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SUTRON CORP
Form 10QSB
August 14, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-QSB

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934
For the quarterly period ended June 30, 2007

COMMISSION FILE NUMBER: 0-12227

SUTRON CORPORATION

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

VIRGINIA

54-1006352

(State or other jurisdiction
of incorporation or organization)

(I.R.S. Employer
Identification Number)

21300 RIDGETOP CIRCLE, STERLING, VIRGINIA 20166

(Address of principal executive offices)

703-406-2800

(Issuer's telephone number)

SECURITIES REGISTERED UNDER SECTION 12(G) OF THE ACT: COMMON STOCK,
\$.01 PAR VALUE

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

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 4,515,632 outstanding shares of the issuer's only class of common equity, Common Stock, \$0.01 par value, on June 30, 2007.

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

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SUTRON CORPORATION
FORM 10-QSB QUARTERLY REPORT
FOR THE QUARTER ENDED JUNE 30, 2007

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SUTRON CORPORATION CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

| | JUNE 30, 2007 | DECEMBER 31, 2006 |
|---|------------------------|------------------------|
| | ----- | ----- |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 628,247 | \$ 1,539,032 |
| Restricted cash and cash equivalents | 949,923 | 138,233 |
| Accounts receivable | 4,526,605 | 6,835,751 |
| Inventory | 4,592,147 | 3,402,017 |
| Prepaid items and other assets | 680,669 | 530,720 |
| Deferred income taxes | 324,000 | 333,000 |
| Total current assets | ----- 11,701,591 | ----- 12,778,753 |
| PROPERTY AND EQUIPMENT, AT COST | 3,402,510 | 3,361,159 |
| Less: Accumulated depreciation and amortization | (2,853,441) | (2,740,941) |
| Property and equipment, net | ----- 549,069 | ----- 620,218 |
| OTHER ASSETS | 101,306 | 50,576 |
| TOTAL ASSETS | ----- \$ 12,351,966 | ----- \$ 13,449,547 |

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| | ===== | ===== |
|---|---------------|---------------|
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 1,006,141 | \$ 1,398,285 |
| Accrued payroll | 78,157 | 317,974 |
| Other accrued expenses | 532,204 | 1,506,950 |
| Notes payable - current | 50,722 | 50,722 |
| | ----- | ----- |
| Total current liabilities | 1,667,224 | 3,273,931 |
| LONG-TERM LIABILITIES | | |
| Notes payable, net of current maturities | 9,414 | 37,678 |
| Deferred income taxes | 120,000 | 129,000 |
| | ----- | ----- |
| TOTAL LONG-TERM LIABILITIES | 129,414 | 166,678 |
| | ----- | ----- |
| TOTAL LIABILITIES | 1,796,638 | 3,440,609 |
| | ----- | ----- |
| STOCKHOLDERS' EQUITY | | |
| Common stock | 45,157 | 44,946 |
| Additional paid-in capital | 2,678,330 | 2,559,281 |
| Retained earnings | 7,851,255 | 7,417,878 |
| Accumulated other comprehensive (loss) income | (19,414) | (13,167) |
| | ----- | ----- |
| TOTAL STOCKHOLDERS' EQUITY | 10,555,328 | 10,008,938 |
| | ----- | ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 12,351,966 | \$ 13,449,547 |
| | ===== | ===== |

See accompanying notes.

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SUTRON CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | THREE MONTHS ENDED JUNE 30, | THREE MONTHS ENDED JUNE 30, |
|--|-----------------------------|-----------------------------|
| | 2007 | 2006 |
| | ----- | ----- |
| Net sales and revenues | \$ 4,217,871 | \$ 4,421,174 |
| Cost of sales and revenues | 2,572,703 | 2,746,675 |
| | ----- | ----- |
| Gross profit | 1,645,168 | 1,674,499 |
| | ----- | ----- |
| Operating expenses: | | |
| Selling, general and administrative expenses | 776,005 | 651,551 |
| Research and development expenses | 291,509 | 325,460 |
| | ----- | ----- |
| Total operating expenses | 1,067,514 | 977,011 |
| | ----- | ----- |
| Operating income | 577,654 | 697,488 |
| Interest income (expense), net | 26,752 | 13,244 |

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| | | |
|------------------------------|------------|------------|
| Income before income taxes | 604,406 | 710,732 |
| Income tax expense (benefit) | 210,000 | 202,000 |
| Net income | \$ 394,406 | \$ 508,732 |
| Net income per share: | | |
| Basic income per share | \$.09 | \$.12 |
| Diluted income per share | \$.08 | \$.10 |

See accompanying notes

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SUTRON CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | SIX MONTHS ENDED JUNE 30, 2007 | 2006 |
|--|-----------------------------------|--------------|
| Net sales and revenues | \$ 7,364,615 | \$ 8,497,282 |
| Cost of sales and revenues | 4,579,407 | 5,068,800 |
| Gross profit | 2,785,208 | 3,428,482 |
| Operating expenses: | | |
| Selling, general and administrative expenses | 1,617,118 | 1,448,181 |
| Research and development expenses | 584,861 | 731,729 |
| Total operating expenses | 2,201,979 | 2,179,910 |
| Operating income | 583,229 | 1,248,572 |
| Interest income (expense), net | 49,148 | 25,599 |
| Income before income taxes | 632,377 | 1,274,171 |
| Income taxes | 199,000 | 406,000 |
| Net income | \$ 433,377 | \$ 868,171 |
| Net income per share: | | |
| Basic income per share | \$.10 | \$.20 |
| Diluted income per share | \$.09 | \$.18 |

See accompanying notes.

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SUTRON CORPORATION CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| | SIX MONTHS ENDED JUNE 30, 2007 | 2006 |
|--|-----------------------------------|--------------|
| | ----- | ----- |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 433,377 | \$ 868,171 |
| Noncash items included in net income: | | |
| Depreciation and amortization | 112,500 | 120,000 |
| Deferred income taxes | -- | (8,000) |
| Stock option compensation | 40,809 | 10,310 |
| Changes in current assets and liabilities: | | |
| Accounts receivable | 2,309,146 | (716,178) |
| Inventory | (1,190,130) | (1,023,804) |
| Prepaid items and other assets | (200,679) | 15,721 |
| Accounts payable | (392,144) | 151,798 |
| Accrued expenses | (1,214,563) | 424,483 |
| | ----- | ----- |
| Net Cash Provided (Used) by Operating Activities | (101,684) | (157,499) |
| | ----- | ----- |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Restricted cash and cash equivalents | (811,690) | 48,742 |
| Purchase of property and equipment | (41,351) | (65,633) |
| | ----- | ----- |
| Net Cash Provided (Used) by Investing Activities | (853,041) | (16,891) |
| | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payments on notes payable | (28,264) | (22,648) |
| Proceeds from stock options exercised | 78,451 | 16,570 |
| | ----- | ----- |
| Net Cash Provided (Used) by Financing Activities | 50,187 | (6,078) |
| | ----- | ----- |
| Effect of exchange rate changes on cash | (6,247) | 8,043 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (910,785) | (172,425) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 1,539,032 | 1,861,627 |
| | ----- | ----- |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 628,247 | \$ 1,689,202 |
| | ===== | ===== |
| CASH PAID DURING THE PERIOD FOR: | | |
| Interest | \$ 40 | \$ 1,480 |
| | ===== | ===== |
| Income taxes paid (received) | \$ 295,462 | \$ 217,987 |
| | ===== | ===== |

See accompanying notes

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(UNAUDITED)

JUNE 30, 2007

1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

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

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

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

2. SIGNIFICANT ACCOUNTING POLICIES

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

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

STOCK COMPENSATION

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

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performance measures and other provisions of the award. See Note 13 of the Company's financial statements in its Annual Report on Form 10-KSB for the year ended December 31, 2006 for additional information related to the stock option plans.

Effective January 1, 2006, the Company adopted SFAS No. 123R ACCOUNTING FOR STOCK BASED COMPENSATION (SFAS 123R), which requires companies to measure and recognize compensation expense for all stock-based payments at fair value. SFAS 123R is being applied on the modified prospective transition method and therefore the Company has not restated results for prior periods. The financial statements for the three months and six months ended June 30, 2007 recognize compensation cost for the portion of outstanding awards which have vested during the period. The Company recognizes stock-based compensation costs on a straight-line basis over the requisite service period of the award, which is generally the option vesting term. For the three and six months ended June 30, 2007, total stock-based compensation expense of \$22,424 and \$40,809 was included in operating expenses as compared to stock-based compensation of \$10,310 for the three and six months ended June 30, 2006. The weighted average fair value of options granted during the three months and six months ended June 30, 2007 was calculated using the Black-Scholes option pricing model with the following valuation assumptions and weighted average fair value as follows:

| | Periods Ended June 30, 2007 | |
|---------------------------------------|-----------------------------|------------|
| | Three Months | Six Months |
| Weighted average fair value of grants | \$7.60 | \$7.06 |
| Expected volatility | 30% | 30% |
| Dividend yield | 0 | 0 |
| Risk-free interest rate | 5.16% | 4.50% |
| Expected term in years | 10.00 | 10.00 |

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

3. STOCK OPTIONS

The Company has granted stock options under the Stock Option Plans to key employees and directors for valuable services provided to the Company. Under the 1996 Plan, the Company authorized 260,000 shares, 259,000 of which have been granted. As of December 31, 2004, the Company authorized 60,000 shares and 400,000 shares under the 1997 and 2002 Stock Option Plans, respectively, all of which have been granted. During 2005, the 2002 Stock Option Plan was amended to authorize 650,000 shares, 503,333 of which have been granted. In addition, all three plans were amended in 2005 to allow Directors to participate in the plan and to provide that vesting schedules will be determined by the Board at the time each individual option is granted.

Shares under all of the plans may be granted at not less than 100 percent of the fair market value at the grant date. All options have a ten-year term from the date of grant. Prior to the 2005 amendments, options vested ratably over five years on each anniversary date the option was granted. The Company elected to accelerate vesting of all outstanding options as of December 31, 2005, as permitted under the plans. Cancelled or expired options are able to be reissued. The following table summarizes stock option activity under the Stock Option Plans for the six months ended June 30, 2007:

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| | Number of Shares | Weighted Avg. Exercise Price | Number of Options Exercisable |
|-----------------------------|---------------------|---------------------------------|----------------------------------|
| Balance - December 31, 2006 | 554,333 | \$1.13 | 554,333 |
| Granted | 65,000 | 7.06 | |
| Exercised | 21,081 | 3.72 | |
| Canceled | 5,000 | 7.60 | |
| Balance - June 30, 2007 | 593,252 | \$1.51 | 593,252 |

4. EARNINGS PER SHARE

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

| | Three Months Ended June 30, | |
|---|-----------------------------|-----------|
| | 2007 | 2006 |
| Net income | \$394,406 | \$508,732 |
| Shares used in calculation of income per share: | | |
| Basic | 4,513,005 | 4,306,925 |
| Effect of dilutive options | 550,530 | 644,865 |
| Diluted | 5,063,535 | 4,951,790 |
| Net income per share: | | |
| Basic | \$.09 | \$.12 |
| Diluted | \$.08 | \$.10 |
| | | |
| | Six Month Ended June 30, | |
| | 2007 | 2006 |
| Net income | \$433,377 | \$868,171 |
| Shares used in calculation of income per share: | | |
| Basic | 4,506,932 | 4,301,098 |
| Effect of dilutive options | 554,264 | 658,376 |
| Diluted | 5,061,196 | 4,959,474 |
| Net income per share: | | |
| Basic | \$.10 | \$.20 |
| Diluted | \$.09 | \$.18 |

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS
OF OPERATIONS

STATEMENTS MADE IN THIS REPORT ON FORM 10-QSB, INCLUDING WITHOUT LIMITATION THIS MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND OPERATIONS,

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OTHER THAN STATEMENTS OF HISTORICAL INFORMATION, ARE FORWARD LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED, AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. THESE FORWARD-LOOKING STATEMENTS MAY SOMETIMES BE IDENTIFIED BY SUCH WORDS AS "MAY," "WILL," "EXPECT," "ANTICIPATE," "BELIEVE," "ESTIMATE" AND "CONTINUE" OR SIMILAR WORDS. WE BELIEVE THAT IT IS IMPORTANT TO COMMUNICATE OUR FUTURE EXPECTATIONS TO INVESTORS. HOWEVER, THESE FORWARD-LOOKING STATEMENTS INVOLVE MANY RISKS AND UNCERTAINTIES. OUR ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE INDICATED IN SUCH FORWARD-LOOKING STATEMENTS AS A RESULT OF CERTAIN FACTORS. WE ARE UNDER NO DUTY TO UPDATE ANY OF THE FORWARD-LOOKING STATEMENTS AFTER THE DATE OF THIS REPORT ON FORM 10-QSB TO CONFORM THESE STATEMENTS TO ACTUAL RESULTS.

OVERVIEW

Our primary focus is to provide real-time systems solutions, including equipment and software, and services to our customers in the areas of hydrological monitoring and control, meteorological monitoring

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including airport weather systems, oceanic monitoring and hydrological services. We design, manufacture and market these products and services to a diversified customer base consisting of federal, state, local and foreign governments, universities and engineering and hydropower companies. Our products and services enable these entities to monitor and collect hydrological, meteorological and oceanic data for the management of critical water resources, for early warning of potentially disastrous floods, storms or tsunamis, for the optimization of hydropower plants and for providing real-time weather conditions at airports.

Our key products are the SatLink2 Transmitter/Logger, Xpert/XLite datalogger, Accububble Self-Contained Bubbler, Accubar Pressure Sensor, Tides Systems and XConnect Systems Software. These are the essential components of most systems and are provided to customers as off-the-shelf equipment or as part of a custom system. The SatLink2 is a key product because it functions both as a transmitter and logger. It is an price-effective solution for small systems that do not require a significant number of sensors or communications options. The Xpert and XLite are more powerful dataloggers that have significantly more logging capability and communications options than the SatLink2. Our Tides Systems are the only National Ocean Survey approved tides monitoring system in the United States.

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's discussion and analysis of financial condition and results of operations are based upon the condensed financial statements, which have been prepared in accordance with generally accepted accounting principles as recognized in the United States of America. The preparation of these financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and disclosure of contingent assets and liabilities. Our estimates include those related to revenue recognition, the valuation of inventory, and valuation of deferred tax

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assets and liabilities, useful lives of intangible assets, warranty obligations and accruals. We base our estimates on historical experience and on various other assumptions that management believes to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. For a complete description of accounting policies, see Note 1 to our financial statements included in the Company's Form 10-KSB for the year ended December 31, 2006. There were no significant changes in critical accounting estimates

RESULTS OF OPERATIONS

THREE MONTHS ENDED JUNE 30, 2007 COMPARED TO THREE MONTHS ENDED JUNE 30, 2006

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

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| | Three Months Ended | |
|--|--------------------|--------|
| | June 30, | |
| | 2007 | 2006 |
| | ----- | ----- |
| Net sales and revenues | 100.0% | 100.0% |
| Cost of sales and revenues | 61.0 | 62.7 |
| | ----- | ----- |
| Gross profit | 39.0 | 37.3 |
| Selling, general and administrative expenses | 18.4 | 14.2 |
| Research and Development expenses | 6.9 | 7.3 |
| | ----- | ----- |
| Operating income | 13.7 | 15.8 |
| | ----- | ----- |
| Interest (income) expense | .6 | .3 |
| | ----- | ----- |
| Income before income taxes | 14.3 | 16.1 |
| Income taxes (benefit) | 5.0 | 4.6 |
| | ----- | ----- |
| Net income | 9.3% | 11.5% |
| | ===== | ===== |

NET SALES AND REVENUES

The Company's net sales and revenues for the three months ended June 30, 2007 decreased 4.6% to \$4,217,871 from \$4,421,174 in 2006 primarily due to decreased international revenues. Overall domestic revenues increased 15% to \$3,316,025 in the second quarter of 2007 versus \$2,889,184 in 2007 while international revenues decreased 41% to \$901,846 in 2007 versus \$1,531,990 in 2007, primarily due to decreased revenue from project work in India. Net sales and revenues are broken down between the Company's operating divisions or profit centers which include the HydroMet Products Division, the Integrated Services Division which includes Special Projects, the Hydrological Services Division, Airport Weather Systems Division and Sutron India Operations.

The HydroMet Products Division, which is responsible for sales of standard products, had a net sales and revenue increase of 55% to \$2,248,410 from \$1,455,223 in 2006. Standard product revenues were higher in 2007 due to increased domestic shipments of SatLink2 Transmitter/Loggers, Water Level Sensors and Accessories. Integrated Systems Division net sales and revenues decreased 26% to \$955,239 from \$1,297,400 in 2006 due primarily to decreased

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India project revenues. Net sales and revenues from the Hydrological Services Division decreased 39% to \$568,437 from \$926,279 in 2006 due a decrease in project deliveries. Airport Weather Systems Division net sales and revenues decreased 55% to \$75,425 from \$167,440 in 2006 as the division completed one shipment in 2007 compared to two shipments in 2006. Sutron India Operations had a net sales and revenue decrease of 36% to \$370,360 from \$574,822 in 2006 due to the Central Water Commission (CWC) of India contract being near completion. There was no significant change in the CWC cost estimate to complete during the second quarter.

Customer orders for the second quarter of 2007 were approximately \$12,742,000 as compared to approximately \$4,355,000 in 2006.

COST OF SALES AND REVENUES

Cost of sales as a percentage of revenues was 61% for the quarter ended June 30, 2007 as compared to 62.7% for the quarter ended June 30, 2006. The decrease in cost of sales is attributed to changes in the product mix that resulted in higher equipment sales and decreased project work. In 2006, substantial costs were associated with projects such as Central Water Commission of India, India Meteorological Department and Prime Controls. Projects do not normally carry as high margins as stand-alone products which benefited the margins in 2007. Cost of sales for both 2007 and 2006 include provisions for inventory obsolescence, physical inventory adjustments and inventory valuation adjustments. The Company continually pursues product cost reductions through continual review of procurement sourcing, product value engineering and improvements in manufacturing processes.

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SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses increased to \$776,005 in 2007 from \$651,551 in 2006, an increase of \$124,454 or 19%. The Company experienced increases in selling and marketing activities due to the addition of two new domestic salesmen who were not with the Company in the prior year, in legal costs due to a lawsuit which the Company has filed against its former Vice President of the Hydrological Services Division and another former HSD employee and in letter of credit costs due to a performance bond that was provided to the Afghanistan Ministry of Energy and Water as security on the contract.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses decreased to \$291,509 in 2007 from \$325,460 in 2006, a decrease of \$33,951 or 10%. Product development expenses decreased primarily due higher costs in 2006 associated with efforts to improve and incorporate state-of-the-art technology into the Xpert datalogger consisting primarily of subcontractor expenses. Dataloggers and water level sensors are the primary components of hydrometeorological systems and we are continuously improving these products as well as developing new products in order to maintain and improve our competitive position.

INTEREST INCOME AND EXPENSE, NET

Due to the Company's cash position, the Company did not use its line of credit during the second quarter of 2007. The Company had net interest income in 2007 of \$26,752 as compared to net interest income of \$13,244 in 2006.

INCOME TAXES

Income taxes increased 4% in 2007 to \$210,000 from \$202,000 in 2006. Taxes as a

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percentage of revenue were 5.0% in 2007 as compared to 4.6% in 2006. The provisions for income taxes represent effective tax rates of approximately 34.8% in 2007 and 28.4% in 2006, respectively. The effective tax rate in 2007 increased over the prior year due to the exercise of non-qualified stock options in the prior year that generated a significant 2006 tax deduction relating to stock option compensation.

SIX MONTHS ENDED JUNE 30, 2007 COMPARED TO THREE MONTHS ENDED JUNE 30, 2006

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

| | Six Months Ended June 30, | |
|--|------------------------------|--------|
| | 2007 | 2006 |
| | ----- | ----- |
| Net sales and revenues | 100.0% | 100.0% |
| Cost of sales and revenues | 62.2 | 59.7 |
| | ----- | ----- |
| Gross profit | 37.8 | 40.3 |
| Selling, general and administrative expenses | 22.0 | 17.0 |
| Research and Development expenses | 7.9 | 8.6 |
| | ----- | ----- |
| Operating income | 7.9 | 14.7 |
| | ----- | ----- |
| Interest (income) expense | .7 | .3 |
| | ----- | ----- |
| Income before income taxes | 8.6 | 15.0 |
| Income taxes (benefit) | 2.7 | 4.8 |
| | ----- | ----- |
| Net income | 5.9% | 10.2% |
| | ===== | ===== |

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NET SALES AND REVENUES

The Company's net sales and revenues for the six months ended June 30, 2007 decreased 13% to \$7,364,615 from \$8,497,282 in 2006. Overall domestic revenues increased 19% to \$5,687,038 in 2007 versus \$4,798,882 in 2006 while international revenues decreased 55% to \$1,677,577 in 2007 versus \$3,698,400 in 2006. Net sales and revenues are broken down between the Company's operating divisions or profit centers which include the HydroMet Products Division, the Integrated Services Division which includes Special Projects, the Hydrological Services Division, Airport Weather Systems Division and Sutron India Operations.

The HydroMet Products Division had a revenue increase of 28% to \$4,298,659 from \$3,365,306 in 2006 due to an increase due to increased domestic shipments of SatLink2 Transmitter/Loggers, Water Level Sensors and Accessories. Integrated Systems Division revenues decreased 35% to \$1,630,136 from \$2,559,511 in 2006 due to decreased international project revenues. Revenues from the Hydrological Services Division decreased 30% to \$980,198 from \$1,401,286 in 2006 due to decreased project activity. Airport Weather Systems Division revenues decreased to \$75,425 in 2007 as compared to \$282,425 in 2006 as the division completed one shipment in 2007 as compared to three shipments in 2006. Sutron India Operations had a net sales and revenue decrease of 57% to \$380,199 from \$888,753 in 2006 due to the Central Water Commission (CWC) of India contract being near completion and major contract expenditures being completed in prior periods.

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Customer orders or bookings for 2007 were approximately \$15,804,000 as compared to approximately \$8,202,000 in 2006. The Company's backlog of orders at June 30, 2007 was approximately \$15,708,000 as compared with approximately \$10,544,000 as of June 30, 2006. The Company anticipates that approximately 52% of its backlog as of June 30, 2007 will be shipped in 2007.

COST OF SALES AND REVENUES

Cost of sales as a percentage of revenues was 62.2% in 2007 as compared to 59.7% in 2006. The increase in cost of sales was primarily due to costs exceeding revenue for the Hydrological Services Division and due to increased CWC contract estimated costs for the two year warranty period after system acceptance that resulted in lower contract revenues for the period. Hydrological Services was reorganized in December 2006 due to the resignation of the Vice President who had managed this division since its inception in 2001. Staff has been reduced. Management is focused on winning new projects that carry higher margins and on executing projects profitably. The revision in the CWC cost estimate resulted in contract costs in excess of contract revenue. Contract estimated costs were increased due to delays in the civil works installation as approximately 30 sites were damaged by monsoons. Also, the CWC contract is the first significant project that has been executed by our India Operations. Due to a lack of experience on projects of this size, warranty costs (the costs to maintain the 168 stations for a period of two years from systems acceptance) were underestimated. Although the contract estimated costs increased due to the reasons discussed above, the CWC contract is profitable. After expiration of the two year warranty period, we will maintain the 168 sites under a four-year maintenance contract.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses increased to \$1,617,118 in 2007 from \$1,448,181 in 2006, an increase of \$168,937 or 12%. The Company experienced increases in selling and marketing activities due to the addition of two new domestic salesmen who were not with the Company in the prior year, in legal costs due to a lawsuit which the Company has filed against its former Vice President of the Hydrological Services Division and a former HSD employee and in letter of credit costs due to a

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performance bond that was provided to the Afghanistan Ministry of Energy and Water as security on the contract.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses decreased to \$584,861 in 2007 from \$731,729 in 2006, a decrease of \$146,868 or 20%. We incurred significant subcontractor expenses in 2006 relating to the development of our next generation Xpert/XLite Datalogger. The contractor tasks have been completed and we anticipate that the next generation Xpert/XLite Datalogger will be released to production in the second quarter of 2007. Our SatLink2 Transmitter/Logger, our Xpert/XLite Dataloggers, our Water Level Sensors and our Tides Systems are the primary components of our hydrometeorological systems and we are continuously improving these products as well as developing new products in order to maintain and improve our competitive position.

INTEREST INCOME AND EXPENSE, NET

Due to the Company's cash position, the Company did not use its line of credit during the six months ended June 30, 2007 except on one occasion. The Company had net interest income in 2007 of \$49,148 as compared to net interest income of

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\$25,599 in 2006.

INCOME TAXES

Income taxes decreased 51% in 2007 to \$199,000 from \$406,000 in 2006 due to the decrease in operating income. Taxes as a percentage of revenue were 2.7% in 2007 as compared to 4.8% in 2006. The provisions for income taxes represent effective tax rates of approximately 31.5% in 2007 and 31.9% in 2006, respectively.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents were \$628,247 at June 30, 2007 compared to \$1,539,032 at December 31, 2006. Working capital increased to \$10,034,367 at June 30, 2007 compared with \$9,504,822 at December 31, 2006.

Net cash used by operating activities was \$101,684 for the six months ended June 30, 2007 as compared to cash used by operating activities of \$157,499 for the six months ended June 30, 2006. The decrease is primarily due to the decrease in net income.

Net cash used by investing activities was \$853,041 for the six months ended June 30, 2007 as compared to cash used by investing activities of \$16,891 for the six months ended June 30, 2006, and was primarily due to an increase in restricted cash that secured a bank guarantee to the Central Water Commission of India for the delivery of contract equipment. We anticipate that the bank guarantee will be released in October 2007.

Net cash provided by financing activities was \$50,187 for the six months ended June 30, 2007 as compared to net cash used by financing activities of \$6,078 for the six months ended June 30, 2006 due to the exercise of employee stock options.

We have a revolving credit facility of \$3,000,000 with BB&T Bank. We are permitted to borrow based on accounts receivable and inventory according to pre-established criteria. The credit facility expires on August 5, 2007 and is secured by substantially all assets of the Company. Borrowings bear interest at the bank's prime rate. During the first six months of 2007, there was one borrowing on the line of credit.

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We frequently bid on and enter into international contracts that require bid and performance bonds. At June 30, 2007 and December 31, 2006, a commercial bank had issued standby letters of credit in the amount of \$1,698,776 and \$532,300 that served as either bid or performance bonds. The amount available to borrow under the line of credit was reduced by these amounts.

Management believes that its existing cash resources, cash flow from operations and short-term borrowings on the existing credit line will provide adequate resources for supporting operations during fiscal 2007. Although there can be no assurance that our revolving credit facility will be renewed, management believes that, if needed, it would be able to find alternative sources of funds on commercially acceptable terms.

ITEM 3. CONTROLS AND PROCEDURES

(A) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Our management (with the participation of our Chief Executive Officer and Chief Financial Officer) evaluated the effectiveness of our disclosure controls and

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procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of June 30, 2007, the end of the fiscal period covered by this report on Form 10-QSB. The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act of 1934 reports are recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, the chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

(B) CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING

There have been no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

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

On May 22, 2007, we filed a lawsuit in the United States District Court, Alexandria, Virginia Division, against Stephen Tarte, the former Vice President of the Hydrological Services Division, and Patricia Diaz, a former HSD employee for violation of their Conflict of Interest and Non-Competition agreements. Damages sought in the lawsuit are \$3,000,000. We believe that an award from this lawsuit is possible however we are unable to estimate the amount.

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

On May 16, 2007, an Annual Meeting of Shareholders of Sutron Corporation was held. Directors elected at the meeting were Raul S. McQuivey, Daniel W. Farrell, Robert F. Roberts, Jr., Andrew D. Lipman and Thomas R. Porter. Thompson, Greenspon & Co., P.C. was appointed as independent accountants for 2007. The election of directors and the appointment of the independent accountants were the only matters voted upon at the meeting. The number of shares eligible to vote at the meeting was 4,512,884. The results of the voting on these matters are shown below.

1. Election of Directors

| Name | Votes For | Votes Withheld |
|------------------------|-----------|----------------|
| ---- | ----- | ----- |
| Raul S. McQuivey | 3,790,647 | 4,200 |
| Daniel W. Farrell | 3,790,647 | 4,200 |
| Robert F. Roberts, Jr. | 3,790,647 | 4,200 |

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| | | |
|------------------|-----------|-------|
| Andrew D. Lipman | 3,790,647 | 4,200 |
| Thomas R. Porter | 3,790,647 | 4,200 |

2. Appointment of Thompson, Greenspon & Co., P.C. as Independent Accountants.

| For | Against | Abstain |
|-----------|---------|---------|
| --- | ----- | ----- |
| 3,790,247 | 4,500 | 100 |

ITEM 6. EXHIBITS

- 10.11 Stock Option Agreement between The Company and Andrew D. Lipman dated May 16, 2007
- 10.12 Stock Option Agreement between The Company and Thomas R. Porter dated May 16, 2007
- 10.13 Stock Option Agreement between The Company and Robert F. Roberts, Jr. dated May 16, 2007
- 31.1 Certification of the President and Chief Executive Officer pursuant to ss.302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer and Treasurer pursuant to ss.302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification of the President and Chief Executive Officer and Chief Financial Officer and Treasurer pursuant to 18 U.S.C. ss.1350, as adopted pursuant to ss.906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

Sutron Corporation
(Registrant)

August 13, 2007

Date

/s/ Raul S. McQuivey

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

August 13, 2007

Date

/s/ Sidney C. Hooper

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

