

SUTRON CORP
Form 10-Q
November 14, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2013

Commission file number: 0-12227

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

(State or other jurisdiction
of incorporation or organization) 54-1006352
(I.R.S. Employer
Identification Number)

22400 Davis Drive, Sterling, Virginia 20164
(Address of principal executive offices)

703-406-2800
(Issuer's telephone number)

Securities registered under Section 12(g) of the Act: Common Stock, \$.01 par value

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one).

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| | | |
|-------------------------|----------------------------------|-------------------|
| Large accelerated filer | <input type="radio"/> | Accelerated |
| filer | <input type="radio"/> | |
| Non-accelerated filer | <input type="radio"/> | Smaller reporting |
| company | <input checked="" type="radio"/> | |

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

There were 5,066,009 outstanding shares of the issuer's only class of common equity, Common Stock, \$0.01 par value, on November 14, 2013.

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

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SUTRON CORPORATION
CONSOLIDATED BALANCE SHEETS

| | (Unaudited) September 30, 2013 | (Audited) December 31, 2012 |
|---|--------------------------------------|-----------------------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$6,161,302 | \$7,576,374 |
| Restricted cash and cash equivalents | 866,978 | 810,396 |
| Accounts receivable, net | 6,356,029 | 5,771,013 |
| Inventory, net | 5,301,383 | 4,291,505 |
| Prepaid items and other assets | 362,686 | 248,546 |
| Income taxes receivable | 981,300 | 1,202,709 |
| Deferred income taxes | 716,000 | 666,000 |
| Total Current Assets | 20,745,678 | 20,566,543 |
| Property and Equipment, Net | 1,617,786 | 1,698,218 |
| Other Assets | | |
| Goodwill | 4,754,152 | 3,768,435 |
| Intangibles, net of amortization | 680,878 | 781,633 |
| Other Assets | 113,256 | 95,217 |
| Total Other Assets | 5,548,286 | 4,645,285 |
| Total Assets | \$27,911,750 | \$26,910,046 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$1,230,563 | \$1,300,917 |
| Accrued payroll | 283,138 | 464,942 |
| Deferred revenue | 794,981 | 531,397 |
| Other accrued expenses | 1,381,804 | 1,134,279 |
| Billings in excess of costs and estimated earnings | 604,693 | 306,148 |
| Total Current Liabilities | 4,295,179 | 3,737,683 |
| Long-Term Liabilities | | |
| Deferred rent | 851,901 | 1,006,893 |
| Deferred income taxes | 126,000 | 39,000 |
| Total Long-term Liabilities | 977,901 | 1,045,893 |
| Total Liabilities | 5,273,080 | 4,783,576 |
| Stockholders' Equity | | |
| Common stock, 12,000,000 shares authorized; 5,066,009 and 5,039,632 issued and outstanding | 50,660 | 50,397 |
| Additional paid-in capital | 5,318,323 | 5,185,325 |
| Retained earnings | 17,537,358 | 17,073,351 |
| Accumulated other comprehensive loss | (267,671) | (182,603) |

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| | | |
|--|--------------|--------------|
| Total Stockholders' Equity | 22,638,670 | 22,126,470 |
| Total Liabilities and Stockholders' Equity | \$27,911,750 | \$26,910,046 |

See accompanying notes.

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SUTRON CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

| | Three Months Ended September 30, | |
|--|-------------------------------------|-------------|
| | 2013 | 2012 |
| Revenue | \$7,124,591 | \$7,042,056 |
| Cost of goods sold | 4,247,587 | 4,080,121 |
| Gross profit | 2,877,004 | 2,961,935 |
| Operating expenses: | | |
| Selling, general and administrative expenses | 1,416,634 | 1,250,138 |
| Research and development expenses | 797,986 | 1,026,573 |
| Total operating expenses | 2,214,620 | 2,276,711 |
| Operating income | 662,384 | 685,224 |
| Financing income, net | 14,591 | 17,228 |
| Income before income taxes | 676,975 | 702,452 |
| Income tax expense | 190,000 | 212,000 |
| Net income | \$486,975 | \$490,452 |
| Net income per share: | | |
| Basic income per share | \$0.10 | \$0.10 |
| Diluted income per share | \$0.10 | \$0.10 |
| Comprehensive income: | | |
| Net income | \$486,975 | \$490,452 |
| Foreign currency translation adjustments | (28,754) | 5,869 |
| Comprehensive income | \$458,221 | \$496,321 |

See accompanying notes.

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SUTRON CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

| | Nine Months Ended September 30, | |
|--|------------------------------------|---------------|
| | 2013 | 2012 |
| Revenue | \$ 19,922,941 | \$ 17,583,405 |
| Cost of goods sold | 12,043,928 | 10,418,376 |
| Gross profit | 7,879,013 | 7,165,029 |
| Operating expenses: | | |
| Selling, general and administrative expenses | 4,517,771 | 3,602,498 |
| Research and development expenses | 2,744,075 | 2,207,475 |
| Total operating expenses | 7,261,846 | 5,809,973 |
| Operating income | 617,167 | 1,355,056 |
| Financing income, net | 23,840 | 43,957 |
| Income before income taxes | 641,007 | 1,399,013 |
| Income tax expense | 177,000 | 433,000 |
| Net income | \$ 464,007 | \$ 966,013 |
| Net income per share: | | |
| Basic income per share | \$ 0.09 | \$ 0.20 |
| Diluted income per share | \$ 0.09 | \$ 0.19 |
| Comprehensive income: | | |
| Net income | \$ 464,007 | \$ 966,013 |
| Foreign currency translation adjustments | (85,071) | (5,912) |
| Comprehensive income | \$ 378,936 | \$ 960,101 |

See accompanying notes.

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SUTRON CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Nine Months Ended September 30, | |
|---|------------------------------------|---------------------|
| | 2013 | 2012 |
| Cash Flows from Operating Activities: | | |
| Net income | \$464,007 | \$966,013 |
| Noncash items included in net income: | | |
| Depreciation and amortization | 389,775 | 207,776 |
| Deferred income taxes | 46,000 | (62,134) |
| Stock based compensation | 115,355 | 109,636 |
| Tax benefit from stock options exercised | (12,996) | (301,413) |
| Change in current assets and liabilities, net of the impact of acquisitions: | | |
| Accounts receivable | (502,163) | (12,969) |
| Inventory | (842,780) | (635,015) |
| Prepaid items and other assets | (134,787) | (72,642) |
| Income taxes receivable | 234,405 | 297,540 |
| Accounts payable | (70,353) | 257,902 |
| Accrued expenses | 22,601 | (308,803) |
| Deferred revenues | 263,584 | - |
| Billings in excess of costs and estimated earnings | 298,545 | 509,998 |
| Deferred rent | (154,992) | (136,874) |
| Net Cash Provided by Operating Activities | 116,201 | 819,015 |
| Cash Flows from Investing Activities: | | |
| Restricted cash and cash equivalents | (56,582) | (193,611) |
| Purchase of property and equipment | (199,072) | (94,359) |
| Certificate of deposit | - | (2,900) |
| Other assets | 5,876 | 6,916 |
| Acquisition and Goodwill | (1,214,330) | (4,241,914) |
| Net Cash Used by Investing Activities | (1,464,108) | (4,525,868) |
| Cash Flows from Financing Activities: | | |
| Tax benefit from stock options exercised | 12,996 | 301,413 |
| Proceeds from stock options exercised | 4,910 | 174,250 |
| Net Cash Provided by Financing Activities | 17,906 | 475,663 |
| Effect of exchange rate changes on cash and cash equivalents | (85,071) | (8,785) |
| Net decrease in cash and cash equivalents | (1,415,072) | (3,239,975) |
| Cash and Cash Equivalents, beginning of period | 7,576,374 | 8,737,543 |
| Cash and Cash Equivalents, end of period | \$6,161,302 | \$5,497,568 |

See accompanying notes.

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SUTRON CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business and Basis of Presentation

Sutron Corporation (the “Company”) was incorporated on December 30, 1975, under the General Laws of the Commonwealth of Virginia. The Company operates from its headquarters located in Sterling, Virginia. The Company has several branch offices located throughout the United States, a branch office in India and a wholly owned subsidiary in India. The Company is a leading provider of real-time data collection and control products, systems software and professional services in the hydrological, meteorological, oceanic, air quality and aviation monitoring markets. The Company’s principal products include data loggers, satellite transmitters/loggers, water level and meteorological sensors, tides systems, ambient air instrumentation and continuous emissions control monitoring and system and application software. Customers consist of a diversified base of Federal, state, local and foreign government agencies, commercial entities, universities, engineering firms and hydropower companies.

The consolidated financial statements included herein have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and disclosures included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been omitted pursuant to such rules and regulations. The consolidated balance sheet as of December 31, 2012 was derived from the audited consolidated financial statements for the year then ended.

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

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

2. Significant Accounting Policies

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. These judgments are difficult as matters that are inherently uncertain directly impact their valuation and accounting. Actual results may vary from management’s estimates and assumptions. The Company’s significant accounting policies are disclosed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

Recent Accounting Standards

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

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

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

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

3. Stock-Based Compensation

The Company's Amended and Restated 1996, 1997 and 2002 Stock Option Plans (the “Stock Option Plans”) provide for the issuance of non-qualified stock options to employees, officers and directors. The Company's 2010 Equity Incentive Plan provides for the grant of stock options, stock appreciation rights, restricted stock, stock units, unrestricted stock, dividend equivalent rights and cash awards. All plans are administered by the Governance & Compensation Committee of the Board of Directors, whose membership is composed of three independent Directors. That Committee selects persons to receive awards and determines the number of shares subject to each award and the terms, conditions, performance measures and other provisions of the award.

The Company has granted stock options under the Stock Option Plans to key employees and directors for valuable services provided to the Company. Under the 1996 Plan, the Company authorized 260,000 shares, 259,000 of which have been granted. The Company authorized 60,000 shares under the 1997 Plan, all of which have been granted. Under the 2002 Stock Option Plan, the Company authorized 650,000 shares, 597,059 of which have been granted. The 1996, 1997 and 2002 Plans remain in effect until such time as no shares of Stock remain available for issuance under the Plans and the Company and the person awarded options have no further rights or obligations under the Plans. Under the 2010 Equity Incentive Plan, the Company authorized 500,000 shares, 88,500 of which have been granted as restricted stock units. The ability to make awards under the 2010 Plan will terminate in May 2020. Stock options under all of the plans may be granted at not less than 100 percent of the fair market value at the grant date. All outstanding options have a ten-year term from the date of grant. Cancelled or expired options and restricted stock units can be reissued.

The Company measures and recognizes compensation expense for all stock-based payments at fair value. The Company recognizes stock-based compensation costs on a straight-line basis over the requisite service period of the award, which is generally the option or restricted stock unit (RSU) vesting term. There were no stock options granted during the nine months ended September 30, 2013. There were 9,000 RSU's granted during the nine months ended September 30, 2013. Stock based compensation expense relating to stock option awards and RSU's for the nine months ended September 30, 2013 and 2012 was \$115,335 and \$44,364, respectively. These expenses were included in the cost of sales and selling, general and administrative lines of the Consolidated Statements of Operations. Unamortized stock compensation expense as of September 30, 2013 relating to stock options totaled approximately \$27,214 and these costs will be expensed over a weighted average period of 1.6 years. Unamortized stock compensation expense as of September 30, 2013 relating to RSU's totaled approximately \$101,031 and these costs will

be expensed over a weighted average period of 1.15 years.

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

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

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

| | Number of Shares | Weighted Average Grant Date Fair Value | Weighted Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|--|---------------------|---|---|---------------------------------|
| Outstanding restricted stock units at January 1, 2013 | 69,375 | \$4.21 | 2.56 | \$350,344 |
| Granted | 9,000 | 5.33 | - | 50,490 |
| Forfeited | (3,000) | 4.86 | - | 16,830 |
| Vested | (19,125) | 4.66 | - | 95,625 |
| Outstanding restricted stock units at September 30, 2013 | 56,250 | \$4.23 | 1.17 | \$281,250 |
| Restricted stock units expected to vest | 34,544 | \$4.54 | 1.15 | \$172,719 |

4. Earnings Per Share

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

| | Three Months Ended September 30, | |
|---|----------------------------------|------------|
| | 2013 | 2012 |
| Net income | \$ 486,975 | \$ 490,452 |
| Shares used in calculation of income per share: | | |
| Basic | 5,066,009 | 4,809,469 |
| Effect of dilutive options | 57,438 | 227,820 |
| Diluted | 5,123,447 | 5,037,289 |
| Net income per share: | | |
| Basic | \$ 0.10 | \$ 0.10 |

| | | |
|---------|---------|---------|
| Diluted | \$ 0.10 | \$ 0.10 |
|---------|---------|---------|

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| | Nine months ended September 30, | |
|---|---------------------------------|------------|
| | 2013 | 2012 |
| Net income | \$ 464,007 | \$ 966,013 |
| Shares used in calculation of income per share: | | |
| Basic | 5,061,710 | 4,744,322 |
| Effect of dilutive options | 57,502 | 228,726 |
| Diluted | 5,119,212 | 4,973,048 |
| Net income per share: | | |
| Basic | \$ 0.09 | \$ 0.20 |
| Diluted | \$ 0.09 | \$ 0.19 |

5. Completed Acquisition

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

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

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

Goodwill

The goodwill amount of \$985,717 represents the excess of the purchase price over the fair value of the identified net tangible assets. The goodwill recognized in this acquisition was derived from expected benefits from future technology, sales synergies and a knowledgeable and experienced workforce who joined the Company. Goodwill is not amortized, but is tested for impairment annually in the fourth quarter of each fiscal year or more frequently if certain indicators of impairment are present. An analysis is made quarterly to identify any indicators that may be present suggesting a broader goodwill analysis should be performed. Goodwill is expected to be tax deductible for income tax purposes. The Company believes there is no impairment of goodwill as of September 30, 2013.

Intangible Assets

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

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

Statements made in this Quarterly Report on Form 10-Q, including without limitation this Management's Discussion and Analysis of Financial Condition and Operations, other than statements of historical information, are forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements may sometimes be identified by such words as "may," "will," "expect," "anticipate," "believe," "estimate" and "continue" or similar words. We believe that it is important to communicate our future expectations to investors. However, these forward-looking statements involve many risks and uncertainties including those identified in the Company's Annual Report on Form 10-K for the year ended December 31, 2012. Our actual results could differ materially from those indicated in such forward-looking statements as a result of certain factors. We are under no duty to update any of the forward-looking statements after the date of this Quarterly Report on Form 10-Q to conform these statements to actual results.

Overview

Our primary focus is to provide real-time systems solutions, including equipment and software, and services to our customers in the areas of hydrological, meteorological, air quality and oceanic monitoring. We design, manufacture, market and sell these products and services to a diversified customer base consisting of federal, state, local and foreign governments, engineering firms, universities, hydropower companies and aviation firms. Our products, systems, software and services enable these entities to monitor and collect air quality, hydrological, meteorological and oceanic data for the management of critical water resources, for early warning of potentially disastrous floods, storms or tsunamis, for the optimization of hydropower plants, for the monitoring of emissions and for the supply of critical aviation information.

Our key products are the SatLink2 Transmitter/Logger, the Xpert/XLite dataloggers, the Accububble Self-Contained Bubbler, the Accubar Pressure Sensor, ambient air instrumentation and continuous emissions control monitoring systems and Tempest, XConnect and LEADS systems software. These are the essential components of most systems and are provided to customers as off-the-shelf equipment or as part of a custom system. The SatLink2 is a key product because it functions both as a transmitter and logger. The Xpert and XLite are more powerful dataloggers that have significant more logging capability and communications options than the SatLink2. Our ambient air instrumentation and continuous emissions control monitoring systems allow us to collect critical air quality data. Our Tempest, XConnect and LEADS systems software allow us to provide turn-key systems solutions to our customers.

We began fiscal year 2013 with a backlog of approximately \$13,354,000 as compared to beginning fiscal year 2012 with a backlog of approximately \$9,599,000. As of September 30, 2013, our backlog totaled approximately \$12,318,599. We have historically experienced significant fluctuations in our quarterly sales and revenue and anticipate that we will continue to experience significant quarterly fluctuations in our sales and revenue in 2013. Operating results will depend upon the product mix and upon the timing and execution of project awards.

International sales, which totaled 57% of total revenue for 2012 and 43% of revenue for the nine months ended September 30, 2013, are a significant portion of our revenue. We believe that international revenue will grow as a percentage of our total business as we plan to develop stronger international partnerships and expand our international sales opportunities. International sales are however difficult to forecast because they are frequently delayed due to different governmental procurement and approval processes. Our domestic business is highly dependent upon government business. Contracts and purchase orders with Federal, state and local government agencies represented approximately 28% of our total 2012 revenue and 30% of our revenue for the nine months ended September 30, 2013.

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

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

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On March 6, 2013, we completed the acquisition of substantially all of the commercial and operating assets of Sabio Instruments (“Sabio”). With this acquisition, we broadened our line of environmental monitoring instrumentation into the expected growth market of air quality monitoring and we are currently developing an expanded set of monitoring and warning products and solutions. We will continue to seek other acquisitions that are compatible with our strategic focus.

Critical Accounting Policies and Estimates

The Company's discussion and analysis of financial condition and results of operations are based upon the financial statements, which have been prepared in accordance with generally accepted accounting principles as recognized in the United States of America. The preparation of these financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and disclosure of contingent assets and liabilities. Our estimates include those related to revenue recognition, the valuation of inventory, and valuation of deferred tax assets and liabilities, warranty obligations and accruals. We base our estimates on historical experience and on various other assumptions that management believes to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. For a complete description of accounting policies, see Note 2 to our financial statements included in the Company's Form 10-K for the year ended December 31, 2012. There were no significant changes in critical accounting estimates in the nine months ended September 30, 2013.

Results of Operations

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

| | Three Months Ended September 30, | |
|--|----------------------------------|---------|
| | 2013 | 2012 |
| Net sales and revenues | 100.0 % | 100.0 % |
| Cost of sales and revenues | 59.6 | 57.9 |
| Gross profit | 40.4 | 42.1 |
| Selling, general and administrative expenses | 19.9 | 17.8 |
| Research and development expenses | 11.2 | 14.6 |
| Operating income (loss) | 9.3 | 9.7 |
| Interest and other income | 0.2 | 0.3 |
| Income (loss) before income taxes | 9.5 | 10.0 |
| Income taxes (benefit) | 2.7 | 3.0 |
| Net income (loss) | 6.8 % | 7.0 % |

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

Net Sales and Revenues

Revenues for the third quarter ended September 30, 2013 increased to \$7,124,591 from \$7,042,056 in 2012. Net sales and revenues are broken down between sales of standard products and sales of systems and services. Standard products had a net sales and revenue increase of 37% to \$3,030,119 in 2013 from \$2,210,001 in 2012. Sales of Sabio air quality systems accounted for \$506,849 of the increase. Net sales and revenues for systems and services decreased 15% to \$4,094,472 in the third quarter of 2013 from \$4,832,055 in 2012. The overall decline in revenue from systems

and services resulted from delayed and decreased project activity. Sales of MeteoStar systems and services were \$1,538,000 in the third quarter of 2013 as compared to \$1,177,000 in the third quarter of 2012. The overall increase is attributed to increased sales of LEADS software.

Overall domestic revenues increased 30% to \$4,757,542 in the third quarter of 2013 versus \$3,648,848 in 2012 due in large part to increased domestic sales in our MeteoStar division for the third quarter of 2013 compared to MeteoStar's domestic sales in the third quarter of 2012. International revenues decreased 30% to \$2,367,049 in the third quarter of 2013 versus \$3,393,208 in the same period in 2012 due primarily to delayed and decreased project activity.

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Customer orders or bookings in the third quarter of 2013 increased 6% to approximately \$6,668,304 as compared to approximately \$6,296,000 in the third quarter of 2012.

Cost of Sales and Revenues

Cost of sales as a percentage of revenues was 60% and 58%, respectively, for the third quarter of 2013 and 2012. Standard product cost of sales was approximately 57% in the third quarter of 2013 as compared to 58% in 2012. Cost of sales for systems and services was 61% in the third quarter of 2013 as compared to 58% in the third quarter of 2012. The increase was primarily due to a differing product mix being used in 2013 compared to 2012.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased to \$1,416,634 for the third quarter of 2013 from \$1,250,138 for the same period in 2012. The increase in selling, general and administrative expenses for the quarter was partly due to planned investments in additional selling and administrative staff consistent with the Company's growth initiatives as well as the addition of Sabio.

Research and Development Expenses

Research and development expenses decreased to \$797,986 for the third quarter of 2013 from \$1,026,573 for the same period in 2012. The decrease is due primarily to increased project sales in MeteoStar that resulted in the diversion of more engineer time to projects as opposed to research and development.

Interest and Other Income, Net

Due to our cash position, we did not use our line of credit during the third quarter of 2013 or 2012. We had interest income for the quarter ended September 30, 2013 of \$14,591 as compared to net interest income of \$17,228 for the quarter ended September 30, 2012.

Income Taxes

We recorded an income tax provision of \$190,000 for the quarter ended September 30, 2013 as compared to \$212,000 for the quarter ended September 30, 2012. The income tax expense represents an effective tax rate of 28% and 30% for 2013 and 2012, respectively.

Nine months ended September 30, 2013 Compared to Nine months ended September 30, 2012

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

| | Nine months ended September 30, | |
|--|---------------------------------|---------|
| | 2013 | 2012 |
| Net sales and revenues | 100.0 % | 100.0 % |
| Cost of sales and revenues | 60.4 | 59.3 |
| Gross profit | 39.6 | 40.7 |
| Selling, general and administrative expenses | 22.7 | 20.5 |

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| | | | | |
|-----------------------------------|------|---|------|---|
| Research and development expenses | 13.8 | | 12.6 | |
| Operating income (loss) | 3.1 | | 7.6 | |
| Interest and other income | 0.1 | | 0.2 | |
| Income (loss) before income taxes | 3.2 | | 7.8 | |
| Income taxes (benefit) | 0.9 | | 2.5 | |
| Net income (loss) | 2.3 | % | 5.3 | % |

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Net Sales and Revenues

Revenues for the nine months ended September 30, 2013 increased 13% to \$19,922,941 from \$17,583,405 in 2012. Net sales and revenues are broken down between sales of standard products and sales of systems and services. Standard products had a net sales and revenue increase in 2013 of 33% to \$8,315,538 from \$6,234,380 in 2012. Sales of Sabio air quality systems accounted for \$972,446 of the increase. Net sales and revenues for systems and services increased 3% to \$11,607,403 from \$11,349,025 in 2012. The increase in systems and services was primarily due to the addition of our MeteoStar and Sabio divisions.

Overall domestic revenues increased 45% to \$11,293,811 for the nine months ended September 30, 2013 versus \$7,803,764 in 2012 due primarily to increased non-federal revenues, the addition of Sabio and owning MeteoStar for the full nine month period compared to the previous year in which the Company only owned MeteoStar for five months of the nine month period ended September 30, 2012. International revenues decreased 12% to \$8,629,130 for the nine months ended September 30, 2013 versus \$9,779,641 in 2012 due to delayed and decreased project activity.

Customer orders or bookings for the nine months ended September 30, 2013 were approximately \$20,433,000 as compared to approximately \$20,397,000 in 2012.

Cost of Sales and Revenues

Cost of sales as a percentage of revenues was 60% and 59%, respectively, for the nine months ended September 30, 2013 and 2012. Standard product cost of sales as a percentage of standard product revenues was approximately 57% and 54%, respectively, for the nine months ended September 30, 2013 and 2012. The increase in standard product cost of sales as a percentage of sales is the result of a differing product mix in 2013 compared to 2012. Cost of sales for systems and services as a percentage of systems and services revenues was 63% for the nine months ended September 30, 2013 as compared to 62% for the nine months ended September 30, 2012.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$4,517,771 in 2013 as compared to \$3,602,498 in 2012, an increase of \$915,273 or 25%. Selling, general and administrative expenses as a percentage of revenues increased to 23% for the nine months ended September 30, 2013 from 21% in 2012. The increase in selling, general and administrative expenses was partly due to planned investments in sales and administrative staff consistent with the Company's growth initiatives as well as the addition of Sabio.

Research and Development Expenses

Research and development expenses increased to \$2,744,075 for the nine months ended September 30, 2013 from \$2,207,475 in 2012, an increase of \$536,600 or 24%. This increase is primarily the result of planned R&D activities at MeteoStar and Sabio.

Interest and Other Income, Net

Due to the Company's cash position, the Company did not use its line of credit during the nine months ended September 30, 2013 and 2012. The Company had net interest income in 2013 of \$23,840 as compared to net interest income of \$43,957 in 2012.

Income Taxes

We recorded an income tax expense of \$177,000 and \$433,000 for the nine months ended September 30, 2013 and 2012, respectively. The income tax provision in 2013 and 2012 represents an effective income tax rate of 28% and 31%, respectively.

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Liquidity and Capital Resources

Cash and cash equivalents were \$6,161,302 at September 30, 2013 compared to \$7,576,374 at December 31, 2012. The decrease in cash and cash equivalents for the nine months ended September 30, 2013 is due primarily to the acquisition of Sabio. Working capital is primarily unchanged at September 30, 2013 compared with December 31, 2012.

We have a revolving credit facility of \$3,000,000 with Branch Banking and Trust (BB&T). We are permitted to borrow based on accounts receivable and inventory according to pre-established criteria. The credit facility expires on September 5, 2015 and is secured by substantially all the assets of the Company. Borrowings bear interest at the bank's prime rate. During the first nine months of 2013, there was no borrowing on the line of credit. We frequently bid on and enter into contracts that require bid and performance bonds. At September 30, 2013 and December 31, 2012, BB&T had issued standby letters of credit in the amount of \$1,694,024 and \$1,094,162, respectively, that served as either bid or performance bonds. The amount available to borrow under the line of credit was reduced by these amounts.

Management believes that its existing cash resources, cash flow from operations and short-term borrowings on the existing credit line will provide adequate resources for supporting operations during fiscal 2013.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about market risk, see Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," of the Annual Report on Form 10-K for the fiscal year ended December 31, 2012. The Company's exposure to market risk has not changed materially since December 31, 2012.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Our management (with the participation of our Chief Executive Officer and interim Chief Financial Officer) evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of September 30, 2013, the end of the fiscal period covered by this report on Form 10-Q. The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act of 1934 reports are recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and interim Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, the Chief Executive Officer and interim Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

(b) Changes in Internal Controls over Financial Reporting

There have been no changes in our internal controls over financial reporting that occurred during the quarter ended September 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

There are no outstanding legal claims involving the business that, in the opinion of management, will have a material effect on our financial statements.

Item 6. Exhibits

- 31.1 Certification of the President and Chief Executive Officer pursuant to Rule 13a-14(a).
- 31.2 Certification of the interim Chief Financial Officer pursuant to Rule 13a-14(a).
- 32 Certification of the President and Chief Executive Officer and the Interim Chief Financial Officer pursuant to 18 United States Code, Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS XBRL Instance Document

101.SCHXBRL Taxonomy Extension Schema Document

101.CALXBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LABXBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Presentation Linkbase Document

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Sutron Corporation
(Registrant)

November 14, 2013
Date

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

November 14, 2013
Date

By: /s/ Glen E. Goold
Glen E. Goold
Interim Chief Financial Officer
(Principal Accounting Officer)

