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SUTRON CORP
Form 10QSB
May 15, 2007

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

FORM 10-QSB

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934
For the quarterly period ended March 31, 2007

COMMISSION FILE NUMBER: 0-12227

SUTRON CORPORATION

(Name of small business issuer as specified in its charter)

VIRGINIA

54-1006352

(State or other jurisdiction
of incorporation or organization)

(I.R.S. Employer
Identification Number)

21300 RIDGETOP CIRCLE, STERLING, VIRGINIA 20166

(Address of principal executive offices)

703-406-2800

(Issuer's telephone number)

SECURITIES REGISTERED UNDER SECTION 12(g) OF THE ACT:

COMMON STOCK, \$.01 PAR VALUE

Check whether the issuer: (1) 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 issuer was required to file such reports); and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] No []

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

There were 4,512,884 outstanding shares of the issuer's only class of common equity, Common Stock, \$.01 par value, on March 31, 2007.

Transitional Small Business Disclosure Format (check one): Yes [] No [X]

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SUTRON CORPORATION
FORM 10-QSB QUARTERLY REPORT
FOR THE QUARTER ENDED MARCH 31, 2007

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SUTRON CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

MARCH 31, DECEMBER 31,
2007 2006

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ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 1,981,220	\$ 1,539,032
Restricted cash and cash equivalents	930,529	138,233
Accounts receivable	4,103,451	6,835,751
Inventory	4,048,686	3,402,017
Prepaid items and other assets	709,597	530,720
Deferred income taxes	313,000	333,000
	-----	-----
Total current assets	12,086,483	12,778,753
PROPERTY AND EQUIPMENT, AT COST	3,372,039	3,361,159
Less: Accumulated depreciation and amortization	(2,797,191)	(2,740,941)
	-----	-----
Property and equipment, net	574,848	620,218
OTHER ASSETS	42,597	50,576
	-----	-----
TOTAL ASSETS	\$ 12,703,928	\$ 13,449,547
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 822,104	\$ 1,398,285
Accrued payroll	171,064	317,974
Other accrued expenses	1,368,848	1,506,950
Notes payable - current	50,722	50,722
	-----	-----
Total current liabilities	2,412,738	3,273,931
LONG-TERM LIABILITIES		
Notes payable, net of current maturities	22,108	37,678
Deferred income taxes	120,000	129,000
	-----	-----
TOTAL LONG-TERM LIABILITIES	142,108	166,678
	-----	-----
TOTAL LIABILITIES	2,554,846	3,440,609
	-----	-----
STOCKHOLDERS' EQUITY		
Common stock	45,129	44,946
Additional paid-in capital	2,654,064	2,559,281
Retained earnings	7,456,850	7,417,878
Accumulated other comprehensive (loss) income	(6,961)	(13,167)
	-----	-----
TOTAL STOCKHOLDERS' EQUITY	10,149,082	10,008,938
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 12,703,928	\$ 13,449,547
	=====	=====

See accompanying notes.

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	THREE MONTHS ENDED MARCH 31,	
	2007	2006
Net sales and revenues	\$ 3,146,744	\$ 4,076,108
Cost of sales and revenues	2,006,703	2,269,935
Gross profit	1,140,041	1,806,173
Operating expenses:		
Selling, general and administrative expenses	841,113	848,820
Research and development expenses	293,353	406,269
Total operating expenses	1,134,466	1,255,089
Operating income	5,575	551,084
Interest income (expense), net	22,397	12,355
Income before income taxes	27,972	563,439
Income tax expense (benefit)	(11,000)	204,000
Net income	\$ 38,972	\$ 359,439
Net income per share:		
Basic income per share	\$.01	\$.08
Diluted income per share	\$.01	\$.07

See accompanying notes.

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SUTRON CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31,	
	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 38,972	\$ 359,439

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Noncash items included in net income:		
Depreciation and amortization	56,250	60,000
Deferred income taxes	11,000	--
Stock option compensation	18,385	--
Changes in current assets and liabilities:		
Accounts receivable	2,732,300	(761,581)
Inventory	(646,669)	(562,311)
Prepaid items and other assets	(170,898)	(61,444)
Accounts payable	(576,181)	647,306
Accrued expenses	(285,012)	532,465
	-----	-----
Net Cash Provided (Used) by Operating Activities	1,178,147	213,874
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Restricted cash and cash equivalents	(792,296)	(13,532)
Purchase of property and equipment	(10,881)	(45,000)
	-----	-----
Net Cash Provided (Used) by Investing Activities	(803,177)	(58,532)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on notes payable	(15,570)	(12,693)
Proceeds from stock options exercised	76,582	400
	-----	-----
Net Cash Provided (Used) by Financing Activities	61,012	(12,293)
	-----	-----
Effect of exchange rate changes on cash	6,206	3,264
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	442,188	146,313
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	1,539,032	1,861,627
	-----	-----
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 1,981,220	\$ 2,007,940
	=====	=====
CASH PAID DURING THE PERIOD FOR:		
Interest	\$ 19	\$ 762
	=====	=====
Income taxes paid (received)	\$ 0	\$ 0
	=====	=====

See accompanying notes.

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SUTRON CORPORATION
NOTES TO FINANCIAL STATEMENTS

(UNAUDITED)

MARCH 31, 2007

1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

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, a branch office in India and a

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wholly owned subsidiary in India. The Company is a leading provider of real-time data collection and control products, systems software and professional services in the hydrological, meteorological and oceanic monitoring markets. The Company's principal products include data loggers, satellite transmitters/loggers, water level and meteorological sensors, tides systems and system and application software. Customers consist of a diversified base of Federal, state, local and foreign government agencies, universities and engineering and hydropower companies.

The financial statements included herein have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and disclosures included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report filed on Form 10-KSB for the year ended December 31, 2006. The condensed consolidated balance sheet as of December 31, 2006 was derived from the audited financial statements for the year then ended.

In the opinion of the Company, all adjustments necessary to present fairly the financial position of the Company and the results of its operations and its cash flows have been included in the accompanying financial statements. The results of operations for interim periods are not necessarily indicative of the expected results for the full year.

2. SIGNIFICANT ACCOUNTING POLICIES

The preparation of condensed consolidated financial statements in conformity with GAAP 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 condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. These judgments are difficult as matters that are inherently uncertain directly impact their valuation and accounting. Actual results may vary from management's estimates and assumptions.

The Company's significant accounting policies are disclosed in the Company's Annual report on Form 10-KSB for the year ended December 31, 2006 filed with the Securities and Exchange Commission.

STOCK COMPENSATION

The Company's Amended and Restated 1996, 1997 and 2002 Stock Option Plans (the "Stock Option Plans") provide for the issuance of non-qualified stock options to employees, officers and directors. The plans are administered by the compensation committee of the Board of Directors, which selects persons to receive awards and determines the number of shares subject to each award and the terms, conditions,

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performance measures and other provisions of the award. See Note 13 of the Company's financial statements in its Annual Report on Form 10-KSB for the year ended December 31, 2005 for additional information related to the stock option plans.

Effective January 1, 2006, the Company adopted SFAS No. 123R ACCOUNTING FOR STOCK BASED COMPENSATION (SFAS 123R), which requires companies to measure and recognize compensation expense for all stock-based payments at fair value. SFAS 123R is being applied on the modified prospective transition method and

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therefore the Company has not restated results for prior periods. The financial statements for the three months ended March 31, 2007 recognize compensation cost for the portion of outstanding awards which have vested during the period. The Company recognizes stock-based compensation costs on a straight-line basis over the requisite service period of the award, which is generally the option vesting term. For the three months ended March 31, 2007, total stock-based compensation expense of \$18,385 was included in operating expenses as compared to stock-based compensation of \$0 for the three months ended March 31, 2006. The weighted average fair value of options granted during the three months ended March 31, 2007 was calculated using the Black-Scholes option pricing model with the following valuation assumptions and weighted average fair value as follows:

	Three Months Ended March 31, 2007
Weighted average fair value of grants	\$6.90
Expected volatility	30%
Dividend yield	0
Risk-free interest rate	4.50%
Expected term in years	10.00

The volatility factor is based on the Company's historical stock price fluctuations. The Company has not, and does not intend to, issue dividends; therefore, the dividend yield assumption is 0. The Company applied the risk-free interest rate based on the U.S. Treasury yield in effect at the time of the grant. The expected term of the option is based on the contractual period of the options granted.

3. STOCK OPTIONS

The Company has granted stock options under the Stock Option Plans to key employees and directors for valuable services provided to the Company. Under the 1996 Plan, the Company authorized 260,000 shares, 259,000 of which have been granted. As of December 31, 2004, the Company authorized 60,000 shares and 400,000 shares under the 1997 and 2002 Stock Option Plans, respectively, all of which have been granted. During 2005, the 2002 Stock Option Plan was amended to authorize 650,000 shares, 493,333 of which have been granted. In addition, all three plans were amended in 2005 to allow Directors to participate in the plan, and to provide that vesting schedules will be determined by the Board at the time each individual option is granted.

Shares under all of the plans may be granted at not less than 100 percent of the fair market value at the grant date. All options have a ten-year term from the date of grant. Prior to the 2005 amendments, options vested ratably over five years on each anniversary date the option was granted. The Company elected to accelerate vesting of all outstanding options as of December 31, 2005, as permitted under the plans. Cancelled or expired options are able to be reissued. The following table summarizes stock option activity under the Stock Option Plans for the three months ended March 31, 2007:

	Number of Shares	Weighted Avg. Exercise Price	Number of Options Exercisable
Balance - December 31, 2006	554,333	\$ 1.13	554,333
Granted	50,000	6.90	=====
Exercised	18,333	4.62	
Canceled	--	--	

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Balance - March 31, 2007	586,000	\$	1.53	586,000

4. EARNINGS PER SHARE

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

	Three Months Ended March 31,	
	2007	2006
Net income	\$ 38,972	\$ 359,439
Shares used in calculation of income per share:		
Basic	4,500,792	4,295,207
Effect of dilutive options	535,722	657,679
Diluted	5,036,514	4,952,886
Net income per share:		
Basic	\$.01	\$.08
Diluted	\$.01	\$.07

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 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.

OVERVIEW

Our primary focus is to provide real-time systems solutions, including equipment and software, and services to our customers in the areas of hydrological monitoring and control, meteorological monitoring including airport weather systems, oceanic monitoring and hydrological services. We design, manufacture and market these products and services to a diversified customer base consisting of federal, state, local and foreign governments, universities and engineering and hydropower companies. Our products and services enable these entities to monitor and collect hydrological, meteorological 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 and for providing real-time weather conditions at airports.

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Our key products are the SatLink2 Transmitter/Logger, Xpert/XLite datalogger, Accububble Self-Contained Bubbler, Accubar Pressure Sensor, Tides Systems and XConnect Systems Software. These are

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the essential components of most 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. It is an excellent solution for small systems that do not require a significant number of sensors or communications options. The Xpert and XLite are more powerful dataloggers that have significantly more logging capability and communications options than the SatLink2. Our Tides Systems are the only National Ocean Survey approved tides monitoring system in the United States.

We anticipate that we will continue to experience significant quarterly fluctuations in our sales and revenues in fiscal year 2007. Operating results will depend upon the product mix and upon the timing of project awards. International sales constitute a significant portion of our revenues but are difficult to project. We are aware of many significant international opportunities and we expect international revenues to grow as a percentage of our total business. We expect our sales and marketing, research and development and general and administrative expenses to increase moderately in 2007 as compared to 2006.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's discussion and analysis of financial condition and results of operations are based upon the condensed financial statements, which have been prepared in accordance with generally accepted accounting principles as recognized in the United States of America. The preparation of these financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and disclosure of contingent assets and liabilities. Our estimates include those related to revenue recognition, the valuation of inventory, and valuation of deferred tax assets and liabilities, useful lives of intangible assets, warranty obligations and accruals. We base our estimates on historical experience and on various other assumptions that management believes to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. For a complete description of accounting policies, see Note 1 to our financial statements included in the Company's Form 10-KSB for the year ended December 31, 2006. There were no significant changes in critical accounting estimates

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 March 31,	
	2007	2006
	-----	-----
Net sales and revenues	100.0%	100.0%
Cost of sales and revenues	63.8	55.7
	-----	-----
Gross profit	36.2	44.3
Selling, general and administrative expenses	26.7	20.8
Research and Development expenses	9.3	10.0

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in contract costs in excess of contract revenue for the quarter. Contract estimated costs were increased due to delays in the civil works installation as approximately 30 sites were damaged by monsoons. Also, the CWC contract is the first significant project that has been executed by our India Operations. Due to a lack of experience on projects of this size, warranty costs (the costs to maintain the 168 stations for a period of two years from systems acceptance) were underestimated. Although the contract estimated costs increased due to the reasons discussed above, the CWC contract is profitable. After expiration of the two year warranty period, we will maintain the 168 sites under a four-year maintenance contract.

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SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses decreased to \$841,113 in 2007 from \$848,820 in 2006. Selling, general and administrative expenses as a percentage of revenues increased to 26.7% in 2007 from 20.8% in 2006 due to the revenue decrease.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses decreased to \$293,353 in 2007 from \$406,269 in 2006, a decrease of \$92,194 or 7.5%. We incurred significant subcontractor expenses in 2006 relating to the development of our next generation Xpert/XLite. The contractor tasks have been completed and we anticipate that the next generation Xpert/XLite will be released to production in the second quarter of 2007. Our satellite transmitter, dataloggers, water level sensors and tides systems are the primary components of hydrometeorological systems and we are continuously improving these products as well as developing new products in order to maintain and improve our competitive position.

INTEREST INCOME AND EXPENSE, NET

Due to the Company's cash position, the Company did not use its line of credit during the first quarter of 2007 except on one occasion. The Company had interest income in 2007 of \$22,397 as compared to interest income of \$12,355 in 2006.

INCOME TAXES

Due to lower first quarter income before taxes, we received an income tax benefit in 2007 of \$11,000 as compared to income taxes of \$204,000 in 2006. The provisions for income taxes represent an effective tax benefit rate of 39.3% in 2007 and an income tax rate of 36.2% in 2006, respectively.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents were \$1,981,220 at March 31, 2007 compared to \$1,539,032 at December 31, 2006. Working capital increased to \$9,673,745 at March 31, 2007 compared with \$9,504,822 at December 31, 2006.

Net cash provided by operating activities was \$1,178,147 for the three months ended March 31, 2007 as compared to cash provided by operating activities of \$213,874 for the three months ended March 31, 2006. The increase is primarily due to a decrease in accounts receivable.

Net cash used by investing activities was \$803,177 for the three months ended March 31, 2007 as compared to cash used by investing activities of \$58,532 for the three months ended March 31, 2006, and was primarily due to an increase in

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restricted cash that secured a bank guarantee to the Central Water Commission of India for the delivery of contract equipment. We anticipate that the bank guarantee will be released in October 2007.

Net cash provided by financing activities was \$61,012 for the three months ended March 31, 2007 as compared to net cash used by financing activities of \$12,293 for the three months ended March 31, 2006 due to the exercise of employee stock options.

We have a revolving credit facility of \$2,500,000 with BB&T Bank. We are permitted to borrow based on accounts receivable and inventory according to pre-established criteria. The credit facility expires on

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August 5, 2007 and is secured by substantially all assets of the Company. Borrowings bear interest at the bank's prime rate. During the first quarter of 2007, there was one borrowing on the line of credit.

We frequently bid on and enter into international contracts that require bid and performance bonds. At March 31, 2007 and December 31, 2006, a commercial bank had issued standby letters of credit in the amount of \$532,300 that served as either bid or performance bonds. The amount available to borrow under the line of credit was reduced by these amounts.

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 2007. Although there can be no assurance that our revolving credit facility will be renewed, management believes that, if needed, it would be able to find alternative sources of funds on commercially acceptable terms.

ITEM 3. CONTROLS AND PROCEDURES

(a) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

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 Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of March 31, 2007, the end of the fiscal period covered by this report on Form 10-QSB. The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act of 1934 reports are recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information 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. Based on this evaluation, the chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

(b) CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING

There have been no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

Various legal claims can arise from time to time in the normal course of business which, in the opinion of management, will have no material effect on our financial statements. We have been named in a compensation claim under the Indian Anti-Trust Law that is pending before The Monopolies and Restrictive Trade Practices Commission in New Delhi, India. Management believes that the case is unsubstantiated and intends to vigorously defend itself.

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ITEM 6. EXHIBITS

31.1 Certification of the President and Chief Executive Officer pursuant to ss.302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of the Chief Financial Officer and Treasurer pursuant to ss.302 of the Sarbanes-Oxley Act of 2002.

32 Certification of the President and Chief Executive Officer and Chief Financial Officer and Treasurer pursuant to 18 U.S.C. ss.1350, as adopted pursuant to ss.906 of the Sarbanes-Oxley Act of 2002.

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)

May 14, 2007

Date

/s/ Raul S. McQuivey

Raul S. McQuivey
President and Chief Executive Officer
(Principal Executive Officer)

May 14, 2007

Date

/s/ Sidney C. Hooper

Sidney C. Hooper
Chief Financial Officer and Treasurer
(Principal Accounting Officer)

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