SUTRON CORP
Form 10-Q
November 14, 2014

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

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2014

Commission file number: 0-12227

SUTRON CORPORATION
(Name of registrant as specified in its charter)

VIRGINIA	54-1006352
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

22400 Davis Drive, Sterling, Virginia 20164
(Address of principal executive offices)

703-406-2800
(Registrant's telephone number)

Securities registered under Section 12(g) of the Act: Common Stock, $.01 par value

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 past 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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 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 þ No o

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

Large accelerated filer o Accelerated filer o
Non-accelerated filer o Smaller reporting company þ

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

There were 5,084,134 outstanding shares of the issuer's only class of common equity, Common Stock, $0.01 par value, on November 14, 2014.

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SUTRON CORPORATION
FORM 10-Q QUARTERLY REPORT
FOR THE QUARTER ENDED SEPTEMBER 30, 2014

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CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, including the sections entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Quantitative and Qualitative Disclosure About Market Risk” under Items 2 and 3, respectively, of Part I of this report, and the section entitled “Legal Proceedings,” of Part II of this report, may contain forward-looking statements. These statements may relate to, but are not limited to, expectations of future operating results or financial performance, macroeconomic trends that we expect may influence our business, plans for capital expenditures, expectations regarding the introduction of new products, regulatory compliance and expected changes in the regulatory landscape affecting our business, expected impact of litigation, plans for growth and future operations, effects of acquisitions, as well as assumptions relating to the foregoing. Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified. These risks and other factors include, but are not limited to, those listed under the section entitled “Risk Factors” included on our Annual Report on Form 10-K for the year ended December 31, 2013, filed March 31, 2014 with the SEC. In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “could,” “expect,” “plan,” “antic “believe,” “estimate,” “predict,” “intend,” “potential,” “continue,” “seek,” or the negative of these terms or other com terminology. These statements are only predictions. Actual events and/or results may differ materially.

We believe that it is important to communicate our future expectations to our investors. However, there may be events in the future that we are not able to predict accurately or to control and that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements. Except as required by applicable law, including the securities laws of the United States and the rules and regulations of the Securities and Exchange Commission, we do not plan to update publicly or revise any forward-looking statements, whether as a result of any new information, future events or otherwise, other than through the filing of periodic reports in accordance with the Securities Exchange Act of 1934, as amended. Investors and potential investors should not place undue reliance on our forward-looking statements. Before you invest in our common stock, you should be aware that the occurrence of any of the events described in the “Risk Factors” section included on our Annual Report on Form 10-K for the year ended December 31, 2013, filed March 31, 2014 with the SEC and elsewhere in this Quarterly Report on Form 10-Q could harm our business, prospects, operating results and financial condition. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SUTRON CORPORATION
CONSOLIDATED BALANCE SHEETS

	(Unaudited) September 30, 2014	(Audited) December 31, 2013
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 7,177,741	$ 8,283,092
Restricted cash and cash equivalents	952,968	850,279
Accounts receivable, net	5,327,202	5,863,636
Inventory, net	5,078,200	4,876,641
Prepaid items and other assets	387,994	446,749
Income taxes receivable	367,471	106,897
Deferred income taxes	896,787	664,558
Total Current Assets	20,188,363	21,091,852
Property and Equipment, Net	1,770,713	1,532,144
Other Assets		
Goodwill	4,452,152	4,452,152
Intangibles, net of amortization	768,724	907,495
Deferred tax assets	49,716	77,357
Other Assets	103,971	81,885
Total Assets	$ 27,333,639	$ 28,142,885
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current Liabilities:		
Accounts payable	$ 865,330	$ 1,170,446
Accrued payroll	245,104	468,454
Deferred Rent	146,438	139,146
Deferred revenue	825,681	686,029
Other accrued expenses	1,683,612	1,520,261
Billings in excess of costs and estimated earnings	125,200	388,687
Total Current Liabilities	3,891,365	4,373,023
Long-Term Liabilities:		
Deferred rent	645,612	751,245
Total Liabilities	4,536,977	5,124,268
Stockholders’ Equity		
Common stock, $0.01 par value, 12,000,000 shares authorized; 5,066,009 issued and outstanding	50,660	50,660
Additional paid-in capital	5,431,634	5,340,277
Retained earnings	17,605,319	17,869,256
Accumulated other comprehensive loss	(290,951)	(241,576)
Total Stockholders’ Equity	22,796,662	23,018,617

Total Liabilities and Stockholders’ Equity	$ 27,333,639	$ 28,142,885

See accompanying notes to consolidated financial statements.

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SUTRON CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Revenue	$ 6,558,381	$ 7,124,591	$ 19,073,266	$ 19,922,941
Cost of goods sold	3,879,341	4,247,587	11,906,470	12,043,928
Gross profit	2,679,040	2,877,004	7,166,796	7,879,013
Operating expenses:				
Selling, general and administrative expenses	1,660,133	1,416,634	5,244,195	4,517,771
Research and development expenses	839,704	797,986	2,424,820	2,744,075
Total operating expenses	2,499,837	2,214,620	7,669,015	7,261,846
Operating income (loss)	179,203	662,384	(502,219)	617,167
Interest and other income, net	17,072	14,591	37,605	23,840
Income (loss) before income taxes	196,275	676,975	(464,614)	641,007
Income tax expense (benefit)	78,501	190,000	(200,677)	177,000
Net income (loss)	$ 117,774	$ 486,975	$ (263,937)	$ 464,007
Net income (loss) per share:				
Basic income (loss) per share	$ 0.02	$ 0.10	$ (0.05)	$ 0.09
Diluted income (loss) per share	$ 0.02	$ 0.10	$ (0.05)	$ 0.09
Comprehensive income:				
Net income (loss)	$ 117,774	$ 486,975	$ (263,937)	$ 464,007
Foreign currency translation adjustments	(26,123)	(28,754)	(49,375)	(85,071)
Comprehensive income (loss)	$ 91,651	$ 458,221	$ (313,312)	$ 378,936

See accompanying notes to consolidated financial statements.

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SUTRON CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited)

	Common Shares	Stock Par Value	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balances, December 31, 2012	5,039,632	$ 50,397	$ 5,185,325	$ 17,073,351	$ (182,603)	$ 22,126,470
Net income	-	-	-	464,007	-	464,007
Foreign currency translation adjustment	-	-	-	-	(85,071)	(85,071)
Issuance of Stock	19,125	191	12,731			12,922
Amortization of stock based compensation	-	-	115,335	-	-	115,335
Exercise of stock options	7,252	72	4,932	-	-	5,004
Balances, September 30, 2013	5,066,009	$ 50,660	$ 5,318,323	$ 17,537,358	$ (267,674)	$ 22,638,667
Balances, December 31, 2013	5,066,009	$ 50,660	$ 5,340,277	$ 17,869,256	$ (241,576)	$ 23,018,617
Net loss	-	-	-	(263,937)	-	(263,937)
Foreign currency translation adjustment	-	-	-	-	(49,375)	(49,375)
Amortization of stock based compensation	-	-	91,357	-	-	91,357
Balances, September 30, 2014	5,066,009	$ 50,660	$ 5,431,634	$ 17,605,319	$ (290,951)	$ 22,796,662

See accompanying notes to consolidated financial statements.

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SUTRON CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Cash Flows from Operating Activities:		
Net (loss) income	$ (263,937)	$ 464,007
Noncash items included in net (loss) income:		
Depreciation	463,761	289,020
Amortization of intangibles	138,771	100,755
Deferred income taxes	(204,588)	46,000
Stock based compensation	91,357	115,335
Tax benefit from stock options exercised	-	(12,996)
Gain on asset disposal	(6,000)	-
Change in current assets and liabilities, net of the impact of acquisitions:		
Accounts receivable	536,434	(502,163)
Inventory	(201,559)	(842,780)
Prepaid expenses and other assets	58,755	(134,767)
Income tax receivable	(260,574)	234,405
Accounts payable	(305,116)	(70,353)
Accrued expenses	(59,999)	22,601
Deferred revenues	139,652	263,584
Billings in excess of costs and estimated earnings	(263,487)	298,545
Deferred rent	(98,341)	(154,992)
Net Cash (Used) Provided by Operating Activities	(234,871)	116,201
Cash Flows from Investing Activities:		
Restricted cash and cash equivalents	(102,689)	(56,582)
Purchase of property and equipment	(702,330)	(199,072)
Proceeds from the sale of property and equipment	6,000	-
Other assets	(22,086)	5,876
Business acquisition	-	(1,214,330)
Net Cash Used by Investing Activities	(821,105)	(1,464,108)
Cash Flows from Financing Activities:		
Tax benefit from stock options exercised	-	12,996
Proceeds from stock options exercised	-	4,910
Net Cash Provided by Financing Activities	-	17,906
Effect of exchange rate changes on cash and cash equivalents	(49,375)	(85,071)
Net (decrease) in cash and cash equivalents	(1,105,351)	(1,415,072)
Cash and Cash Equivalents, beginning of period	8,283,092	7,576,374
Cash and Cash Equivalents, end of period	$ 7,177,741	$ 6,161,302

See accompanying notes to consolidated financial statements.

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SUTRON CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization

Sutron Corporation (the "Company") was incorporated on December 30, 1975, under the General Laws of the Commonwealth of Virginia. The Company operates from its headquarters located in Sterling, Virginia. The Company has several branch offices located throughout the United States and a branch office in India.

The Company is a leading provider of real-time data collection and control products, systems and applications software and professional services in the hydrological, meteorological, air quality and oceanic monitoring markets. We design, manufacture, market and sell products, systems, and software as well as provide services that enable government and commercial entities to monitor and collect hydrological, meteorological, air quality and oceanic data for the management of critical water resources, for early warning of potentially disastrous floods, storms or tsunamis, for the optimization of hydropower plants, emissions monitoring, for the supply of critical aviation information and for other environmental applications. We provide real-time data collection and control products consisting primarily of dataloggers, satellite transmitters/loggers, water level and meteorological sensors and tide monitoring systems. We provide turnkey integrated systems for hydrological, meteorological, air quality and oceanic networks and related services consisting of installation, training and maintenance of hydrological, meteorological and air quality networks. We provide both systems and applications software that is used to provide data necessary for the management of vital resources. Our customers include a diversified base of federal, state, local and foreign governments, engineering firms, universities, hydropower companies and aviation firms.

2. Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. All significant intercompany transactions and accounts have been eliminated upon consolidation. The Company consolidates investments where it has a controlling financial interest. The usual condition for controlling financial interest is ownership of a majority of the voting interest and, therefore, as a general rule, ownership, directly or indirectly, of more than 50% of the outstanding voting shares is a condition indicating consolidation. For investments in variable interest entities, the Company would consolidate when it is determined to be the primary beneficiary of a variable interest entity. The Company does not have any variable interest entities.

Unaudited Interim Financial Information

The consolidated interim financial statements included in this quarterly report on Form 10-Q have been prepared by the Company without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and disclosures included in the consolidated interim financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP") have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures contained in this quarterly report comply with the requirements of Section 13(a) of the Securities and Exchange Act of 1934, as amended, for the quarterly report on Form 10-Q and are adequate to make the information presented not misleading. The consolidated interim financial statements included herein reflect all adjustments (consisting of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. These consolidated interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, filed March 31, 2014 with the SEC. The results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results to be anticipated for the entire year ending December 31, 2014 or thereafter. All references to September 30, 2014 and 2013 or to the three and nine months ended September 30, 2014 and 2013 in the notes to the consolidated interim financial statements are unaudited. The Company's significant accounting policies are disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 filed with the SEC.

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Recent Pronouncements

In June 2014, the FASB issued ASU No. 2014-12, "Compensation – Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period". The new guidance applies to reporting entities that grant employees share-based payments in which the terms of the award allow a performance target to be achieved after the requisite service period. The amendments in the ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Existing guidance in "Compensation – Stock Compensation (Topic 718)" should be applied to account for these types of awards. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Early adoption is permitted and reporting entities may choose to apply the amendments in the ASU either on a prospective or retrospective basis. The Company is currently assessing the impact that ASU 2014-12 will have on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers: Topic 606". This ASU applies to any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The guidance supersedes the revenue recognition requirements in Topic 605, "Revenue Recognition", most industry-specific guidance, and some cost guidance included in Subtopic 605-35, "Revenue Recognition—Construction-Type and Production-Type Contracts". The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To be in alignment with the core principle, an entity must apply a five step process including: identification of the contract(s) with a customer, identification of performance obligations in the contract(s), determination of the transaction price, allocation of the transaction price to the performance obligations, and recognition of revenue when (or as) the entity satisfies a performance obligation. Additionally, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer have also been amended to be consistent with the guidance on recognition and measurement. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. The Company is currently assessing the impact that ASU 2014-09 will have on its consolidated financial statements.

In April 2014, the FASB issued ASU 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." The amendments in this ASU change the criteria for reporting discontinued operations while enhancing disclosures in this area. Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization's operations and financial results and include disposals of a major geographic area, a major line of business, or a major equity method investment. The new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. Additionally, the new guidance requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. The amendments in the ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The Company does not expect the adoption of ASU 2014-08 to have a material impact on its consolidated financial statements.

In July 2013, the FASB issued ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists, which requires standard presentation of an unrecognized tax benefit when a carryforward related to net operating losses or tax credits exist. This update is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2013. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

3. Stock-Based Compensation

The Company grants stock options under the Stock Option Plans to key employees and directors for valuable services provided to the Company. During the three months ended September 30, 2014, the Company did not grant any stock options. Stock based compensation expense relating to stock option awards and restricted stock units (RSU's) for the three months ended September 30, 2014 and 2013 was $38,052 and $35,255, respectively.

These expenses were included in the cost of sales and selling, general and administrative lines of the Consolidated Statements of Comprehensive Income (Loss). Stock Compensation expense relating to stock option awards and restricted stock units (RSU's) for the nine months ended September 30, 2014 and 2013 was $91,357 and $115,335, respectively.

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Unamortized stock compensation expense as of September 30, 2014 relating to stock options totaled $309,768 and these costs will be expensed over a weighted average period of 9.57 years. Unamortized stock compensation expense as of September 30, 2014 relating to RSU's totaled $77,440 and these costs will be expensed over a weighted average period of 1.81 years. Further details of the Company's stock-based compensation are disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 filed with the SEC.

The following table summarizes stock option activity under the Stock Option Plans for the nine months ended September 30, 2014:

	Number of Shares		Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)		Aggregate Intrinsic Value
Outstanding at January 1, 2014	113,726	$	6.66	4.94	$	1,600
Granted	200,000		4.52			
Exercised	-		-			
Forfeited or expired	(10,000)		6.47			
Outstanding at September 30, 2014	303,726	$	5.26	7.73	$	114,694
Exercisable at September 30, 2014	98,726	$	6.36	3.93	$	1,334
Nonvested at September 30, 2014	205,000	$	4.73	9.57	$	113,360

The following table summarizes RSU activity under the 2010 Equity Incentive Plan for the nine months ended September 30, 2014:

	Number of Shares		Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term (Years)		Aggregate Intrinsic Value
Outstanding at January 1, 2014	46,125	$	4.36	1.24	$	237,083
Granted	9,000		5.00			
Forfeited	(1,000)		5.14			
Vested	(18,125)		5.66			
Outstanding at September 30, 2014	36,000	$	5.49	1.97	$	183,240
Expected to vest	25,830	$	5.43	1.81	$	131,475

4. Earnings Per Share

The following table shows the weighted average number of shares used in computing earnings (loss) per share and the effect on weighted average number of shares of potential dilutive common stock.

	Three Months Ended September 30,				Nine Months Ended September 30,			
		2014		2013		2014		2013
Net income (loss)	$	117,774	$	486,975	$	(263,937)	$	464,007
Shares used in calculation of income per share:								
Basic		5,066, 009		5,066,009		5,066,009		5,061,710

Effect of dilutive options		21,822		1,188		25,715		1,252
Effect of dilutive restricted shares		36,000		56,250		36,000		56,250
Diluted		5,123,831		5,123,447		5,127,724		5,119,212
Net income (loss) per share:								
Basic	$	0.02	$	0.10	$	(0.05)	$	0.09
Diluted	$	0.02	$	0.10	$	(0.05)	$	0.09

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes to those statements included elsewhere in this Quarterly Report on Form 10-Q . In addition to historical financial information, the following discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results and timing of selected events may differ materially from those anticipated in these forward-looking statements as a result of many factors, including those discussed under “Risk factors” included on our Annual Report on Form 10-K for the year ended December 31, 2013, filed March 31, 2014 with the SEC and elsewhere in this document. See also “Cautionary Note Concerning Forward Looking Statements” at the beginning of this Quarterly Report on Form 10-Q.

Overview

We provide real-time integrated system solutions including equipment, software, and services to our customers in the areas of hydrological, meteorological, air quality and oceanic monitoring. We design, manufacture, market and sell both products and services to a diversified customer base consisting of federal, state, local and foreign governments, engineering firms, universities, hydropower companies and aviation firms. Our products, systems, software and services enable organizations to monitor and to collect air quality, hydrological, meteorological and oceanic data to facilitate critical water resource management, the monitoring, forecasting, early event detection and warning of potentially disastrous floods, storms or tsunamis, the optimization of hydropower plants, emissions monitoring, the supply of critical aviation information, and other environmental applications.

Our key products are the SatLink2 Transmitter/Logger, the Xpert/XLite dataloggers, the Accububble Self-Contained Bubbler, the Accubar Pressure Sensor, ambient air instrumentation and continuous emissions control monitoring systems and Tempest, XConnect and LEADS® systems software. These key products are the essential components of most of Sutron’s integrated systems and are provided to customers as off-the-shelf equipment or as part of a custom system. The SatLink2 is a key product because it functions both as a transmitter and logger. The Xpert and XLite are more powerful dataloggers that have significant more logging capability and communications options than the SatLink2. Our ambient air instrumentation and continuous emissions control monitoring systems allow us to collect critical air quality data. Our Tempest, XConnect and LEADS® systems software allow us to provide turn-key systems solutions to our customers in our core markets.

We began fiscal year 2014 with a backlog of approximately $12,469,000 as compared to beginning fiscal year 2013 with a backlog of approximately $13,354,000. As of September 30, 2014, our backlog totaled approximately $15,348,000. We have historically experienced significant fluctuations in our quarterly sales and revenue and anticipate that we will continue to experience quarterly fluctuations in our sales and revenue in 2014. Operating results will depend upon the product mix sold in a given period as well as upon the timing and execution of project awards.

International sales, which totaled 49% of total revenue for the first nine months of 2014, are a significant portion of our revenue. We believe that international revenue will grow as a percentage of our total business as we plan to develop stronger international partnerships and to expand our international sales opportunities. International sales are however difficult to forecast because they are frequently delayed due to various governmental procurement, approval and funding processes. Our domestic business is highly dependent upon government business that is frequently solicited on a competitive bid basis. Contracts and purchase orders with Federal, state and local government agencies represented approximately 32% of our total revenues for the first nine months of 2014.

We are committed in our ongoing sales, marketing and research and development activities to sustain and to grow sales and revenue from existing and new products and services. As such, we invested during the second and third quarters of 2014 in Surface Mount Technology (SMT) equipment. This investment provides us with the robotic ability to place with high precision surface-mount devices onto a printed circuit board ensuring our quality standards are consistently met during our production process. We have also invested in the hiring of a Quality Assurance Manager and a SMT operator to ensure the success of this new operation. We believe that we will be able to manufacture these devices at a lower cost than our suppliers have charged and will reduce the elapsed time to produce finished products.

Due to increased depreciation from the investment in our SMT equipment as well as investment in our sales force and our administrative staff as we build our foundation to manage our growing organization and improve our ability to execute our vision of bringing end to end solutions to market, our marketing, research and development and administrative expenses are moderately higher year over year.

On March 6, 2013, we completed the acquisition of substantially all of the commercial and operating assets of Sabio Instruments (“Sabio”). With this acquisition, we broadened our line of environmental monitoring instrumentation into the expected growth market of air quality monitoring and we are continuing to develop an expanded set of monitoring and warning products and solutions.

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Results of Operations

The following table sets forth for the periods indicated the percentage of total revenue represented by certain items reflected in our statements of operations:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	59.2	59.6	62.4	60.4
Gross profit	40.8	40.4	37.6	39.6
Selling, general and administrative expenses	25.3	19.9	27.5	22.7
Research and development expenses	12.8	11.2	12.7	13.8
Operating income (loss)	2.7	9.3	(2.6)	3.1
Interest and other income	0.3	0.2	.2	0.1
Income (loss) before income taxes	3.0	9.5	(2.4)	3.2
Income tax expense (benefit)	1.2	2.7	(1.0)	0.9
Net income (loss)	1.8%	6.8%	(1.4)%	2.3%

Three and Nine Months period ended September 30, 2014 Compared to the Three and Nine Months period ended September 30, 2013

Revenue

Revenue for the third quarter ended September 30, 2014 was $6,558,381 compared to $7,124,591 in the third quarter of 2013 representing a decrease of $566,210, or approximately 8%. Revenue is broken down between sales of standard products and sales of systems and services. Revenue related to standard products increased 7% to $3,243,546 in the third quarter of 2014 from $3,030,119 in the same period of 2013 primarily due to the timing of delivery and mix of products between years. Revenue for systems and services decreased 19% to $3,314,835 for the three months ended September 30, 2014 from $4,094,472 for the same three month period in 2013. The overall decrease in revenue is due to delayed projects resulting in fourth quarter deliveries on projects that had been anticipated to occur earlier in the year.

Overall domestic revenues decreased by 19% to $3,892,547 during the three months ended September 30, 2014 as compared to $4,810,802 during the three months ended September 30, 2013. This decrease was due in part to timing issues and fewer third quarter orders from government customers compared to 2013. International revenues increased by 15% to $2,665,834 in the three month period ended September 30, 2014 as compared to $2,313,789 during the same period in 2013 due to delayed project activity that was completed in the third quarter and to completing anticipated third quarter projects.

Customer orders or bookings in the three months ended September 30, 2014 remained constant with $6,669,567 as compared to approximately $6,668,304 for the same three month period in 2013.

Revenue of $19,073,266 represents a decrease of $849,675 or approximately 4%, during the nine months ended September 30, 2014, as compared to $19,922,941 during the nine months ended September 30, 2013. Revenue is broken down between sales of standard products and sales of systems and services. Revenue related to standard products decreased 6% to $7,811,660 in 2014 from $8,315,538 in 2013. Sales of Sabio air quality products has increased $126,746 year over year, largely due to owning Sabio for the full nine months of 2014 opposed to only owning Sabio for seven months of 2013 through September 30. Revenue for systems and services decreased 3% to

$11,261,606 for the nine months ended September 30, 2014 from $11,607,403 for the same nine month period in 2013. Sales of MeteoStar systems and services were $3,892,912 for the nine months ended September 30, 2014 as compared to $4,418,852 for the nine months ended September 30, 2013. The decrease in MeteoStar systems and services year over year is due primarily to forecasted projects that have been delayed to future periods.

Overall domestic revenues decreased by 13% to $9,817,796 during the nine months ended September 30, 2014 as compared to $11,293,811 during the nine months ended September 30, 2013. This decrease was due in part to decreased domestic sales of $2,652,312 in our MeteoStar division for the nine month period ended September 30, 2014 as compared to $3,316,054 in the same nine month period in 2013. The MeteoStar Division continues to have a robust pipeline of projects that have been delayed, but are anticipated to close in future months. International revenues increased by 7% to $9,255,470 in the nine month period ended September 30, 2014, as compared to $8,629,130 during the same period in 2013 due primarily to increased project activity year over year. The Company is pursuing a number of larger projects and expects to close several of them in the fourth quarter of 2014.

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Customer orders or bookings in the nine months ended September 30, 2014 increased by 8% to approximately $22,162,000, as compared to approximately $20,433,000 for the same nine month period in 2013.

Cost of Sales and Revenues

Cost of sales and revenues consists primarily of operational costs associated with our standard products production facilities, as well as the costs associated with the design and development of customized software systems and services that we provide to our customers.

Cost of sales as a percentage of revenues was 59% for the three months ended September 30, 2014 as compared to 60% for the three months ended September 30, 2013. Standard product cost of sales was approximately 55% for the three months ended September 30, 2014, as compared to 57% for the same period in 2013. Cost of sales for systems and services was 64% in the three months ended September 30, 2014, as compared to 61% for the three months ended September 30, 2013. The differences in costs both on standard products and systems and services is due primarily to the mix of products being sold in 2014 compared to 2013.

Cost of sales as a percentage of revenues was 62% for the nine months ended September 30, 2014 as compared to 60% for the nine months ended September 30, 2014. Standard product cost of sales was approximately 61% for the nine months ended September 30, 2014, as compared to 57% for the same period in 2013. Cost of sales for systems and services remained constant at 63% for both of the nine month periods ended September 30, 2014 and 2013. While the standard product cost of sales for the three months ended September 30, 2014 was more consistent with historical performance, the increase in the cost of sales for the nine months ended September 30, 2014 is due to the higher cost of sales realized in the first half of 2014 resulting from a different product mix in the early part of 2014.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consists primarily of salaries, benefits, stock-based compensation, professional fees, rent and other facility related costs, depreciation and amortization of acquired intangible assets. All selling and marketing costs are expensed as incurred.

Selling, general and administrative expenses increased to $1,660,133, or approximately 17%, during the three months ended September 30, 2014 as compared to $1,416,634 for the three months ended September 30, 2013. The increase is primarily attributable to increased commissions associated with expanding our worldwide business, increased travel related costs to support our sales growth initiatives, additional depreciation recognized on the SMT equipment the Company has acquired, and increased legal expenses.

Selling, general and administrative expenses increased to $5,244,195, or approximately 16%, during the nine months ended September 30, 2014, as compared to $4,517,771 for the nine months ended September 30, 2013. The increase was attributable to the addition of our Sabio operations for a full nine months in 2014 compared to only seven months in 2013, increased commissions associated with expanding our worldwide business, increased travel related costs to support of sales growth initiatives, additional depreciation recognized on the SMT equipment the Company has acquired, and additional legal expenses.

Research and Development Expenses

The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products. Research and development expenses include new product development costs, consisting primarily of salaries, benefits and related costs for personnel associated with research and development activities, fees paid to third parties to develop new products and allocated overhead, which is comprised of rent and other facilities related costs, and depreciation expense generated by general purpose equipment and software.

Research and development expenses of $839,704 increased $41,718, or approximately 5% during the three months ended September 30, 2014 compared to $797,986 for the three months ended September 30, 2013. The increase is primarily due to engineers devoting more of their time to research and development efforts related to new products and specifically software development efforts in our MeteoStar division.

Research and development expenses of $2,424,820 decreased $319,255, or approximately 12%, during the nine months ended

September 30, 2014 compared to $2,744,075 for the nine months ended September 30, 2013. The decrease is primarily due to engineers devoting more of their time to project work as opposed to research and development during the extended time period.

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Interest and Other Income, Net

Due to our strong cash position in both periods, we did not use our line of credit during the three or nine months ended September 30, 2014 or 2013.

We had interest income for the three months ended September 30, 2014 of $17,072 compared to $14,591 for the three months ended September 30, 2013.

We had interest income for the nine months ended September 30, 2014 of $37,605 compared to $23,840 for the nine months ended September 30, 2013.

Income Taxes

We recorded an income tax expense of $78,501 for the three months ended September 30, 2014 as compared to a $190,000 tax expense for the three months ended September 30, 2013. The income tax expense represents an effective tax rate of 40% and 28% for 2014 and 2013, respectively.

We recorded an income tax benefit of $200,677 for the nine months ended September 30, 2014 as compared to a $177,000 tax expense for the nine months ended September 30, 2013. The income tax benefit represents an effective tax rate of 43% and 28% for 2014 and 2013, respectively.

Liquidity and Capital Resources

The following table summarizes our cash flows:

	Nine Months Ended September 30,			
		2014		2013
Net cash (used) provided by operating activities	$	(234,871)	$	116,201
Net cash used by investing activities		(821,105)		(1,464,108)
Net cash provided by financing activities		-		17,906
Effect of exchange rate changes on cash		(49,375)		(85,071)
Net decrease in cash and cash equivalents	$	(1,105,351)	$	(1,415,072)

Cash and cash equivalents were $7,177,741 at September 30, 2014 compared to $6,161,302 at September 30, 2013. Working capital decreased to approximately $16,297,000 at September 30, 2014 compared with approximately $16,450,000 at September 30, 2013.

Our principal uses of cash historically have consisted of cash paid for business acquisitions, payroll and other operating expenses and payments related to the investments in equipment primarily to support and to expand our customer base.

Operating Activities

Our cash flows from operating activities are significantly influenced by our investments in personnel and infrastructure to support the anticipated growth in our business, the timing of inventory purchases and subsequent order delivery, as well as, the timing of payments received from our customers.

We used $234,871 of net cash from operating activities during the nine months ended September 30, 2014. Our cash flows from operations were impacted by our net loss of $263,937 offset by $483,301 non-cash items such as depreciation, amortization, stock-based compensation and deferred taxes. In addition, our operating cash flows were primarily impacted by an increase of $201,559 in the level of inventory on hand related to orders to be delivered in the fourth quarter and $305,116 for payments made to our suppliers. These uses of cash were offset primarily by $536,434 of payments received from our customers decreasing our Accounts Receivable balance.

We generated $116,201 of net cash from operating activities during the nine months ended September 30, 2013. Our cash flows from operations were positively impacted by our net income of $464,007 and $538,114 of non-cash items such as depreciation, amortization, stock-based compensation, and deferred taxes. Our operating cash flows were negatively impacted by an $842,780 increase in the level of inventory on hand to fulfill customer product orders and build comprehensive custom solutions, a $502,163 increase in accounts receivable, an increase of approximately $134,767 for prepayments made to our vendors, offset by favorable impacts of $562,129 from deferred revenue and billings in excess of costs and estimated earnings.

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Investing Activities

Our primary investing activities have consisted of purchases of manufacturing equipment to support our production facility and payments related to the acquisitions of several companies. As our customer base and product suite expands, we expect purchases of technical infrastructure equipment to similarly increase. The extent of these investments will be impacted by our ability to expand existing customer relationships, grow our customer base, introduce new business opportunities to the market and increase our international presence.

We used $821,105 of net cash in investing activities during the nine months ended September 30, 2014. Our cash used for investing activities was primarily driven by the use of $702,330 of net cash associated with the purchase of property and equipment to expand our manufacturing and technology infrastructures. Our decision to employ Surface Mount Technology (SMT) internally commenced at the end of the second quarter with the delivery of the initial equipment purchases with the remainder being delivered and the equipment being placed in service during the third quarter. Our overall investment in SMT equipment in 2014 has been $527,000. This technology allows us to have more control over the quality and production lead times related to the electronic circuits mounted on our printed circuit boards.

Net cash used by investing activities of $1,464,108 during the first nine months of 2013 was primarily for the acquisition of Sabio Instruments.

Financing Activities

We did not engage in any financing activities during the nine months ended September 30, 2014. We generated net cash of $17,906 during the nine months ended September 30, 2013 for financing activities primarily due to proceeds from the exercise of employee stock options and the tax benefits related to those exercises.

We have a line of credit facility of $4,000,000 with a commercial bank. The line of credit is collateralized by the assets of the Company. Borrowings under the line of credit may be used for working capital and the issuance of stand-by letters of credit. We are permitted to borrow based on accounts receivable and inventory according to pre-established criteria. The issuance of letters of credit against the line of credit reduces the borrowing capacity of the facility for working capital purposes. The maturity date of the credit facility is December 20, 2015. Borrowings under the agreement bear interest payable monthly based on the bank’s prime rate. During the first nine months of 2014 and 2013, the Company did not borrow on the line of credit.

The Company maintains letters of credit to satisfy bid or performance guarantees under certain contracts. As of September 30, 2014 and December 31, 2013, the commercial bank had issued stand-by letters of credit on behalf of the Company in the amount of $1,502,556 and $1,663,000, respectively. The amount available under the line of credit was reduced by this amount.

Under the terms of the loan agreement, the Company is required to maintain usual and customary covenants, including, but not limited to a financial covenant with regard to Tangible Net Worth. As of September 30, 2014, the Company was in full compliance with all covenants contained in the agreement and remains so as of the date of this report.

Management believes that its existing cash resources, cash flow from operations and short-term borrowings on the existing credit line will provide adequate resources for supporting operations during fiscal 2014.

We do not have any special purpose entities and we do not engage in off-balance sheet financing arrangements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about market risk, see Item 7A, “Quantitative and Qualitative Disclosures About Market Risk,” of the Annual Report on Form 10-K for the fiscal year ended December 31, 2013. The Company’s exposure to market risk has not changed materially since December 31, 2013.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

In March 2014, it came to the Company's attention that a number of beneficial ownership disclosure reports required to be filed by a director and officers of the Company under Sections 16(a) and 13(d) of the Exchange Act had inadvertently not been filed with the SEC - specifically Forms 3, Forms 4, Forms 5 and amended Schedules 13G. In addition, the failure to file these reports was not properly disclosed in several of the Company's Annual Reports on Forms 10-K and Definitive Proxy Statements, as filed with the SEC. This resulted in the SEC instituting administrative proceedings against the Company’s Chief Executive Officer and former Chief Financial Officer for failing to promptly report information about their holdings and transactions in Company stock. Both proceedings were settled with the SEC issuing on September 10, 2014, a cease-and-desist order and a civil penalty against each of these two individuals. The Company was not charged. As a result of this error, the Company has implemented certain procedures including, among other things, that Section 16 filings are tracked under the supervision of the Company's Chief Financial Officer, who is also charged with reviewing the disclosure required by Item 405 of Regulation S-K in the Company's Annual Reports on Form 10-K and Definitive Proxy Statements.

Our management (with the participation of our Chief Executive Officer and Chief Financial Officer) evaluated the effectiveness of our disclosure controls and procedures (as defined in the Securities and Exchange Act of 1934 (the “Exchange Act”) Rules 13a-15(e) and 15d-15(e) as of the end of the period covered by this report (the “Evaluation Date”), and have concluded that as of the Evaluation Date, our disclosure controls and procedures were effective, in all material respects, to ensure that information required to be disclosed in the reports that we file and submit under the Exchange Act (i) is recorded, processed, summarized, and reported, within the time periods specified in the SEC’s rule and forms and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in Internal Controls over Financial Reporting

There have been no changes in our internal controls over financial reporting, except as noted above regarding disclosure controls and procedures, that occurred during the quarter ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

There are no outstanding legal claims involving the business that, in the opinion of management, will have a material effect on our financial statements.

Item 1A. Risk Factors

See our risk factors listed under the section entitled “Risk Factors” included in our Annual Report on Form 10-K for the year ended December 31, 2013.

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

(a) Unregistered Sales of Equity Securities during the Three Months Ended September 30, 2014

None.

(b) Use of Proceeds from Sale of Registered Equity Securities

None.

(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

31.1 Certification of the President and Chief Executive Officer pursuant to Rule 13a-14(a).

31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a).

32 Certification of the President and Chief Executive Officer and the Chief Financial Officer pursuant to 18 United States Code, 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 Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Presentation Linkbase Document

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	Sutron Corporation (Registrant)	
November 14, 2014 Date	By:	/s/ Raul S. McQuivey Raul S. McQuivey President and Chief Executive Officer (Principal Executive Officer)
November 14, 2014 Date	By:	/s/ Glen E. Goold Glen E. Goold Chief Financial Officer (Principal Accounting Officer)