

# SONO•TEK Corporation



Full Coating Solutions

## R&D, Lab Environment, Pilot Scale, and High Volume Production Coating Machines



**On the Cover:** Sono-Tek's application and engineering expertise have enabled the development of a mature line of customizable motion controlled coating systems, unparalleled in their range of capabilities. Full integration of our patented ultrasonic nozzles into highly automated, programmable coating machines offers customers full turnkey solutions that ensure the best quality, and most repeatable manufacturing processes.

Sono-Tek's customer base is expanding into one that requires unique custom solutions, application expertise, and industry knowledge. We have been able to leverage our engineering resources to meet this demand, resulting in larger, more sophisticated systems, offered in conjunction with coating services. This is an area where other competitive technologies lack depth of experience and know-how.

## Corporate Highlights

- **Challenging year with 18% sales decrease worldwide.**
- **Positive net income, even after significant drop in sales due to uncertain economic environment.**
- **Cash and cash equivalents grew substantially due to LEAN program implementation.**

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## Significant Press Releases

*Interview in "MEMS Journal" - Published October 7, 2016*

Excerpt: "Bennett Bruntl, Director of Electronics and Advanced Energy, was recently interviewed by 'MEMS Journal' to discuss ultrasonic spray in comparison to high speed spin coating for MEMS and other precision semiconductor wafers with difficult to coat aspect ratios. The interview discusses market trends as well as the unique challenges Sono-Tek has overcome in depositing uniform photoresist for these applications in the development of the SPT200, a spray deposition tool designed specifically for these challenging photoresist applications."

*Sono-Tek Coating Equipment Enables Research & Development in Production Feasibility of Thin Film Solar Cells at TOBB University of Economics and Technology (TOBB ETU) in Ankara, Turkey - Published August 12, 2016*

Excerpt: "The main research interest of (the TOBB) group is focused on environmentally friendly, cost-efficient and solution processed chalcopyrite based thin film solar cells on both rigid and flexible substrates. For this topic, we have published numerous papers in different scientific journals. In these studies, we employed Sono-Tek's FlexiCoat spray pyrolysis system with ultrasonic impact nozzles. Sono-Tek's technology provided us remarkably high deposition yield (up to 40 times) with the same solution amount."

*Sono-Tek Unveils New Photoresist Deposition System - Published June 28, 2016*

Excerpt: "SPT200 is designed specifically to meet the unique challenges of coating high aspect ratios and deep well topographies such as MEMS wafers with photoresist. The SPT200 replaces traditional spin coating equipment, providing more uniform coverage of side walls in difficult to coat applications. Ultrasonic spray has been used for photoresist deposition for years, and is a well-proven method for semiconductor lithography manufacturing."

*Sono-Tek Corp. and Branson to Highlight Laser Welding Solution at MD&M East - Published June 9, 2016*

Excerpt: "(Sono-Tek and Branson's) collaborative solution for superior clear on clear laser welds using Clearweld 100, 200 and 900 Series coating materials (is) perfect for diagnostic devices, cell culture flasks, and other plastic welded medical components."

## Overview

*Sono-Tek has developed a unique and proprietary series of ultrasonic atomizing nozzles and systems which are being used in an increasing variety of electronics, advanced energy (solar and fuel cells), medical device, glass, textiles and food applications. These nozzles are electrically driven and create a fine, uniform, low velocity spray of atomized liquid particles, in contrast to common pressure nozzles. These characteristics create a series of commercial applications that benefit from the precise, uniform, thin coatings that can be achieved. When combined with significant reductions in liquid waste and less overspray than can be achieved with ordinary pressure nozzle systems, there is lower environmental impact and lower energy use.*

*In addition, over half of our sales come from outside the United States, and we are geographically present directly and through distributors and trade representatives in North and Latin America, Europe and Asia.*

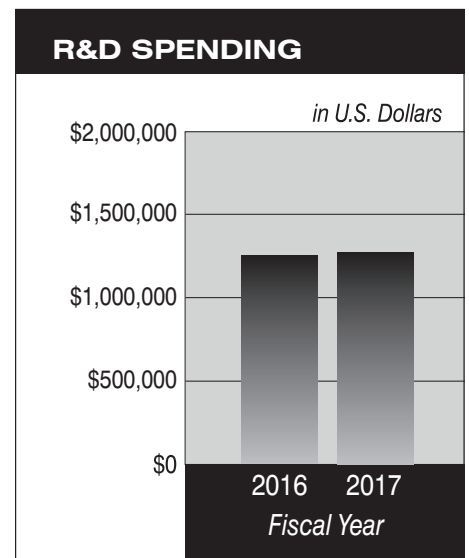
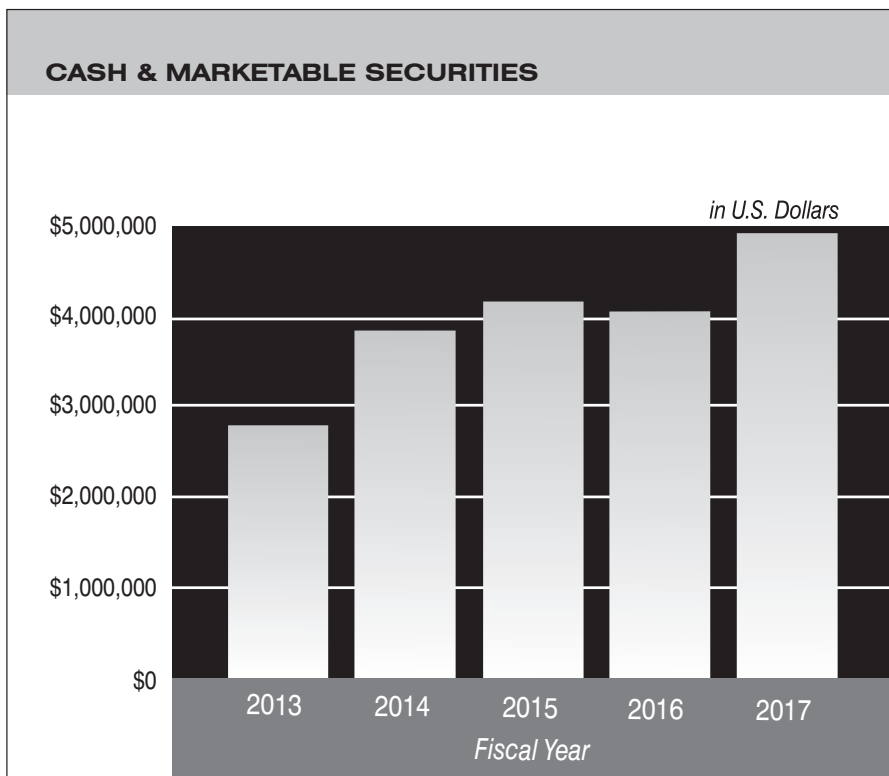
## Overview of Fiscal Year (March 1, 2016 - February 28, 2017)

This past fiscal year was a challenging one, with economic and political uncertainty in several of our major geographical markets. Europe, parts of Asia, and Latin America were affected as investment decisions were postponed or in some cases cancelled. Two of our industrial market segments were more affected than others, glass line installations and medical device coating installations. As a result, our sales for the past year declined by 18% to \$9.7 million.

Normally, such a decline in sales would mean cutting back on R&D and product development, experiencing a loss for the year, and a reduction in cash reserves. However, none of these things occurred at Sono-Tek this past year. What did happen was that we recognized our very strong cash position and decided to continue our investment in R&D and product development at the same level as the previous year. We believe that our future is dependent on organic technology development, which in turn will drive our business forward as it has done in the past.

Furthermore, we did not show a loss, but rather managed to have a profitable year and also substantially increased our cash and marketable securities position. Most of these welcome results can be attributed to the implementation of a LEAN manufacturing program at Sono-Tek over the past two years. We have found that we can operate the business more efficiently and with less inventory on hand by changing our manufacturing and engineering processes. The changes come from the engagement and contributions of our team members combined with the application of more computerized work station interfaces.

The result is that we had a much better than expected year and have positioned ourselves for recovery and growth as the global economic conditions improve. The charts on this page and the next tell the story in graphical terms.



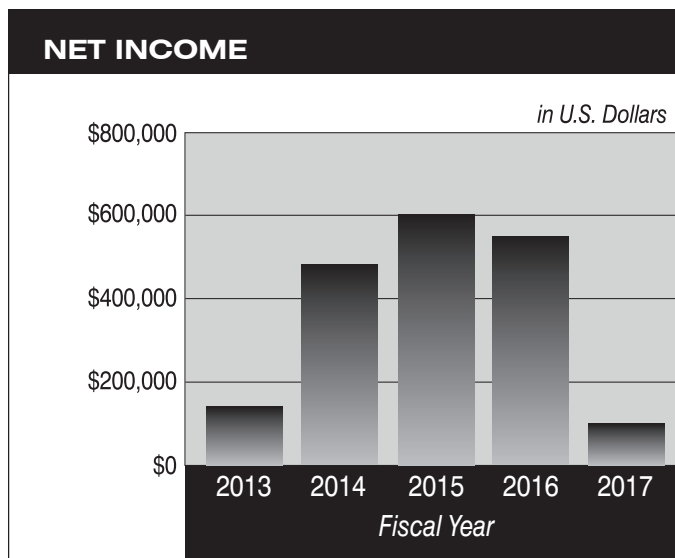
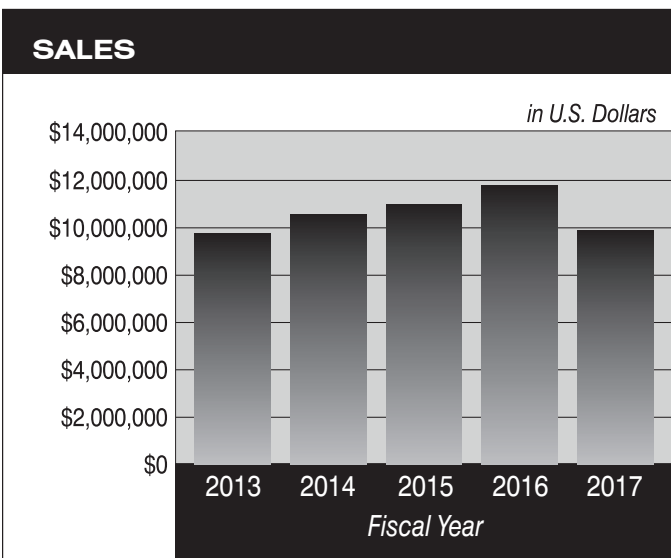
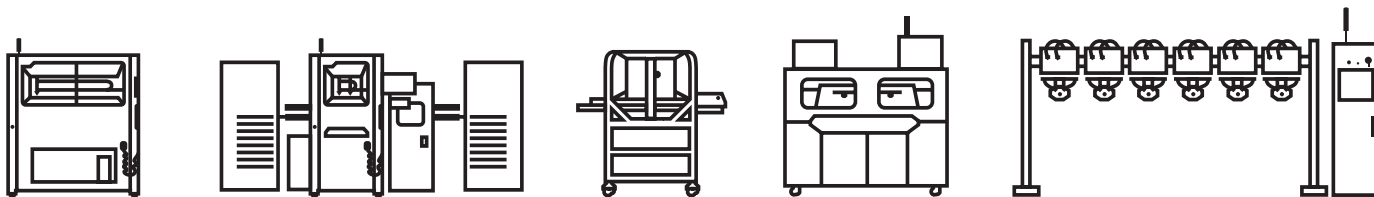
## Stock Price

Sono-Tek has demonstrated the ability to grow revenues, profits, and cash reserves over the past decade. Today, we have a strong balance sheet, which provides us the ability to choose investments in our future growth either organically or in terms of possible strategic additions from outside. The Company has a relatively small public float, and thus has not been adequately followed by public market investors. Therefore, the Company's public market valuation at times does not necessarily reflect the value associated with its proprietary technology, unique products and substantial growth potential. We do take steps to bring our story to new investors, and will continue to do so in the future. We believe that the market responds over time to companies like ours that demonstrate sound financial results coupled with the proven ability to grow profitably.

## Our Products

Sono-Tek's product line has evolved from selling a variety of ultrasonic atomizing nozzle configurations to providing complete, full coating solutions. New products are added to the Company's portfolio of offerings every year, in response to market demand, as well as improvements and next generation technologies for existing products. The wide range of capabilities and automated features offered are a result of the Company's seasoned and knowledgeable engineering, applications engineering, and New Product Development (NPD) teams. Our products find markets in research and development laboratories and universities, low-volume and pilot scale manufacturing, mid-volume, and continuous high-volume manufacturing.

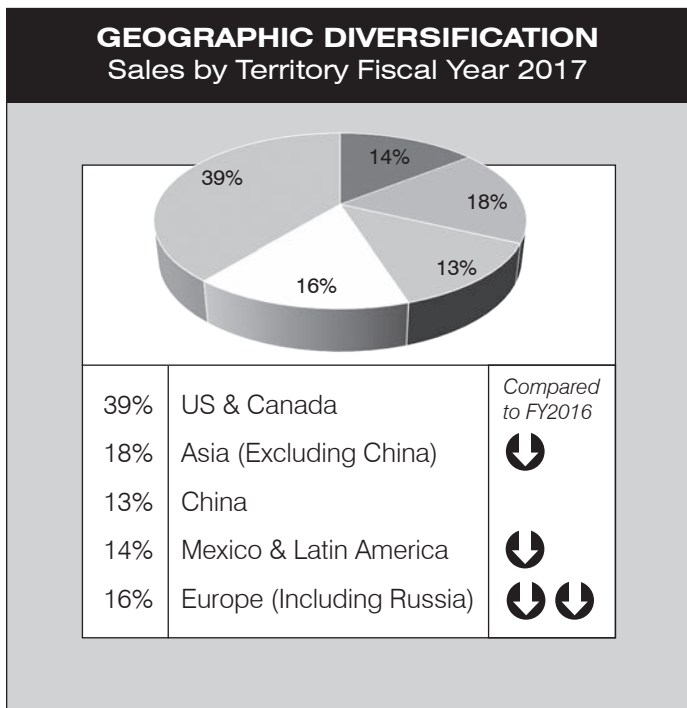
We expect to continue this culture of innovation and customer-oriented solutions as we find new markets and expand existing ones.



## Our Markets

We follow our markets in two dimensions—geographically and by application segment. The first chart below shows our sales distribution by geographical area in the past fiscal year. Most areas were affected by economic or political uncertainty which affected investment decisions. Europe and Latin America were most affected, and instability in Brazil and the Mexican peso also contributed to sales weakness. However, the problems seen last year seem to be diminishing as we enter our new fiscal year.

The other dimension of our markets is by application. Each application requires an understanding of the customer’s processes and a design that helps them solve a manufacturing problem or improve their process efficiency. Each of these areas has required an investment of our time and resources to develop hardware and application knowledge that wins repeat business over time. In the past year, the Fuel Cell and Semiconductor segments performed well, while the others suffered from deferred investment decisions, as seen in the chart below. The Solar industry continued to decline in 2016, as we’ve seen in the past few fiscal years, due to a reduction in government spending. At this point, Solar manufacturing is no longer a significant market segment for the Company. However, we are seeing a shift in some of the government funded research from Solar to Fuel Cell development, resulting in positive sales in the Fuel Cell sector. We are seeing a rebound from several other market segments as well, in conjunction with growing sales from newly introduced products. We are optimistic that the new fiscal year will continue in this direction.



**MARKETS**  
Sales by Market Fiscal Year 2017  
*Compared to FY2016*

Semiconductor	↑↑
Fuel Cell	↑
Fluxing	↓
Textiles	↓
Stents	↓↓
Float Glass	↓↓↓



## 2017 Chairman's Message

Every year has its own story, and this past year has been one of challenges: how to maintain the future growth of the business while sales are in a down cycle, how to protect the financial strength of the business, and whether to maintain our investment in R&D and product development in a lean year. Coincidentally, it was the implementation of our LEAN program that helped us to square the circle this past year. We were able to maintain our R&D and product development at the same pace as last year, and we were able to grow the financial strength of the business at the same time. In fact, we grew our cash and marketable securities to the highest level in our history this past year. The LEAN program has engaged most of our team members in new ways as they helped to define more streamlined workflow procedures and handoffs. We have made extensive use of computerized interfaces between work stations and our financial tracking system, which gives more control and ownership to individual team members as they execute orders

We have introduced and sold several new products such as SonoBraze, SimCoat, and ALIGN, and we have prepared several product upgrades for the new year such as Auto PCB Recognition and a new combined platform for our SPT200 coater for the semiconductor market. SonoBraze is our first attempt to enter the automobile heat exchanger industry, and the first application has been successful. SimCoat is a small XYZ robotic coating platform that has already appealed to R&D customers as a lower cost, first entry unit. ALIGN is a LEAN product that combines four previous product designs and a variety of applications into one unit that can be tailored to the requisite application at the time of order, saving both time and money.

A challenging year can bring out the best in people, and that is true too of organizations such as Sono-Tek. We look forward to the new year and to a greater awareness in this country of the importance of government policies supporting and encouraging businesses to succeed in global competition and the resulting job creation here.

Sincerely,



Christopher L. Coccio, Ph.D.  
Chairman and CEO  
July 25, 2017



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Forward-Looking Statements

We discuss expectations regarding our future performance, such as our business outlook, in our annual and quarterly reports, press releases, and other written and oral statements. These "forward-looking statements" are based on currently available competitive, financial and economic data and our operating plans. They are inherently uncertain, and investors must recognize that events could turn out to be significantly different from our expectations. These factors include, among other considerations, general economic and business conditions; political, regulatory, competitive and technological developments affecting our operations or the demand for our products; timely development and market acceptance of new products; adequacy of financing; capacity additions, the ability to enforce patents and the ability to achieve increased sales volume and continued profitability.

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

### Overview

We have developed a unique and proprietary series of ultrasonic atomizing nozzles and systems, which are being used in an increasing variety of electronics, advanced energy (solar and fuel cells), medical device, glass, textiles and food applications. These nozzles are electrically driven and create a fine, uniform, low velocity spray of atomized liquid particles, in contrast to common pressure nozzles. These characteristics create a series of commercial applications that benefit from the precise, uniform, thin coatings that can be achieved. When combined with significant reductions in liquid waste and less overspray than can be achieved with ordinary pressure nozzle systems, there is lower environmental impact and lower energy use.

### Market Diversity

During the past several years we have invested significant time, monies and efforts to enhance our market diversity. Based on our core ultrasonic coating technology, we increased our portfolio of products, the industries we serve and the countries in which we sell our products.

Today we serve six major industries: electronics, advanced energy (solar and fuel cells), medical device, glass, textiles and food.

In recent years, a substantial portion of our sales originated outside the United States, and we are geographically present directly and through distributors and trade representatives in North and Latin America, Europe and Asia. The infrastructure upon which this diversified market approach is based, includes a newly equipped process development laboratory, a strengthened sales organization with application engineers, an engineering team with additional talent and the latest, most sophisticated design software tools, as well as an expanded, highly trained installation and service organization.

The new products which we have introduced, the new markets that we have penetrated, and the regions in which we now sell our products, are a strong foundation for our future sales growth and enhanced profitability.

### Liquidity and Capital Resources

**Working Capital** – Our working capital increased \$530,000 from \$5,855,000 at February 29, 2016 to \$6,385,000 at February 28, 2017. The increase in working capital is due to net income of \$96,000 and our non-cash expenses of \$440,000 for depreciation and amortization, \$47,000 for stock based compensation, \$112,000 for an increase in the market values of our Available-For-Sale Investments and \$161,000 for an increase in our deferred tax asset. These non-cash expenses were offset by cash outflows of \$183,000 for the purchase of equipment and furnishings and \$143,000 for the repayment of notes payable. The Company's current ratio was 5.4 to 1 at February 28, 2017 as compared to 4.5 to 1 at February 29, 2016.

At February 28, 2017, our working capital includes \$2,557,000 of cash and \$2,342,000 of marketable securities, a total of \$4,899,000. At February 29, 2016, our working capital included \$2,388,000 of cash and \$1,696,000 of marketable securities, a total of \$4,084,000. The aggregate balance of cash and marketable securities increased \$815,000 during the twelve-month period ended February 28, 2017.

**Stockholders' Equity** – Stockholders' equity increased \$255,000 from \$7,668,000 at February 29, 2016 to \$7,923,000 at February 28, 2017. The increase in stockholders' equity is the result of the current year's net income of \$96,000, stock based compensation of \$47,000 and an increase in our accumulated comprehensive income of \$112,000.



**Operating Activities** – Our operating activities provided \$1,029,000 of cash for the year ended February 28, 2017 as compared to providing \$629,000 for the year ended February 29, 2016. For the year ended February 28, 2017, we had net income of \$96,000, accounts receivable decreased \$64,000, inventories decreased \$525,000, prepaid expenses and other assets increased \$17,000, accounts payable and accrued expenses decreased \$16,000, customer deposits decreased \$123,000 and income taxes payable decreased \$73,000. In addition, we incurred non-cash expenses of \$440,000 for depreciation and amortization, \$47,000 for stock based compensation expense, \$6,000 for an increase in deferred taxes and an increase in our inventory reserve of \$80,000.

**Investing Activities** – For the year ended February 28, 2017, we used \$716,000 of cash in our investing activities as compared to using \$648,000 for the year ended February 29, 2016. In 2017 and 2016, we used \$183,000 and \$465,000, respectively, for the purchase or manufacture of equipment, furnishings and leasehold improvements. In 2017 and 2016, we used \$534,000 and \$165,000, respectively, for the purchase of marketable securities. In 2016, we used \$18,000 for patent application costs compared to none in 2017.

**Financing Activities** – For the year ended February 28, 2017, we used \$143,000 of cash in our financing activities as compared to using \$155,000 for the year ended February 29, 2016. In 2017 and 2016, we used \$143,000 and \$158,000, respectively, for the repayments of notes payable. In 2016, we received \$3,000 for the exercise of stock options.

**Net Increase in Cash** – For the year ended February 28, 2017, our cash balance increased by \$169,000 as compared to a decrease of \$174,000 for the year ended February 29, 2016. During the year ended February 28, 2017, our operations provided \$1,029,000 of cash, we used \$717,000 in our investing activities and used \$143,000 in our financing activities.

**Bank Credit Facilities** – We currently have a revolving credit line of \$750,000 and a \$250,000 equipment purchase facility, both of which are with a bank. The revolving credit line is collateralized by all of the assets of the Company, except for the land and buildings. The line of credit is payable on demand and must be retired for a 30 day period once annually. As of February 28, 2017, there were no outstanding borrowings under the line of credit.

We had outstanding borrowings under a note payable of \$1,176,000 at February 28, 2017. The note is payable over seven years and accrues interest at 4.15%. The note payable is secured by a mortgage on our land and buildings.

## Results of Operations

### Ultrasonic Spraying Systems Segment:

#### Sales:

	Twelve Months Ended		Increase (Decrease)	
	February 28, 2017	February 29, 2016	\$	%
Net Sales .....	\$ 9,635,000	\$11,739,000	\$(2,104,000)	(18)%
Cost of Goods Sold.....	5,231,000	6,196,000	(965,000)	(16)%
Gross Profit.....	<u>\$ 4,404,000</u>	<u>\$ 5,543,000</u>	<u>\$(1,139,000)</u>	<u>(21)%</u>
Gross Profit %.....	<u>46%</u>	<u>47%</u>		

For the year ended February 28, 2017, our sales decreased \$2,104,000 to \$9,635,000 as compared to \$11,739,000 for the year ended February 29, 2016, a decrease of 18%. During the year ended February 28, 2017, we experienced decreases in sales of our WideTrack Glass Coating Units, Nozzles and Ultrasonic Generators, PCB Fluxing Units, Servo PCB Fluxing Units and Stent Coating Units. These decreases were partially offset by an increase in sales of our XYZ Platform Units and Spray Brazing Units.

For the year ended February 28, 2017, sales of our WideTrack Glass Coating Units decreased \$1,615,000 when compared to the prior fiscal year. The decrease in sales of these units was primarily driven by lower demand from individual customers.

For the year ended February 28, 2017, sales of our XYZ Platform Units increased \$509,000 when compared to the prior fiscal year.

#### Gross Profit:

Our gross profit decreased \$1,139,000 or 21%, to \$4,404,000 for the year ended February 28, 2017 from \$5,543,000 for the year ended February 29, 2016. Our gross profit margin percentage was 46% for the year ended February 28, 2017 compared to 47% for the year ended February 29, 2016.

The decrease in the current year's gross profit is primarily due to the decrease in sales of our higher gross profit margin WideTrack Glass Coating Units, Stent Coating Units and Nozzles and Ultrasonic Generators. In addition, our fixed overhead costs remained constant during the current fiscal year.

**Export Sales:**

	Twelve Months Ended		Change	
	February 28, 2017	February 29, 2016	\$	%
Western Europe .....	\$ 1,695,000	\$ 2,643,000	\$ (948,000)	(36)%
Far East .....	2,702,000	2,947,000	(245,000)	(8)%
Middle East.....	232,000	247,000	(15,000)	(6)%
South America .....	208,000	208,000	-	-
Mexico .....	275,000	421,000	(146,000)	(35)%
Other.....	249,000	111,000	138,000	100%
Total Export Sales .....	<u>\$ 5,361,000</u>	<u>\$ 6,577,000</u>	<u>\$(1,216,000)</u>	<u>(18)%</u>
Percentage of Total Sales .....	<u>56%</u>	<u>56%</u>		

For the year ended February 28, 2017, sales to customers located in European countries decreased by \$948,000 or 36%, sales to customers located in Asian countries decreased by \$245,000 or 8%, sales to Mexico decreased by \$146,000 or 35% and sales to other non-US based customers increased by \$138,000 or 100%.

**Operating Expenses:**

	Twelve Months Ended		Change	
	February 28, 2017	February 29, 2016	\$	%
Research and product development .....	\$ 1,250,000	\$ 1,268,000	\$ (18,000)	(1)%
Marketing and selling .....	\$ 2,198,000	\$ 2,371,000	\$ (173,000)	(7)%
General and administrative .....	\$ 1,034,000	\$ 1,100,000	\$ (66,000)	(6)%

**Research and Product Development:**

Research and product development costs decreased \$18,000 to \$1,250,000 for the year ended February 28, 2017 as compared to \$1,268,000 for the year ended February 29, 2016. For the year ended February 28, 2017, we experienced decreases in engineering materials and supplies expense. These decreases were partially offset by increases in engineering salaries, insurance and depreciation.

**Marketing and Selling:**

Marketing and selling costs decreased \$173,000 to \$2,198,000 for the year ended February 28, 2017 as compared to \$2,371,000 for the year ended February 29, 2016. For the year ended February 28, 2017, we experienced decreases in international commission expense and depreciation expense. In addition, in the prior year period we incurred expenses related to our international distributor training. We did not provide distributor training in the fiscal year ended February 28, 2017. These decreases were partially offset by increased sales salaries, insurance expense and advertising and trade show expenses.

During the year ended February 28, 2017, we expended approximately \$417,000 for commissions as compared to \$590,000 for the year ended February 29, 2016, a decrease of \$173,000.

During the year ended February 28, 2017, we expended approximately \$286,000 for advertising and trade show expense compared to \$228,000 for the year ended February 29, 2016, an increase of \$58,000.

**General and Administrative:**

General and administrative costs decreased \$66,000 to \$1,034,000 for the year ended February 28, 2017 as compared to \$1,100,000, for the year ended February 29, 2016. For the year ended February 28, 2017, we experienced decreases in insurance expense, salary expense and corporate and other miscellaneous expenses. These decreases were partially offset by an increase in professional fees.

**Operating (Loss) Income – Ultrasonic Spraying:**

We incurred an operating loss of \$78,000 for the year ended February 28, 2017, compared to operating income of \$804,000 for the year ended February 29, 2016, a decrease of \$882,000. During the current year, our gross profit decreased by \$1,139,000 when compared to the prior year. The decrease in gross profit was offset by decreases in Research and Development costs, Marketing and Selling expenses and General and Administrative expenses, which collectively decreased by \$257,000 when compared to the prior year.

### **Rental Real Estate Operations:**

For the year ended February 28, 2017, our real estate operations generated \$90,000 in rental income from unrelated third parties as compared to \$95,000 for the year ended February 29, 2016. Our real estate operations incurred \$34,000 in operating expenses compared to \$35,000 for the prior year period, real estate taxes of \$53,000 compared to \$51,000 for the prior year period, depreciation expense of \$74,000 compared to \$73,000 for the prior year period and \$52,000 in interest expense compared to \$58,000 for the prior year period. For the year ended February 28, 2017, our real estate operations reported a net loss of \$123,000 compared to a net loss of \$122,000 for the prior year period. The reported losses exclude any inter-company rent.

A summary of our real estate operations is as follows:

	Twelve Months Ended		Change	
	February 28, 2017	February 29, 2016	\$	%
<b>Statements of Operations</b>				
Rental Income .....	\$ 90,000	\$ 95,000	\$ (5,000)	(5)%
Real Estate Taxes .....	53,000	51,000	2,000	4%
Interest Expense .....	52,000	58,000	(6,000)	(10)%
Depreciating Expense .....	74,000	73,000	1,000	1%
Operating Expenses .....	34,000	35,000	(1,000)	(1)%
Net Loss From Real Estate Operations.....	<u>\$ (123,000)</u>	<u>\$ (122,000)</u>	<u>\$ (1,000)</u>	<u>(1)%</u>
Per Square Foot Cost Based on 50,000 sq. feet .....	<u>\$ 2.46</u>	<u>\$ 2.44</u>	<u>\$ -</u>	<u>-</u>

	Twelve Months Ended	
	February 28, 2017	February 29, 2016
<b>Statements of Cash Flows</b>		
Net Loss .....	\$ (123,000)	\$ (122,000)
Adjustments to reconcile net loss to net cash used in real estate operations:		
Depreciation .....	74,000	73,000
Repayment of long term debt .....	<u>(143,000)</u>	<u>(138,000)</u>
Net Cash (Used) in Real Estate Operations.....	<u>\$ (192,000)</u>	<u>\$ (187,000)</u>
Cash Used Per Square Foot Cost Based on 50,000 sq. feet ..	<u>\$ 3.84</u>	<u>\$ 3.74</u>

For the years ended February 28, 2017 and February 29, 2016, net cash outflows related to the industrial park were \$192,000 and \$187,000, respectively. These cash outflows are net of rental income and depreciation expense and include the principal payments on the industrial park's mortgage and the costs of capital improvements. Prior to purchasing the industrial park in December 2010, our annual rental expense was approximately \$136,000 or \$7.14 per square foot. If we are able to lease additional vacant space, it will provide positive cash flow for the industrial park when compared to our prior rental payments of \$136,000.

Our rental income was approximately \$6.00 per square foot, based on 15,600 square feet leased to third parties for the years ended February 28, 2017 and February 29, 2016.

### **Interest Expense:**

Interest expense decreased to \$52,000 for the year ended February 28, 2017 as compared to \$58,000 for the year ended February 29, 2016.

### **Interest and Dividend Income:**

Interest and dividend income increased to \$71,000 for the year ended February 28, 2017 as compared to \$55,000 for the year ended February 29, 2016. Our present investment policy is to invest excess cash in highly liquid mutual funds. Our holdings are rated at or above investment grade.

### **Other Income:**

During the year ended February 28, 2017, we received a payout of \$200,000 in life insurance proceeds from the death of a former employee.

**Income Tax (Benefit) Expense:**

We recorded an income tax benefit of \$19,000 for the year ended February 28, 2017 as compared to an expense of \$195,000 for the year ended February 29, 2016. The details of the current year's tax benefit are explained in Note 12 in our financial statements.

**Net Income:**

For the year ended February 28, 2017, we had net income of \$96,000 as compared to \$548,000 for the year ended February 29, 2016. The decrease in our net income is due to a decrease in our revenues and gross profit which was partially offset by a decrease in operating expenses. In addition, in the current year period, we received a payout of \$200,000 in life insurance proceeds from the death of a former employee.

For the years ended February 28, 2017 and February 29, 2016, we do not believe that our sales revenue or net income has been adversely affected by the impact of inflation or changing prices.

**Other Comprehensive Income (Loss)****Net unrealized income (loss) on marketable securities:**

As of February 28, 2017, certain of our marketable securities were in an unrealized gain position. Unrealized gains (losses) are principally due to changes in the fair value of our investments held as available-for-sale. Because we have the ability and intent to hold the securities until maturity, or for the foreseeable future as classified as available-for-sale, we do not deem the gain or decline to be other-than-temporary.

For the year ended February 28, 2017, the unrealized gain on our available-for-sale marketable securities was \$112,000 compared to a loss of \$70,140 for the year ended February 29, 2016.

**Off - Balance Sheet Arrangements**

We do not have any Off - Balance Sheet Arrangements as of February 28, 2017.

**Critical Accounting Policies**

The discussion and analysis of the Company's financial condition and results of operations are based upon the Company's 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. As of February 28, 2017, management believes there are no critical accounting policies applicable to the Company that are reflective of significant judgments and or uncertainties.

**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. We currently use a Black-Scholes option pricing model to calculate the fair value of stock options. We primarily use historical data to determine the assumptions to be used in the Black-Scholes model and have 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**

All accounting pronouncements issued but not yet effective have been deemed to be not applicable or the adoption of such accounting pronouncement is not expected to have a material impact on the financials.


## Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders  
Sono-Tek Corporation

We have audited the accompanying consolidated balance sheets of Sono-Tek Corporation as of February 28, 2017 and February 29, 2016 and the related consolidated statements of operations and comprehensive income, stockholders' equity, and cash flows for each of the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of February 28, 2017 and February 29, 2016, and the results of its operations and cash flows for each of the years then ended, in conformity with generally accepted accounting principles in the United States.



LIGGETT & WEBB, P.A.  
Certified Public Accountants  
New York, New York 10016  
May 26, 2017

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

	February 28, 2017	February 29, 2016
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents .....	\$ 2,557,223	\$ 2,388,355
Marketable securities .....	2,342,184	1,695,689
Accounts receivable (less allowance of \$46,000) .....	1,150,801	1,214,713
Inventories, net .....	1,340,684	1,945,383
Prepaid expenses and other current assets .....	127,276	109,954
Deferred tax asset .....	<u>315,171</u>	<u>154,914</u>
Total current assets .....	<u>7,833,339</u>	<u>7,509,008</u>
Land .....	250,000	250,000
Buildings, net .....	1,875,074	1,939,714
Equipment, furnishings and leasehold improvements, net .....	624,197	796,788
Intangible assets, net .....	<u>153,326</u>	<u>174,027</u>
<b>TOTAL ASSETS .....</b>	<b><u>\$10,735,936</u></b>	<b><u>\$10,669,537</u></b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable .....	\$ 336,561	\$ 475,297
Accrued expenses .....	868,755	746,036
Customer deposits .....	78,902	201,478
Current maturities of long term debt .....	149,698	143,388
Income taxes payable .....	<u>14,619</u>	<u>87,660</u>
Total current liabilities .....	<u>1,448,535</u>	<u>1,653,859</u>
Deferred tax liability .....	337,726	171,719
Long term debt, less current maturities .....	<u>1,026,650</u>	<u>1,176,349</u>
Total Liabilities .....	<u>2,812,911</u>	<u>3,001,927</u>
Commitments and Contingencies .....	-	-
Stockholders' Equity		
Common stock, \$.01 par value; 25,000,000 shares authorized, 14,961,076 and 14,955,400 issued and outstanding, respectively .....	149,611	149,554
Additional paid-in capital .....	8,859,486	8,812,224
Accumulated deficit .....	(1,128,322)	(1,224,028)
Accumulated other comprehensive income (loss) .....	<u>42,250</u>	<u>(70,140)</u>
Total stockholders' equity .....	<u>7,923,025</u>	<u>7,667,610</u>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY .....</b>	<b><u>\$10,735,936</u></b>	<b><u>\$10,669,537</u></b>

See notes to consolidated financial statements.

## SONO-TEK CORPORATION

**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME**

	Fiscal Year Ended	
	February 28, 2017	February 29, 2016
Net Sales .....	\$ 9,724,553	\$11,833,730
Cost of Goods Sold .....	<u>5,230,559</u>	<u>6,195,953</u>
Gross Profit .....	<u>4,493,994</u>	<u>5,637,777</u>
Operating Expenses		
Research and product development .....	1,249,591	1,268,010
Marketing and selling .....	2,197,991	2,371,064
General and administrative .....	1,034,239	1,099,783
Real estate operations expense .....	<u>160,440</u>	<u>158,629</u>
Total Operating Expenses .....	<u>4,642,261</u>	<u>4,897,486</u>
Operating (Loss) Income .....	(148,267)	740,291
Other Income (Expense):		
Interest Expense .....	(52,294)	(58,447)
Interest and Dividend Income .....	70,797	54,757
Other Income .....	<u>206,096</u>	<u>5,851</u>
Income before Income Taxes .....	76,332	742,452
Income Tax (Benefit) Expense .....	<u>(19,374)</u>	<u>194,723</u>
Net Income .....	<u>\$ 95,706</u>	<u>\$ 547,729</u>
Other Comprehensive Income (Loss)		
Net unrealized income (loss) on marketable securities .....	<u>112,390</u>	<u>(70,140)</u>
Comprehensive Income .....	<u>\$ 208,096</u>	<u>\$ 477,589</u>
Basic Earnings Per Share .....	<u>\$ .01</u>	<u>\$ .04</u>
Diluted Earnings Per Share .....	<u>\$ .01</u>	<u>\$ .04</u>
Weighted Average Shares – Basic .....	<u>14,961,076</u>	<u>14,943,018</u>
Weighted Average Shares – Diluted .....	<u>15,018,282</u>	<u>15,029,601</u>

See notes to consolidated financial statements.

## SONO-TEK CORPORATION

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY****YEARS ENDED FEBRUARY 28, 2017 AND FEBRUARY 29, 2016**

	Common Stock Par Value \$.01		Additional Paid – In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount				
Balance – February 28, 2015.....	14,933,107	\$149,331	\$8,766,160	-	\$(1,771,757)	\$7,143,734
Exercise of stock options.....	22,293	223	2,662	-	-	2,885
Stock based compensation expense.....	-	-	43,402	-	-	43,402
Unrealized (loss) on marketable... securities .....	-	-	-	(70,140)	-	(70,140)
Net Income.....	-	-	-	-	547,729	547,729
Balance – February 29, 2016.....	<u>14,955,400</u>	<u>\$149,554</u>	<u>\$8,812,224</u>	<u>(70,140)</u>	<u>\$(1,224,028)</u>	<u>\$7,667,610</u>
Exercise of stock options.....	5,676	57	(57)	-	-	-
Stock based compensation expense.....	-	-	47,319	-	-	47,319
Unrealized gain on marketable securities.....	-	-	-	112,390	-	112,390
Net Income.....	-	-	-	-	95,706	95,706
Balance – February 28, 2017.....	<u>14,961,076</u>	<u>\$149,611</u>	<u>\$8,859,486</u>	<u>\$ 42,250</u>	<u>\$(1,128,322)</u>	<u>\$7,923,025</u>

See notes to consolidated financial statements.



SONO-TEK CORPORATION  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Fiscal Year Ended	
	February 28, 2017	February 29, 2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income .....	\$ 95,706	\$ 547,729
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization .....	440,223	476,528
Stock based compensation expense.....	47,319	43,402
Inventory reserve .....	80,006	(119,924)
Allowance for doubtful accounts.....	-	2,953
Deferred tax expense .....	5,750	106,826
 (Increase) Decrease in:		
Accounts receivable.....	63,912	(188,416)
Inventories .....	524,693	233,718
Prepaid expenses and other assets .....	(17,322)	(15,467)
 (Decrease) Increase in:		
Accounts payable and accrued expenses .....	(16,017)	(55,568)
Customer deposits.....	(122,576)	(260,690)
Income taxes payable.....	(73,041)	(142,267)
Net Cash Provided by Operating Activities.....	<u>1,028,653</u>	<u>628,824</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of equipment, furnishings and leasehold improvements .....	(182,837)	(465,427)
(Purchase) of marketable securities.....	(533,559)	(164,825)
Patent application and other asset costs.....	-	(17,700)
Net Cash (Used In) Investing Activities .....	<u>(716,396)</u>	<u>(647,952)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of options .....	-	2,885
Repayment of long term debt .....	(143,389)	(158,184)
Net Cash (Used In) Financing Activities.....	<u>(143,389)</u>	<u>(155,299)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS.....	168,868	(174,427)
CASH AND CASH EQUIVALENTS:		
Beginning of year .....	<u>2,388,355</u>	<u>2,562,782</u>
End of year .....	<u>\$ 2,557,223</u>	<u>\$ 2,388,355</u>
Supplemental Cash Flow Disclosure:		
Interest Paid.....	<u>\$ 52,294</u>	<u>\$ 58,447</u>
Income Taxes Paid.....	<u>\$ 56,502</u>	<u>\$ 230,289</u>

See notes to consolidated financial statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**YEARS ENDED FEBRUARY 28, 2017 AND FEBRUARY 29, 2016**

**NOTE 1: BUSINESS DESCRIPTION**

The Company was incorporated in New York on March 21, 1975 for the purpose of engaging in the development, manufacture, and sale of ultrasonic liquid atomizing nozzles, which are sold world-wide. Ultrasonic nozzle systems atomize low to medium viscosity liquids by converting electrical energy into mechanical motion in the form of high frequency ultrasonic vibrations that break liquids into minute drops that can be applied to surfaces at low velocity.

Based on its core technology of ultrasonic liquid atomizing nozzles, the Company has developed intellectual property in the area of precision spray coating of liquids. The Company is presently engaged in the development, manufacture, sales, installation and servicing of diverse ultrasonic coating equipment for various manufacturing industries worldwide.

**NOTE 2: SIGNIFICANT ACCOUNTING POLICIES**

**Advertising Expenses** – The Company expenses the cost of advertising in the period in which the advertising takes place. Advertising expense for the years ended February 28, 2017 and February 29, 2016 was \$285,572 and \$227,825, respectively.

**Allowance for Doubtful Accounts** – The Company records a bad debt expense/allowance based on management's estimate of uncollectible accounts. All outstanding accounts receivable accounts are reviewed for collectability on an individual basis. The bad debt expense recorded for the years ended February 28, 2017 and February 29, 2016 was approximately \$0 and \$3,000, respectively.

**Available-for-Sale Investments** – The Company's available for sale investments are carried at fair value with the unrealized gains or losses, net of tax, included as a component of accumulated other comprehensive income (loss) in stockholders' equity. Realized losses and declines in value below cost judged to be other than temporary, if any, are included as a component of asset impairments expense in the consolidated statement of operations. The fair value of the available-for-sale investments are based on quoted market prices. The Company's fair value determination method is discussed below in "Fair Value of Financial Instruments".

**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 one customer, which accounted for 7% of sales during the year ended February 28, 2017. Six customers accounted for 46% of the outstanding accounts receivables at February 28, 2017.

The Company had one customer, which accounted for 7% of sales during the year ended February 29, 2016. Four customers accounted for 40% of the outstanding accounts receivables at February 29, 2016.

**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 Industrial Park, LLC. Sono-Tek Industrial Park, LLC, 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 February 28, 2017 and February 29, 2016, respectively:

	Quoted Prices in Active Markets (Level 1)	
	February 28, 2017	February 29, 2016
Marketable Securities .....	<u>\$2,342,184</u>	<u>\$1,695,689</u>

Marketable Securities include mutual funds of \$2,342,184 and \$1,695,689, that are considered to be highly liquid and easily tradeable as of February 28, 2017 and February 29, 2016, respectively. These securities are valued using inputs observable in active markets for identical securities and are therefore classified as Level 1 within the Company’s fair value hierarchy. The Company’s marketable securities are considered to be available-for-sale investments as defined under ASC 320 “Investments – Debt and Equity Securities”.

**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 \$138,777 and \$127,900 at February 28, 2017 and February 29, 2016, respectively. Annual amortization expense of such intangible assets is expected to be approximately \$11,000 per year for the next five years.

**Inventories** – Inventories are stated at the lower of cost or market. 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.

**New Accounting Pronouncements** – All new accounting pronouncements issued but not yet effective have been deemed to be not applicable to the Company. Hence, the adoption of these new accounting pronouncements once effective are not expected to have an impact on the Company.

**Product Warranty** – Expected future product warranty expense is recorded when the product is sold.

**Reclassifications** – Where appropriate, prior year's financial statements reflect reclassifications to conform to the current year's presentation.

**Recognition of Revenue** – Sales are recorded at the time title passes to the customer, which, based on shipping terms, generally occurs when the product is shipped to the customer. Based on prior experience, the Company reasonably estimates its sales returns and 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.

**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: SEGMENT INFORMATION

The Company operates in two segments: ultrasonic spray coating systems, which is the business of developing, manufacturing, selling, installing and servicing ultrasonic spray coating equipment; and real estate operations, which is the business of owning and operating the Sono-Tek Industrial Park.

All inter-company transactions are eliminated in consolidation. Segment information is as follows:

	Fiscal Year Ended February 28, 2017				Fiscal Year Ended February 29, 2016			
	Ultrasonic Spraying	Rental Real Estate Operations	Eliminations	Consolidated	Ultrasonic Spraying	Rental Real Estate Operations	Eliminations	Consolidated
Net Sales.....	\$ 9,634,956	\$ 285,895	\$ 196,298	\$ 9,724,553	\$11,738,982	\$ 291,046	\$ 196,298	\$11,833,730
Rental Expense.....	\$ 196,298	\$ -	\$(196,298)	\$ -	\$ 196,298	\$ -	\$(196,298)	\$ -
Rental Operations Expense .....	\$ -	\$ 85,976		\$ 85,976		\$ 85,887		\$ 85,887
Depreciation Expense .....	\$ 354,896	\$ 74,464		\$ 429,360	\$ 392,803	\$ 72,629		\$ 465,432
Interest Expense .....	\$ -	\$ 52,294		\$ 52,294	\$ 83	\$ 58,364		\$ 58,447
Net Income (Loss)...	\$ 218,843	\$ (123,137)		\$ 95,706	\$ 669,974	\$ (122,245)		\$ 547,729
Assets .....	\$ 8,346,183	\$ 2,389,753		\$10,735,936	\$ 8,214,873	\$ 2,454,664		\$10,669,537
Debt.....	\$ -	\$ 1,176,348		\$ 1,176,348	\$ -	\$ 1,319,737		\$ 1,319,737

#### NOTE 4: 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.

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

	Fiscal Year Ended	
	February 28, 2017	February 29, 2016
Expected life .....	4 years	8 years
Risk free interest rate.....	1.16%	.91% - 1.03%
Expected volatility.....	28.02%	18.73% - 23.72%
Expected dividend yield .....	0%	0%

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

For the years ended February 28, 2017 and February 29, 2016, net income and earnings per share reflect the actual deduction for stock-based compensation expense. The impact of applying ASC 718 approximated \$47,319 and \$43,402 in additional compensation expense for the years then ended, respectively. Such amount is included in general and administrative expenses on the statement of operations. The expense for stock-based compensation is a non-cash expense item.

#### NOTE 5: INVENTORIES

Inventories consist of the following:

	February 28, 2017	February 29, 2016
Raw materials and subassemblies .....	\$1,197,506	\$1,452,566
Finished goods.....	369,428	549,106
Work in process.....	28,460	118,415
Total .....	1,595,394	2,120,087
Less: Allowance.....	(254,710)	(174,704)
Net inventories.....	<u>\$1,340,684</u>	<u>\$1,945,383</u>

**NOTE 6: BUILDINGS, EQUIPMENT, FURNISHINGS AND LEASEHOLD IMPROVEMENTS**

Equipment, furnishings and leasehold improvements consist of the following:

	February 28, 2017	February 29, 2016
Buildings.....	\$ 2,250,000	\$ 2,250,000
Laboratory equipment .....	1,012,824	872,836
Machinery and equipment.....	858,694	857,994
Leasehold improvements.....	369,433	368,572
Trade show and demonstration equipment .....	1,072,425	1,037,830
Furniture and fixtures.....	<u>907,428</u>	<u>891,443</u>
Totals.....	6,470,804	6,278,675
Less: Accumulated depreciation.....	<u>(3,971,533)</u>	<u>(3,542,173)</u>
	<u>\$ 2,499,271</u>	<u>\$ 2,736,502</u>

Depreciation expense for the years ended February 28, 2017 and February 29, 2016 was \$429,360 and \$465,432, respectively.

**NOTE 7: ACCRUED EXPENSES**

Accrued expenses consist of the following:

	February 28, 2017	February 29, 2016
Accrued compensation .....	\$ 303,711	\$ 305,189
Estimated warranty costs .....	32,700	38,250
Accrued commissions.....	255,604	172,461
Professional fees .....	63,462	51,492
Other accrued expenses .....	<u>213,278</u>	<u>178,644</u>
	<u>\$ 868,755</u>	<u>\$ 746,036</u>

**NOTE 8: REVOLVING LINE OF CREDIT**

The Company has a \$750,000 revolving line of credit at prime which was 3.75% at February 28, 2017 and 3.50% at February 29, 2016. The line of credit is collateralized by all assets of the Company, except for the land and buildings. The line of credit is payable on demand and must be retired for a 30 day period once annually. If the Company fails to perform the 30 day annual pay down or if the bank elects to terminate the credit line, the bank may at its option convert the outstanding balance to a 36 month term note with payments including interest in 36 equal installments. As of February 28, 2017 and February 29, 2016, the Company's outstanding balance was \$0, and the unused credit line was \$750,000.

**NOTE 9: LONG-TERM DEBT**

Long-term debt consists of the following:

	February 28, 2017	February 29, 2016
Note payable, bank, collateralized by land and buildings, payable in monthly installments of principal and interest of \$16,358 through January 2024. Interest rate 4.15%. 10 year term. ....	<u>1,176,348</u>	<u>1,319,737</u>
Total long term debt.....	1,176,348	1,319,737
Due within one year .....	<u>149,698</u>	<u>143,388</u>
Due after one year .....	<u>\$ 1,026,650</u>	<u>\$ 1,176,349</u>

Long-term debt is payable as follows:

<u>Fiscal Year ending February 28,</u>	
2018.....	149,698
2019.....	156,119
2020.....	162,816
2021.....	169,716
2022.....	177,081
Thereafter.....	<u>360,918</u>
	<u>\$1,176,348</u>

#### **NOTE 10: BANK GUARANTEES**

As of February 28, 2017, \$77,543 of the Company's cash on deposit with a foreign bank was being utilized to collateralize guarantees issued by the bank in favor of international customers of the Company to secure cash deposits on orders that have been remitted to the Company. The customers may exercise the guarantees, subject to certain performance requirements being met by the Company. The guarantees expire at various dates in 2017.

#### **NOTE 11: COMMITMENTS AND CONTINGENCIES**

The Company did not have any material commitments or contingencies as of February 28, 2017.

#### **NOTE 12: INCOME TAXES**

The annual provision (benefit) for income taxes differs from amounts computed by applying the maximum U.S. Federal income tax rate of 34% to pre-tax income as follows:

	<u>February 28, 2017</u>	<u>February 29, 2016</u>
Expected federal income tax.....	\$ 64,165	\$ 252,321
State tax, net of federal.....	10,002	39,059
Research and development tax credits .....	(70,827)	(135,904)
Overaccrual of prior year taxes .....	(63,351)	(67,579)
Deferred tax expense .....	(5,080)	106,826
Permanent timing difference .....	17,795	-
Other adjustments.....	<u>27,922</u>	<u>-</u>
Income tax (Benefit) Expense .....	<u>\$ (19,374)</u>	<u>\$ 194,723</u>

The deferred tax asset and liability are comprised of the following:

	<u>February 28, 2017</u>	<u>February 29, 2016</u>
Inventory.....	\$ 253,500	\$ 87,000
Allowance for accounts receivable.....	18,100	18,000
Accrued expenses and other .....	<u>43,500</u>	<u>50,000</u>
Deferred tax asset - Current.....	<u>315,100</u>	<u>155,000</u>
Research tax credits.....	143,000	102,000
Accrued expenses.....	13,000	15,000
Intangible asset amortization .....	(30,000)	(39,000)
Building and leasehold depreciation.....	<u>(464,000)</u>	<u>(250,000)</u>
Deferred tax liability – Long Term .....	<u>\$ (338,000)</u>	<u>\$ (172,000)</u>

At February 28, 2017 and February 29, 2016, the Company had \$143,000 and \$102,000 of research and development tax credits, respectively, being carried forward.

## NOTE 13: STOCKHOLDERS' EQUITY

**Stock Options** – Under the 2013 Stock Incentive Plan, as amended (“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 February 28, 2017, there were 634,100 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 of the Company’s common shares. As of February 28, 2017, there were 205,500 options outstanding under the 2003 Plan, under which no additional options may be granted.

Under the 2013 Stock Incentive Plan, 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 plan or unless otherwise specified at the discretion of the Board of Directors, no option may be exercised prior to one year after date of grant, with the balance becoming exercisable in cumulative installments over a three-year period during the term of the option, and terminating at a stipulated period of time after an employee’s termination of employment.

During Fiscal Year 2017, the Company granted options to acquire 400,000 shares to officers, at an exercise price of \$0.91.

During Fiscal Year 2016, the Company granted options to acquire 73,500 shares exercisable at prices from \$1.07 to \$1.17, to employees of the Company.

A summary of the activity of both plans for the years ended February 28, 2017 and February 29, 2016 is as follows:

	Stock Options		Weighted Average		Fair Value Vested
	Outstanding	Exercisable	Exercise Price \$ Outstanding	Exercise Price \$ Exercisable	
Balance – February 28, 2015.....	489,434	353,934	\$ 0.97	\$ 0.86	\$ 0.32
Granted .....	73,500		1.16		
Exercised .....	(41,334)		(0.61)		
Cancelled .....	(57,500)		(1.08)		
Balance – February 29, 2016.....	<u>464,100</u>	<u>349,820</u>	<u>\$ 0.91</u>	<u>\$ 0.83</u>	<u>\$ 0.39</u>
Granted .....	400,000		\$ 0.91		
Exercised .....	(10,000)		(0.48)		
Cancelled .....	(14,500)		(1.21)		
Balance – February 28, 2017.....	<u>839,600</u>	<u>395,405</u>	<u>\$ 0.91</u>	<u>\$ 0.89</u>	<u>\$ 0.32</u>

The intrinsic value of the Company’s options exercised during the years ended February 28, 2017 and February 29, 2016 was \$1,632 and \$12,479, respectively.

Information, at date of issuance, regarding stock option grants for the years ended February 28, 2017:

	Shares	Weighted Average Exercise Price	Weighted Average Fair Value
Year ended February 28, 2017:			
Exercise price exceeds market price .....	-	-	-
Exercise price equals market price.....	400,000	\$ 0.91	\$ 0.16
Exercise price is less than market price.....	-	-	-

The aggregate intrinsic value of the Company’s outstanding options at February 28, 2017 and February 29, 2016 was \$226,601 and \$176,348, respectively.



The following table summarizes information about stock options outstanding and exercisable at February 28, 2017:

Range of exercise prices:	Number Outstanding	Weighted Average		Number Exercisable
		Remaining Life in Years	Exercise Price	
\$ .42 to \$.50 .....	14,000	5.01	\$ 0.47	14,000
\$ .51 to \$1.00 .....	571,500	8.14	\$ 0.83	171,500
\$1.01 to \$1.30 .....	254,100	7.35	\$ 1.14	209,905
Total Options: .....	<u>839,600</u>			<u>395,405</u>

#### NOTE 14: EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share:

	February 28, 2017	February 29, 2016
Numerator for basic and diluted earnings per share .....	<u>\$ 95,706</u>	<u>\$ 547,729</u>
Denominator for basic earnings per share - weighted average .....	14,961,076	14,943,018
Effects of dilutive securities:		
Stock options for employees, directors and outside consultants.....	<u>57,206</u>	<u>86,583</u>
Denominator for diluted earnings per share .....	<u>15,018,282</u>	<u>15,029,601</u>
Basic Earnings Per Share – Weighted Average .....	<u>\$ 0.01</u>	<u>\$ 0.04</u>
Diluted Earnings Per Share – Weighted Average.....	<u>\$ 0.01</u>	<u>\$ 0.04</u>

#### NOTE 15: OTHER COMPREHENSIVE INCOME (LOSS)

As of February 28, 2017, certain of our marketable securities were in an unrealized gain position. Unrealized gains (losses) are principally due to changes in the fair value of our investments held as available-for-sale. Because we have the ability and intent to hold the securities until maturity, or for the foreseeable future as classified as available-for-sale, we do not deem the gain or decline to be other-than-temporary.

For the year ended February 28, 2017, the unrealized gain on our available-for-sale marketable securities was \$112,000 compared to a loss of \$70,000 for the year ended February 29, 2016.

As of February 28, 2017, the unrealized gain on our available-for-sale securities was \$42,250.

The following table sets forth the changes in Accumulated Other Comprehensive Gain (Loss) for the year ended February 28, 2017:

	Unrealized Gain (Loss) on Available for Sale Securities
Beginning Balance February 29, 2016 .....	\$ (70,140)
Current Period Unrealized Gains.....	<u>112,390</u>
Ending Balance February 28, 2017 .....	<u>\$ 42,250</u>

## NOTE 16: SIGNIFICANT CUSTOMERS AND FOREIGN SALES

Export sales to customers located outside the United States were approximately as follows:

	February 28, 2017	February 29, 2016
Western Europe .....	\$ 1,695,000	\$ 2,643,000
Far East .....	2,702,000	2,947,000
Middle East.....	232,000	247,000
South America .....	208,000	208,000
Mexico .....	275,000	421,000
Other.....	249,000	111,000
	<u>\$ 5,361,000</u>	<u>\$ 6,577,000</u>

During Fiscal Years 2017 and 2016, sales to foreign customers accounted for approximately \$5,361,000 and \$6,577,000, respectively, of total revenues. For both fiscal years, sales to foreign customers accounted for approximately 56% of total revenues.

One customer accounted for 7% of the Company's sales for Fiscal Year ended February 28, 2017.

## NOTE 17: SUBSEQUENT EVENTS

The Company has evaluated subsequent events for disclosure purposes.

### Common Stock

Our common stock currently trades on the OTCQX Tier of the OTC Markets under the ticker symbol "SOTK". The following table sets forth the range of high and low closing bid quotations for our Common Stock for the periods indicated.

	Years Ended			
	February 28, 2017		February 29, 2016	
	HIGH	LOW	HIGH	LOW
First Quarter .....	\$ 1.14	\$ 0.91	\$ 1.16	\$ 1.01
Second Quarter .....	1.08	0.84	1.25	1.03
Third Quarter.....	1.19	1.00	1.19	1.08
Fourth Quarter.....	1.30	1.01	1.15	1.02

The above quotations are believed to represent inter-dealer quotations without retail markups, markdowns or commissions and may not represent actual transactions.

As of February 28, 2017, there were 150 shareholders of record of our Common Stock, according to our stock transfer agent. We estimate that we have between 1,000 and 1,400 beneficial shareholders of our common stock. The difference between the shareholders of record and the total shareholders is due to stock being held in street names at our transfer agent.

We have not paid any cash dividends on our Common Stock since inception. We intend to retain earnings, if any, for use in our business and for other corporate purposes.

# Corporate Directory

## Directors

Christopher L. Coccio, Ph.D. - Chairman and CEO

R. Stephen Harshbarger - President

Joseph Riemer, Ph.D. - Former Vice President, Food Business Development and Food Consultant. Member of the Compensation Committee

Samuel Schwartz - Chairman Emeritus and former Chairman of the Board, retired Chairman and CEO of Krystinel Corporation.

Edward J. Handler, Esq. - Compensation and Audit Committees, retired partner from Kenyon and Kenyon intellectual property law firm, President and COO of The Bronx Project, Inc., past President of the West Point Society of New York.

Eric Haskell, CPA - Audit Committee, former Executive Vice President and Chief Financial Officer of SunCom Wireless Holdings, Inc., former Chief Financial Officer of Systems & Computer Technology Corp.

Philip A. Strasburg, CPA - Chairman of the Audit Committee, Compensation Committee, Certified Public Accountant in New York State, retired partner from the accounting firm of Anchin Block and Anchin, LLP.

Donald F. Mowbray, Ph.D. - Chairman of the Compensation Committee, Independent Consultant, Retired head of General Electric's Corporate R&D Mechanical Engineering Laboratory.

## Executive Officers

Christopher L. Coccio, Ph.D. - Chairman and CEO

R. Stephen Harshbarger - President

Stephen J. Bagley, CPA - Chief Financial Officer

Robb Engle - Vice President, Engineering

## Corporate Headquarters

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