

SONO TEK CORP
Form 10-Q
July 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: **May 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 (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

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:

<u>Class</u>	<u>Outstanding as of</u> <u>July 10, 2014</u>
Common Stock, par value \$.01 per share	14,711,696

SONO-TEK CORPORATION

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SONO-TEK CORPORATION**CONDENSED CONSOLIDATED BALANCE SHEETS**

	May 31, 2014 (Unaudited)	February 28, 2014
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 2,209,398	\$3,232,021
Marketable securities	1,136,697	630,794
Accounts receivable (less allowance of \$35,000 and \$32,000 at May 31 and February 28, respectively)	877,896	860,296
Inventories, net	1,791,384	1,674,815
Prepaid expenses and other current assets	114,887	160,373
Total current assets	6,130,262	6,558,299
Land	250,000	250,000
Buildings, net	2,057,183	2,071,875
Equipment, furnishings and building improvements, net	652,003	637,138
Intangible assets, net	186,603	171,828
Deferred tax asset	90,021	90,021
TOTAL ASSETS	\$9,366,072	\$9,779,161
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$471,373	\$556,194
Accrued expenses	545,775	565,121
Customer deposits	133,689	362,846
Current portion of long term debt	194,451	191,466
Income taxes payable	17,469	129,398
Total current liabilities	1,362,757	1,805,025
Long term debt, less current maturities	1,428,115	1,479,058
Total liabilities	2,790,872	3,284,083
Stockholders' Equity		
Common stock, \$.01 par value; 25,000,000 shares authorized, 14,711,696 and 14,708,518 shares issued and outstanding, respectively	147,117	147,085
Additional paid-in capital	8,739,331	8,725,883
Accumulated deficit	(2,311,248)	(2,377,890)
Total stockholders' equity	6,575,200	6,495,078
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$9,366,072	\$9,779,161

See notes to condensed consolidated financial statements.

SONO-TEK CORPORATION**CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

	Three Months Ended May	
	31,	
	2014	2013
Net Sales	\$2,420,699	\$2,374,394
Cost of Goods Sold	1,272,733	1,232,979
Gross Profit	1,147,966	1,141,415
Operating Expenses		
Research and product development costs	235,848	225,594
Marketing and selling expenses	543,847	489,010
General and administrative costs	241,585	269,090
Rental operations expense	39,159	34,482
Total Operating Expenses	1,060,439	1,018,176
Operating Income	87,527	123,239
Interest Expense	(16,035)	(27,775)
Other (expense) income	10,299	(1,528)
Income Before Income Taxes	81,791	93,936
Income Tax Expense	15,149	20,188
Net Income	\$66,642	\$73,748
Basic Earnings Per Share	\$0.00	\$0.01
Diluted Earnings Per Share	\$0.00	\$0.01
Weighted Average Shares - Basic	14,709,773	14,503,010
Weighted Average Shares - Diluted	14,836,943	14,559,441

See notes to condensed consolidated financial statements.

SONO-TEK CORPORATION**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	Three Months Ended May	
	31,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	\$66,642	\$73,748
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	93,283	82,923
Stock based compensation expense	13,480	4,410
Allowance for doubtful accounts	3,000	3,000
Inventory reserve	30,000	13,343
Decrease (Increase) in:		
Accounts receivable	(20,600)	78,417
Inventories	(146,568)	112,707
Prepaid expenses and other current assets	45,486	2,446
(Decrease) Increase in:		
Accounts payable and accrued expenses	(104,167)	36,620
Customer Deposits	(229,157)	129,376
Income taxes payable	(111,929)	20,188
Net Cash Provided by (Used In) Operating Activities	(360,530)	557,178
CASH FLOWS FROM INVESTING ACTIVITIES:		
Patent application costs	(17,550)	(7,782)
Purchase of equipment and furnishings	(90,682)	(18,698)
Sale (Purchase) of marketable securities	(505,903)	2,510
Net Cash (Used In) Investing Activities	(614,135)	(23,970)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of notes payable and loans	(47,958)	(31,049)
Net Cash (Used In) Financing Activities	(47,958)	(31,049)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,022,623)	502,159
CASH AND CASH EQUIVALENTS		
Beginning of period	3,232,021	1,940,906
End of period	\$2,209,398	\$2,443,065

SUPPLEMENTAL DISCLOSURE:

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Interest paid	\$16,035	\$27,775
Taxes Paid	\$127,046	\$0

See notes to condensed consolidated financial statements.

SONO-TEK CORPORATION

Notes to Condensed Consolidated Financial Statements

Three Months Ended May 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 May 31, 2014 and February 28, 2014:

**Quoted Prices in Active Markets
(Level 1)**

May 31, 2014	February 28, 2014
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Marketable Securities \$	1,136,697	\$	630,794
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Marketable Securities include mutual funds of \$1,136,697, which are considered to be highly liquid and easily tradable as of May 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 \$108,359 and \$105,585 at May 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 July 2013, the FASB issued Accounting Standards Update “ASU” 2013-11 on “Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists”. The amendments in this ASU are to improve the current U.S. GAAP because they are expected to reduce diversity in practice by providing guidance on the presentation of unrecognized tax benefits and will better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. For nonpublic entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted.

NOTE 2: INVENTORIES

Inventories consist of the following:

May 31, February 28,

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	2014	2014
Finished goods	\$374,459	\$445,035
Work in process	603,054	402,377
Raw materials and subassemblies	1,038,964	1,022,496
Total	2,016,477	1,869,908
Less: Allowance	(225,093)	(195,093)
Net inventories	\$1,791,384	\$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 May 31, 2014, there were 135,500 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 May 31, 2014, there were 805,573 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. For the three months ended May 31, 2014 no options were issued.

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 three months ended May 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 \$13,480 and \$4,410 in additional compensation expense during the three months ended May 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 May 31, 2014 and 2013, are calculated as follows:

	Three Months Ended May 31,	
	2014	2013
Denominator for basic earnings per share	14,709,773	14,503,010
Dilutive effect of stock options	127,170	56,431
Denominator for diluted earnings per share	14,836,943	14,559,441

NOTE 6: LONG TERM DEBT

Long-term debt consists of the following:

	May 31, 2014	February 28, 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.	\$66,063	\$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.	1,556,503	1,589,360
Total long term debt	1,622,566	1,670,524
Due within one year	194,451	191,466
Due after one year	\$1,428,115	\$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 May 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 May 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 three months ended May 31, 2014 and 2013, segment information is as follows:

	Three Months Ended May 31, 2014				Three Months Ended May 31, 2013			
	Ultrasonic Spraying	Rental Real Estate Operations	Eliminations	Consolidated	Ultrasonic Spraying	Rental Real Estate Operations	Eliminations	Consolidated
Net Sales	\$2,401,949	\$67,824	\$ 49,074	\$2,420,699	\$2,353,979	\$54,350	\$ 33,935	\$2,374,394
Rental Expense	\$49,074	\$39,159	\$(49,074)	\$39,159	\$33,935	\$34,482	\$(33,935)	\$34,482
Interest Expense	\$394	\$16,035		\$16,429	\$726	\$27,049		\$27,775
Net Income (Loss)	\$54,012	\$12,630		\$66,642	\$80,928	\$(7,180)		\$73,748
Assets	\$6,876,160	\$2,489,912		\$9,366,072	\$6,821,131	\$2,478,605		\$9,299,736
Debt	\$66,091	\$1,556,475		\$1,622,566	\$125,858	\$1,956,328		\$2,082,186

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 our operations or the demand for our 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 we sell our products.

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

A majority 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 sell our products, are a strong foundation for our future sales growth and enhanced profitability.

Markets

Our rapid growth and diversification program over the past several years has positioned us to offer 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.

1. Electronics Industry.

We serve this industry primarily in two sectors; Printed Circuit Board (PCB) manufacturing and Semiconductor manufacturing.

We provide manufacturers of PCBs with state-of-the-art solder fluxers. Spray fluxers are used in the manufacturing process of PCBs to apply flux, which removes oxidation and prepares the PCB for the process of soldering components onto it.

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.

Pursuant to an exclusive distribution agreement with EVS International Ltd (“EVS”) for the territories of the United States and Canada, we offer the EVS solder recovery system to our PCB customer base.

We also have a significant established customer base in the semi-conductor industry. The semi-conductor industry utilizes our ultrasonic atomizing nozzles and XYZ coating platforms for the application and deposition of photo-resist onto semiconductor wafers. Certain of our semi-conductor manufacturing industry customers engaged in the production of micro-electro-mechanical systems, “MEMS”, have proven the ability of our technology to apply micron thick coatings to these complex wafers.

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 provide superior surface uniformity and density, 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 of our products marketed to the advanced energy industry include: ExactaCoat FC & SC, FlexiCoat FC & SC, and SonoFlow Fusion.

3. Medical Device Industry.

Our ultrasonic coating technology is 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 of our products marketed to the medical device industry include: MediCoat I; Medicoat II; Medicoat PSI; AccuMist; MicroMist; Balloon Catheter Coater.

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 to precisely and uniformly apply 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 many 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 is rapidly expanding to introduce high performance value adding coatings onto fabrics, such as anti-microbial, anti-stain, flame retardant and moisture barriers. The current manufacturing process for applying these expensive coatings has significant waste of material, energy and water. We are working with this industry to incorporate our ultrasonic technology; often in combination with unique pre and post treatments of the coating materials, to reduce the effective material usage by as much as 90%.

We have demonstrated to several 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 future capital investment budgets.

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, with our primary focus on coating of flavors, nutraceuticals and anti-microbial agents. Most of our food industry equipment is designed on the WideTrack platform.

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 primary customers for the SonoFlux 2000F are original equipment manufacturers that produce their own electronic circuit boards.

2. SonoFlux EZ- spray fluxer product - applies solder flux to electronic printed circuit boards that vary from two inches to up to 18 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. This is an economically priced system which sells effectively in the price competitive Asian market.

3. SonoFlux Servo – a newer 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.

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 minimize waste of expensive drug polymer coatings and provide 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.

WideTrack – Wide area modular coating system – designed to be used in applications that require efficient web-coating or wide area spraying capability. One module can cover substrates from six 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 large number of systems have been sold over the past six 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. 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.

Exactacoat/Flexicoat – We offer a line of robotic XYZ coating equipment for applications involving 3D coatings for fuel cell membranes, solar energy panels and specialty lens products. This equipment is offered in bench-top configurations as our Exactacoat product and standalone as our Flexicoat product. These platforms position and move our nozzle systems in a precise three dimensional application pattern. These coaters are extremely efficient especially when combined with our novel ultrasonic syringe pump (patent pending) to agitate and suspend the carbon based suspensions needed in fuel cell applications.

Other Product Offerings – EVS Solder Recovery System

We have an exclusive distribution relationship with EVS to distribute EVS's line of solder recovery systems and spare parts in 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 our existing customer base for spray fluxer sales in the printed circuit board industry.

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 29,000 square feet of the park for our operations. We presently lease 21,000 square feet of the park to unrelated third parties.

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 \$14,000 from a working capital of \$4,753,000 at February 28, 2014 to \$4,767,000 at May 31, 2014. The increase in working capital is due to the current period's net income of \$67,000, offset by cash outflows of \$17,000 for patent application costs, \$91,000 for the purchase of equipment and furnishings, \$48,000 for the repayments of notes payable and \$3,000 for investment expenses. In addition, we incurred non-cash expenses for depreciation and amortization of \$93,000 and stock based compensation expense of \$13,000. The Company's current ratio is 4.5 to 1 at May 31, 2014 as compared to 3.6 to 1 at February 28, 2014.

Our customer deposits on hand decreased \$229,000 from \$363,000 at February 28, 2014 to \$134,000 at May 31, 2014. The decrease in customer deposits is due to sales that were completed and shipped during the quarter ended May 31, 2014. The amount of our customer deposits will vary from quarter to quarter. The amount depends upon a number of factors which include: the timing of the sales, customer requested delivery dates and the customer's preferred payment option.

Stockholders' Equity – Stockholder's Equity increased \$80,000 from \$6,495,000 at February 28, 2014 to \$6,575,000 at May 31, 2014. The increase is a result of net income of \$67,000 and stock based compensation expense of \$13,000.

Operating Activities – Our operating activities used \$361,000 of cash for the three months ended May 31, 2014 as compared to providing \$557,000 for the three months ended May 31, 2013. During the three months ended May 31, 2014, the current period net income is \$67,000, accounts receivable increased \$20,000, inventories increased \$147,000, prepaid expenses decreased \$45,000, accounts payable and accrued expenses decreased \$104,000, customer deposits decreased \$229,000 and income taxes payable decreased \$112,000 compared to the prior year's period. In addition, in the current period we incurred non-cash expenses of \$93,000 for depreciation and amortization, \$13,000 for stock based compensation expense, \$3,000 for bad debt expense and \$30,000 for our inventory reserve.

Investing Activities – Our investing activities used \$614,000 of cash for the three months ended May 31, 2014 as compared to using \$24,000 for the three months ended May 31, 2013. We used \$91,000 for the purchase of capital equipment, \$18,000 for patent application costs and \$506,000 for the purchase of marketable securities.

Financing Activities – For the three months ended May 31, 2014, we used \$48,000 for the repayment of our notes payable compared to \$31,000 for the prior year period.

Net Decrease in Cash – For the three months ended May 31, 2014, our cash balance decreased by \$1,023,000 as compared to an increase of \$502,000 for the three months ended May 31, 2013. During the three months ended May 31, 2014, our operations used \$361,000 of cash, we used \$614,000 in investing activities and we used \$48,000 in our

financing activities.

Results of Operations

Ultrasonic Spraying Systems Segment:

For the three months ended May 31, 2014, our sales increased \$48,000 to \$2,402,000 as compared to \$2,354,000 for the three months ended May 31, 2013. During the three month period ended May 31, 2014, we experienced an increase in sales of our Stentcoaters and XYZ platform units. These increases were offset by a decrease in sales of Widetrack Units.

Sales of our Stentcoaters, XYZ platform units, Widetrack Units and Servo Units typically vary from quarter to quarter. We have seen the demand for our products fluctuate and demand is dependent upon market conditions. The continuing expansion of our product lines has reduced our dependence on any specific market and provides us flexibility to adapt to changing economic conditions.

Our gross profit increased \$7,000 to \$1,148,000 for the three months ended May 31, 2014 from \$1,141,000 for the three months ended May 31, 2013. The gross profit margin was 47% of sales for the three months ended May 31, 2014 compared to 48% for the prior year period. During the current period we experienced an increase in installation costs and personnel costs. In addition, our gross profit margin was negatively effected by an increase in our inventory allowance for obsolescence.

Research and product development costs increased \$10,000 to \$236,000 for the three months ended May 31, 2014 from \$226,000 for the three months ended May 31, 2013. The increase is due to increased salaries and depreciation offset by a decrease in materials .

Marketing and selling costs increased \$55,000 to \$544,000 for the three months ended May 31, 2014 from \$489,000 for the three months ended May 31, 2013. During the three months ended May 31, 2014, we experienced increases in international commission expense of \$24,000 and travel of \$21,000. We expected the increase in international commission expense during the current period. In the prior year period, we recorded four large sales that were shipped to Asia. These Asian sales originated in house by our internal sales staff and, as such, no external commissions applied to these sales.

General and administrative costs decreased \$27,000 to \$242,000 for the three months ended May 31, 2014 from \$269,000 for the three months ended May 31, 2013. The decrease was due to decreased corporate expenses, decreased salaries and decreased professional fees.

Rental Real Estate Operations:

For the three months ended May 31, 2014, our real estate operations generated \$19,000 in rental income from unrelated third parties and incurred \$39,000 in operating expenses and \$16,000 in interest expense resulting in a net loss of \$36,000. The \$36,000 loss excludes any inter-company rent. We are presently working with an independent real estate broker to lease our vacant warehouse space.

Interest Expense:

Interest expense decreased \$12,000 to \$16,000 for the three months ended May 31, 2014 as compared to \$28,000 for the prior year period. The decrease in interest expense is a result of the refinancing of the Industrial Park that took place in December 2013.

Condensed Consolidated Results:

We had net income of \$67,000 for the three months ended May 31, 2014 as compared to \$74,000 for the three months ended May 31, 2013. The decrease in our net income for the three months ended May 31, 2014 is due to a decrease in

our gross profit margin combined with an increase in marketing and selling costs and research and development costs.

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 28, 2013.

Accounting for Income Taxes

As part of the process of preparing the Company's condensed 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.

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 our 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. All of our sales transactions are completed in US dollars.

Although the Company's assets included \$2,209,000 in cash and \$1,137,000 in marketable securities, 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 May 31, 2014. 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 first fiscal quarter of 2015 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

Note 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 Calculation Linkbase Document

101.DEF – XBRL Taxonomy Extension Definition Linkbase Document

101.LAB – XBRL 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: July 15, 2014

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

