SONO TEK CORP
Form 10-Q
October 15, 2014

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: **August 31, 2014**

OR

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

Commission File No.: **0-16035**

(Exact name of registrant as specified in its charter)

New York	**14-1568099**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

2012 Rt. 9W, Milton, NY 12547

(Address of Principal Executive Offices) (Zip Code)

Issuer's telephone no., including area code: **(845) 795-2020**

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 |X| NO |_|

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (section 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). |X | Yes | | No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer |_| Accelerated Filer |_| Smaller reporting company |X|

Non Accelerated Filer |_| (Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES |_| NO |X|

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Class	Outstanding as of October 9, 2014
Common Stock, par value $.01 per share	**14,721,880**

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CONDENSED CONSOLIDATED BALANCE SHEETS

	Unaudited August 31, 2014	**February 28, 2014**
ASSETS		
Current Assets:		
Cash and cash equivalents	$2,215,709	$3,232,021
Marketable Securities	1,140,038	630,794
Accounts receivable (less allowance of $38,000 and $32,000 at August 31 and February 28, respectively)	1,404,596	860,296
Inventories, net	2,006,204	1,674,815
Prepaid expenses and other current assets	26,081	160,373
Total current assets	6,792,628	6,558,299
Land	250,000	250,000
Buildings, net	2,043,750	2,071,875
Equipment, furnishings and building improvements, net	591,525	637,138
Intangible and other assets, net	180,055	171,828
Deferred tax asset	90,021	90,021
TOTAL ASSETS	$9,947,979	$9,779,161
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$583,771	$556,194
Accrued expenses	597,362	565,121
Customer deposits	400,878	362,846
Current maturities of long term debt	185,830	191,466
Income taxes payable	91,009	129,398
Total current liabilities	1,858,850	1,805,025
Long term debt, less current maturities	1,389,036	1,479,058
Total liabilities	3,247,886	3,284,083
Commitments and Contingencies	—	—
Stockholders' Equity		
Common stock, $.01 par value; 25,000,000 shares authorized, 14,718,162 and 14,708,518 shares issued and outstanding, at August 31 and February 28, respectively	147,182	147,085
Additional paid-in capital	8,749,134	8,725,883
Accumulated deficit	(2,196,223)	(2,377,890)
Total stockholders' equity	6,700,093	6,495,078

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$9,947,979	$9,779,161

See notes to condensed consolidated financial statements.

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SONO-TEK CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Unaudited Six Months Ended August 31,		**Unaudited Three Months Ended August 31,**	
	2014	**2013**	**2014**	**2013**
Net Sales	$5,054,426	$4,911,772	$2,633,727	$2,537,378
Cost of Goods Sold	2,604,373	2,528,126	1,331,640	1,295,146
Gross Profit	2,450,053	2,383,646	1,302,087	1,242,232
Operating Expenses				
Research and product development costs	490,830	457,236	254,983	231,642
Marketing and selling expenses	1,097,694	988,625	553,846	499,616
General and administrative costs	493,264	522,595	251,680	253,505
Rental operations expense	81,574	70,100	42,414	35,618
Total Operating Expenses	2,163,362	2,038,556	1,102,923	1,020,381
Operating Income	286,691	345,090	199,164	221,851
Interest Expense	(32,310)	(55,244)	(16,275)	(27,649)
Other (expense) income	15,975	(23,573)	5,675	(21,865)
Income from Operations Before Income Taxes	270,356	266,273	188,564	172,337
Income Tax Expense	88,689	87,096	73,540	66,908
Net Income	$181,667	$179,177	$115,024	$105,429
Basic Earnings Per Share	$0.01	$0.01	$0.01	$0.01
Diluted Earnings Per Share	$0.01	$0.01	$0.01	$0.01
Weighted Average Shares - Basic	14,711,770	14,503,040	14,713,788	14,503,070
Weighted Average Shares - Diluted	14,859,769	14,558,306	14,876,819	14,604,147

See notes to condensed consolidated financial statements.

SONO-TEK CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Unaudited Six Months Ended August 31,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	$181,667	$179,177
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	193,613	164,421
Stock based compensation expense	23,348	9,712
Allowance for doubtful accounts	6,000	6,000
Inventory reserve	60,000	31,343
(Increase) Decrease in:		
Accounts receivable	(550,300)	(330,432)
Inventories	(391,388)	(192,622)
Prepaid expenses and other current assets	134,290	(51,522)
Increase (Decrease) in:		
Accounts payable and accrued expenses	59,638	260,280
Customer Deposits	38,032	441,611
Income Taxes Payable	(38,358)	79,693
Net Cash (Used in) Provided by Operating Activities	(283,458)	597,661
CASH FLOWS FROM INVESTING ACTIVITIES:		
Patent application and other asset costs	(17,400)	(17,621)
Purchase of equipment and furnishings	(110,552)	(25,461)
Proceeds from sale of equipment	—	38,531
(Purchase) Sale of marketable securities	(509,244)	30,617
Net Cash (Used In) Provided by Investing Activities	(637,196)	26,066
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	—	158
Repayments of notes payable and loans	(95,658)	(62,379)
Net Cash (Used In) Financing Activities	(95,658)	(62,221)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,016,312)	561,506
CASH AND CASH EQUIVALENTS		
Beginning of period	3,232,021	1,940,906
End of period	$2,215,709	$2,502,412

SUPPLEMENTAL DISCLOSURE:		
Interest paid	$32,310	$55,244
Taxes Paid	$127,046	$—

See notes to condensed consolidated financial statements.

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SONO-TEK CORPORATION

Notes to Condensed Consolidated Financial Statements

Six Months Ended August 31, 2014 and 2013

(Unaudited)

NOTE 1: SIGNIFICANT ACCOUNTING POLICIES

Consolidation - The accompanying condensed consolidated financial statements of Sono-Tek Corporation, a New York corporation (the "Company"), include the accounts of the Company and its wholly owned subsidiaries, Sono-Tek Cleaning Systems Inc. and Sono-Tek Industrial Park, LLC. Sono-Tek Cleaning Systems, Inc., a New Jersey Corporation, ceased operations during the Fiscal Year Ended February 28, 2002. Sono-Tek Industrial Park, LLC, operates as a real estate holding company for the Company's real estate operations.

Cash and Cash Equivalents – Cash and cash equivalents consist of money market mutual funds, short term commercial paper and short-term certificates of deposit with original maturities of 90 days or less.

Fair Value of Financial Instruments - Effective June 1, 2008, the Company adopted the guidance in the Fair Value Measurements and Disclosure Topic of the Accounting Standards Codification for assets and liabilities measured at fair value on a recurring basis. This guidance establishes a common definition for fair value to be applied to existing generally accepted accounting principles that require the use of fair value measurements, establishes a framework for measuring fair value and expands disclosure about such fair value measurements. The adoption of this guidance did not have an impact on the Company's financial position or operating results, but did expand certain disclosures. The guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Additionally, the guidance requires the use of valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. These inputs are prioritized below:

Level 1: Quoted prices in active markets.

Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs for which there is little or no market data, which require the use of the reporting entity's own assumptions.

The fair values of financial assets of the Company were determined using the following categories at August 31, 2014 and February 28, 2014:

	Quoted Prices in Active Markets (Level 1)	
	August 31, 2014	**February 28, 2014**
Marketable Securities	$1,140,038	$630,794

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Marketable Securities include mutual funds of $1,140,038, which are considered to be highly liquid and easily tradable as of August 31, 2014. These securities are valued using inputs observable in active markets for identical securities and are therefore classified as Level 1 within the Company's fair value hierarchy.

Interim Reporting - The attached summary condensed consolidated financial information does not include all disclosures required to be included in a complete set of financial statements prepared in conformity with accounting principles generally accepted in the United States of America. Such disclosures were included with the financial statements of the Company at February 28, 2014, and included in its report on Form 10-K. Such statements should be read in conjunction with the data herein.

The financial information reflects all adjustments, normal and recurring, which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The results for such interim periods are not necessarily indicative of the results to be expected for the year.

Intangible Assets – Include cost of patent applications that are deferred and charged to operations over seventeen years for domestic patents and twelve years for foreign patents. The accumulated amortization is $113,113 and $105,585 at August 31, 2014 and February 28, 2014, respectively. Annual amortization expense of such intangible assets is expected to be $12,000 per year for the next five years.

Reclassifications – Certain reclassifications have been made to the prior period to conform to the presentations of the current period.

Impact of New Accounting Pronouncements - All new accounting pronouncements issued but not yet effective have been deemed to be not applicable to the Company, hence the adoption of these new accounting pronouncements once effective are not expected to have any impact on the Company.

In June 2014, FASB issued Accounting Standards Update ("ASU") No. 2014-09, "*Revenue from Contracts with Customers*". The update gives entities a single comprehensive model to use in reporting information about the amount and timing of revenue resulting from contracts to provide goods or services to customers. The proposed ASU, which would apply to any entity that enters into contracts to provide goods or services, would supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance throughout the Industry Topics of the Codification. Additionally, the update would supersede some cost guidance included in Subtopic 605-35, Revenue Recognition – Construction-Type and Production-Type Contracts. The update removes inconsistencies and weaknesses in revenue requirements and provides a more robust framework for addressing revenue issues and more useful information to users of financial statements through improved disclosure requirements. In addition, the update improves comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets and simplifies the preparation of financial statements by reducing the number of requirements to which an entity must refer. The update is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company iscurrently reviewing the provisions of this ASU to determine if there will be any impact on our results of operations, cash flows or financial condition.

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NOTE 2: INVENTORIES

Inventories consist of the following:

	August 31, 2014	February 28, 2014
Finished goods	$474,025	$445,035
Work in process	565,562	402,377
Raw materials and subassemblies	1,221,710	1,022,496
Total	2,261,297	1,869,908
Less: Allowance	(255,093)	(195,093)
Net inventories	$2,006,204	$1,674,815

NOTE 3: STOCK OPTIONS AND WARRANTS

Stock Options – Under the 2013 Stock Incentive Plan, as amended ("2013 Plan"), options can be granted to officers, directors, consultants and employees of the Company and its subsidiaries to purchase up to 2,500,000 shares of the Company's common stock. Under the 2013 Plan, options expire ten years after the date of grant. As of August 31, 2014, there were 140,500 options outstanding under the 2013 plan.

Under the 2003 Stock Incentive Plan, as amended ("2003 Plan"), until May 2013, options were available to be granted to officers, directors, consultants and employees of the Company and its subsidiaries to purchase up to 1,500,000 of the Company's common shares. As of August 31, 2014, there were 781,573 options outstanding under the 2003 Plan, under which no additional options may be granted.

NOTE 4: STOCK BASED COMPENSATION

The weighted-average fair value of options are estimated on the date of grant using the Black-Scholes options-pricing model.

In computing the impact, the fair value of each option is estimated on the date of grant based on the Black-Scholes options-pricing model utilizing certain assumptions for a risk free interest rate; volatility; and expected remaining lives of the awards. The assumptions used in calculating the fair value of share-based payment awards represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and the Company uses different assumptions, the Company's stock-based compensation expense could be materially different in the future. In addition, the Company is required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. In estimating the Company's forfeiture rate, the Company analyzed its historical forfeiture rate, the remaining lives of unvested options, and the number of vested options as a percentage of total options outstanding. If the Company's actual forfeiture rate is materially different from its estimate, or if the Company reevaluates the forfeiture rate in the future, the stock-based compensation expense could be significantly different from what the Company has recorded in the current period.

For the six months ended August 31, 2014 and 2013, net income and earnings per share reflect the actual deduction for stock-based compensation expense. The impact of applying ASC 718 approximated $23,000 and $10,000 in additional compensation expense during the six months ended August 31, 2014 and 2013, respectively. Such amounts are included in general and administrative expenses on the statement of operations. The expense for stock-based compensation is a non-cash expense item.

NOTE 5: EARNINGS PER SHARE

The denominator for the calculation of diluted earnings per share at August 31, 2014 and 2013 are calculated as follows:

	Six Months Ended August 31,		**Three Months Ended August 31,**	
	2014	**2013**	**2014**	**2013**
Denominator for basic earnings per share	14,711,770	14,503,040	14,713,788	14,503,070
Dilutive effect of stock options	147,999	55,266	163,031	101,077
Denominator for diluted earnings per share	14,859,769	14,558,306	14,876,819	14,604,147

NOTE 6: LONG TERM DEBT

Long-term debt consists of the following:

	August 31,	**February 28,**
	2014	**2014**
Equipment loan, bank, collateralized by related production equipment, payable in monthly installments of principal and interest of $5,158 through June 2015. Interest rate 2.12%. 48 month term.	$51,073	$81,164
Note payable, bank, collateralized by land and buildings, payable in monthly installments of principal and interest of $16,358 through January 2024. Interest rate 4.15%. 10 year term.	1,523,793	1,589,360
Total long term debt	1,574,866	1,670,524
Due within one year	185,830	191,466
Due after one year	$1,389,036	$1,479,058

NOTE 7: REVOLVING LINE OF CREDIT

The Company has a $750,000 revolving line of credit at prime which was 3.25% at August 31, 2014. The loan is collateralized by all of the assets of the Company, except for the land and buildings. The line of credit is payable on demand and must be retired for a 30 day period once annually. If the Company fails to perform the 30 day annual pay down or if the bank elects to terminate the credit line, the bank may at its option convert the outstanding balance to a 36 month term note with payments including interest in 36 equal installments. As of August 31, 2014, the Company's outstanding balance was $0, and the unused credit line was $750,000.

NOTE 8: SEGMENT INFORMATION

The Company operates in two segments: ultrasonic spray coating systems, which is the business of developing, manufacturing, selling, installing and servicing ultrasonic spray coating equipment; and real estate operations, which is the business of owning and operating the Sono-Tek Industrial Park.

All inter-company transactions are eliminated in consolidation. For the six and three months ended August 31, 2014 and 2013, segment information is as follows:

	Six Months Ended August 31, 2014				Three Months Ended August 31, 2014			
	Ultrasonic Spraying	**Rental Real Estate Operations**	**Eliminations**	**Consolidated**	**Ultrasonic Spraying**	**Rental Real Estate Operations**	**Eliminations**	**Consolidated**
Net Sales	$5,011,376	$ 141,199	$ 98,149					