VERAMARK TECHNOLOGIES INC
Form 10-Q
May 13, 2005

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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

For Quarter Ended March 31, 2005

Commission File Number 0-13898

Veramark Technologies, Inc.

(Exact name of registrant as specified in its charter)

Delaware	16-1192368
(State or other jurisdiction of Incorporation or Organization)	(IRS Employer Identification Number)

3750 Monroe Avenue, Pittsford, NY 14534

(Address of principal executive offices)(Zip Code)

(585) 381-6000

(Registrant s telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirement for the past 90 days.

YES þ NO o

Indicate by check mark whether the Registrant is an accelerated filer (as defined by Rule 12b-2 of the Act).

YES o NO þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of March 31, 2005

Common stock, par value $.10	8,694,954 shares

This report consists of 26 pages.

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PART I FINANCIAL INFORMATION

VERAMARK TECHNOLOGIES, INC.

CONDENSED BALANCE SHEETS

	(Unaudited) March 31, 2005	December 31, 2004
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 590,902	$ 722,020
Investments	387,360	381,237
Accounts receivable, trade (net of allowance for doubtful accounts of $25,000 and $24,000, respectively)	1,350,159	1,276,204
Inventories, net	36,385	30,717
Prepaid expenses and other current assets	145,467	109,809
Total Current Assets	2,510,273	2,519,987
PROPERTY AND EQUIPMENT		
Cost	5,743,894	5,740,535
Less accumulated depreciation	(4,893,000)	(4,846,475)
Property and Equipment (Net)	850,894	894,060
OTHER ASSETS:		
Software development costs (net of accumulated amortization of $1,708,040 and $1,506,777, respectively)	2,597,673	2,518,482
Pension and related assets	2,802,304	2,778,482
Deposits and other assets	797,745	797,745
Total other assets	6,197,722	6,094,709
TOTAL ASSETS	$ 9,558,889	$ 9,508,756

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

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VERAMARK TECHNOLOGIES, INC.

CONDENSED BALANCE SHEETS

	(Unaudited) March 31, 2005	December 31, 2004
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 278,059	$ 298,063
Accrued compensation and related taxes	447,750	557,805
Deferred revenue	2,676,591	2,572,120
Other accrued liabilities	171,330	187,977
Total Current Liabilities	3,573,730	3,615,965
Pension obligation	4,600,367	4,439,398
Total Liabilities	8,174,097	8,055,363
STOCKHOLDERS EQUITY:		
Common Stock, par value $.10; shares authorized, 40,000,000; shares issued and outstanding 8,775,179 and 8,749,179	877,518	874,918
Additional paid-in capital	21,757,517	21,744,969
Accumulated deficit	(20,880,414)	(20,795,128)
Treasury stock (80,225 shares, at cost)	(385,757)	(385,757)
Accumulated other comprehensive income	15,928	14,391
Total Stockholders Equity	1,384,792	1,453,393
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 9,558,889	$ 9,508,756

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

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VERAMARK TECHNOLOGIES, INC.

CONDENSED STATEMENTS OF OPERATIONS (Unaudited)

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
NET SALES		
Product Sales	$ 954,583	$ 943,099
Service Sales	1,671,789	1,730,599
Total Net Sales	2,626,372	2,673,698
COSTS AND OPERATING EXPENSES:		
Cost of sales	440,051	380,487
Engineering and software development	301,792	238,048
Selling, general and administrative	1,971,107	2,039,191
Total Costs and Operating Expenses	2,712,950	2,657,726
INCOME (LOSS) FROM OPERATIONS	(86,578)	15,972
NET INTEREST INCOME	1,292	9,566
INCOME (LOSS) BEFORE INCOME TAXES	(85,286)	25,538
INCOME TAXES		
NET INCOME (LOSS)	$ (85,286)	$ 25,538
NET INCOME (LOSS) PER SHARE		
Basic	$ (0.01)	$ 0.00
Diluted	$ (0.01)	$ 0.00

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

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VERAMARK TECHNOLOGIES, INC.

CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)

	Three Months Ended March 31,	
	2005	**2004**
OPERATING ACTIVITIES:		
Net income (loss)	$ (85,286)	$ 25,538
Adjustments to reconcile net income (loss) to net cash flows provided by operating activities		
Depreciation and amortization	269,018	171,911
Provision for bad debts	(5,512)	(12,207)
Loss on disposal of fixed assets		11,548
Compensation expense-stock options	4,043	15,248
Increase in cash surrender value of company-owned life insurance policies	(23,822)	(23,823)
Changes in assets and liabilities		
Accounts receivable	(68,443)	90,282
Inventories	(5,668)	(27,711)
Prepaid expenses and other current assets	(35,658)	19,349
Deposits and other assets		39,930
Accounts payable	(20,004)	147,888
Accrued compensation and related taxes	(110,055)	(28,480)
Deferred revenue	104,471	(149,114)
Other accrued liabilities	(16,647)	(67,642)
Pension obligation	160,969	102,218
Net cash flows provided by operating activities	167,406	314,935
INVESTING ACTIVITIES:		
Sale (purchase) of investments	(4,586)	18,114
Capitalized software development costs	(280,454)	(458,476)
Additions to property and equipment	(24,589)	(53,786)
Net cash flows used by investing activities:	(309,629)	(494,148)
FINANCING ACTIVITY:		
Exercise of Stock Options	11,105	
Repayment of capital lease obligation		(1,842)
Net cash flows provided (used) by financing activities	11,105	(1,842)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(131,118)	(181,055)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	722,020	644,005

CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 590,902	$ 462,950

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	Three Months Ended March 31,	
	2005	**2004**
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash Transactions:		
Income taxes paid (received), net	$ (3,000)	$ 25,123
Interest paid	$	$ 53

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

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NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(1) GENERAL

The accompanying unaudited financial statements include all adjustments of a normal and recurring nature which, in the opinion of Company s management, are necessary to present fairly the Company s financial position as of March 31, 2005 and the results of its operations and cash flows for the three months ended March 31, 2005 and 2004.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to the rules and regulations of the Securities and Exchange Commission. These condensed financial statements should be read in conjunction with the financial statements and related notes contained in the Company s annual report on Form 10-K to the Securities and Exchange Commission for the year ended December 31, 2004.

The results of operations and cash flows for the three months ended March 31, 2005 are not necessarily indicative of the results to be expected for the full year s operation.

(2) PROPERTY AND EQUIPMENT

The major classifications of property and equipment at March 31, 2005, and December 31, 2004 were:

	March 31, 2005	December 31, 2004
Machinery and equipment	$ 794,314	$ 794,314
Computer hardware and software	1,939,344	1,935,985
Furniture and fixtures	1,627,677	1,627,677
Leasehold improvements	1,382,559	1,382,559
	$ 5,743,894	$ 5,740,535

For the quarter ended March 31, 2005, the Company recorded depreciation expense of $67,755. Depreciation expense for the quarter ended March 31, 2004 was $68,697.

(3) STOCK-BASED COMPENSATION

In 2002, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. This standard provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. Additionally, the standard also requires prominent disclosures in the Company s financial statements about the method of accounting used for stock-based employee compensation, and the effect of the method used when reporting financial results.

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The Company accounts for stock-based compensation in accordance with SFAS No. 123, Accounting for Stock-Based Compensation. As permitted by SFAS No. 123, the Company continues to measure compensation for such plans using the intrinsic value based method of accounting, prescribed by Accounting Principles Board (APB), Opinion No. 25, Accounting for Stock Issued to Employees. Had compensation cost for the Company s stock-based compensation plans been determined based on the fair value at the grant dates for awards consistent with the method of SFAS No. 123, the Company s net income (loss) and net income (loss) per common share would have been adjusted to the pro forma amounts indicated below:

		Three Months Ended March 31, 2005	2004
Net income (loss)	As reported	$ (85,286)	$ 25,538
Add: total stock-based compensation expense included in net income, net of related tax effects		4,044	15,248
Deduct: total stock-based compensation expense determined under fair value, net of related tax effects		(35,546)	(106,986)
	Pro forma	$ (116,788)	$ (66,200)
Net income (loss) per common share	As reported		
	Basic	$ (0.01)	$ 0.00
	Diluted	$ (0.01)	$ 0.00
	Pro forma		
	Basic	$ (0.01)	$ (0.01)
	Diluted	$ (0.01)	$ (0.01)

For purposes of the disclosure above, the fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 2005 and 2004:

	2005	2004
Dividend yield		
Expected volatility	147.56%	144.43%
Risk-free interest rate	3.89%	3.27%
Expected life	5 years	5 years

During the quarter ending March 31, 2005, no options were granted

(4) TOTAL COMPREHENSIVE INCOME (LOSS)

Total comprehensive income (loss) for the first quarter of 2005 and 2004 was as follows:

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	Three Months Ended March 31, 2005	2004
Net income (loss)	$ (85,286)	$ 25,538
Accumulated other comprehensive income	1,537	4,665
Total comprehensive income (loss)	$ (83,749)	$ 30,203

(5) NET INCOME (LOSS) PER SHARE (EPS)

SFAS 128 Earnings Per Share requires the Company to calculate net income (loss) per share based on basic and diluted net income (loss) per share, as defined. Basic EPS excludes dilution and is computed by dividing net income (loss) by the weighted average number of shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The dilutive effect of outstanding options issued by the Company are reflected in diluted EPS using the treasury stock method. Under the treasury stock method, options will only have a dilutive effect when the average market price of common stock during the period exceeds the exercise price of the options.

Calculations of Earnings (Loss) Per Share

	Three Months Ended March 31, 2005	2004
Basic		
Net income (loss)	$ (85,286)	$ 25,538
Weighted average common shares outstanding	8,673,998	8,562,829
Net income (loss) per common share	$ (0.01)	$ 0.00
Diluted		
Net income (loss)	$ (85,286)	$ 25,538
Weighted average common shares outstanding	8,673,998	8,562,829
Additional dilutive effect of stock options and warrants after application of treasury stock method	(1)	1,254,428
Weighted average dilutive shares outstanding	8,673,998	9,817,257

Net income (loss) per common share assuming full obligation	$	(0.01)	$	0.00

(1) There were no dilutive effects of stock options in 2005, as the effect would be anti-dilutive due to the net loss incurred.

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(6) INDEMNIFICATION OF CUSTOMERS

Our agreements with customers generally require us to indemnify the customer against claims that our software infringes third party patent, copyright, trademark or other proprietary rights. Such indemnification obligations are generally limited in a variety of industry-standard respects, including our right to replace an infringing product. As of March 31, 2005 we had not experienced any material losses related to these indemnification obligations and no material claims with respect thereto were outstanding. We do not expect significant claims related to these indemnification obligations, and consequently, we have not established any related reserves.

(7) BENEFIT PLANS

The Company sponsors an employee incentive savings plan under Section 401(k) for all eligible employees. The Company s contributions to the plan are discretionary. There were no contributions to the plan for the three months ended March 31, 2005 and 2004.

The Company also sponsors an unfunded Supplemental Executive Retirement Program (SERP), which is a non-qualified plan that provides certain key employees defined pension benefits. Periodic pension expense for the three months ended March 31, 2005 and 2004 consists of the following:

	Three Months Ended March 31,	
	2005	**2004**
Current Service Cost	$ 114,248	$ 74,693
Amortization of Prior Service Cost	22,650	21,721
Interest Cost	65,605	47,337
Pension Expense	$ 202,503	$ 143,751

The Company paid pension obligations of $41,534 for both the three months ended March 31, 2005 and 2004.

The discount rate used in determining the actuarial present value of the projected benefit obligation was 6% for the three months ended March 31, 2005 and 2004.

The Company maintains life insurance covering certain key employees under its Supplemental Executive Retirement Program with the Company named as beneficiary. The Company intends to use the death benefits of these policies, as well as loans against the accumulating cash surrender value of the policies, to fund the pension obligation. The total death benefit associated with these policies is $10.2 million, with an associated accumulated cash surrender value of approximately $2,237,000 at March 31, 2005. The accumulated cash surrender values of these policies at December 31, 2004 was approximately $2,214,000.

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

Results of Operations

Management s Discussion and Analysis contains statements that are forward-looking. Such statements are identified by the use of words like plans, expects, intends, believes, will, anticipates, estimates and other v similar meaning in conjunction with, among other things, discussions of future operations, financial performance, the Company s strategy for growth, product development, regulatory approvals, market position and expenditures. Forward-looking statements are based on management s expectations as of the date of this report. The Company cannot guarantee that any forward-looking statement will be accurate, although the Company believes that it has been reasonable in its expectations and assumptions. Forward-looking statements are subject to the risks identified in Issues and Risks and elsewhere in this report. Readers are cautioned not to place undue reliance on forward-looking statements and are advised to review the risks identified in Issues and Risks and elsewhere in this report. The Company has no obligation to update forward-looking statements.

Sales for Veramark s first quarter ended March 31, 2005 were $2,626,000 a decrease of 2% from sales of $2,674,000 for the first quarter of 2004. The net loss incurred for the quarter ended March 31, 2005 was $85,000 or $0.01 per share, which compares with a net profit of $26,000, or $0.00 per diluted share for the quarter ended March 31, 2004.

The change in net income for the quarter ended March 31, 2005, versus the prior year, is primarily attributable to a reduction in the amounts of engineering and development expenses capitalized. For the quarter ended March 31, 2005, we capitalized $281,000 of development costs as opposed to $459,000 of capitalization for the same quarter of 2004. Amounts capitalized for the second and third quarters of 2005 are expected to increase as we continue the development efforts of VeraSMART® version 4.0, currently scheduled for release in the third quarter of this year.

While recent reports state that general economic conditions appear favorable, we remain concerned with the current levels of capital equipment spending particularly in the Telecom Industry. We continue to see a significant number of customers delaying major purchases, and/or upgrades to their telecommunication networks, the result of which has impacted sales of VeraSMART, our enterprise-level product.

For the quarter ended March 31, 2005, sales of VeraSMART and its predecessor product, Quantum Series ® decreased 9% from the quarter ended March 31, 2004. In addition, although new proposal activity remains strong, the sales cycle, from initial proposal to final implementation, continues to lengthen. For example, a number of new orders, that we had anticipated receiving during the first quarter of 2005, were delayed to at least the second quarter of the year.

In January of 2005, we released VeraSMART version 3.0. This most recent version of VeraSMART incorporates a series of invoice management tools that allows companies to collect their billing data from a wide range of service providers, and once collected, allows them to review, approve and budget more efficiently.

Sales of telemanagement products and their associated services have been less affected by economic conditions. For the quarter ended March 31, 2005 revenues generated by eCAS the Company s core telemanagement product, increased 2% from the same quarter of 2004, accounting for 63% of total sales versus 61% of total sales a year ago.

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Additionally, we realized a 5% increase in sales generated by our Outsourced Solutions Group for the first quarter of 2005 from the same quarter a year ago. A number of new outsourcing proposals were made during the quarter, which we have hopes of finalizing during the second and third quarters of 2005. Revenues from Outsourced Solutions accounted for 5% of total sales for the quarter ended March 31, 2005, up from 4% for the first quarter of 2004.

The Company earned a gross margin (defined as sales less cost of sales) of $2,186,000, or 83% of sales for the quarter ended March 31, 2005. For the same period a year ago, we earned a gross margin of $2,293,000 or 86% of sales. The lower margin is attributable to an $87,000 increase in the amortization of previously capitalized software development costs, attributable to VeraSMART versions 2.0 and 3.0. These amortization costs are charged directly to cost of sales.

Net engineering and development expenses of $302,000 for the quarter ended March 31, 2005 increased 27% from the first quarter of 2004 due to the reduced level of software capitalization referred to earlier, which offset a reduction of $115,000 in actual gross expenses for engineering and development from the prior year. The table below details gross expenses incurred in engineering and development, amounts capitalized and amortized, and the overall impact of engineering and development efforts on the Company s Statement of Operations for the quarters ended March 31, 2005 and 2004.

	Three Months Ended March 31,	
	2005	**2004**
Gross expenditures for engineering and software development	$ 582,246	$ 696,524
Less: Software development costs capitalized	(280,454)	(458,476)
Net expenses for engineering and software development included in the Company s statement of operations	301,792	238,048
Plus: Software development costs amortized and charged to cost of sales	201,263	103,214
Total Expense Recognized	$ 503,055	$ 341,262

During the first quarter of 2005, our engineering and development team began work on VeraSMART version 4.0. This version of VeraSMART will contain additional functionality to our operational support modules, and a new module for work orders. The addition of these improvements will compliment the billing elements currently available in VeraSMART and allow us to enter markets outside of our traditional telecom environment.

Selling, general, and administrative expenses incurred of $1,971,000 for the quarter ended March 31, 2005 decreased 3% from $2,039,000 for the quarter ended March 31, 2004. The reduction in expense was attributable to lower payroll and benefit expenses incurred as a result of a lower average employment level from a year ago, particularly in the marketing and customer support functions. We do, however, continue to expand our direct sales force in an effort to reach additional VeraSMART opportunities, as well as expand our penetration of new and existing distribution channels associated with sales of our core telemanagement products.

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Liquidity and Capital Resources

For the quarter ended March 31, 2005, net cash decreased by $125,000 from $1,103,000 at December 31, 2004 to $978,000 at March 31, 2005. Net cash consists of cash and cash equivalents plus short-term investments. The reduction in net cash primarily resulted from reducing our trade accounts payable and the payment of accrued compensation due to employees from December 31, 2004 balances.

Accounts receivable at March 31, 2005 of $1,350,000 increased 6% from the December 31, 2004 balance of $1,276,000. The increase in receivables is a function of the timing of payments from customers and does not reflect any change in the historical payment patterns of major customers.

Prepaid expenses of $145,000 increased from $110,000 at December 31, 2004 due to the first quarter renewal of the Company s general business insurance policies for 2005. It is expected that prepaid expenses will increase again in the second quarter as the remaining policies pertaining for 2005 coverages come up for renewal.

During the quarter ended March 31, 2005, the Company purchased $25,000 of capital equipment largely related to upgrades to our internal communication network infrastructure. Additionally we wrote off approximately $22,000 of obsolete equipment during the quarter, all of which had been fully depreciated in past years.

The carrying value of capitalized software related to the Company s software development efforts increased from $2,518,000 at December 31, 2004 to $2,598,000 at March 31, 2005. During the first quarter of 2005, we capitalized $280,000 of current software development costs, all related to further VeraSMART® expansion, and amortized $201,000 of development costs capitalized in previous years.

Pension and related assets increased $24,000 during the first quarter of 2005 to $2,802,000, reflecting an increase in the cash surrender values of Company-owned life insura