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SONO TEK CORP
Form 10QSB
July 11, 2008

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: May 31, 2008

OR

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

Commission File No.: 0-16035

SONO-TEK CORPORATION
(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)

Registrant'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 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
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

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:

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Class	Outstanding as of June 25, 2008
Common Stock, par value \$.01 per share	14,361,091

SONO-TEK CORPORATION

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SONO-TEK CORPORATION CONSOLIDATED BALANCE SHEETS

ASSETS	May 31, 2008 Unaudited	February 29, 2008
Current Assets	Unaudited	
Cash and cash equivalents	\$ 1,553,573	\$ 2,339,550
Accounts receivable (less allowance of \$18,500 at May 31 and February 29)	821,601	614,378
Inventories	1,822,360	1,602,511
Prepaid expenses and other current assets	111,692	69,032
Deferred tax asset	70,000	70,000
Total current assets	4,379,226	4,695,471
Equipment, furnishings and leasehold improvements (less accumulated depreciation of \$1,074,750 and \$1,046,195 at May 31 and February 29, respectively)	520,197	536,892
Intangible assets, net	46,220	34,011
Other assets	7,171	7,171
Deferred tax asset	615,803	615,803
TOTAL ASSETS	\$ 5,568,617	\$ 5,889,348

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LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:		
Accounts payable	\$ 287,761	\$ 412,692
Accrued expenses	342,879	452,911
Current maturities of long term debt	21,137	23,909
Deferred tax liability	16,239	16,239
	-----	-----
Total current liabilities	668,016	905,751
Long term debt, less current maturities	23,283	27,628
Deferred tax liability	57,978	57,978
	-----	-----
Total liabilities	749,277	991,357
	-----	-----
Commitments and Contingencies	--	--
Stockholders' Equity		
Common stock, \$.01 par value; 25,000,000 shares authorized, 14,361,091 shares issued and outstanding at May 31 and February 29	143,612	143,612
Additional paid-in capital	8,395,687	8,343,880
Accumulated deficit	(3,719,959)	(3,589,501)
	-----	-----
Total stockholders' equity	4,819,340	4,897,991
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 5,568,617	\$ 5,889,348
	=====	=====

See notes to consolidated financial statements.

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SONO-TEK CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Unaudited

	Three Months Ended May 31,	
	2008	2007
	-----	-----
Net Sales	\$ 1,620,521	\$ 1,232,643
Cost of Goods Sold	831,657	629,133
	-----	-----
Gross Profit	788,864	603,510
	-----	-----
Operating Expenses		
Research and product development costs	205,570	194,740
Marketing and selling expenses	413,910	234,044
General and administrative costs	308,655	214,988
	-----	-----
Total Operating Expenses	928,135	643,772
	-----	-----
Operating (Loss)	(139,271)	(40,262)
	-----	-----

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Interest Expense	(803)	(1,235)
Interest Income	6,785	24,767
Other Income	2,831	2,831
	-----	-----
	8,813	26,363
	-----	-----
(Loss) Before Income Taxes	(130,458)	(13,899)
Income Tax (Benefit)	--	(33,813)
	-----	-----
Net (Loss) Income	\$ (130,458)	\$ 19,914
	=====	=====
Basic Earnings Per Share	\$ (0.01)	\$ 0.00
	=====	=====
Diluted Earnings Per Share	\$ (0.01)	\$ 0.00
	=====	=====
Weighted Average Shares - Basic	14,361,091	14,360,541
	=====	=====
Weighted Average Shares - Diluted	14,361,091	14,436,298
	=====	=====

See notes to consolidated financial statements.

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SONO-TEK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Unaudited

	Three Months Ended May 31,	
	2008	2007

CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (Loss) Income	\$ (130,458)	\$ 19,914
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	50,413	32,459
Stock based compensation expense	51,807	10,538
Gain on sale of equipment	23,384	--
Decrease (Increase) in:		
Accounts receivable	(207,223)	259,639
Inventories	(219,849)	(146,790)
Prepaid expenses and other current assets	(42,660)	(33,552)
Deferred tax asset	--	(35,000)
Increase (Decrease) in:		
Accounts payable and accrued expenses	(234,963)	(39,187)
	-----	-----
Net Cash (Used In) Provided By Operating Activities	(709,549)	68,021

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	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Patent application costs	(13,142)	--
Purchase of equipment and furnishings	(56,169)	(28,788)
	-----	-----
Net Cash Used In Investing Activities	(69,311)	(28,788)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of notes payable	(7,117)	(6,701)
	-----	-----
Net Cash Used In Financing Activities	(7,117)	(6,701)
	-----	-----
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(785,977)	32,532
CASH AND CASH EQUIVALENTS		
Beginning of year	2,339,550	2,268,976
	-----	-----
End of period	\$ 1,553,573	\$ 2,301,508
	=====	=====
SUPPLEMENTAL DISCLOSURE:		
Interest paid	\$ 801	\$ 1,294
	=====	=====
Income taxes paid	\$ 6,250	\$ 1,187
	=====	=====

See notes to consolidated financial statements.

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SONO-TEK CORPORATION
Notes to Consolidated Financial Statements
Three Months Ended May 31, 2008 and 2007

NOTE 1: SIGNIFICANT ACCOUNTING POLICIES

Consolidation - The accompanying consolidated financial statements of Sono-Tek Corporation, a New York Corporation (the "Company"), include the accounts of the Company and its wholly owned subsidiary, Sono-Tek Cleaning Systems, Inc., a New Jersey Corporation ("SCS") which the Company acquired on August 3, 1999, whose operations have been discontinued. There have been no operations of this subsidiary since Fiscal Year Ended February 28, 2002. All significant intercompany accounts and transactions are eliminated in consolidation.

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. The Company occasionally has cash or cash equivalents on hand in excess of the \$100,000 insurable limits at a given bank.

Fair Value of Financial Instruments - The carrying amounts reported in the balance sheet for cash, receivables, accounts payable and accrued expenses approximate fair value based on the short-term maturity of these instruments.

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Interim Reporting - The attached summary 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 29, 2008, and included in its report on Form 10-KSB. 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 \$59,883 and \$58,949 at May 31, 2008 and February 29, 2008, respectively. Annual amortization expense of such intangible assets is expected to be \$4,600 per year for the next five years.

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

NOTE 2: INVENTORIES

Inventories at May 31, 2008 are comprised of:

Finished goods	\$ 886,446
Work in process	558,938
Consignment	9,770
Raw materials and sub-assemblies	580,403

Total	2,035,557
Less: Allowance	(213,197)

Net inventories	\$ 1,822,360
	=====

NOTE 3: STOCK OPTIONS AND WARRANTS

Stock Options - Under the 2003 Stock Incentive Plan, as amended ("2003 Plan"), options can 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. The 2003 Plan supplemented and replaced the 1993 Stock Incentive Plan (the "1993 Plan"), under which no further options may be granted. Options granted under the 1993 Plan expire on various dates through 2013. As of May 31, 2008 there were 80,000 options outstanding under the 1993 Plan and 1,157,375 options outstanding under the 2003 plan.

Under both the 1993 and 2003 Stock Incentive Plans, option prices must be at least 100% of the fair market value of the common stock at time of grant. For qualified employees, except under certain circumstances specified in the plans

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or unless otherwise specified at the discretion of the Board of Directors, no option may be exercised prior to one year after date of grant, with the balance becoming exercisable in cumulative installments over a three year period during the term of the option, and terminating at a stipulated period of time after an employee's termination of employment.

NOTE 4: STOCK BASED COMPENSATION

On March 1, 2006, the Company adopted SFAS No. 123R, "Share Based Payments." SFAS No. 123R requires companies to expense the value of employee stock options and similar awards for periods beginning after December 15, 2005, and applies to all outstanding and vested stock-based awards at a company's adoption date.

During the transition period of the Company's adoption of SFAS 123R, the weighted-average fair value of options has been estimated on the date of grant using the Black-Scholes options-pricing model. The weighted-average Black-Scholes assumptions are as follows:

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	2008	2007
	-----	-----
Expected life	4 years	4 years
Risk free interest rate	1.8% - 3.13%	4.35% - 5.07%
Expected volatility	55% - 70%	39% - 78%
Expected dividend yield	0%	0%

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 amount 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 quarters ended May 31, 2008 and 2007, net income and earnings per share reflect the actual deduction for stock-based compensation expense. The impact of applying SFAS 123R approximated \$51,807 and \$10,538 in additional compensation expense during the quarters ended May 31, 2008 and 2007, respectively. Such amount is 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 May 31, 2008 and 2007 are calculated as follows:

	May 31, 2008	May 31, 2007
	-----	-----

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Denominator for basic earnings per share	14,361,091	14,360,541
Dilutive effect of stock options	--	75,757
	-----	-----
Denominator for diluted earnings per share	14,361,091	14,436,298
	=====	=====

The effect of stock options for the three months ended May 31, 2008 is not used in the calculation of diluted earnings per share. Due to the net loss for the three months ended May 31, 2008, the inclusion of stock options in the calculation would have an anti-dilutive effect.

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NOTE 6: OTHER INCOME

As previously reported on Form 8-K, filed on July 5, 2005, the Company determined that a former employee had misappropriated approximately \$250,000 of the Company's monies, primarily through unauthorized check writing from the Company's accounts over a period of three calendar years. The Company had previously expensed substantially all of the misappropriated funds over the years.

The Company has recovered approximately 73% of these funds to date. The Company has a promissory note that is being repaid by the former employee. The note has been fully reserved for as the collectibility is questionable. As previously discussed, the Company can offer no assurances that it will be successful in its attempts to collect the balance of the remaining restitution.

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SONO-TEK CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

Forward-Looking Statements

We discuss expectations regarding our future performance, such as our business outlook, in our annual and quarterly reports, press releases, and other written and oral statements. These "forward-looking statements" are based on currently available competitive, financial and economic data and our operating plans. They are inherently uncertain, and investors must recognize that events could turn out to be significantly different from our expectations. These factors include, among other considerations, general economic and business conditions; political, regulatory, competitive and technological developments affecting the Company's operations or the demand for its products; timely development and market acceptance of new products; adequacy of financing; capacity additions, the ability to enforce patents and the successful implementation of the business development program.

We undertake no obligation to update any forward-looking statement.

Overview

Sono-Tek has developed a unique and proprietary series of ultrasonic atomizing nozzles, which are being used in an increasing variety of electronic, medical, industrial, and nanotechnology applications. These nozzles are electrically

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driven and create a fine, uniform, low velocity spray of atomized liquid particles, in contrast to common pressure nozzles. These characteristics create a series of commercial applications that benefit from the precise, uniform, thin coatings that can be achieved. When combined with significant reductions in liquid waste and less overspray than can be achieved with ordinary pressure nozzle systems, there is lower environmental impact and lower energy use.

We have a well established position in the electronics industry with our SonoFlux spray fluxing equipment. It saves customers from 40% to 80% of the liquid flux required to solder printed circuit boards over other methods, such as foam fluxing. Less flux equates to less material cost, fewer chemicals in the workplace, and less clean-up. Also, the SonoFlux equipment reduces the number of soldering defects, which reduces the amount of rework.

One change that has proven successful is our diversification into the medical device market. In the past several years, we have focused engineering resources on the medical device market, with emphasis on providing coating solutions for the new generation of drug coated stents. We have sold a significant number of specialized ultrasonic nozzles and MediCoat stent coating systems to large medical device customers. Sono-Tek's stent coating systems are superior compared to pressure nozzles in their ability to uniformly coat the very small arterial stents without creating webs or gaps in the coatings. We sell a bench-top, fully outfitted stent coating system to a wide range of customers that are manufacturing stents and/or applying coatings to be used in developmental trials. We have also introduced and sold several multiple stent coaters known as Medicoat II, designed for production use.

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Another change that has stimulated an increase in business has been the development of the WideTrack coating system, a broad based platform for applying a variety of coatings to moving webs of glass, textiles, plastic, metal, food products and packaging materials. The WideTrack is a long-term product and market development effort. Thus far, we have made successful inroads with WideTrack systems into the glass, medical textile (bandages), textiles and solar and fuel cell industries. We plan to increase our marketing efforts into the broader textile and food industry markets. This will require a continuation of market and technology development in these areas in the years ahead. Some of these WideTrack applications involve nano-technology based liquids. We believe there is an excellent fit between the thin, precise films required in nano-technology coating applications and our ultrasonic nozzle systems.

The creation of technological innovations and the expansion into new geographical markets requires the investment of both time and capital. Although there is no guarantee of success, we expect that over time, these newer markets will be the basis for Sono-Tek's continued growth and will contribute to future profitability. It is management's opinion that this strategy will be a better one than relying solely on our traditional domestic electronics business.

Liquidity and Capital Resources

Working Capital - Our working capital decreased \$79,000 from a working capital of \$3,790,000 at February 29, 2008 to \$3,711,000 at May 31, 2008. The Company's current ratio is 6.6 to 1 at May 31, 2008 as compared to 5.2 to 1 at February 28, 2008.

Stockholders' Equity - Stockholder's Equity decreased \$79,000 from \$4,898,000 at February 29, 2008 to \$4,819,000 at May 31, 2008. The decrease is a result of the net loss of \$130,000 and an adjustment for stock based compensation expense of \$51,000.

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Operating Activities - We used \$710,000 of cash in our operating activities for the three months ended May 31, 2008. The use of cash resulted from the current period net loss of \$130,000, an increase in accounts receivable of \$207,000, an increase in inventories of \$220,000 and an increase of \$43,000 in prepaid assets. In addition to the above, our accounts payable and accrued expenses decreased \$235,000 during the current period.

Investing Activities - We used \$56,000 for the purchase of capital equipment and \$13,000 for patent application costs during the three months ended May 31, 2008. For the three months ended May 31, 2007, we used \$29,000 for the purchase of capital equipment.

Financing Activities - For the three months ended May 31, 2008 and May 31, 2007, we used \$7,000 in financing activities resulting from the repayment of our notes payable.

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Results of Operations

For the three months ended May 31, 2008, our sales increased \$388,000 or 31% to \$1,621,000 as compared to \$1,233,000 for the three months ended May 31, 2007. Our sales for the quarter ended May 31, 2008 were improved over the same period last year due to additional sales of our WideTrack product. In addition, we also saw an increase in sales of our programmable XYZ precision coating units and Spray Dryer units. During the quarter ended May 31, 2008, sales of fluxer units, EVS solder recovery units and stent coating systems decreased when compared to the quarter ended May 31, 2007.

Our gross profit increased \$185,000 to \$789,000 for the three months ended May 31, 2008 from \$604,000 for the three months ended May 31, 2007. The increase in gross profit is due to the current period increase in sales. The gross profit margin was 49% of sales for the three months ended May 31, 2008 and the three months ended May 31, 2007.

Research and product development costs increased \$11,000 to \$206,000 for the three months ended May 31, 2008 from \$195,000 for the three months ended May 31, 2007. The increase was principally due to an increase in salary expense.

Marketing and selling costs increased \$180,000 to \$414,000 for the three months ended May 31, 2008 from \$234,000 for the three months ended May 31, 2007. The increase in these expenditures is due to the reorganization of our sales force into two separate Strategic Business Units. We have added additional sales personnel, increased the number of trade shows we participate in and we have engaged an outside marketing firm to help increase the awareness of our products. These increases are part of the business development program which was initiated last year.

General and administrative costs increased \$94,000 to \$309,000 for the three months ended May 31, 2008 from \$215,000 for the three months ended May 31, 2007. The increase was principally due to an increase in salary expense and an increase in stock based compensation expense.

Critical Accounting Policies

The discussion and analysis of the Company's financial condition and results of operations are based upon the consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires

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the Company to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure on contingent assets and liabilities at the date of the financial statements. Actual results may differ from these estimates under different assumptions and conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and may potentially result in materially different results under different assumptions and conditions. The Company believes that critical accounting policies are limited to those described below. For a detailed discussion on the application of this and other accounting policies see Note 2 to the Company's consolidated financial statements included in Form 10-KSB for the year ended February 29, 2008.

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Accounting for Income Taxes

As part of the process of preparing the Company's consolidated financial statements, the Company is required to estimate its income taxes. Management judgment is required in determining the provision on its deferred tax asset. The Company reduced the valuation reserve for the deferred tax asset resulting from the net operating losses carried forward due to the Company having demonstrated consistent profitable operations. In the event that actual results differ from these estimates, the Company may need to again adjust such valuation reserve.

Stock-Based Compensation

Prior to fiscal year 2007, the Company accounted for employee stock options under the fair value provisions of SFAS No. 123. On March 1, 2006, the Company adopted SFAS No. 123R, "Share Based Payments." SFAS No. 123R requires companies to expense the value of employee stock options and similar awards for periods beginning after December 15, 2005, and applies to all outstanding and vested stock-based awards at a company's adoption date. Results from prior periods have not been restated in the Company's historical financial statements.

Impact of New Accounting Pronouncements

None.

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SONO-TEK CORPORATION CONTROLS AND PROCEDURES

The Company has established and maintains "disclosure controls and procedures" (as those terms are defined in Rules 13a -15(e) and 15d-15(e) under the Securities and Exchange Act of 1934 (the "Exchange Act"). Christopher L. Coccio, Chief Executive Officer (principal executive) and Stephen J. Bagley, Chief Financial Officer (principal accounting officer) of the Company, have evaluated the Company's disclosure controls and procedures as of May 31, 2008. Based on this evaluation, they have concluded that the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (1) recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (2) accumulated and communicated to Management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding timely disclosure.

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In addition, there were no changes in the Company's internal controls over financial reporting during the first fiscal quarter of 2009 that have materially affected, or are reasonably likely to materially affect, internal controls over financial reporting.

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PART II - OTHER INFORMATION

- Item 1. Legal Proceedings
None
- Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.
None
- Item 3. Defaults Upon Senior Securities
None
- Item 4. Submission of Matters to a Vote of Security Holders
None
- Item 5. Other Information
None
- Item 6. Exhibits and Reports
 - (a) Exhibits
 - 10.1 Executive Agreement between Sono-Tek Corporation and R. Stephen Harshbarger dated March 5, 2008.
 - 31.1 - 31.2 - Rule 13a - 14(a)/15d - 14(a) Certification
 - 32.1 - 32.2 - Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: July 11, 2008

SONO-TEK CORPORATION
(Registrant)

By: /s/ Christopher L. Coccio

Christopher L. Coccio
Chief Executive Officer

By: /s/ Stephen J. Bagley

Stephen J. Bagley
Chief Financial Officer