwaters a certificate, executed by the President of HTI, dated as of the Closing Date, certifying to the fulfillment of the conditions specified in Section 5.3.

5.10 Certificates and Documents. HTI shall have delivered to Headwaters:

(a) Certificates, as of the most recent practicable dates, as to the corporate and tax good standing of HTI issued by the Department of Treasury of the State of New Jersey and the Secretary of State of each other state in which HTI is currently qualified to transact business; and

(b) Resolutions of the Board of Directors of HTI and (if required by applicable law) the HTI Stockholders, authorizing and approving all matters in connection with this Agreement, the Exchange Agreement, and the Transaction and certified by the Secretary or Assistant Secretary of HTI as of the Closing Date.



5.11 Dissenters' Shares. Holders of no more than one percent (1%) of the Outstanding Shares shall have exercised, nor shall they have any continued right to exercise, appraisal, dissenters', or similar rights under applicable law with respect to their shares by virtue of the Merger.

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5.12 Consents and Approvals. HTI shall have obtained the consents and approvals referred to in Section 2.4 of the HTI Disclosure Letter.

5.13 Environmental Status.

(a) HTI shall have received written confirmation from the NJDEP reasonably satisfactory to Headwaters that no further action need be taken regarding environmental remediation of the real property owned by HTI; provided that this condition precedent shall be waived as of June 30, 2001, as long as HTI has received and provided to Headwaters a No Further Action letter from the NJDEP relating to the "Marco" portion of the property and the NJDEP has given Headwaters and its counsel no reason to believe that a No Further Action letter relating to the rest of the property will not be forthcoming.

(b) HTI shall have satisfied the filing, notice and approval requirements of ISRA as described in Section 4.17 of this Agreement; provided, however, if the NJDEP requires one or more Remediation Agreements pursuant to ISRA, the costs and the time required to carry out such Remediation Agreements shall be immaterial, in Headwaters' reasonable discretion.

5.14 HTI Further Financial Statements. HTI shall have provided Headwaters at least one week prior to Closing with (i) unaudited quarterly financial statements for the quarterly periods ended as of March 31, 2001, December 31, 2000, and March 31, 2000; and (ii) the audited balance sheet as of December 31, 2000, and the related statement of operations, shareholders' equity and cash flows for the one-year period then ended.

#### ARTICLE VI CONDITIONS TO OBLIGATIONS OF HTI

The obligations of HTI hereunder are subject to the satisfaction, or waiver thereof by HTI, of the following conditions:

6.1 Stockholder Approval. This Agreement and the Merger shall have been approved and adopted by the HTI Stockholders by the requisite vote under applicable law and HTI's Certificate of Incorporation.

6.2 No Actions or Proceedings. No judgment, writ, order, injunction, award, or decree of or by any Governmental Entity shall have been issued that would, and no action or proceeding shall have been instituted by or before any Governmental Entity seeking to, enjoin or prevent the consummation of the transactions contemplated hereby.

6.3 Representations and Warranties. The representations and warranties of Headwaters shall be true and correct in all material respects on and as of the Effective Time, with the same effect as though such representations and warranties had been made on and as of such date, except for changes which, in the aggregate, would not have a material adverse effect on the financial condition, properties, business, prospects, or results of operations of Headwaters, and each and all of the agreements of Headwaters to be performed or complied with in all material respects pursuant to the terms of this Agreement shall have been duly performed and complied with.

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6.4 Certificates. Headwaters shall have delivered to HTI (a) a certificate, executed by a duly authorized officer of Headwaters, dated as of the Closing Date, certifying to the fulfillment of the conditions specified in Section 6.3, and (b) resolutions of the Board of Directors of Headwaters, authorizing and approving all matters in connection with this Agreement, the Exchange Agreement, and the Transaction, certified by the Secretary or Assistant Secretary of Headwaters as of the Closing Date.

6.5 Board Representation. The designees of the Representative shall have been appointed to the Headwaters Board of Directors, with such appointments effective as of the Effective Date.

6.6 No Material Adverse Effect. No event shall have occurred since the date of this Agreement that has had or would reasonably be expected to have a Material Adverse Effect on Headwaters.

6.7 Consents and Approvals. Headwaters shall have obtained the consents and approvals referred to in Section 3.2 of the Headwaters Disclosure Letter.

6.8 Loan Agreement. Headwaters shall have repaid the balance due under the loan agreements between HTI and Yardville National Bank dated as of October 5, 1999 and April 18, 2001 in the principal amounts of \$1,000,000 and \$500,000, respectively, or caused the release of the individual guarantees of Alfred G. Comolli, Lap-Keung (Theo) Lee, and David L. Tanner thereunder.

6.9 Opinion of Counsel.. There shall be delivered to HTI on the Closing Date of the Merger an opinion or opinions of counsel to Headwaters, dated the Closing Date of the Merger and satisfactory in form and substance to HTI and its counsel, in substantially the form of Exhibit G hereto.

6.10 ISRA Status. If the NJDEP requires one or more Remediation Agreements pursuant to ISRA, the costs required to carry out such Remediation Agreements to be treated as an indemnification event pursuant to Section 4.17(b) of this Agreement shall be immaterial, in HTI's reasonable discretion, or Headwaters shall have agreed to waive any claim of indemnification following the Effective Time with respect to such Remediation Agreements.

## ARTICLE VII

Notwithstanding any investigation made by or on behalf of Headwaters or HTI, the representations and warranties of HTI and Headwaters contained in this Agreement shall be continuing representations and warranties and shall survive the Effective Time of the Merger until the second anniversary thereof; provided, however, that the representations and warranties with respect to taxes and tax liabilities of HTI contained in Section 2.7 hereof shall be continuing representations and warranties and shall survive until the expiration of the third year following the date on which HTI shall have completed filing all required tax returns for any partial tax period ending at the Effective Time of the Merger, or, if all required returns are filed before the last day prescribed by law or by regulations to file such returns, then until the expiration of the third year following such last day, or for such longer period following the filing of any such return during

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which the period of the statute of limitations applicable to such return shall have been extended by action of HTI or any governmental authority; and provided further that the representations and warranties concerning compliance with law and environmental matters in Sections 2.9 and 2.14 shall be continuing representations and warranties and shall survive the Effective Time of the Merger until the fourth anniversary thereof.

ARTICLE VIII  
INDEMNITY OF HEADWATERS

8.1 Indemnification of Headwaters. Headwaters shall be indemnified by the holders of the Exchanged Shares in accordance with the terms of the Exchange Agreement.

8.2 No Limitation of Remedies. Notwithstanding anything contained in this Agreement or the Exchange Agreement to the contrary, nothing shall preclude or limit Headwaters' or the Surviving Corporation's rights to exercise any other remedy Headwaters or the Surviving Corporation may have in law or equity regarding intentional misrepresentation or any remedies available to Headwaters or the Surviving Corporation under any other agreement; provided, however, that other than for intentional misrepresentation, or as provided in any other agreement, Headwaters' or the Surviving Corporation's sole remedy hereunder shall be limited to the indemnification set forth in Sections 9.1 and 9.2 of the Exchange Agreement.

ARTICLE IX  
COSTS INCIDENT TO AGREEMENT

Except as otherwise expressly provided herein, each of the parties hereto will pay all the costs incurred by it incident to the preparation, execution, or delivery of this Agreement or the performance of its obligations hereunder, including, without limitation, the fees and disbursements of its

attorneys, accountants, investment bankers, consultants, brokers, and persons providing other services.

ARTICLE X  
TERMINATION

10.1 Termination. Except as provided in Section 10.2 below, this Agreement and the Exchange Agreement may be terminated and the Merger and the Exchange abandoned at any time prior to the Effective Time:

(a) by mutual written consent of HTI and Headwaters;

(b) by Headwaters if there shall be any action taken, or any statute, rule, regulation, or order enacted, promulgated, or issued or deemed applicable to the Transaction, by any Governmental Entity, which would: (i) prohibit Headwaters' or HTI's ownership or operation of any portion of the business of HTI or (ii) compel Headwaters or HTI to dispose of or hold separate, as a result of the Transaction, any portion of the business or assets of HTI or Headwaters; in either case, the unavailability of which assets or business would have a Material Adverse Effect on

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Headwaters or would reasonably be expected to have a material adverse effect on Headwaters' ability to realize the benefits expected from the Transaction.

(c) by Headwaters, if it is not in material breach of its obligations under this Agreement or the Exchange Agreement and there has been a breach of any representation, warranty, covenant, or agreement contained in this Agreement on the part of HTI, and as a result of such breach the conditions set forth in Section 5.3 would not then be satisfied; provided, however, that if such breach is curable by HTI within thirty (30) days through the exercise of its reasonable best efforts, then, for so long as HTI continues to exercise such reasonable best efforts, Headwaters may not terminate this Agreement or the Exchange Agreement under this Section 10.1(c) unless such breach is not cured within thirty (30) days (but no cure period shall be required for a breach which by its nature cannot be cured);

(d) by HTI, if it is not in material breach of its obligations under this Agreement or the Exchange Agreement, and there has been a breach of any representation, warranty, covenant, or agreement contained in this Agreement or the Exchange Agreement on the part of Headwaters or Merger Sub, and as a result of such breach the conditions set forth in Section 6.3 would not then be satisfied; provided, however, that if such breach is curable by Headwaters or Merger Sub within thirty (30) days through the exercise of its reasonable best efforts, then, for so long as Headwaters or Merger Sub continues to exercise such reasonable best efforts, HTI may not terminate this Agreement and the Exchange Agreement under this Section 10.1(d) unless such breach is not cured within thirty (30) days (but no cure period shall be required for a breach which by its nature cannot be cured); or

(e) by either HTI or Headwaters if the Merger shall not have been consummated by July 31, 2001; provided, however, that the right to terminate this Agreement and the Exchange Agreement under this Section 10.1(e) shall not be available to any party whose action or failure to act has been a principal cause of or resulted in the failure of the Exchange and the Merger to occur on or before such date and such action or failure to act constitutes a willful and material breach of this Agreement and the Exchange Agreement;

Where action is taken to terminate this Agreement and the Exchange Agreement pursuant to this Section 10.1, it shall be sufficient for such action to be authorized by the board of directors of the party taking such action.

10.2 Effect of Termination. In the event of termination of this Agreement and the Exchange Agreement as provided in Section 10.1, this Agreement and the Exchange Agreement shall forthwith become void and there shall be no liability or obligation on the part of Headwaters, Merger Sub, or HTI, or their respective officers, directors, or stockholders, provided that the provisions of this Article X shall remain in full force and effect and survive any termination of this Agreement and the Exchange Agreement.

10.3 Amendment. Except as is otherwise required by applicable law, prior to the Closing, this Agreement and the Exchange Agreement may be amended by the parties hereto at any time by execution of an instrument in writing signed by Headwaters, HTI, and the HTI Founders. Except as is otherwise required by applicable law, after the Closing, this Agreement and the Exchange

Agreement may be amended by the parties hereto at any time by execution of an instrument in writing signed by Headwaters, HTI, and the HTI Founders.

10.4 Extension; Waiver. At any time prior to the Effective Time, Headwaters and Merger Sub, on the one hand, and HTI, on the other, may, to the extent legally allowed, (i) extend the time for the performance of any of the obligations of the other party hereto, (ii) waive any inaccuracies in the representations and warranties made to such party contained herein or in any document delivered pursuant hereto, and (iii) waive compliance with any of the agreements or conditions for the benefit of such party contained herein. Any agreement on the part of a party hereto to any such extension or waiver shall be valid only if set forth in an instrument in writing signed on behalf of such party.

ARTICLE XI  
MISCELLANEOUS

11.1 Successors and Assigns. This Agreement and the Exchange Agreement shall be binding upon the parties hereto, their legal representatives, successors in interest, assignees, transferees, creditors (including judgment creditors), trustees (including trustees in bankruptcy), receivers, and all

holders or possessors of, or purported holders or possessors of, any of the stock of HTI, including without limitation, assignees, transferees, pledgees, holders of security interests in and liens upon any of such stock and trustees, and all persons with notice or knowledge, or chargeable with notice or knowledge, of the provisions hereof. This Agreement and the Exchange Agreement cannot be amended or modified except by a written agreement executed by the parties hereto; provided, however, that no such amendment or modification may be made after the HTI Stockholders approve and adopt this Agreement and the Exchange Agreement if such amendment or modification, in the judgment of the Board of Directors of HTI, would materially and adversely affect the interest of the HTI Stockholders. Except for the purposes or in the events set forth in Section 1.6(c), this Agreement and the rights, duties and obligations hereunder may not be assigned by any party without the prior written consent of the other parties; provided, however, that this Agreement and the Exchange Agreement may be assigned by Headwaters to any directly or indirectly wholly-owned subsidiary of Headwaters, provided that Headwaters shall continue to be bound by this Agreement and the Exchange Agreement after such assignment.

11.2 Notices. Any notices or other communications required or permitted hereunder will be in writing and will be deemed sufficiently given only if delivered in person or sent by telegram, telecopy or telex or by first-class or air mail or by recognized air courier service, postage or other charges prepaid, addressed as follows:

If to HTI:

Hydrocarbon Technologies, Inc.  
1501 New York Avenue  
Lawrenceville, NJ 08648  
Attention: Alfred G. Comolli, President

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Copy to:

Richard J. Pinto  
Smith, Stratton, Wise, Heher & Brennan  
600 College Road East  
Princeton, NJ 08540  
Facsimile Number: (609) 987-6651

If to Headwaters:

Headwaters Incorporated  
11778 S. Election Drive  
Suite 210  
Draper, UT 84020  
Attention: Kirk A. Benson, Chief Executive Officer  
Facsimile Number: (801) 984-9410

Copy to:

Linda C. Williams, Esq.  
Pillsbury Winthrop LLP

or to such other address as the addressee may have specified in a notice duly given to the sender as provided herein. Such notice or communication will be deemed to have been given as of the date so delivered, telegraphed, telecopied, telexed, mailed, or sent by courier.

11.3 Entire Agreement. This Agreement, including the Exhibits attached hereto, and the Disclosure Letter constitute the entire understanding of the parties relating to the subject matter hereof and supersede all prior and contemporaneous agreements and understandings, whether oral or written, relating to the subject matter hereof.

11.4 Remedies. In the event of a breach, or a threatened or attempted breach, of any provision of this Agreement by any party, any other party shall, in addition to all other remedies, be entitled to (i) a temporary or permanent injunction against such breach without the necessity of showing any actual damages and (ii) a decree for the specific performance of the Agreement.

11.5 Waiver. The waiver by any party of the breach of any of the terms and conditions of, or any right under, this Agreement shall not be deemed to constitute the waiver of any other breach of the same or any other term or condition or of any similar right. No such waiver shall be binding or effective unless expressed in writing and signed by the party giving such waiver.

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11.6 Adjustments to Shares. The number of shares for purposes of this Agreement shall be adjusted to reflect fully the effect of any stock split, reverse stock split, stock dividend (including any dividend or distribution of securities convertible into Headwaters Common Stock or HTI Common Stock), reorganization, recapitalization, or other like change with respect to Headwaters Common Stock or HTI Common Stock occurring on or after the date hereof.

11.7 Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of New Jersey.

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IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

HEADWATERS INCORPORATED

By: /s/ Kirk A. Benson

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Kirk A. Benson,  
Chief Executive Officer

HEADWATERS SUB CORPORATION

By: /s/ Kirk A. Benson

-----  
Kirk A. Benson,  
Chief Executive Officer

HYDROCARBON TECHNOLOGIES, INC.

By: /s/ Alfred G. Comolli

-----  
Alfred G. Comolli, President

"HTI FOUNDERS"

/s/ Alfred G. Comolli

-----  
Alfred G. Comolli

/s/ L.K. (Theo) Lee, Ph.D.

-----  
L.K. (Theo) Lee, Ph.D.

/s/ David Tanner

-----  
David Tanner

/s/ Michael Kelley

-----  
Michael Kelley

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AGREEMENT AND PLAN OF REORGANIZATION

Dated as of May 2, 2001

By and Among



HEADWATERS INCORPORATED  
HEADWATERS SUB CORPORATION  
HYDROCARBON TECHNOLOGIES, INC.

and

the HTI Founders Named Herein

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LIST OF EXHIBITS

Exhibit A	Exchange Agreement
Exhibit B	Certificate of Merger
Exhibit C	Certificate of Incorporation
Exhibit D	Opinion of HTI Counsel
Exhibit E	Non-Compete Agreement
Exhibit F	Affiliate Agreement
Exhibit G	Opinion of Headwaters Counsel

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EXHIBIT A

EXCHANGE AGREEMENT

EXHIBIT B

CERTIFICATE OF MERGER

EXHIBIT C

CERTIFICATE OF INCORPORATION

EXHIBIT D

OPINION OF HTI COUNSEL

EXHIBIT E

NON-COMPETE AGREEMENT

EXHIBIT F

AFFILIATE AGREEMENT

EXHIBIT G

OPINION OF HEADWATERS COUNSEL

SHARE EXCHANGE AGREEMENT

THIS SHARE EXCHANGE AGREEMENT (the "Exchange Agreement") is made and entered into, effective as of May 2, 2001, by and among HEADWATERS INCORPORATED, a Delaware corporation ("Headwaters"), HEADWATERS SUB CORPORATION, a New Jersey corporation and a wholly-owned subsidiary of Headwaters ("Merger Sub"), HYDROCARBON TECHNOLOGIES, INC., a New Jersey corporation ("HTI"), and each of the individuals listed on the signature pages hereto (the "Transferors"). (Headwaters, HTI, Merger Sub, and the Transferors are referred to collectively herein as the "Parties.")

RECITALS

A. Each of the Transferors owns shares of common stock, \$.01 par value per share, of HTI (the "HTI Common Stock"). Each Transferor owns the number of shares of HTI Common Stock set forth opposite his or her name on the signature pages hereto.

B. In order to enable Headwaters to directly acquire one hundred percent (100%) of the capital stock of HTI, the Parties are entering into this Exchange Agreement, under which each Transferor agrees with Headwaters, among other things, to exchange all of the Transferor's interest in HTI Common Stock (each an "Exchange, and collectively the "Exchanges"), representing in the aggregate for all Transferors up to approximately ninety-seven percent (97%) of the outstanding shares of HTI Common Stock, to Merger Sub in exchange for cash and shares of Headwaters Common Stock (the "Headwaters Shares"), as provided herein.

C. In connection with the execution of this Exchange Agreement, Headwaters, HTI, Merger Sub, and certain individual HTI shareholders (the "HTI Founders") are entering into an Agreement and Plan of Reorganization dated as of May 2, 2001 (the "Merger Agreement"), pursuant to which Headwaters and HTI will enter into a business combination transaction pursuant to which Merger Sub will merge with and into HTI following the Exchanges (the "Merger").

D. Headwaters, Merger Sub, HTI, and the Transferors each desire to make certain representations and warranties and other agreements in connection with the Exchanges and the Merger.

NOW, THEREFORE, in consideration of the premises and of the mutual agreements herein contained, the Parties do hereby agree as follows:

ARTICLE I  
THE share Exchange

1.1 The Share Exchange. Subject to the satisfaction of the conditions precedent set forth in Articles VI and VII below, as of the Closing (as defined herein), each Transferor hereby agrees to transfer to Merger Sub, and Merger Sub agrees to accept, the number of shares of HTI Common Stock shown opposite such Transferor's name on the signature pages hereto (each such share an

"Exchanged Share" and collectively the "Exchanged Shares"), in exchange for the consideration provided herein. The Parties agree that the Exchanges shall be part of a single transaction. As a result, the obligation of each Transferor to transfer the Exchanged Shares to Merger Sub is conditioned on the simultaneous transfer by each other Transferor of such Transferor's HTI Common Stock or waiver by Merger Sub, in its sole discretion, of the obligations of such non-transferring Transferors.

1.2 Closing. The closing of the Exchanges (the "Closing") shall take place at the offices of HTI or Headwaters, at a time and date to be specified by the Parties after the last of the conditions precedent set forth in Articles VI and VII below shall have been satisfied or waived, and shall occur immediately prior to the closing of the Merger, pursuant to Section 1.2 of the Merger Agreement, or at such other time, date, and location as the Parties agree in writing (the date of the Closing being the "Closing Date").

### 1.3 Effect on Capital Stock.

(a) Definitions. For purposes of this Exchange Agreement:

(i) Business Plan shall mean the business plan prepared by HTI and dated February 2000.

(ii) Business Unit shall mean the business unit of Headwaters after the Merger that includes the business and operations of HTI as they existed immediately prior to the Effective Time (as defined in the Merger Agreement), which business unit shall include only HTI's business and operations unless consented to in writing by the Representative.

(iii) EBITDA shall mean earnings before interest, taxes, depreciation, and amortization of the Business Unit, after elimination of intracompany transfers and costs incurred in connection with the transactions contemplated hereby and by the Merger Agreement, as reported on Headwaters' statement of operations prepared in accordance with GAAP consistently applied in accordance with HTI's practices in effect immediately prior to the Closing, and without the effect of any restatement of the financial statements of HTI or the Business Unit unless HTI (in the case of any pre-Closing restatement) or the Representative (in the case of any post-Closing restatement) consents thereto in writing.

(iv) 2001 Actual EBITDA shall mean EBITDA of the Business Unit for the year ended December 31, 2001 (calculated to reflect the elimination of intracompany transfers and costs incurred in connection with the

transactions contemplated hereby and by the Merger Agreement), not including revenues from any sale of material assets or other extraordinary corporate events; provided that, for this purpose, a sale of Chemsampco or its assets or the nonexclusive licensing of intellectual property rights of the Business Unit in the ordinary course of business will not be considered a sale of material assets or an extraordinary corporate event.

(v) 2001 Projected EBITDA shall mean \$3,670,000; provided that, if, with the consent of Headwaters, HTI's financial statements are restated in a manner that would affect 2001 Actual EBITDA, 2001 Projected EBITDA will be correspondingly adjusted.

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(vi) 2002 Actual EBITDA shall mean the EBITDA of the Business Unit for the year ended December 31, 2002 (calculated to reflect the elimination of intracompany transfers and costs incurred in connection with the transactions contemplated hereby and by the Merger Agreement), not including revenues from any sale of material assets or other extraordinary corporate events; provided that, for this purpose, a sale of Chemsampco or its assets or the nonexclusive licensing of intellectual property rights of the Business Unit in the ordinary course of business will not be considered a sale of material assets or an extraordinary corporate event.

(vii) 2002 Projected EBITDA shall mean \$3,362,000; provided that, if, with the consent of Headwaters, HTI's financial statements are restated in a manner that would affect 2002 Actual EBITDA, 2002 Projected EBITDA will be correspondingly adjusted.

(viii) Fully Diluted Number shall mean the aggregate of (1) the number of shares of HTI Common Stock outstanding immediately prior to the Closing, plus (2) the number of shares of HTI Common Stock underlying all vested and unvested HTI Stock Options (as defined below) outstanding immediately prior to the Closing.

(ix) GAAP shall mean generally accepted accounting principles.

(x) Headwaters Common Stock shall mean the common stock, \$0.01 par value per share, of Headwaters.

(xi) HTI Stock Options shall mean all options pursuant to HTI's Stock Option Plan or pursuant to any other agreement of HTI.

(xii) Merger Shares shall mean the number of shares of HTI Common Stock outstanding immediately prior to the Closing, minus the number of Exchanged Shares.

(xiii) Purchaser Representative shall mean that person or entity selected by HTI, which shall assist the Transferors in

evaluating the merits and risks of the investment decision contemplated hereunder, and which shall satisfy the requirements of Rule 501(b) of Regulation D promulgated under the Securities Act of 1933, as amended (the "Securities Act"), as required by securities laws for the protection of non-accredited investors.

(xiv) Representative shall mean a three-member committee initially consisting of Alfred G. Comolli, L.K. (Theo) Lee, Ph.D., and David Tanner, acting together as representative for the Transferors as set out in this Exchange Agreement. The decisions of the Representative, including without limitation the designation of new members if a vacancy on such committee should occur, shall be made by majority vote.

(b) Share Exchange Consideration. At Closing, Merger Sub shall acquire the Exchanged Shares, the aggregate consideration for which (the "Exchange Consideration") shall consist of shares of Headwaters Common Stock and cash, as set out below, subject to the provisions of this Section 1.3:

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(i) Stock Consideration. The stock portion of the Exchange Consideration (the "Stock Consideration") shall consist of 1,330,154 shares of Headwaters Common Stock; and

(ii) Cash Consideration. The cash portion of the Exchange Consideration (the "Cash Consideration") shall consist of (A) \$2,893,750, less any costs to be borne by HTI pursuant to Section 5.6(c), minus (B) that amount which is equal to \$14,468,750 divided by the Fully Diluted Number and then multiplied by the number of Merger Shares; provided that the cash portion of any payment(s) provided for in Section 1.3(c) may be adjusted pursuant to Section 1.3(f).

(c) Conversion of HTI Common Stock. Subject to Section 1.2 hereof, at the Closing, by virtue of the Exchanges, and without any action on the part of the Transferors, each Exchanged Share, and all rights to accrued dividends in respect thereof, will be transferred to Merger Sub in exchange for the right to receive, on the dates specified below, the following aggregate consideration for each Exchanged Share; provided that twenty percent (20%) of each of the Closing Stock Amount and the Closing Cash Amount (as defined below) to each Transferor shall be placed into escrow (for which purpose, the numbers of shares of stock of each Transferor to be placed into escrow shall be rounded to the next whole number of shares), pursuant to the terms of an Escrow Agreement in substantially the form attached hereto as Exhibit A (the "Escrow Agreement"), until the Final Release Date (as defined in the Escrow Agreement); and provided further that each Transferor will be deemed to be the record holder of the shares of Headwaters Common Stock held in escrow:

(i) at the Closing,

(x) (A) an amount of cash equal to fifty

percent (50%) of the Cash Consideration, plus the aggregate exercise price of any vested HTI Stock Options exercised between the date hereof and the Effective Time, minus fifty percent (50%) of the Merger Consideration (as defined in the Merger Agreement), divided by (B) the Fully Diluted Number (the "Closing Cash Amount"); and

(y) the right to receive a number of shares of Headwaters Common Stock equal to fifty percent (50%) of the Stock Consideration divided by the Fully Diluted Number (the "Closing Stock Amount");

(ii) at March 31, 2002, or such later time as is set forth in Section 1.3(d), up to an additional twenty-five percent (25%) of the Cash Consideration and the Stock Consideration (the "First Contingent Payment") shall be deemed earned and shall be paid, in each case divided by the Fully Diluted Number, in the event that HTI:

(x) has 2001 Actual EBITDA equal to or in excess of (the 2001 Projected EBITDA (the "2001 EBITDA Test"), in which event the full First Contingent Payment shall be deemed to have been earned and shall

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be paid, in each case divided by the Fully Diluted Number; or, if the 2001 EBITDA Test is not met:

(y) has entered into a coal liquefaction license agreement with the Shenhua Group of the Peoples' Republic of China ("PRC") ("Shenhua"), containing terms that can reasonably be expected to result in license revenues consistent with the Business Plan, and containing other commercial terms and conditions common in this type of agreement, by March 31, 2002, and such license agreement, if entered into prior to October 31, 2001, is still in effect as of October 31, 2001 (the "Shenhua Test"), in which event sixty percent (60%) each of the cash and stock

portions of the First Contingent Payment shall be deemed to have been earned and shall be paid, in each case divided by the Fully Diluted Number; and

- (z) has entered into a heavy oil licensing agreement, containing terms that can reasonably be expected to result in license revenues consistent with the Business Plan, and containing other commercial terms and conditions common in this type of agreement, with PetroChina Company Limited, PRC ("PetroChina") by March 31, 2002, and such license agreement, if entered into prior to October 31, 2001, is still in effect as of October 31, 2001 (the "PetroChina Test"), in which event forty percent (40%) each of the cash and stock portions of the First Contingent Payment shall be deemed to have been earned and shall be paid, in each case divided by the Fully Diluted Number

(collectively, the "First Milestone").

Notwithstanding the foregoing,

(A) in addition to any amounts earned pursuant to Section 1.3(c)(ii)(y) or (z), if HTI fails to satisfy the 2001 EBITDA Test and one or both of the Shenhua Test and the PetroChina Test, but has 2001 Actual EBITDA of greater than eighty percent (80%) of 2001 Projected EBITDA, a portion of each of the cash and stock components of the First Contingent Payment (in each case divided by the Fully Diluted Number) shall be deemed earned and shall be paid that is, in each case, equal to the ratio of (i) 2001 Actual EBITDA minus eighty percent (80%) of 2001 Projected EBITDA to (ii) twenty percent (20%) of 2001 Projected EBITDA. For purposes of clarity, if 2001 Actual EBITDA is eighty percent (80%) (or less) of 2001 Projected EBITDA, the amount deemed to have been earned and that shall be paid (the "Amount Earned") will be zero; if eighty-five percent (85%), the Amount Earned will be twenty-five percent (25%) of the First Contingent Payment; if ninety percent (90%), the Amount Earned will be fifty percent (50%) of the First Contingent Payment; if ninety-five percent (95%), the Amount Earned will be seventy-five percent (75%) of the First Contingent Payment (in each case divided by the Fully Diluted Number);



(B) in addition to any amounts earned pursuant to Section 1.3(c)(ii)(y), (z), or (A), if (i) HTI fails to satisfy the 2001 EBITDA Test and (ii) fails to sign a license agreement with either or both Shenhua and/or PetroChina by March 31, 2002, but executes one or both of the aforesaid license agreements with Shenhua and/or PetroChina, as applicable, in a form otherwise satisfying the Shenhua Test and/or the PetroChina Test, as applicable, after March 31, 2002, but by March 31, 2003, half of each of the cash and stock portions of the First Contingent Payment that would have been deemed to have been earned if HTI had met the Shenhua Test and/or the PetroChina Test, as applicable, shall be deemed to have been earned and shall be paid;

provided that in no event shall the aggregate amounts paid pursuant to this Section 1.3(c)(ii) exceed the amount of the First Contingent Payment.

(iii) at March 31, 2003, or such later time as is set forth in Section 1.3(d), an additional twenty-five percent (25%) of the Cash Consideration and twenty-five percent (25%) of the Stock Consideration (the "Second Contingent Payment"), in each case divided by the Fully Diluted Number, shall be deemed earned and shall be paid in the event that the 2002 Actual EBITDA is equal to or exceeds the 2002 Projected EBITDA (the "Second Milestone"); provided that, if the 2002 Actual EBITDA is greater than eighty percent (80%) of 2002 Projected EBITDA, but less than the 2002 Projected EBITDA, a portion of the Second Contingent Payment (in each case divided by the Fully Diluted Number) shall be deemed earned and shall be paid that is, in each case, equal to the ratio of (i) 2002 Actual EBITDA minus eighty percent (80%) of 2002 Projected EBITDA to (ii) twenty percent (20%) of 2002 Projected EBITDA. For purposes of clarity, if 2002 Actual EBITDA is eighty percent (80%) of 2002 Projected EBITDA (or less), the Second Contingent Payment will be zero; if eighty-five percent (85%), the Amount Earned will be twenty-five percent (25%) of the Second Contingent Payment; if ninety percent (90%), the Amount Earned will be fifty percent (50%) of the Second Contingent Payment; if ninety-five percent (95%), the Amount Earned will be seventy-five percent (75%) of the Second Contingent Payment (in each case divided by the Fully Diluted Number). (The First Milestone and the Second Milestone shall each be referred to herein as a "Milestone".)

(d) Requirements as to Contingent Payments. With respect to the First Contingent Payment and the Second Contingent Payment (collectively, the "Contingent Payments"):

(i) Headwaters shall complete its calculations as to whether the EBITDA-related Milestones have been satisfied as promptly as practicable following the appropriate year-end, and in any event by the date which is 90 days following the end of the year in which such EBITDA-related Milestone is to be achieved. Headwaters will pay the Contingent Payments that are not EBITDA-related within fifteen (15) days after such Contingent Payments are earned. Each of the Milestones will stand alone and must be achieved separately.

(ii) Headwaters agrees not to cause the Business Unit to dividend any cash or profits or make any other distributions from the Business Unit during the periods in which the Milestones are to be achieved. Headwaters agrees to make funds available to the Business Unit to be used for reasonable and budgeted operating expenses of the Business Unit, and to provide other general operational assistance and advice to the Business Unit. Subject to Headwaters' sole

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discretion, Headwaters agrees to make other resources available to the Business Unit, upon the Business Unit's reasonable request therefor, to assist the Business Unit in achieving the Milestones. Headwaters will also maintain an independent profit and loss statement for the Business Unit that will include the business and operations of the Business Unit after the consummation of the Merger for the period through and including the calculation of the Second Milestone. The Business Unit will make commercially reasonable efforts to achieve the performance objectives set forth in the Business Plan. Headwaters will refrain from taking any action, including without limitation engaging in any activities which compete with those of the Business Unit, which may impair achievement of each of the Milestones within the time periods set forth in this Section 1.3.

(iii) The Business Unit shall provide recommendations to Headwaters concerning the proposed sales price for each product of the Business Unit. Headwaters shall consider such recommendations in establishing pricing, but shall have ultimate authority for establishing the prices of such products, provided that such prices shall be commercially reasonable. In the event that any product of the Business Unit is combined with or incorporated into another Headwaters product for resale (an "Integrated Product"), rather than being sold on a "stand-alone" basis, the price of such Integrated Product for purposes of this Exchange Agreement shall be determined to be an amount equal to not less than the price at which such product would be sold if it were sold commercially on a stand-alone basis. Such price determination shall be made by Headwaters with the consent of the Representative (which consent shall not be unreasonably withheld).

(iv) In the event that, after the Signing Date, there has occurred (i) a merger or consolidation of Headwaters with or into any other corporation or corporations pursuant to which the stockholders of Headwaters immediately prior to the transaction own less than fifty percent (50%) of the voting securities of the surviving corporation or a sale of all or substantially all of the assets of Headwaters (an "Acquisition"), or (ii) any merger, consolidation, reorganization, sale of all or substantially all of the assets or of any material asset of the Business Unit, or any spin-off of the securities of any entity conducting the business of the Business Unit (a "Spin Off"), or (iii) a material violation of this Exchange Agreement by Headwaters such that one or more Milestones could not reasonably be achieved within the time periods established in Section 1.3, all unpaid Contingent Payments shall be deemed to be earned. Any Contingent Payment which is accelerated pursuant to subsection (i)

or (ii) of the preceding sentence shall be paid at the consummation of the event described in such subsection; any Contingent Payment which is accelerated pursuant to subsection (iii) of the preceding sentence shall be payable at the earlier of the date such payment would otherwise be due or five business days after final resolution of any dispute regarding the occurrence of an applicable event (provided, however, that if the Contingent Payment is not made at such date, Transferors shall be entitled to interest at the then applicable legal interest rate for judgments from the date any such payment is due to the date payment is made); and provided, further, that if the payment to be made hereunder is the result of a breach of this Exchange Agreement that affects the achievability of one or more Milestones, only the Contingent Payment relating to the affected Milestone shall be paid pursuant to this subsection.

(v) In the event that, after the Effective Time, Headwaters materially modifies or alters the business plan or operations of the Business Unit, including, without limitation, Headwaters causing the termination without cause of (i) more than fifty percent (50%) of the

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operational and maintenance employees, or more than twenty percent (20%) of the other employees, who were employed by HTI as of the Closing Date or (ii) any employment agreement to which HTI is a party on the Closing Date, in each case such that one or more Milestones could not reasonably be achieved within the time periods established in Section 1.3, all unpaid Contingent Payments with respect to the affected Milestone(s) shall be deemed earned and payable in full on the date on which such Contingent Payment(s) would otherwise be due.

(vi) Headwaters agrees to provide promptly all information as reasonably requested by the Representative to the Representative or a designated accountant, and to make available for inspection and review to the Representative or a designated accountant, during business hours upon reasonable prior notice, the books and records of Headwaters relating to the Business Unit, including, but not limited to, all production reports and projections, purchase orders, and worksheets for the period under review and the computations underlying the determination of whether the Milestones have been achieved.

(vii) Headwaters shall deliver to the Representative no later than five days prior to the payment date of each year for a Contingent Payment, a certificate signed by an officer of Headwaters containing a detailed summary of all computations, including any adjustments, as described above, performed by Headwaters in arriving at the Contingent Payment for such year (the "Contingent Payment Certificate"). The Representative shall have a period of sixty (60) days after receipt of the Contingent Payment Certificate to dispute any amounts reflected thereon; provided that the Representative shall notify Headwaters in writing of each disputed item in reasonable detail and shall specify the amount thereof in dispute within such sixty (60) day period. Headwaters agrees to cooperate with any such confirmation request and make available to the Representative or his designated accountant, at all reasonable

times, for inspection and review, the books and records of Headwaters relating to the Business Unit, including, but not limited to, all worksheets for the period under review and the aforementioned computations. If no objections are raised within such sixty (60) day period or if the Representative consents in writing to the amounts reflected in the Certificate prior to the end of such period, the Contingent Payment Certificate and the Contingent Payment shall be final, binding, and conclusive upon all of the parties hereto and Headwaters shall make the Contingent Payment within ten (10) business days after the earlier of the expiration of such sixty (60) day period or its receipt of the written consent of the Representative. If, during his review of the Contingent Payment Certificate and accompanying worksheets and records, the Representative or his designated accountant disagrees with the computation prepared by Headwaters and such disagreement cannot, with good faith effort, be promptly settled, Headwaters and the Representative shall appoint a mutually satisfactory independent certified public accountant (the "Resolution Accountant") to review the computations of both Headwaters and the Representative. The determination of the Resolution Accountant, which shall be based on GAAP, shall be delivered within ninety (90) days after the appointment of the Resolution Accountant and shall be binding on Headwaters and the Transferors. The fees and costs of the Resolution Accountant shall be borne one-half by Headwaters and one-half by the Transferors. Within three (3) business days after the Resolution Accountant makes his determination, Headwaters shall pay the Transferors the Contingent Payment as so finally determined.

(e) No Fractional Shares. No fractional shares of Headwaters Common Stock shall be issued to any holder of HTI Common Stock in the Exchanges. To the extent that application

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of the conversion procedures of Section 1.3(c) to shares of HTI Common Stock held by a Transferor would result in a fractional number of shares of Headwaters Common Stock being issued to the Transferor in the Exchange, the number of shares of Headwaters Common Stock issuable to such holder in respect of all such shares in the Merger shall be rounded up to the next whole number of shares of Headwaters Common Stock.

(f) Adjustments for Tax-Free Reorganization. At HTI's option, Headwaters and HTI, without the necessity of obtaining the approval of any Transferor, shall cooperate with making any necessary, nonmaterial adjustments to reduce the Closing Cash Amount and the cash portion of any Contingent Payments in order to achieve an 80%-20% stock-to-cash ratio based on the closing price of Headwaters Common Stock required to be used for purposes of determining tax-free reorganization treatment for the transaction comprised of the Exchanges and the Merger.

(g) Representative's Holdback. Notwithstanding anything to the contrary contained herein, at the time the First Contingent Payment (or any portion thereof) is paid, Headwaters shall deduct from the First Contingent Payment, or from such portion thereof as is then payable, and deliver to the

Representative one hundred thousand dollars (\$100,000) in cash, which amount will be held by the Representative and applied as the Representative, in its sole discretion, deems desirable or appropriate to expenses incurred in connection with this Exchange Agreement, the Escrow Agreement, or the Merger Agreement. The Representative shall deliver the balance of such amount remaining after application to such expenses to the Transferors at such time as the Representative determines, in its sole discretion, that such amounts will not be needed for application to such expenses.

1.4 Exchange Procedures. Promptly after the Closing, Headwaters shall mail to each Transferor (i) a letter of transmittal, which shall specify that delivery shall be effected, and risk of loss and title to the HTI Share certificate or certificates (the "Certificates") shall pass, only upon delivery of the Certificates to Headwaters, and which shall be in such form and have such other provisions as Headwaters may reasonably specify ("the Letter of Transmittal") and (ii) instructions for use in effecting the transfer of the Certificates in exchange for the applicable portion of the Exchange Consideration pursuant to Section 1.3. Upon surrender of Certificates for cancellation to Headwaters, together with the Letter of Transmittal, duly completed and validly executed in accordance with the instructions thereto, the holders of such Certificates shall be entitled to receive in exchange therefor the applicable portion of the Exchange Consideration pursuant to Section 1.3. Notwithstanding the foregoing, Headwaters shall cooperate with the Transferors to cause the Letters of Transmittal to be made available prior to the Closing Date so they may be completed by the Transferors before the Closing.

1.5 Tax Treatment. The parties intend that the Exchanges, the Merger, and the other transactions contemplated herein and therein (i) will not be consummated unless all such transactions are consummated and (ii) will be a reorganization within the meaning of Section 368 of the Internal Revenue Code and hereby adopt this Exchange Agreement and the Merger Agreement as a "plan of reorganization" within the meaning of Sections 1.368-2(g) and 1.368-3(a) of the Treasury Regulations. Notwithstanding the foregoing, each Transferor acknowledges and agrees that he or she must consult with his or her tax advisors concerning tax treatment of the Exchanges and the Merger

and that neither HTI nor Headwaters is responsible for the tax treatment of the Exchanges or the Merger.

## ARTICLE II REPRESENTATIONS AND WARRANTIES OF ALL TRANSFERORS

Each Transferor, severally and not jointly, hereby makes the following representations and warranties to Headwaters and Merger Sub:

2.1 Authority. Such Transferor has all requisite power and authority to enter into this Exchange Agreement, and to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Exchange

Agreement and the consummation of the transactions contemplated hereby and thereby, have been duly and validly authorized by all necessary action on the part of such Transferor, and no other action on the part of such Transferor is necessary to authorize such execution and delivery. This Exchange Agreement has been duly and validly executed and delivered by such Transferor and, assuming the valid authorization, execution, and delivery thereof by the other parties thereto, constitutes valid and binding obligations of such Transferor, enforceable against such Transferor in accordance with its terms, except as enforceability may be limited by bankruptcy and other similar laws and general principles of equity.

2.2 Title to the HTI Common Stock. As of the date hereof such Transferor is, and at the time of Closing such Transferor will be, the owner (both beneficially and of record) of the shares of HTI Common Stock set forth opposite such person's name on the signature pages hereto. Except for the shares of HTI Common Stock and HTI Stock Options set forth opposite such person's name on the signature pages hereto, such Transferor is not the record or beneficial owner (as defined in Rule 13d-3 under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) of, and does not have any other rights of any nature to acquire any shares of HTI Common Stock. Such Transferor owns, and at the time of Closing will own, all of the shares of HTI Common Stock set forth opposite such person's name on the signature pages hereto free and clear of all liens, claims, pledges, options, rights of first refusal, agreements, limitations on voting rights, charges, and other encumbrances of any nature whatsoever, subject to whatever rights, if any, HTI may have to repurchase such shares (which rights HTI shall waive as of the Closing). Such Transferor has, and at the time of Closing will have, sole power of disposition with respect to all of the shares of HTI Common Stock set forth opposite such person's name on the signature pages hereto. Upon delivery by such Transferor of its shares of HTI Common Stock, Merger Sub will receive valid and marketable title thereto free and clear of any lien, claim, security interest, or other encumbrance.

2.3 No Conflict with Other Instruments. The execution and delivery of the Transferor Agreements by the Transferors do not, and the performance of the Transferor Agreements by the Transferors will not, to the knowledge of such Transferor after reasonable inquiry, conflict with or violate any law, rule, regulation, order, judgment, or decree applicable to any Transferor, or by which any Transferor, or any of their respective properties, is bound or affected.

2.4 Investment Intent. The Headwaters Shares to be issued to such Transferor upon consummation of the transactions contemplated hereby are being acquired by such Transferor for such person's own account pursuant to this Exchange Agreement and not for any other person, and

for investment only and with no intention of distributing or reselling such Headwaters Shares or any part thereof or any interest therein in any transaction that would be in violation of the securities laws of the United States, or any state thereof. Such Transferor has no contract, undertaking, agreement, or

arrangement with any person to sell or transfer to such person, except as permitted hereunder, any of the Headwaters Shares.

2.5 No Registration of the Headwaters Shares. Such Transferor understands that the Headwaters Shares are not being registered under the Securities Act of 1933, as amended (the "Securities Act") on the ground that the transactions contemplated hereby are exempt from the registration requirements thereof, and that Headwaters' reliance on an exemption under the Securities Act is predicated on such Transferor's representations set forth herein.

2.6 Knowledge and Experience. Such Transferor, either alone or with his or her Purchaser Representative, is able to fend for himself or herself in the transactions contemplated by this Exchange Agreement, has such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of its investment, has the ability to bear the economic risks of its investment, and has been furnished with or has had access to all information such person deemed necessary for such person's full and complete evaluation of Headwaters, and such Transferor has had during the course of this transaction and prior to the Exchange the opportunity to ask questions of and receive answers from Headwaters, its employees, and representatives concerning financial affairs of Headwaters, and all questions which have been asked have been adequately answered.

2.7 Holding Period. Pursuant to Section 5.1 to this Exchange Agreement, Headwaters has agreed to file a registration statement on Form S-3 registering the resale of the Headwaters Shares by Transferors. Notwithstanding such agreement by Headwaters, such Transferor understands and agrees that, if a registration statement covering the securities under the Securities Act is not in effect and an exemption from the registration requirements is not available when he or she desires to sell the Headwaters Shares, he or she may be required to hold such Headwaters Shares for an indeterminate period. Such Transferor understands that any sale of the Headwaters Shares which might be made by him or her in reliance upon Rule 144 under the Securities Act may be made only in limited amounts in accordance with the terms and conditions of that rule.

### ARTICLE III

#### REPRESENTATIONS AND WARRANTIES OF ACCREDITED INVESTORS

Each Transferor who is identified on the signature pages hereto as an "accredited investor" hereby represents and warrants to Headwaters and Merger Sub that such person satisfies at least one of the following suitability standards:

- (a) that he or she is a natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his or her purchase exceeds \$1,000,000; or
- (b) that he or she is a natural person who had (i) an individual income in excess of \$200,000 in each of the two most recent years and who reasonably expects

an income in excess of \$200,000 in the current year or (ii) a joint income with that person's spouse in excess of \$300,000 in each of the two most recent years and who reasonably expects a joint income in excess of \$300,000 in the current year.

ARTICLE IV  
REPRESENTATIONS AND WARRANTIES OF HEADWATERS AND MERGER SUB

Each of Headwaters and Merger Sub represents and warrants to the Transferors, except as set forth in the disclosure letter supplied by Headwaters to the Transferors on or before the date hereof and certified by a duly authorized officer of Headwaters and Merger Sub (the "Headwaters Disclosure Letter"), as follows:

4.1 Organization of Headwaters. Each of Headwaters and Merger Sub is a corporation duly organized, validly existing, and in good standing under the laws of the jurisdiction of its incorporation, has the corporate power to own, lease, and operate its property and to carry on its business as now being conducted, and is duly qualified to do business and is in good standing as a foreign corporation in each jurisdiction in which the failure to be so qualified would have a material adverse effect on the business, assets (including intangible assets), financial condition, or results of operations (a "Material Adverse Effect") of Headwaters and its subsidiaries taken as a whole.

4.2 Authority.

(a) Each of Headwaters and Merger Sub has all requisite corporate power and authority to enter into this Exchange Agreement and to consummate the transactions contemplated hereby. The execution and delivery of this Exchange Agreement and the consummation of the transactions contemplated hereby have been duly authorized by all necessary corporate action on the part of Headwaters and Merger Sub. This Exchange Agreement has been duly executed and delivered by Headwaters and Merger Sub and, assuming the due authorization, execution, and delivery by each of the Transferors, constitutes valid and binding obligations of Headwaters and Merger Sub, enforceable in accordance with its terms, except as enforceability may be limited by bankruptcy and other similar laws and general principles of equity. The execution and delivery of this Exchange Agreement by Headwaters and Merger Sub do not, and the performance of this Exchange Agreement by Headwaters and Merger Sub will not, (i) conflict with or violate the Certificate of Incorporation or Bylaws of Headwaters and Merger Sub or the equivalent organizational documents of any of Headwaters' other subsidiaries, (ii) conflict with or violate any law, rule, regulation, order, judgment, or decree applicable to Headwaters or any of its subsidiaries or by which its or any of their respective properties is bound or affected pursuant to any note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise, or other instrument or obligation to which



Headwaters or any of its subsidiaries is a party or by which Headwaters or any of its subsidiaries or its or any of their respective properties are bound or affected, except, with respect to clause (ii), for the consent of Zion's First National Bank, and for any such conflicts, violations, defaults, or other occurrences that would not have a Material Adverse Effect on Headwaters and its subsidiaries taken as a whole. The Headwaters Disclosure Letter lists all consents, waivers, and approvals under any of Headwaters' or any of its subsidiaries' agreements, contracts, licenses, or leases required to be obtained in connection with the consummation of the transactions contemplated

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hereby which, if not obtained, would have a Material Adverse Effect on Headwaters and its subsidiaries taken as a whole or have a material adverse effect on the ability of the Parties to consummate the Exchanges.

(b) No consent, approval, order, or authorization of, or registration, declaration, or filing with, any Governmental Entity is required by or with respect to Headwaters or Merger Sub in connection with the execution and delivery of this Exchange Agreement or the consummation of the transactions contemplated hereby, except for

(i) the filing with the Securities and Exchange Commission (the "SEC") of a Form D under Regulation D under the Securities Act, any required state filings related to the Exchanges, and such reports under the Exchange Act as may be required in connection with this Exchange Agreement and the transactions contemplated hereby; and

(ii) such other consents, authorizations, filings, approvals, and registrations which, if not obtained or made, would not have a Material Adverse Effect on Headwaters and its subsidiaries taken as a whole or have a material adverse effect on the ability of the Parties to consummate the Exchanges.

4.3 No Material Misrepresentations. This Exchange Agreement, taken together with the Headwaters Disclosure Letter, contains no untrue statement of material fact and, when this Exchange Agreement is taken in its entirety, contains no untrue statement of a material fact and does not omit to state a material fact necessary to make the statements contained herein not misleading as of the date hereof.

4.4 Available Funds. Headwaters and Merger Sub, collectively, have sufficient capital available to consummate the transactions contemplated by this Exchange Agreement and are not relying on obtaining additional financing in connection with such transactions.

4.5 SEC Documents. Headwaters has filed all required reports, schedules, forms, statements, and other documents with the SEC since October 1, 1999 (collectively, and in each case including all exhibits and schedules

thereto and documents incorporated by reference therein, the "Headwaters SEC Documents"). As of their respective dates, the Headwaters SEC Documents complied in all material respects with the requirements of the Securities Act or the Exchange Act, as the case may be, and the rules and regulations of the SEC promulgated thereunder applicable to such Headwaters SEC Documents. As of their respective dates, none of the Headwaters SEC Documents (including any and all financial statements therein) contained any untrue statement of a material fact or failed to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. The consolidated financial statements of Headwaters included in the Headwaters SEC Documents comply as to form in all material respects with applicable accounting requirements and the published rules and regulations of the SEC with respect thereto, have been prepared in accordance with GAAP (except, in the case of unaudited consolidated quarterly statements, as permitted by Form 10-Q of the SEC) applied on a consistent basis during the period involved (except as may be indicated in the notes thereto), and present fairly, in all material respects, the consolidated financial position of

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Headwaters and its subsidiaries at the respective dates thereof and the consolidated results of operations and cash flows for the periods specified (subject, in the case of unaudited quarterly statements, to normal year-end audit adjustments). Except as reflected or reserved against in the Headwaters Financial Statements or otherwise disclosed in the Headwaters Disclosure Letter, Headwaters and its subsidiaries have no material liabilities or other obligations (including contingent liabilities and obligations) except, (i) since the date of the most recent audited balance sheet included in the Headwaters Financial Statements, liabilities and obligations incurred in the ordinary course of business or (ii) that would not be required to be reflected or reserved against in the consolidated balance sheet of Headwaters and its subsidiaries prepared in accordance with GAAP.

4.6 Absence of Certain Changes or Events. Except as disclosed in the Headwaters SEC Documents or in the Headwaters Disclosure Letter, since the date of the most recent audited balance sheet included in the Headwaters SEC Documents, there is not and has not been (a) any material adverse change to Headwaters, or (b) any condition, event, or occurrence that could reasonably be expected to prevent or materially delay Headwaters from consummating the transactions contemplated by this Exchange Agreement; provided that, for purposes of this Section 4.6, a change in the price of Headwaters Common Stock shall not be deemed to constitute a "material adverse change".

4.7 Shares Reserved. Headwaters has authorized and reserved, and shall keep available, for issuance and delivery, the number of shares of Headwaters Common Stock issuable in connection with the Exchanges. Upon issuance, such shares will be validly issued, fully paid, and nonassessable.

4.8 Securities Law Compliance. Headwaters shall take such steps as may

be necessary to comply with the securities and blue sky laws of all jurisdictions that are applicable to the issuance of the Headwaters Common Stock pursuant hereto. HTI and the Transferors shall use their best efforts to assist Headwaters as may be necessary to comply with the securities and blue sky laws of all jurisdictions which are applicable in connection with the issuance of Headwaters Common Stock pursuant hereto.

4.9 Nasdaq National Market Listing. Headwaters shall authorize for listing on the Nasdaq National Market the shares of Headwaters Common Stock issuable pursuant hereto and shall use its best efforts to maintain such listing on the Nasdaq National Market (or such other principal stock exchange on which shares of Headwaters Common Stock are then listed).

ARTICLE V  
ADDITIONAL AGREEMENTS

5.1 Registration.

(a) Registration Rights.

(i) Headwaters will prepare and file with the SEC within 60 days of the Closing Date (the "Required Filing Date") a "shelf" registration statement on Form S-3 (or other appropriate form) (as the same may be amended, the "Registration Statement") pursuant to Rule 415

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under the Securities Act providing for the resale from time to time by the Transferors of the shares of Headwaters Common Stock issuable in connection with the Exchange (including the Stock Consideration included in the First and Second Contingent Payments, except such shares as to which it has then been determined that such shares will not be earned) and all shares of Headwaters Common Stock issued in connection therewith by way of a stock dividend or stock split or in connection with a combination of shares, reclassification, recapitalization, merger or consolidation or reorganization (the "Headwaters Shares"), through or to brokers or dealers or directly to investors pursuant to the prospectus contained in the Registration Statement (or another prospectus contained in and forming a part of an effective registration statement under the Securities Act) or in transactions that are exempt from the requirements of registration under the Securities Act, at a fixed price or prices, which may be changed from time to time, at market prices prevailing at the time of such sale, at prices related to such market prices or at negotiated prices; provided, however, that such transactions shall not include an underwritten public offering. Headwaters shall use its reasonable efforts to cause the Registration Statement to become effective, provided that, in any event, any obligation to maintain the effectiveness of the Registration Statement shall terminate on the earlier of (i) all Headwaters Shares having been sold under the Registration Statement and (ii) the first date on which all Headwaters Shares can be sold in a three-month period, one year from the Closing Date. By written notice to the Transferors, Headwaters may stop the use of the Registration Statement for such resales for a

period of no longer than 90 days in aggregate after the date of the notice if Headwaters or its subsidiaries are engaged in confidential negotiations or other confidential business activities, disclosure of which, in the reasonable determination of the Headwaters Board of Directors, would be required in such registration statement (but would not be required if such registration statement were not filed).

(ii) Headwaters will use its reasonable best efforts to prepare and file with the SEC such amendments and supplements to the Registration Statement and the prospectus contained therein as may be necessary to keep such Registration Statement effective for a period ending on the date on which all of the Headwaters Shares can be sold in a three-month period, or such shorter period as shall terminate when all Headwaters Shares covered by such registration statement have been sold;

(iii) Headwaters will as soon as reasonably practicable, furnish to each Transferor, prior to filing the Registration Statement, copies of such registration statement as proposed to be filed, and thereafter furnish to such Transferor such number of copies of such Registration Statement, each amendment and supplement thereto (in each case, if specified by such Transferor, including all exhibits thereto), the prospectus included in such Registration Statement (including each preliminary prospectus) and such other documents as such Transferor may reasonably request in order to facilitate the disposition of Headwaters Shares owned by such Transferor.

(iv) Headwaters will promptly notify the Transferors at any time when a prospectus relating thereto is required to be delivered under the Securities Act within the period that Headwaters is required to keep the Registration Statement effective of the happening of any event as a result of which the prospectus included in such Registration Statement (as then in effect) contains an untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances then existing, not

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misleading, and Headwaters will promptly prepare and file a supplement or amendment to such prospectus so that, as thereafter delivered to the purchasers of such Headwaters Shares, such prospectus will not contain an untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances then existing, not misleading; provided, however, that notwithstanding the foregoing, if the Headwaters Board of Directors determines in its good faith judgment that the filing of any supplement or amendment to the Registration Statement to keep such Registration Statement available for use by the Transferors for resales of Headwaters Shares would require the disclosure of material information that Headwaters has a bona fide business purpose for preserving as confidential, then upon written notice of such determination by Headwaters to each Transferor, the obligation of Headwaters to supplement or amend the Registration Statement will be suspended until Headwaters notifies the

Transferors in writing that the reasons for suspension of such obligations on the part of Headwaters no longer exist and Headwaters amends or supplements the Registration Statement as may be required; provided that the aggregate number of days (whether or not consecutive) during which Headwaters may delay the filing of any such supplement or amendment (together with the number of days referred to in Section 5.1(a) hereof) shall in no event exceed ninety (90) days in any twelve (12) month period.

(v) Headwaters will promptly notify each Transferor of any stop order issued by the SEC and take all reasonable actions to obtain the removal of any such stop order.

(vi) Before filing any registration statement or prospectus or any amendments or supplements thereto, Headwaters will furnish to counsel selected by the Representative copies of such documents, which shall be subject to the reasonable approval of such counsel.

(b) Conditions and Limitations. Headwaters' obligations under Section 5.1(a) shall be subject to the following limitations:

(i) Headwaters shall not be required to file more than one Registration Statement pursuant to this Agreement.

(ii) Headwaters shall have received the information and documents specified in Section 5.1(c) and each Transferor shall have observed or performed its other covenants and conditions contained in such section and, as a condition to registration of its Headwaters Shares, each Transferor shall agree in the Letter of Transmittal to perform the covenants and conditions applicable to him or her contained in such Section 5.1(c); provided that the failure of a Transferor to have observed and performed such other covenants and conditions shall not excuse Headwaters' obligations hereunder with respect to Transferors who have so observed and performed such covenants and conditions.

(iii) Each Transferor agrees that, upon receipt of any notice from Headwaters of the happening of any event of the kind described in Section 5.1(a)(iv), such Transferor will forthwith discontinue disposition of Headwaters Shares until such Transferor's receipt of the copies of the supplemented or amended prospectus contemplated by Section 5.1(a)(iv) hereof, and, if so directed by Headwaters, such Transferor will deliver to Headwaters (at

Headwaters' expense) all copies, other than permanent file copies then in such Transferor's possession, of the prospectus covering such Headwaters Shares at the time of receipt of such notice.

(iv) Each Transferor agrees that, upon receipt of any notice from Headwaters stating that Headwaters has determined to effect a

registered underwritten public offering of securities and has taken substantial steps to effect such offering, such Transferor will forthwith discontinue disposition of Headwaters Shares until such Transferor's receipt of notice from Headwaters that such dispositions may be continued, provided that the aggregate number of days (whether or not consecutive) during which Headwaters may suspend use of the Registration Statement pursuant to this Section shall in no event exceed ninety (90) days in any twelve (12) month period, and provided further that the officers and directors of Headwaters have agreed to refrain from sales during such period.

(c) Information from and Certain Covenants of Transferors. Headwaters may require the Transferors to furnish to Headwaters such information regarding the Transferors and the distribution of such Headwaters Shares as Headwaters may from time to time reasonably request in writing to carry out its obligations as to the Registration Statement. Each Transferor agrees to notify Headwaters as promptly as practicable of any inaccuracy or change in information previously furnished by such Transferor to Headwaters or of the occurrence of any event in either case as a result of which any prospectus relating to such registration contains an untrue statement of a material fact regarding such Transferor or the distribution of such Headwaters Shares or omits to state any material fact regarding such Transferor or the distribution of such Headwaters Shares required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances then existing, and promptly to furnish to Headwaters any additional information required to correct and update any previously furnished information or required so that such prospectus shall not contain, with respect to such Transferor or the distribution of such Headwaters Shares, an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances then existing, not misleading. Each Transferor shall execute all consents, powers of attorney, and other documents reasonably required to be signed by him or her in order to cause such registration statement to become effective. Each Transferor covenants that, in disposing of his or her Headwaters Shares, he or she will comply with all applicable securities laws, including the prospectus delivery requirements under the Securities Act.

(d) Registration Expenses. All Registration Expenses will be borne by Headwaters. Any broker's fee, underwriting discount, and commission applicable to the sale of Headwaters Shares shall be borne by the holder of the Headwaters Shares to which such broker's fee, discount, or commission relates, and each Transferor shall be responsible for all fees and expenses incurred by such Transferor in connection with any registration under this Article IX other than Registration Expenses. For purposes of this Section 5.1(d), "Registration Expenses" shall mean all expenses incident to Headwaters' performance of or compliance with Section 5.1, including, without limitation, all registration and filing fees, messenger and delivery expenses incurred by Headwaters, internal expenses incurred by Headwaters (including, without limitation, all salaries and expenses of its officers and employees performing legal or accounting duties), all expenses relating to the preparation, printing, distribution, and reproduction of the registration statement and the prospectus, the fees and expenses incurred in connection with the listing of the shares of Headwaters

Stock on any securities exchange, fees and disbursements of counsel for Headwaters and of its independent public accountants, and the fees and disbursements of one counsel for the Transferors who are selling Headwaters Shares pursuant to the Registration Statement.

(e) Indemnification.

(i) Headwaters agrees to indemnify and hold harmless each Transferor who has sold Headwaters Shares pursuant to the Registration Statement from and against any and all losses, claims, damages, liabilities, and expenses (including reasonable costs of investigation and defense) arising out of or based upon any untrue statement or alleged untrue statement of a material fact contained in the Registration Statement or the final prospectus contained therein or in any amendment or supplement thereto, or arising out of or based upon any omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, except insofar as such losses, claims, damages, liabilities, or expenses arise out of, or are based upon, any such untrue statement or omission or allegation thereof based upon information furnished in writing to Headwaters by such Transferor or on such Transferor's behalf expressly for use therein.

(ii) Each Transferor agrees to indemnify and hold harmless Headwaters, its officers, directors, and agents and each person, if any, who controls Headwaters within the meaning of either Section 15 of the Securities Act or Section 20 of the Exchange Act, from and against any and all losses, claims, damages, liabilities, and expenses (including reasonable costs of investigation and defense) arising out of or based upon any untrue statement or alleged untrue statement of a material fact by such Transferor contained in the Registration Statement or the prospectus contained therein or in any amendment or supplement thereto, or arising out of or based upon any omission or alleged omission by such Transferor to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, provided that such losses, claims, damages, liabilities, or expenses arise out of, or are based upon, any such untrue statement or omission or allegation thereof based upon information furnished in writing to Headwaters by such Transferor or on such Transferor's behalf expressly for use therein. Notwithstanding the foregoing, no Transferor shall be obligated to pay hereunder more than the net proceeds realized by him or her upon his or her sale of Headwaters Shares included in the Registration Statement.

(iii) The provisions of Section 9.3 (but not the liability limitations in Section 9.1) shall apply to any actions or proceedings subject to the indemnification provisions of this Section 5.1.

5.2 Transfer Restrictions. Each Transferor agrees that, so long as required by law, the Exchanged Shares and any securities issued in exchange for

or in respect thereof shall be subject to a transfer restriction substantially to the following effect, which shall be conspicuously stamped or otherwise imprinted on each certificate evidencing Exchanged Shares:

THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR UNDER THE SECURITIES OR BLUE SKY LAWS OF ANY STATE, AND MAY NOT BE OFFERED, SOLD, PLEDGED, TRANSFERRED, OR OTHERWISE DISPOSED OF EXCEPT PURSUANT TO AN

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EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT AND OTHER APPLICABLE LAWS OR PURSUANT TO AN EXEMPTION FROM THE SECURITIES ACT OR OTHER LAWS.

5.3 Legal Requirements. Each of Headwaters, HTI, and the Transferors will take all reasonable actions necessary or desirable to comply promptly with all legal requirements which may be imposed on them with respect to the consummation of the transactions contemplated by this Exchange Agreement (including furnishing all information required in connection with approvals of or filings with any Governmental Entity, and prompt resolution of any litigation prompted hereby) and will promptly cooperate with and furnish information to any Party necessary in connection with any such requirements imposed upon any of them or their respective subsidiaries in connection with the consummation of the transactions contemplated by this Exchange Agreement.

5.4 Notification of Certain Matters. Subject to the terms and provisions of this Exchange Agreement, each Party will give prompt notice to the other Parties of the occurrence, or failure to occur, of any event, which occurrence or failure to occur would be reasonably likely to cause (a) any representation or warranty contained in this Exchange Agreement to be untrue or inaccurate in any material respect at any time from the date of this Exchange Agreement to the Closing Date, or (b) any material failure of such Party, as the case may be, or of any officer, director, employee, or agent thereof, to comply with or satisfy any covenant, condition, or agreement to be complied with or satisfied by him, her, or it under this Exchange Agreement. Notwithstanding the above, the delivery of any notice pursuant to this section will not limit or otherwise affect the remedies available hereunder to the Party receiving such notice.

5.5 Commercially Reasonable Efforts and Further Assurances. Subject to the respective rights and obligations of Headwaters and the Transferors under this Exchange Agreement, each of the Parties will use its commercially reasonable efforts to effectuate the Exchanges and the other transactions contemplated hereby and to fulfill and cause to be fulfilled the conditions to Closing under this Exchange Agreement. Each Party, at the reasonable request of another Party, will execute and deliver such other instruments and do and perform such other acts and things as may be necessary or desirable for effecting completely the consummation of the transactions contemplated hereby.



## 5.6 Purchaser Representative and Representative.

(a) Each Transferor expressly designates and appoints the individuals comprising the Representative as his or her true and lawful attorney-in-fact and agent and expressly authorizes the Representative (i) to execute and deliver, in his or her name, the Escrow Agreement in such form as the Representative deems desirable or appropriate, the execution of such agreement to be conclusive evidence of such determination, and (ii) to take all actions and carry out all responsibilities of the Representative under this Exchange Agreement, the Escrow Agreement, and the Merger Agreement, which actions shall include, without limitation, (A) receiving a portion of the Exchange Consideration pursuant to Section 1.3(g) hereof and paying from such amount any expenses incurred in connection with this Exchange Agreement, the Escrow Agreement, or the Merger Agreement, and (B) acting on his or her behalf in connection with any disputes or disagreements arising under this Exchange Agreement (including without limitation Section 1.3

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hereof), the Escrow Agreement, or the Merger Agreement, including, without limitation, agreeing to any resolution thereof.

(b) The Transferors agree that the Purchaser Representative and the individuals comprising the Representative will not be liable for any act done or omitted as Purchaser Representative or Representative, respectively, hereunder while acting in good faith and such act is not an act of willful misconduct in the performance of his, her or its obligation.

(c) Headwaters shall pay up to forty thousand dollars (\$40,000) of the costs of retaining the Purchaser Representative. The remainder of such costs, if any, shall be borne by HTI and shall constitute a reduction to the Cash Consideration.

5.7 Treatment of Exchanges and Merger as a Qualifying Reorganization. Each of HTI and the Transferors shall (a) treat the Exchanges and the Merger as a reorganization under Section 368 of the Code, (b) report the Exchanges, the Merger, and all related transactions consistently therewith in any and all Tax Returns filed by him, her, or it, (c) take all such actions as may be reasonably required to cause the Exchanges and the Merger to be treated as a qualifying reorganization, and (d) take no action which could disqualify the Exchanges and the Merger from reorganization status under Section 368 of the Code.

## ARTICLE VI

### CONDITIONS TO OBLIGATIONS OF HEADWATERS AND MERGER SUB

The obligations of Headwaters and Merger Sub hereunder are subject to the satisfaction, or waiver thereof by Headwaters and Merger Sub, of the following conditions:

6.1 No Actions or Proceeding. No judgment, writ, order, injunction,

award, or decree of or by any Governmental Entity shall have been issued that would, and no action or proceeding shall have been instituted by or before any Governmental Entity seeking to, enjoin or prevent the consummation of the transactions contemplated hereby and under the Merger Agreement. Notwithstanding the generality of the foregoing, no person shall have (i) commenced, or shall have notified either HTI, Headwaters, or any Transferor that it intends to commence, an action or proceeding or (ii) provided HTI, Headwaters, or any Transferor with notice, in either case which allege(s) that any of the intellectual property presently embodied, or proposed to be embodied, in HTI's products or design environments infringes or otherwise violates the intellectual property rights of such person or is available for licensing from a potential licensor providing the notice, or otherwise alleges that HTI does not otherwise own or have the right to exploit such intellectual property.

6.2 Representations and Warranties. The representations and warranties of the Transferors shall be true and correct in all material respects on and as of the Closing Date, with the same effect as though such representations and warranties had been made on and as of such date, and each and all of the agreements of the Transferors to be performed or complied with pursuant to the terms of this Exchange Agreement shall have been duly performed and complied with in all material respects.

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6.3 No Material Adverse Effect. No event shall have occurred since the date of this Exchange Agreement that has had or would reasonably be expected to have a Material Adverse Effect on HTI.

6.4 Merger Agreement. Each of the conditions precedent to the closing under Article V of the Merger Agreement shall have been satisfied or waived by Headwaters.

6.5 Exchanges. Transferors shall have offered, pursuant to this Exchange Agreement, to exchange at least ninety percent (90%) of the outstanding shares of HTI Common Stock.

## ARTICLE VII CONDITIONS TO OBLIGATIONS OF THE TRANSFERORS

The obligations of the Transferors hereunder are subject to the satisfaction, or waiver thereof by each Transferor, of the following conditions:

7.1 No Actions or Proceedings. No judgment, writ, order, injunction, award, or decree of or by any Governmental Entity shall have been issued that would, and no action or proceeding shall have been instituted by or before any Governmental Entity seeking to, enjoin or prevent the consummation of the transactions contemplated hereby.

7.2 Representations and Warranties. The representations and warranties of Headwaters and Merger Sub shall be true and correct in all material respects

on and as of the Closing Date, with the same effect as though such representations and warranties had been made on and as of such date, except for changes which, in the aggregate, would not have a material adverse effect on the financial condition, properties, business, prospects, or results of operations of Headwaters and its subsidiaries, taken as a whole, and each and all of the agreements of Headwaters and Merger Sub to be performed or complied with pursuant to the terms of this Exchange Agreement shall have been duly performed and complied with in all material respects.

7.3 Merger Agreement. Each of the conditions precedent to the closing under Article VI of the Merger Agreement shall have been satisfied or waived by HTI.

ARTICLE VIII  
SURVIVAL OF REPRESENTATIONS AND WARRANTIES

Notwithstanding any investigation made by or on behalf of Headwaters and Merger Sub or the Transferors, the representations and warranties of the Transferors and of Headwaters and Merger Sub contained in this Exchange Agreement shall be continuing representations and warranties and shall survive the Closing Date until the second anniversary thereof.

ARTICLE IX  
INDEMNITY OF HEADWATERS

9.1 Indemnification of Headwaters. Each of the Transferors shall jointly, but not severally, indemnify, defend, and hold harmless Headwaters, Merger Sub, and the Surviving Corporation, and their respective employees, officers, directors, stockholders, controlling persons,

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and affiliates (collectively, the "Indemnified Persons") from and against his or her pro rata share of any claims, damages, costs (including, without limitation, interest on any loss from the date thereof to the date of payment), or expenses (including, without limitation, attorneys' fees and disbursements) (collectively, the "Losses") arising out of (i) any misrepresentation in or breach of the representations, warranties, or covenants of the Transferors contained herein or made to Headwaters or Merger Sub in any exhibit, certificate, or other instrument or document furnished or to be furnished by the Transferors pursuant to this Exchange Agreement or in connection with the transactions contemplated herein and (ii) any misrepresentation in or breach of the representations, warranties, or covenants of HTI contained in the Merger Agreement or made to Headwaters or Merger Sub in any exhibit, certificate, or other instrument or document furnished or to be furnished by HTI pursuant to the Merger Agreement or in connection with the transactions contemplated therein; provided, however, that, (A) the liability of all of the Transferors, other than officers and directors of HTI as of the Signing Date, pursuant to this Section 9.1 shall not exceed the sum of (i) the amounts in the Escrow Account (as defined in the Escrow Agreement) and (ii) any future Contingent Payments that

ultimately are earned; and (B) the liability of any Transferor who is an officer or director of HTI as of the Signing Date shall not exceed the total Exchange Consideration he or she has received, including his or her portion of any amounts in the Escrow Account, plus any future Contingent Payments that ultimately are earned. Notwithstanding the foregoing, no payments shall be made pursuant to this Section 9.1 unless and until the aggregate amount of such Losses exceeds \$150,000 (the "Threshold"), in which case Headwaters shall be entitled to the full amount of the Losses in excess of \$150,000, after deducting any amounts otherwise to be paid with respect to Dissenting Shares pursuant to Section 1.7 of the Merger Agreement. Notwithstanding the immediately preceding sentence, Losses resulting from any misrepresentation in or breach of the representations and warranties in Section 2.2 of the Merger Agreement, relating to HTI's capital structure, shall not be subject to the Threshold.

9.2 Indemnification for Dissenting Shares. The Indemnified Persons shall be indemnified from and against any Losses as a result of claims asserted against Headwaters by holders of Dissenting Shares (as defined in the Merger Agreement), and shall be entitled to recover the full amount of such Losses, after deducting any amounts otherwise to be paid with respect to such Dissenting Shares pursuant to Section 1.3(c) hereof; provided that any such Losses shall first be satisfied from Merger Consideration that, in the absence of the exercise of dissenters' rights, would have been paid with respect to such shares.

9.3 Notice. Promptly after service of notice of any claim or of process on any Indemnified Person by any third person in any matter in respect of which indemnity may be sought pursuant to Section 5.1(e) or this Article IX, Headwaters shall notify the Transferors at the Transferors' addresses set forth on the signature pages attached hereto. The Transferors may, at their option, assume the defense of any such claim or process or settlement thereof. Regardless of whether any such third-party claim is defended by Headwaters or the Transferors, the defending Party(ies) shall (i) settle or defend such claim or proceeding with reasonable diligence; (ii) cooperate with the other Parties in the investigation and analysis of such claim or proceeding; (iii) afford the other Parties reasonable access to such relevant information as he, she, or it may have in its possession; and (iv) keep the other Parties reasonably informed regarding such claim or proceeding. The generality of the foregoing notwithstanding, the Transferors shall not settle any such claim or proceeding without the consent of Headwaters, which consent shall not be unreasonably withheld;

provided that if Headwaters shall withhold such consent, the Transferors shall continue to defend such claim or proceeding and all defense costs from the date of such refusal to consent onward shall be payable by the Transferors, subject to the maximum limits of such indemnity under this Article IX. If the Transferors shall become obligated to indemnify and hold harmless any Indemnified Person pursuant to this Article IX, such obligation will be the joint, and not several, obligation of the Transferors only and in no event will

the Transferors be entitled to any contribution from the Surviving Corporation with respect to such indemnity obligation of the Transferors, nor shall the Transferors assert any claim against the Surviving Corporation, whether for contribution or otherwise, with respect to any such indemnity obligation of the Transferors.

9.4 Survival of Indemnification Obligation. The indemnification provided in this Article IX shall survive the Closing Date for the periods specified Article VIII with respect to the representations and warranties of the Transferors herein, and for the periods specified in Article VII of the Merger Agreement with respect to the representations and warranties of HTI therein, and for any additional period required to resolve any claim under this Article IX.

#### 9.5 Notice of Claim.

(a) At any time prior to the end of the period specified in Article VIII, Headwaters may give the Transferors a written notice which states the general nature of a claim for indemnity ("Claim") pursuant to this Article IX with reasonable detail as to the alleged basis of the indemnity claim ("Notice of Claim"), together with notice that Headwaters intends to apply all or part of the escrow to the payment of the Losses specified in such Notice of Claim. In the event that a Loss has not been liquidated or determined, Headwaters may, at any time prior to the end of the period specified in Article IX, give the Representative a Notice of Claim in which Headwaters describes the general nature of the Claim and makes a good faith estimate of the Loss.

(b) If the Representative does not give written notice to Headwaters within thirty (30) days after the receipt of such Notice of Claim that he protests the Claim set forth in the Notice of Claim, then Headwaters shall be entitled to indemnification for such Claim and all Losses hereunder, including the right of offset as set forth in Section 9.5(d) below.

(c) If the Representative does give written notice to Headwaters within 30 days after the receipt of such Notice of Claim that he protests the Claim, Headwaters and the Representative will use their best efforts to resolve such disagreement amicably prior to initiating use of the Dispute Resolution procedures specified in Section 12.4. Upon resolution of such dispute, Headwaters shall be entitled to indemnification for such Claim and all Losses hereunder, including the right of offset as set forth in Section 9.5(d) below.

(d) Any indemnification of Headwaters shall be applied first against the Headwaters Common Stock in the Escrow Account, valued at the Signing Price (as defined in the Merger Agreement), then against the cash in the Escrow Account. Notwithstanding the foregoing, the Representative, at its sole discretion, may determine to have any indemnification Claim satisfied by having cash in the Escrow Account paid in lieu of, or before, Headwaters Common Stock. Any person required by Article IX to indemnify Headwaters from funds other than amounts in the Escrow Account or future Contingent Payments may satisfy such obligations in cash or in Headwaters

Common Stock, valued at the Signing Price (as defined in the Merger Agreement).

9.6 No Limitation of Remedies. Notwithstanding anything contained in this Exchange Agreement to the contrary, nothing shall preclude or limit Headwaters' rights to exercise any other remedy Headwaters may have in law or equity regarding intentional misrepresentation or any remedies available to Headwaters under the Non-Compete Agreement (as defined in the Merger Agreement) with any HTI Founder, provided, however, that other than for intentional misrepresentation, or as provided in any other agreement, Headwaters' or the Surviving Corporation's sole remedy hereunder shall be limited to Sections 9.1 and 9.2 of this Exchange Agreement.

ARTICLE X  
COSTS INCIDENT TO AGREEMENT

Except as otherwise expressly provided herein, each of the Parties will pay all the costs incurred by such Party incident to the preparation, execution, or delivery of this Exchange Agreement or the performance of such Party's obligations hereunder, including, without limitation, the fees and disbursements of its attorneys, accountants, investment bankers, consultants, brokers, and persons providing other services.

ARTICLE XI  
TERMINATION

11.1 Termination. Except as provided in Section 11.2 below, this Exchange Agreement and the Merger Agreement may be terminated and the Merger and the Exchanges abandoned at any time prior to the Closing:

(a) upon termination of the Merger Agreement;

(b) by Headwaters, if it is not in material breach of its obligations under this Exchange Agreement or the Merger Agreement and there has been a breach of any representation, warranty, covenant, or agreement contained in this Agreement on the part of HTI or a Transferor, and as a result of such breach the conditions set forth in Section 6.2 would not then be satisfied; provided, however, that if such breach is curable by HTI or such Transferor within thirty (30) days through the exercise of its reasonable best efforts, then, for so long as HTI or such Transferor continues to exercise such reasonable best efforts, Headwaters may not terminate this Exchange Agreement or the Merger Agreement under this Section 11.1(b) unless such breach is not cured within thirty (30) days (but no cure period shall be required for a breach which by its nature cannot be cured); or

(c) by HTI or a Transferor, if he, she, or it is not in material breach of its obligations under this Exchange Agreement or the Merger Agreement, and there has been a breach of any representation, warranty,

covenant, or agreement contained in this Exchange Agreement or the Merger Agreement on the part of Headwaters or Merger Sub, and as a result of such breach the conditions set forth in Section 7.2 would not then be satisfied; provided, however, that if such breach is curable by Headwaters or Merger Sub within thirty (30) days through the exercise of its reasonable

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best efforts, then, for so long as Headwaters or Merger Sub continues to exercise such reasonable best efforts, HTI or such Transferor may not terminate this Exchange Agreement and the Merger Agreement under this Section 11.1(c) unless such breach is not cured within thirty (30) days (but no cure period shall be required for a breach which by its nature cannot be cured).

Where action is taken to terminate this Exchange Agreement and the Merger Agreement pursuant to Section 11.1, it shall be sufficient for such action to be authorized by the Board of Directors (as applicable) of the party taking such action.

11.2 Effect of Termination. In the event of termination of this Exchange Agreement as provided in Section 11.1, this Exchange Agreement shall forthwith become void and there shall be no liability or obligation on the part of Headwaters, Merger Sub, HTI, or any of the Transferors, or their respective officers, directors, or stockholders, provided that the provisions of this Article XI shall remain in full force and effect and survive any termination of this Exchange Agreement.

11.3 Amendment. Except as is otherwise required by applicable law, prior to the Closing, this Exchange Agreement may be amended by the Parties at any time by execution of an instrument in writing signed by Headwaters, Merger Sub, HTI, and a majority in interests of the Transferors who have signed this Exchange Agreement. Except as is otherwise required by applicable law, after the Closing, this Exchange Agreement may be amended by the Parties at any time by execution of an instrument in writing signed by Headwaters, Merger Sub, HTI, and a majority in interests of the Transferors who have signed this Exchange Agreement.

11.4 Extension; Waiver. At any time prior to the Closing, Headwaters, Merger Sub, HTI, and a majority in interests of the Transferors who have signed this Exchange Agreement may, to the extent legally allowed, (i) extend the time for the performance of any of the obligations of another Party, (ii) waive any inaccuracies in the representations and warranties made to such Party contained herein or in any document delivered pursuant hereto, and (iii) waive compliance with any of the agreements or conditions for the benefit of such Party contained herein. Any agreement on the part of a Party to any such extension or waiver shall be valid only if set forth in an instrument in writing signed by or on behalf of such Party.

ARTICLE XII  
MISCELLANEOUS

12.1 Successors and Assigns. This Exchange Agreement shall be binding upon the Parties, their legal representatives, successors in interest, assignees, transferees, creditors (including judgment creditors), trustees (including trustees in bankruptcy), receivers, including, without limitation, assignees, transferees, pledgees, holders of security interests in and liens upon any of such stock, and trustees, and all persons with notice or knowledge, or chargeable with notice or knowledge, of the provisions hereof. This Exchange Agreement cannot be amended or modified except by a written agreement executed by the Parties. This Exchange Agreement and the rights, duties, and obligations hereunder may not be assigned by any Party without the prior written consent of the other Parties; provided, however, that this Exchange Agreement may be assigned by Headwaters on behalf of itself and Merger Sub to any directly or indirectly wholly-owned subsidiary

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of Headwaters, provided that Headwaters and Merger Sub shall continue to be bound by this Exchange Agreement after such assignment.

12.2 Notices. Any notices or other communications required or permitted hereunder shall be in writing and shall be deemed sufficiently given only if delivered in person or sent by telegram, telecopy, or telex or by first-class or air mail or by recognized air courier service, postage or other charges prepaid, addressed as follows:

If to a Transferor, to the address listed on the signature pages hereto.

If to HTI:

Hydrocarbon Technologies, Inc.  
1501 New York Avenue  
Lawrenceville, NJ 08648  
Attention: Alfred G. Comolli, President

Copy to:

Richard J. Pinto  
Smith, Stratton, Wise, Heher & Brennan  
600 College Road East  
Princeton, NJ 08540  
Facsimile Number: (609) 987-6651

If to Headwaters or Merger Sub:

Headwaters Incorporated  
11778 S. Election Drive  
Suite 210  
Draper, UT 84020  
Attention: Kirk A. Benson, Chief Executive Officer  
Facsimile Number: (801) 984-9410



Copy to:

Linda C. Williams, Esq.  
Pillsbury Winthrop LLP  
50 Fremont Street  
San Francisco, CA 94105  
Facsimile Number: (415) 983-1200

or to such other address as the addressee may have specified in a notice duly given to the sender as provided herein. Such notice or communication will be deemed to have been given as of the date so delivered, telegraphed, telecopied, telexed, mailed, or sent by courier.

12.3 Entire Agreement. This Exchange Agreement and the Merger Agreement, including the Exhibits and Schedules attached hereto and thereto, and the Headwaters Disclosure Letter constitute the entire understanding of the Parties relating to the subject matter hereof and supersede

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all prior and contemporaneous agreements and understandings, whether oral or written, relating to the subject matter hereof.

12.4 Dispute Resolution. In the event of any dispute relating to this Exchange Agreement, the parties to the dispute, including the Representative in his capacity as Representative, shall first use their reasonable best efforts to resolve the dispute amicably. If, after ten (10) days, they have been unable to do so, the Chief Executive Officer of Headwaters shall meet with the Representative and the Chief Executive Officer of the Surviving Corporation within ten (10) days to attempt to resolve the dispute. If such dispute has still not been resolved after such meeting, the Board of Directors of Headwaters shall meet with the Representative within ten (10) days to attempt to resolve the dispute. Only after such dispute resolution procedures have been followed may any Party (or the Representative acting in his capacity of Representative) initiate litigation.

12.5 Remedies. In the event of a breach, or a threatened or attempted breach, of any provision of this Exchange Agreement by any Party, any other Party shall, in addition to all other remedies, be entitled to (i) a temporary or permanent injunction against such breach without the necessity of showing any actual damages and (ii) a decree for the specific performance of the Exchange Agreement.

12.6 Adjustments. All references to shares of HTI Common Stock or Headwaters Common Stock herein shall be adjusted to reflect fully the effect of any stock split, reverse stock split, stock dividend (including any dividend or distribution of securities convertible into Headwaters Common Stock or HTI Common Stock), reorganization, recapitalization, or other like change with respect to Headwaters Common Stock or HTI Common Stock occurring on or after the date hereof.

12.7 Waiver. The waiver by any Party of the breach of any of the terms and conditions of, or any right under, this Exchange Agreement shall not be deemed to constitute the waiver of any other breach of the same or any other term or condition or of any similar right. No such waiver shall be binding or effective unless expressed in writing and signed by the Party giving such waiver.

12.8 Governing Law. This Exchange Agreement shall be governed by and construed in accordance with the laws of the State of New Jersey.

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IN WITNESS WHEREOF, the parties hereto have executed this Exchange Agreement as of the day and year first above written.

HEADWATERS INCORPORATED

By: /s/ Kirk A. Benson

-----  
Kirk A. Benson, Chief Executive Officer

HYDROCARBON TECHNOLOGIES, INC.

By: /s/ Alfred G. Comolli

-----  
Alfred G. Comolli, President

HEADWATERS SUB CORPORATION

By: /s/ Kirk A. Benson

-----  
Title: President

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"TRANSFERORS"

Signature:

/s/ Alfred G. Comolli

Printed Name:

Alfred G. Comolli

Address:

1128 University Dr.  
Yardley, PA  
19067

Number of Shares of HTI Common Stock Owned:

319,555

Number of Options to Acquire HTI Common  
Stock Owned:

72,000

I represent that I am an "accredited  
investor" (see Article III of the Agreement)

Yes  No

Date: 5/1/01

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"TRANSFERORS"

Signature:

/s/ David C. Tanner

Printed Name:

David C. Tanner

Address:

233 Andover Pl  
Robbinsville, NJ  
08691

Number of Shares of HTI Common Stock Owned:

145,677

Number of Options to Acquire HTI Common  
Stock Owned:

28,500

I represent that I am an "accredited  
investor" (see Article III of the Agreement)

Yes [X]

No [ ]

Date: 5/1/01

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"TRANSFERORS"

Signature:

/s/ Lap-Keung (Theo) Lee

Printed Name:

Lap-Keung (Theo) Lee

Address:

12 East Kincaid Dr.  
West Windsor, NJ  
08550

Number of Shares of HTI Common Stock Owned:

227,879

Number of Options to Acquire HTI Common  
Stock Owned:

39,000

I represent that I am an "accredited investor" (see Article III of the Agreement)

Yes

No

Date: May 1, 2001

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"TRANSFERORS"

Signature:

/s/ Michael T. Kelley

Printed Name:

Michael T. Kelley

Address:

7800 Foxhound Rd.

McLean, VA

22102-2448

Number of Shares of HTI Common Stock Owned:

87,246

Number of Options to Acquire HTI Common Stock Owned:

0

I represent that I am an "accredited investor" (see Article III of the Agreement)

Yes

No

Date: May 1, 2001

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HEADWATERS INCORPORATED

2000 EMPLOYEE STOCK PURCHASE PLAN

(Adopted by the Board on May 25, 2000 and amended by the Board on February 23, 2001 and April 23, 2001)

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HEADWATERS INCORPORATED

2000 EMPLOYEE STOCK PURCHASE PLAN



SECTION 1

Purpose Of The Plan.

The Plan was adopted by the Board on May 25, 2000, effective as of June 1, 2000. The purpose of the Plan is to provide Eligible Employees with an opportunity to increase their proprietary interest in the success of the Company by purchasing Stock in the Company on favorable terms and to pay for such purchases through payroll deductions. The Plan is intended to qualify under section 423 of the Code.

SECTION 2

Definitions.

(a) "Board" means the Board of Directors of the Company, as constituted from time to time.

(b) "Code" means the Internal Revenue Code of 1986, as amended.

(c) "Committee" means a committee of the Board, as described in Section 3.

(d) "Company" means Headwaters Incorporated, a Delaware Corporation (formerly Covol Technologies, Inc.).

(e) "Compensation" means (i) the total compensation paid in cash to a Participant by a Participating Company, including salaries, wages, bonuses, incentive compensation, commissions, overtime pay and shift premiums, plus (ii) any pre-tax contributions made by the Participant under section 401(k) or 125 of the Code. "Compensation" shall exclude all non-cash items, moving or relocation allowances, cost-of-living equalization payments, car allowances, tuition reimbursements, imputed income attributable to cars or life insurance, severance pay, fringe benefits, contributions or benefits received under employee benefit plans, income attributable to the exercise of stock options, and similar items. The Committee shall determine whether a particular item is included in Compensation.

(f) "Corporate Reorganization" means:

(i) The consummation of a merger or consolidation of the Company with or into another entity, or any other corporate reorganization; or

(ii) The sale, transfer or other disposition of all or substantially all of the Company's assets or the complete liquidation or dissolution of the Company.

(g) "Eligible Employee" means any Employee of a Participating Company who meets both of the following requirements:

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(i) His or her customary employment is for more than five

months per calendar year and for more than 20 hours per week; and

(ii) He or she has been an Employee of a Participating Company for not less than three consecutive months.

The foregoing notwithstanding, Employees employed on the Plan's effective date do not have to satisfy the service requirements specified above.

The foregoing notwithstanding, an individual shall not be considered an Eligible Employee if his or her participation in the Plan is prohibited by the law of any country which has jurisdiction over him or her or if he or she is subject to a collective bargaining agreement that does not provide for participation in the Plan.

(h) "Employee" means an individual paid from W-2 Payroll of the Company or a Subsidiary. If, during any period, the Company (or Subsidiary, as applicable) has not treated an individual as an Employee and, for that reason, has not paid such individual in a manner which results in the issuance of a Form W-2 and withheld taxes with respect to him or her, then that individual shall not be eligible to participate in the Plan for that period, even if any person, court of law or government agency determines, retroactively, that such individual is or was a common-law employee during all or any portion of that period. "W-2 Payroll" means whatever mechanism or procedure that the Company or a Subsidiary uses to pay any individual which results in the issuance of Form W-2 to the individual. "W-2 Payroll" does not include any mechanism or procedure which results in the issuance of any form other than a Form W-2 to an individual, including, but not limited to, any Form 1099 which may be issued to an independent contractor, an agency employee or a consultant. Whether a mechanism or procedure qualifies as a "W-2 Payroll" shall be determined in the absolute discretion of the Company (or Subsidiary, as applicable), and the Company's or Subsidiary's determination shall be conclusive and binding on all persons.

(i) "Exchange Act" means the Securities Exchange Act of 1934, as amended.

(j) "Fair Market Value" with respect to a Share, shall mean the market price of one Share of Stock, determined by the Committee as follows:

(i) If the Stock was traded over-the-counter on the date in question but was not traded on The Nasdaq Stock Market, then the Fair Market Value shall be equal to the last transaction price quoted for such date by the OTC Bulletin Board or, if not so quoted, shall be equal to the mean between the last reported representative bid and asked prices quoted for such date by the principal automated inter-dealer quotation system on which the Stock is quoted or, if the Stock is not quoted on any such system, by the "Pink Sheets" published by the National Quotation Bureau, Inc.;

(ii) If the Stock was traded on The Nasdaq Stock Market, then the Fair Market Value shall be equal to the last reported sale price

(iii) If the Stock was traded on a United States stock exchange on the date in question, then the Fair Market Value shall be equal to the closing price reported for such date by the applicable composite-transactions report; and

(iv) If none of the foregoing provisions is applicable, then the Fair Market Value shall be determined by the Committee in good faith on such basis as it deems appropriate.

In all cases, the determination of Fair Market Value by the Committee shall be conclusive and binding on all persons.

(k) "Offering Period" means a calendar quarter period with respect to which the right to purchase Stock may be granted under the Plan, as determined pursuant to Section 4(a).

(l) "Participant" means an Eligible Employee who elects to participate in the Plan, as provided in Section 4(b).

(m) "Participating Company" means (i) the Company and (ii) each present or future Subsidiary designated by the Committee as a Participating Company.

(n) "Plan" means this Headwaters Incorporated 2000 Employee Stock Purchase Plan, as it may be amended from time to time.

(o) "Plan Account" means the account established for each Participant pursuant to Section 8(a).

(p) "Purchase Price" means the price at which Participants may purchase Stock under the Plan, as determined pursuant to Section 8(b).

(q) "Stock" means the Common Stock of the Company.

(r) "Subsidiary" means any corporation (other than the Company) in an unbroken chain of corporations beginning with the Company, if each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

### SECTION 3 Administration Of The Plan.

(a) Committee Composition. The Plan shall be administered by the Committee. The Committee shall consist exclusively of one or more directors of the Company, who shall be appointed by the Board.

(b) Committee Responsibilities. The Committee shall interpret the Plan

and make all other policy decisions relating to the operation of the Plan. The Committee may adopt such rules, guidelines and forms as it deems appropriate to implement the Plan. The Committee's determinations under the Plan shall be final and binding on all persons.

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#### SECTION 4 Enrollment And Participation.

(a) Offering Periods. While the Plan is in effect, one Offering Period shall commence in each calendar quarter. The Offering Periods shall consist of the quarterly periods commencing on the first day of each calendar quarter and ending on the last day of each calendar quarter.

(b) Enrollment. Any individual who, on the day preceding the first day of an Offering Period, qualifies as an Eligible Employee may elect to become a Participant in the Plan for such Offering Period by executing the enrollment form prescribed for this purpose by the Committee. The enrollment form shall be filed with the Company at the prescribed location not later than 15 days prior to the commencement of such Offering Period.

(c) Duration of Participation. Once enrolled in the Plan, a Participant shall continue to participate in the Plan until he or she ceases to be an Eligible Employee, withdraws from the Plan under Section 6(a) or reaches the end of the Offering Period in which his or her employee contributions were discontinued under Section 5(d) or 9(b). A Participant who discontinued employee contributions under Section 5(d) or withdrew from the Plan under Section 6(a) may again become a Participant, if he or she then is an Eligible Employee, by following the procedure described in Subsection (b) above. A Participant whose employee contributions were discontinued automatically under Section 9(b) shall automatically resume participation at the beginning of the first Offering Period beginning in the next calendar year, if he or she then is an Eligible Employee.

#### SECTION 5 Employee Contributions.

(a) Frequency of Payroll Deductions. A Participant may purchase shares of Stock under the Plan solely by means of payroll deductions. Payroll deductions, as designated by the Participant pursuant to Subsection (b) below, shall occur on each payday during participation in the Plan.

(b) Amount of Payroll Deductions. An Eligible Employee shall designate on the enrollment form the portion of his or her Compensation that he or she elects to have withheld for the purchase of Stock. Such portion shall be a whole percentage of the Eligible Employee's Compensation, but not less than 1% and not more than 10%.

(c) Changing Withholding Rate. A Participant may change the rate of withholding once every six months. If a Participant wishes to change the rate of payroll withholding, he or she may do so by filing the prescribed form with the Company at the time specified. The new withholding rate shall be effective as of

the first day of the January or July next following the date such form has been timely received by the Company. The new withholding rate shall be a whole percentage of the Eligible Employee's Compensation, but not less than 1% and not more than 10%.

(d) Discontinuing Payroll Deductions. If a Participant wishes to discontinue employee contributions entirely, he or she may do so by filing the prescribed form with the Company at the prescribed location at any time. Payroll withholding shall cease as soon as reasonably practicable after such form has been received by the Company. (In addition, employee contributions may be discontinued automatically pursuant to Section 9(b).) A Participant who has discontinued

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employee contributions may resume such contributions by filing a new enrollment form with the Company at the prescribed location. Payroll withholding shall resume effective as of the first day of the January or July next following the date such form has been timely received by the Company.

#### SECTION 6 Withdrawal From The Plan.

(a) Withdrawal. A Participant may elect to withdraw from the Plan by filing the prescribed form with the Company at the prescribed location at any time before the last day of an Offering Period. As soon as reasonably practicable thereafter, payroll deductions shall cease and the entire amount credited to the Participant's Plan Account shall be refunded to him or her in cash, without interest. No partial withdrawals shall be permitted.

(b) Re-enrollment After Withdrawal. A former Participant who has withdrawn from the Plan shall not be a Participant until he or she re-enrolls in the Plan under Section 4(c). Re-enrollment shall be effective as of the first day of the January or July next following the date the enrollment form has been timely received by the Company.

#### SECTION 7 Change In Employment Status.

(a) Termination of Employment. Termination of employment as an Eligible Employee for any reason, including death, shall be treated as an automatic withdrawal from the Plan under Section 6(a). (A transfer from one Participating Company to another shall not be treated as a termination of employment.)

(b) Leave of Absence. For purposes of the Plan, employment shall not be deemed to terminate when the Participant goes on a military leave, a sick leave or another bona fide leave of absence, if the leave was approved by the Company in writing. Employment, however, shall be deemed to terminate 90 days after the Participant goes on a leave, unless a contract or statute guarantees his or her right to return to work. Employment shall be deemed to terminate in any event when the approved leave ends, unless the Participant immediately returns to work.

(c) Death. In the event of the Participant's death, the amount credited to his or her Plan Account shall be paid to a beneficiary designated by him or her for this purpose on the prescribed form or, if none, to the Participant's estate. Such form shall be valid only if it was filed with the Company at the prescribed location before the Participant's death.

SECTION 8                      Plan Accounts And Purchase Of Shares.

(a) Plan Accounts. The Company shall maintain a Plan Account on its books in the name of each Participant. Whenever an amount is deducted from the Participant's Compensation under the Plan, such amount shall be credited to the Participant's Plan Account. Amounts credited to Plan Accounts shall not be trust funds and may be commingled with the Company's general assets and applied to general corporate purposes. No interest shall be credited to Plan Accounts.

(b) Purchase Price. The Purchase Price for each share of Stock purchased at the close of an Offering Period shall be the lower of :

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(i) 85% of the Fair Market Value of such share on the last trading day in such Offering Period; or

(ii) 85% of the Fair Market Value of such share on the last trading day before the commencement of such Offering Period.

(c) Number of Shares Purchased. As of the last day of each Offering Period, each Participant shall be deemed to have elected to purchase the number of shares of Stock calculated in accordance with this Subsection (c), unless the Participant has previously elected to withdraw from the Plan in accordance with Section 6(a). The amount then in the Participant's Plan Account shall be divided by the Purchase Price, and the number of shares that results shall be purchased from the Company with the funds in the Participant's Plan Account. The foregoing notwithstanding, no Participant shall purchase more than the amounts of Stock set forth in Sections 9(b) and 14(a). The Committee may determine with respect to all Participants that any fractional share, as calculated under this Subsection (c), shall be (i) rounded down to the next lower whole share or (ii) credited as a fractional share.

(d) Available Shares Insufficient. In the event that the aggregate number of shares that all Participants elect to purchase during an Offering Period exceeds the maximum number of shares remaining available for issuance under Section 14(a), then the number of shares to which each Participant is entitled shall be determined by multiplying the number of shares available for issuance by a fraction, the numerator of which is the number of shares that such Participant has elected to purchase and the denominator of which is the number of shares that all Participants have elected to purchase.

(e) Issuance of Stock. Certificates representing the shares of Stock

purchased by a Participant under the Plan shall be issued to him or her as soon as reasonably practicable after the close of the applicable Offering Period, except that the Committee may determine that such shares shall be held for each Participant's benefit by a broker designated by the Committee (unless the Participant has elected that certificates be issued to him or her). Shares may be registered in the name of the Participant or jointly in the name of the Participant and his or her spouse as joint tenants with right of survivorship or as community property.

(f) Unused Cash Balances. Any amount remaining in the Participant's Plan Account that represents the Purchase Price for a fractional share shall be carried over in the Participant's Plan Account to the next Offering Period. Any amount remaining in the Participant's Plan Account that represents the Purchase Price for whole shares that could not be purchased by reason of Subsection (c) above, Section 9(b) or Section 14(a) shall be refunded to the Participant in cash, without interest.

(g) Stockholder Approval. The Company's stockholders must approve the adoption of the Plan within twelve months after the Plan is adopted by the Board of Directors of the Company.

#### SECTION 9                    Limitations On Stock Ownership.

(a) Five Percent Limit. Any other provision of the Plan notwithstanding, no Participant shall be granted a right to purchase Stock under the Plan if such Participant, immediately after

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his or her election to purchase such Stock, would own stock possessing more than 5% of the total combined voting power or value of all classes of stock of the Company or Subsidiary of the Company. For purposes of this Subsection (a), the following rules shall apply:

(i) Ownership of stock shall be determined after applying the attribution rules of section 424(d) of the Code; and

(ii) Each Participant shall be deemed to own any stock that he or she has a right or option to purchase under this or any other plan.

(b) Dollar Limit. Any other provision of the Plan notwithstanding, no Participant shall purchase Stock with a Fair Market Value in excess of the following limit:

(i) In the case of Stock purchased during an Offering Period that commenced in the current calendar year, the limit shall be equal to (A) \$25,000 minus (B) the Fair Market Value of the Stock that the Participant previously purchased in the current calendar year (under this Plan and all other employee stock purchase plans of the Company or Subsidiary of the Company).

(ii) Any other provision of the Plan notwithstanding, no Participant shall purchase Stock with a Fair Market Value in excess of \$25,000 per calendar year (under this Plan and all other employee stock purchase plans of the Company or any Subsidiary of the Company).

For purposes of this Subsection (b), the Fair Market Value of Stock shall be determined in each case as of the beginning of the Offering Period in which such Stock is purchased. Employee stock purchase plans not described in section 423 of the Code shall be disregarded. If a Participant is precluded by this Subsection (b) from purchasing additional Stock under the Plan, then his or her employee contributions shall automatically be discontinued and shall resume at the beginning of the earliest Offering Period ending in the next calendar year (if he or she then is an Eligible Employee).

SECTION 10                    Rights Not Transferable.

The rights of any Participant under the Plan, or any Participant's interest in any Stock or moneys to which he or she may be entitled under the Plan, shall not be transferable by voluntary or involuntary assignment or by operation of law, or in any other manner other than by beneficiary designation or the laws of descent and distribution. If a Participant in any manner attempts to transfer, assign or otherwise encumber his or her rights or interest under the Plan, other than by beneficiary designation or the laws of descent and distribution, then such act shall be treated as an election by the Participant to withdraw from the Plan under Section 6(a).

SECTION 11                    No Rights As An Employee

Nothing in the Plan or in any right granted under the Plan shall confer upon the Participant any right to continue in the employ of a Participating Company for any period of specific duration or interfere with or otherwise restrict in any way the rights of the Participating

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Companies or of the Participant, which rights are hereby expressly reserved by each, to terminate his or her employment at any time and for any reason, with or without cause.

SECTION 12                    No Rights As A Stockholder.

A Participant shall have no rights as a stockholder with respect to any shares of Stock that he or she may have a right to purchase under the Plan until such shares have been purchased on the last day of the applicable Offering Period.

SECTION 13                    Securities Law Requirements.

Shares of Stock shall not be issued under the Plan unless the issuance



and delivery of such shares comply with (or are exempt from) all applicable requirements of law, including (without limitation) the Securities Act of 1933, as amended, the rules and regulations promulgated thereunder, state securities laws and regulations, and the regulations of any stock exchange or other securities market on which the Company's securities may then be traded.

SECTION 14                    Stock Offered Under The Plan.

(a) Authorized Shares. The aggregate number of shares of Stock available for purchase under the Plan shall be 500,000, subject to adjustment pursuant to this Section 14. The Company may either use authorized but unissued stock, treasury stock, or stock purchased on the open market in order to fulfill its obligations under the Plan.

(b) Antidilution Adjustments. The aggregate number of shares of Stock offered under the Plan and the price of shares that any Participant has elected to purchase shall be adjusted proportionately by the Committee for any increase or decrease in the number of outstanding shares of Stock resulting from a subdivision or consolidation of shares or the payment of a stock dividend, any other increase or decrease in such shares effected without receipt or payment of consideration by the Company, the distribution of the shares of a Subsidiary to the Company's stockholders or a similar event.

(c) Reorganizations. Any other provision of the Plan notwithstanding, immediately prior to the effective time of a Corporate Reorganization, the Offering Period then in progress shall terminate and shares shall be purchased pursuant to Section 8, unless the Plan is assumed by the surviving corporation or its parent corporation pursuant to the plan of merger or consolidation. The Plan shall in no event be construed to restrict in any way the Company's right to undertake a dissolution, liquidation, merger, consolidation or other reorganization.

SECTION 15                    Amendment Or Discontinuance.

The Board shall have the right to amend, suspend or terminate the Plan at any time and without notice. Except as provided in Section 14, any increase in the aggregate number of shares of Stock to be issued under the Plan shall be subject to approval by a vote of the stockholders of the Company. In addition, any other amendment of the Plan shall be subject to approval by a vote of the stockholders of the Company to the extent required by an applicable law or regulation.

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SECTION 16                    Execution.

To record the adoption of the Plan by the Board as of the date first above written, the Company has caused its authorized officer to execute the same.

Headwaters Incorporated

By: /s/ Steven G. Stewart

Title: CFO

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