SONO TEK CORP
Form 10-Q
July 12, 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: May 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 incorporation or organization)	(IRS Employer Identification No.)

2012 Rt. 9W, Milton, NY 12547

(Address of Principal Executive Offices) (Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES 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

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 July 2, 2012
Common Stock, par value $.01 per share	14,479,610

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SONO-TEK CORPORATION

CONSOLIDATED BALANCE SHEETS

ASSETS

	May 31, 2012 (Unaudited)	**February 29, 2012**
Current Assets:		
Cash and cash equivalents	$1,851,320	$2,531,689
Marketable Securities	654,093	253,987
Accounts receivable (less allowance of $29,000 and $26,000 at May 31 and February 29, respectively)	1,059,403	754,605
Inventories, net	2,532,567	2,559,128
Prepaid expenses and other current assets	117,875	112,392
Total current assets	6,215,258	6,211,801
Land	250,000	250,000
Buildings, net	2,215,297	2,229,650
Equipment, furnishings and building improvements, net	559,680	617,200
Intangible assets, net	105,277	83,455
Deferred tax asset	86,167	86,167
TOTAL ASSETS	$9,431,679	$9,478,273
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$464,346	$552,979
Accrued expenses	646,537	529,732
Customer Deposits	271,137	316,246
Current portion of long term debt	122,031	120,303
Income taxes payable	6,384	37,250
Total current liabilities	1,510,435	1,556,510
Long term debt, less current maturities	2,082,607	2,114,196
Total liabilities	3,593,042	3,670,706
Stockholders' Equity		
Common stock, $.01 par value; 25,000,000 shares authorized, 14,467,685 and 14,455,444 shares issued and outstanding, respectively at May 31 and February 29	144,675	144,553
Additional paid-in capital	8,677,477	8,657,629
Accumulated deficit	(2,983,515)	(2,994,615)
Total stockholders' equity	5,838,637	5,807,567
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$9,431,679	$9,478,273

See notes to consolidated financial statements.

SONO-TEK CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended May 31,	
	2012	2011
Net Sales	$2,839,702	$2,989,070
Cost of Goods Sold	1,490,004	1,555,971
Gross Profit	1,349,698	1,433,099
Operating Expenses		
Research and product development costs	254,070	255,059
Marketing and selling expenses	652,912	567,632
General and administrative costs	358,546	303,184
Rental operations expense	29,020	39,829
Total Operating Expenses	1,294,548	1,165,704
Operating Income	55,150	267,395
Interest Expense	(28,970)	(29,773)
Other (expense) income	(7,940)	246
Income from Operations Before Income Taxes	18,240	237,868
Income Tax (Benefit) Expense	7,140	(727)
Net Income	$11,100	$238,595
Basic Earnings Per Share	$0.00	$0.02
Diluted Earnings Per Share	$0.00	$0.02
Weighted Average Shares - Basic	14,459,579	14,441,511
Weighted Average Shares - Diluted	14,570,514	14,752,316

See notes to consolidated financial statements.

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SONO-TEK CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended May 31, 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	$ 11,100	$ 238,595
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	83,576	73,889
Stock based compensation expense	10,964	12,943
Allowance for doubtful accounts	3,000	3,000
Decrease (Increase) in:		
Accounts receivable	(307,798)	(225,723)
Inventories	26,561	(311,545)
Prepaid expenses and other current assets	(5,483)	23,451
(Decrease) Increase in:		
Accounts payable and accrued expenses	28,175	(6,763)
Customer Deposits	(45,109)	196,035
Income taxes payable	(30,866)	-
Net Cash (Used In) Provided by Operating Activities	(225,880)	3,882
CASH FLOW FROM INVESTING ACTIVITIES:		
Patent application costs	(24,115)	(2,110)
Purchase of equipment and furnishings	(9,412)	(42,536)
Purchase of marketable securities	(400,106)	-
Net Cash (Used In) Investing Activities	(433,633)	(44,646)
CASH FLOW FROM FINANCING ACTIVITIES:		
Repayments of notes payable and loans	(29,862)	(17,242)
Proceeds from exercise of options	9,006	
Net Cash (Used In) Financing Activities	(20,856)	(17,242)
NET (DECREASE) IN CASH AND CASH EQUIVALENTS	(680,369)	(58,006)
CASH AND CASH EQUIVALENTS		
Beginning of period	2,531,689	1,683,801
End of period	$ 1,851,320	$ 1,625,795
SUPPLEMENTAL DISCLOSURE:		
Interest paid	$ 28,970	$ 29,773
Taxes Paid	$ 38,848	$ 0

See notes to consolidated financial statements.

SONO-TEK CORPORATION

Notes to Consolidated Financial Statements

Three Months Ended May 31, 2012 and 2011

(Unaudited)

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 and started operating in December 2010.

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:

	Quoted Prices in Active Markets (Level 1)	
	May 31, 2012	**February 29, 2012**
Marketable Securities	$654,093	$253,987

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Marketable Securities include mutual funds of $654,093, that are considered to be highly liquid and easily tradeable as of May 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.

In addition, the guidance of the Fair Value Option for Financial Assets and Financial Liabilities Topic of the Codification was effective for June 1, 2008. The guidance expands opportunities to use fair value measurements in financial reporting and permits entities to choose to measure many financial instruments and certain other items at fair value.

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 $88,276 and $85,983 at May 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:

	May 31, 2012	February 29, 2012
Finished goods	$917,859	$905,142
Work in process	641,596	544,805
Consignment	-	7,127
Raw materials and subassemblies	1,178,997	1,295,938
Total	2,738,452	2,753,012
Less: Allowance	(205,885)	(193,884)
Net inventories	$2,532,567	$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 May 31, 2012, there were 40,000 options outstanding under the 1993 Plan and 1,266,218 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:

	2013	**2012**
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 three months ended May 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 $10,964 and $12,943 in additional compensation expense during the three months ended May 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 May 31, 2012 and 2011, are calculated as follows:

	Three Months Ended May 31,	
	2012	**2011**
Denominator for basic earnings per share	14,459,579	14,441,511
Dilutive effect of stock options	110,935	310,805
Denominator for diluted earnings per share	14,570,514	14,752,316

NOTE 6: LONG TERM DEBT

Long-term debt consists of the following:

	May 31, 2012	February 29, 2012
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.	$2,020,161	$2,035,579
	184,477	198,920

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.		
Total long term debt	2,204,638	2,234,499
Due within one year	122,031	120,303
Due after one year	$2,082,607	$2,114,196

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, 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 May 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.

For the three months ended May 31, 2012, segment information is as follows. All inter-company transactions are eliminated in consolidation.

	Ultrasonic Spraying	**Rental Real Estate Operations**	**Eliminations**	**Consolidated**
Net Sales	$2,818,857	$54,779	$ 33,934	$ 2,839,702
Rental Expense	$33,934	$29,020	$ (33,934)	$ 29,020
Interest Expense	$1,051	$27,919	-	$ 28,970
Net Income (Loss)	$13,260	$(2,160)	-	$ 11,100
Assets	$6,918,542	$2,513,137	-	$ 9,431,679
Debt	$184,477	$2,020,161	-	$ 2,204,638

NOTE 9: SUBSEQUENT EVENTS

The Company has evaluated subsequent events for disclosure purposes.

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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 we operate.

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 operate, 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

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6. 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 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

An outcome of our rapid growth and diversification program over the past two years, 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.

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.

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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 to the same customer base, EVS solder recovery systems, as per our exclusive distribution agreement with EVS International Ltd for the territory of the United States and Canada.

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, nutriceuticals, 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 $50,000 from a working capital of $4,655,000 at February 29, 2012 to $4,705,000 at May 31, 2012. The increase in working capital is a result of the current period's net income of $11,000, depreciation and amortization of $95,000, equipment acquisitions and patent costs of $34,000, long term debt reduction of $31,000 and proceeds from stock options of $9,000. The Company's current ratio is 4.1 to 1 at May 31, 2012 as compared to 4 to 1 at February 29, 2012.

Stockholders' Equity – Stockholder's Equity increased $31,000 from $5,808,000 at February 29, 2012 to $5,839,000 at May 31, 2012. The increase is a result of net income of $11,000, an adjustment for stock based compensation expense of $11,000 and the proceeds from stock option exercises of $9,000.

Operating Activities – We used $226,000 in our operating activities for the three months ended May 31, 2012 as compared to providing $4,000 for the three months ended May 31, 2011. During the three months ended May 31, 2012, accounts receivable increased $308,000, inventory increased $26,000, prepaid expenses increased $5,000, accounts payable and accrued expenses increased $28,000, customer deposits decreased $45,000 and income taxes payable decreased $31,000. In addition, we incurred non-cash expenses of $84,000 for depreciation and amortization, $11,000 for stock based compensation expense and $3,000 for bad debt expense.

Investing Activities – We used $9,000 for the purchase of capital equipment, $24,000 for patent application costs and $400,000 for the purchase of marketable securities during the three months ended May 31, 2012. We used $43,000 for the purchase of capital equipment and $2,000 for patent application costs during the three months ended May 31, 2011.

Financing Activities – For the three months ended May 31, 2012 we used $30,000 for the repayment of our notes payable and had proceeds from stock option exercises of $9,000. For the three months ended May 31, 2011 we used $17,000 for the repayment of our notes payable.

Net Decrease in Cash – For the three months ended May 31, 2012, our cash balance decreased by $680,000 as compared to a decrease of $58,000 for the three months ended May 31, 2011. During the three months ended May 31, 2012, we used $226,000 in our operating activities, we used $434,000 in investing activities and we used $21,000 in our financing activities.

Results of Operations

Ultrasonic Spraying Systems Segment:

For the three months ended May 31, 2012, our sales decreased $148,000 to $2,819,000 as compared to $2,967,000 for the three months ended May 31, 2011. During the three month period ended May 31, 2012, we experienced an increase in sales in of our EVS Units, Servo Units, stentcoaters, and XYZ platform units. During this period we experienced a decrease in sales of our fluxer units and nozzles and related generator units.

Our gross profit decreased $82,000 to $1,315,000 for the three months ended May 31, 2012 from $1,397,000 for the three months ended May 31, 2011. The gross profit margin was 47% of sales for the three months ended May 31, 2012 and 2011.

Research and product development costs remained flat at $254,000 when compared to the three months ended May 31, 2011.

Marketing and selling costs increased $85,000 to $653,000 for the three months ended May 31, 2012 from $568,000 for the three months ended May 31, 2011. During the three months ended May 31, 2012, we experienced an increase in international commission expense of $105,000. The increase in commission expense was offset by a decrease in travel, trade show and depreciation expenses.

The increase in international commission expense is due to four large sales that were shipped to Asia during the quarter. These Asian sales are subject to a higher commission rate, but the increase is partially offset by a reduction in in-house installation expense.

General and administrative costs increased $56,000 to $359,000 for the three months ended May 31, 2012 from $303,000 for the three months ended May 31, 2011. This increase was due to increased corporate expenses, increased salaries and bonuses, and outside consulting fees related to strategic opportunities and enhanced growth opportunities.

Rental Real Estate Operations:

For the three months ended May 31, 2012, our real estate operations generated $21,000 in rental income from unrelated third parties, incurred $29,000 in operating expenses and $28,000 in interest expense. Overall, the real estate operations incurred a net loss of $36,000 for the three months ended May 31, 2012. 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.

Consolidated Results:

We had net income of $11,000 for the three months ended May 31, 2012 as compared to $239,000 for the three months ended May 31, 2011. The decline in our results for the three months ended May 31, 2012 is due to a decrease in sales combined with additional marketing and selling costs and general and administrative expenses.

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.

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.

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 $1,851,000 in cash and $654,000 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, 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 first 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

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.

SIGNATURES

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

Dated: July 11, 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