

SUTRON CORP
Form 10-Q
August 13, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2013
Commission file number: 0-12227

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

VIRGINIA
(State or other jurisdiction
of incorporation or organization)

54-1006352
(I.R.S. Employer
Identification Number)

22400 Davis Drive, Sterling, Virginia 20164
(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 No

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 No

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. (Check one).

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

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Non-accelerated filer
company

Smaller reporting

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

There were 5,066,009 outstanding shares of the issuer's only class of common equity, Common Stock, \$0.01 par value, on August 13, 2013.

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SUTRON CORPORATION
FORM 10-Q QUARTERLY REPORT
FOR THE QUARTER ENDED JUNE 30, 2013

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

SUTRON CORPORATION
CONSOLIDATED BALANCE SHEETS

| | (Unaudited) June 30, 2013 | (Audited) December 31, 2012 |
|---|---------------------------------|-----------------------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$6,322,489 | \$7,576,374 |
| Restricted cash and cash equivalents | 818,453 | 810,396 |
| Accounts receivable, net | 5,597,267 | 5,771,013 |
| Inventory | 4,893,888 | 4,291,505 |
| Prepaid items and other assets | 310,445 | 248,546 |
| Income taxes receivable | 1,277,154 | 1,202,709 |
| Deferred income taxes | 745,000 | 666,000 |
| Total Current Assets | 19,964,696 | 20,566,543 |
| Property and Equipment, Net | 1,679,802 | 1,698,218 |
| Other Assets | | |
| Goodwill | 4,754,152 | 3,768,435 |
| Intangibles, net of amortization | 714,463 | 781,633 |
| Other Assets | 90,799 | 95,217 |
| Total Assets | \$27,203,912 | \$26,910,046 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$1,149,407 | \$1,300,917 |
| Accrued payroll | 349,524 | 464,942 |
| Deferred revenue | 556,979 | 531,397 |
| Other accrued expenses | 1,431,795 | 1,134,279 |
| Billings in excess of costs and estimated earnings | 539,344 | 306,148 |
| Total Current Liabilities | 4,027,049 | 3,737,683 |
| Long-Term Liabilities | | |
| Deferred rent | 886,672 | 1,006,893 |
| Deferred income taxes | 145,000 | 39,000 |
| Total Long-term Liabilities | 1,031,672 | 1,045,893 |
| Total Liabilities | 5,058,721 | 4,783,576 |
| Stockholders' Equity | | |
| Common stock, 12,000,000 shares authorized; 5,066,009 and 5,039,632 issued and outstanding | 50,469 | 50,397 |
| Additional paid-in capital | 5,283,259 | 5,185,325 |
| Retained earnings | 17,050,383 | 17,073,351 |
| Accumulated other comprehensive loss | (238,920) | (182,603) |
| Total Stockholders' Equity | 22,145,191 | 22,126,470 |

| | | |
|--|--------------|--------------|
| Total Liabilities and Stockholders' Equity | \$27,203,912 | \$26,910,046 |
|--|--------------|--------------|

See accompanying notes.

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

| | Three Months Ended June 30, | |
|--|-----------------------------|-------------|
| | 2013 | 2012 |
| Revenue | \$6,343,240 | \$6,804,168 |
| Cost of goods sold | 3,987,068 | 4,027,666 |
| Gross profit | 2,356,172 | 2,776,502 |
| Operating expenses: | | |
| Selling, general and administrative expenses | 1,467,134 | 1,347,544 |
| Research and development expenses | 976,254 | 627,633 |
| Total operating expenses | 2,443,388 | 1,975,177 |
| Operating income (loss) | (87,216) | 801,325 |
| Financing income, net | 6,046 | 15,345 |
| Income (loss) before income taxes | (81,170) | 816,670 |
| Income tax expense (benefit) | (28,000) | 265,000 |
| Net income (loss) | \$(53,170) | \$551,670 |
| Net income (loss) per share: | | |
| Basic income (loss) per share | \$(0.01) | \$0.12 |
| Diluted income (loss) per share | \$(0.01) | \$0.11 |
| Comprehensive income (loss): | | |
| Net income (loss) | \$(53,170) | \$551,670 |
| Foreign currency translation adjustments | (60,344) | (35,952) |
| Comprehensive income (loss) | \$(113,514) | \$515,718 |

See accompanying notes.

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

| | Six Months Ended June 30, | |
|--|---------------------------|--------------|
| | 2013 | 2012 |
| Revenue | \$12,798,350 | \$10,541,349 |
| Cost of goods sold | 7,796,037 | 6,338,255 |
| Gross profit | 5,002,313 | 4,203,094 |
| Operating expenses: | | |
| Selling, general and administrative expenses | 3,101,137 | 2,352,360 |
| Research and development expenses | 1,946,393 | 1,180,901 |
| Total operating expenses | 5,047,530 | 3,533,261 |
| Operating income (loss) | (45,217) | 669,833 |
| Financing income, net | 9,249 | 26,728 |
| Income (loss) before income taxes | (35,968) | 696,561 |
| Income tax expense (benefit) | (13,000) | 221,000 |
| Net income (loss) | \$(22,968) | \$475,561 |
| Net income per share: | | |
| Basic income per share | \$0.00 | \$0.10 |
| Diluted income per share | \$0.00 | \$0.09 |
| Comprehensive income (loss): | | |
| Net income (loss) | (22,968) | 475,561 |
| Foreign currency translation adjustments | (56,317) | (12,017) |
| Comprehensive income (loss) | \$(79,285) | \$463,544 |

See accompanying notes.

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SUTRON CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Six Months Ended June 30, | |
|--|---------------------------|---------------------|
| | 2013 | 2012 |
| Cash Flows from Operating Activities: | | |
| Net income (loss) | \$(22,968 |) \$475,561 |
| Noncash items included in net income: | | |
| Depreciation and amortization | 259,850 | 143,365 |
| Deferred income taxes | 36,000 | (32,134) |
| Stock based compensation | 80,080 | 44,364 |
| Tax benefit from stock options exercised | (12,996) | (9,873) |
| Change in current assets and liabilities: | | |
| Accounts receivable | 256,599 | 323,534 |
| Inventory | (435,285) | (639,217) |
| Prepaid items and other assets | (58,632) | (153,153) |
| Income taxes receivable | (61,449) | 67,636 |
| Accounts payable | (151,510) | (55,571) |
| Accrued expenses | 138,976 | (124,933) |
| Deferred revenues | 25,582 | 174,860 |
| Billings in excess of costs and estimated earnings | 233,196 | 282,572 |
| Deferred rent | (120,221) | (102,103) |
| Net Cash Provided by Operating Activities | 167,222 | 394,908 |
| Cash Flows from Investing Activities: | | |
| Restricted cash and cash equivalents | (8,057) | (131,551) |
| Purchase of property and equipment | (164,747) | (30,264) |
| Certificate of deposit | - | (1,933) |
| Other assets | 4,418 | 5,093 |
| Business Acquisition | (1,214,330) | (4,241,914) |
| Net Cash Used by Investing Activities | (1,382,716) | (4,400,569) |
| Cash Flows from Financing Activities: | | |
| Tax benefit from stock options exercised | 12,996 | 9,873 |
| Proceeds from stock options exercised | 4,930 | 89,000 |
| Net Cash Provided by Financing Activities | 17,926 | 98,873 |
| Effect of exchange rate changes on cash and cash equivalents | (56,317) | (17,601) |
| Net decrease in cash and cash equivalents | (1,253,885) | (3,924,389) |
| Cash and Cash Equivalents, beginning of period | 7,576,374 | 8,737,543 |
| Cash and Cash Equivalents, end of period | \$6,322,489 | \$4,813,154 |

See accompanying notes.

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SUTRON CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 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, oceanic, air quality and aviation monitoring markets. The Company’s principal products include data loggers, satellite transmitters/loggers, water level and meteorological sensors, tides systems, ambient air instrumentation and continuous emissions control monitoring and system and application software. Customers consist of a diversified base of Federal, state, local and foreign government agencies, commercial entities, universities, engineering firms 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 (“SEC”). Certain information and disclosures included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been omitted pursuant to such rules and regulations. The consolidated balance sheet as of December 31, 2012 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.

We recommend that you read the unaudited consolidated financial statements included herein in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, filed with the SEC on March 29, 2013.

2. Significant Accounting Policies

The preparation of 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 consolidated financial statements and the reported amounts of revenue 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-K for the year ended December 31, 2012.

Recent Accounting Standards

In December 2011, the FASB issued ASU 2011-11, “Balance Sheet (Topic 210) – Disclosures about Offsetting Assets and Liabilities.” This ASU requires entities to disclose both gross information and net information about both instruments and transactions eligible for offset in the balance sheet and instruments and transactions subject to an agreement similar to a master netting arrangement. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The adoption of the new guidance did not have a material impact on the Company’s consolidated financial statements.

In July 2012, the FASB issued ASU 2012-02, "Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment," which provides entities with the option to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If the entity concludes that it is more likely than not that the asset is impaired, it is required to determine the fair value of the intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying value in accordance with Topic 350. If the entity concludes otherwise, no further quantitative assessment is required. ASU 2012-02 is effective on January 1, 2013. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

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In January 2013, the FASB issued ASU 2013-01, “Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities.” The amendments in this ASU clarify the scope for derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements and securities borrowing and securities lending transactions that are either offset or subject to netting arrangements. An entity is required to apply the amendments for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In February 2013, the FASB issued ASU 2013-02, “Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.” The amendments in this ASU require an entity to present (either on the face of the statement where net income is presented or in the notes) the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income. In addition, the amendments require a cross-reference to other disclosures currently required for other reclassification items to be reclassified directly to net income in their entirety in the same reporting period. Companies should apply these amendments for fiscal years, and interim periods within those years, beginning on or after December 15, 2012. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

3. Stock-Based 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 Company's 2010 Equity Incentive Plan provides for the grant of stock options, stock appreciation rights, restricted stock, stock units, unrestricted stock, dividend equivalent rights and cash awards. All plans are administered by the Governance & Compensation committee of the Board of Directors who select persons to receive awards and determines the number of shares subject to each award and the terms, conditions, performance measures and other provisions of the award.

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. The Company authorized 60,000 shares under the 1997 Plan, all of which have been granted. Under the 2002 Stock Option Plan, the Company authorized 650,000 shares, 597,059 of which have been granted. The 1996, 1997 and 2002 Plans remain in effect until such time as no shares of Stock remain available for issuance under the Plans and the Company and the person awarded options have no further rights or obligations under the Plans. Under the 2010 Equity Incentive Plan, the Company authorized 500,000 shares, 88,500 of which have been granted as restricted stock units. The ability to make awards under the 2010 Plan will terminate in May 2020. Stock options under all of the plans may be granted at not less than 100 percent of the fair market value at the grant date. All outstanding options have a ten-year term from the date of grant. Cancelled or expired options and restricted stock units can be reissued.

The Company measures and recognizes compensation expense for all stock-based payments at fair value. 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 or restricted stock unit (RSU) vesting term. There were no stock options granted during the six months ended June 30, 2013. There were 9,000 RSU's granted during the six months ended June 30, 2013. Stock based compensation expense relating to stock option awards and RSU's for the six months ended June 30, 2013 and 2012 was \$80,080 and \$44,364, respectively. These expenses were included in the cost of sales and selling, general and administrative lines of the Consolidated Statements of Operations. Unamortized stock compensation expense as of June 30, 2013 relating to stock options totaled approximately \$27,214 and these costs will be expensed over a weighted average period of 2.4 years. Unamortized stock compensation expense as of June 30, 2013 relating to RSU's totaled approximately \$143,029 and these costs will be expensed over a weighted average period of 2.8 years.

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The following table summarizes stock option activity under the Stock Option Plans for the six months ended June 30, 2013:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|------------------------------------|---------------------|---------------------------------------|---|---------------------------------|
| Outstanding at beginning of period | 155,978 | \$6.45 | 5.55 | \$33,991 |
| Granted | - | - | - | - |
| Exercised | 7,252 | 0.68 | - | 32,489 |
| Forfeited or expired | - | - | - | - |
| Outstanding at end of period | 148,726 | \$6.73 | 4.82 | \$7,800 |
| Exercisable at end of period | 134,726 | \$6.76 | 4.66 | \$7,800 |
| Nonvested at end of period | 14,000 | \$6.47 | 6.38 | \$- |

The following table summarizes RSU activity under the 2010 Equity Incentive Plan for the six months ended June 30, 2013:

| | Number of Shares | Weighted Average Grant Date Fair Value | Weighted Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|---|---------------------|---|---|---------------------------------|
| Outstanding restricted stock units at January 1, 2013 | 69,375 | \$4.21 | 2.56 | \$350,344 |
| Granted | 9,000 | 5.33 | - | 47,966 |
| Forfeited | 3,000 | 4.86 | - | 14,592 |
| Vested | 19,125 | 4.66 | - | 89,196 |
| Outstanding restricted stock units at June 30, 2013 | 56,250 | \$4.29 | 2.78 | \$241,513 |
| Restricted stock units expected to vest | 34,994 | \$4.29 | 4.47 | \$197,373 |

4. Earnings (Loss) 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 June 30, | |
|---|-----------------------------|------------|
| | 2013 | 2012 |
| Net income | \$ (53,170) | \$ 551,670 |
| Shares used in calculation of income per share: | | |
| Basic | 5,062,251 | 4,717,654 |
| Effect of dilutive options | 57,719 | 357,127 |
| Diluted | 5,119,970 | 5,074,781 |
| Net income per share: | | |
| Basic | \$ (0.01) | \$ 0.12 |
| Diluted | \$ (0.01) | \$ 0.11 |

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| | Six Months Ended June 30, | |
|---|---------------------------|------------|
| | 2013 | 2012 |
| Net income | \$ (22,968) | \$ 475,561 |
| Shares used in calculation of income per share: | | |
| Basic | 5,059,524 | 4,711,390 |
| Effect of dilutive options | 57,643 | 357,127 |
| Diluted | 5,117,167 | 5,068,517 |
| Net income per share: | | |
| Basic | \$ (0.00) | \$ 0.10 |
| Diluted | \$ (0.00) | \$ 0.09 |

5. Completed Acquisition

On March 6, 2013 the Company completed its acquisition of substantially all of the commercial and operating assets of Sabio Instruments (“Sabio”) for the cash amount of \$1,214,330. Sabio provides air quality monitoring products including ambient air instrumentation and continuous emission monitoring systems. The acquisition of Sabio was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration paid were recorded at their estimated fair values as of the acquisition date.

The purchase consideration was allocated to the tangible assets acquired and liabilities assumed on the basis of their respective fair values on the acquisition date. The Company’s allocation of the total purchase price is as follows:

| | Value |
|--------------------------------|--------------|
| Accounts Receivable | \$ 82,853 |
| Inventory | 167,099 |
| Prepaid items and other assets | 3,267 |
| Property and equipment | 9,516 |
| Deferred tax asset | 9,000 |
| Accrued expenses | (43,122) |
| Goodwill | 985,717 |
| Totals | \$ 1,214,330 |

Goodwill

The goodwill amount of \$985,717 represents the excess of the purchase price over the fair value of the identified net tangible assets. The goodwill recognized in this acquisition was derived from expected benefits from future technology, sales synergies and a knowledgeable and experienced workforce who joined the Company. Goodwill will not be amortized, but will be tested instead for impairment annually in the fourth quarter of each fiscal year or more frequently if certain indicators of impairment are present. Goodwill is expected to be tax deductible for income tax purposes. There is no impairment of goodwill as of June 30, 2013.

Intangible Assets

Intangible assets will be reviewed and may be established. Any material adjustments to the estimates will be reflected, retroactively, as of the date of the acquisition including valuation of any intangible assets that have not yet been reviewed.

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

Statements made in this Quarterly Report on Form 10-Q, 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 including those identified in the Company's Annual Report on Form 10-K for the year ended December 31, 2012. 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 Quarterly Report on Form 10-Q 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, meteorological, air quality and oceanic monitoring. We design, manufacture, market and sell these 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 these entities to monitor and collect air quality, 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, for the monitoring of emissions and for the supply of critical aviation information.

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 are 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. 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.

We began fiscal year 2013 with a backlog of approximately \$13,354,000 as compared to beginning fiscal year 2012 with a backlog of approximately \$9,599,000. As of June 30, 2013, our backlog totaled approximately \$14,562,000. We have historically experienced significant fluctuations in our quarterly sales and revenue and anticipate that we will continue to experience significant quarterly fluctuations in our sales and revenue in 2013. Operating results will depend upon the product mix and upon the timing and execution of project awards.

International sales, which totaled 57% of revenue for 2012 and 49% of revenue for the first six months of 2013, 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 expand our international sales opportunities. International sales are however difficult to forecast because they are frequently delayed due to the different governmental procurement and approval processes. Our domestic business is highly dependent upon government business. Contracts and purchase orders with Federal, state and local government agencies represented approximately 28% of our 2012 revenue and 33% of our revenue for the first six months of 2013.

We are committed in our ongoing sales, marketing and research and development activities to sustain and grow our sales and revenue from our existing and new products and services. We expect our sales and marketing, research and

development and general and administrative expenses to increase in 2013 as compared to 2012 due to planned spending on sales and marketing activities and on the development of new products and applications in our new MeteoStar and Sabio divisions as well as our legacy business..

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 currently developing an expanded set of monitoring and warning solutions. We will continue to seek other acquisitions that are compatible with our strategic focus.

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Critical Accounting Policies and Estimates

The Company's discussion and analysis of financial condition and results of operations are based upon the 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, 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 2 to our financial statements included in the Company's Form 10-K for the year ended December 31, 2012. There were no significant changes in critical accounting estimates in the six months ended June 30, 2013.

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 June 30, | |
|--|-----------------------------|---------|
| | 2013 | 2012 |
| Net sales and revenues | 100.0 % | 100.0 % |
| Cost of sales and revenues | 62.9 | 59.2 |
| Gross profit | 37.1 | 40.8 |
| Selling, general and administrative expenses | 23.1 | 19.8 |
| Research and development expenses | 15.4 | 9.2 |
| Operating income (loss) | (1.4) | 11.8 |
| Interest and other income | 0.1 | 0.2 |
| Income (loss) before income taxes | (1.3) | 12.0 |
| Income taxes (benefit) | (0.5) | 3.9 |
| Net income (loss) | (0.8) % | 8.1 % |

Three Months ended June 30, 2013 Compared to Three Months Ended June 30, 2012

Net Sales and Revenues

Revenues for the second quarter ended June 30, 2013 decreased 7% to \$6,343,240 from \$6,804,168 in 2012. Net sales and revenues are broken down between sales of standard products and sales of systems and services. Standard products had a net sales and revenue increase of 52% to \$2,444,229 in 2013 from \$1,607,404 in 2012. Sales of Sabio air quality systems accounted for \$391,631 of the increase. Net sales and revenues for systems and services decreased 25% to \$3,899,011 in the second quarter of 2013 from \$5,196,764 in 2012. Sales of MeteoStar systems and services were \$1,153,244 in the second quarter of 2013 as compared to \$511,320 in the second quarter of 2012. The overall decrease is attributed to decreased project activity in 2013.

Overall domestic revenues increased 40% to \$3,134,182 in the second quarter of 2013 versus \$2,246,134 in 2012 due primarily to increased non-federal revenues. International revenues decreased 30% to \$3,209,058 in the second quarter of 2013 versus \$4,558,034 in the same period in 2012 due primarily to decreased project activity.

Customer orders or bookings in the second quarter of 2013 increased 3% to approximately \$7,765,000 as compared to approximately \$7,557,000 in the second quarter of 2012.

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Cost of Sales and Revenues

Cost of sales as a percentage of revenues was 63% and 59%, respectively, for the second quarter of 2013 and 2012. Standard product cost of sales was approximately 56% in the second quarter of 2013 as compared to 55% in 2012. Cost of sales for systems and services was 67% in the second quarter of 2013 as compared to 61% in the second quarter of 2012. The increase was primarily due to shipment of lower margin systems.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased to \$1,467,134 for the second quarter of 2013 from \$1,347,544 for the same period in 2012. The increase in selling, general and administrative expenses for the quarter was primarily due to the additions of MeteoStar and Sabio for the full quarter in 2013 as compared to the second quarter of 2012 which only included one month of MeteoStar selling, general and administrative expenses.

Research and Development Expenses

Research and development expenses increased to \$976,254 for the second quarter of 2013 from \$627,633 for the same period in 2012. MeteoStar and Sabio research and development activities accounted for the increase. MeteoStar development efforts were focused on LEADS6 software development and Sabio development efforts were focused on expanding their product line of air quality sensors.

Interest and Other Income, Net

Due to our cash position, we did not use our line of credit during the second quarter of 2013 or 2012. We had interest income for the quarter ended June 30, 2013 of \$6,047 as compared to net interest income of \$15,345 for the quarter ended June 30, 2012.

Income Taxes

We received an income tax benefit of \$28,000 for the quarter ended June 30, 2013. We recorded an income tax expense of \$265,000 for the quarter ended June 30, 2012. The income tax benefit in 2013 represents an effective tax benefit rate of 34%. The income tax provision in 2012 represents an effective income tax rate of 32%.

Six months ended June 30, 2013 Compared to Six Months Ended June 30, 2012

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, | |
|--|---------------------------|---------|
| | 2013 | 2012 |
| Net sales and revenues | 100.0 % | 100.0 % |
| Cost of sales and revenues | 60.9 | 60.1 |
| Gross profit | 39.1 | 39.9 |
| Selling, general and administrative expenses | 24.2 | 22.3 |
| Research and development expenses | 15.2 | 11.2 |
| Operating income (loss) | (0.3) | 6.4 |

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| | | | | |
|-----------------------------------|------|-----|-----|---|
| Interest and other income | 0.0 | | 0.3 | |
| Income (loss) before income taxes | (0.3 |) | 6.6 | |
| Income taxes (benefit) | (0.1 |) | 2.1 | |
| Net income (loss) | (0.2 |) % | 4.5 | % |

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Net Sales and Revenues

Revenues for the six months ended June 30, 2013 increased 21% to \$12,798,350 from \$10,541,349 in 2012. Net sales and revenues are broken down between sales of standard products and sales of systems and services. Standard products had a net sales and revenue increase in 2013 of 31% to \$5,285,419 from \$4,024,379 in 2012. Sales of Sabio air quality systems accounted for \$465,597 of the increase. Net sales and revenues for systems and services increased 14% to \$7,512,931 from \$6,516,970 in 2012. The increase was primarily due to our Meteostar Division sales and revenue of \$2,880,407 in 2013 as compared to \$511,320 in 2012 that reflected only one month's sales and revenues. The increase in Meteostar sales and revenues offset decreased project activity in 2013.

Overall domestic revenues increased 56% to \$6,483,009 for the six months ended June 30, 2013 versus \$4,154,916 in 2012 due primarily to increased non-federal revenues. International revenues decreased 1% to \$6,315,340 for the six months ended June 30, 2013 versus \$6,386,433 in 2012 due to decreased project activity.

Customer orders or bookings for the six months ended June 30, 2013 were approximately \$14,028,000 as compared to approximately \$14,092,000 in 2012.

Cost of Sales and Revenues

Cost of sales as a percentage of revenues was 61% and 60%, respectively, for the six months ended June 30, 2013 and 2012. Standard product cost of sales as a percentage of standard product revenues was approximately 56% and 53%, respectively, for the six months ended June 30, 2013 and 2012. Cost of sales for systems and services as a percentage of systems and services revenues was 64% for the six months ended June 30, 2013 as compared to 65% for the six months ended June 30, 2012.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$3,101,137 in 2013 as compared to \$2,352,360 in 2012, an increase of \$748,777 or 32%. Selling, general and administrative expenses as a percentage of revenues increased to 24% for the six months ended June 30, 2013 from 22% in 2012. The increase in SG&A expenses was primarily due to increased expenses of approximately \$563,000 relating to Meteostar operations and increased amortization expenses of approximately \$67,000 relating to Meteostar intangible assets.

Research and Development Expenses

Research and development expenses increased to \$1,946,393 for the six months ended June 30, 2013 from \$1,180,901 in 2012, an increase of \$765,492 or 65%. Increased Meteostar and Sabio research and development expenses of approximately \$827,000 were partially offset by decreases in other research and development activities.

Interest and Other Income, Net

Due to the Company's cash position, the Company did not use its line of credit during the six months ended June 30, 2013 and 2012. The Company had net interest income in 2013 of \$9,249 as compared to net interest income of \$26,728 in 2012.

Income Taxes

We received an income tax benefit of \$13,000 for the six months ended June 30, 2013. We recorded an income tax expense of \$221,000 for the six months ended June 30, 2012. The income tax benefit in 2013 represents an effective

tax benefit rate of 36%. The income tax provision in 2012 represents an effective income tax rate of 32%.

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Liquidity and Capital Resources

Cash and cash equivalents were \$6,322,489 at June 30, 2013 compared to \$7,576,374 at December 31, 2012. Working capital decreased to approximately \$16 million at June 30, 2013 compared with approximately \$17 million at December 31, 2012.

We have a revolving credit facility of \$3,000,000 with Branch Banking and Trust (BB&T). We are permitted to borrow based on accounts receivable and inventory according to pre-established criteria. The credit facility expires on September 5, 2013 and is secured by substantially all the assets of the Company. Borrowings bear interest at the bank's prime rate. During the first six months of 2013, there was no borrowing on the line of credit. We frequently bid on and enter into contracts that require bid and performance bonds. At June 30, 2013 and December 31, 2012, BB&T had issued standby letters of credit in the amount of \$1,717,376 and \$1,094,162, respectively, 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 2013.

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, 2012. The Company's exposure to market risk has not changed materially since December 31, 2012.

Item 4T. 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 June 30, 2013, the end of the fiscal period covered by this report on Form 10-Q. 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 controls over financial reporting that occurred during the quarter ended June 30, 2013 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 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 Chief Financial Officer pursuant to 18 U.S.C. ss.1350, as adopted pursuant to ss.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)

August 13, 2013
Date

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

August 13, 2013
Date

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

