

SONO TEK CORP  
Form 10-Q  
October 11, 2012

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, 2012**

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 (IRS Employer  
incorporation or organization) 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**

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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 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). 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:

Class	Outstanding as of October 4, 2012
Common Stock, par value \$.01 per share	<b>14,483,010</b>

SONO-TEK CORPORATION

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## SONO-TEK CORPORATION

## CONSOLIDATED BALANCE SHEETS

## ASSETS

	<b>August 31, 2012 (Unaudited)</b>	<b>February 29, 2012</b>
Current Assets:		
Cash and cash equivalents	\$ 1,430,048	\$ 2,531,689
Marketable Securities	958,364	253,987
Accounts receivable (less allowance of \$16,380 and \$26,000 at August 31 and February 29, respectively)	1,034,879	754,605
Inventories, net	2,427,113	2,559,128
Prepaid expenses and other current assets	192,812	112,392
Total current assets	6,043,216	6,211,801
Land	250,000	250,000
Buildings, net	2,192,924	2,229,650
Equipment, furnishings and leasehold improvements (less accumulated depreciation of \$2,225,636 and \$2,156,136 at August 31 and February 29, respectively)	550,041	617,200
Intangible assets, net	110,848	83,455
Deferred tax asset	86,167	86,167
<b>TOTAL ASSETS</b>	<b>\$9,233,196</b>	<b>\$ 9,478,273</b>

## LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:		
Accounts payable	\$ 313,347	\$ 552,979
Accrued expenses	594,426	529,732
Customer deposits	194,866	316,246
Current maturities of long term debt	123,573	120,303
Income taxes payable	35,642	37,250
Total current liabilities	1,261,854	1,556,510
Long term debt, less current maturities	2,050,935	2,114,196
Total liabilities	3,312,789	3,670,706
Commitments and Contingencies	-	-
Stockholders' Equity		
Common stock, \$.01 par value; 25,000,000 shares authorized, 14,483,010 and 14,455,444 shares issued and outstanding, at August 31 and February 29, respectively	144,830	144,553
Additional paid-in capital	8,699,356	8,657,629
Accumulated deficit	(2,923,779 )	(2,994,615 )
Total stockholders' equity	5,920,407	5,807,567
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$9,233,196</b>	<b>\$ 9,478,273</b>

See notes to consolidated financial statements.

## SONO-TEK CORPORATION

## CONSOLIDATED STATEMENTS OF INCOME

	<b>Six Months Ended August 31 Unaudited</b>		<b>Three Months Ended August 31 Unaudited</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Net Sales	\$5,230,809	\$6,139,028	\$2,391,107	\$3,149,960
Cost of Goods Sold	2,715,739	3,027,484	1,225,735	1,471,513
Gross Profit	2,515,070	3,111,544	1,165,373	1,678,447
Operating Expenses				
Research and product development costs	486,787	539,941	232,717	284,885
Marketing and selling expenses	1,205,723	1,148,253	552,811	580,617
General and administrative costs	674,388	627,037	315,842	323,853
Rental operations expense	57,630	63,793	28,610	23,965
Total Operating Expenses	2,424,528	2,379,024	1,129,981	1,213,320
Operating Income	90,542	732,520	35,392	465,127
Interest Expense	(57,648 )	(59,367 )	(28,678 )	(29,594 )
Other (expense) income	(1,705 )	3,220	6,234	2,973
Income from Operations Before Income Taxes	31,189	676,373	12,948	438,506
Income Tax (Benefit) Expense	(39,647 )	253	(46,787 )	980
Net Income	\$70,836	\$676,120	\$59,735	\$437,526
Basic Earnings Per Share	\$0.00	\$0.05	\$0.00	\$0.03
Diluted Earnings Per Share	\$0.00	\$0.05	\$0.00	\$0.03
Weighted Average Shares - Basic	14,466,892	14,441,921	14,472,849	14,442,211
Weighted Average Shares - Diluted	14,582,873	14,759,663	14,576,509	14,784,319

See notes to consolidated financial statements.

## SONO-TEK CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	<b>Six Months Ended August 31, Unaudited</b>	
	<b>2012</b>	<b>2011</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net Income	\$ 70,836	\$ 676,120
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	155,634	154,420
Stock based compensation expense	21,658	25,829
Allowance for doubtful accounts	6,000	6,000
Inventory reserve	30,000	36,000
Decrease (Increase) in:		
Accounts receivable	(273,528 )	30,462
Inventories	102,015	(835,330 )
Prepaid expenses and other current assets	(80,420 )	(40,531 )
(Decrease) Increase in:		
Accounts payable and accrued expenses	(174,938 )	81,421
Customer Deposits	(121,380 )	168,668
Net Cash (Used in) Provided by Operating Activities	(264,123 )	303,059
<b>CASH FLOW FROM INVESTING ACTIVITIES:</b>		
Patent application costs	(32,218 )	(4,760 )
Purchase of equipment and furnishings	(61,277 )	(112,563 )
Purchase of marketable securities	(704,377 )	-
Net Cash Used In Investing Activities	(797,872 )	(117,323 )
<b>CASH FLOW FROM FINANCING ACTIVITIES:</b>		
Proceeds from exercise of stock options	20,346	358
Proceeds from equipment financing - bank	-	237,000
Repayments of notes payable and loans	(59,992 )	(41,033 )
Net Cash Provided by (Used In) Financing Activities	(39,646 )	196,325
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(1,101,641 )</b>	<b>382,061</b>
<b>CASH AND CASH EQUIVALENTS</b>		
Beginning of period	2,531,689	1,683,801
End of period	\$ 1,430,048	\$ 2,065,862

## SUPPLEMENTAL DISCLOSURE:

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Interest paid	\$57,648	\$59,368
Taxes Paid	\$-	\$253

See notes to consolidated financial statements.



SONO-TEK CORPORATION

Notes to Consolidated Financial Statements

Six Months Ended August 31, 2012 and 2011

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 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** - 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, 2012:

**Quoted Prices in Active  
Markets  
(Level 1)  
August 31, February 29,  
2012 2012**

Marketable Securities	\$958,364	\$253,987
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Marketable Securities include mutual funds of \$958,364, that are considered to be highly liquid and easily tradeable as of August 31, 2012. 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 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, 2012, 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 \$90,808 and \$85,983 at August 31, 2012 and February 29, 2012, respectively. Annual amortization expense of such intangible assets is expected to be \$9,100 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.

NOTE 2: INVENTORIES

Inventories consist of the following:

	<b>August 31, 2012</b>	<b>February 29, 2012</b>
Finished goods	\$847,720	\$ 905,142
Work in process	629,256	544,805
Consignment	6,191	7,127

Raw materials and subassemblies	1,167,830	1,295,938
Total	2,650,997	2,753,012
Less: Allowance	(223,884 )	(193,884 )
Net inventories	\$2,427,113	\$ 2,559,128

### 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 August 31, 2012, there were 40,000 options outstanding under the 1993 Plan and 1,263,218 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 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**

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:

	<b>2013</b>	<b>2012</b>
Expected life	4 years	4 years
Risk free interest rate	.29%	.57% - 1.17%
Expected volatility	53%	37% - 53%
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 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, 2012 and 2011, net income and earnings per share reflect the actual deduction for stock-based compensation expense. The impact of applying ASC 718 approximated \$21,658 and \$25,829 in additional compensation expense during the six months ended August 31, 2012 and 2011, 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, 2012 and 2011 are calculated as follows:

	<b>Six Months Ended</b>		<b>Three Months Ended</b>	
	<b>August 31,</b>		<b>August 31,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Denominator for basic earnings per share	14,466,892	14,441,921	14,472,849	14,442,211
Dilutive effect of stock options	115,981	317,742	103,660	342,108
Denominator for diluted earnings per share	14,582,873	14,759,663	14,576,509	14,784,319

**NOTE 6: LONG TERM DEBT**

Long-term debt consists of the following:

	<b>August 31,</b>	<b>February</b>
	<b>2012</b>	<b>29,</b>
Note payable, individual, collateralized by land and buildings, payable in monthly installments of principal and interest of \$14,446 through January 2031. Interest rate 5.5%. 20 year term.	\$2,004,529	\$2,035,579
Equipment loan, bank, collateralized by related office equipment, payable in monthly installments of principal and interest of \$5,154 through June 2015. Interest rate 2.12%. 48 month term.	169,979	198,920
Total long term debt	2,174,508	2,234,499
Due within one year	123,573	120,303
Due after one year	\$2,050,935	\$2,114,196

**NOTE 7: REVOLVING LINE OF CREDIT**

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The Company has a \$750,000 revolving line of credit at prime which was 3.25% at August 31, 2012. 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, 2012, 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 spraying systems and rental real estate operations.

All inter-company transactions are eliminated in consolidation. For the six and three months ended August 31, 2012 and 2011, segment information is as follows:

	Six Months Ended August 31, 2012				Three Months Ended August 31, 2012			
	Ultrasonic Spraying	Rental Real Estate Operations	Eliminations	Consolidated	Ultrasonic Spraying	Rental Real Estate Operations	Eliminations	Consolidated
Net Sales	\$5,201,514	\$ 97,164	\$ 67,869	\$5,230,809	\$2,382,657	\$42,385	\$ 33,935	\$2,391,107
Rental Expense	\$67,869	\$ 57,630	\$ (67,869 )	\$57,630	\$33,935	\$28,610	\$ (33,935 )	\$28,610
Interest Expense	\$2,023	\$ 55,625		\$57,648	\$972	\$27,706		\$28,678
Net Income (Loss)	\$86,926	(\$16,090 )		\$70,836	\$73,666	\$(13,931 )		\$59,735
Assets	\$6,725,311	\$ 2,507,885		\$9,233,196	\$6,725,311	\$2,507,885		\$9,233,196
Debt	\$169,979	\$ 2,004,529		\$2,174,508	\$169,979	\$2,004,529		\$2,174,508
	Six Months Ended August 31, 2011				Three Months Ended August 31, 2011			
	Ultrasonic Spraying	Rental Real Estate Operations	Eliminations	Consolidated	Ultrasonic Spraying	Rental Real Estate Operations	Eliminations	Consolidated
Net Sales	\$6,094,342	\$112,558	\$ 67,872	\$6,139,028	\$3,127,614	\$56,279	\$ 33,933	\$3,149,960
Rental Expense	\$67,872	\$63,793	\$ (67,872 )	\$63,793	\$33,933	\$23,965	\$ (33,933 )	\$23,965
Interest Expense	\$2,086	\$57,282		\$59,368	\$1,054	\$28,540		\$29,594
Net Income (Loss)	\$684,637	\$(8,517 )		\$676,120	\$433,749	\$3,777		\$437,526
Assets	\$6,550,462	\$2,536,816		\$9,087,278	\$6,550,462	\$2,536,816		\$9,087,278
Debt	\$228,055	\$2,065,788		\$2,293,843	\$228,055	\$2,065,788		\$2,293,843

**NOTE 9: SUBSEQUENT EVENTS**

The Company has evaluated subsequent events for disclosure purposes.





## **ITEM 2 – Management’s Discussion and Analysis of Financial Condition and Results 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 ability to achieve increased sales volume and continued profitability.

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

### **Overview**

We have developed a unique and proprietary series of ultrasonic atomizing nozzles, which are being used in an increasing variety of electronics, advanced energy (solar and fuel cells), medical device, glass, textiles and food applications. These nozzles are electrically 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.

### **Market Diversity**

During the past four years we have invested significant time, monies and efforts to enhance our market diversity. Based on our core ultrasonic coating technology, we increased our portfolio of products, the industries we serve and the countries in which our products are marketed and sold.

Today we serve six major industries: electronics, advanced energy (solar and fuel cells), medical device, glass, textiles and food.

Most of our sales now originate outside the United States, and we are geographically present directly and through distributors and trade representatives in North and Latin America, Europe and Asia. The infrastructure upon which this diversified market approach is based, includes a newly equipped process development laboratory, a strengthened sales organization with application engineers, an engineering team with additional talent and the latest, most sophisticated design software tools, as well as an expanded, highly trained installation and service organization.

The new products which were introduced, the new markets that were penetrated, and the regions in which we now conduct marketing and sales, are a strong foundation for our future sales growth and enhanced profitability.

## Products

We have core technology and have developed and market the following products:

1. SonoFlux 2000F – spray fluxer product – designed for high volume operations with standard width lines requiring low maintenance using a variety of solder fluxes, including rosin flux. It is designed to be used by electronic circuit board manufacturers to apply solder flux to fixed width circuit boards. The major customers for the SonoFlux 2000F are original equipment manufacturers that produce their own electronic circuit boards.

2. SonoFlux 2000FP, SonoFlux XL and SonoFlux EZ- spray fluxer product - applies solder flux to electronic printed circuit boards that vary from two inches to up to 24 inches in width in a cost-effective and uniform manner. They are designed to be used by either OEMs or contract manufacturers of electronic circuit assemblies. All SonoFlux products provide substantial benefits in terms of reduced use of fluxing agents, reduced need for maintenance and reduced cost of operations compared to foam fluxers and competitive pressure nozzle fluxing products.

3. SonoFlux Servo – a new spray fluxer capable of providing flux to both wide areas of a circuit board as well as selective fluxing. We also sell a selective fluxing apparatus known as Selectaflux.

4. MediCoat and MediCoat II for stent coating – table-top and stand alone, fully-contained systems designed to apply thin layers of polymer and drug coatings to arterial stents with high precision. The system incorporates motion control of the stent during the coating process and produces coatings having excellent uniformity. The MediCoat systems use either the Accumist or MicroMist nozzle systems, which are precision nozzle configurations used in applications where precise patterns and coatings are required. These products provide customers the ability to achieve a minimal amount of waste of expensive drug polymer coatings and high uniformity of drug addition from stent to stent. MediCoat II is similar to the MediCoat, but it has higher throughput capabilities more suited for a production environment. We have recently developed additional medical coating platforms to address developing market segments for drug coated balloons, catheters and other implantable devices.

5. WideTrack – Wide area modular coating system – One module can cover substrates from 6 inches to 24 inches wide, depending on the application. Much greater widths can be achieved by linking modules together, and these systems have been applied in glass lines of up to four meters wide. A number of systems have been sold over the past four years, and this application holds promise for the future due to cost and environmental savings demonstrated at customer sites. It uses non-clogging ultrasonic atomizing nozzles to produce a low velocity, highly controllable spray. It is designed to be used in applications that require efficient web-coating or wide area spraying capability. The WideTrack System offers significant advantages over conventional pressure-spray methods in a broad range of applications such as non-woven fabrics, float glass, or odd-shaped industrial or consumer products. Since the ultrasonic spray can be easily controlled, it is possible to use fewer chemicals and less water and energy in applying

coatings to glass, textiles, food products and packaging materials than with traditional nozzles. This also results in reduced environmental impact due to less overspray

Advanced Energy Applications – We now offer a line of equipment for applications involving coatings for fuel cell membranes and solar energy panels. This equipment is offered in bench-top configurations as our Exactacoat product and standalone as our Flexicoat product. These are robotic XYZ platforms that position and move our 6. nozzle systems in a precise application pattern. We have also introduced a new product, the Hypersonic, a high speed reciprocator spraying system for this market. We have seen increasing sales in these growing industries, especially when combined with a novel ultrasonic syringe pump (patent pending) to agitate and suspend the carbon based suspensions needed in fuel cell applications.

#### Other Product Offerings

We have an exclusive distribution relationship with EVS International. Ltd. (“EVS”), a U.K. Company, to distribute EVS’s line of solder recovery systems and spares parts. The territory for this distribution relationship is the United States and Canada. EVS manufactures the EVS6000, EVS3000 and the EVS1000 solder recovery systems which are used to reclaim solder from the dross which accumulates in the wave-solder equipment of circuit board manufacturers. The customer base for distribution of these systems is synergistic with Sono-Tek’s existing customer base for spray fluxer sales in the printed circuit board industry.

#### Markets

During the past four years we have invested significant time, monies and efforts to enhance our market diversity. Based on our core ultrasonic coating technology, we increased our portfolio of products, the industries we serve and the countries in which we market and sell our products. An outcome of our rapid growth and diversification program, is that we are now capable of offering a unique and superior family of customized products to the six major industries we serve.

All of these systems are based on our core technology of ultrasonic spray coating. Many of these systems have been commercially proven in 24/7 working schedules, under harsh and challenging industrial manufacturing environments, where they provide value in a continuous and reliable fashion.

Today we offer products to six major industries: electronics, advanced energy (solar and fuel cells), medical device, glass, textiles and food.

**1. Electronics Industry.**

We serve this industry by providing manufacturers of electronic printed circuit boards with state-of-the-art solder fluxers. Our ultrasonic spray fluxers reduce the amount of fluxing chemical needed, enhance the quality of the boards, and provide our customers with a better product at reduced costs of operations, when compared with conventional foam fluxers and pressure assisted fluxers.

We are recognized as a standard setter in the industry, and our systems are incorporated by various original equipment manufacturers (OEM), in their own manufacturing lines for making electronic printed circuit boards. Some examples include: SonoFlux 2000F, SonoFlux 2000FP, SonoFlux XL, SonoFlux EZ and SonoFlux Servo. We also offer the EVS solder recovery systems to the same customer base

**2. Advanced Energy Industry.**

Manufacturers of solar cells and fuel cells share two major technical and business challenges: enhancing the energy efficiency of their products and manufacturing their products in a cost effective way. Extremely uniform, thin layer coatings are at the heart of the solution for these advanced energy systems' challenges.

Our precision coating systems are now presented in scientific conferences and trade shows around the world for the superior surface uniformity and density they provide, which are directly related to enhanced energy efficiency. Our systems also afford our energy industry clients with the capabilities of saving up to 80% of the expensive catalysts and nano-materials used in these manufacturing processes. Some examples include: ExactaCoat, FlexiCoat, Hypersonic and SonoFlow CSP.

**3. Medical Device Industry.**

Our ultrasonic coating technology is being used by medical device manufacturers worldwide. The leading applications for this industry are coating of arterial stents with precise and uniform micronic layers of polymers and drugs; coating of various implantable devices with lubricous materials and coating of blood collection tubes with anti-coagulants. These applications are typically performed under strict regulatory supervision of governmental agencies in different countries, and the continuing demand for our systems from these customers is indicative of the high quality performance that our systems provide these customers.

Some examples include: MediCoat I; Medicoat II; Medicoat SPI; AccuMist; MicroMist.

**4. Glass Industry.**

The manufacture of float glass occurs under extremely harsh conditions of elevated temperatures. Our ultrasonic coating technology provides this manufacturing process with the means of precise and uniform application of anti-stain, and other specialty chemical agents, on the hot glass. Our customers benefit from an improved quality product, enhanced productivity and significantly reduced expenditures on annual maintenance, often resulting in a return on investment of less than one year. Based on this equipment's recent successful performance, our systems are now specified by global glass manufacturers as their equipment of choice.

The equipment we offer to the glass industry is the WideTrack – wide area modular coating system.



**5. Textiles Industry.**

The textiles industry has yet to recover from the recent economic downturn related to the declines in new housing construction (carpets), automotive and clothing (fabrics).

This industry coats expensive chemicals such as flame retardant, anti-stain, anti-microbial as well as moisture barriers, which are currently applied using inefficient dip or padding methods, resulting in significant waste of material, energy and water. We have demonstrated to a few leading textile manufacturers the technical advantages and financial benefits of our WideTrack coating system for their specific operations, and we are hopeful that these manufacturers will prioritize the WideTrack in their capital investment budgets, as soon as the general economy improves.

**6. Food Industry.**

The food industry is traditionally a slow adapter to new technologies. Accordingly, we focus our efforts on a select few global food companies, where our technical advantages and economic benefits could translate into successful market penetration and sales growth. We have introduced our ultrasonic coating systems to various segments of the food industry. These include: baked goods, dairy, meat and biodegradable food packaging. The leading applications are coating of flavors, oils, nutraceuticals, anti-microbial agents, decorative glazes and coating of moisture barrier compounds on films, trays and cups. Most of our food industry equipment is designed on the WideTrack platform.

Rental Real Estate Operations

In December 2010, we purchased the industrial park where our facilities are located in Milton, NY. The park is an improved 3.13 acre parcel of land comprised of five buildings of office/industrial space, with 50,000 square feet of gross leasable floor area. We currently utilize 24,000 square feet of the park for our operations. We presently lease 16,000 square feet of the park to unrelated third parties and 10,000 square feet is currently vacant and available for rent.

For financial reporting purposes, we report the results of the park as rental real estate operations.

Liquidity and Capital Resources

**Working Capital** – Our working capital increased \$126,000 from \$4,655,000 at February 29, 2012 to \$4,781,000 at August 31, 2012. The increase in working capital is primarily a result of the current period's net income of \$71,000,

depreciation and amortization of \$156,000, equipment acquisitions and patent costs of \$93,000, long term debt reduction of \$60,000 and proceeds from stock options of \$20,000. The Company's current ratio is 4.8 to 1 at August 31, 2012 as compared to 4 to 1 at February 29, 2012.

***Stockholders' Equity*** – Stockholder's Equity increased \$112,000 from \$5,808,000 at February 29, 2012 to \$5,920,000 at August 31, 2012. The increase is a result of net income of \$71,000, and an adjustment for stock based compensation expense of \$21,000 and the proceeds from stock option exercises of \$20,000.

**Operating Activities** – We used \$264,000 in our operating activities for the six months ended August 31, 2012 as compared to providing \$303,000 for the six months ended August 31, 2011. During the six months ended August 31, 2012, accounts receivable increased \$274,000, inventory decreased \$102,000, prepaid expenses increased \$80,000, accounts payable and accrued expenses decreased \$175,000 and customer deposits decreased \$121,000. In addition, we incurred non-cash expenses of \$156,000 for depreciation and amortization, \$21,000 for stock based compensation expense, \$6,000 for bad debt expense and increased our inventory reserve by \$30,000.

The increase in our accounts receivable balance during the six months ended August 31, 2012 is due to an increased number of sales in August 2012. In addition, our customer deposits decreased during the six months ended August 31, 2012 which increased our accounts receivable balance and decreased our cash balance.

Our prepaid expenses increased primarily due to a New York State research and development tax credit.

**Investing Activities** – During the six months ended August 31, 2012, we used \$61,000 for the purchase of capital equipment, \$32,000 for patent application costs and \$704,000 for the purchase of marketable securities. During the six months ended August 31, 2011, we used \$113,000 for the purchase of capital equipment and \$5,000 for patent application costs.

**Financing Activities** – During the six months ended August 31, 2012, we used \$60,000 for the repayment of our notes payable and had proceeds from stock option exercises of \$20,000. For the six months ended August 31, 2011, we had proceeds from equipment financing of \$237,000 and repayments of our notes payable of \$41,000.

**Net Decrease in Cash** – For the six months ended August 31, 2012, our cash balance decreased \$1,102,000. During the six months ended August 31, 2012, we used \$264,000 in our operating activities, \$798,000 in our investing activities and \$40,000 in our financing activities. It should be noted that we purchased \$704,000 of marketable securities during the six months ended August 31, 2012. This purchase is included in the investing activities noted above.

## **Results of Operations**

For the six months ended August 31, 2012, our sales decreased \$908,000 or 15% to \$5,231,000 as compared to \$6,139,000 for the six months ended August 31, 2011. During the six month period ended August 31, 2012, we experienced a decrease in sales of our nozzles and generators, fluxers, stent coating units, XYZ units and hypersonic units. We did, however, see an increase in sales of our servo units and a small increase in our widetrack sales.

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For the three months ended August 31, 2012, our sales decreased \$759,000 to \$2,391,000 or 24% as compared to \$3,150,000 for the three months ended August 31, 2011. During the three month period ended August 31, 2012, we experienced a decrease in sales of our stent coating units, XYZ units, nozzles and generators and EVS systems. The decrease in these sales was offset by an increase in sales of our fluxer units and servo units.

During the three months ended August 31, 2012 we have experienced a softening in the markets we serve in Asia and Europe due to the worldwide economic slowdown. We have seen several European governments reduce or eliminate their investments in high tech sectors where our coatings systems are commonly used. Our ultrasonic systems are often directly or indirectly funded by these governmental agencies.

For the six months ended August 31, 2012, our gross profit decreased \$597,000 to \$2,515,000 from \$3,112,000 for the six months ended August 31, 2011. The gross profit margin was 48% of sales for the six months ended August 31, 2012 and 51% of sales for the six months ended August 31, 2011. The decrease in our gross profit margin for the six months ended August 31, 2012 is due to a decrease in sales of our nozzles and generators, fluxers, stent coating units, XYZ units and hypersonic units.

For the three months ended August 31, 2012, our gross profit decreased \$513,000 to \$1,165,000 from \$1,678,000 for the three months ended August 31, 2011. The gross profit margin was 49% of sales for the three months ended August 31, 2012 and 53% of sales for the three months ended August 31, 2011. The decrease in our gross profit margin for the three months ended August 31, 2012 is due to a decrease in sales of our stent coating units, XYZ units, nozzles and generators and EVS systems.

Research and product development costs decreased \$53,000 to \$487,000 for the six months ended August 31, 2012 from \$540,000 for the six months ended August 31, 2011 and \$52,000 to \$233,000 for the three months ended August 31, 2012 from \$285,000 for the three months ended August 31, 2011. The decreases were due to reduced salary expense and research and development materials in the current periods.

Marketing and selling expenses increased \$58,000 to \$1,206,000 for the six months ended August 31, 2012 from \$1,148,000 for the six months ended August 31, 2011. During the six months ended August 31, 2012, we experienced an increase in international commission expense which was offset by a decrease in insurance and depreciation. The increase in international commission expense is due to four large sales orders that were shipped to Asia during the first quarter of this fiscal year. These Asian sales were subject to a higher commission rate, but the increase is partially offset by a reduction in in-house installation expense.

For the three months ended August 31, 2012, marketing and selling expenses decreased \$28,000. During the three months ended August 31, 2012, we experienced decreases in salaries, commissions and depreciation.

General and administrative costs increased \$47,000 to \$674,000 for the six months ended August 31, 2012 from \$627,000 for the six months ended August 31, 2011 and were flat for the three months ended August 31, 2012 compared to the three months ended August 31, 2011. The increase for the six months ended August 31, 2012 was due to increased corporate expenses, increased salaries and bonuses and outside consulting fees related to the consideration of strategic opportunities and enhanced growth opportunities.

***Rental Real Estate Operations:***

For the six and three months ended August 31, 2012, the results of our rental real estate operations are as follows:

	<b>Six months ended August 31, 2012</b>	<b>Three months ended</b>
Rental Income	\$29,295	\$8,450
Depreciation	\$28,706	\$14,353
Insurance	\$4,500	\$2,250
Grounds and Landscaping	\$3,788	\$1,703
Property taxes	\$20,442	\$10,226
Miscellaneous	\$194	\$77
Loss before Interest	\$(28,335)	\$(20,159)
Interest expense	\$55,625	\$28,540
Net Loss	\$(83,960)	\$(48,699)

***Consolidated Results:***

We had net income of \$71,000 for the six months ended August 31, 2012 as compared to net income of \$676,000 for the six months ended August 31, 2011. During the three months ended August 31, 2012 we had net income of \$60,000 as compared to net income of \$437,000 for the three months ended August 31, 2011. During the six and three months ended August 31, 2012, our results were negatively affected by a decrease in sales of our products combined with a decrease in our gross profit margin.

**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 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 these and other accounting policies see Note 2 to the Company's consolidated financial statements included in Form 10-K for the year ended February 29, 2012.

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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 for the deferred tax asset. During the fiscal year ended February 28, 2009, the Company increased the valuation reserve for the deferred tax asset. In the event that actual results differ from these estimates, the Company may need to again adjust such valuation reserve.

### *Stock-Based Compensation*

The computation of the expense associated with stock-based compensation requires the use of a valuation model. ASC 718 is a complex accounting standard, the application of which requires significant judgment and the use of estimates, particularly surrounding Black-Scholes assumptions such as stock price volatility, expected option lives, and expected option forfeiture rates, to value equity-based compensation. The Company currently uses a Black-Scholes option pricing model to calculate the fair value of its stock options. The Company primarily uses historical data to determine the assumptions to be used in the Black-Scholes model and has no reason to believe that future data is likely to differ materially from historical data. However, changes in the assumptions to reflect future stock price volatility and future stock award exercise experience could result in a change in the assumptions used to value awards in the future and may result in a material change to the fair value calculation of stock-based awards. ASC 718 requires the recognition of the fair value of stock compensation in net income. Although every effort is made to ensure the accuracy of the Company's estimates and assumptions, significant unanticipated changes in those estimates, interpretations and assumptions may result in recording stock option expense that may materially impact our financial statements for each respective reporting period.

### **Impact of New Accounting Pronouncements**

Accounting pronouncements issued but not yet effective have been deemed to be not applicable or the adoption of such accounting pronouncements are not expected to have a material impact on the financial statements of the Company.

### **ITEM 3 - Quantitative and Qualitative Disclosures about Market Risk**

The Company does not issue or invest in financial instruments or derivatives for trading or speculative purposes. Substantially all of the operations of the Company are conducted in the United States, and, as such, are not subject to material foreign currency exchange rate risk. Although the Company's assets included \$1,430,000 in cash, the market rate risk associated with changing interest rates in the United States is not material.



**ITEM 4 – 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 August 31, 2012. 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.

In addition, there were no changes in the Company's internal controls over financial reporting during the second fiscal quarter of 2013 that have materially affected, or are reasonably likely to materially affect, internal controls over financial reporting.

## PART II - OTHER INFORMATION

Item 1. Legal Proceedings  
None

Item 1A. Risk Factors  
None Required for Smaller Reporting Companies

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.  
None

Item 3. Defaults Upon Senior Securities  
None

Item 4. Mine Safety Disclosures  
None

Item 5. Other Information  
None

Item 6. Exhibits and Reports

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.

101.INS — XBRL Instance Document.

101.SCH — XBRL Taxonomy Extension Schema Document

101.CAL — XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF — XBRL Taxonomy Extension Definition Linkbase Document

101.LAB — XBRL Taxonomy Extension Label Linkbase Document

101.PRE — XBRL Taxonomy Extension Presentation Linkbase Document



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: October 4, 2012

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