SONICS & MATERIALS INC
Form 10KSB
September 30, 2002

U. S. Securities and Exchange Commission
Washington, D. C. 20549

FORM 10-KSB

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED JUNE 30, 2002.

[_] 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	060854713
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
53 CHURCH HILL ROAD, NEWTOWN, CT	06470
(Address of principal executive offices)	(Zip Code)

Issuer's telephone number: (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 [X] No [_]

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B 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. [X]

The issuer's revenues for the most recent fiscal year were: $9,274,227

The aggregate market value of the common stock held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common stock as of September 24, 2002 as reported on the Over the Counter Bulletin Board was approximately $520,243. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of September 24, 2002, the issuer had outstanding 3,520,100 shares of Common Stock, par value $.03 per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement relating to the 2002 Annual Meeting of Stockholders are incorporated by reference in Part III.

Transitional Small Business Disclosure Format (check one): Yes [_] No [X]

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 a 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 two patents in the field of vibration welding.

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 distributor 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, 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 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, liquid processors reduce particle size and facilitate mixing; in the preparation of paints and dyes, they blend and homogenize materials. In the ink industry, processors disperse black carbon. In the beverage and other industries, liquid processors 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 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 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.

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INDUSTRY BACKGROUND

Management believes that in the past twelve months, there has been minimal growth 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 impacted 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, beverage and medical industries may provide for continued growth. Management believes, however, that the slowdown in the economy has also had a negative affect on the growth of this product line of the Company.

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 with respect to supplies and materials. However, it is not certain that the occurrence of shortages or delays would not have an adverse impact on Sonics' operations in the future. In fiscal years 2001 and 2002, two suppliers, B&R Machine, Inc., and AB Electronics, Inc., accounted for more than 5%, but less than 10% of Sonics' 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 such 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.

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 the Company's ultrasonic welder and liquid processor. Sonics 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, 2001 and 2002, expenses attributable to warranties were approximately $71,000 and $151,760 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 (with respect to its devices sold in Europe). These services are performed upon specific orders without contracts at various rates. The Company usually charges for the

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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, 2001 and 2002, the Company had income of approximately $617,000 and $486,362 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 39 sales representatives in 48 states. Sonics relies on approximately 80 distributors and several sales representatives to distribute its products in 49 foreign 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 upon 30 days prior notice. The contract provides for exclusive territorial and product representation and commissions payable to the sales representative 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 each of the fiscal years 2001 and 2002, 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

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 by either party 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 cover sales of both ultrasonic bonding systems and liquid processor lines. 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 2001, one distributor accounted for over 10% but less than 15% of sales. In fiscal year 2002, one distributor accounted for over 5% but less than 10% 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.

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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, OEMs, 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 year 2001 or fiscal year 2002.

INTERNATIONAL OPERATIONS

The Company's international operations are an important portion of its business. Approximately 23% and 27% of its sales for fiscal years 2001 and 2002, 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 (other than 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 respect 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 based on 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 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 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 the ultrasonics market are Branson and Dukane. Some of these competitors also offer spin and vibration devices in addition to ultrasonic devices.

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

BACKLOG

As of June 30, 2002, the Company's backlog was approximately $1,330,725, as compared with a backlog of $3,623,000 as of June 30, 2001. No one customer accounted for more than 10% of such backlog

at June 30, 2002. However, two customers did account for more than 10% of such backlog at June 30, 2001. The decrease in the backlog from fiscal year end 2001 to fiscal year end 2002 is primarily the result of an order which was to be released over a period of three years. By the end of fiscal year 2002 such order had been substantially completed.

The Company's backlog figures are based on written purchase orders executed by customers 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 $410,000 for the fiscal year ended June 30, 2001, and $402,000 for fiscal year ended June 30, 2002.

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 (which business has been discontinued). There can be no assurance that others have not developed, or will not develop, the same or similar information or obtain and use proprietary information of the Company.

Sonics has obtained written assurances regarding its proprietary information from its employees, sales representatives and distributors under confidentiality agreements.

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. This patent expires on June 24, 2018. In addition, on May 5, 2001, U.S. Patent and Trademark Office issued the Company a patent for the tooling developed by the Company for producing fabric covered panels with a vibration welder. This patent expires on February 7, 2020. On April 2, 2002, the Company was issued another patent relating to its vibration welder. This patent was specifically for the mechanism developed for measuring the frequency of the vibration welder tooling. The patent expires on June 5, 2020. The U.S. Patent and Trademark Office had previously issued the Company a patent on October 19, 1999 and December 12, 2000 for its ultrasonic surgical device. Those patents expire on May 1, 2017, and December 10, 2018.

GOVERNMENT REGULATION

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

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. 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 effect 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 the failure to comply 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 24, 2002, the Company had 58 full-time employees including its officers, of whom 32 were engaged in manufacturing, 3 in repair services, 4 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 on favorable terms, if at all.

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 improvements to the property was approximately $2,200,000. The Company believes the Newtown Property to be in good condition.

On August 30, 2001, the Company sold the Newtown Property 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 (for Sonics) to renew the lease for two additional five-year periods.

Pursuant to the terms of the lease, Sonics has committed in the second year of the term of the lease to reduce the space it occupies from 58,363 square feet 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 casualties in an amount the Company believes to be adequate.

The following table lists the Company's leased offices by location as of September 24, 2002, and certain other information:

	APPROXIMATE TOTAL AREA LEASED IN SQUARE FOOTAGE	EXPIRATION DATE OF LEASE	APPROXIMATE ANNUAL R
Newtown, Connecticut........	44,500	August 30, 2011(2)	$309,00
Aston, Pennsylvania.........	2,475	November 1, 2006	24,00
Gland, Switzerland..........	3,000	January 31, 2001(2)	13,80

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

(2) Contains renewal option as listed below:

Newtown, Connecticut .... 5 years

Gland Switzerland............................ 1 year

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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 Company's Common Stock and Warrants to Purchase Common Stock were traded and quoted through the Over the Counter Bulletin Board ("OTCBB"). The Company's securities 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.

	Stock		Warrants	
QUARTER ENDED	High	Low	High	Low
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
September 30, 2001	.46	.46	N/A	N/A
December 31, 2001	.38	.38	N/A	N/A
March 31, 2002	.43	.43	N/A	N/A
June 30, 2002	.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 24, 2002, the closing price of the Common Stock of the Company, as reported by the OTCBB, was $.51 per share. On September 24, 2002, the Company had 41 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. The Company has never paid dividends and does not anticipate 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.

CRITICAL ACCOUNTING POLICIES

The Company's significant accounting policies are described in Note B to the financial statements included in Item 13 of this Annual Report on Form 10-KSB.

INVENTORY - Estimates for inventory obsolescence reserves are developed using inventory aging reports for finished goods, work-in-process and raw materials, combined with historical and forecasted usage. As trends in these variables change, valuation reserves are updated.

ACCOUNTS RECEIVABLE - The $24,322 estimate of allowance for doubtful accounts is comprised of two parts, a specific account analysis and a general reserve. Accounts where specific information indicates a potential loss may exist are reviewed and a specific reserve against amounts due is recorded. As additional information becomes available such specific account reserves are updated. Additionally, a general reserve is applied to the aging categories based on historical collection and write-off experience. As trends in historical collection and write-off experience change, the estimates are updated.

REALIZATION OF LONG-LIVED ASSETS - The Company evaluates the recoverability of property and equipment and intangible or other assets if facts and circumstances indicate that any of those assets might be impaired. If an evaluation is required, the estimated future undiscounted cash flows associated with the asset are compared to the asset's carrying amount to determine if a write-down to market value or discounted cash flow value is necessary.

REVENUE RECOGNITION - Revenue is recognized upon the shipment of finished merchandise to customers. 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 the

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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.

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 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.

RESULTS OF OPERATIONS

YEAR ENDED JUNE 30, 2002 ("fiscal 2002") COMPARED TO YEAR ENDED JUNE 30, 2001 ("fiscal 2001")

On August 21, 2001, the Company completed the sale of 90% of the common stock of its wholly-owned subsidiary, Tooltex, Inc., at which time the consolidation of Tooltex operations ceased.

NET SALES. Net sales decreased by $2,074,000 in fiscal 2002. However, excluding Tooltex sales, net sales increased by $68,000 or 0.8% compared with the prior fiscal year.

COST OF SALES AND GROSS PROFIT. Gross profits totaled $3,580,000 in fiscal 2001 and $3,589,000 in fiscal 2002 resulting in gross margins of 31.5% and 38.7%, respectively. After excluding Tooltex gross profits, Sonics alone achieved gross profits of $3,439,000 in fiscal 2001 and $3,563,000 in fiscal 2002 resulting in gross margins of 37.7% and 38.8%, respectively.

SELLING EXPENSES. Selling expenses declined by $642,000 in fiscal 2002. After excluding Tooltex expenses incurred in fiscal 2001 and fiscal 2002, selling expenses decreased by $380,000. The primary causes for this decrease were the continuing effects of prior year reductions in payroll and benefit costs associated with sales personnel, a decrease in promotional costs, and a decline in commission expenses as a result of an increase in the ratio of sales made to distributors versus sales made through manufacturers' representatives.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses decreased $418,000 in fiscal 2002. After excluding Tooltex expenses incurred in fiscal 2001 and fiscal 2002, general and administrative expenses decreased $35,000 or 3.8%. This decrease resulted from lower legal and accounting costs and was partially offset by higher payroll costs.

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 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 $238,000 or 66.2% compared with the prior fiscal year. There were several reasons for this decline. The most significant factor was the reduction in interest expense resulting from the pay-off of Connecticut Industrial Revenue Bonds out of the proceeds of the sale of the Newtown Property in August 2001. Interest also decreased due to the pay down of $1,000,000 of the Company's Line of Credit facility (as defined below) during fiscal 2002. The downward trend in interest rates in the current fiscal year afforded the Company additional interest savings. While interest expense has decreased, the Company now has the added expense of lease payments as a result of the sale-leaseback of the Newtown Property.

INTEREST AND OTHER INCOME. Interest and other income increased $46,000 in the current fiscal year. This increase was primarily a result of the amortization, over a ten year period, of the deferred gain of $337,000 realized on the sale of the Newtown Property. The ten-year amortization period corresponds to the ten-year term of the initial lease the Company entered into with the buyer of the property.

PROVISION FOR INCOME TAXES. 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 consisted primarily of writedowns related to the subsequent sale of Tooltex, inventory reserves, and allowances for doubtful accounts. During fiscal 2002, based on the Company's return to profitability, management reversed a portion of the valuation allowance, but maintained the reserve on the Company's capital loss carryforward resulting in a $112,000 income tax benefit.

YEAR ENDED JUNE 30, 2001 ("fiscal 2001") COMPARED TO YEAR ENDED JUNE 30, 2000 ("fiscal 2000")

NET SALES. Net sales in fiscal 2001 decreased $2,976,000 or 20.8% compared with sales of the prior fiscal year. This decrease was primarily attributable to a decline in sales at Tooltex, a wholly owned subsidiary substantially disposed of in the first quarter of fiscal 2002, as well as the plastic welding equipment product line. Other reasons for this decline included 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% during such fiscal year.

COST OF SALES. Corresponding to the sales decline, cost of sales decreased $1,379,000 in fiscal 2001. After excluding the effect of a $755,000 inventory charge in cost of sales for fiscal 2001, gross profit margins increased from 36.1% in fiscal 2000 to 38.2% in fiscal 2001.

SELLING EXPENSES. In fiscal 2001, 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 the then current volume levels.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses in fiscal 2001 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, Inc.

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, Inc. to PK Spur Co., whose principal shareholders are Tooltex president, Paul Spurgeon, and Kathy Spurgeon. During fiscal 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 transaction costs of $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 during this fiscal year was subject to floating interest rates based on LIBOR.

INTEREST AND OTHER INCOME. Interest and other income in fiscal 2001 declined principally as a result of cash being used for other working capital needs.

PROVISION FOR 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.

LIQUIDITY AND CAPITAL RESOURCES

The Company continued to improve its balance sheet in fiscal 2002, both in terms of liquidity and in terms of its capital structure. Its working capital ratio rose from 2.57 at June 30, 2001 to 4.38 at June 30, 2002. This improvement resulted primarily from a $1,000,000 reduction in the Company's Line of Credit facility and an increase in its cash position by $428,000. The principal reasons for the improvement in liquidity stemmed from the sale of Tooltex and the sale of the Company's manufacturing facility both of which took place in the early part of the current fiscal year.

The Company's principal outside source of working capital is a $1,500,000 bank credit facility (the "Line of Credit") with Brown Brothers Harriman & Co. (the "Bank"). The Line of Credit bears interest at the Bank's base lending rate (4.75% at June 30, 2002). 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, 2002 was $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 and the term loans are secured by substantially all of the assets of the Company. The credit agreement governing the Line of Credit 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.

Significant improvement was also made in the capital structure of the Company. In August 2001, the Company entered into a sale and leaseback arrangement for the Newtown Property, which allowed the Company to eliminate virtually all of the its long-term debt while adding $483,000 to its cash balances. This was a primary reason for the significant improvement in the Company's debt/equity ratio, declining from approximately 1.2 at June 30, 2001 to 0.3 at June 30, 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, 2002, the Company met all such covenants.

IMPACT OF INFLATION

The Company does not believe that inflation significantly affected its results of operations for fiscal year 2002.

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 Revenue 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 ACCOUNTING PRONOUNCEMENTS

In August 2001, the FASB issued SFAS 144, "Accounting for the Impairment and Disposal of Long-Lived Assets". SFAS 144, which establishes accounting and reporting requirements for the impairment and disposal of long-lived assets, is required to be adopted for fiscal years beginning after December 15, 2001. Because earlier adoption is permissible, the Company effectively adopted the standard as of July 1, 2001. The Company was already in compliance with SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", which was superseded by SFAS 144; consequently, the adoption of SFAS 144 did not have a material impact on the Company.

In April 2002, the FASB issued SFAS No. 145, "Rescission of SFAS No. 4, 44 and 64, Amendment of SFAS Statement No. 13, and Technical Corrections." This statement rescinds the following statement of SFAS 4, "Reporting Gains and Losses from Extinguishment of Debt," and its amendment SFAS No. 64, "Extinguishments of Debt Made to Satisfy Sinking Fund Requirements," as well as, SFAS No. 44, "Accounting for Intangible Assets of Motor Carriers." The statement also amends SFAS No. 13, "Accounting for Leases", by eliminating an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. SFAS No. 145 is effective for fiscal years beginning after May 15, 2002. Management does not believe that this statement will have a material impact on the results of operations or financial conditions of the Company at the time of adoption.

In June 2002, the FASB issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities". SFAS 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. This statement supercedes the guidance provided by Emerging Issues Task Force 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". SFAS 146 is required to be adopted for exit or disposal activities initiated after December 31, 2002. The Company does not expect the adoption of SFAS 146 to have a material impact on its financial statements.

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.

COMPANY'S STATEMENT REGARDING FORWARD LOOKING STATEMENTS

Certain statements in this Annual Report on Form 10-KSB that are not historical fact, as well as certain information incorporated herein by reference, constitute "forward-looking statements" made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve risks and uncertainties and often depend on assumptions, data or methods that may be incorrect or imprecise. The Company's future operating results may differ materially from the results discussed in, or implied by, forward-looking statements made by the Company. Factors that may cause such differences include, but are not limited to, those discussed below and the other risks detailed in the Company's other reports filed with the Securities and Exchange Commission.

Forward-looking statements give our current expectations or forecasts of future events. You can usually identify these statements by the fact that they do not relate strictly to historical or current facts. They often use words such as "anticipate," "estimate," "expect," "project," "intend," "plan," "believe," and other words and terms of similar meaning in connection with any discussion of future operating or financial performance. In particular, these include statements relating to future actions, future performance or results of current and anticipated products, sales efforts, expenses, and financial results.

Any or all of our forward-looking statements in this Annual Report on Form 10-KSB and information incorporated by reference may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in this discussion - for example, product competition and the competitive environment - will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially. The Company undertakes no obligation to revise any of these forward-looking statements to reflect events or circumstances after the date hereof.

Other Factors That May Affect Future Results

- changes in governmental laws, regulations and accounting standards and the enforcement thereof that may be adverse to us

- other legal factors including environmental concerns

- agency or government actions or investigations affecting the industry in general or us in particular

- risks associated with maintaining international operations

- changes in business strategy or development plans

- business acquisitions, dispositions, discontinuations or restructurings

- availability, terms and deployment of capital

- economic factors over which we have no control, including changes in inflation and interest rates

- the developing nature of the market for our products and technological change

- intensifying competition in the ultrasonic bonding equipment industry, and the ultrasonic liquid processing industry

- success of operating initiatives

- operating costs

- advertising and promotional efforts

- the existence or absence of adverse publicity

- the possibility that adequate insurance coverage and reimbursement levels for our products will not be available

- our dependence on outside suppliers and manufacturers

- the ability to retain management

- business abilities and judgment of personnel

- availability of qualified personnel

- labor and employee benefit costs

- unanticipated economic impacts of the September 11, 2001 terrorist attack on the United States, any subsequent terrorists acts or of any related military action.

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 SEC within 120 days following the end of Sonics' fiscal year ended June 30, 2002, relating to its 2002 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 SEC within 120 days following the end of Sonics' fiscal year ended June 30, 2002, relating to its 2002 Annual Meeting of Stockholders.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information required by this Item 11 is incorporated herein by reference from the definitive proxy statement of Sonics to be filed with the SEC within 120 days following the end of Sonics' fiscal year ended June 30, 2002, relating to its 2002 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).
4(i)	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 10-KSB 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 10-KSB 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 10-KSB 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 10-KSB for the year ended June 30, 1997).
10(xi)	Lease between Registrant and Acme Realty, dated August 30, 2001 (incorporated by reference from Exhibit 10(xi) of the Registrant's Form 10-KSB for the year ended June 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(incorporated by reference from Exhibit 10(xii) of the Registrant's Form 10-KSB for the year ended June 30, 2001).
21	Subsidiaries of the Registrant (incorporated by reference from Exhibit (21 of the Registrants Form 10-KSB for the year ended June 30, 1998).

b) The Company did not file any Current Reports on Form 8-K during the quarter ended June 30, 2002.

ITEM 14. CONTROLS AND PROCEDURES

We currently have in place systems relating to internal controls and procedures with respect to our financial information. Our management periodically reviews and evaluates these internal control systems with our independent accountants. We have completed such a review and evaluation in connection with the preparation of this Annual Report. We have determined that there have been no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to our most recent evaluation. While we believe our internal controls and procedures are effective, we understand that the SEC may be promulgating additional rules relating to internal controls. We cannot provide assurance that our current internal controls will not change in the future to reflect potential new rules of the SEC.

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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 30, 2002

SONICS & MATERIALS, INC.

By: /s/ ROBERT S. SOLOFF

ROBERT S. SOLOFF
CHIEF EXECUTIVE OFFICER 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, Treasurer, Chief Executive Officer	September 30, 2002
/s/ LAUREN H. SOLOFF ------------------------ (LAUREN H. SOLOFF)	Secretary, Director, Vice President	September 30, 2002
/s/ RONALD KALB ------------------------ (RONALD KALB)	Director	September 30, 2002
/s/ JACK T. TYRANSKY ------------------------ (JACK T. TYRANSKY)	Director	September 30, 2002
/s/ STEVEN A. BOWEN ------------------------ (STEVEN A. BOWEN)	Chief Financial Officer	September 30, 2002

CERTIFICATION

I, Robert S. Soloff, certify that:

1. I have reviewed this annual report on Form 10-KSB of Sonics & Materials, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report; and

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.

Date: September 30, 2002.

/s/ Robert S. Soloff

Robert S. Soloff
Chief Executive Officer

CERTIFICATION

I, Steven A. Bowen, certify that:

1. I have reviewed this annual report on Form 10-KSB of Sonics & Materials, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report; and

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.

Date: September 30, 2002.

/s/ Steven A. Bowen

Steven A. Bowen
Chief Financial Officer

EXHIBIT INDEX

EXHIBIT NO.	DESCRIPTION	LOCATION O SEQUENTIAL N
3(i)	Certificate of Incorporation of the Registrant, as amended .	Incorporated by reference to Registration Statement
3(ii)	Amended By-laws of the Registrant.	Incorporated by reference Statement No. 33-96414
4(i)	Form of Warrant Agreement between Registrant and Warrant Agent	Incorporated by reference to Registration Statement
10(i)	Form of Employment Agreement between the Registrant and Robert S. Soloff.	Incorporated by reference Statement No. 33-96414
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10(iii)	Lease between Registrant and Aston Investment Associates (Aston, PA).	Incorporated by reference Statement No. 33-96414
10(iv)	Lease between Registrant and Janine Berger (Gland, Switzerland).	Incorporated by reference No. 33-96414
10(v)	Form of Sales Representation Agreement.	Incorporated by reference Statement No. 33-96414
10(vi)	Form of Sales Distribution Agreement.	Incorporated by reference

		Statement No. 33-96414
10(vii)	Credit Agreement, dated September 19, 1997, between Brown Brothers Harriman & Co. and Registrant	Incorporated by reference Registrant's Form 10-KSB f
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 Registrant's Form 10-KSB f
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21	Subsidiaries of the Registrant.	Incorporated by reference Registrants Form 10-KSB fo

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INDEX TO FINANCIAL STATEMENTS

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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 subsidiary as of June 30, 2001 and 2002, and the related consolidated statements of income (loss), stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 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 subsidiary as of June 30, 2001 and 2002, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Schneider & Associates LLP

Jericho, New York
September 23, 2002

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SONICS & MATERIALS, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

	June 30,	
	2001	2002
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 820,835	$ 1,249

Accounts receivable, net of allowance for doubtful accounts of $53,470 and $24,322 in 2001 and 2002, respectively	1,335,861	1,299
Inventories	3,961,383	3,675
Other current assets	65,788	148
Total current assets	6,183,867	6,372
PROPERTY AND EQUIPMENT - net	3,754,724	251
OTHER ASSETS	618,925	454
Total assets	$ 10,557,516	$ 7,078
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Note payable - bank	$ 1,190,000	$ 190
Current maturities of long-term debt	186,781	69
Accounts payable	347,580	594
Customer advances	147,535	168
Commissions payable	76,903	88
Accrued expenses	452,734	342
Total current liabilities	2,401,533	1,453
NON-CURRENT LIABILITIES		
Long-term debt	3,381,460	60
Deferred gain on sale of real estate	--	303
Total non-current liabilities	3,381,460	364
Total liabilities	5,782,993	1,817
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, 2001 and 2002	105,603	105
Additional paid-in capital	6,575,010	6,575
Accumulated deficit	(1,906,090)	(1,420
Total stockholders' equity	4,774,523	5,260
Total liabilities and stockholders' equity	$ 10,557,516	$ 7,078

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

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

	Years ended June 30,	
	2001	2002

Net sales	$ 11,347,937	$ 9,274,227
Cost of sales	7,767,931	5,684,741
Gross profit	3,580,006	3,589,486
Operating expenses:		
Selling	2,477,305	1,835,052
General and administrative	1,340,930	923,050
Research and development	410,346	402,041
Loss on assets held for sale	1,016,094	--
Total operating expenses	5,244,675	3,160,143
Operating income (loss)	(1,664,669)	429,343
Other income (expense):		
Interest expense	(359,715)	(121,623)
Interest and other income	19,906	66,201
Total other income (expense)	(339,809)	(55,422)
Income (loss) before income taxes	(2,004,478)	373,921
Income tax expense (benefit)	73,737	(112,000)
Net income (loss)	$ (2,078,215)	$ 485,921
Per share:		
Basic and diluted:		
Net income (loss)	$ (.59)	$ .14
Shares used in basic and diluted per share computations	3,520,100	3,520,100

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

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SONICS & MATERIALS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

Years ended June 30, 2001 and 2002

	Common Stock			
	Shares	Par Value	Paid-in Capital	Accumula Defici

Balances - July 1, 2000	3,520,100	$ 105,603	$ 6,575,010	$ 172,
Net loss	--	--	--	(2,078,
Balances - June 30, 2001	3,520,100	105,603	6,575,010	(1,906,
Net income	--	--	--	485,
Balances - June 30, 2002	3,520,100	$ 105,603	$ 6,575,010	$(1,420,

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

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

	Years ended June 30,	
Increase (decrease) in cash and cash equivalents	2001	2002
Cash flows from operating activities		
Net income (loss)	$(2,078,215)	$ 485,921
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation	162,623	80,616
Amortization of goodwill	55,503	--
Loss on assets held for sale	989,362	--
Reserves and allowances	730,844	(185,202)
Gain on sale of real estate	--	(33,674)
Decrease (increase) in:		
Accounts receivable	1,160,195	65,865
Inventories	(222,237)	733,500
Other current assets	15,229	(82,992)
Prepaid income taxes	(9,951)	--
Deferred income taxes	75,048	--
Other assets	104,540	(66,744)
Increase (decrease) in:		
Accounts payable	(199,840)	246,773

Customer advances	45,503	21,046
Commissions payable	(117,087)	12,093
Accrued expenses	(113,118)	(110,118)
Net cash provided by operating activities	598,399	1,167,084
Cash flows from investing activities:		
Purchase of property and equipment	(59,311)	(56,201)
Sale of property and equipment	--	3,755,523
Net cash provided by (used in) investing activities	(59,311)	3,699,322
Cash flows from financing activities:		
Payments of note payable - bank	(100,000)	(1,000,000)
Payments of long-term debt	(289,932)	(3,384,037)
Payments of capital lease obligations	(57,314)	(53,959)
Net cash used in financing activities	(447,246)	(4,437,996)
Net increase in cash and cash equivalents	91,842	428,410
Cash and cash equivalents at beginning of year	728,993	820,835
Cash and cash equivalents at end of year	$ 820,835	$ 1,249,245
Supplemental information:		
Cash paid during the period for:		
Interest	$ 400,415	$ 143,574
Income taxes	$ 2,595	$ 16,003

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

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SONICS & MATERIALS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2001 AND 2002

NOTE A - BUSINESS

Sonics & Materials, Inc. (the "Company") is a manufacturer and distributor of ultrasonic assembly and liquid processing machinery and equipment. 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. The Company operates in one business segment.

The Company also manufactured automated systems used in the plastics industry through its subsidiary, Tooltex, Inc. which is located in Grove City, Ohio. In August 2001, the Company completed the sale of a 90% interest in Tooltex, Inc. (see Note C).

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

These financial statements include the accounts of the Company for the entire year and Tooltex, Inc. through August 21, 2001. 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 the straight-line method is designed to amortize the cost of various classes of assets over their estimated useful lives, ranging generally from five to seven years. Expenditures for replacements are capitalized and the replaced items are retired. Maintenance and repairs are expensed as incurred.

Use of Estimates

Preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States 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, inventory reserves 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.

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.

In July 2001, the FASB issued SFAS 142, "Goodwill and Other Intangible Assets". SFAS 142 eliminates goodwill amortization, provides guidance and requirements for periodic impairment testing of goodwill and discusses the treatment of other intangible assets. Adoption of the standard is required for fiscal years beginning after December 15, 2001. However, because earlier adoption is permissible, the Company adopted the standard effective July 1, 2001. During the fourth quarter of fiscal 2001, the Company recorded impairment charges of $874,000 for unamortized goodwill and $115,000 for undepreciated fixed assets. The charges were based on the anticipated selling price of 90% of the Company's interest in its Tooltex, Inc. subsidiary (see Note C).

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 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.

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 using the treasury stock method.

The following securities have been excluded from the dilutive per share computation as they are antidilutive:

	Years ended June 30,	
	2001	2002

Stock options	346,366	331,366
	=======	=======

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, 2001 and 2002 consisted of money market funds.

Revenue Recognition

Revenue is recognized upon the shipment of finished merchandise to customers.

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 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.

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 $112,000 and $83,000 for the years ended June 30, 2001 and 2002, respectively.

New Accounting Pronouncements

In August 2001, the FASB issued SFAS 144, "Accounting for the Impairment and Disposal of Long-Lived Assets". SFAS 144, which establishes accounting and reporting requirements for the impairment and disposal of long-lived assets, is required to be adopted for fiscal years beginning after December 15, 2001. Because earlier adoption is permissible, the Company effectively adopted the standard as of July 1, 2001. The Company was already in compliance with SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", which was superseded by SFAS 144; consequently, the adoption of SFAS 144 did not have a material impact on the Company.

In April 2002, the FASB issued SFAS No. 145, "Rescission of SFAS No. 4, 44 and 64, Amendment of SFAS Statement No. 13, and Technical Corrections." This statement rescinds the following statement of SFAS 4, "Reporting Gains and Losses from Extinguishment of Debt," and its amendment SFAS No. 64, "Extinguishments of Debt Made to Satisfy Sinking Fund Requirements," as well as, SFAS No. 44, "Accounting for Intangible Assets of Motor Carriers." The statement also amends SFAS No. 13, "Accounting for Leases", by eliminating an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. SFAS No. 145 is effective for fiscal years beginning after May 15, 2002. Management does not believe that this statement will have a material impact on the results of operations or financial condition of the Company at the time of adoption.

In June 2002, the FASB issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities". SFAS 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. This statement supercedes the guidance provided by Emerging Issues Task Force 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". SFAS 146 is required to be adopted for exit or disposal activities initiated after December 31, 2002. The Company does not expect the adoption of SFAS 146 to have a material impact on its financial statements.

NOTE C - 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 changed 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 $90,000 (unaudited) during fiscal 2001 and 2002, respectively; and a net loss of approximately $219,000 (unaudited) and $25,000 (unaudited) during fiscal 2001 and fiscal 2002, respectively.

In connection with the sale of Tooltex, the Company adjusted the net assets of Tooltex to their estimated net realizable values in the fiscal 2001 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 writedown through cost of sales of approximately $314,000 and a bad debt charge through general and administrative expenses of $35,000.

NOTE D - INVENTORIES

Inventories consist of the following:

	June 30, 2001	June 30, 2002
Raw materials	$ 898,284	$ 739,144
Work-in-process	1,890,542	1,647,536
Finished goods	1,172,557	1,289,047
	$3,961,383	$3,675,727

Inventories at June 30, 2001 and 2002 are stated net of reserves for excess and obsolete inventory, of $441,000 and $137,000, respectively. Reserve activity is recorded through cost of sales.

NOTE E - PROPERTY AND EQUIPMENT

A summary of property and equipment follows:

	June 30, 2001	June 30, 2002
Land	$ 462,486	$ --
Building	3,219,205	--
Machinery and equipment	943,148	948,082
Tooling	146,482	153,632
Office furniture and equipment	308,663	310,271
Transportation equipment	60,441	60,441
Data processing equipment	618,673	654,027

	5,759,098	2,126,453
Less: Accumulated depreciation	2,004,374	1,875,179
	$3,754,724	$ 251,274

Depreciation expense was $162,623 and $80,616 in fiscal 2001 and 2002, respectively.

On August 31, 2001, the Company sold its Newtown, Connecticut property (see Note F).

NOTE F - SALE OF COMPANY FACILITY

On August 31, 2001, the Company sold to Acme Realty (Acme), a New York general partnership, its manufacturing facility located in Newtown, Connecticut for $4,000,000 in cash, less expenses of $244,000. 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 connection 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. The Company recorded a deferred gain on the sale of $337,000, which is being amortized over the lease term. Amortization totaled $33,674 in fiscal 2002.

NOTE G - OTHER ASSETS

At June 30, 2001 and 2002, the major components of Other Assets were:

	June 30, 2001	June 30, 2002
Demonstration equipment - net of accumulated depreciation of $99,554 and $138,171 in 2001 and 2002, respectively	$364,192	$178,828
Other	254,733	275,298
	$618,925	$454,126

Demonstration equipment is carried at cost less accumulated depreciation. Depreciation is provided for using the straight-line method 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, 2001 and 2002, the major components of accrued expenses were:

	June 30, 2001	June 30, 2002
Accrued compensation	$287,546	$234,851
Professional fees	63,542	35,500
Other accruals	101,646	72,265
	$452,734	$342,616

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SONICS & MATERIALS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2001 AND 2002

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 (4.75% at June 30, 2002). 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.

Long-term debt

	June 30, 2001	June 30, 2002
(a) Industrial Revenue Bonds	$ 3,308,684	$ --
(b) Bank term loan	100,471	25,117
(c) Capital lease obligations	159,086	105,127
	3,568,241	130,244
Less: Current portion	(186,781)	(69,277)
Long-term debt	$ 3,381,460	$ 60,967

(a) Industrial Revenue Bonds issued in December 1997 through the Connecticut Development Authority in the original principal amount 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 was payable at the rate of 75% of the bank's base lending rate. Principal was payable in 228 equal installments of $16,711 commencing in January 1999. The bonds were repaid from the proceeds of the sale of the Company's Newtown, Connecticut property in August 2001 (see Note F).

(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 principal balance on October 1, 2002. The loan bears interest at the bank's base lending rate (4.75% at June 30, 2002).

(c) The Company has entered into two equipment leases which qualify for capitalization under applicable accounting guidelines. The leases expire at various dates through 2005.

Indebtedness under the Company's line of credit and the term loans are secured by substantially all of the assets of the Company. A first mortgage lien on the Company's Newtown, CT property was released in August 2001 when the property was sold. 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.

The aggregate maturities of long-term debt are as follows:

Year ending June 30,	
2003	$ 69,277
2004	31,889
2005	29,078
	$130,244

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, 2002, there were 204,000 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 share expiring at various dates through 2004.

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 consistent with the provisions of SFAS No. 123, net (loss) income would have (increased) decreased by approximately $(4,800) and $3,300, in fiscal 2001 and 2002, respectively, with no material impact on income (loss) per share in either period.

There were no option grants in 2001 and 2002.

For the two years ended June 30, 2002, option activity was as follows:

	Number of Shares	Weighted-Average Exercise Price
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
Canceled	(15,000)	1.35
Outstanding at June 30, 2002	331,366	$ .95

The following table summaries information about stock options outstanding at June 30, 2002:

	Options Outstanding			Options Exercisable	
Range of Exercise prices	Number Outstanding	Weighted-average Exercise Price	Weighted average Remaining Contractual Life	Number Exercisable	Wei av Exe P
$ .22 - $ .63	50,976	$ .46	2.0 years	44,309	$
1.03 - 1.44	280,390	1.04	2.5 years	279,057	
	331,366	$ .95		323,366	$

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 2011.

The following is a schedule of future minimum lease payments for operating leases as of June 30, 2002:

Year ending June 30,	
2003	$ 343,033
2004	316,816
2005	326,522
2006	336,302
2007	346,452
Thereafter	1,557,388
Total	$3,226,513

Rental expense for operating leases totaled approximately $205,000 and $463,506 for the years ended June 30, 2001 and 2002, respectively.

SONICS & MATERIALS, INC. AND SUBSIDIARY
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NOTE L - INCOME TAXES

The components of the provision for income taxes (income tax benefit) are as follows:

Years ended June 30,

	2001	2002
Current		
Federal	$ (37,206)	$ --
State	40,289	24,000
	3,083	24,000
Deferred:		
Federal	70,654	(136,000)
State	--	--
	70,654	(136,000)
Total tax provision (income tax benefit)	$ 73,737	$(112,000)

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

	June 30, 2001	June 30, 2002
Deferred tax assets:		
Capital loss on Tooltex disposition	$ 468,447	$ 370,215
Deferred gain on real estate	--	103,041
Accrued expenses	--	12,446
Allowance for doubtful accounts	30,080	8,269
Inventories	229,960	52,374
Total deferred tax assets	728,487	546,345
Deferred tax liabilities:		
Accumulated depreciation	--	40,130
Subtotal	728,487	506,215
Less: Valuation allowance	(728,487)	(370,215)
Net deferred tax assets	$ --	$ 136,000

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 consisted primarily of writedowns related to the subsequent sale of Tooltex, inventory reserves, and allowances for doubtful accounts. During fiscal 2002, based on the Company's return to profitability, management reversed a portion of the valuation allowance, but maintained the reserve on the Company's capital loss carryforward resulting in a $112,000 income tax benefit.

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,	
	2001	2002
Provision for federal income taxes at the statutory rate	$(683,776)	$ 126,960
State and local taxes, net of federal tax effect	17,975	33,936
Nondeductible expenses	11,051	6,650
Valuation allowance	728,487	(280,070)
Other	--	524
Actual provision for income taxes (income tax benefit)	$ 73,737	$(112,000)

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 $33,000 and $20,693 for the years ended June 30, 2001 and 2002, 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 $4,226 and $58,080 for the years ended June 30, 2001 and 2002, respectively.

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.

Net sales by geographic area are as follows:

	Years ended June 30, 2001	2002
United States	$ 8,761,000	$ 6,781,000
Europe	1,143,000	812,000
Asia/Pacific Rim	936,000	1,056,000
Canada and Mexico	286,000	411,000
Other	222,000	214,000
	$11,348,000	$ 9,274,000

Foreign sales are generally denominated in U. S. dollars. Currency gains and losses were immaterial in fiscal 2001 and 2002.

NOTE O - RELATED PARTY TRANSACTIONS

Prior to the disposition of Tooltex in August 2001, the Company leased manufacturing facilities in Ohio from an entity owned by Tooltex stockholders. During the years ended June 30, 2001 and 2002, the Company incurred rent expense on this property of $84,320 and $7,027, respectively.

NOTE P - ALLOWANCE FOR DOUBTFUL ACCOUNTS

	Balance at beginning of period	Charged to costs and expenses	Deduction from reserve	Balance at end of period
Year ended June 30, 2002	53,470	24,242	53,390 (a)	24,322
Year ended June 30, 2001	88,470	21,939	21,939 (a) 35,000 (b)	53,470

(a) Amounts represent uncollectible accounts charged off.
(b) Amount represents reversal of Tooltex reserve upon disposition.