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SONICS & MATERIALS INC
Form 10KSB40
September 27, 2001

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U. S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-KSB

(MARK ONE)

ANNUAL REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934. FOR THE FISCAL YEAR ENDED JUNE 30, 2001.

TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934. FOR THE TRANSITION PERIOD FROM _____ TO _____.

COMMISSION FILE NUMBER: 0-20753

SONICS & MATERIALS, INC.
(Name of Small Business Issuer in Its Charter)

DELAWARE
(State or Other Jurisdiction of
Incorporation or Organization)

060854713
(I.R.S. Employer
Identification No.)

53 CHURCH HILL ROAD, NEWTOWN, CT
(Address of Principal Executive Offices)

06470
(Zip Code)

Issuer's Telephone Number, Including Area Code: (203) 270-4600

SECURITIES REGISTERED UNDER SECTION 12(B) OF THE EXCHANGE ACT: None

SECURITIES REGISTERED UNDER SECTION 12(G) OF THE EXCHANGE ACT:
Common Stock, par value \$.03 per share
(Title of class)
Warrants to purchase Common Stock
(Title of class)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes No

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is contained in this form, and no disclosure will be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

The issuer's revenues for the most recent fiscal year were: \$11,347,937

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based upon the closing sale price of the Company's Common Stock on September 21, 2001 as reported on the Over the Counter Bulletin Board, was approximately \$474,747. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of September 21, 2001, the issuer had outstanding 3,520,100 shares of Common Stock, par value \$.03 per share.

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

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement relating to the 2001 Annual Meeting of Stockholders are incorporated by reference in Part III.

PART I

ITEM 1. DESCRIPTION OF BUSINESS

Sonics & Materials, Inc. (the "Company" or "Sonics") designs, manufactures and sells (i) ultrasonic bonding equipment for the welding, joining and fastening of thermoplastic components, textiles and other synthetic materials, and (ii) ultrasonic liquid processors for dispersing, blending, cleaning, degassing, atomizing and reducing particles as well as expediting chemical reactions. To further address the needs of its customers, the Company also manufactures a spin welder and the vibration welder, both of which are used for the bonding of thermoplastic components.

The Company was incorporated in New Jersey in April 1969, and was reincorporated in Delaware in October 1978. Robert S. Soloff, its chairman, president and founder, invented the ultrasonic plastic welding process early in his career. He has been granted nine patents in the field of power ultrasonics and is considered to be a pioneer in the application of ultrasonic technology to industrial processes. Mr. Soloff has also been issued a patent in the field of vibration welding. The patents granted to Mr. Soloff in the field of power ultrasonics have expired and the technology related to them is now in the public domain and is used in part in the development and manufacture of the Company's products.

On August 21, 2001, the Company sold 90% of the common stock of its wholly-owned subsidiary, Tooltex, Inc., to PK Spur Company, whose sole shareholders are Tooltex's president, Paul Spurgeon, and Kathy Spurgeon. Tooltex is a manufacturer of automated systems used in the plastics industry. In exchange for 90% of the Tooltex common stock, the Company received a note from PK Spur for \$125,000 which is payable over a twenty-four month period. In conjunction with the sale of the stock, Tooltex and Sonics entered into a representation and distribution agreement whereby Tooltex will continue to act as a distribution organization for Sonics' welding equipment. Sonics originally acquired Tooltex from Paul Spurgeon on July 25, 1997.

PRODUCTS

The Company manufactures equipment in the following categories:

ULTRASONIC WELDERS -- Manufactured by the Company since its founding, this line of ultrasonic devices welds, bonds, fastens, sews and rivets thermoplastic components and other synthetic materials. As new applications were requested by industrial customers, the line has expanded over the years. Plastic welders and related devices are used in a wide variety of industries and applications. These include the automotive, computer, electronics, packaging,

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toy, home entertainment, medical device, textile and garment, and home appliance industries.

There are certain advantages to ultrasonic bonding in comparison to more traditional welding techniques. Uniform production is often accomplished due to the consistency, speed and focusing of the energy applied to the welded part. The bond created between the components is generally strong and clean. Because no solvents, adhesives or external heat are involved, adverse environmental factors are minimized. Materials which may not be easily assembled or welded by other technologies can be effectively bonded ultrasonically. Moreover, ultrasonic bonding is generally faster and requires less skilled labor or training than many other methods.

LIQUID PROCESSORS - Liquid processors, which are sold under the Company's trade name "Vibra-Cell" or under private label, are ultrasonic devices that disperse, break up, emulsify, atomize, mix and blend substances in a liquid or semi-liquid media. Substances affected by liquid processing include molecules, cells, tissues, fluids, chemicals and particles. These devices are available in different power configurations for low, medium and high volume applications with various capacities, features and accessories. Operating similarly to ultrasonic bonding systems and composed of many of the same components, liquid processors produce a different result because they are utilized in liquid, semi-liquid and powdered media.

Liquid processors are utilized in biotechnology by scientists, biologists, chemists and pharmacologists, primarily in laboratories for research and testing purposes. The Company has extended the applications for its liquid processors from the research laboratories to industrial settings. The liquid processor also functions to process and test materials and substances on the production line and in vats and tanks. In the manufacture of pharmaceuticals and in the processing of petroleum products and certain specialty chemicals, they reduce particle size and facilitate mixing; in the preparation of paint and dyes, they blend and homogenize materials. In the ink industry, processors disperse black carbon. In the beverage and other industries, they are used to de-gas carbonated soda, wine, beer, spirits and solvents. The Company's liquid processors are also used as high-intensity cleaners. These ultrasonic cleaning devices are effective in spot cleaning and removing various contaminants, such as radioactive particles, proteins, rust, blood, and oil from laboratory equipment.

The Company also manufactures a liquid processor with a spray nozzle that atomizes fluids by producing ultra-fine sprays in precisely measured dosages or at extremely low flow rates. Utilized in laboratories and plants, ultrasonic atomizers can coat, moisten, or deposit micro-droplets of liquid on glass, fabric, paper, semiconductors, pharmaceuticals, ceramics or tubes. They are also used to apply silicone and Teflon, disinfect surfaces and lubricate small parts.

VIBRATION WELDER -- Vibration welders are generally used to weld larger plastic components together, and have the ability to weld a wider variety of plastics. In this technology, a non-vibrating part is hydraulically lifted from below to meet a horizontally-vibrating part. The vibrations cause friction and heat, melting the plastic, and a bond is effectuated between the plastic parts. The vibration welder that has been designed and is currently being manufactured by the Company is computer-controlled and has a power supply, digital display and other features similar to the Company's ultrasonic welder.

SPIN WELDER -- The Company has developed and currently manufactures spin welders based on a non-ultrasonic process known as rotary friction welding. Rotary friction welding is a bonding technology generally used only when assembling cylindrical or round-shaped thermoplastic parts. It is also better suited for plastics of a semi-crystalline nature and assemblies requiring

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significant tooling relief. In spin welding, one plastic component is spun against a mating plastic part that is held stationary in a nesting fixture. Friction generated by the spinning action produces heat which melts the plastic and fuses the two parts together.

The spin welding system offered by Sonics features, among other things, a multi-function programmable controller, RPM display, and a two horsepower electronic drive motor that spins the plastic part. The spin welder is composed of a steel frame and column with a control box. Other components of the system include a pneumatic head, an automotive spindle bearing, an air brake and clutch system, and steel plates.

ULTRASONIC SURGICAL INSTRUMENT - Through a wholly owned subsidiary, Vibra-Surge Corporation, the Company designed, developed and marketed an ultrasonic medical device, the Vibra-Surge (TM) System Model VS 2120 ("Vibra-Surge"), for the removal of soft tissue in general and reconstructive and plastic surgery. In May 2000, Sonics' elected to discontinue the Company's Vibra-Surge operation.

INDUSTRY BACKGROUND

Management believes that in the past twelve months, there has been a slowdown in market demand for ultrasonic bonding systems, and other plastic assembly systems.. Although it had appeared that more companies were seeking to replace metal components with thermoplastics in order to reduce the weight of products or to capitalize on other special properties of synthetic substances, the recent slowdown in the economy has affected the growth of this product line. The market for liquid processors in the past has experienced inconsistent growth and occasional contractions, however, new and more extensive

applications of such technology in other industries, such as the paint, chemical, petroleum and beverage industries, and medical industries has provided for continued growth.

MANUFACTURING AND SUPPLY

Sonics' manufacturing operations, conducted at its facilities located in Newtown, Connecticut, and Aston, Pennsylvania are run on a batch basis in which a series of products move irregularly from station to station. The Company manufactures its products pursuant to historical and projected sales data as well as specific customer orders.

Most supplies and materials required in the manufacture of the Company's products are available from many sources. Many of its suppliers are based in the same general locality as the Company's manufacturing operations. To date, Sonics has experienced few shortages and delays regarding supplies and materials. However, it is not certain that such shortages or delays may not have an adverse impact on Sonics' operations in the future. In fiscal year 2000, one supplier accounted for more than 5%, but less than 10% of its total purchases for inventory. In fiscal year 2001, two suppliers accounted for more than 5%, but less than 10% of its total purchases for inventory. Although management believes that in all cases alternate sources of supplies can be located, a certain amount of time would inevitably be required to find substitutes. During any such interruption in supplies, the Company may have to curtail the production and sale of its devices and systems for an indefinite period.

Sonics is not a party to any formal written contract regarding the delivery of its supplies and materials. It generally purchases such items pursuant to written purchase orders of both the individual and blanket varieties. Blanket purchase orders usually entail the purchase of larger amounts of items at fixed prices for delivery and payment on specific dates ranging from two months to one year.

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Sonics has qualified its Connecticut facility to meet the quality management and assurance standards of an international rating organization (ISO 9001). ISO 9001 certification indicates that the Company has successfully implemented a quality assurance system that satisfies this standard. Sonics has also obtained CE approvals, which are now necessary for sales in Europe, for many models of its ultrasonic welder and liquid processor. It is working towards CE approvals for its other product lines.

MAINTENANCE AND SERVICE

The Company offers warranties on all its products, including parts and labor that range from one year to three years depending upon the type of product concerned. For the fiscal years ended June 30, 2000 and 2001, expenses attributable to warranties were approximately \$59,000, and \$71,000 respectively. Sonics performs repair services on all of its products sold domestically either at its Connecticut or Pennsylvania facilities or at customer locations. Servicing of foreign sales is usually handled by distributors abroad or in the Company's Swiss branch office regarding its devices sold in Europe. These services are performed upon specific orders without contracts at various rates. The Company usually charges for the time that its employees expend on the task and the cost of the materials or parts involved in the repair. For the fiscal years ended June 30, 2000 and 2001, the Company had income of approximately \$644,000, and \$617,000 respectively, for out-of-warranty services performed. Company devices generally have a long operating life, and Sonics has repaired machines manufactured by it that are more than 30 years old.

SALES AND MARKETING

Sonics generally markets and sells its products in the United States and abroad through a network of sales representatives and distributors to end users and original equipment manufacturers ("OEMs"). In the United States, the Company and its Ultra Sonic Seal division ("USS") utilize approximately 46 sales representatives in 48 states throughout the country. In the overseas market, it relies on approximately 71 distributors and several sales representatives to distribute its products in 49 countries. The areas covered by these third parties include North and South America, the Middle and Far East, Europe and Australia.

SALES REPRESENTATIVES

The Company's relationship with its sales representatives is usually governed by a written contract which is generally terminable by either party on 30 days prior notice. The contract provides for exclusive territorial and product representation and commissions payable to them on their sales depending on whether basic units or accessories are involved and typically covers ultrasonic bonding systems and liquid processors. OEM sales made by the Company are excluded from the commission arrangements. Generally, the sales representatives do not purchase for their own account, but merely sell Sonics' products on the Company's behalf. They also may represent other manufacturers but generally not those competitive with the Company's products. In fiscal year 2000, two sales representatives each accounted for more than 5% but less than 15% of Sonics' sales. In fiscal year 2001, no sales representative accounted for more than 5% of total sales.

USS sells its plastic welder under its division name. USS maintains a network of sales representatives in the United States different from those for Sonics' main product lines. The terms of these arrangements with its sales representatives are similar to the terms Sonics negotiates with its own sales representatives.

DISTRIBUTORS

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Sales of Sonics' products to distributors are also generally made pursuant to written contracts. Under such contracts, distributors provide repair service and are prevented from selling devices competitive to the Company's products. Generally, payments must be made in U.S. dollars within 30 days of delivery of the product. Distribution arrangements are either exclusive or non-exclusive and are cancelable upon 30 days notice. The contracts generally exclude private label sales made by Sonics in the distributor's territory even if the relationship is of an exclusive type and typically covers sales of both ultrasonic bonding systems and liquid processor lines. The Company now also offers both its spin welder and vibration welder to its sales representatives and distributors. The Company also sells these products directly to end-users or under private label. The Company usually grants discounts to distributors, depending on the product and quantity sold. In fiscal year 2000, one distributor accounted for over 5%, but less than 10%, of sales. In fiscal year 2001, one distributor accounted for over 10% but less than 15% of sales. The loss of such distributors in substantial numbers or at key locations could have a material adverse effect on the Company's business.

The Company promotes the sale of its products through direct mailings, trade shows, product literature, press releases, advertising in trade magazines and listings in catalogs. The Company occasionally engages in cooperative advertising with some of its distributors.

CUSTOMERS

Sonics sells its products, directly or indirectly, to numerous customers, ranging in size from small companies to large Fortune 100 corporations. Its customers are end-users, original equipment manufacturers, system integrators and resellers as well as distributors. Many of its customers are repeat purchasers. None of its customers represented more than 5% of Sonics' sales for fiscal 2000 or 2001.

INTERNATIONAL OPERATIONS

The Company's international activities are an important portion of its business. Approximately 22% and 23% of its sales for fiscal years 2000 and 2001, respectively, are attributable to sales of its products outside the United States. The Company also operates a branch office in Gland, Switzerland where it sells and services its ultrasonic devices for the European market except for the United Kingdom.

Internationally, the Company sells its ultrasonic products under its own label to end users and distributors or under the trade name of the distributor. In most cases, Sonics' devices are shipped to foreign distributors and end users as completed units. However, in certain situations, especially with regard to distributors of ultrasonic welders located in Asia and South America, the Company's systems are made available in kit form and assembled there. Kits frequently contain all components for devices but in some instances only a portion of the requisite components is provided. For some foreign sales, no written distribution arrangement exists.

COMPETITION

The Company competes in each of its markets against a variety of other concerns, many of which are larger and have greater financial, technical, marketing, distribution and other resources than Sonics. It competes on the bases of service, performance, reliability, price and delivery.

Prior to making a sale, the Company will expend time and resources exploring whether it can profitably handle a new application for potential and existing customers. Generally, the Company receives no compensation for this

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pre-sale activity except when special tooling is required and payment for such services only occurs when and if product sales are consummated. Like nearly all manufacturers in this industry, the Company invests heavily in this pre-sale examination of new applications. Such examination represents another area in which such manufacturers compete, and those with greater resources and manpower may possess a competitive advantage.

With respect to its ultrasonic bonding equipment, the Company encounters competition from Branson Ultrasonics Co. ("Branson"), a subsidiary of Emerson Electric Co., Dukane Corp. ("Dukane"), Herrmann Ultrasonics, Inc., Forward Technology Industries, Inc. and other smaller manufacturers. The two dominant companies in this area are Branson and Dukane. Some of these competitors also offer spin and vibration devices as well as ultrasonic ones.

In the ultrasonic liquid processor market, the Company's principal competitors are Branson and Misonix Inc. Management believes that in this market Sonics has the largest market share.

BACKLOG

As of June 30, 2001, the Company's backlog was approximately \$3,623,000 as compared with a backlog of \$2,561,567 as of June 30, 2000. No one customer accounted for more than 10% of such backlog at June 30, 2000, however, two customers did account for more than 10% of such backlog at June 30, 2001.

Substantially all of the Company's backlog figures are based on written purchase orders executed by the customer and involve product deliveries and not engineering services. All orders are subject to cancellation.

RESEARCH AND DEVELOPMENT

The Company maintains an engineering staff responsible for the improvement of existing products, modification of products to meet customer needs and the engineering, research and development of new products and applications. Engineering and research and development expenses were approximately \$408,000 for 2000 and \$410,000 for 2001.

INTELLECTUAL PROPERTY

Proprietary information and know-how are important to the Company's success. Sonics has trademark protection for its "Vibra-Cell" trade name and its "Vibra-Surge" trade name. There can be no assurance that others have not developed, or will not develop, independently the same or similar information or obtain and use proprietary information of the Company. Sonics has obtained written assurances from its employees, sales representatives and distributors under confidentiality agreements regarding its proprietary information.

On May 23, 2000, the U.S. Patent and Trademark office issued the Company a patent for a method of producing fabric covered panels with a vibration welder. On September 22, 2000, the Company received a Notice of Allowance and Allowability from the U.S. Patent and Trademark office for the tooling developed by the Company for producing fabric covered panels. The U.S. Patent and Trademark office issued the Company a patent on October 12, 1999 for its ultrasonic surgical device. On August 29, 2000, the Company received Notice of Allowance and Allowability from the U.S. Patent and Trademark office for an additional patent related to the Company's ultrasonic surgical device.

GOVERNMENT REGULATION

Sonics' bonding and liquid processor lines generally are not governed by specific legal rules and laws.

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Sonics' sales abroad may make it subject to other U.S. and foreign laws. The Company and its agents are also governed by the restrictions of the Foreign Corrupt Practices Act of 1977, as amended (the "FCPA"). The FCPA prohibits the promise or payments of any money, remuneration or other items of value to foreign government officials, public office holders, political parties and others with regard to obtaining or preserving commercial contracts or orders. Sonics has urged its foreign distributors to comply with the requirements of the FCPA. All these restrictions may hamper the Company in its marketing efforts abroad.

In addition, other federal, state and local agencies, including those in the environmental, fire hazard control, and working conditions areas could have a material adverse affect upon the Company's ability to do business. Sonics is not involved in any pending or threatened proceedings that would require curtailment of, or otherwise restrict, its operations because of such regulations and compliance with applicable environmental or other regulations. None of these laws has had a material effect upon its capital expenditures, financial condition or results of operations.

EMPLOYEES

As of September 25, 2001, the Company had 64 full-time employees including its officers, of whom 37 were engaged in manufacturing, 3 in repair services, 5 in administration and financial control, 7 in engineering and research and development, and 12 in marketing and sales.

None of Sonics' employees is covered by a collective bargaining agreement or represented by a labor union. Sonics considers its relationship with its employees to be good.

The design and manufacture of the Company's equipment requires substantial technical capabilities in many disparate disciplines, from mechanics and computer science to electronics and mathematics. While management believes that the capability and experience of its technical employees compares favorably with other similar manufacturers, there can be no assurance that it can retain existing employees or attract and hire the highly capable technical employees necessary in the future on favorable terms, if at all.

COMPANY'S STATEMENT REGARDING FORWARD LOOKING STATEMENTS

Any statements in this Annual Report that are not statements of historical fact are forward-looking statements that are subject to a number of important risks and uncertainties that could cause actual results to differ materially. Specifically, any forward looking statements in this Annual Report related to the Company's objectives of future growth, profitability and financial returns are subject to a number of risks and uncertainties, including, but not limited to, risks related to a growing market demand for Sonics' existing and new products, continued growth in sales and market share of Sonics and its USS products, pricing, market acceptance of existing and new products, a fluctuation in the sales product mix, general economic conditions, interest rate fluctuations, competitive products, and product and technology development. There can be no assurance that such objectives will be achieved.

ITEM 2. DESCRIPTION OF PROPERTY

The Company's primary manufacturing and office facility is located in Newtown, Connecticut in one 64,000 square foot steel and cinder block building (the "Newtown Property"). This facility is considered adequate for the Company's current needs, as well as its anticipated future requirements. The facility was purchased on September 19, 1997. The Company renovated the building and consolidated all of its former Danbury facilities into the Newtown Property in May of 1998. The Newtown Property was purchased for \$1,265,000 and the cost of

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improvements to the property was approximately \$2,200,000.

On August 30, 2001, the Company sold the Newtown manufacturing facility to Acme Realty for \$4,000,000. Upon the completion of the sale, Sonics signed a ten year triple net lease with Acme Realty, with an option to renew the lease for two additional five year periods. Sonics presently occupies approximately 58,363 square feet of the building. By the beginning of the second year of the lease, Sonics will reduce the space it occupies to approximately 44,500 square feet.

Sonics had previously leased 7,200 square feet of the building to an unrelated third party. This lease has been assigned to Acme Realty.

The Newtown Property is insured against fire and other casualty in an amount the Company believes to be adequate.

The following table lists the Company's leased offices by location as of September 25, 2001, and certain other information:

	APPROXIMATE TOTAL AREA LEASED IN SQUARE FOOTAGE	EXPIRATION DATE OF LEASE	APPROXIMATE CURRENT ANNUAL RENT
Newtown, Connecticut.....	58,363	August 30, 2011(2)	\$393,950
Aston, Pennsylvania.....	4,900	September 30, 2002	40,300(1)
Gland, Switzerland.....	3,000	January 31, 2001(2)	13,800(1)

(1) Includes proportionate cost of utilities, repairs, cleaning, snow removal, taxes and insurance.

(2) Contains renewal option as listed below:

Newtown, Connecticut.....5 years
Gland Switzerland.....1 year

The Company believes that it has adequate insurance coverage for all of its leased properties. The Company also leases certain automobiles and equipment.

ITEM 3. LEGAL PROCEEDINGS

There is no pending or threatened material litigation or proceeding against the Company.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY-HOLDERS

Not applicable.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

From February 27, 1996 to July 24, 1998, the Common Stock and Warrants to Purchase Common Stock of the Company had been traded and quoted through the National Association of Securities Dealers Inc. ("NASDAQ") National Market System under the symbols "SIMA" and "SIMAW," respectively. From July 24, 1998 to April 13, 1999, the Company's Common Stock and Warrants to purchase Common Stock had been traded and quoted through the NASDAQ SmallCap Market under the same symbols used on NASDAQ's National Market System. The Company transferred to the NASDAQ SmallCap Market when its Common Stock and Warrants no longer satisfied the National Market System minimum maintenance requirements for the market capitalization of the Common Stock's public float. As of April 14, 1999, the

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Company's Common Stock and Warrants to Purchase Common Stock were traded and quoted through the Over the Counter Bulletin Board ("OTCBB"). The Company transferred to the OTCBB when its Common Stock and Warrants no longer satisfied the NASDAQ SmallCap Market's minimum maintenance requirements for the market capitalization of the Common Stock's public float and the minimum bid price of the Common Stock. The Company's Warrants expired as of February 27, 2001.

The following table sets forth the range of high and low bids for the Company's Common Stock and Warrants for the periods indicated as reported by the NASDAQ SmallCap Market and OTCBB.

QUARTER ENDED	Stock		Warrants	
	High	Low	High	Low
September 30, 1999	.56	.56	.13	.01
December 31, 1999	.31	.31	.01	.01
March 31, 2000	1.69	1.69	.25	.001
June 30, 2000	1.02	1.02	.14	.04
September 30, 2000	.94	.94	.04	.04
December 31, 2000	.44	.44	.01	.01
March 31, 2001	.44	.44	N/A	N/A
June 30, 2001	.51	.51	N/A	N/A

The prices presented in the table are bid prices, which represent prices between broker-dealers and do not include retail mark-ups and mark-downs or any commission to the dealer. The prices presented may not reflect actual transactions.

On September 21, 2001, the closing price of the Common Stock of the Company, as reported by the OTCBB, was \$.47 per share. On September 21, 2001, the Company had 39 stockholders of record. The Company has been informed by its registrar and transfer agent that these are holders in nominee name. The Company believes that the number of beneficial holders is greater.

The Company intends to follow a policy of retaining any earnings to finance the development and growth of its business. Accordingly, it does not anticipate other payments of cash dividends in the foreseeable future. The payment of dividends, if any, rests within the discretion of the Board of Directors and will depend upon, among other things, the Company's earnings, its capital requirements and its overall financial condition.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following discussion and analysis provides information which the Company's management believes, is relevant to an assessment and understanding of the Company's results of operations and financial condition. All references to full years are to the applicable fiscal year of the Company. This discussion should be read in conjunction with the financial statements and notes thereto included elsewhere herein.

RESULTS OF OPERATIONS

During Fiscal Year 2001 and in the first quarter of Fiscal Year 2002, the Company implemented an extensive restructuring program resulting in a significant reduction in costs, and an improved cash position. As part of the Company's restructuring program, the Company, in the first quarter of fiscal year 2002, completed the sale of 90% of the common stock of its wholly-owned subsidiary, Tooltex, Inc. and entered into a sale and leaseback arrangement for its Newtown, Connecticut manufacturing facility (see Note Q to the consolidated financial statements). Also, through layoffs and attrition made throughout the year, the Company estimates that it has reduced expenses by approximately

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\$1,800,000 on an annualized basis.

YEAR ENDED JUNE 30, 2001 COMPARED TO YEAR ENDED JUNE 30, 2000

NET SALES. Net sales in fiscal year 2001 decreased \$2,976,000 or 20.8% compared with sales of the prior fiscal year. This decrease is primarily attributable to a decline in sales at Tooltex, a wholly owned subsidiary substantially disposed of in the first quarter of fiscal year 2002, as well as the plastic welding equipment product line. Other reasons for this decline include a slowdown in the economy, in general, and a particular softness in the auto industry, a major user of plastic welding equipment. Despite the decline in overall sales, the liquid processing product line continued its positive trend, growing at 5.9% in the current fiscal year. Although the Company anticipates that the sale of Tooltex will adversely affect its revenue for the fiscal year 2002, the Company believes the sale should have a positive impact on the Company's cash flow in the future.

COST OF SALES. Corresponding to the sales decline, cost of sales decreased \$1,379,000 in the current fiscal year. This decline was net of a charge for inventory losses of \$755,000 which related to 1) a writedown of Tooltex inventory to net realizable value in connection with the pending sale and 2) a Sonics inventory reserve of \$441,000 primarily for excess and obsolete spare parts. After excluding the effect of these inventory charges from cost of sales, gross profit margins improved slightly in the current year, increasing from 36.1% in fiscal year 2000 to 38.2% in the current fiscal year.

SELLING EXPENSES. In the current fiscal year, selling expenses decreased by \$459,000 or 15.6%. Declining sales resulted in a significant decline in commissions paid to manufacturers' representatives. Sales department expenses such as payroll, advertising and trade show costs were also reduced to adjust the business to current volume levels.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses in the current fiscal year increased by \$165,000 or 14.1% over the comparable prior year. The principal reason for the increase in this expense category was higher legal and accounting fees and writedowns of assets associated with the sale of Tooltex.

RESEARCH AND DEVELOPMENT EXPENSES. Research and development expenses remained at approximately the same level as in the prior fiscal year.

LOSS ON ASSETS HELD FOR SALE. In August, 2001 the Company completed the sale of 90% of the common stock of Tooltex to PK Spur Co., whose principal shareholders are Tooltex president, Paul Spurgeon, and Kathy Spurgeon. During fiscal year 2001, the Company adjusted the net assets of Tooltex, Inc. to their net realizable values based on the consideration to be paid by the buyer of \$125,000. The loss on assets held for sale of \$1,016,000 includes a writedown of unamortized goodwill of \$874,000, a writedown of fixed assets of \$115,000, and estimated transaction costs of approximately \$27,000.

INTEREST EXPENSE. Interest expense declined \$56,000 or 13.5% compared with the prior fiscal year. This decline was due both to interest rate reductions during the year as well as overall debt reduction. All of the Company's debt is subject to floating interest rates based on LIBOR. In fiscal year 2002, interest expense will decline significantly as a result of the pay-off of the Connecticut Industrial Revenue Bonds associated with the sale of the Company's manufacturing facility.

INTEREST AND OTHER INCOME. Interest and other income in the current fiscal year declined principally as a result of lower interest income owing to invested cash being used for other working capital needs.

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INCOME TAXES. The Company's effective combined federal and state tax rate for fiscal 2001 was 4% as compared to 38% in fiscal 2000. At June 30, 2001 management established a valuation allowance on all deferred tax assets due to uncertainty as to their ultimate realization.

YEAR ENDED JUNE 30, 2000 COMPARED TO YEAR ENDED JUNE 30, 1999

NET SALES. Net sales for fiscal 2000 increased \$1,958,000 or 15.8% over fiscal 1999. This increase is primarily the result of increased domestic sales generated by the sale of specialized equipment by Sonics and the Company's formerly wholly owned subsidiary, Tooltex.

COST OF SALES. Cost of sales increased \$2,166,000 from fiscal 1999 to fiscal 2000. This increase is primarily the result of specialized equipment generated by Sonics and, Tooltex, which typically has lower margins than the Company's standard equipment. In fiscal 2000, an increased portion of the customer base for the Company's ultrasonic liquid processing products purchased from Company distributors as opposed to the Company's manufacturer representatives. As a result, cost of goods percentage was effected by volume distributor discounts.

SELLING EXPENSES. Selling expenses for fiscal 2000 decreased \$49,000 or 1.6% over fiscal 1999. As a percentage of net sales these expenses decreased to 20.5% in fiscal 2000 from 24.1% in fiscal 1999. This is due to greater sales to distributorships as opposed to manufacturer representatives in the Company's ultrasonic liquid processing line.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses for fiscal 2000 decreased \$129,000 or 9.9% over fiscal 1999. As a percentage of net sales, these expenses decreased to 8.2% in fiscal 2000 from 10.5% in fiscal 1999. This decrease is partially the result of lower professional fees and legal costs.

RESEARCH AND DEVELOPMENT EXPENSES. Research and development expenses increased \$40,000 or 10.9% over fiscal 1999. The increase is primarily the result of a planned expansion of the research and development department, which included the addition of one research and development technician.

INTEREST AND OTHER INCOME. Interest income decreased \$18,000 or 22.9% in fiscal 2000. This is due to the use of invested funds to repay Tooltex bank debt of \$187,000.

INTEREST EXPENSE. Total interest expense decreased by \$39,000 or 8.6% over fiscal 1999. The impact of rate increases in 2000 was offset in part by overall debt reduction. In December 1999, the Company's lender approved the application of approximately \$187,000 of restricted cash toward the repayment of Tooltex bank debt. The lender also lifted restrictions on the balance of the funds (\$213,000) which are available for working capital purposes. Interest charges are expected to increase in the light of the rising interest rate environment. All of the Company's outstanding debt is subject to floating rates based on LIBOR.

INCOME TAXES. The Company's effective federal and state income tax rate for fiscal 2000 was approximately 38% as compared to 3% in fiscal 1999. During 1999, management determined that the tax benefits of deferred tax assets were realizable and accordingly, reversed the entire valuation allowance that had been established in the prior year. There were no such offsetting adjustments to income tax expense in fiscal 2000. However, federal taxes liabilities are expected to be lower than the current year's provision due to the availability of the loss from discontinued operations and net operating loss carryforwards

LIQUIDITY AND CAPITAL RESOURCES

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The Company continued to improve its balance sheet in fiscal year 2001, both in terms of liquidity and in terms of its capital structure. The working capital ratio rose from 2.46 times at June 30, 2000 to 2.60 times at June 30, 2001. Accounts receivable levels at fiscal year-end 2001 were down significantly reflecting improved collections performance. Although the nature of the Company's business necessitates a

heavy investment in inventory, management continues its efforts to minimize inventory levels to improve liquidity.

The Company's principal outside source of working capital is a \$1,500,000 bank credit facility (the "Line of Credit"). The Line of Credit bears interest at the Bank's base lending rate (6.75% at June 30, 2001). Advances under the Line of Credit are at the Bank's sole discretion. The entire principal balance of the Line of Credit, which at June 30, 2001 was \$1,190,000, is due and payable upon the demand of the Bank. The borrowings under the Line of Credit may be prepaid in whole or in part, without premium or penalty, at any time. Indebtedness under the Company's Line of Credit, industrial revenue bonds, and the term loans are secured by substantially all of the assets of the Company, including a first mortgage lien on the Company's new manufacturing facility. The credit agreement also subjects the Company to various covenants, including restrictions on future borrowings and encumbrances, and the maintenance of minimum tangible net worth, and leverage and fixed charge coverage ratios, as defined. In September, 2001 the Company paid the Line of Credit down by \$400,000.

Significant improvement was also made in the capital structure of the Company. As explained in Note Q to the consolidated financial statements, the Company, in August 2001, entered into a sale and leaseback arrangement for its Newtown, Connecticut manufacturing facility. Although not reflected in the June 30, 2001 balance sheet, this transaction will eliminate virtually all of the Company's long-term debt while adding \$483,000 to its cash balances. The Company expects to significantly improve its debt/equity ratio, declining from approximately 1 to 1 at June 30, 2000 to an expected 0.5 to 1 in the first fiscal quarter of 2002.

The Company's credit facility contains a loan covenant that requires it to maintain a fixed charge coverage ratio of at least 1.10 on a quarterly basis, at least 1.40 on a trailing six-month basis and minimum tangible net worth of at least \$5,150,000. At June 30, 2001, the Company was in violation of all three tests. The bank has provided a waiver of these violations as of June 30, 2001 and has agreed to renegotiate these covenants for succeeding periods based on the significant changes which took place in the business in the first fiscal quarter of 2002.

IMPACT OF INFLATION

The Company does not believe that inflation significantly affected its results of operations for the 2001 fiscal year.

MARKET RISK

The Company does not hold or trade derivative instruments. Financial instruments subject to changes in interest rates consist primarily of floating rate debt. Due to the repayment in August 2001 of its Industrial Development Bonds, the Company's exposure to interest rate fluctuations is not material. The Company's transactions are generally conducted and its accounts are denominated in U.S. dollars. Consequently, exposure to foreign currency risk is not significant.

RECENTLY ISSUED PRONOUNCEMENTS

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In June 2001, the FASB issued SFAS No. 141, Business Combinations, which addressed the initial recognition and measurement of goodwill and other intangible assets acquired in a business combination. SFAS No. 141 requires the purchase method of accounting to be used for business combinations initiated after June 30, 2001 and eliminates the pooling of interests method. The adoption of this statement is not expected to have a material impact on the Company's financial position or results of operations.

In June 2001, the FASB issued SFAS No. 142, Goodwill and Other Intangible Assets, which addressed the recognition and measurement of goodwill and other intangible assets subsequent to their

acquisition. SFAS No. 142 also addressed the initial recognition and measurement of intangible assets acquired outside of a business combination whether acquired individually or with a group of other assets. SFAS No. 142 provides that intangible assets with finite useful lives be amortized and that intangible assets with indefinite lives and goodwill will not be amortized, but will rather be tested at least annually for impairment. Although SFAS No. 142 is not required to be adopted by the Company until fiscal 2003, its provisions must be applied to goodwill and other intangible assets acquired after June 30, 2001. As of June 30, 2001, the Company does not have any goodwill or other intangible assets relating to business combinations that were accounted for under APB Opinion No. 16. Accordingly, the adoption of SFAS No. 142 is not expected to have a material impact on the Company's financial position or results of operations.

ITEM 7. FINANCIAL STATEMENTS

The response to this item is submitted in this report under the heading "Financial Statements" and is incorporated herein by reference.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

Information required by this Item 9 is incorporated herein by reference from the definitive proxy statement of Sonics to be filed with the Securities and Exchange Commission ("SEC") within 120 days following the end of Sonics' fiscal year ended June 30, 2001, relating to its 2001 Annual Meeting of Stockholders.

ITEM 10. EXECUTIVE COMPENSATION

Information required by this Item 10 is incorporated herein by reference from the definitive proxy statement of Sonics to be filed with the Securities and Exchange Commission ("SEC") within 120 days following the end of Sonics' fiscal year ended June 30, 2001, relating to its 2001 Annual Meeting of Stockholders.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

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Information required by this Item 10 is incorporated herein by reference from the definitive proxy statement of Sonics to be filed with the Securities and Exchange Commission ("SEC") within 120 days following the end of Sonics' fiscal year ended June 30, 2001, relating to its 2001 Annual Meeting of Stockholders.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Not applicable.

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

- 3(i) Certificate of Incorporation of the Registrant, as amended (incorporated by reference from Exhibit 3.1 of Amendment No. 3 to Registration Statement No. 33-96414).
- 3(ii) Amended By-laws of the Registrant (incorporated by reference from Exhibit 3.2 of Registration Statement No. 33-96414).
- 3(iii) Form of Warrant Agreement between Registrant and Warrant Agent (incorporated by reference from Exhibit 4.3 of Amendment No. 3 to Registration Statement No. 33-96414).
- 10(i) Form of Employment Agreement between the Registrant and Robert S. Soloff (incorporated by reference from Exhibit 10.1 of Registration Statement No. 33-96414).
- 10(ii) 1995 Incentive Stock Option Plan and form of Stock Option Agreement (incorporated by reference from Exhibit 10.3 of Registration Statement No. 33-96414).
- 10(iii) Lease between Registrant and Aston Investment Associates (Aston, PA) (incorporated by reference from Exhibit 10.5 of Registration Statement No. 33-96414).
- 10(iv) Lease between Registrant and Janine Berger (Gland, Switzerland) (incorporated by reference from Exhibit 10.7 of Registration Statement No. 33-96414).
- 10(v) Form of Sales Representation Agreement (incorporated by reference from Exhibit 10.8 of Registration Statement No. 33-96414).
- 10(vi) Form of Sales Distribution Agreement (incorporated by reference from Exhibit 10.9 of Registration Statement No. 33-96414).
- 10(vii) Credit Agreement, dated September 19, 1997, between Brown Brothers Harriman & Co. and Registrant (incorporated by reference from Exhibit 10(xii) of the Registrant's Form 10KSB for the year ended June 30, 1997).
- 10(viii) Term Loan Note of Registrant, dated September 19, 1997, payable to the order of Brown Brothers Harriman & Co. in the original principal amount of \$427,000 (incorporated by reference from Exhibit 10(xiii) of the Registrants Form 10KSB for the year ended June 30, 1997).
- 10(ix) Line of Credit Note of Registrant, dated September 19, 1997, payable to the order of Brown Brothers Harriman & Co. in the original principal amount of \$1,500,000 (incorporated by reference from Exhibit 10(xiv) of the Registrants Form 10KSB for the year ended June 30, 1997).
- 10(x) General Security Agreement from Registrant to Brown Brothers Harriman & Co. dated September 19, 1997 (incorporated by reference from Exhibit 10(xvii) of the Registrants Form 10KSB for the year ended June 30, 1997).
- 10(xi) Lease between Registrant and Acme Realty, dated August 30, 2001 (filed herewith).
- 10(xii) Stock Purchase Agreement by and between PK Spur Co., and

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21 Sonics & Materials, Inc., with Respect to 90% of the Issued and Outstanding Shares of Common Stock of Tooltex, Inc., dated August 21, 2001 (filed herewith).
Subsidiaries of the Registrant (incorporated by reference from Exhibit (21 of the Registrants Form 10KSB for the year ended June 30, 1998).

(b)

On August 27, 2001, the Company filed a Current Report on Form 8-K announcing the sale of 90% of the Common Stock of Tooltex to PK Spur, Co.

On August 31, 2001, the Company filed a Current Report on Form 8-K announcing the Sale-Leaseback of the Company's Newtown, Connecticut Manufacturing Facility.

On September 14, 2001, the Company filed a Current Report on Form 8-K disclosing the disposition of its facility in Newtown, Connecticut.

SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: September 27, 2001

SONICS & MATERIALS, INC.

By: /s/ ROBERT S. SOLOFF

ROBERT S. SOLOFF
CHAIRMAN AND PRESIDENT

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature -----	Title -----	Date -----
/s/ ROBERT S. SOLOFF ----- (ROBERT S. SOLOFF)	Chairman, President, Treasurer, Chief Executive and Chief Financial Officer	September 27, 2001
/s/ LAUREN H. SOLOFF ----- (LAUREN H. SOLOFF)	Secretary and Director	September 27, 2001
/s/ Ronald Kalb ----- (RONALD KALB)	Director	September 27, 2001

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/s/ JACK T. TYRANSKY Director September 27, 2001

 (JACK T. TYRANSKY)

/s/ STEVEN A. BOWEN Controller September 27, 2001

 Principal Accounting Officer
 (STEVEN A. BOWEN)

EXHIBIT INDEX

EXHIBIT NO. -----	DESCRIPTION -----	LOCATION OF EXHIBIT SEQUENTIAL NUMBERING -----
3(i)	Certificate of Incorporation of the Registrant, as amended.	Incorporated by reference from E Amendment No. 3 to Registration 33-96414
3(ii)	Amended By-laws of the Registrant.	Incorporated by reference from E Registration Statement No. 33-96
10(I)	Form of Employment Agreement between the Registrant and Robert S. Soloff.	Incorporated by reference from E Registration Statement No. 33-96
10(ii)	1995 Incentive Stock Option Plan and form of Stock Option Agreement.	Incorporated by reference from E Registration Statement No. 33-96
10(iii)	Lease between Registrant and Aston Investment Associates (Aston, PA).	Incorporated by reference from E Registration Statement No. 33-96
10(iv)	Lease between Registrant and Janine Berger (Gland, Switzerland).	Incorporated by reference from 1 Registration Statement No. 33-96
10(v)	Form of Sales Representation Agreement.	Incorporated by reference from E Registration Statement No. 33-96
10(vi)	Form of Sales Distribution Agreement.	Incorporated by reference from E Registration Statement No. 33-96
10(vii)	Credit Agreement, dated September 19, 1997, between Brown Brothers Harriman & Co. and Registrant	Incorporated by reference from E of the Registrant's Form 10-KSB ended June 30, 1997
10(viii)	Term Loan Note of Registrant, dated September 19, 1997, payable to the order of Brown Brothers Harriman & Co. in the original principal amount of \$427,000.	Incorporated by reference from E of the Registrant's Form 10-KSB ended June 30, 1997
10(ix)	Line of Credit Note of Registrant, dated September 19, 1997, payable to the order of Brown Brothers Harriman & Co. in the original principal amount of \$1,500,000.	Incorporated by reference from E of the Registrant's Form 10-KSB ended June 30, 1997
10(x)	General Security Agreement from Registrant to Brown Brothers Harriman & Co. dated September 19, 1997.	Incorporated by reference from E of the Registrant's Form 10-KSB ended June 30, 1997
10(xi)	Lease between Registrant and Acme Realty dated	Filed herewith.

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August 30, 2001.

- 10(xii) Stock Purchase Agreement by and between PK Spur Co., and Sonics & Materials, Inc., with Respect to 90% of the Issued and Outstanding Shares of Common Stock of Tooltex, Inc., dated August 21, 2001. Filed herewith.
- 21 Subsidiaries of the Registrant. Incorporated by reference from E of the Registrants Form 10KSB fo June 30, 1998.

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors and Stockholders
Sonics & Materials, Inc.

We have audited the accompanying consolidated balance sheets of Sonics & Materials, Inc. and its subsidiary as of June 30, 2000 and 2001, and the related consolidated statements of income (loss), stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by

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management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sonics & Materials, Inc. and its subsidiary as of June 30, 2000 and 2001, and the results of their operations and their cash flows for the years then ended, in conformity with generally accepted accounting principles.

Schneider & Associates LLP

Jericho, New York
September 6, 2001

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC. CONSOLIDATED BALANCE SHEETS

	June 30,	
	2000	2001
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 728,993	\$ 820,835
Accounts receivable, net of allowance for doubtful accounts of \$88,470 and \$53,470 in 2000 and 2001	2,692,786	1,335,861
Inventories	4,489,967	3,961,383
Deferred income taxes	75,048	--
Other current assets	75,865	65,788
Total current assets	8,062,659	6,183,867
PROPERTY AND EQUIPMENT - net	4,050,052	3,754,724
GOODWILL - net of accumulated amortization of \$166,508 in 2000	929,091	--
OTHER ASSETS	672,215	618,925
Total assets	\$13,714,017	\$10,557,516
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Note payable - bank	\$ 1,290,000	\$ 1,190,000
Current maturities of long-term debt	331,097	186,781
Accounts payable	701,929	347,580
Customer advances	133,816	147,535
Commissions payable	193,356	76,903

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Accrued expenses	626,691	452,734
	-----	-----
Total current liabilities	3,276,889	2,401,533
LONG-TERM DEBT	3,584,390	3,381,460
	-----	-----
Total liabilities	6,861,279	5,782,993
COMMITMENTS - see notes		
STOCKHOLDERS' EQUITY		
Common stock - par value \$.03 per share; authorized 10,000,000 shares; issued and outstanding 3,520,100 shares at June 30, 2000 and 2001	105,603	105,603
Additional paid-in capital	6,575,010	6,575,010
Retained earnings (accumulated deficit)	172,125	(1,906,090)
	-----	-----
Total stockholders' equity	6,852,738	4,774,523
	-----	-----
Total liabilities and stockholders' equity	\$13,714,017	\$10,557,516
	=====	=====

The accompanying notes are an integral part
of these consolidated financial statements.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
CONSOLIDATED STATEMENTS OF INCOME (LOSS)

	Years ended June 30,	
	2000	2001
	-----	-----
Net sales	\$14,323,644	\$11,347,937
Cost of sales	9,147,385	7,767,931
	-----	-----
Gross profit	5,176,259	3,580,006
	-----	-----
Operating expenses:		
Selling	2,936,169	2,477,305
General and administrative	1,175,433	1,340,930
Research and development	407,525	410,346
Loss on assets held for sale	--	1,016,094
	-----	-----
Total operating expenses	4,519,127	5,244,675
	-----	-----
Operating income (loss)	657,132	(1,664,669)
	-----	-----
Other income (expense):		
Interest expense	(415,975)	(359,715)
Interest and other income	61,943	19,906
	-----	-----
Total other income (expense)	(354,032)	(339,809)
	-----	-----
Income (loss) before income taxes	303,100	(2,004,478)
Provision for income taxes	116,140	73,737
	-----	-----
Income (loss) from continuing operations	186,960	(2,078,215)
Loss from discontinued operations		

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(net of income tax benefit of \$65,557)	(107,121)	--
Net income (loss)	\$ 79,839	\$ (2,078,215)
Per share:		
Basic:		
Income (loss) from continuing operations	\$.05	\$ (.59)
Loss from discontinued operations	(.03)	--
Net income (loss)	\$.02	\$ (.59)
Diluted:		
Income (loss) from continuing operations	\$.05	\$ (.59)
Loss from discontinued operations	(.03)	--
Diluted net income (loss) per share	\$.02	\$ (.59)
Shares used in basic per share computation	3,520,100	3,520,100
Incremental shares from issuance of common stock options and warrants	60,375	--
Shares used in diluted per share computation	3,580,475	3,520,100

The accompanying notes are an integral part
of these consolidated financial statements.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years ended June 30, 2000 and 2001

	Common Stock		Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)
	Shares	Par Value		
Balances - July 1, 1999	3,520,100	\$105,603	\$6,575,010	\$ 92,286
Net income	--	--	--	79,839
Balances - June 30, 2000	3,520,100	105,603	6,575,010	172,125
Net loss	--	--	--	(2,078,215)
Balances - June 30, 2001	3,520,100	\$105,603	6,575,010	\$ (1,906,090)

The accompanying notes are an integral part of these consolidated financial statements.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended June 30,	
	2000	2001
	-----	-----
Cash flows from operating activities		
Net income (loss)	\$ 79,839	\$(2,078,215)
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Net loss from discontinued operations	107,121	--
Depreciation	151,829	162,623
Amortization of goodwill	55,503	55,503
Loss on assets held for sale	--	989,362
Reserves and allowances	--	730,844
Decrease (increase) in:		
Accounts receivable	(703,839)	1,160,195
Inventories	488,542	(222,237)
Other current assets	9,646	15,229
Prepaid income taxes	--	(9,951)
Deferred income taxes	(14,065)	75,048
Other assets	59,196	104,540
Increase (decrease) in:		
Accounts payable	122,162	(199,840)
Customer advances	(70,964)	45,503
Commissions payable	51,910	(117,087)
Income taxes	80,008	--
Accrued expenses	161,879	(113,118)
	-----	-----
Net cash provided by operating activities	578,767	598,399
	-----	-----

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Cash provided by discontinued operations	93,943	--
	-----	-----
Cash flows from investing activities:		
Purchase of property and equipment	(95,059)	(59,311)
Short-term investments	400,000	--
Restricted cash from industrial revenue bond	136,000	--
	-----	-----
Net cash provided by (used in) investing activities	440,941	(59,311)
	-----	-----
Cash flows from financing activities:		
Payments of note payable - bank	(175,101)	(100,000)
Payments of long-term debt	(522,123)	(289,932)
Payments of capital lease obligations	(38,034)	(57,314)
	-----	-----
Net cash used in financing activities	(735,258)	(447,246)
	-----	-----
Net increase in cash and cash equivalents	378,393	91,842
	-----	-----
Cash and cash equivalents at beginning of year	350,600	728,993
	-----	-----
Cash and cash equivalents at end of year	\$ 728,993	\$ 820,835
	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended June 30,	
	2000	2001
	-----	-----
Supplemental information:		
Cash paid during the period for:		
Interest	\$ 412,017	\$ 400,415
	=====	=====
Income taxes	\$ 49,386	\$ 2,595
	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2000 AND 2001

NOTE A - BUSINESS

Sonics & Materials, Inc. (the "Company") is a manufacturer and distributor of ultrasonic assembly and liquid processing machinery and equipment. The Company also manufactures automated systems used in the plastics industry through its subsidiary, Tooltex, Inc., which is located in Grove City, Ohio. Sales are made throughout the United States, Europe, Asia, South America and Australia. The Company's headquarters and principal manufacturing operations are located in Newtown, Connecticut.

In August 2001, the Company completed the sale of a 90% interest in Tooltex (see Note Q).

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

These financial statements include the accounts of the Company and its wholly-owned subsidiary, Tooltex, Inc. All material intercompany balances and transactions have been eliminated in consolidation.

Inventories

Inventories are stated at the lower of cost, determined on a first-in, first-out basis, or market.

Property and Equipment

Property and equipment are carried at cost less accumulated depreciation and amortization. Depreciation using both the declining-balance and straight-line methods is designed to amortize the cost of various classes of assets over their estimated useful lives, ranging generally from five to seven years. The building is being depreciated on a straight-line basis over 40 years. Leasehold improvements are amortized over the shorter of the life of the related asset, or the term of the lease. Expenditures for replacements are capitalized and the replaced items are retired. Maintenance and repairs are expensed as incurred.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2000 AND 2001

Use of Estimates

Preparation of the consolidated financial statements in conformity with generally accepted accounting principles 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 financial statements and the reported amounts of revenues and expenses during the reporting period. The more significant estimates made by management include the allowance for doubtful accounts receivable and the valuation allowance for deferred tax assets. Actual amounts could differ from the estimates made. Management periodically evaluates estimates used in the preparation of the financial statements for continued reasonableness. Appropriate adjustments, if any, to the estimates used are made prospectively based upon such periodic evaluation.

Goodwill

Goodwill represents the excess purchase price paid over the fair market value of the net assets acquired. Goodwill is being amortized on a straight-line basis over a twenty-year period. Amortization expense for the years ended June 30, 2000 and 2001 was \$55,503 and \$55,503, respectively.

The carrying value of Goodwill is based on management's current assessment of recoverability. Management evaluates recoverability using both objective and subjective factors. Objective factors include management's best estimates or projected future earnings, cash flows and analysis of historical and recent sales and earnings trends. Subjective factors include competitive analysis and the Company's strategic focus.

Long-lived assets

In accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", the Company records impairment losses on long-lived assets used in operations, when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2000 AND 2001

Income Taxes

The Company accounts for its income taxes using the liability method, which requires the establishment of a deferred tax asset or liability for the recognition of future deductible or taxable amounts and operating loss carryforwards. Deferred tax expense or benefit is recognized as a result of the changes in the assets and liabilities

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during the year. Valuation allowances are established when necessary to reduce deferred tax assets to amounts expected to be realized.

Deferred tax assets are reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that all or some portion of the deferred tax assets will not be realized. The ultimate realization of the deferred tax asset depends on the Company's ability to generate sufficient taxable income in the future.

Stock options

Under SFAS No. 123, "Accounting for Stock-based Compensation", the Company must either recognize in its financial statements costs related to its employee stock-based compensation plans, such as stock option plans, using the fair value method, or make pro forma disclosures of such costs in a footnote to the financial statements. The Company has elected to continue to use the intrinsic value-based method of APB Opinion No. 25, as allowed under SFAS No. 123, to account for its employee stock-based compensation plans, and to include the required pro forma disclosures based on fair value accounting.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Earnings per share

Basic net income per share is calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted net income per share is calculated by dividing net income by the weighted-average number of common shares outstanding plus the weighted-average number of net shares that would be issued upon exercise of stock options and warrants using the treasury stock method.

Cash Equivalents

For purposes of the Statement of Cash Flows, the Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash equivalents at June 30, 2000 and 2001 consisted of money market funds.

Revenue Recognition

Revenue is recognized upon the shipment of finished merchandise to customers. Allowance for sales returns are recorded as a component of net sales in the periods in which the related sales are recognized.

In December 1999, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 101 "Revenue Recognition" ("SAB 101"), which provides guidance on the recognition, presentation and disclosure of revenue in financial statements filed with the SEC. SAB 101 outlines

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the basic criteria that must be met to recognize revenue and provides guidance for disclosures related to revenue recognition policies. The Company adopted SAB 101 during fiscal 2001. Management believes that the Company's revenue recognition policy complies with the provisions of SAB 101 and that the adoption of SAB 101 has had no material effect on the financial position or results of operations of the Company.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2000 AND 2001

Research and Development Costs

Expenditures relating to the development of new products and processes, including significant improvements and refinements to existing products, are expensed as incurred.

Fair Value of Financial Instruments

Based on borrowing rates currently available to the Company for bank loans with similar terms and maturities, the fair value of the Company's debt approximates the carrying value. Furthermore, the carrying values of all other financial instruments potentially subject to valuation risk (principally consisting of cash, cash equivalents, accounts receivable and accounts payable) also approximate fair value due to their short-term nature.

Advertising Costs

All costs related to advertising are expensed in the period incurred. Advertising costs were approximately \$175,000 and \$112,000 for the years ended June 30, 2000 and 2001, respectively.

Recently issued pronouncements

In June 2001, the FASB issued SFAS No. 141, Business Combinations, which addressed the initial recognition and measurement of goodwill and other intangible assets acquired in a business combination. SFAS No. 141 requires the purchase method of accounting to be used for business combinations initiated after June 30, 2001 and eliminates the pooling of interests method. The adoption of this statement is not expected to have a material impact on the Company's financial position or results of operations.

In June 2001, the FASB issued SFAS No. 142, Goodwill and Other Intangible Assets, which addressed the recognition and measurement of goodwill and other intangible assets subsequent to their acquisition. SFAS No. 142 also addressed the initial recognition and measurement of intangible assets acquired outside of a business combination whether acquired individually or with a group of other assets. SFAS No. 142 provides that intangible assets with finite useful lives be amortized and that

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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intangible assets with indefinite lives and goodwill will not be amortized, but will rather be tested at least annually for impairment. Although SFAS No. 142 is not required to be adopted by the Company until fiscal 2003, its provisions must be applied to goodwill and other intangible assets acquired after June 30, 2001. As of June 30, 2001, the Company does not have any goodwill or other intangible assets relating to business combinations that were accounted for under APB Opinion No. 16. Accordingly, the adoption of SFAS No. 142 is not expected to have a material impact on the Company's financial position or results of operations.

NOTE C - DISCONTINUED OPERATIONS

In May 2000, management and the board of directors elected to discontinue the Company's VibraSurge operation after reviewing the marketability of its line of ultrasonic surgical products and its recurring operating losses. As a result, the Company's balance sheets, statements of income, and statements of cash flows have been reclassified to report the net assets and operating results of the VibraSurge business as discontinued for 2000. As of June 30, 2000, VibraSurge operations have ceased and remaining net assets, consisting principally of inventory and accounts receivable, have been written off.

NOTE D - LOSS ON ASSETS HELD FOR SALE

In connection with the sale of a 90% interest in its Tooltex subsidiary in August 2001, the Company has adjusted the net assets of Tooltex to their estimated net realizable values in the current Statement of Income (Loss). The loss on assets held for sale of \$1,016,000 includes a writedown of unamortized goodwill of \$874,000, a writedown of fixed assets of \$115,000, and estimated transaction costs of approximately \$27,000. The Company also recorded in fiscal 2001 a Tooltex inventory reserve through cost of sales of approximately \$314,000 and a bad debt charge through general and administrative expenses of \$35,000.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE E - INVENTORIES

Inventories consist of the following:

	June 30, 2000	June 30, 2001
Raw materials	\$ 967,971	\$ 898,284
Work-in-process	2,128,815	1,890,542
Finished goods	1,393,181	1,172,557

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\$4,489,967 \$3,961,383
 =====

During fiscal 2001, the Company established a reserve for excess and obsolete inventory of \$441,000. The charge to operations was recorded through cost of sales. Inventories at June 30, 2001 are stated net of the reserve.

NOTE F - PROPERTY AND EQUIPMENT

A summary of property and equipment follows:

	June 30, 2000	June 30, 2001
	-----	-----
Land	\$ 462,486	\$ 462,486
Building	3,219,205	3,219,205
Trade show booth	50,494	--
Machinery and equipment	1,017,586	943,148
Tooling	147,449	146,482
Office furniture and equipment	319,619	308,663
Leasehold improvements	49,890	--
Transportation equipment	60,441	60,441
Data processing equipment	718,706	618,673
	-----	-----
	6,045,876	5,759,098
Less: Accumulated depreciation	1,995,824	2,004,374
	-----	-----
	\$4,050,052	\$3,754,724
	=====	=====

Depreciation expense was \$151,829 and \$162,623 in fiscal 2000 and 2001, respectively.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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On August 31, 2001, the Company sold its Newtown, Connecticut property (see Note Q).

NOTE G - OTHER ASSETS

At June 30, 2000 and 2001, the major components of other assets were:

	June 30, 2000	June 30, 2001
	-----	-----
Demonstration equipment - net of accumulated depreciation of \$122,422 and \$99,554 in 2000 and 2001, respectively	\$ 537,815	\$ 364,192
Other	134,400	254,733
	-----	-----
	\$ 672,215	\$ 618,925
	=====	=====

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Demonstration equipment is carried at cost less accumulated depreciation. Depreciation is provided for using straight-line and accelerated methods over the estimated useful life of seven years. The net book value is used to calculate any gain or loss on sale of the related demonstration equipment.

NOTE H - ACCRUED EXPENSES

At June 30, 2000 and 2001, the major components of accrued expenses were:

	June 30, 2000	June 30, 2001
	-----	-----
Accrued compensation	\$ 351,832	\$ 287,546
Professional fees	42,819	63,542
Other accruals	232,040	101,646
	-----	-----
	\$ 626,691	\$ 452,734
	=====	=====

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2000 AND 2001

NOTE I - BANK AND OTHER DEBT

Note payable - bank

Outstanding indebtedness against the bank line of credit is evidenced by a note bearing interest at the bank's base lending rate (6.75% at June 30, 2001). Advances under the line of credit are at the bank's sole discretion, are due on demand, and are limited to the lesser of \$1,500,000 or a percentage of the Company's available borrowing base, as defined.

	June 30, 2000	June 30, 2001
	-----	-----
Long-term debt		
(a) Industrial Revenue Bonds	\$3,509,211	\$3,308,684
(b) Bank term loan	175,824	100,471
(c) Capital lease obligations	216,400	159,086
(d) Other loans	14,052	--
	-----	-----
	3,915,487	3,568,241
Less: Current portion	(331,097)	(186,781)
	-----	-----
Long-term debt	\$3,584,390	\$3,381,460
	=====	=====

(a) Industrial Revenue Bonds issued in December 1997 through the Connecticut Development Authority in the original principal amount

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of \$3,810,000. The bonds were purchased by the Company's lender pursuant to the credit agreement between the parties. Interest on principal balances is payable at the rate of 75% of the bank's base lending rate. Principal is payable in 228 equal installments of \$16,711 commencing in January 1999. The bondholder, however, may make written demand for redemption of all or a part of outstanding principal and accrued interest commencing in December 2000.

The bonds were repaid from the proceeds of the sale of the Company's Newtown, Connecticut property in August 2001.

- (b) Term loan in the original amount of \$427,000. The loan, as amended on July 21, 1998, is payable in nine monthly installments of \$11,861 through July 1, 1998, fifty-one monthly installments of \$6,269, and a final payment of the remaining

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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principal balance on October 1, 2002. The loan bears interest at the bank's base lending rate.

- (c) The Company has entered into three equipment leases which qualify for capitalization under applicable accounting guidelines. The leases expire at various dates through 2005.
- (d) Equipment loans payable in monthly installments through 2001, secured by financed assets.

Indebtedness under the Company's line of credit, industrial revenue bonds, and the term loans are secured by substantially all of the assets of the Company, including a first mortgage lien on the Company's principal manufacturing facility. The credit agreement also subjects the Company to various covenants, including restrictions on future borrowings and encumbrances, and the maintenance of minimum tangible net worth, and leverage and fixed charge coverage ratios, as defined. At June 30, 2001, the Company was in violation of its tangible net worth and fixed charge coverage ratios. The bank has provided a waiver for these violations.

The aggregate maturities of long-term debt for the next five fiscal years, adjusted for the repayment of bonds in August 2001, are as follows:

Year ending June 30, -----	
2002	\$186,781
2003	43,935

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2004	31,642
2005	31,716
2006	--

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2000 AND 2001

NOTE J - STOCKHOLDERS' EQUITY

Warrants

In February 2001, all outstanding common stock purchase warrants, consisting of 1,705,000 warrants exercisable at \$6.00 per share and 100,000 warrants exercisable at \$.25 per share, expired.

Incentive Stock Option Plan

The Company has reserved a total of 250,000 shares for issuance under its Incentive Stock Option Plan (the "Plan"). Options may be granted to officers, directors, and other key Company employees. Options granted under the Plan are intended to qualify as incentive stock options as defined in the Internal Revenue Code of 1986, as amended.

The Plan is administered by the Board of Directors and a Committee presently consisting of two members of the Board that determine which persons are to receive options, the number of options granted and their exercise prices. In the event an optionee voluntarily terminates employment with the Company, the optionee has the right to exercise his accrued options within thirty (30) days of such termination. However, the Company may redeem any accrued options held by each optionee by paying the difference between the option exercise price and the then fair market value.

All employee options issued to date under the Plan have a five-year term and vest evenly over the first three years commencing on the date of grant. Director options vest over a one-year period. At June 30, 2001, there were 189,000 shares available for future grant under the Plan.

Nonqualified Stock Options

The Company has also granted nonqualified stock options for 285,366 shares of common stock at option prices ranging from \$.31 to \$1.03 per

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share expiring at various dates through 2004.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2000 AND 2001

Summary Information

The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock Based Compensation". Accordingly, no compensation cost has been recognized for the stock options granted to employees and directors. Had compensation cost been determined based on the fair value at the grant date for the stock option awards in fiscal 2000 and 2001 consistent with the provisions of SFAS No. 123, net income would have decreased by approximately \$29,000 and \$4,800 and earnings per share reduced by \$.01 and \$.01 in 2000 and 2001, respectively.

The weighted average fair value at date of grant for all options granted in fiscal 2000 was \$.26. There were no option grants in 2001. The fair value of each option at date of grant was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

	2000

Expected stock price volatility	45.8%
Expected life of options	4 years
Risk-free interest rate	5.91%
Expected dividend yield	0%

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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For the two years ended June 30, 2001, option activity was as follows:

	Number of Shares	Weighted- average Exercise Price
	-----	-----
Outstanding at June 30, 1999	434,866	\$1.49
Granted	57,000	.60

Outstanding at June 30, 2000	491,866	1.39
Expired	(53,500)	5.00
Canceled	(92,000)	.87

Outstanding at June 30, 2001	346,366	\$.97
=====		

The following table summarizes information about stock options outstanding at June 30, 2001:

Range of Exercise prices	Options Outstanding		Options Exercisable		Wei av Exe P
	Number Outstanding	Weighted- average Exercise Price	Weighted average Remaining Contractual Life	Number Exercisable	
-----	-----	-----	-----	-----	-----
\$.22 - \$.63	60,976	\$.48	3.0 years	54,309	
1.03 - 1.63	280,390	1.04	2.5 years	279,057	
2.94	5,000	2.94	1.8 years	5,000	
	-----			-----	
	346,366	\$.97		338,366	
	=====			=====	

NOTE K - COMMITMENTS

Leases

The Company leases certain facilities and vehicles under lease agreements that are classified as operating leases and expire in various years through 2003.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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The following is a schedule of future minimum lease payments for operating leases as of June 30, 2001:

Year ending June 30,	
2002	\$142,310
2003	26,337

Total	\$168,647
	=====

Rental expense for operating leases totaled approximately \$198,000 and \$205,000 for the years ended June 30, 2000 and 2001, respectively.

Employment contracts

In connection with the Tooltex acquisition in July 1997, the Company entered into five-year employment agreements with the two Tooltex stockholders. The agreements each provide for initial annual salaries of \$75,000, with annual increases equal to the rate of inflation, up to 5%, and various fringe benefits. The agreements also contain bonus provisions based on annual sales increases.

Legal settlement

In June 2000, the Company settled a customer lawsuit for \$80,000, payable in four installments of \$20,000 plus interest through September 2000. The Company accrued for the settlement in fiscal 1998 as an adjustment to the Tooltex acquisition price.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2000 AND 2001

NOTE L - INCOME TAXES

The components of the provision for income taxes are as follows:

	Years ended June 30,	
	2000	2001
	-----	-----
Current		
Federal	\$ 120,839	\$ (37,206)
State	9,366	40,289
	-----	-----
	130,205	3,083
	-----	-----
Deferred:		
Federal	(14,065)	(590,877)
State	--	(66,956)
Less: Valuation allowance	--	728,487
	-----	-----
	(14,065)	70,654
	-----	-----
Total tax provision	\$ 116,140	\$ 73,737
	=====	=====

The tax effect of temporary differences which give rise to deferred tax assets and liabilities are as follows:

	June 30, 2000	June 30, 2001
	-----	-----
Deferred tax assets:		
Unrealized loss on Tooltex investment	\$ --	\$ 468,447
Accrued expenses	36,545	--
Allowance for doubtful accounts	30,080	30,080
Inventories	18,478	229,960
	-----	-----
Total deferred tax assets	85,103	728,487
Deferred tax liabilities:		
Deferred charges	10,055	--
	-----	-----
Subtotal	75,048	728,487
Less: Valuation allowance	--	(728,487)
	-----	-----
Net deferred tax asset	\$ 75,048	\$ --
	=====	=====

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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During fiscal 2001, management established a valuation allowance to offset the benefits of significant temporary tax differences due to the uncertainty of their realization. These deferred tax assets consist primarily of writedowns related to the subsequent sale of Tooltex, inventory reserves, and allowances for doubtful accounts.

The following is a reconciliation of the statutory Federal income tax rate to the effective rate reported in the consolidated financial statements:

	Years ended June 30,	
	2000	2001
Provision for federal income taxes at the statutory rate	\$ 103,156	\$ (683,776)
State and local taxes, net of federal tax effect	4,620	17,975
Nondeductible expenses	26,071	11,051
Change in valuation allowance	--	728,487
Tax credits	(6,008)	--
Other	(11,699)	--
	-----	-----
Actual provision for income taxes	\$ 116,140	\$ 73,737
	=====	=====

NOTE M - 401(k) AND PROFIT SHARING PLANS

The Company has a 401(k) plan for eligible employees. Under provisions of the plan, eligible employees may elect to contribute up to 15% of their annual compensation. In addition, the plan provides for the Company to make additional contributions at its discretion of up to 4% of each participant's annual compensation. Expenses under the 401(k) plan were approximately \$31,000 and \$33,000 for the years ended June 30, 2000 and 2001, respectively.

The Company also has a nonqualified profit sharing plan. Under this plan, the Company distributes to eligible employees 10% of its pretax profits, based on a three-month moving average. Expenses under the profit sharing plan were approximately \$14,000 and \$-0- for the years ended June 30, 2000 and 2001, respectively.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2000 AND 2001

NOTE N - CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash, cash equivalents, and trade accounts receivable. The Company deposits its cash balances in commercial bank accounts and money market funds. Commercial bank balances may from time to time exceed federal insurance limits; money market funds are uninsured.

The Company performs ongoing credit evaluations of its customers in order to minimize credit losses. Credit risk on receivables is minimized as a result of the diverse nature of the Company's worldwide customer base. The Company does not generally require collateral from its customers.

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The Company operates in one business segment. Net sales by geographic area are as follows:

	Year ended June 30,	
	2000	2001
United States	\$11,063,000	\$ 8,760,000
Europe	1,555,000	1,143,000
Asia/Pacific Rim	1,136,000	936,000
Canada and Mexico	363,000	286,000
Other	207,000	223,000
	-----	-----
	\$14,324,000	\$11,348,000
	=====	=====

NOTE O - RELATED PARTY TRANSACTIONS

The Company leases manufacturing facilities in Ohio from an entity owned by the selling stockholders of Tooltex under a five-year lease expiring in 2002. During the year ended June 30, 2000 and 2001, the Company incurred \$84,320 and \$84,320, respectively, for rental of these facilities.

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 JUNE 30, 2000 AND 2001

NOTE P - UNAUDITED CONSOLIDATED FINANCIAL INFORMATION

The following is a summary of the unaudited quarterly results of operations for 2000 and 2001:

	2000	2001
1st quarter		
Net revenues	\$3,507,110	\$ 2,803,316
Gross profit	1,189,237	1,079,171
Net income (loss)	93,804	(91,711)
Net income (loss) per share	\$.03	\$ (.03)
2nd quarter		
Net revenues	\$3,210,804	\$ 2,926,626
Gross profit	1,247,462	1,022,756
Net income (loss)	45,622	(255,184)
Net income (loss) per share	\$.01	\$ (.07)

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3rd quarter		
Net revenues	\$3,665,932	\$ 2,791,109
Gross profit	1,370,381	1,101,580
Net income	63,679	15,345
Net income per share	\$.02	\$.01
4th quarter		
Net revenues	\$3,939,798	\$ 2,826,886
Gross profit	1,369,179	376,499
Net loss	(123,266)	(1,746,665)
Net loss per share	\$ (.04)	\$ (.50)

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SONICS & MATERIALS, INC. AND ITS SUBSIDIARY TOOLTEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2000 AND 2001

NOTE Q - SUBSEQUENT EVENTS

Sale of Tooltex stock

On August 21, 2001, the Company sold a 90% interest in the stock of Tooltex to PK Spur Co. (PK), an Ohio corporation owned by the president of Tooltex, and his wife. In consideration, PK issued a \$125,000 promissory note, payable in 23 installments of \$2,000 including interest at 7% per annum commencing in October 2001, with a final balloon payment of outstanding principal and accrued interest. The note is guaranteed by the president and Tooltex, and is secured by a security interest in certain Tooltex assets. In conjunction with the sale, the Company and Tooltex entered into a representation and distribution agreement pursuant to which Tooltex will sell and distribute the Company's products.

The Company will change the accounting for its investment in Tooltex from the consolidation to the cost method, effective on the date of sale. Tooltex reported sales of approximately \$2.6 million (unaudited) and a net loss of approximately \$219,000 (unaudited) in fiscal 2001.

Sale of Company facility

On August 31, 2001, the Company sold to Acme Realty (Acme), a New York

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general partnership, its manufacturing facility located in Newtown, Connecticut for \$4,000,000 in cash, less estimated expenses of approximately \$240,000. The Company used the proceeds to pay outstanding Industrial Revenue Bond principal and accrued interest totaling \$3,289,000, and to increase working capital. In conjunction with the sale, the Company entered into a triple net lease with Acme for an initial term of ten years plus two five-year renewal options.

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