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SONO TEK CORP
Form 10QSB
July 13, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended: May 31, 2006

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 small business issuer 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 small business issuer (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 small business issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

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 June 16, 2006 -----
Common Stock, par value \$.01 per share	14,360,541

SONO-TEK CORPORATION

INDEX

Part I - Financial Information	Page
Item 1 - Consolidated Financial Statements:	1 - 3

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Consolidated Balance Sheets - May 31, 2006 (Unaudited) and February 28, 2006	1
Consolidated Statements of Income - Three Months Ended May 31, 2006 and 2005 (Unaudited)	2
Consolidated Statements of Cash Flows - Three Months Ended May 31, 2006 and 2005 (Unaudited)	3
Notes to Consolidated Financial Statements	4 - 6
Item 2 - Management's Discussion and Analysis or Plan of Operations	7 - 11
Item 3 - Controls and Procedures	12
Part II - Other Information	13
Signatures and Certifications	14 - 21

SONO-TEK CORPORATION CONSOLIDATED BALANCE SHEETS

ASSETS

	May 31, 2006 Unaudited	
Current Assets	-----	-----
Cash and cash equivalents	\$ 1,769,012	\$
Accounts receivable (less allowance of \$22,150 and \$18,500 at May 31 and February 28, respectively)	1,051,350	
Inventories	1,684,971	
Prepaid expenses and other current assets	75,364	
Deferred tax asset	270,000	
	-----	-----
Total current assets	4,850,697	-----
	-----	-----
Equipment, furnishings and leasehold improvements (less accumulated depreciation of \$797,836 and \$788,245 at May 31 and February 28, respectively)	256,334	
Intangible assets, net	30,770	
Other assets	7,171	
Deferred tax asset	315,000	
	-----	-----
TOTAL ASSETS	\$ 5,459,972	\$
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:		
Accounts payable	\$ 396,250	\$
Accrued expenses	584,325	
Current maturities of long term debt	26,091	
	-----	-----
Total current liabilities	1,006,666	

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Long term debt, less current maturities	72,071	

Total liabilities	1,078,737	

Commitments and Contingencies	--	
Stockholders' Equity		
Common stock, \$.01 par value; 25,000,000 shares authorized, 14,360,541 and 14,354,416 shares issued and outstanding at May 31 and February 28, respectively	143,606	
Additional paid-in capital	8,273,457	
Stock subscription receivable	(15,750)	
Accumulated deficit	(4,020,078)	

Total stockholders' equity	4,381,235	

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 5,459,972	\$
	=====	==

See notes to consolidated financial statements.

1

SONO-TEK CORPORATION
CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended May 31,	

	Unaudited	
	2006	2005
	-----	-----
Net Sales	\$ 1,781,744	\$ 1,832,364
Cost of Goods Sold	953,123	944,278
	-----	-----
Gross Profit	828,621	888,086
	-----	-----
Operating Expenses		
Research and product development costs	179,510	145,773
Marketing and selling expenses	320,488	311,558
General and administrative costs	219,186	199,293
	-----	-----
Total Operating Expenses	719,184	656,624
	-----	-----
Operating Income	109,437	231,462
Interest Expense	(1,294)	(2,761)
Interest Income	13,857	947
Other Income	2,831	--
	-----	-----
	15,394	(1,814)
Income from Operations Before Income Taxes	124,831	229,648

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Income Tax Expense	--	(250)
	-----	-----
Net Income	\$ 124,831	\$ 229,398
	=====	=====
Basic Earnings Per Share	\$ 0.01	\$ 0.02
	=====	=====
Diluted Earnings Per Share	\$ 0.01	\$ 0.02
	=====	=====
Weighted Average Shares - Basic	14,358,140	13,952,488
	=====	=====
Weighted Average Shares - Diluted	14,468,868	14,386,259
	=====	=====

See notes to consolidated financial statements.

2

SONO-TEK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	

	Unaudited	
	2006	

CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	\$ 124,831	\$
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	18,838	
Provision for doubtful accounts	3,650	
Stock based compensation expense	23,879	
Decrease (Increase) in:		
Accounts receivable	(99,906)	
Inventories	(164,574)	
Prepaid expenses and other current assets	(7,340)	
Increases in:		
Accounts payable and accrued expenses	151,370	
Net Cash Provided By (Used In) Operating Activities	50,748	
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of equipment and furnishings	(18,721)	
Net Cash Used In Investing Activities	(18,721)	
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Line of credit repayment	--	

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Proceeds from exercise of stock options and warrants	2,548	
Proceeds from issuance of stock	--	
Proceeds (Repayments) of notes payable	(6,367)	
	-----	-----
Net Cash (Used In) Provided By Financing Activities	(3,819)	-----
	-----	-----
 NET INCREASE IN CASH AND CASH EQUIVALENTS	 28,208	
 CASH AND CASH EQUIVALENTS		
Beginning of period	1,740,804	
	-----	-----
End of period	\$ 1,769,012	\$
	=====	=====
 SUPPLEMENTAL DISCLOSURE:		
Interest paid	\$ 1,294	\$
	=====	=====
Income taxes paid	\$ --	\$
	=====	=====

See notes to consolidated financial statements.

3

SONO-TEK CORPORATION Notes to Consolidated Financial Statements Three Months Ended May 31, 2006 and 2005

NOTE 1: SIGNIFICANT ACCOUNTING POLICIES

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

Cash and Cash Equivalents - Cash and cash equivalents consist of money market mutual funds, short term commercial paper and short term certificates of deposit with original maturities of 90 days or less.

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, 2006, and included in its report on Form 10-KSB. Such statements should be read in conjunction with the data herein.

The financial information reflects all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. 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

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charged to operations over seventeen years for domestic patents and twelve years for foreign patents. The accumulated amortization is \$50,833 and \$49,780 at May 31, 2006 and February 28, 2006, respectively.

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

4

NOTE 2: INVENTORIES

Inventories at May 31, 2006 are comprised of:

Finished goods	\$ 547,689
Work in process	644,945
Consignment	6,746
Raw materials and subassemblies	729,571

Total	1,928,951
Less: Allowance	(243,980)

Net inventories	\$ 1,684,971
	=====

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, 2006 there were 121,500 options outstanding under the 1993 Plan and 807,875 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 Company previously accounted for stock-based compensation issued to its employees using the intrinsic value method. Accordingly, compensation cost for stock options issued was measured as the excess, if any, of the fair value of our common stock at the date of grant over the exercise price of the options. The pro forma net earnings per share amounts as if the fair value method had been used are presented below for the three months ended May 31, 2005 and the actual net earnings per share are presented below for the three months ended May 31, 2006 in accordance with the Company's adoption of SFAS 123(R) effective March 1, 2006.

For purposes of the following disclosures during the transition period of adoption of SFAS 123(R), the weighted-average fair value of options has been estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted-average assumptions used: expected volatility

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ranging from 40% to 109%; risk-free interest rate ranging from 4% to 3.25%; and an expected four-year term for options granted. For the quarter ended May 31, 2006, the net income and earnings per share reflect the actual deduction for option expense as compensation. The total option expense for the quarter ended May 31, 2006 was \$23,879. Compensation recorded for stock options is a non-cash expense item.

5

Had the compensation cost for the quarter ended May 31, 2005 been determined based on the fair value at the grant, the Company's net income and basic and diluted earnings per share would have been reduced to the pro forma amount for that period indicated below.

	Three Months Ended May 31, 2005 -----
Net Income as reported	\$229,398
Deduct: Total stock based employee compensation under intrinsic value based method for all awards, net of tax effects	53,111 -----
Pro forma net income (loss)	\$176,287 =====
Basic and diluted earnings per share:	
As reported	\$ 0.02
Pro-forma	\$ 0.01

NOTE 5: EARNINGS PER SHARE

The denominator for the calculation of diluted earnings per share at May 31, 2006 and 2005 are calculated as follows:

	May 31, 2006 -----	May 31, 2005 -----
Denominator for basic earnings per share	14,358,140	13,952,488
Dilutive effect of warrants	--	51,888
Dilutive effect of stock options	110,728 -----	381,883 -----
Denominator for diluted earnings per share	14,468,868 =====	14,386,259 =====

NOTE 6: OTHER INCOME

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

The Company recovered \$2,831 during the three months ended May 31, 2006 and \$157,605 during the year ended February 28, 2006. The Company is pursuing appropriate remedies to recover the balance of the funds. As previously discussed, the Company can offer no assurances that it will be successful in its

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attempts to collect the balance of the remaining restitution.

6

SONO-TEK CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

Forward-Looking Statements

We discuss expectations regarding our future performance, such as our business outlook, in our annual and quarterly reports, press releases, and other written and oral statements. These "forward-looking statements" are based on currently available competitive, financial and economic data and our operating plans. They are inherently uncertain, and investors must recognize that events could turn out to be significantly different from our expectations. The following risks are by no means all inclusive but are designed to highlight what we believe are important factors to consider when evaluating our trends and future results.

- Our ability to respond to competition in national and global markets.
- General economic conditions in our markets.

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

Overview

Sono-Tek has developed a unique and proprietary series of ultrasonic atomization nozzles, which are being used in an increasing variety of electronic, 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.

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 lower material cost, fewer chemicals in the workplace, and less clean-up. Also, the SonoFlux equipment reduces the number of soldering defects, which reduces the level of rework.

In the past three years, we have focused engineering resources on the medical device market, with emphasis on providing coating solutions for the new generation of drug coated stents. We have sold a significant number of specialized ultrasonic nozzles and MediCoat stent coating systems to large medical device customers. Sono-Tek's stent coating systems are superior compared to pressure nozzles in their ability to uniformly coat the very small arterial stents without creating webs or gaps in the coatings. We also 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 committed engineering resources to develop a general industrial coating product, the WideTrack coating system, which is finding increasing applications in the glass, food and textile manufacturing industries. The

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WideTrack is saving customers money by reducing the use of materials and lessening the environmental impact by significantly reducing overspray, which is common with other types of coating systems.

7

One of the new markets we are participating in is nanotechnology. We have been able to enter this market with our SonoDry nozzle spraying system and WideTrack technology.

In conclusion, while the current quarter sales are slightly below the previous year, our sales levels have increased over time. The increase in sales is the result of an improved economy, product development efforts, and related marketing thrusts which have had the effects of improving net income, reducing debt, and increasing stockholders' equity.

Liquidity and Capital Resources

Working Capital - Our working capital increased \$145,000 from a working capital of \$3,699,000 at February 28, 2006 to \$3,844,000 at May 31, 2006. The Company's current ratio is 4.82 to 1 at May 31, 2006 as compared to 5.33 to 1 at February 28, 2006.

Inventory increased \$165,000 from \$1,520,000 to \$1,685,000 as the result of diversification of the Company's product lines and an increase in finished goods for anticipated future sales.

Stockholders' Equity - Stockholder's Equity increased \$151,000 from \$4,230,000 at February 28, 2006 to \$4,381,000 at May 31, 2006. The increase is the result of net income of \$125,000, stock option exercises of \$2,500 and an adjustment for stock based compensation expense of \$24,000.

Operating Activities - Our operations provided \$51,000 of cash for the three months ended May 31, 2006, an increase of \$105,000 when compared to the three months ended May 31, 2005.

Investing Activities - We used \$19,000 for the purchase of capital equipment during the three months ended May 31, 2006 compared to the use of \$74,000 during the three months ended May 31, 2005.

Financing Activities - For the three months ended May 31, 2006, we used \$3,800 in financing activities resulting from the repayment of our notes payable \$6,400 and the proceeds of stock option exercises of \$2,500. For the three months ended May 31, 2005, the net cash provided by financing activities was \$298,000 resulting from: the issuance of stock and stock option exercises of \$607,000, repayment of the outstanding line of credit of \$350,000 and the proceeds of notes payable of \$41,000.

8

Results of Operations

For the three months ended May 31, 2006, our sales decreased \$51,000 or 3% to \$1,782,000 as compared to \$1,832,000 for the three months ended May 31, 2005. During the quarter ended May 31, 2006, sales of both WideTrack and EVS units decreased when compared to the quarter ended May 31, 2005. The decrease in sales of these units was offset by an increase in sales of our Nozzles and Fluxer units.

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Our gross profit decreased \$59,000 to \$829,000 for the three months ended May 31, 2006 from \$888,000 for the three months ended May 31, 2005. The gross profit margin was 46.5% of sales for the three months ended May 31, 2006 as compared to 48.5% of sales for the three months ended May 31, 2005. The decrease in gross profit is due to a decrease in sales and an increase in our field service expenses related to travel, customer training and increased payroll costs.

Research and product development costs increased \$34,000 to \$180,000 for the three months ended May 31, 2006 from \$146,000 for the three months ended May 31, 2005. The increase was principally due to an increase in engineering personnel and increased purchases of research and development materials in the current period.

Marketing and selling costs increased \$8,000 to \$320,000 for the three months ended May 31, 2006 from \$312,000 for the three months ended May 31, 2005. The increase was due principally to increased travel expenses.

General and administrative costs increased \$20,000 to \$219,000 for the three months ended May 31, 2006 from \$199,000 for the three months ended May 31, 2005. The increase was principally due to recording the current period stock based compensation expense of \$24,000. We are now required to directly expense the effects of stock based compensation expense, a non-cash expense item.

Our net income was \$125,000 for the three months ended May 31, 2006 as compared to \$229,000 for three months ended May 31, 2005. The decrease is due to a decrease in sales of \$51,000, an increase in research and product development costs of \$34,000, an increase in marketing and selling costs of \$9,000 and the effects of stock based compensation expense of \$24,000.

The Company's backlog of firm orders was \$ 426,000 at May 31, 2006. All of these orders are deliverable before the end of the Company's current fiscal year, which is February 28, 2007.

As previously disclosed on Form 8-K, filed on July 5, 2005, the Company determined that a former employee had misappropriated Company monies, primarily through unauthorized check writing from Company accounts over a period of time. The Company has previously expensed these monies and the net effect on the Company's results for the quarter ended May 31, 2005 is an increase in expenses of approximately \$18,000.

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 the one described below. For a detailed discussion on the application of this and other

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accounting policies see Note 2 to the Company's consolidated financial statements included in Form 10-KSB for the year ended February 28, 2006.

Accounting for Income Taxes

As part of the process of preparing the Company's consolidated financial statements, the Company is required to estimate its income taxes. Management judgment is required in determining the provision on its deferred tax asset. During the fourth quarter of the year ended February 29, 2004, the Company reduced the valuation reserve for the deferred tax asset resulting from the net operating losses carried forward due to the Company having demonstrated consistent profitable operations. In the event that actual results differ from these estimates, the Company may need to again adjust such valuation reserve.

Impact of New Accounting Pronouncements

FASB 123 (revised 2004) - Share-Based Payments

In December 2004, the FASB issued a revision to FASB Statement No. 123, Accounting for Stock Based Compensation. This Statement supercedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. This Statement does not change the accounting guidance for share-based payment transactions with parties other than employees provided in Statement 123 as originally issued and EITF Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services." This Statement does not address the accounting for employee share ownership plans, which are subject to AICPA Statement of Position 93-6, Employers' Accounting for Employee Stock Ownership Plans.

A nonpublic entity will measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of those instruments, except in certain circumstances.

A public entity will initially measure the cost of employee services received in exchange for an award of liability instruments based on its current fair value; the fair value of that award will be re-measured subsequently at each reporting date through the settlement date. Changes in fair value during the requisite service period will be recognized as compensation cost over that period. A nonpublic entity may elect to measure its liability awards at their intrinsic value through the date of settlement.

10

The grant-date fair value of employee share options and similar instruments will be estimated using the option-pricing models adjusted for the unique characteristics of those instruments (unless observable market prices for the same or similar instruments are available).

Excess tax benefits, as defined by this Statement, will be recognized as an addition to paid-in-capital. Cash retained as a result of those excess tax benefits will be presented in the statement of cash flows as financing cash inflows. The write-off of deferred tax assets relating to unrealized tax

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benefits associated with recognized compensation cost will be recognized as income tax expense unless there are excess tax benefits from previous awards remaining in paid-in capital to which it can be offset.

The notes to the financial statements of both public and nonpublic entities will disclose information to assist users of financial information to understand the nature of share-based payment transactions and the effects of those transactions on the financial statements.

For public entities that file as small business issuers the effective date will be as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. Management intends to comply with this Statement at the scheduled effective date for the relevant financial statements of the Company.

11

SONO-TEK CORPORATION CONTROLS AND PROCEDURES

The Company has established and maintains "disclosure controls and procedures" (as those terms are defined in Rules 13a -14(c) and 15d- 14(c) under the Securities and Exchange Act of 1934 (the "Exchange Act"). Christopher L. Coccio, Chief Executive Officer and President (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, 2006. Based on this evaluation, they have concluded that the Company's disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by SEC rules and forms.

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls after May 31, 2006. There were no significant deficiencies or material weaknesses, and therefore there were no corrective actions taken.

12

PART II - OTHER INFORMATION

- Item 1. Legal Proceedings
None
- Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.
None
- Item 3. Defaults Upon Senior Securities
None
- Item 4. Submission of Matters to a Vote of Security Holders
None
- Item 5. Other Information
None
- Item 6. Exhibits and Reports
 - (a) Exhibits

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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.

13

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 12, 2006

SONO-TEK CORPORATION
(Registrant)

By: /s/ Christopher L. Coccio

Christopher L. Coccio
Chief Executive Officer and President

By: /s/ Stephen J. Bagley

Stephen J. Bagley
Chief Financial Officer

14