SONO TEK CORP
Form 10-Q
October 14, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: **August 31, 2011**

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 |X| NO |_|

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

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Class	**Outstanding as of**

	September 30, 2011
Common Stock, par value $.01 per share	14,442,211

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CONSOLIDATED BALANCE SHEETS

	August 31, 2011 (Unaudited)	**February 28, 2011**
ASSETS		
Current Assets:		
Cash and cash equivalents	$2,065,862	$1,683,801
Marketable Securities	251,842	249,100
Accounts receivable (less allowance of $32,000 and $26,000 at August 31 and February 28, respectively)	939,877	976,339
Inventories	2,667,474	1,868,144
Prepaid expenses and other current assets	171,935	131,404
Total current assets	6,096,990	4,908,788
Land	250,000	250,000
Buildings, net	2,258,427	2,280,175
Equipment, furnishings and leasehold improvements (less accumulated depreciation of $1,947,089 and $1,834,560 at August 31 and February 28, respectively)	395,152	414,210
Intangible assets, net	80,167	79,150
Other assets	6,542	6,542
TOTAL ASSETS	$9,087,278	$7,938,865
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$778,907	$643,315
Accrued expenses	453,346	507,517
Customer deposits	542,245	373,577
Current maturities of long term debt	119,457	62,247
Total current liabilities	1,893,955	1,586,656
Long term debt, less current maturities	2,174,386	2,035,579
Total liabilities	4,068,341	3,622,235
Commitments and Contingencies	—	—
Stockholders' Equity		
Common stock, $.01 par value; 25,000,000 shares authorized, 14,442,211 and 14,437,511 shares issued and outstanding, at August 31 and February 28, respectively	144,423	144,416
Additional paid-in capital	8,625,302	8,599,122
Accumulated deficit	(3,750,788)	(4,426,908)
Total stockholders' equity	5,018,937	4,316,630
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$9,087,278	$7,938,865

See notes to consolidated financial statements.

SONO-TEK CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

	Six Months Ended August 31 Unaudited		Three Months Ended August 31 Unaudited	
	2011	**2010**	**2011**	**2010**
Net Sales	$ 6,139,028	$ 4,715,788	$ 3,149,960	$ 2,432,137
Cost of Goods Sold	3,027,484	2,482,488	1,471,513	1,315,865
Gross Profit	3,111,544	2,233,300	1,678,447	1,116,272
Operating Expenses				
Research and product development costs	539,941	398,349	284,885	188,803
Marketing and selling expenses	1,148,253	1,033,254	580,617	510,833
General and administrative costs	627,037	576,226	323,853	289,061
Rental operations expense	63,793	—	23,965	—
Total Operating Expenses	2,379,024	2,007,829	1,213,320	988,697
Operating Income	732,520	225,471	465,127	127,575
Interest Expense	(59,367)	(5,835)	(29,594)	(2,397)
Interest Income	3,220	1,220	2,973	760
Income from Operations Before Income Taxes	676,373	220,856	438,506	125,938
Income Tax Expense	253	216	980	50
Net Income	$ 676,120	$ 220,640	$ 437,526	$ 125,888
Basic Earnings Per Share	$ 0.05	$ 0.02	$ 0.03	$ 0.01
Diluted Earnings Per Share	$ 0.05	$ 0.02	$ 0.03	$ 0.01
Weighted Average Shares - Basic	14,442,211	14,437,511	14,442,211	14,437,511
Weighted Average Shares - Diluted	14,759,663	14,594,030	14,784,319	14,568,332

See notes to consolidated financial statements.

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SONO-TEK CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended August 31, Unaudited	
	2011	**2010**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	$676,120	$220,640
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	154,420	143,129
Stock based compensation expense	25,829	26,528
Allowance for doubtful accounts	6,000	4,000
Decrease (Increase) in:		
Accounts receivable	30,462	22,074
Inventories	(799,330)	(142,337)
Prepaid expenses and other current assets	(40,531)	(60,767)
(Decrease) Increase in:		
Accounts payable and accrued expenses	81,421	(415,741)
Customer Deposits	168,668	294,217
Net Cash Provided by Operating Activities	303,059	91,743
CASH FLOW FROM INVESTING ACTIVITIES:		
Patent application costs	(4,760)	(6,797)
Purchase of equipment and furnishings	(112,563)	(59,807)
Net Cash Used In Investing Activities	(117,323)	(66,604)
CASH FLOW FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	358	—
Proceeds from equipment financing - bank	237,000	
Repayments of notes payable and loans	(41,033)	(9,171)
Net Cash Provided by (Used In) Financing Activities	196,325	(9,171)
NET INCREASE IN CASH AND CASH EQUIVALENTS	382,061	15,968
CASH AND CASH EQUIVALENTS		
Beginning of period	1,683,801	1,787,516
End of period	$2,065,862	$1,803,484
SUPPLEMENTAL DISCLOSURE:		
Interest paid	$59,368	$5,819
Taxes Paid	$253	$216

See notes to consolidated financial statements.

SONO-TEK CORPORATION

Notes to Consolidated Financial Statements

Six Months Ended August 31, 2011 and 2010

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 at August 31, 2011:

	Quoted prices in active markets (Level 1)
Marketable Securities	$251,842

Marketable Securities include mutual funds of $251,842, that are considered to be highly liquid and easily tradeable as of August 31, 2011. 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.

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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 28, 2011, 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 $81,801 and $78,058 at August 31, 2011 and February 28, 2011, respectively. Annual amortization expense of such intangible assets is expected to be $7,300 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:

	August 31, 2011	February 28, 2011
Finished goods	$1,003,621	$729,142
Work in process	790,648	594,744
Consignment	4,333	7,861
Raw materials and subassemblies	1,167,831	799,355
Total	2,966,432	2,131,102
Less: Allowance	(298,958)	(262,958)
Net inventories	$2,667,474	$1,868,144

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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, 2011, there were 40,000 options outstanding under the 1993 Plan and 1,317,693 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:

	2012	**2011**
Expected life	4 years	4 years
Risk free interest rate	.71% - 1.17%	.57% - 1.17%
Expected volatility	29% - 31%	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, 2011 and 2010, net income and earnings per share reflect the actual deduction for stock-based compensation expense. The impact of applying ASC 718 approximated $25,829 and $26,528 in additional compensation expense during the six months ended August 31, 2011 and 2010, 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.

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NOTE 5: EARNINGS PER SHARE

The denominator for the calculation of diluted earnings per share at August 31, 2011 and 2010 are calculated as follows:

	Six Months Ended August 31,		Three Months Ended August 31,	
	2011	**2010**	**2011**	**2010**
Denominator for basic earnings per share	14,442,211	14,437,511	14,442,211	14,437,511
Dilutive effect of stock options	317,742	156,519	342,108	130,821
Denominator for diluted earnings per share	14,759,663	14,594,030	14,784,319	14,568,332

NOTE 6: LONG TERM DEBT

Long-term debt consists of the following:

	August 31, 2011	**February 28,**
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	$2,065,788	$2,095,179
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	228,055	0
Equipment loan, bank, collateralized by related office equipment, payable in monthly installments of principal and interest of $529 through September 2011. Interest rate 5.22%. 36 month term	0	2,647
Total long term debt	2,293,843	2,097,826
Due within one year	119,457	62,247
Due after one year	$2,174,386	$2,035,579

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NOTE 7: REVOLVING LINE OF CREDIT

The Company has a $750,000 revolving line of credit at prime which was 3.25% at August 31, 2011. The loan is collateralized by all of the assets of the Company. 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, 2011, 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 six and three months ended August 31, 2011, segment information is as follows. All inter-company transactions are eliminated in consolidation.

	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

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

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

In recent years we have diversified our product lines. For example, we have successfully entered into the medical device market. To accomplish this goal, we have focused engineering resources on the medical device market, with an emphasis on providing coating solutions for the newest generations of drug coated stents and other implantable devices. We have sold a significant number of specialized ultrasonic nozzles and MediCoat stent coating systems to large medical device customers. Sono-Tek's stent coating systems are superior compared to pressure nozzles in their ability to uniformly coat the very small arterial stents without creating webs or gaps in the coatings. We sell a bench-top, fully outfitted stent coating system to a wide range of customers that are manufacturing stents and/or applying coatings to be used in developmental trials. We have also introduced and sold a production oriented stent coater known as Medicoat II. In addition, we are selling an increasing number of specialized medical implant coating devices now.

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

More recently, we have also invested time and money in developing equipment solutions for applications in the solar cell and fuel cell clean energy markets. We have seen significant growth in these markets and are serving them with our Exactacoat, Flexicoat and Hypersonic products. We now have four diversified market/application areas, which creates a stable base for all of our business.

In our four core areas: the electronics, medical device, advanced energy and WideTrack coating markets, it has been incumbent upon us to focus our attention and resources on the development of a much greater international presence. We believe we have accomplished this and plan to continue our marketing efforts. Our international sales have risen from approximately 20% of total revenues in Fiscal Year 2003 to approximately 60% today. This geographic market diversity in North America, Europe, Latin America and Asia is expected to provide us with additional business stability going forward.

The creation of technological innovations and markets and the expansion into new geographical markets requires the investment of both time and capital. Although there is no guarantee of success, we expect that over time, these newer markets will be the basis for Sono-Tek's continued growth and will contribute to future profitability.

Liquidity and Capital Resources

Working Capital – Our working capital increased $881,000 from $3,322,000 at February 28, 2011 to $4,203,000 at August 31, 2011. The increase in working capital is primarily a result of the current period's net income. The Company's current ratio is 3.2 to 1 at August 31, 2011 as compared to 3.1 to 1 at February 28, 2011.

During the six months ended August 31, 2010, our inventories increased approximately $799,000. The increase is a result of our increased sales volume during the period. During the current period, our raw material inventory increased $339,000, finished good increased $276,000 and work in process increased $184,000. The increase in inventory is due to an increase in committed orders based upon our backlog at August 31, 2011.

Stockholders' Equity – Stockholder's Equity increased $702,000 from $4,317,000 at February 28, 2011 to $5,019,000 at August 31, 2011. The increase is a result of net income of $676,000, and an adjustment for stock based compensation expense of $26,000.

Operating Activities – Our operating activities provided $303,000 of cash for the six months ended August 31, 2011 as compared to providing $92,000 for the six months ended August 31, 2010. During the six months ended August 31, 2011, accounts receivable decreased $30,000, inventory increased $799,000, prepaid expenses increased $41,000, accounts payable and accrued expenses increased $81,000 and customer deposits increased $169,000. In addition, we incurred non-cash expenses of $154,000 for depreciation and amortization, $26,000 for stock based compensation expense and $6,000 for bad debt expense.

Investing Activities – During the six months ended August 31, 2011, we used $112,000 for the purchase of capital equipment and $5,000 for patent application costs. During the six months ended August 31, 2010, we used $60,000 for the purchase of capital equipment and $7,000 for patent application costs.

Financing Activities – During the six months ended August 31, 2011, we had proceeds from equipment financing of $237,000. For the six months ended August 31, 2011 and 2010, we used $41,000 and $9,000, respectively for the repayment of our notes payable.

Results of Operations

For the six months ended August 31, 2011, our sales increased $1,423,000 or 30% to $6,139,000 as compared to $4,716,000 for the six months ended August 31, 2010. During the six month period ended August 31, 2011, we experienced an increase in sales of our nozzles and generators, fluxer spare parts, stent coating units, XYZ units and hypersonic units.

For the three months ended August 31, 2011, our sales increased $718,000 to $3,150,000 or 30% as compared to $2,432,000 for the three months ended August 31, 2010. During the three month period ended August 31, 2011, we experienced an increase in sales of our nozzles and generators, stent coating units and fluxer units.

For the six months ended August 31, 2011, our gross profit increased $879,000 to $3,112,000 from $2,233,000 for the six months ended August 31, 2010. The gross profit margin was 51% of sales for the six months ended August 31, 2011 and 47% of sales for the six months ended August 31, 2010. The increase in our gross profit margin for the six months ended August 31, 2011 is due to an increase in sales of our nozzles and generators, fluxer spare parts, stent coating units, XYZ units and hypersonic units.

For the three months ended August 31, 2011, our gross profit increased $562,000 to $1,678,000 from $1,116,000 for the three months ended August 31, 2010. The gross profit margin was 53% of sales for the three months ended August 31, 2011 and 46% of sales for the three months ended August 31, 2010. The increase in our gross profit margin for the three months ended August 31, 2011 is due to an increase in sales of our nozzles and generators, fluxer spare parts, stent coating units.

Research and product development costs increased $142,000 to $540,000 for the six months ended August 31, 2011 from $398,000 for the six months ended August 31, 2010 and $96,000 to $285,000 for the three months ended August 31, 2011 from $189,000 for the three months ended August 31, 2010. The increases were due to increases in salary expense for additional engineering personnel in the current periods and increased expenditures for research and development materials.

Marketing and selling expenses increased $115,000 to $1,148,000 for the six months ended August 31, 2011 from $1,033,000 for the six months ended August 31, 2010 and $70,000 to $581,000 for the three months ended August 31, 2011 from $511,000 for the three months ended August 31, 2010. During the six months ended August 31, 2011, we experienced increases in salary expense due to the addition of personnel, travel expense and trade show expense. For the three months ended August 31, 2011, we experienced increases in salary expense, commission expense, travel expense and trade show expense. During the three months ended August 31, 2011, commission expense increased but not in proportion with the increase in sales, this is due to the mix of sales in the quarter.

General and administrative costs increased $51,000 to $627,000 for the six months ended August 31, 2011 from $576,000 for the six months ended August 31, 2010 and $35,000 to $324,000 for the three months ended August 31, 2011 from $289,000 for the three months ended August 31, 2010. The increases were principally due to an increase in consulting fees, professional fees and other corporate expenses.

The six and three months ended August 31, 2010 includes rent expense of $68,454 and $34,519 allocated as follows:

	Six months ended	Three months ended
	August 31, 2010	
Cost of Good Sold	$28,107	$14,371
Research and Development	$17,673	$8,826
Marketing and Selling	$13,392	$6,684
General and Administrative	$9,282	$4,638
	$68,454	$34,519

The six and three months ended August 31, 2011 results do not include any rental expense as all inter company transactions are eliminated in consolidation due to our purchase of the Sono-Tek Industrial Park in December 2010.

Rental Real Estate Operations:

For the six and three months ended August 31, 2011 the results of our rental real estate operations are as follows:

	Six months ended	Three months ended
	August 31, 2011	
Rental Income	$44,686	$22,344
Depreciation	$28,638	$14,319
Insurance	$7,060	$4,810
Grounds and Landscaping	$12,850	$11,056
Property taxes	$14,737	$9,260
Miscellaneous	$508	$432
Loss before Interest	$(19,107)	$(17,533)
Interest expense	$57,282	$28,540
Net Loss	$(76,389)	$(46,073)

It should be noted that the Company’s elimination of rental expense as detailed in the results of operations was replaced by rental operations expense as detailed in the above table.

Consolidated Results:

We had net income of $676,000 for the six months ended August 31, 2011 as compared to net income of $221,000 for the six months ended August 31, 2010. During the three months ended August 31, 2011 we had net income of $438,000 as compared to net income of $126,000 for the three months ended August 31, 2010. Our results for the six and three months ended August 31, 2011 were improved over the same period last year due to an increase in sales and gross profit.

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, 2011.

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.

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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 $2,066,000 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, 2011. 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 2012 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. Reserved

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: October 12, 2011

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