SUTRON CORP
Form 10QSB
May 17, 2005

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: March 31, 2005

Commission file number 0-12227

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

Virginia
(State or other jurisdiction of incorporation organization)

54-1006352
(I.R.S. Employer Identification No.)

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

20166
(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 [X] 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 March 31, 2005.

SUTRON CORPORATION
FORM 10-QSB QUARTERLY REPORT
FOR THE QUARTER ENDED MARCH 31, 2005
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PART I. CONDENSED FINANCIAL INFORMATION

Item 1. Financial Statements

SUTRON CORPORATION
BALANCE SHEETS

(Unaudited)

	March 31, 2005	December 31, 2004
ASSETS		
Current Assets		
Cash and cash equivalents	$ 873,777	$1,419,171
Accounts receivable	4,559,493	3,755,439
Inventory	2,388,583	2,371,476
Prepaid items and other	403,760	270,014
Deferred income taxes	179,000	179,000
Total Current Assets	8,404,613	7,995,100
Property and equipment, at cost	3,073,943	3,038,168
Less - Accumulated depreciation and amortization	(2,388,497)	(2,328,496)
Net property, plant and equipment	685,446	709,672
Other assets	36,905	51,133
Total Assets	$9,126,964	$8,755,905

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities		
Accounts payable	$ 800,587	$ 943,616

Accrued payroll	170,444	272,601
Other accrued expenses	1,247,008	1,400,779
Accrued income taxes	386,866	-
Notes payable - current	25,613	25,613
Total Current Liabilities	2,630,518	2,642,609
Long-Term Liabilities		
Notes payable, net of current maturities	55,681	89,666
Deferred income taxes	172,000	111,000
Total Liabilities	2,858,199	2,904,275
Stockholders' Equity		
Common stock	42,896	42,896
Additional paid-in capital	2,306,655	2,306,655
Retained earnings	3,890,221	3,497,930
Accumulated other comprehensive income	28,993	4,149
Total Stockholders' Equity	6,268,765	5,851,630
Total Liabilities and Stockholders' Equity	$9,126,964	$8,755,905

See Accompanying Notes to Financial Statements

SUTRON CORPORTION
STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended March 31, 2005	2004
Revenues	$3,893,933	$3,727,228
Cost of Goods Sold	2,239,270	2,362,101
Gross Profit	1,654,663	1,365,127
Research and Development Expenses	309,494	247,895
Selling, General, and Administrative Expenses	730,738	546,743
Income (Loss) from Operations	614,431	570,489
Interest income (expense)	3,860	(15,210)
Income (Loss) before Provision for Income Taxes	618,291	555,279
Provisions for Income Taxes	226,000	190,000
Net Income	$ 392,291	$ 365,279
Net Income per Common Share	$ .09	$ .09

Weighted Average Number of Common Shares	4,289,551	4,289,551

See Accompanying Notes to Financial Statements

SUTRON CORPORTION
STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31, 2005	2004
Cash Flows from Operating Activities:		
Net income (loss)	$ 392,291	$ 365,279
Depreciation and amortization	60,001	53,903
(Increase) Decrease in:		
Accounts receivables	(804,054)	(399,038)
Inventory	(17,107)	(49,092)
Prepaid items and other	(133,746)	83,982
Deferred income taxes	0	(91,658)
Other assets	14,228	(700)
Increase (Decrease) in:		
Accounts payable	(143,029)	(221,953)
Accrued expenses	130,938	517,015
Net Cash Provided by Operating Activities	(500,478)	257,738
Cash Flows from Investing Activities:		
Capital expenditures	(35,775)	(88,419)
Net Cash Used in Investing Activities	(35,775)	(88,419)
Cash Flows from Financing Activities:		
Payments on line of credit	-	(399,454)
Payments on Term notes payable	(33,985)	27,435
Net Cash (Used) by Financing Activities	(33,985)	(372,019)
Currency adjustments		
Effect of exchange rate changes on cash	24,844	-
Net Increase (Decrease) in Cash	(545,394)	(202,700)
Cash and Cash Equivalents, January 1	1,419,171	388,612
Cash and Cash Equivalents, March 31	$ 873,777	$ 185,912

See Accompanying Notes to Financial Statements

SUTRON CORPORATION

NOTES TO FINANCIAL STATEMENTS

March 31, 2005

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 2004 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

	Three Months Ended March 31, 2005	2004
Basic EPS		
Average shares outstanding	4,289,551	4,289,551
Net Income	$ 392,291	$ 365,279
Net Income per common share	$.09	$.09
Dilutive EPS		
Average shares outstanding	4,289,551	4,289,551
Effect of dilutive securities	653,992	391,760
Total average shares outstanding	4,943,543	4,681,311
Net earnings	$ 392,291	$ 365,279
Net income per diluted share	$.08	$.08

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.

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 disasterous 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 realtime 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 Companys 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. Anticipated losses 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.

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:

	2005	2004
Revenues	100.0%	100.0%
Cost of sales	58.5	63.4
Gross profit	42.5	36.6
Selling, general and administrative expenses	18.7	14.7
Research and Development expenses	8.0	6.7
Operating income	15.8	15.2
Interest income (expense)	.1	(.3)
Income before income taxes	15.9	14.9
Income taxes (benefit)	5.8	5.1
Net income	10.1%	9.8%

Net Revenues

The Company's revenues for the three months ended March 31, 2005 increased 4.5% to $3,893,933 from $3,727,228 in 2004. The Company derives its revenues from the sale of products consisting primarily of dataloggers, satellite transmitters/loggers and sensors, integrated systems, hydrological services consisting primarily of equipment installation and maintenance and engineering services and airport weather systems.

Company revenues are broken down between the Company's operating divisions or profit centers which include the HydroMet Products Division, the Integrated Services Division which includes Special Projects and the Company's India Branch Office, the Hydrological Services Division and the Airport Weather Systems Division.
The HydroMet Products Division, which is responsible for sales of standard products, had a revenue decrease of 19.3% to $1,782,780 from $2,209,608 in 2004. In 2004, the Company shipped approximately $500,000 of standard product to a Canadian consortium for a project in Poland. There was no similiar sized shipment in 2005. Integrated Systems revenues increased 9.5% to $1,244,294 from $1,136,360 in 2004. Revenues from the Hydrological Services Division increased 37.4% to $512,171 from $372,860 in 2004 due to increased contract awards primarily from the South Florida Water Management District. Airport Weather Systems revenues increased to $354,688 from $8,400 in 2004 due to shipments to the Meteorological Service of the Netherlands Antilles and Aruba. The Airport Weather Systems Division was established in July 2003 and services a market that the Company

previously was not able to compete in due to a lack of expertise. The Company hired a manager with over 20 years experience in the aiport weather monitoring market and this hiring is viewed as critical to the success of this division.

Overall domestic sales increased 9.7% to $2,265,596 in the first quarter of 2005 versus $2,053,056 in 2004 while international sales decreased 2.7% to $1,628,337 in 2005 versus $1,674,172 in 2004.

Bookings for the first quarter of 2005 were $3,025,257 as compared to $4,147,838 in the first quarter of 2004. The Company's backlog of orders at March 31, 2005 was $4,752,292 as compared with $4,771,481 as of March 31, 2004. The Company anticipates that 70% of its backlog as of March 31, 2005 will be shipped in 2005.

Cost of Sales

Cost of sales as a percentage of revenues was 57.5% for the quarter ended March 31, 2005 as compared to 63.4% for the quarter ended March 31, 2004. Although Company revenues increased 4.5%, cost of sales decreased $122,831 in 2005 as compared to 2004 due primarily to the SatLink2. The SatLink2 was certified in January 2004 but units were not delivered until May 2004. The SatLink2 redesign was done in order to reduce parts, improve manufacturability and to add increased functionality. Cost of goods sold on this product was reduced significantly due to the redesign. Also contributing to the lower cost of sales was improved margins on Integrated Systems projects and on Airport Weather Systems projects. Both divisions had revenue increases and performed projects in line with cost and margin expectations.

Gross Profit

Gross profit for 2005 increased 21.2% to $1,654,663 from $1,365,127 in 2004. Gross margin as a percentage of revenues for 2005 increased to 42.5% as compared to 36.6% in 2004. The increase in the Company's gross margin is due to increased sales volume, to the product mix and to the effect of the SatLink2 on gross margins in 2005. The SatLink2 was certified in January 2004 but units were not delivered until May 2004. The SatLink2 redesign was done in order to reduce parts, improve manufacturability and to add increased functionality. Gross margin on this product has improved significantly for the reasons stated above.

Selling, General And Administrative

Selling, general and administrative expenses increased to $730,738 in 2005 from $546,743 in 2004, an increase of $183,995 or 34%. The Company experienced increases in legal fees, banking fees, bad debt writeoffs, marketing activities and international agent commissions. The Company also has made an accrual for the estimated profit sharing contribution for 2005 that is reflected in selling, general and administrative expenses.

Research and Development

Research and development expenses increased to $309,494 in 2005 from $247,895 in 2004, an increase of $61,599 or 25%. In 2004, significant engineeringlabor was performed on the Hanscom Air Force Base FMQ-13(V)2 Wind Sensor Replacement contract which was direct billable work versus R&D engineering work. This resulted in lower R&D expenses. The Company also has accrued a prorata share of the estimated profit sharing contribution for 2005 that is reflected in R&D expenses.

Interest Income/Expense
Due to the Company's cash position, the Company did not use its line of credit during the first quarter of 2005. The Company had interest income in 2005 of $3,860 as compared with interest expenses of $15,210 in 2004.

Income Taxes
The Company's first quarter profits resulted in an increase in income taxes. Taxes increased 18.9% in 2005 to $226,000 from $190,000 in 2004. Taxes as a percentage of revenue were 5.8% in 2005 as compared to 5.1% in 2004.

Net Income
The Company's net income in 2005 increased 7.4% to $392,291 from $365,279 in 2004. Net income as a percentage of revenue was 10.1% in 2005 as compared to 9.8% in 2004.

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Liquidity and Capital Resources

The Companys working capital was $5.77 million at March 31, 2005 compared with $5.35 million at December 31, 2004. Cash on hand was $873,777 at March 31, 2005 compared to $1,419,171 at December 31, 2004. Of the cash balance on hand at March 31, 2005, $85,813 was restricted and served as bid bonds on international tenders. Of the cash balance on hand at December 31, 2004, $277,454 was restricted and served as collateral for international standby letters of credit and $108,568 was restricted and served as bid bonds on international tenders.

Net cash used by operating activities was $500,478 for the quarter ended March 31, 2005 as compared to cash provided by operating activities of $257,738 for the quarter ended March 31, 2004.

Net cash used by investing activities was $35,775 for the quarter ended March 31, 2005 as compared to cash used by investing activities of $88,419 for the quarter ended March 31, 2004, and was primarily due to purchases of property and equipment.

Net cash used by financing activities was $33,985 for the quarter ended March 31, 2005 due to payments on installment notes. Net cash used by financing activities was $372,019 for the quarter ended March 31, 2004 due to payments on the line of credit and on term and installment notes.

The Company has a $1,625,000 line of credit with a commercial bank. The line of credit is collateralized by substantially all of the assets of the Company and guaranteed by the primary stockholders of the Company and expires August 2005. Under the terms of the line of credit, the Company is required to maintain certain financial covenants. Interest is charged at the banks prime rate plus one-half percent and is payable monthly. There was no balance outstanding at March 31, 2005 and at December 31, 2004.

The Company frequently bids on and enters into international contracts that require bid and performance bonds. At March 31, 2005 and December 31, 2004, the bank had issued standby letters of credit in the amount of $346,962 and $186,354, respectively, that served as either bid or performance bonds. The amount available 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 2005.

Item 3. Controls and Procedures

a) Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were not effective to enable us to record, process, summarize and report information required to be included in the Companys periodic SEC filings and annual proxy statement within the required time period.

Specifically, during the quarter ended March 31, 2005, we discovered that we failed to timely file a Current Report on Form 8-K relating to our quarterly earnings press release. In addition, in connection with outside counsels review of our definitive proxy statement on Schedule 14A, we identified control weaknesses relating to our non-compliance with certain disclosure requirements in the SECs rules relating to proxy statements. After discovering such weaknesses, and in an effort to address and remedy the weaknesses, we promptly filed a Current Report on Form 8-K and amended our definitive proxy materials to ensure appropriate public disclosures.

Our control weaknesses relate to our failure to devote sufficient resources to keep abreast of changing disclosure requirements, including those requirements that were imposed after the passage of the Sarbanes-Oxley Act of 2002. We are in the process of correcting the identified weakness by, among other things, allocating additional personnel to the disclosure process, adopting written disclosure controls and procedures, forming a disclosure controls committee that will consider the materiality of information and determine disclosure obligations on a timely basis, and engaging outside counsel to review prior SEC filings in addition to future filings. These actions should be completed during the second quarter.

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, 2005 that have materially affected, or are likely to materially effect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

From time to time, the Company is involved in litigation with customers, vendors, suppliers and others in the ordinary course of business, and a number of such claims may exist at any given time. All such existing proceedings are not expected to have a material adverse impact on the Company's results of operations or financial condition. The Company is a party to the proceedings discussed below.

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 believed that the Company had established a branch office in India and was 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 had not opened a branch office in India. The income tax amount that is at issue was approximatly $770,000.

The Advance Tax Court of India heard the case in September 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 fulfills 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 entered into an agreement with Ernst & Young, New Delhi, India to file tax returns for the tax periods April 1, 2002 to March 31, 2003 and April 1, 2003 to March 31, 2004. The returns for both tax periods were filed in October 2004. A refund in the amount of approximately $137,000 will be issued to Sutron for the tax period ending March 31, 2003 resulting from excess withholdings by the Government of Andhra Pradesh in excess of the tax amount of approximately $5,250. A tax payment of approximately $5,600 was made for the tax period ending March 31, 2004. All taxes paid in India will be applied as income tax credits on the Company's U.S. tax returns in accordance with the Double Taxation Avoidance Agreement with the United States of America and will therefore offset federal taxes.

The Company is currently awaiting acceptance on two systems that were provided to the Government of Andhra Pradesh in 2002. All contractual items on the systems have been accepted with the exception of four water level monitoring sites that are located at reservoirs. The Government of Andhra Pradesh believes that the sites should go down approximately 100 meters at the sites. The Company does not believe that it is required to provide monitoring at 100 meters due to lack of specification in the Request for Proposal (RFP) and the Company's proposal that specified 10 meters at each site. This matter has not yet been but will most likely be referred to an arbitrator as per provisions of the contract. In the event that the Company loses the arbitration hearing, additional costs of approximately $120,000 will be incurred to install the sites down to 100 meters.

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

None.

Item 6. Exhibits and Reports on Form 8-K

B. Reports on Form 8-K

The Company filed two Reports on Form 8-K during this quarter. A Form 8-K was filed on January 28, 2005 in regards to the Company's 2004 Third Quarter earnings news release and a Form 8-K was filed on March 15, 2005 in regards to the Company's 2004 Fourth Quarter earnings news release. Both filings were done in accordance with SEC Release No. 33-8255.

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)

May 16, 2005	/s/Raul S. McQuivey
Date	Raul S. McQuviey
	Principal Executive Officer

May 16, 2005	/s/Sidney C. Hooper
Date	Sidney C. Hooper
	Principal Accounting Officer