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SUTRON CORP
Form 10QSB
August 09, 2004

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

FORM 10-QSB

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

For the quarterly period ended: June 30, 2004

Commission file number 0-12227

Sutron Corporation
(Exact name of registrant as specified in its charter.)

Virginia 54-1006352
(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation organization)

21300 Ridgetop Circle, Sterling Virginia 20166
(Address of principal executive offices) (Zip Code)

(703) 406-2800
(Registrant's telephone number, including area code)

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

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

Common Stock, \$.01 Par Value - 4,289,551 shares of as of June 30, 2004.

SUTRON CORPORATION
FORM 10-QSB QUARTERLY REPORT
FOR THE QUARTER ENDED JUNE 30, 2004
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PART I. CONDENSED FINANCIAL INFORMATION

Item 1. Financial Statements

SUTRON CORPORATION
BALANCE SHEETS
(Unaudited)

| | June 30, 2004 | December 31, 2003 | |
|-------------------------------------|------------------|----------------------|---------|
| | ----- | ----- | |
| Assets | | | |
| Current Assets: | | | |
| Cash | \$ 270,809 | \$ 388,612 | |
| Accounts receivables | 4,308,209 | 3,062,205 | |
| Inventory | 2,297,919 | 2,438,275 | |
| Prepaid items and other | 85,040 | 122,150 | |
| Deferred income taxes | 180,658 | 120,000 | |
| | ----- | ----- | |
| Total Current Asset | \$7,142,635 | \$6,131,242 | |
| Property, Plant, and Equipment Cost | 2,860,156 | 2,723,107 | |
| Accumulated depreciation | (2,233,624) | (2,125,624) | |
| | ----- | ----- | |
| Net Property, Plant and Equipment | 626,532 | 597,483 | |
| Income taxes receivable | | 0 | 129,000 |
| Other | | 23,986 | 22,986 |
| | ----- | ----- | |
| TOTAL ASSETS | \$7,793,153 | \$6,880,711 | |

LIABILITIES AND STOCKHOLDERS' EQUITY

| | | | |
|--|------------|-------------|---------|
| Current Liabilities: | | | |
| Accounts payable | \$ 663,323 | \$1,043,805 | |
| Accrued payroll | | 255,896 | 50,142 |
| Accrued expenses | 912,457 | 850,726 | |
| Accrued income taxes | 430,712 | | - |
| Current maturities of long-term notes: | | | |
| Line of credit | | 279,153 | 399,454 |
| Notes payable-stockholders | 130,000 | 330,000 | |
| Notes payable | | 105,121 | 49,936 |
| | | ----- | ----- |

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| | | |
|--|-------------|-------------|
| Total Current Liabilities | \$2,776,662 | \$2,724,063 |
| Long-term liabilities: | | |
| Long-term notes payable | 57,696 | 100,129 |
| Deferred income taxes | 111,000 | 111,000 |
| Total liabilities | 2,945,358 | 2,935,192 |
| Stockholders' Equity: | | |
| Common stock, \$.01 par value, | 42,896 | 42,896 |
| Additional paid in capital | 2,306,655 | 2,306,655 |
| Retained Earnings | 2,498,244 | 1,595,968 |
| Total Stockholders' Equity | 4,847,795 | 3,945,519 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$7,793,153 | \$6,880,711 |

See Accompanying Notes to Financial Statements

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SUTRON CORPORATION
STATEMENTS OF OPERATIONS
(Unaudited)

| | Three Months Ended | |
|---|--------------------|-------------|
| | June 30, | |
| | 2004 | 2003 |
| Revenues | \$4,073,841 | \$2,818,796 |
| Cost of Goods Sold | 2,392,705 | 1,826,539 |
| Gross Profit | 1,681,136 | 992,257 |
| Research and Development Expenses | | 252,003 |
| | | 267,077 |
| Selling, General, and Administrative Expenses | 574,167 | 542,255 |
| Income (Loss) from Operations | 854,966 | 182,925 |
| Interest Expense | 8,968 | 4,233 |
| Income (Loss) before Provision for Income Taxes | | 845,998 |
| | | 178,692 |
| Provisions for Income Taxes | 309,000 | (50,000) |
| Net Income | \$ 536,998 | \$ 128,692 |
| Net Income per Common Share | \$.13 | \$.03 |
| Weighted Average Number of Common Shares | 4,289,551 | 4,289,551 |

See Accompanying Notes to Financial Statements

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SUTRON CORPORATION STATEMENTS OF OPERATIONS (Unaudited)

| | Six Months Ended | |
|--|-------------------|---------------------|
| | June 30, | |
| | 2004 | 2003 |
| Revenues | \$7,801,069 | \$5,078,597 |
| Cost of Goods Sold | 4,754,806 | 3,593,408 |
| Gross Profit | <u>3,046,263</u> | <u>1,485,190</u> |
| Research and Development Expenses | | 499,898 |
| | | 584,014 |
| Selling, General, and Administrative Expenses | | 1,120,910 |
| | | 1,193,150 |
| Income (Loss) from Operations | <u>1,425,455</u> | <u>(291,974)</u> |
| Interest Expense | 24,179 | 8,522 |
| Income (Loss) before Provision for Income Taxes | | <u>1,401,276</u> |
| | | (300,496) |
| Provisions for Income Taxes | 499,000 | (146,000) |
| Net Income | <u>\$ 902,276</u> | <u>\$ (154,496)</u> |
| Net Income per Common Share | \$.21 | \$ (.04) |
| Weighted Average Number of Common Shares | 4,289,551 | 4,289,551 |
| See Accompanying Notes to Financial Statements | | |

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SUTRON CORPORATION STATEMENTS OF CASH FLOWS (Unaudited)

| | Six Months Ended | |
|---------------------------------------|------------------|--------------|
| | June 30, | |
| | 2004 | 2003 |
| Cash Flows from Operating Activities: | | |
| Net income (loss) | \$ 902,276 | \$ (154,496) |
| Depreciation and amortization | 108,000 | 107,400 |
| (Increase) Decrease in: | | |
| Accounts receivables | (1,246,004) | (468,177) |
| Inventory | | 140,356 |
| Prepaid items and other | 37,110 | 24,443 |
| Deferred income taxes | | (60,658) |
| Income tax receivable | | 129,000 |
| Other assets | | (1,000) |
| Increase (Decrease) in: | | |
| Accounts payable | (380,482) | 410,034 |
| Accrued expenses | | 267,485 |
| | | 430,197 |

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| | | | |
|---|------------|------------|---|
| Accrued income taxes | 430,712 | - | |
| Net Cash Provided by Operating Activities | 326,795 | (156,007) | |
| Cash Flows from Investing Activities: | | | |
| Capital expenditures | (137,049) | (79,151) | |
| Net Cash Used in Investing Activities | (137,049) | (79,151) | |
| Cash Flows from Financing Activities: | | | |
| Payments on line of credit | | (120,301) | - |
| Payments on term notes payable | - | (46,602) | |
| Payments on shareholder notes payable | (200,000) | - | |
| Proceeds from term notes payable | | 12,752 | - |
| Net Cash (Used) by Financing Activities | (307,549) | (46,602) | |
| Net Increase (Decrease) in Cash | (117,803) | (281,760) | |
| Cash and Cash Equivalents, January 1 | 388,612 | 401,740 | |
| Cash and Cash Equivalents, June 30 | \$ 270,809 | \$ 119,980 | |

See Accompanying Notes to Financial Statements

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SUTRON CORPORATION

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

1. Basis of Presentation

The accompanying financial statements, which should be read in conjunction with the financial statements of Sutron Corporation ("the Company") included in the 2003 Annual Report filed on Form 10-KSB, are unaudited but have been prepared in the ordinary course of business for the purpose of providing information with respect to the interim period. The Company believes that all adjustments (none of which were other than normal recurring accruals) necessary for a fair presentation for such periods have been included.

2. Earnings Per Share

The Company has adopted Statement of Financial Accounting Standards ("SFAS") No. 128 which establishes standards for computing and presenting earnings per share (EPS) for entities with publicly held common stock. The standard requires presentation of two categories of earning per share, basic EPS and diluted EPS. Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the year. 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 or resulted in the issuance of common stock that then shared in the earnings of the Company.

Computation of Per Share Earnings

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| | Three Months Ended | | |
|----------------------------------|--------------------|-------------|-----------|
| | June 30, | | |
| | 2004 | 2003 | |
| <hr/> | | | |
| Basic EPS | | | |
| Average shares outstanding | 4,289,551 | 4,289,551 | |
| Net Income | | \$ 536,998 | \$128,692 |
| Net Income per common share | \$.13 | \$.03 | |
| | | | |
| Dilutive EPS | | | |
| Average shares outstanding | 4,289,551 | 4,289,551 | |
| Effect of dilutive securities | 535,783 | 59,403 | |
| Total average shares outstanding | 4,825,334 | 4,348,954 | |
| Net earnings | \$ 536,998 | \$(283,188) | |
| Net income per diluted share | \$.11 | \$ (.07) | |

| | Six Months Ended | | |
|----------------------------------|------------------|-------------|-------------|
| | June 30, | | |
| | 2004 | 2003 | |
| <hr/> | | | |
| Basic EPS | | | |
| Average shares outstanding | 4,289,551 | 4,289,551 | |
| Net Income | | \$ 902,276 | \$(154,496) |
| Net Income per common share | \$.21 | \$ (.04) | |
| | | | |
| Dilutive EPS | | | |
| Average shares outstanding | 4,289,551 | 4,289,551 | |
| Effect of dilutive securities | 535,783 | 98,769 | |
| Total average shares outstanding | 4,825,334 | 4,388,320 | |
| Net earnings | \$ 902,276 | \$(154,496) | |
| Net income per diluted share | \$.19 | \$ (.04) | |

3. Cash and Cash Equivalents

The Company has entered into certain international contracts that require provision of letters of guarantee to the customer until acceptance of the system by the customer. Standby irrevocable letters of credit were issued by the Company's previous bank that do not expire until March 2005. As of June 30, 2004, \$277,454 of the cash and cash equivalents balance is restricted and is held as security by M&T Bank for these standby letters of credit.

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

Statements made in this Report on Form 10-QSB, including without limitation this Management's Discussion and Analysis of Financial Condition and Operations, other than statements of historical information, are forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements may sometimes be identified by such words as "may," "will," "expect," "anticipate," "believe," "estimate" and "continue" or similar words. We believe that it is important to communicate our

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future expectations to investors. However, these forward-looking statements involve many risks and uncertainties. Our actual results could differ materially from those indicated in such forward-looking statements as a result of certain factors. We are under no duty to update any of the forward-looking statements after the date of this Report on Form 10-QSB to conform these statements to actual results.

Sutron Corporation (the Company) was incorporated on December 30, 1975 under the General Laws of the Commonwealth of Virginia. The Company's headquarters is located at 21300 Ridgetop Circle, Sterling, Virginia 20166, and the Company's telephone number at that location is (703) 406-2800. The Company maintains a worldwide web address at www.sutron.com. The Company designs, manufactures and markets products and solutions that enable government and commercial entities to monitor and collect hydrological and meteorological data for the management of critical water resources, for early warning of potentially disastrous floods or storms and for the optimization of hydropower plants.

The Company is focused on providing real-time solutions and services to our customers in three areas of the hydrological and meteorological markets. First, we provide real-time data collection and control products consisting primarily of dataloggers, satellite transmitters and sensors. Second, we provide turnkey integrated systems for hydrological and meteorological networks and airport weather systems. Third, we provide services consisting of installation, maintenance of hydrological and meteorological systems, and other related engineering services. The Company's customers include a diversified base of federal, state, local and foreign governments, engineering companies, universities, and hydropower companies.

The Company utilizes the accrual method of accounting for both financial statement and tax return reporting purposes. The Company recognizes revenue from product sales upon shipment. Selling, general, and administrative expenses are charged against periodic income as incurred. Revenue from fixed-price contracts is recognized on the percentage-of-completion method based on costs incurred in relation to total estimated costs. Revenue from time-and-materials contracts is recognized to the extent of billable rates, times hours delivered, plus materials costs incurred. Contract costs include allocated indirect costs and anticipated losses on contracts are recognized as soon as they become known.

Our revenue and operating results are subject to substantial variations based on our customers' expenditures and the frequency with which we are chosen to perform services for our customers. Revenue from any given customer will vary from period to period. Our gross margins are affected by the product mix and can vary substantially based on quantities and contract requirements.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our financial statements and notes thereto and the other financial information included elsewhere in this Report on Form 10-QSB.

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Results of Operations

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

Three months ended June 30, 2004 Compared to 2003

| | 2004 | 2003 | | 2004 | 2003 |
|--|------|------|--|--------|--------|
| | ---- | ---- | | ---- | ---- |
| Revenues | | | | 100.0% | 100.0% |
| Cost of sales | 58.7 | | | 64.8 | |
| Gross profit | 41.3 | | | 35.2 | |
| Selling, general and administrative expenses | 14.1 | | | 19.3 | |
| Research and Development expenses | 6.2 | | | 9.5 | |
| Operating income | 21.0 | | | 6.5 | |
| Interest expense | | .2 | | | .2 |
| Income before income taxes | 20.8 | | | 6.3 | |
| Income taxes (benefit) | 7.6 | | | 1.8 | |
| Net income | | | | 13.2% | 4.5% |

Net Revenues. The Company's revenues for the three months ended June 30, 2004 increased 45% to \$4,073,841 from \$2,818,796 in 2003. Domestic sales decreased to \$2,242,380 in the second quarter of 2004 versus \$2,252,954 in 2003. International sales were \$1,831,461 in 2004 versus \$565,842 in 2003. Domestic sales of standard products and systems declined but were offset by increased revenues from hydrological services and engineering services totalling approximately \$443,000. The international sales increase was primarily due to the shipment of XLite dataloggers and bubblers, a water level sensor, to a Canadian consortium for the Emergency Flood Recovery Project in Poland.

Bookings for the second quarter of 2004 were \$4,763,775 as compared to \$3,072,970 in the second quarter of 2003.

Gross Profit. Gross profit for 2004 increased to \$1,681,136 from \$992,257 in 2003. Gross margin as a percentage of revenues for 2004 increased to 41% as compared to 35% in 2003. The increase in the Company's gross margin is due to increased sales volume and to the product mix. Sales of 9210 XLites for the Emergency Flood Recovery Project in Poland significantly improved margins as well as FMQ-13(v)2 Wind Sensor Systems that shipped to Hanscom Air Force Base.

Selling, General And Administrative. Selling, general and administrative expenses increased to \$574,167 in 2004 from \$542,255 in 2003, an increase of \$31,912 or 6%. The primary cause of the increase was sales and marketing expenses related to Sutron's new Airport Weather Systems division.

Research And Development. Research and development expenses decreased to \$252,003 in 2004 from \$267,077 in 2003, a decrease of \$15,074 or 6%. This decrease is due to work performed on the Hanscom Air Force Base FMQ-13(V)2 Wind Sensor Replacement contract that required significant engineering effort

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which is direct billable work versus indirect engineering work.

Interest Expenses. Interest expenses increased to \$8,968 in 2004 from \$4,233 in 2003 due to borrowings from shareholders to supplement the bank line of credit in order to finance inventory growth and project requirements.

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

Six months ended June 30, 2004 Compared to 2003

| | | 2004 | | 2003 |
|--|------|--------|--------|--------|
| | | ---- | | ---- |
| Revenues | | 100.0% | 100.0% | |
| Cost of sales | 61.0 | | 70.8 | |
| Gross profit | 39.0 | | 29.2 | |
| Selling, general and administrative expenses | 14.4 | | 23.4 | |
| Research and Development expenses | 6.4 | | 11.5 | |
| Operating income | 18.3 | | (5.7) | |
| Interest expense | | .3 | | .2 |
| Income before income taxes | 18.0 | | (5.9) | |
| Income taxes (benefit) | 6.4 | | (2.9) | |
| Net income | | 11.6% | | (3.0)% |

Net Revenues. The Company's revenues for the six months ended June 30, 2004 increased 54% to \$7,801,069 from \$5,078,597 in 2003. Domestic sales increased to \$4,255,476 in the first six months of 2004 versus \$3,267,320 in 2003. International sales were \$3,545,593 in 2004 versus \$1,811,277 in 2003. The domestic sales increase was primarily due to approximately \$489,000 of sales of FMQ-13(v)2 Wind Sensor systems to Hanscom Air Force Base and increased services revenues of approximately \$650,00 by the Hydrological Services Division on contracts with the South Florida Water Management District. These increases offset a decrease in domestic standard products and systems which were down by approximately \$151,000. The international sales increase was primarily due to the shipment of XLite dataloggers to a Canadian consortium for the Emergency Flood Recovery Project in Poland.

Bookings for the first six months of 2004 were \$8,911,613 as compared to \$5,212,193 in 2003. As a result to the Company's strong bookings, the Company's backlog of orders at June 30, 2004 was \$5,503,328 as compared to \$2,933,052 as of June 30, 2003. The Company anticipates that 75% of its backlog as of June 30, 2004 will be shipped in 2004.

Gross Profit. Gross profit for 2004 increased to \$3,046,263 from \$1,485,190 in 2003. Gross margin as a percentage of revenues for 2004 increased to 39% as compared to 29% in 2003. The increase in the Company's gross margin is due to increased sales volume and to the product mix. Sales of 9210 XLites for the Emergency Flood Recovery Project in Poland significantly improved margins as well as FMQ-13(v)2 Wind Sensor Systems

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that shipped to Hanscom Air Force Base.

Selling, General And Administrative. Selling, general and administrative expenses decreased to \$1,120,910 in 2004 from \$1,193,150 in 2003, a decrease of \$72,240 or 6%. The primary cause of the decrease was a reduction in international agent commissions.

Research And Development. Research and development expenses decreased to \$499,898 in 2004 from \$584,014 in 2003, a decrease of \$84,116 or 14%. This decrease is due to work performed on the Hanscom Air Force Base FMQ-13(V)2 Wind Sensor Replacement contract that required significant engineering effort which is direct billable work versus indirect engineering work.

Interest Expenses. Interest expenses increased to \$24,179 in 2004 from \$8,522 in 2003 due to borrowings from shareholders to supplement the bank line of credit in order to finance inventory growth and project requirements.

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Liquidity and Capital Resources

Cash and cash equivalents decreased to \$270,809 at June 30, 2004, compared to \$388,612 at December 31, 2003.

The ratio of current assets to current liabilities was 2.57:1 as of June 30, 2004, compared to 2.25 as of December 31, 2003. Working capital at June 30, 2004 increased to \$4,366,278 compared to \$3,407,179 at the end of fiscal 2003. Free cash flow, which is the net of cash provided or used by operations and capital expenditures, improved to \$189,746 in 2004 compared with a loss of \$235,158 in 2003.

The Company has a revolving credit facility of \$1,625,000 with BB&T Bank that expires on August 5, 2005. Borrowings on the line of credit are based on a percentage of billed receivables and finished goods inventory. In addition to the revolving credit facility, the Company borrowed \$330,000 from three shareholders in 2003 in order to finance inventory growth and project requirements. In April 2004, the Company paid one of these notes in full in the amount of \$200,000. The remaining notes are due and payable on demand to Raul S. McQuivey, President, and Thomas N. Keefer, Vice President.

Management believes that its existing cash resources, cash flow from operations and short-term borrowings on the existing line of credit will provide adequate financial resources for supporting operations during the remainder of fiscal 2004.

Item 3. Controls and Procedures

Based on their evaluation of the Companys disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934) as of a date within 90 days of the filing date of this Quarterly Report on Form 10-QSB the Companys chief executive officer and chief financial officer have concluded that the Companys disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange

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Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and are operating in an effective manner.

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their most recent evaluation.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

In 2003, the Company filed a claim with the Advance Tax Court of India seeking a ruling on a decision by the Government of Andhra Pradesh (GoAP) of India to assess a 48% income tax on the Company's contract of approximately \$1,606,000. The GoAP believes that the Company has established a branch office in India and is therefore subject to Indian income tax. Although the Company did file an application for branch office status and received approval to open a branch office, the Company did not complete the registration and approval process with the Government of India and has not opened a branch office in India. The income tax amount that is at issue is approximately \$770,000.

The Advance Tax Court of India heard the case in June 2004 and ruled that Sutron Corporation has a Permanent Establishment in India by virtue of its Country Manager who maintains an office in New Delhi. The Country Manager has the authority to sign contracts and perform other duties on behalf of the Company that fulfill the requirements of Indian tax law and as defined in Double Taxation Avoidance Agreement with the United States of America.

As a result of this ruling, Sutron Corporation has entered into an agreement with Ernst & Young, New Delhi, India to file prior year tax returns. Taxes that will be paid for business activities in India are not known at this time but are anticipated to be significantly less than \$770,000. All taxes paid in India will be applied as income tax credits on the Company's 2004 U.S. tax return in accordance with the Double Taxation Avoidance Agreement with the United States of America and will therefore offset federal taxes in 2004.

Item 4. Submission of Matters to a Vote of Security Holders.

On May 12, 2004, an Annual Meeting of Shareholders of Sutron Corporation was held. Directors elected at the meeting were Raul S. McQuivey, Thomas N. Keefer, Daniel W. Farrell, Sidney C. Hooper and Robert F. Roberts, Jr.

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Thompson, Greenspon & Co., P.C. were appointed as independent accountants for 2004. The election of directors and the appointment of the independent accountants were

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the only matters voted upon at the meeting. The number of shares eligible to vote at the meeting were 4,289,551. The results of the voting on these three matters are shown below.

1. Election of Directors

| Name | Votes For | Votes Withheld |
|------------------------|-----------|----------------|
| Raul S. McQuivey | 2,657,962 | 300 |
| Thomas N. Keefer | 2,657,962 | 300 |
| Daniel W. Farrell | 2,657,962 | 300 |
| Sidney C. Hooper | 2,657,962 | 300 |
| Robert F. Roberts, Jr. | 2,657,962 | 300 |

2. Appointment of Thompson, Greenspon & Co., P.C.
as Independent Accountants.

| For | Against | Abstain |
|-----------|---------|---------|
| 2,657,582 | 580 | 100 |

Item 6. Exhibits and Reports on Form 8-K

B. Reports on Form 8-K

No reports have been filed on Form 8-K during this quarter.

SUTRON CORPORATION

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)

August 6, 2004
Date

/s/Raul S. McQuivey
Raul S. McQuivey
Principal Executive Officer

August 6, 2004
Date

/s/Sidney C. Hooper
Sidney C. Hooper
Principal Accounting Officer