

# SONO TEK CORP

## FORM 10-Q (Quarterly Report)

Filed 10/15/20 for the Period Ending 08/31/20

Address	2012 RT 9W BLDG 3 MILTON, NY, 12547
Telephone	8457952020
CIK	0000806172
Symbol	SOTK
SIC Code	3690 - Miscellaneous Electrical Machinery, Equipment and Supplies
Industry	Industrial Machinery & Equipment
Sector	Industrials
Fiscal Year	02/28

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended: August 31, 2020

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  
(State or other jurisdiction of  
incorporation or organization)

14-1568099  
(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

Securities Registered Pursuant to Section 12(b) of the Act: None

<u>Title of each class</u>	<u>Trading Symbol(s)</u>	<u>Name of each exchange on which registered</u>
None	N/A	N/A

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

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

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

Large Accelerated Filer   
Non-Accelerated Filer

Accelerated Filer   
Smaller reporting company   
Emerging Growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

<u>Class</u>	<u>Outstanding as of October 12, 2020</u>
Common Stock, par value \$.01 per share	15,439,660

## SONO-TEK CORPORATION

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

	August 31, 2020 (Unaudited)	February 29, 2020
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 3,971,611	\$ 3,659,551
Marketable securities	3,852,601	4,219,240
Accounts receivable (less allowance of \$71,000)	1,348,648	929,701
Inventories, net	2,462,048	2,381,891
Prepaid expenses and other current assets	94,835	153,698
Total current assets	<u>11,729,743</u>	<u>11,344,081</u>
Land	250,000	250,000
Buildings, net	1,614,391	1,654,061
Equipment, furnishings and building improvements, net	1,236,607	1,212,578
Intangible assets, net	97,999	106,291
Deferred tax asset	<u>176,314</u>	<u>176,314</u>
<b>TOTAL ASSETS</b>	<u>\$ 15,105,054</u>	<u>\$ 14,743,325</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 712,704	\$ 668,721
Accrued expenses	1,319,327	1,613,409
Customer deposits	988,102	1,648,690
Current maturities of long term debt	725,743	169,716
Income taxes payable	63,743	70,621
Total current liabilities	<u>3,809,619</u>	<u>4,171,157</u>
Deferred tax liability	251,761	251,761
Long term debt, less current maturities	899,573	538,000
Total liabilities	<u>4,960,953</u>	<u>4,960,918</u>
Commitments and Contingencies - (Note 10)	—	—
Stockholders' Equity		
Common stock, \$.01 par value; 25,000,000 shares authorized, 15,435,935 and 15,348,180 shares issued and outstanding, respectively	154,360	153,482
Additional paid-in capital	9,033,531	9,018,406
Accumulated earnings	956,210	610,519
Total stockholders' equity	<u>10,144,101</u>	<u>9,782,407</u>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<u>\$ 15,105,054</u>	<u>\$ 14,743,325</u>

See notes to unaudited condensed consolidated financial statements.

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

	Six Months Ended August 31,		Three Months Ended August 31,	
	2020	2019	2020	2019
Net Sales	\$ 6,909,185	\$ 6,168,250	\$ 3,480,641	\$ 3,345,822
Cost of Goods Sold	3,727,486	3,316,323	1,859,675	1,798,830
Gross Profit	<u>3,181,699</u>	<u>2,851,927</u>	<u>1,620,966</u>	<u>1,546,992</u>
Operating Expenses				
Research and product development costs	834,940	658,870	423,516	321,697
Marketing and selling expenses	1,388,987	1,476,696	682,270	799,284
General and administrative costs	572,254	619,475	313,852	333,662
Total Operating Expenses	<u>2,796,181</u>	<u>2,755,041</u>	<u>1,419,638</u>	<u>1,454,643</u>
Operating Income	385,518	96,886	201,328	92,349
Interest Expense	(17,704)	(17,465)	(9,287)	(8,518)
Interest and Dividend Income	25,483	56,983	2,837	25,812
Other income	<u>19,519</u>	<u>16,877</u>	<u>8,084</u>	<u>12,122</u>
Income Before Income Taxes	412,816	153,281	202,962	121,765
Income Tax Expense	<u>67,125</u>	<u>13,303</u>	<u>25,199</u>	<u>7,000</u>
Net Income	<u>\$ 345,691</u>	<u>\$ 139,978</u>	<u>\$ 177,763</u>	<u>\$ 114,765</u>
Basic Earnings Per Share	<u>\$ 0.02</u>	<u>\$ 0.01</u>	<u>\$ 0.01</u>	<u>\$ 0.01</u>
Diluted Earnings Per Share	<u>\$ 0.02</u>	<u>\$ 0.01</u>	<u>\$ 0.01</u>	<u>\$ 0.01</u>
Weighted Average Shares - Basic	<u>15,410,952</u>	<u>15,285,024</u>	<u>15,424,126</u>	<u>15,301,613</u>
Weighted Average Shares - Diluted	<u>15,530,910</u>	<u>15,376,906</u>	<u>15,533,010</u>	<u>15,399,163</u>

See notes to unaudited condensed consolidated financial statements.

**SONO-TEK CORPORATION**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
**SIX AND THREE MONTHS ENDED AUGUST 31, 2020 AND 2019**

**Six Months Ended August 31, 2020 and 2019**

	<u>Common Stock</u> Par Value \$.01		<u>Additional</u> <u>Paid - In</u> <u>Capital</u>	<u>Accumulated</u> <u>Earnings</u> <u>(Deficit)</u>	<u>Total</u> <u>Stockholders'</u> <u>Equity</u>
	<u>Shares</u>	<u>Amount</u>			
Balance – February 29, 2020	15,348,180	\$ 153,482	\$ 9,018,406	\$ 610,519	\$ 9,782,407
Cashless exercise of stock options	87,755	878	(878)		—
Stock based compensation expense			16,003		16,003
Net Income				345,691	345,691
Balance – August 31, 2020 (Unaudited)	<u>15,435,935</u>	<u>\$ 154,360</u>	<u>\$ 9,033,531</u>	<u>\$ 956,210</u>	<u>\$ 10,144,101</u>

	<u>Common Stock</u> Par Value \$.01		<u>Additional</u> <u>Paid - In</u> <u>Capital</u>	<u>Accumulated</u> <u>Earnings</u> <u>(Deficit)</u>	<u>Total</u> <u>Stockholders'</u> <u>Equity</u>
	<u>Shares</u>	<u>Amount</u>			
Balance – February 28, 2019	15,197,563	\$ 151,976	\$ 8,929,607	\$ (496,923)	\$ 8,584,660
Cashless exercise of stock options	104,050	1,040	(1,040)		—
Stock based compensation expense			43,827		43,827
Net Income				139,978	139,978
Balance – August 31, 2019 (Unaudited)	<u>15,301,613</u>	<u>\$ 153,016</u>	<u>\$ 8,972,394</u>	<u>\$ (356,945)</u>	<u>\$ 8,768,465</u>

**Three Months Ended August 31, 2020 and 2019**

	<u>Common Stock</u> Par Value \$.01		<u>Additional</u> <u>Paid - In</u> <u>Capital</u>	<u>Accumulated</u> <u>Earnings</u> <u>(Deficit)</u>	<u>Total</u> <u>Stockholders'</u> <u>Equity</u>
	<u>Shares</u>	<u>Amount</u>			
Balance – June 1, 2020 (Unaudited)	15,422,985	\$ 154,230	\$ 9,025,755	\$ 778,447	\$ 9,958,432
Cashless exercise of stock options	12,950	130	(130)		
Stock based compensation expense			7,906		7,906
Net Income				177,763	177,763
Balance – August 31, 2020 (Unaudited)	<u>15,435,935</u>	<u>\$ 154,360</u>	<u>\$ 9,033,531</u>	<u>\$ 956,210</u>	<u>\$ 10,144,101</u>

	<u>Common Stock</u> Par Value \$.01		<u>Additional</u> <u>Paid - In</u> <u>Capital</u>	<u>Accumulated</u> <u>Earnings</u> <u>(Deficit)</u>	<u>Total</u> <u>Stockholders'</u> <u>Equity</u>
	<u>Shares</u>	<u>Amount</u>			
Balance – June 1, 2019 (Unaudited)	15,301,613	\$ 153,016	\$ 8,939,877	\$ (471,710)	\$ 8,621,183
Stock based compensation expense			32,517		32,517
Net Income				114,765	114,765
Balance – August 31, 2019 (Unaudited)	<u>15,301,613</u>	<u>\$ 153,016</u>	<u>\$ 8,972,394</u>	<u>\$ (356,945)</u>	<u>\$ 8,768,465</u>

See notes to unaudited condensed consolidated financial statements.

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

	<b>Unaudited</b>	
	<b>Six Months Ended</b>	
	<b>August 31,</b>	
	<b>2020</b>	<b>2019</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net Income	\$ 345,691	\$ 139,978
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	214,280	191,977
Stock based compensation expense	16,003	43,827
Inventory reserve	36,000	32,000
Decrease (Increase) in:		
Accounts receivable	(418,947)	125,491
Inventories	(116,157)	(952,898)
Prepaid expenses and other current assets	58,863	212,642
(Decrease) Increase in:		
Accounts payable and accrued expenses	(250,099)	352,124
Customer Deposits	(660,588)	434,894
Income taxes payable	(6,878)	8,472
Net Cash (Used In) Provided by Operating Activities	<u>(781,832)</u>	<u>588,507</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of equipment and furnishings	(290,347)	(319,055)
Capital expenditure grant proceeds	100,000	—
Sale (purchase) of marketable securities	366,639	(1,051,898)
Net Cash Provided by (Used in) Investing Activities	<u>176,292</u>	<u>(1,370,953)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from note payable - bank	1,001,640	—
Repayment of long term debt	(84,040)	(80,696)
Net Cash Provided by (Used In) Financing Activities	<u>917,600</u>	<u>(80,696)</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>312,060</b>	<b>(863,142)</b>
<b>CASH AND CASH EQUIVALENTS</b>		
Beginning of period	3,659,551	3,144,123
End of period	<u>\$ 3,971,611</u>	<u>\$ 2,280,981</u>
<b>SUPPLEMENTAL CASH FLOW DISCLOSURE:</b>		
Interest paid	\$ 13,972	\$ 17,465
Income Taxes Paid	<u>\$ 74,004</u>	<u>\$ 4,831</u>

See notes to unaudited condensed consolidated financial statements.

**SONO-TEK CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SIX MONTHS ENDED AUGUST 31, 2020 and 2019**  
**(Unaudited)**

**NOTE 1: BUSINESS DESCRIPTION**

Sono-Tek Corporation (the “Company”, “Sono-Tek”, “We” or “Our”) was incorporated in New York on March 21, 1975. We are the world leader in the design and manufacture of ultrasonic coating systems for applying precise, thin film coatings to protect, strengthen or smooth surfaces on parts and components for the microelectronics/electronics, alternative energy, medical, industrial and emerging research & development/other markets. We design and manufacture custom-engineered ultrasonic coating systems and also provide patented nozzles and generators for manufacturers’ equipment.

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information. Accordingly, the Condensed Consolidated Financial Statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of the Company’s management, all adjustments considered necessary for a fair presentation (consisting of normal recurring adjustments) have been included. The results for the interim periods are not necessarily indicative of what the results will be for the fiscal year. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements as of and for the fiscal year ended February 29, 2020 (“fiscal year 2020”) contained in the Company’s 2020 Annual Report on Form 10-K filed with the SEC. The Company’s current fiscal year ends on February 28, 2021 (“fiscal 2021”).

**NOTE 2: SIGNIFICANT ACCOUNTING POLICIES**

**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.

**Concentration of Credit Risk** – The Company does not believe that it is subject to any unusual or significant risks in the normal course of business. The Company had three customers, which accounted for 30% of sales during the six months ended August 31, 2020. Three customers accounted for 47% of the outstanding accounts receivables at August 31, 2020.

Financial instruments and related items, which potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents. The Company places its cash and temporary cash investments with credit quality institutions. At times, such amounts may be in excess of the FDIC insurance limit. At August 31, 2020, deposits in excess of the FDIC limits were \$6,534,000.

**Consolidation** - The accompanying condensed consolidated financial statements of the Company, include the accounts of the Company and its wholly owned subsidiary, Sono-Tek Industrial Park, LLC (“SIP”). SIP operates as a real estate holding company for the Company’s real estate operations.

**Earnings Per Share** - Basic earnings per share (“EPS”) is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

**Equipment, Furnishings and Leasehold Improvements** – Equipment, furnishings and leasehold improvements are stated at cost. Depreciation of equipment and furnishings is computed by use of the straight-line method based on the estimated useful lives of the assets, which range from three to five years.

**Fair Value of Financial Instruments** - The Company follows 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 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, 2020 and February 29, 2020, respectively:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Marketable Securities – August 31, 2020	\$ 3,401,677	\$ 450,924	\$ —	\$ 3,852,601
Marketable Securities – February 29, 2020	\$ 3,565,629	\$ 653,611	\$ —	\$ 4,219,240

Marketable Securities include mutual funds, certificates of deposit and US Treasury securities, totaling \$3,852,601 and \$4,219,240 that are considered to be highly liquid and easily tradeable as of August 31, 2020 and February 29, 2020, respectively. Mutual funds & US Treasury securities are valued using inputs observable in active markets for identical securities and are therefore classified as Level 1 and certificates of deposit are classified as Level 2 within the Company's fair value hierarchy. The Company's marketable securities are considered to be available-for-sale investments as defined under ASC 320 "Investments – Debt and Equity Securities."

**Grant Proceeds** - The Company was awarded a \$100,000 Wired Innovations Center grant in June 2019 from the utility that provides its electricity service. Proceeds of the grant was conditioned upon the Company's successful completion of certain energy efficiency related improvements. In addition, the grant was subject to certain other requirements and was provided on a reimbursement basis only. The Company expended approximately \$580,000 related to these improvements during the fiscal year ended February 29, 2020. During the second quarter of fiscal 2021, the Company received the \$100,000 grant in its entirety.

The Company has concluded that this grant is not within the scope of ASC 606, as it does not meet the definition of a contract with a "customer". The Company has further concluded that Subtopic 958-605, Not-for-Profit-Entities-Revenue Recognition also does not apply, as the Company is a business entity and the grant is from a public utility. Grants and related receivables are recognized when there is reasonable assurance that the grant will be received, and all attaching conditions will be complied with. The Company has applied the grant proceeds against the cost of the capitalized improvements applicable to the grant, reducing the carrying value and the related depreciation expense going forward.

**Income Taxes** - The Company accounts for income taxes under the asset and liability method. Under this method, deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. If it is more likely than not that some portion or all of a deferred tax asset will not be realized, a valuation allowance is recognized.

**Intangible Assets** - Include costs of patent applications which are deferred and charged to operations over seventeen years for domestic patents and twelve years for foreign patents. The accumulated amortization of patents is \$176,566 and \$171,210 at August 31, 2020 and February 29, 2020, respectively. Annual amortization expense of such intangible assets is expected to be approximately \$11,000 per year for the next five years.

**Interim Reporting** - The attached summary condensed consolidated financial information does not include all disclosures required to be included in a complete set of financial statements prepared in conformity with accounting principles generally accepted in the United States of America. Such disclosures were included with the financial statements of the Company at February 29, 2020, 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.

**Inventories** - Inventories are stated at the lower of cost or net realized value. Cost is determined using the first-in, first-out (FIFO) method for raw materials, subassemblies and work-in-progress and the specific identification method for finished goods.

**Land and Buildings** - Land and buildings are stated at cost. Buildings are being depreciated by use of the straight-line method based on an estimated useful life of forty years.

**Long-Lived Assets** - The Company periodically evaluates the carrying value of long-lived assets, including intangible assets, when events and circumstances warrant such a review. The carrying value of a long-lived asset is considered impaired when the anticipated undiscounted cash flow from such asset is separately identifiable and is less than its carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair market value of the long-lived asset. Fair market value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risk involved.

**Management Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

**Marketable Securities** - The Company adopted ASU 2016-01, "Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities." ASU 2016-01 requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income, requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset, and eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost.

#### ***New Accounting Pronouncements -***

In December 2019, the FASB issued ASU 2019-12, "Income Taxes (Topic 740) - Simplifying the Accounting for Income Taxes." The guidance issued in this update simplifies the accounting for income taxes by eliminating certain exceptions to the guidance in ASC 740 related to the approach for intra-period tax allocation, the methodology for calculating income taxes in an interim period and the recognition for deferred tax liabilities for outside basis differences. ASU 2019-12 also simplifies aspects of the accounting for franchise taxes and enacted changes in tax laws or rates and clarifies the accounting for transactions that result in a step-up in the tax basis of goodwill. The ASU will be effective for the Company on March 1, 2021, with early adoption permitted, and is not expected to have a significant impact on the Company's financial statements.

Other than ASU 2019-12 discussed above, 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, is not expected to have an impact on the Company.

**Reclassifications** - Where appropriate, certain reclassifications have been made to the prior period to conform to the presentations of the current period.

**Research and Product Development Expenses** - Research and product development expenses represent engineering and other expenditures incurred for developing new products, for refining the Company's existing products and for developing systems to meet unique customer specifications for potential orders or for new industry applications and are expensed as incurred.

**Shipping and Handling Costs** - Shipping and handling costs are included in cost of sales in the accompanying consolidated statements of operations.

### NOTE 3: REVENUE RECOGNITION

A majority of the Company's sales revenue is derived from short term contracts with customers, which, on average, are in effect for less than twelve months. Sales revenue from manufactured equipment transferred at a single point in time accounts for a majority of the Company's revenue.

Sales revenue is recognized when control of the Company's manufactured equipment is transferred to its customers, in an amount that reflects the consideration the Company expects to receive based upon the agreed transaction price. The Company's performance obligations are satisfied when its customers take control of the purchased equipment, as defined by the contract terms. Based on prior experience, the Company reasonably estimates its warranty reserves. Sales are presented net of discounts and allowances. Discounts and allowances are determined when a sale is negotiated. The Company does not grant its customers or independent representatives, the ability to return equipment nor does it grant price adjustments after a sale is complete.

The Company does not capitalize any sales commission costs related to the acquisition of a contract. All commissions related to a performance obligation that are satisfied at a point in time are expensed when the customer takes control of the purchased equipment.

The Company receives cash deposits for customer orders based upon contract terms. Upon receipt, customer deposits are recorded as a short-term liability. Cash deposits received from customers may not always equal 100% of the contracted revenue for a given contract. In addition to cash deposits, the Company will accept irrevocable standby letters of credit from customers based upon contract terms. The Company also provides negotiated payment terms to its customers. At February 29, 2020, the Company had received \$1,649,000 in cash deposits from customers. During the six months ended August 31, 2020, the Company applied 100% of these deposits against customer accounts receivable when the Company's performance obligations were met.

At August 31, 2020, the Company had received \$988,000 in cash deposits for customer orders and had issued Letters of Credit in the amount of \$1,271,000 to secure some of these cash deposits. Subsequent to August 31, 2020, the Company received an additional \$618,000 in cash deposits that is secured by the outstanding Letters of Credit.

### NOTE 4: INVENTORIES

Inventories consist of the following:

	August 31, 2020	February 29, 2020
Raw materials and subassemblies	\$ 1,035,721	\$ 967,089
Finished goods	690,835	752,999
Work in process	964,772	855,083
Total	2,691,328	2,575,171
Less: Allowance	(229,280)	(193,280)
Net inventories	<u>\$ 2,462,048</u>	<u>\$ 2,381,891</u>

## NOTE 5: STOCK OPTIONS

**Stock Options** – Under the 2013 Stock Incentive Plan ("2013 Plan"), options can be granted to officers, directors, consultants and employees of the Company and its subsidiaries to purchase up to 2,500,000 shares of the Company's common stock. Under the 2013 Plan options expire ten years after the date of grant. As of August 31, 2020, there were 427,709 options outstanding under the 2013 Plan.

Under the 2003 Stock Incentive Plan, as amended ("2003 Plan"), until May 2013, options were available to be granted to officers, directors, consultants and employees of the Company and its subsidiaries to purchase up to 1,500,000 shares of the Company's common stock. As of August 31, 2020, there were 47,500 options outstanding under the 2003 Plan, under which no additional options may be granted.

During the six months ended August 31, 2020, 136,458 options were exercised on a cashless basis into 87,755 shares of common stock.

## NOTE 6: STOCK BASED COMPENSATION

The Company adopted ASC 718, "Share Based Payments," which requires companies to expense the value of employee stock options and similar awards.

During the three and six months ended August 31, 2020, the Company granted options to acquire 22,500 shares to employees exercisable at \$3.70. The options granted to employees vest over three years and expire in ten years. The options had a weighted average grant date fair value of \$1.25 per share.

The weighted-average fair value of options are estimated on the date of grant using the Black-Scholes options-pricing model. The weighted-average Black-Scholes assumptions are as follows:

	<b>Six Months Ended August 31, 2020</b>
Expected Life	8 years
Risk free interest rate	0.46%
Expected volatility	33.55%
Expected dividend yield	0%

In computing the impact, the fair value of each option is estimated on the date of grant based on the Black-Scholes options-pricing model utilizing certain assumptions for a risk free interest rate; volatility; and expected remaining lives of the awards. The assumptions used in calculating the fair value of share-based payment awards represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and the Company uses different assumptions, the Company's stock-based compensation expense could be materially different in the future. In addition, the Company is required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. In estimating the Company's forfeiture rate, the Company analyzed its historical forfeiture rate, the remaining lives of unvested options, and the number of vested options as a percentage of total options outstanding. If the Company's actual forfeiture rate is materially different from its estimate, or if the Company reevaluates the forfeiture rate in the future, the stock-based compensation expense could be significantly different from what the Company has recorded in the current period.

For the three and six months ended August 31, 2020 and 2019, net income and earnings per share reflect the actual deduction for stock-based compensation expense. The impact of applying ASC 718 approximated \$8,000 and \$33,000 in additional compensation expense during the three months ended August 31, 2020 and 2019, respectively. The impact of applying ASC 718 approximated \$16,000 and \$44,000 in additional compensation expense during the six months ended August 31, 2020 and 2019, respectively. Such amounts are included in general and administrative expenses on the statement of operations. The expense for stock-based compensation is a non-cash expense item.

**NOTE 7: EARNINGS PER SHARE**

The denominators for the calculation of diluted earnings per share at August 31, 2020 and 2019 are calculated as follows:

	Six Months Ended August 31,		Three Months Ended August 31,	
	2020	2019	2020	2019
Numerator for basic and diluted earnings per share	\$ 345,691	\$ 139,978	\$ 177,763	\$ 114,765
Denominator for basic earnings per share – weighted average	15,410,952	15,285,024	15,424,126	15,301,613
Effects of dilutive securities				
Stock options for employees, directors and outside consultants	119,958	91,882	108,884	97,550
Denominator for diluted earnings per share	15,530,910	15,376,906	15,533,010	15,399,163
Basic earnings per share	\$ 0.02	\$ 0.01	\$ 0.01	\$ 0.01
Diluted earnings per share	\$ 0.02	\$ 0.01	\$ 0.01	\$ 0.01

**NOTE 8: LONG TERM DEBT**

Long-term debt consists of the following:

	August 31, 2020	February 29, 2020
Note payable, bank, collateralized by land and buildings, payable in monthly installments of principal and interest of \$16,358 through January 2024 with an interest rate of 4.15% and a 10-year term.	\$ 623,676	\$ 707,716
Note Payable, bank, unsecured, Paycheck Protection Program funding, payable in monthly installments of principal and interest of \$56,370 through April 2022. Interest rate 1%. 2-year term, no repayments required for the first six months. Under the terms of the CARE Act, forgiveness for all or a portion of the loan may be granted based upon use of the loan proceeds for eligible payroll and related payroll costs and other qualified expenses.	1,001,640	—
Total long-term debt	1,625,316	707,716
Due within one year	725,743	169,716
Due after one year	\$ 899,573	\$ 538,000

**NOTE 9: REVOLVING LINE OF CREDIT**

The Company has a \$1,500,000 revolving line of credit at prime which was 3.25% at August 31, 2020. The revolving credit line is collateralized by the Company's accounts receivable and inventory. 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, 2020, \$1,271,000 of the Company's credit line was being utilized to collateralize letters of credit issued to customers that have remitted cash deposits to the Company on existing orders. The letters of credit expire at various times in the fiscal years ending February 28, 2021 and 2022. As of August 31, 2020, there were no outstanding borrowings under the line of credit and the unused portion of the credit line was \$229,000 as of August 31, 2020.

**NOTE 10: COMMITMENTS AND CONTINGENCIES**

Other than the letters of credit disclosed in Note 9, the Company did not have any material commitments or contingencies as of August 31, 2020.

**NOTE 11: 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, tax, competitive and technological developments affecting our operations or the demand for our products; the duration and scope of the COVID-19 pandemic; the extent and duration of the pandemic’s adverse effect on economic and social activity, consumer confidence, discretionary spending and preferences, labor and healthcare costs, and unemployment rates, any of which may reduce demand for some of our products and impair the ability of those with whom we do business to satisfy their obligations to us; our ability to sell and provide our services and products, including as a result of continued pandemic related travel restrictions, mandatory business closures, and stay-at home or similar orders; any temporary reduction in our workforce, closures of our offices and facilities and our ability to adequately staff and maintain our operations resulting from the pandemic; the ability of our customers and suppliers to continue their operations as result of the pandemic, which could result in terminations of contracts, losses of revenue; the recovery of the Electronics/Microelectronics and Medical markets following COVID-19 related slowdowns and further adverse effects to our supply chain; the forgiveness of our PPP loan; maintenance of increased order backlog, including effects of any COVID-19 related cancellations; the imposition of tariffs; timely development and market acceptance of new products and continued customer validation of our coating technologies; adequacy of financing; capacity additions, the ability to enforce patents; maintenance of operating leverage; consummation of order proposals; completion of large orders on schedule and on budget; successful transition from primarily selling ultrasonic nozzles and components to a more complex business providing complete machine solutions and higher value subsystems; and realization of quarterly and annual revenues as forecasted.

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

### **OVERVIEW**

Founded in 1975, Sono-Tek Corporation designs and manufactures ultrasonic coating systems that apply precise, thin film coatings to a multitude of products for the microelectronics/electronics, alternative energy, medical and industrial markets, including specialized glass applications in construction and automotive. We also sell our products to emerging research and development and other markets. We have invested significant resources to enhance our market diversity by leveraging our core ultrasonic coating technology. As a result, we have increased our portfolio of products, the industries we serve and the countries in which we sell our products.

Our ultrasonic nozzle systems use high frequency, ultrasonic vibrations that atomize liquids into minute drops that can be applied to surfaces at low velocity providing thin layers of protective materials over a surface such as glass or metals. Our solutions are environmentally friendly, efficient and highly reliable. They enable dramatic reductions in overspray, savings in raw material, water and energy usage and provide improved process repeatability, transfer efficiency, high uniformity and reduced emissions.

We believe product superiority is imperative and that it is attained through the extensive experience we have in the coatings industry, our proprietary manufacturing know-how and skills and our unique work force we have built over the years. Our growth strategy is to leverage our innovative technologies, proprietary know-how, unique talent and experience, and global reach to further advance the use of ultrasonic coating technologies for the microscopic coating of surfaces in a broader array of applications that enable better outcomes for our customers’ products and processes.

We are a global business with approximately 58% of our sales generated from outside the United States and Canada during the first six months of fiscal 2021. Our direct sales team and our distributor and sales representative network are located in North America, Latin America, Europe and Asia. Over the last few years, we have expanded our sales capabilities by increasing the size of our direct sales force, adding new distributors and sales representatives (“reps”). In addition, we have established testing labs at our distribution partner sites in China, Taiwan, Germany, Turkey, Korea and Japan, while also expanding our first testing lab that is co-located with our manufacturing facilities in New York. These labs provide significant value for demonstrating to prospective customers the capabilities of our equipment and enabling us to develop custom solutions to meet their needs.

Over the last decade, we have shifted our business from primarily selling our ultrasonic nozzles and components to a more complex business providing complete machine solutions and higher value subsystems to original equipment manufacturers (“OEMs”). The range for our average full system selling price has increased as a result, going from tens of thousands of dollars to hundreds of thousands of dollars. As a result of this transition, we have broadened our addressable market and we believe that we can grow sales on a larger scale, however, we expect that we will experience wide variations in both order flow and shipments from quarter to quarter.

**Second Quarter Fiscal 2021 Highlights** (compared with the second quarter of fiscal 2020 unless otherwise noted) We refer to the three-month periods ended August 31, 2020 and 2019 as the second quarter of fiscal 2021 and fiscal 2020, respectively.

- Net sales were \$3,481,000, up 4% or \$135,000, driven by increased sales of highly customized multi axis coating systems and integrated coating systems; with strong demand for our alternative energy products.
- Gross profit margin remained constant at 46%.
- Operating income increased to \$201,000, compared with operating income of \$92,000. Growth in revenue and gross profit improved operating income during the quarter.
- Backlog on August 31, 2020 was up 45% to \$5,106,000, compared with backlog of \$3,517,000 on February 29, 2020. Increase is due to two major orders.

**First Half Fiscal 2021 Highlights** (compared with the first half of fiscal 2020 unless otherwise noted) We refer to the six-month periods ended August 31, 2020 and 2019 as the first half of fiscal 2021 and fiscal 2020, respectively.

- Net sales were \$6,909,000, up 12% or \$741,000, driven primarily by increased demand from the Alternative Energy market, and strong sales of our integrated systems in the industrial market segment. This was a result of the effectiveness of our efforts to provide application engineering expertise and custom-designed complex coating solutions, of high customer value and greater selling price and increased revenue.
- Gross profit margin remained consistent at 46% for both periods, but on a dollar basis, improved due to increased sales.
- Operating income increased to \$386,000, compared with \$97,000. Growth in revenue and gross profit were key factors in the improvement of operating income during the first half of fiscal 2021.

## **RESULTS OF OPERATIONS**

### **Sales:**

#### **Product Sales**

	Three Months Ended		Change		Six Months Ended		Change	
	August 31,				August 31,			
	2020	2019	\$	%	2020	2019	\$	%
Fluxing Systems	\$ 94,000	\$ 211,000	(117,000)	(55%)	\$ 438,000	\$ 602,000	(164,000)	(27%)
Integrated Coating Systems	673,000	413,000	260,000	63%	1,849,000	810,000	1,039,000	128%
Multi-Axis Coating Systems	1,985,000	1,815,000	170,000	9%	2,898,000	2,888,000	10,000	—
OEM Systems	232,000	246,000	(14,000)	(6%)	654,000	565,000	89,000	16%
Other	497,000	661,000	(164,000)	(25%)	1,070,000	1,303,000	(233,000)	(18%)
<b>TOTAL</b>	<b>\$ 3,481,000</b>	<b>\$ 3,346,000</b>	<b>135,000</b>	<b>4%</b>	<b>\$ 6,909,000</b>	<b>\$ 6,168,000</b>	<b>741,000</b>	<b>12%</b>

Sales growth during the first half of fiscal 2021 was driven by a significant shipment of an integrated coating system for the Industrial Market valued at approximately \$400,000 combined with a strong quarter for Multi-Axis coating systems sold to the Alternative Energy markets. The sales increase in these product lines more than offset the current quarter’s sales decrease in fluxing systems and in the Other product category.

#### **Market Sales**

	Three Months Ended		Change		Six Months Ended		Change	
	August 31,				August 31,			
	2020	2019	\$	%	2020	2019	\$	%
Electronics/Microelectronics	\$ 811,000	\$ 1,376,000	(565,000)	(41%)	\$ 3,051,000	\$ 2,913,000	138,000	5%
Medical	961,000	1,250,000	(289,000)	(23%)	1,653,000	1,792,000	(139,000)	(8%)
Alternative Energy	826,000	223,000	603,000	270%	1,221,000	610,000	611,000	100%
Emerging R&D and Other	479,000	400,000	79,000	20%	516,000	685,000	(169,000)	(25%)
Industrial	404,000	97,000	307,000	316%	468,000	168,000	300,000	179%
<b>TOTAL</b>	<b>\$ 3,481,000</b>	<b>\$ 3,346,000</b>	<b>135,000</b>	<b>4%</b>	<b>\$ 6,909,000</b>	<b>\$ 6,168,000</b>	<b>741,000</b>	<b>12%</b>



The Alternative Energy market showed significant growth, primarily driven by sales to US - based companies for electrolyzer coating equipment used for fuel cell manufacturing and advanced carbon emission reduction technology. We also saw a strong quarter from the Industrial market resulting from our latest developed float glass coating platform, shipping to a US-based customer. The Electronics/ Microelectronics and Medical markets both declined with several potential orders being put on hold due to COVID concerns. We are optimistic that these orders will increase as countries come back online from COVID lockdowns.

### Geographic Sales

	Three Months Ended		Change		Six Months Ended		Change	
	August 31,				August 31,			
	2020	2019	\$	%	2020	2019	\$	%
U.S. & Canada	\$ 2,156,000	\$ 933,000	1,223,000	131%	\$ 2,911,000	\$ 2,164,000	747,000	35%
Asia Pacific (APAC)	232,000	642,000	(410,000)	(64%)	718,000	553,000	165,000	30%
China	223,000	215,000	8,000	4%	1,659,000	787,000	872,000	111%
Europe, Middle East, Asia (EMEA)	767,000	883,000	(116,000)	(13%)	1,198,000	1,512,000	(314,000)	(21%)
Latin America	103,000	673,000	(570,000)	(85%)	423,000	1,152,000	(729,000)	(63%)
TOTAL	\$ 3,481,000	\$ 3,346,000	135,000	4%	\$ 6,909,000	\$ 6,168,000	741,000	12%

In the first half of fiscal 2021, approximately 58% of sales originated outside of the United States and Canada compared with 65% in the prior year period.

In the second quarter of fiscal 2021, approximately 38% of sales originated outside of the United States and Canada compared with 72% in the prior year period.

The increase in US and Canada based sales was influenced by the COVID-19 pandemic, as we saw a decrease in orders from several geographic territories outside the US during COVID-19 peaks. Sono-Tek has proven capable at adapting to COVID-19 country wide lockdowns by quickly refocusing efforts to those countries that are operational. This flexibility has been helpful in softening the impact of the pandemic and will continue to be part of our strategy for the foreseeable future.

### Gross Profit:

	Three Months Ended		Change		Six Months Ended		Change	
	August 31,				August 31,			
	2020	2019	\$	%	2020	2019	\$	%
Net Sales	\$ 3,481,000	\$ 3,346,000	135,000	4%	\$ 6,909,000	\$ 6,168,000	741,000	12%
Cost of Goods Sold	1,860,000	1,799,000	61,000	3%	3,727,000	3,316,000	411,000	12%
Gross Profit	\$ 1,621,000	\$ 1,547,000	74,000	5%	\$ 3,182,000	\$ 2,852,000	330,000	12%
Gross Profit %	46.6%	46.2%			46.1%	46.2%		

For the second quarter of fiscal 2021, gross profit increased \$74,000, or 5%, compared with the prior-year period due to increased revenue. Gross profit margin remains strong at 46.6% compared with 46.2% for the prior year period.

Gross profit increased \$330,000, or 12%, to \$3,182,000 for the first half of fiscal 2021 compared with \$2,852,000 in the prior year period due to increased revenue. Gross profit margin remains strong at 46.1% compared with 46.2% for the prior year period.

### Operating Expenses:

	Three Months Ended		Change		Six Months Ended		Change	
	August 31,				August 31,			
	2020	2019	\$	%	2020	2019	\$	%
Research and product development	\$ 424,000	\$ 322,000	102,000	32%	\$ 835,000	\$ 659,000	176,000	27%
Marketing and selling	682,000	799,000	(117,000)	(15%)	1,389,000	1,477,000	(88,000)	(6%)
General and administrative	314,000	334,000	(20,000)	(6%)	572,000	619,000	(47,000)	(8%)
Total Operating Expenses	\$ 1,420,000	\$ 1,455,000	(35,000)	(2%)	\$ 2,796,000	\$ 2,755,000	41,000	1%

**Research and Product Development:**

Research and product development costs increased in both the second quarter and first half of fiscal 2021 due to increased salaries and related costs. In the prior year period, some of our personnel were assigned to specific customer sales orders and the associated research and development costs were recorded in inventory, as incurred.

**Marketing and Selling:**

Marketing and selling costs decreased in the second quarter of fiscal 2021 due to decreases in commissions, travel and trade show expenses.

Marketing and selling costs decreased in the first half of fiscal 2021 due to decreases in commissions, travel and trade show expenses. These decreases were partially offset by increased salaries and related costs in the first quarter of fiscal 2021.

In the second quarter of fiscal 2021, we expended approximately \$117,000 for commissions as compared with \$175,000 for the prior year fiscal period, a decrease of \$58,000. In the second quarter of fiscal 2021, our external commission expense decreased by \$77,000. This decrease was partially offset by an increase in internal commission expense of \$19,000. In the first half of fiscal 2021, we expended approximately \$247,000 for commissions as compared with \$276,000 for the prior year fiscal period, a decrease of \$29,000.

**General and Administrative:**

In the second quarter of fiscal 2021, we experienced decreases in professional fees and stock-based compensation expense. These decreases were partially offset by increased annual meeting and proxy expenses due to the Covid-19 outbreak.

In the first half of fiscal 2021, we experienced decreases in salaries, professional fees, travel, and stock based compensation. These decreases were partially offset by increased health insurance premiums and annual meeting expenses.

**Health Insurance Premiums:**

The Company's health insurance program requires employee contributions. In the second quarter of fiscal 2020, the Company's net health insurance expense was approximately \$91,000 as compared with \$73,000 for the prior year fiscal period, an increase of \$18,000 or 25%. In the first half of fiscal 2020, the Company's net health insurance expense was approximately \$191,000 as compared with \$146,000 for the prior year fiscal period, an increase of \$45,000 or 31%.

**Operating Income:**

Our operating income increased \$109,000, to \$201,000 in the second quarter of fiscal 2021 compared with \$92,000 for the prior year period. Growth in revenue and gross profit were key factors in the improvement of operating income in the second quarter of fiscal 2021. Operating margin for the quarter increased to 5.8% compared with 2.8% in the prior year period.

For the first half of fiscal 2021, operating income increased \$289,000, to \$386,000 compared with \$97,000 for the prior year period. Growth in revenue and gross profit were key factors in the improvement of operating income in the first half of fiscal 2021. Operating margin for the first half of fiscal 2021 increased to 5.6% compared with 1.6% in the prior year period.

**Interest Expense:**

Interest expense was \$9,000 in the second fiscal quarter of 2020 compared with \$8,000 for the prior year period. Interest expense was \$18,000 in the first half of 2020 compared with \$17,000 for the prior year period.

**Interest and Dividend Income:**

Interest and dividend income decreased \$23,000 to \$3,000 in the second quarter of fiscal 2021 as compared with \$26,000 for the second quarter of fiscal 2020. In the first half of fiscal 2021 interest and dividend income decreased \$32,000 to \$25,000 as compared with \$57,000 for the first half of fiscal 2020. The decrease in both periods is due to the decline in market rates. Our present investment policy is to invest excess cash in highly liquid, lower risk US Treasury securities. At August 31, 2020, the majority of our holdings are rated at or above investment grade.

**Other Income:**

Included in other income is the net revenue related to the rental of the Company's real estate. For the second quarter of fiscal 2021, the Company's net rental income was \$8,000. This compares with the second quarter of fiscal 2020 when net rental income was \$7,000.

For the first half of fiscal 2021, the Company's net rental income was \$19,000. This compares with the first half of fiscal 2020 when net rental income was \$12,000.

***Income Tax Expense:***

We recorded income tax expense of \$25,000 for the second quarter of fiscal 2021 compared with \$7,000 for the prior year period.

We recorded income tax expense of \$67,000 for the first half of fiscal 2021 compared with \$13,000 for the first half of fiscal 2020.

***Net Income:***

Net income increased by \$63,000 to \$178,000 for the second quarter of fiscal 2021 compared with \$115,000 for the prior year period.

Net income increased by \$206,000 to \$346,000 for the first half of fiscal 2021 compared with \$140,000 for the prior year period.

**Impact of Covid 19**

In December 2019, the novel coronavirus ("COVID-19") outbreak occurred in China and has since spread to other parts of the world. On March 11, 2020, the World Health Organization declared COVID-19 to be a global pandemic and recommended containment and mitigation measures. On March 13, 2020, the United States declared a national emergency concerning the outbreak. Along with these declarations, extraordinary and wide-ranging actions have been taken by international, federal, state, and local public health and governmental authorities to contain and combat the outbreak and spread of COVID-19 in regions across the United States and the world. These actions include quarantines, social distancing and "stay-at-home" orders, travel restrictions, mandatory business closures and other mandates that have substantially restricted individuals' daily activities and curtailed or ceased many businesses' normal operations.

In response to the pandemic and these actions, we began implementing changes in our business in March 2020 to protect our employees and customers:

- We implemented social distancing and other health and safety protocols.
- We have flexed the workforce in our manufacturing operations based on business needs, including the addition of a second shift and the implementation of remote, alternative and flexible work arrangements.
- We have enhanced cleaning and sanitary procedures.
- We temporarily eliminated domestic and international travel for the first quarter of fiscal 2021 and have maintained significantly reduced travel for the second fiscal quarter of 2021.
- We restricted access to our facilities to only employees and essential non-employees with strict protocols.

While all of these measures have been necessary and appropriate, they may result in additional costs and may adversely impact our business and financial performance. As our response to the pandemic evolves, we may incur additional costs and will potentially experience adverse impacts to our business, each of which may be significant. In addition, an extended period of remote work arrangements could impair our ability to effectively manage our business, and introduce additional operational risks, including, but not limited to, cybersecurity risks and increased vulnerability to security breaches, cyber-attacks, computer viruses, ransomware, or other similar events and intrusions. We may experience, decreases in demand and customer orders for our products in all sales channels, as well as temporary disruptions and closures of our facilities due to decreased demand and government mandates.

COVID-19 has also impacted various aspects of the supply chain as our suppliers experience similar business disruptions due to operating restrictions from government mandates. We continue to monitor procurement of raw materials and components used in the manufacturing, distribution and sale of our products, but continued disruptions in the supply chain due to COVID-19 may cause difficulty in sourcing materials or unexpected shortages or delays in delivery of raw materials and components, and may result in increased costs in our supply chain.

We have implemented plans to reduce spending in certain areas of our business, including reductions or delays in capital expenditures, reduced trade show participation costs, reduced travel expenditures and may need to take additional actions to reduce spending in the future.

We are closely monitoring and assessing the impact of the pandemic on our business. The extent of the impact on our results of operations, cash flow, liquidity, and financial performance, as well as our ability to execute near- and long-term business strategies and initiatives, will depend on numerous evolving factors and future developments, which are highly uncertain and cannot be reasonably predicted.

Given the inherent uncertainty surrounding COVID-19, we expect the pandemic may continue to have an adverse impact on our business in the near term. Should these conditions persist for a prolonged period, the COVID-19 pandemic, including any of the above factors and others that are currently unknown, may have a material adverse effect on our business, results of operations, cash flow, liquidity, and financial condition.

### **Liquidity and Capital Resources**

**Working Capital** – Our working capital increased \$747,000 to \$7,920,000 at August 31, 2020 from \$7,173,000 at February 29, 2020. The increase in working capital was mostly the result of the current period’s net income and noncash charges and the proceeds of a long term note payable partially offset by purchases of equipment and the repayment of long-term debt.

The Company aggregates cash and cash equivalents and marketable securities in managing its balance sheet and liquidity. For purposes of the following analysis, the total is referred to as “Cash.” At August 31, 2020 and February 29, 2020, our working capital included:

	August 31, 2020	February 29, 2020	Cash Increase (Decrease)
Cash and cash equivalents	\$ 3,972,000	\$ 3,660,000	\$ 312,000
Marketable securities	3,853,000	4,219,000	(366,000)
Total	<u>\$ 7,825,000</u>	<u>\$ 7,879,000</u>	<u>\$ (54,000)</u>

The following table summarizes the accounts and the major reasons for the \$54,000 decrease in “Cash”:

	Impact on Cash	Reason
Net income, adjusted for non-cash items	\$ 612,000	
Accounts receivable increase	(419,000)	Timing of receipts.
Inventories increase	(116,000)	Required to support backlog.
Equipment purchases	(290,000)	Equipment upgrade for productivity.
Customer deposits decrease	(661,000)	Shipment of orders.
Accounts payable decrease	(250,000)	Timing of disbursements.
Repayment of long-term debt	(84,000)	Repayment of debt.
Note payable proceeds	1,002,000	Paycheck Protection Program loan proceeds.
Capital expenditure grant proceeds	100,000	Receipt of grant proceeds.
Other - net	52,000	Timing of disbursements and other miscellaneous items.
Net decrease in cash	<u>\$ (54,000)</u>	

**Stockholders’ Equity** – Stockholders’ Equity increased \$362,000 from \$9,782,000 at February 29, 2020 to \$10,144,000 at August 31, 2020. The increase is a result of the current period’s net income of \$346,000 and \$16,000 in additional equity related to stock-based compensation awards.

**Operating Activities** – Our operating activities used \$782,000 of cash in the first half of fiscal 2021 compared with generating \$589,000 in the first half of fiscal 2020. The increased use of cash in our operating activities was mostly the result of increases in accounts receivable and inventories and decreases in customer deposits and accounts payable. These uses of cash were partially offset by the current period’s net income and non-cash charges.

**Investing Activities** – For the first half of fiscal 2021, our investing activities generated \$176,000 of cash compared with using \$1,371,000 in the first half of fiscal 2020. For the first halves of fiscal years 2021 and 2020, we used \$290,000 and \$319,000, respectively, for the purchase or manufacture of equipment, furnishings and leasehold improvements. For the first half of 2021, our marketable securities provided \$367,000 compared with the use of \$1,052,000 for the purchase of marketable securities in the first half of fiscal 2020.

In the second quarter of fiscal 2021, we received \$100,000 in grant proceeds from the utility which provides our electricity as a result of our completion of certain energy efficiency related improvements.

**Financing Activities** – In the first halves of fiscal years 2021 and 2020, we used \$84,000 and \$81,000, respectively, for the repayment of our note payable.

#### Paycheck Protection Program Loan

During the first quarter of fiscal 2021, we borrowed \$1,001,640 (the “PPP Loan”) from a bank under the Paycheck Protection Program (“PPP”). The PPP, established as part of the Coronavirus Aid, Relief and Economic Security Act (“CARES Act”), provides for loans to qualifying companies and is administered by the U.S. Small Business Administration (the “SBA”). The PPP Loan has a two-year term, bears interest at the rate of 1.0% per annum, and may be prepaid at any time without payment of any premium. No payments of principal or interest are due until November 2020, at which time we are required to make 18 monthly payments of principal and interest in the amount of \$56,370.

Under the terms of the CARES Act, PPP loan recipients can apply for and be granted forgiveness for all or a portion of the loan granted under the PPP, with such forgiveness to be determined, subject to limitations, based on the use of the loan proceeds for payment of payroll costs and any payments of mortgage interest, rent, and utilities. However, at least 60 percent of the PPP Loan proceeds must be used for eligible payroll and payroll related costs. The terms of any forgiveness may also be subject to further requirements in any regulations and guidelines the SBA may adopt.

We intend to use the entire PPP Loan proceeds for designated qualifying expenses and to apply for forgiveness of the PPP Loan in accordance with the terms of the PPP. No assurance can be given that we will obtain forgiveness of the PPP Loan in whole or in part. With respect to any portion of the PPP Loan that is not forgiven, the PPP Loan will be subject to customary provisions for a loan of this type, including customary events of default relating to, among other things, payment defaults, breaches of the provisions of the PPP note and cross defaults. As of the date of this Report, we have incurred approximately \$776,000 in payroll, payroll related costs and other qualifying expenses. We have been informed by the bank which made our PPP Loan that the SBA has not begun processing forgiveness applications as of the date of this Report.

**Net Increase in Cash** – In the first half of fiscal 2021, our cash balance increased by \$312,000 as compared to a decrease of \$863,000 in the first half of 2020. In the first half of fiscal 2021, our operating activities used \$782,000 of cash. In addition, we used \$290,000 for the purchase or manufacture of equipment, furnishings and leasehold improvements, our marketable securities provided \$367,000 of cash, and we used \$84,000 for the repayment of our notes payable. In the first half of fiscal 2020, we received \$1,002,000 in proceeds from a PPP Loan and \$100,000 in grant proceeds from the utility which provides our electricity as a result of our completion of certain energy efficiency related improvements.

#### **CRITICAL ACCOUNTING POLICIES**

The discussion and analysis of the Company’s financial condition and results of operations are based upon the consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure on contingent assets and liabilities at the date of the financial statements. Actual results may differ from these estimates under different assumptions and conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and may potentially result in materially different results under different assumptions and conditions. The Company believes that critical accounting policies are limited to those described below. For a detailed discussion on the application of these and other accounting policies see Note 2 to the Company’s consolidated financial statements included in Form 10-K for the year ended February 29, 2020.

#### **Accounting for Income Taxes**

As part of the process of preparing the Company’s condensed consolidated financial statements, the Company is required to estimate its income taxes. Management judgment is required in determining the provision for the deferred tax asset.

***Stock-Based Compensation***

The computation of the expense associated with stock-based compensation requires the use of a valuation model. ASC 718 is a complex accounting standard, the application of which requires significant judgment and the use of estimates, particularly surrounding Black-Scholes assumptions such as stock price volatility, expected option lives, and expected option forfeiture rates, to value equity-based compensation. The Company currently uses a Black-Scholes option pricing model to calculate the fair value of its stock options. The Company primarily uses historical data to determine the assumptions to be used in the Black-Scholes model and has no reason to believe that future data is likely to differ materially from historical data. However, changes in the assumptions to reflect future stock price volatility and future stock award exercise experience could result in a change in the assumptions used to value awards in the future and may result in a material change to the fair value calculation of stock-based awards. ASC 718 requires the recognition of the fair value of stock compensation in net income. Although every effort is made to ensure the accuracy of our estimates and assumptions, significant unanticipated changes in those estimates, interpretations and assumptions may result in recording stock option expense that may materially impact our financial statements for each respective reporting period.

**IMPACT OF NEW ACCOUNTING PRONOUNCEMENTS**

For information regarding new accounting pronouncements and their effect on the Company, see “New Accounting Pronouncements” in Note 2 of the unaudited notes to the condensed consolidated financial statements.

**ITEM 3 - Quantitative and Qualitative Disclosures about Market Risk**

The Company does not issue or invest in financial instruments or derivatives for trading or speculative purposes. Substantially all of the operations of the Company are conducted in the United States, and, as such, are not subject to material foreign currency exchange rate risk. All of our sales transactions are completed in US dollars.

Although the Company’s assets included \$3,972,000 in cash and \$3,853,000 in marketable securities, the market rate risk associated with changing interest rates in the United States is not material.

**ITEM 4 – Controls and Procedures**

The Company has established and maintains “disclosure controls and procedures” (as those terms are defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934 (the “Exchange Act”). Christopher L. Coccio, Chief Executive Officer (principal executive) and Stephen J. Bagley, Chief Financial Officer (principal accounting officer) of the Company, have evaluated the Company’s disclosure controls and procedures as of August 31, 2020. 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 2021 that have materially affected, or are reasonably likely to materially affect, internal controls over financial reporting.

## PART II - OTHER INFORMATION

**Item 1. Legal Proceedings**

None

**Item 1A. Risk Factors**

Note Required for Smaller Reporting Companies

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Mine Safety Disclosures**

None

**Item 5. Other Information**

None

**Item 6. Exhibits and Reports**

[31.1](#) - [31.2](#) - Rule 13a - 14(a)/15d - 14(a) Certification

[32.1](#) - [32.2](#) - Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

101.INS - XBRL Instance Document.

101.SCH - XBRL Taxonomy Extension Schema Document

101.CAL - XBRL Taxonomy Calculation Linkbase Document

101.DEF - XBRL Taxonomy Extension Definition Linkbase Document

101.LAB - XBRL Extension Label Linkbase Document

101.PRE - XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

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

Dated: October 15, 2020

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



**RULE 13a-14/15d - 14(a) CERTIFICATION**

I, Christopher L. Coccio, Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sono-Tek Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for the periods presented in this report;
4. Sono-Tek Corporation's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d - 15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the issuer and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. Sono-Tek Corporation's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: October 15, 2020

/s/ Christopher L. Coccio  
Christopher L. Coccio  
Chief Executive Officer

**RULE 13a-14/15d - 14(a) CERTIFICATION**

I, Stephen J. Bagley, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sono-Tek Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for the periods presented in this report;
4. Sono-Tek Corporation's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d - 15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. Sono-Tek Corporation's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: October 15, 2020

/s/ Stephen J. Bagley  
Stephen J. Bagley  
Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Sono-Tek Corporation (the "Company") on Form 10Q for the period ended August 31, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"). I, Christopher L. Coccio, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) and 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: October 15, 2020

/s/ Christopher L. Coccio  
Christopher L. Coccio  
Chief Executive Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Sono-Tek Corporation (the "Company") on Form 10Q for the period ended August 31, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"). I, Stephen J. Bagley, Chief Financial Officer, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) and 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: October 15, 2020

/s/ Stephen J. Bagley  
Stephen J. Bagley  
Chief Financial Officer