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SONO TEK CORP  
Form 10QSB  
January 12, 2007

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: November 30, 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

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<br>January 9, 2007 |
|---|--------------------------------------|
| -----                                   | -----                                |
| Common Stock, par value \$.01 per share | 14,360,541                           |

SONO-TEK CORPORATION

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### SONO-TEK CORPORATION CONSOLIDATED BALANCE SHEETS

|   | November 30,<br>2006<br>Unaudited<br>----- | February 28,<br>2006<br>----- |
|---|--|-------------------------------|
| ASSETS  |  |                               |
| Current Assets:   |  |                               |
| Cash and cash equivalents   | \$ 2,147,896                               | \$ 1,740,804                  |
| Accounts receivable (less allowance of \$23,900 and \$18,500<br>at November 30 and February 28, respectively)   | 869,232                                    | 955,094                       |
| Inventories   | 1,519,429                                  | 1,520,397                     |
| Prepaid expenses and other current assets   | 68,290                                     | 68,024                        |
| Deferred tax asset  | 270,000                                    | 270,000                       |
|   | -----                                      | -----                         |
| Total current assets  | 4,874,847                                  | 4,554,319                     |
|   | -----                                      | -----                         |
| Equipment, furnishings and leasehold improvements<br>(less accumulated depreciation of \$851,029 and<br>\$788,245 at November 30 and February 28, respectively) | 366,777                                    | 257,299                       |
| Intangible assets, net  | 31,502                                     | 29,922                        |
| Other assets  | 7,171                                      | 7,171                         |
| Deferred tax asset  | 315,000                                    | 315,000                       |
|   | -----                                      | -----                         |
| TOTAL ASSETS  | \$ 5,595,297<br>=====                      | \$ 5,163,711<br>=====         |

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## LIABILITIES AND STOCKHOLDERS' EQUITY

|   |              |              |
|---|--------------|--------------|
| Current Liabilities:  |              |              |
| Accounts payable  | \$ 148,017   | \$ 330,701   |
| Accrued expenses  | 606,557      | 498,504      |
| Current maturities of long term debt  | 26,938       | 25,415       |
|   | -----        | -----        |
| Total current liabilities   | 781,512      | 854,620      |
| Long term debt, less current maturities   | 58,492       | 79,114       |
|   | -----        | -----        |
| Total liabilities   | 840,004      | 933,734      |
|   | -----        | -----        |
| Commitments and Contingencies   | --           | --           |
| Stockholders' Equity  |              |              |
| Common stock, \$.01 par value; 25,000,000 shares authorized,<br>14,360,541 and 14,354,416 shares issued and outstanding<br>at November 30 and February 28, respectively | 143,606      | 143,545      |
| Additional paid-in capital  | 8,299,536    | 8,247,091    |
| Stock subscription receivable   | (15,750)     | (15,750)     |
| Accumulated deficit   | (3,672,099)  | (4,144,909)  |
|   | -----        | -----        |
| Total stockholders' equity  | 4,755,293    | 4,229,977    |
|   | -----        | -----        |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY  | \$ 5,595,297 | \$ 5,163,711 |
|   | =====        | =====        |

See notes to consolidated financial statements.

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## SONO-TEK CORPORATION

### CONSOLIDATED STATEMENTS OF INCOME

|  | Nine Months Ended November 30,<br>Unaudited |              | Three Months Ende<br>Unaudit |
|--|---|--------------|------------------------------|
|  | 2006  | 2005         | 2006                         |
|  | -----                                       | -----        | -----                        |
| Net Sales                              | \$ 5,239,698                                | \$ 5,082,730 | \$ 1,624,015                 |
| Cost of Goods Sold                     | 2,624,967                                   | 2,596,543    | 812,990                      |
|  | -----                                       | -----        | -----                        |
| Gross Profit                           | 2,614,731                                   | 2,486,187    | 811,025                      |
|  | -----                                       | -----        | -----                        |
| Operating Expenses                     |   |              |                              |
| Research and product development costs | 596,624                                     | 446,512      | 219,289                      |
| Marketing and selling expenses         | 965,940                                     | 831,605      | 305,604                      |
| General and administrative costs       | 629,188                                     | 600,711      | 190,393                      |
|  | -----                                       | -----        | -----                        |
| Total Operating Expenses               | 2,191,752                                   | 1,878,828    | 715,286                      |

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|  | -----      | -----      | -----      |
|--|------------|------------|------------|
| Operating Income                           | 422,979    | 607,359    | 95,739     |
| Interest Expense                           | (4,834)    | (4,642)    | (1,526)    |
| Interest Income                            | 49,254     | 7,811      | 20,380     |
| Other Income                               | 8,692      | 56,100     | 2,831      |
|  | -----      | -----      | -----      |
| Income from Operations Before Income Taxes | 476,091    | 666,628    | 117,424    |
| Income Tax Expense                         | 3,281      | 250        | 3,281      |
|  | -----      | -----      | -----      |
| Net Income                                 | \$ 472,810 | \$ 666,378 | \$ 114,143 |
|  | =====      | =====      | =====      |
| <br>                                       |            |            |            |
| Basic Earnings Per Share                   | \$ 0.03    | \$ 0.05    | \$ 0.01    |
|  | =====      | =====      | =====      |
| Diluted Earnings Per Share                 | \$ 0.03    | \$ 0.05    | \$ 0.01    |
|  | =====      | =====      | =====      |
| Weighted Average Shares - Basic            | 14,359,738 | 14,111,339 | 14,204,448 |
|  | =====      | =====      | =====      |
| Weighted Average Shares - Diluted          | 14,456,779 | 14,417,106 | 14,298,155 |
|  | =====      | =====      | =====      |

See notes to consolidated financial statements.

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SONO-TEK CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | Nine Months Ended Nov | Unaudited |
|---|-----------------------|-----------|
|   | 2006                  | -----     |
|   | -----                 | -----     |
| CASH FLOWS FROM OPERATING ACTIVITIES:   |                       |           |
| Net Income  | \$ 472,810            | \$        |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                       |           |
| Depreciation and amortization   | 85,530                |           |
| Provision for doubtful accounts   | 5,800                 |           |
| Stock based compensation expense  | 49,958                |           |
| Gain on sale of equipment   | 17,723                |           |
| Decrease (Increase) in:   |                       |           |
| Accounts receivable   | 80,462                |           |
| Inventories   | 968                   |           |
| Prepaid expenses and other current assets   | (266)                 |           |
| (Decrease) Increase in:   |                       |           |

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|  |                |       |
|--|----------------|-------|
| Accounts payable and accrued expenses                | (74,631)       |       |
|  | -----          |       |
| Net Cash Provided By Operating Activities            | 638,354        |       |
|  | -----          |       |
| <b>CASH FLOW FROM INVESTING ACTIVITIES:</b>          |                |       |
| Patent Application Costs                             | (5,021)        |       |
| Purchase of equipment and furnishings                | (209,690)      |       |
|  | -----          |       |
| Net Cash (Used In) Investing Activities              | (214,711)      |       |
|  | -----          |       |
| <b>CASH FLOW FROM FINANCING ACTIVITIES:</b>          |                |       |
| Line of Credit Repayment                             | --             |       |
| Proceeds from exercise of stock options and warrants | 2,548          |       |
| Proceeds from issuance of stock                      | --             |       |
| Repayments of notes payable and loans                | (19,099)       |       |
| Proceeds from Notes Payable                          | --             |       |
|  | -----          |       |
| Net Cash Provided by (Used In) Financing Activities  | (16,551)       |       |
|  | -----          |       |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>     | <b>407,092</b> |       |
| <b>CASH AND CASH EQUIVALENTS</b>                     |                |       |
| Beginning of period                                  | 1,740,804      |       |
|  | -----          |       |
| End of period  | \$ 2,147,896   | \$    |
|  | -----          | ===== |
|  | -----          | ===== |
| <b>SUPPLEMENTAL DISCLOSURE:</b>                      |                |       |
| Interest paid  | \$ 4,552       | \$    |
|  | -----          | ===== |
|  | -----          | ===== |

See notes to consolidated financial statements.

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SONO-TEK CORPORATION  
Notes to Consolidated Financial Statements  
Nine Months Ended November 30, 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, and 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

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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, consisting of 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 \$53,220 and \$49,780 at November 30, 2006 and February 28, 2006, respectively.

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

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### NOTE 2: INVENTORIES

Inventories at November 30, 2006 are comprised of:

|                                 |             |
|---------------------------------|-------------|
| Finished goods                  | \$280,562   |
| Work in process                 | 645,228     |
| Consignment                     | 9,605       |
| Raw materials and subassemblies | 799,318     |
|                                 | -----       |
| Total                           | 1,734,713   |
| Less: Allowance                 | (215,284)   |
|                                 | -----       |
| Net inventories                 | \$1,519,429 |
|                                 | =====       |

### 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. During the nine months ended November 30, 2006, the Board of Directors approved the issuance of 30,000 options. As of November 30, 2006, there were 119,000 options outstanding under the 1993 Plan and 815,375 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

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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.

A summary of the activity of both plans for the nine months ended November 30, 2006 is as follows:

|   |         |
|---|---------|
| Stock Options Outstanding February 28, 2006 | 935,500 |
| Granted                                     | 30,000  |
| Expired                                     | 25,000  |
| Exercised                                   | 6,125   |
|   | -----   |
| Stock Options Outstanding November 30, 2006 | 934,375 |
|   | =====   |

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#### NOTE 4: STOCK-BASED COMPENSATION

On March 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) 123R, Share-Based Payment, under the modified prospective method. The Company had previously accounted for stock-based compensation plans under the fair value provisions of SFAS 123. The adoption of SFAS 123 did not significantly impact the Company's financial position or results of operations. Under SFAS 123R, actual tax benefits recognized in excess of tax benefits previously established upon grant are reported as a financing cash inflow. Prior to adoption, such excess tax benefits were reported as an increase to operating cash flows.

During the transition period of the Company's adoption of SFAS 123R, 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 ranging from 40% to 109%; risk-free interest rate ranging from 3.25% to 4%; and an expected four-year term for options granted.

For the nine months ended November 30, 2006, net income and earnings per share reflect the actual deduction for stock-based compensation expense. The total stock-based compensation expense for the nine months ended November 30, 2006 was \$49,958. The expense for stock-based compensation is a non-cash expense item.

Under the requirements of FAS 123R, the Company is not required to restate prior period earnings, however, the Company is required to supplement its financial statements with additional pro forma disclosures. Had compensation cost for the Company's stock option plan been determined based on the fair value at the date of grant, the Company's net income and basic and diluted earnings per share would have been reduced to the pro forma amounts for the periods indicated below.

|   | Nine Months Ended<br>November 30, 2005<br>----- | Three Months Ended<br>November 30, 2005<br>----- |
|---|---|--|
| Net Income:   |   |  |
| As reported   | \$666,378                                       | \$280,203  |
| Deduct: Stock based employee<br>compensation expense under<br>fair value based method for all<br>awards, net of tax effects | 27,029  | 7,816  |

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|                                       |                             |                             |
|---------------------------------------|-----------------------------|-----------------------------|
| Pro forma net income                  | -----<br>\$639,349<br>===== | -----<br>\$272,387<br>===== |
| Basic and diluted earnings per share: |                             |                             |
| As reported                           | \$ 0.05                     | \$ 0.02                     |
| Pro forma                             | \$ 0.04                     | \$ 0.02                     |

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NOTE 5: EARNINGS PER SHARE

The denominator for the calculation of diluted earnings per share at November 30, 2006 and 2005 are calculated as follows:

|  | Nine Months Ended<br>November 30, |            | Three Months Ended<br>November 30, |          |
|--|-----------------------------------|------------|------------------------------------|----------|
|  | 2006                              | 2005       | 2006                               | 2005     |
|  | -----                             | -----      | -----                              | -----    |
| Denominator for basic earnings per share   | 14,359,738                        | 14,111,339 | 14,204,448                         | 14,048,2 |
| Dilutive effect of warrants                | --                                | 41,010     | --                                 | 1,5      |
| Dilutive effect of stock options           | 97,041                            | 264,757    | 93,707                             | 113,4    |
|  | -----                             | -----      | -----                              | -----    |
| Denominator for diluted earnings per share | 14,456,779                        | 14,417,106 | 14,298,155                         | 14,163,2 |
|  | =====                             | =====      | =====                              | =====    |

NOTE 6: OTHER INCOME

As previously disclosed 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 \$8,492 during the nine months ended November 30, 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 attempt to collect the balance of the remaining restitution.

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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

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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 had a well established position in the domestic electronics assembly industry for many years, based on our SonoFlux spray fluxing equipment, which accounted for a significant portion of our business. Our SonoFlux equipment 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.

Several years ago, we recognized that the trend in the electronics assembly industry was a move toward offshore production into China and other developing countries. The change in the global structure of this business created the need for Sono-Tek to change as well.

One change that has proven to be successful is our diversification into the medical device market. 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

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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.

Another change 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) and solar and fuel

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cell industries. We plan to increase our marketing efforts into the broader textile and food industry markets. This will require a continuation of market and technology development in these areas in the years ahead. Some of these WideTrack 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.

In the electronics, medical device 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 over 54% today, and we expect to increase that percentage in the years ahead.

Past history shows the cyclical nature of the electronics business. This cycle, coupled with the increasing trend toward moving electronics production offshore, created a need to diversify. As expected, our US based electronics business has declined this year and is approximately 20% below previous levels, as a result of the trend toward production moving offshore, coupled with a slower economy and the reduced competitiveness of our US based automotive customers. We have been able to offset this reduction in US electronics sales with an increase in our international electronics, medical device and WideTrack coating sales.

The creation of technological innovations and the expansion into new geographical markets requires the investment of both time and capital. These investments are clearly shown in the year over year increase in both R&D and Marketing and Sales expenses, resulting in a reduction in our reported net income. However, the Company is in a good position to make these expenditures based on its strong balance sheet with an excellent cash position and virtually no debt. 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. It is management's opinion that this strategy will be a better one than being bound to a shrinking domestic market.

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### Liquidity and Capital Resources

**Working Capital** - Our working capital increased \$394,000 from a working capital of \$3,699,000 at February 28, 2006 to \$4,093,000 at November 30, 2006. The Company's current ratio is 6.24 to 1 at November 30, 2006 as compared to 5.33 to 1 at February 28, 2006.

**Stockholders' Equity** - Stockholder's Equity increased \$525,000 from \$4,230,000 at February 28, 2006 to \$4,755,000 at November 30, 2006. The increase is the result of net income of \$473,000, stock option exercises of \$2,500 and an adjustment for stock based compensation expense of \$50,000.

**Operating Activities** - Our operations provided \$638,000 of cash for the nine months ended November 30, 2006, an increase of \$333,000 when compared to the nine months ended November 30, 2005.

**Investing Activities** - We used \$215,000 for the purchase of capital equipment and patent application costs during the nine months ended November 30, 2006 compared to the use of \$135,000 during the nine months ended November 30, 2005.

**Financing Activities** - For the nine months ended November 30, 2006, we used \$16,500 in financing activities resulting from the repayment of notes payable of \$19,000 and the proceeds of stock option exercises of \$2,500. For the nine months ended November 30, 2005, the net cash provided by financing activities

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was \$343,000 resulting from: the issuance of stock and stock option exercises of \$623,000, repayment of the outstanding line of credit of \$350,000 and the net proceeds of notes payable of \$70,000.

### Results of Operations

During the nine month period ended November 30, 2006, our sales increased \$157,000 or 3% to \$5,240,000 as compared to \$5,083,000 for the nine months ended November 30, 2005. For the three months ended November 30, 2006, our sales decreased \$47,000 when compared to the three months ended November 30, 2005. During the nine month period ended November 30, 2006, sales of our Nozzles, Medi-Coat systems and Fluxer units increased. The increase in sales of these units was offset by a decrease in sales of WideTrack units and EVS systems.

Our gross profit increased \$129,000 to \$2,615,000 for the nine months ended November 30, 2006 from \$2,486,000 for the nine months ended November 30, 2005. The gross profit margin was 49.9% of sales for the nine months ended November 30, 2006 as compared to 48.91% of sales for the nine months ended November 30, 2005. Our gross profit decreased \$6,000 to \$811,000 for the three months ended November 30, 2006 from \$817,000 for the three months ended November 30, 2005. The gross profit margin was 49.94% of sales for the three months ended November 30, 2006 as compared to 48.91% of sales for the three months ended November 30, 2005.

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Research and product development costs increased \$150,000 to \$597,000 for the nine months ended November 30, 2006 from \$447,000 for the nine months ended November 30, 2005 and \$67,000 to \$219,000 for the three months ended November 30, 2006 from \$152,000 for the three months ended November 30, 2005. The increases were due to increased engineering personnel, engineering materials, food industry initiatives and increased depreciation expense.

Marketing and selling costs increased \$134,000 to \$966,000 for the nine months ended November 30, 2006 from \$832,000 for the nine months ended November 30, 2005 and \$53,000 to \$306,000 for the three months ended November 30, 2006 from \$253,000 for the three months ended November 30, 2005. The increases were due principally to increased international travel expenses, international representative commissions and trade show expenses.

General and administrative costs increased \$28,000 to \$629,000 for the nine months ended November 30, 2006 from \$601,000 for the nine months ended November 30, 2005 and \$2,000 to \$190,000 for the three months ended November 30, 2006 from \$188,000 for the three months ended November 30, 2005. The increase was principally due to recording the current period stock based compensation expense of \$50,000. We are now required to directly expense the effects of stock based compensation expense, a non-cash expense item.

Interest income increased \$41,000 to \$49,000 for the nine months ended November 30, 2006 compared to the nine months ended November 30, 2005. Our present investment policy is to invest excess cash in short term commercial paper with an S & P rating of at least A1+.

Our net income was \$473,000 and \$114,000 for the nine and the three month periods ended November 30, 2006 as compared to \$666,000 and \$280,000 for the nine and three month periods ended November 30, 2005.

The Company's backlog of firm orders was \$253,000 at November 30, 2006. All of these orders are deliverable before the end of the Company's current fiscal

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year, which is February 28, 2007.

### 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.

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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 this and other 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.

### Stock-Based Compensation

The computation of the expense associated with stock-based compensation requires the use of a valuation model. SFAS 123R is a new and very 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. SFAS 123R 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

FASB 157 - Fair Value Measurements

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In September 2006, the FASB issued FASB Statement No. 157. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is a relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practices. This Statement is effective for financial statements for fiscal years beginning after November 15, 2007. Earlier application is permitted provided that the reporting entity has not yet issued financial statements for that fiscal year. Management believes this Statement will have no impact on the financial statements of the Company once adopted.

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### SONO-TEK CORPORATION 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 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 November 30, 2006. 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 third fiscal quarter of 2007 that have materially affected, or are reasonably likely to materially affect, internal controls over financial reporting.

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### 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

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Item 6. Exhibits and Reports

(a) Exhibits

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.

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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: January 12, 2007

SONO-TEK CORPORATION  
(Registrant)

/s/ Christopher L. Coccio  
By: \_\_\_\_\_  
Christopher L. Coccio  
Chief Executive Officer and President

/s/ Stephen J. Bagley  
By: \_\_\_\_\_  
Stephen J. Bagley  
Chief Financial Officer

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