

VERAMARK TECHNOLOGIES INC

Form 10-Q

November 13, 2003

Table of Contents

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 September 30, 2003

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 X No _____

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

Yes _____ No X

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of September 30, 2003

Common stock, par value \$.10

8,516,751 shares

This report consists of 23 pages

TABLE OF CONTENTS

FORM 10-Q

PART I FINANCIAL INFORMATION

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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

Item 3 Quantitative and Qualitative Disclosures About Market Risk

Item 4 Controls and Procedures

PART II OTHER INFORMATION

Item 5 Sections 302 and 906

Item 6 Exhibits and Reports on Form 8-K

SIGNATURES

EX-31.1 CERTIFICATION OF CEO PURSUANT TO RULE 302

EX-31.2 CERTIFICATION OF CFO PURSUANT TO RULE 302

EX-32.1 CERTIFICATION OF CEO PURSUANT TO RULE 906

EX-32.2 CERTIFICATION OF CFO PURSUANT TO RULE 906

Table of Contents

INDEX

| | Pages |
|--|--------------|
| | <hr/> |
| PART I | |
| FINANCIAL INFORMATION | |
| Item 1 Financial Statements | |
| Condensed Consolidated | |
| Balance Sheets - | |
| September 30, | |
| 2003 and | |
| December 31, | |
| 2002 3 - | |
| 4 Condensed Consolidated | |
| Statements of Operations - | |
| Three and Nine Months Ended | |
| September 30, | |
| 2003 and | |
| 2002 5 Condensed Consolidated | |
| Statements of Cash Flows - | |
| Nine Months Ended | |
| September 30, | |
| 2003 and | |
| 2002 6 Notes To Condensed Consolidated | |
| Financial Statements 7 - | |
| 10 Item | |
| 2 Management s Discussion and | |
| Analysis of Financial Condition and | |
| Results of Operations 11 - | |
| 15 Item | |
| 3 Quantitative and Qualitative | |
| Disclosures About Market | |
| Risk 16 Item | |
| 4 Controls and Procedures 16 | |
| PART | |
| II OTHER | |
| INFORMATION Item | |
| 5 Certification of Chief Executive | |
| Officer and Chief Accounting | |
| Officer 17 Item | |
| 6 Exhibits and | |

Edgar Filing: VERAMARK TECHNOLOGIES INC - Form 10-Q

Reports on
Form 8-K 17

Table of Contents**PART I FINANCIAL INFORMATION****VERAMARK TECHNOLOGIES, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)**

| | <u>September 30,</u> <u>2003</u> | <u>December 31,</u> <u>2002</u> |
|---|-------------------------------------|------------------------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| | Cash and cash equivalents | \$ 744,612 \$ 623,194 |
| Investments | 997,314 | 924,682 |
| Accounts receivable, trade (net of allowance for doubtful accounts of \$70,000 and \$80,000 respectively) | 1,339,841 | 1,135,776 |
| Inventories, net | 25,488 | 92,276 |
| Prepaid expenses | 178,860 | 182,630 |
| <hr/> | | |
| <hr/> | | |
| Total Current Assets | 3,286,115 | 2,958,558 |
| <hr/> | | |
| <hr/> | | |
| PROPERTY AND EQUIPMENT | | |
| Cost | 5,830,855 | 6,656,249 |
| Less accumulated depreciation | (4,763,067) | (5,404,203) |
| <hr/> | | |
| <hr/> | | |
| Property and Equipment (Net) | | |

Edgar Filing: VERAMARK TECHNOLOGIES INC - Form 10-Q

1,067,788 1,252,046

OTHER ASSETS:

Software development costs (net of
accumulated amortization of \$825,707
and \$2,985,453, respectively)

1,451,034 1,590,054

Pension related assets

2,424,083 2,303,580

Deposits and other assets

838,674 742,474

Total other assets

4,713,791 4,636,108

TOTAL ASSETS

\$9,067,694 \$8,846,712

See notes to Condensed Consolidated Financial Statements

(Continued)

Table of Contents

VERAMARK TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

| | September 30, 2003 | December 31, 2002 |
|---|--------------------------|-------------------------|
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | | |
| \$273,820 | \$265,184 | |
| Accrued compensation and related taxes | | |
| 586,074 | 392,808 | |
| Deferred revenue | | |
| 2,977,227 | 3,200,145 | |
| Capital lease obligation - current | | |
| 10,868 | 17,334 | |
| Other accrued liabilities | | |
| 176,709 | 167,808 | |
| <hr/> | | |
| <hr/> | | |
| Total Current Liabilities | | |
| 4,024,698 | 4,043,279 | |
| Long term portion of capital lease obligation | | |
| 7,400 | | |
| Pension obligation | | |
| 3,915,646 | 3,625,000 | |
| <hr/> | | |
| <hr/> | | |
| Total Liabilities | | |
| 7,940,344 | 7,675,679 | |
| <hr/> | | |
| <hr/> | | |
| STOCKHOLDERS EQUITY: | | |
| Common Stock, par value \$.10; shares authorized, 40,000,000; shares issued and outstanding 8,596,976 and | | |

Edgar Filing: VERAMARK TECHNOLOGIES INC - Form 10-Q

8,470,959, respectively
859,698 847,096
Additional paid-in capital
21,788,946 21,686,196
Retained deficit
(21,147,503) (20,976,502)
Accumulated other comprehensive
income
11,966
Treasury stock (80,225 shares, at cost)
(385,757) (385,757)

Total Stockholders' Equity
1,127,350 1,171,033

TOTAL LIABILITIES AND
STOCKHOLDERS' EQUITY
\$9,067,694 \$8,846,712

See notes to Condensed Consolidated Financial Statements

(Concluded)

Table of Contents

VERAMARK TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------------------|---|-------------|--|-------------|
| | 2003 | 2002 | 2003 | 2002 |
| NET SALES | | | | |
| Product Sales | | | | |
| \$1,094,131 | \$1,024,305 | \$3,219,868 | \$3,350,351 | |
| Service Sales | | | | |
| 1,823,048 | 1,648,324 | 5,399,846 | 5,029,223 | |
| <hr/> | | | | |
| <hr/> | | | | |
| <hr/> | | | | |
| <hr/> | | | | |
| Total Net Sales | | | | |
| 2,917,179 | 2,672,629 | 8,619,714 | 8,379,574 | |
| <hr/> | | | | |
| <hr/> | | | | |
| <hr/> | | | | |
| <hr/> | | | | |
| COSTS AND OPERATING EXPENSES: | | | | |
| Cost of sales | | | | |
| 458,332 | 557,569 | 1,348,154 | 1,721,968 | |
| Engineering and software development | | | | |
| 432,449 | 726,747 | 1,683,106 | 2,170,085 | |
| Selling, general and administrative | | | | |
| 1,920,823 | 2,020,180 | 5,772,174 | 6,087,946 | |
| <hr/> | | | | |
| <hr/> | | | | |

Total Costs and Operating Expenses
2,811,604 3,304,496 8,803,434 9,979,999

INCOME (LOSS) FROM OPERATIONS
105,575 (631,867) (183,720) (1,600,425)
OTHER INCOME
3,953 4,061 12,719 5,397

INCOME (LOSS) BEFORE INCOME TAXES
109,528 (627,806) (171,001) (1,595,028)
INCOME TAXES

NET INCOME (LOSS)
\$109,528 \$(627,806) \$(171,001) \$(1,595,028)

NET INCOME (LOSS) PER SHARE

Basic

\$0.01 \$(0.07) \$(0.02) \$(0.19)

Diluted

\$0.01 \$(0.07) \$(0.02) \$(0.19)

See notes to Condensed Consolidated Financial Statements.

Table of Contents

VERAMARK TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

| | Nine Months Ended September 30, | |
|---|--|---------------|
| | 2003 | 2002 |
| OPERATING ACTIVITIES: | | |
| Net loss | | |
| | \$(171,001) | \$(1,595,028) |
| <hr/> | | |
| <hr/> | | |
| Adjustments to reconcile net loss to net cash flows (used) provided by operating activities | | |
| Depreciation and amortization | | |
| | 599,099 | 1,116,878 |
| Provision for bad debts | | |
| | (14,151) | 52,500 |
| Provision for inventory obsolescence | | |
| | 37,494 | 25,750 |
| Loss on disposal of fixed assets | | |
| | 1,003 | 18 |
| Compensation expense-stock options | | |
| | 57,953 | 224,000 |
| Repayment of note receivable | | |
| | 11,171 | |
| Changes in assets and liabilities | | |
| Accounts receivable | | |
| | (189,914) | 180,592 |
| Inventories | | |
| | 29,294 | (8,695) |
| Prepaid expenses | | |
| | 3,770 | (258,507) |
| Deposits and other assets | | |
| | (216,703) | (100,143) |
| Accounts payable | | |
| | 8,636 | 47,755 |
| Accrued compensation and related taxes | | |
| | 193,266 | 63,539 |
| Deferred revenue | | |
| | (222,918) | 507,851 |
| Other accrued liabilities | | |
| | 8,901 | (63,695) |
| Pension obligation | | |
| | 290,646 | 154,736 |

Net cash flows provided by operating activities
415,375 358,722

INVESTING ACTIVITIES:

Purchase of investments
(60,666) (329,286)
Additions to property and equipment
(64,350) (27,534)
Capitalized software development costs
(212,474)

Net cash flows used by investing activities
(337,490) (356,820)

FINANCING ACTIVITIES:

Proceeds from exercise of stock options
48,752
Repayment of capital lease obligation
(13,866) (11,839)
Proceeds from employee stock purchase plan
8,647 18,940

Edgar Filing: VERAMARK TECHNOLOGIES INC - Form 10-Q

Net cash flows provided by financing
activities
43,533 7,101

NET INCREASE IN CASH AND
CASH EQUIVALENTS
121,418 9,003
CASH AND CASH EQUIVALENTS,
BEGINNING OF PERIOD
623,194 633,138

CASH AND CASH EQUIVALENTS,
END OF PERIOD
\$744,612 \$642,141

See notes to Condensed Consolidated Financial Statements.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) GENERAL

The accompanying unaudited consolidated 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 September 30, 2003, the results of its operations for the three and nine months ended September 30, 2003 and 2002, and cash flows for the nine months ended September 30, 2003 and 2002.

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 consolidated financial statements should be read in conjunction with the consolidated 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, 2002.

The results of operations for the three and nine months ended September 30, 2003 are not necessarily indicative of the results to be expected for the full year's operation.

(2) INVENTORIES, NET

The composition of inventories at September 30, 2003 and December 31, 2002 was as follows:

| | September 30, 2003 | December 31, 2002 |
|--------------------------------|-----------------------------------|----------------------------------|
| Purchased parts and components | \$ 9,459 | \$ 75,402 |
| Work in process | 7,944 | 10,344 |
| Finished goods | 8,085 | 6,530 |
| <hr/> | | |
| <hr/> | | |
| | \$25,488 | \$92,276 |
| <hr/> | | |
| <hr/> | | |

(3) PROPERTY AND EQUIPMENT

The major classifications of property and equipment at September 30, 2003, and December 31, 2002 were:

September 30, December 31,

Edgar Filing: VERAMARK TECHNOLOGIES INC - Form 10-Q

| | <u>2003</u> | <u>2002</u> |
|--------------------------------|-------------|-------------|
| Machinery and equipment | \$789,131 | \$788,131 |
| Computer hardware and software | | |
| 1,890,353 | 2,715,527 | |
| Furniture and fixtures | | |
| 1,768,812 | 1,770,032 | |
| Leasehold improvements | | |
| 1,382,559 | 1,382,559 | |
| <hr/> | | |
| <hr/> | | |
| | \$5,830,855 | \$6,656,249 |
| <hr/> | | |
| <hr/> | | |

Table of Contents**(4) 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.

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 September 30, | | Nine Months Ended September 30, | |
|-------------------|-------------|-------------------------------------|-------------|------------------------------------|---------------|
| | | 2003 | 2002 | 2003 | 2002 |
| Net income (loss) | As reported | \$ 109,528 | \$(627,806) | \$(171,001) | \$(1,595,028) |

Pro forma
 \$45,287 \$(899,474) \$(532,240) \$(2,039,933)Net
 income (loss) per common share
 As reported

Basic
 \$0.01 \$(0.07) \$(0.02) \$(0.19)
 Diluted
 \$0.01 \$(0.07) \$(0.02) \$(0.19)
 Pro forma

Basic
 \$0.01 \$(0.11) \$(0.06) \$(0.24)
 Diluted
 \$0.01 \$(0.11) \$(0.06) \$(0.24)

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 2003 and 2002:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------|--|---------|--|---------|
| | 2003 | 2002 | 2003 | 2002 |
| Dividend yield | | | | |
| Expected volatility | 145.91% | 137.65% | 142.68% | 137.65% |
| Risk-free interest rate | 3.11% | 3.00% | 2.72% | 4.25% |

Expected life
5 years 5 years 5 years 5 years

Table of Contents

(5) COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) for three and nine months ended September 30, 2003 and 2002 was as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-------------|------------------------------------|---------------|
| | 2003 | 2002 | 2003 | 2002 |
| Net income (loss) | \$ 109,528 | \$(627,806) | \$(171,001) | \$(1,595,028) |
| Other comprehensive income (loss) - unrealized gain (loss) on investments (4,839) 11,966 | | | | |
| <hr/> | | | | |
| <hr/> | | | | |
| <hr/> | | | | |
| <hr/> | | | | |
| Comprehensive income (loss) | \$104,689 | \$(627,806) | \$(159,035) | \$(1,595,028) |
| <hr/> | | | | |
| <hr/> | | | | |
| <hr/> | | | | |
| <hr/> | | | | |

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

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.

Table of Contents

The Company's calculation of income (loss) per share is calculated as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2003 | 2002 | 2003 | 2002 |

Basic

Net Income (Loss)

\$109,528 \$(627,806) \$(171,001) \$(1,595,028)

Weighted Average Common Shares Outstanding

8,461,134 8,360,825 8,415,394 8,337,156

Net Income (Loss) Per Common Share

\$0.01 \$(0.07) \$(0.02) \$(0.19)

Diluted

Net Income (Loss)

\$109,528 \$(627,806) \$(171,001) \$(1,595,028)

Weighted Average Common Shares Outstanding
8,461,134 8,360,825 8,415,934 8,337,156
Additional Dilutive Effect of Stock Options and Warrants after
Application of Treasury Stock Method
933,524

Weighted Average Common Shares Outstanding Assuming
Dilution
9,394,658 8,360,825 8,415,394 8,337,156

Net Income (Loss) per Common Share
\$0.01 \$(0.07) \$(0.02) \$(0.19)

(7) 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 September 30, 2003, 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.

Table of Contents

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

Except for the historical information contained herein, the matters discussed in this report are forward-looking statements, which involve risks and uncertainties including, but not limited to, economic, competitive, governmental and technological factors, affecting the Company's operations, markets, products, services and prices, as well as other factors discussed in the Company's filings with the Securities and Exchange Commission.

Results of Operations

For the Company's third quarter ended September 30, 2003, sales of \$2,917,179 increased 9% from sales of \$2,672,629 recorded for the quarter ended September 30, 2002. For the nine months ended September 30, 2003, sales of \$8,619,714 increased 3% from sales of \$8,379,574 achieved for the same nine month period of 2002.

The increase in overall sales continues to be attributable to strong market acceptance of the Company's eCAS product, sales of which have increased every quarter since its initial launch in the fourth quarter of 2001. Sales of call accounting products and services increased 30% for the quarter ended September 30, 2003, when compared to the same quarter of 2002, and 17% for the nine months ended September 30, 2003, from the same nine month period of 2002. Call accounting products and services accounted for 61% of the Company's total sales for the nine months ended September 30, 2003, versus 54% of sales for the nine months ended September 30, 2002.

Sales of the Company's enterprise level products continue to be adversely impacted by the current economic conditions that have caused potential customers to delay major capital expenditures. Sales of enterprise level products have declined 20% and 14% respectively for the three and nine month periods ended September 30, 2003, as compared to the same three and nine month periods of 2002. Enterprise level products have accounted for 33% of year-to-date 2003 sales, compared to 39% of total sales for the first nine months of 2002. During the second quarter of 2003, the Company announced the release of VeraSMART, the industry's first totally web-based Enterprise Telemangement platform. The first application available on the new VeraSMART platform is an expansion of the Company's current call management capabilities, allowing the Company to target significantly larger multi-site business enterprises with very large data volumes, well above the capacity of the current eCAS product line. Veramark is currently developing additional modules which will expand the features and functionality of the enterprise platform, a process which will enable the Company to eventually replace its current Quantum Series product.

Sales generated by the Company's Service Bureau continued to grow at a steady rate, increasing 19% for the three months ended September 30, 2003 and 15% for the nine months ended September 30, 2003, when compared to the same three and nine month periods of 2002. Outsourcing allows companies to reap the benefits of controls on their telemangement expenses without significant investment in equipment or internal staff to carry out those functions.

The company continues to experience an increasing proportion of its revenues from post-sale activities, which typically include maintenance, installation, training, customization, and database services. For the nine months ended September 30, 2003, sales generated from these post-sale activities accounted for 63% of the Company's total sales, as compared with 60% a year ago.

Table of Contents

Gross profit margins of 84% of sales for both the three and nine months ended September 30, 2003 increased from 79% of sales for both the three and nine months ended September 30, 2002. The improved margins reflect lower amortization costs associated with development efforts capitalized in prior years.

Net engineering and software development expenses of \$432,449 for the three months ended September 30, 2003 are 40% lower than the engineering and development expense of \$726,747 incurred for the same quarter of the prior year, and 22% below the prior year levels for the nine months ended September 30, 2003, as compared to 2002. The reduction in net expenses reflects in part the capitalization of \$212,474 of software development costs in the third quarter of 2003 associated with the expansion of the Company's new enterprise level platform, which will become the Company's next generation replacement to the existing Quantum Series product. The chart below summarizes gross engineering and development expenses, amounts capitalized, and net engineering and development costs included in the Company's Statements of Operations for the three and nine months ended September 30, 2003 and 2002:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-----------|------------------------------------|-------------|
| | 2003 | 2002 | 2003 | 2002 |
| Gross Engineering and Software Development Expense | \$644,923 | \$726,747 | \$1,895,580 | \$2,170,085 |
| Less: Development Costs Capitalized (212,474) (-) (212,474) (-) | | | | |
| <hr/> | | | | |
| <hr/> | | | | |
| <hr/> | | | | |
| <hr/> | | | | |
| Net Engineering and Software Development Expense | \$432,449 | \$726,747 | \$1,683,106 | \$2,170,085 |
| <hr/> | | | | |
| <hr/> | | | | |
| <hr/> | | | | |
| <hr/> | | | | |

Selling, general and administrative expenses incurred of \$1,920,823, for the three months ended September 30, 2003 and \$5,772,174 for the nine months ended September 30, 2003 declined by 5% from expense levels of \$2,020,180 and \$6,087,946, for the three and nine months ended September 30, 2002. The decreased costs reflect a reduction in expenses for salaries, benefits and travel costs realized as a result of lower staffing levels throughout 2003 as compared to 2002.

The Company recorded a net profit of \$109,528, or \$0.01 per diluted share, for the three months ended September 30, 2003, as compared with a net loss of \$627,806 or a loss of \$0.07 per share, for the three months ended September 30, 2002. For the nine months ended September 30, 2003, the Company's accumulated net loss of \$171,001, or \$0.02 per share, reflects a significant improvement from the net loss of \$1,595,028 or \$0.19 per share incurred for the first nine months of 2002.

Liquidity and Capital Resources

Edgar Filing: VERAMARK TECHNOLOGIES INC - Form 10-Q

As of September 30, 2003, the Company's total cash and investment position was \$1,741,926, an increase of \$351,432, or 25%, from the June 30, 2003 total cash and investment position of \$1,390,494, and an increase of 13% from the December 31, 2002 balance of \$1,547,876.

Accounts receivable at September 30, 2003 of \$1,339,841 have increased 18% from the December 31, 2003 balance of \$1,135,776, due to increased sales volumes in the third quarter of 2003. The increase in accounts receivable does not reflect any negative change in payment trends from customers. The allowance for bad debts has been reduced from \$80,000 at December 31, 2002 to \$70,000 at September 30, 2003 based on an improvement in the overall aging of receivables.

Table of Contents

Prepaid expenses, which consist primarily of maintenance contracts on specified equipment used throughout the Company and the unutilized portion of current business insurance premiums have decreased from \$182,630 at December 31, 2002 to \$178,860 at September 30, 2002. This balance is expected to decline further in the fourth quarter of 2003, as the costs of those contracts and policies are charged against income.

During the third quarter of 2003, the Company purchased capital equipment at a cost of \$9,777. Year to date through September 30, 2003, capital expenditures total \$64,350. The Company has recently begun a program of replacing and upgrading computer equipment within engineering, development, and sales and support functions, the result of which will be a higher level of capital spending throughout the next two quarters. Earlier in 2003 the Company wrote-off \$874,281, representing the original purchase price of obsolete equipment, no longer in use, recording a loss of approximately \$1,000 on the disposal of that equipment.

Software development costs of \$1,451,034 at September 30, 2003 have declined from \$1,590,054 at December 31, 2002; these costs, however, will increase throughout the fourth quarter of 2003, due to the requirement to capitalize development costs of the Company's new enterprise level platform. For the nine months ended September 30, 2003, the Company has amortized \$351,494 of previously capitalized development costs, and capitalized \$212,474 of current third quarter 2003 development costs.

Pension related assets, which consist of the cash surrender value of life insurance policies and an intangible asset required to account for past service costs associated with the Company's executive retirement plan, increased from \$2,303,580 at December 31, 2002, to \$2,424,083 at September 30, 2003. The increase is attributable to a growth in the cash surrender value of those policies.

Accounts payable at September 30, 2003 of \$273,820 were reduced from the June 30, 2003 balance of \$340,529, and are comparable to the December 31, 2002 balance of \$265,184. The Company continues to remain current with all vendors and suppliers.

Accrued compensation and related taxes, which consists primarily of accruals for salaries payable, commissions payable, and fringe benefits, has increased from \$392,808 at December 31, 2002 to \$586,074 at September 30, 2003. The increase is attributable to the timing of the Company's bi-weekly payroll processing, and an increase in accruals required for fringe benefits and commissions payable. The Company expects the balance in accrued compensation to decline during the fourth quarter of 2003.

Deferred revenue, which represents services for which the Company has billed customers, but for which it has not yet performed the associated services, decreased \$222,918 from the December 31, 2002 balance of \$3,200,145 to \$2,977,227 at September 30, 2003. These services typically include training, installation and maintenance and support. All services currently deferred, are expected to be provided over the next twelve months, and recorded as sales revenue at the time service is actually rendered. The decrease in deferred revenue reflects the reduced sales of the Company's Quantum Series enterprise level product, which typically include significant amounts of follow-on services for training, installation, customization and consulting services.

Other accrued liabilities total \$176,709 at September 30, 2003 and have increased from \$167,808 at December 31, 2002 due to an increase in provisions required for state sales taxes due as a result of a recent audit of sales and use tax by the State of New York.

Long-term obligations of the Company, which consist solely of an accrual to cover future expected pension costs of the Company's executive retirement program increased from \$3,625,000 at December 31, 2002

Table of Contents

to \$3,915,646 at September 30, 2003. As of September 30, 2003, the Company continues to remain free of debt.

Stockholders' Equity of \$1,127,350 at September 30, 2003 compares with \$1,171,033 at December 31, 2002. The reduction includes the net loss incurred for the nine months ended September 30, 2003 of \$171,001, offset by additions to equity from the exercise of employee stock options and stock purchased by employees through the Company's Employee Stock Purchase Plan. During the third quarter of 2003, there were 84,700 stock options exercised, yielding proceeds to the Company of \$36,421.

Despite the net loss incurred for the first nine months of 2003, the Company believes that at its current operating expense levels, the current cash and investments on hand, and the absence of borrowed debt, sufficient resources are available to meet all financial obligations, as well as support current operating plans.

Accounting Pronouncements

In April 2003, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. This amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. This statement clarifies the accounting guidance on derivative instruments, including certain derivative instruments embedded in other contracts, and hedging activities. The standard is effective for contracts entered into or modified after June 30, 2003. The adoption of this standard has not had a material impact on the Company's financial condition or results of operations.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with characteristics of both Liabilities and Equity. This statement establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within the scope of SFAS No. 150 as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. This statement is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of nonpublic entities. The adoption of this standard has not had a material impact on the Company's financial condition or results of operations.

On January 17, 2003 the FASB issued Financial Interpretation No. 46, Consolidation of Variable Interest Entities. The objective of Financial Interpretation No. 46 is to improve financial reporting by companies involved with variable interest entities. Financial Interpretation No. 46 changes certain consolidation requirements by requiring a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. The consolidation requirements apply to entities created before February 1, 2003, no later than the beginning of the first fiscal year or interim period beginning after December 15, 2003, as amended by FASB Staff Position Financial Interpretation 46-6. The Company does not expect the adoption of this standard to have a material impact on its financial condition or results of operations.

Table of Contents

Critical Accounting Policies

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported therein. The most significant of these involving difficult or complex judgments in 2003 include:

Revenue recognition

Capitalization of software development costs

In each situation, management is required to make estimates about the effects of matters or future events that are inherently uncertain.

The Company's overall policies with regard to revenue recognition are based on the terms of sale with the customer. The terms and arrangements vary by product and services provided, owing to the differing nature of the customers and channels. The Company believes its revenue recognition policies are appropriate in all circumstances, and that its policies are reflective of complexities arising from customer arrangements involving such features as maintenance, warranty agreements, license agreements, and other normal course of business arrangements.

The Company capitalizes software development costs when technological feasibility has been established for the software in accordance with Statement of Financial Accounting Standards (SFAS) No. 86, Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed. Such capitalized costs are amortized on a product-by-product basis over their economic life or the ratio of current revenues to current and anticipated revenues from such software, whichever provides the greater amortization. Should the Company inaccurately determine when a product reaches technological feasibility or the economic life of a product, results could differ materially from those reported. The Company used what it believes are reasonable assumptions and where applicable, established valuation techniques in making its estimates.

Table of Contents

Item 3 Quantitative and Qualitative Disclosures About Market Risk

The Company has no long-term bank debt obligations. The Company has no foreign currency exchange risk and has no foreign currency exchange contracts.

Item 4 Controls and Procedures

Based upon an evaluation as of the end of the period covered by this quarterly report, the Company's Chief Executive Officer and Treasurer (Chief Accounting Officer) concluded that the Company's disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. There have been no changes in the Company's internal controls over financial reporting, that occurred during the period covered by this quarterly report, that have materially affected, or are reasonably likely to materially affect the Company's internal controls over financial reporting.

The Company's disclosure controls and procedures and internal controls over financial reporting provide reasonable, but not absolute, assurance that all deficiencies in design or operation of those control systems, or all instances of errors or fraud, will be prevented or detected. Those control systems are designed to provide reasonable assurance of achieving the goals of those systems in light of the Company's resources and nature of the Company's business operations. The Company's disclosure controls and procedures and internal control over financial reporting remain subject to risks of human error and the risk that controls can be circumvented for wrongful purposes by one or more individuals in management or non-management positions.

Table of Contents

PART II OTHER INFORMATION

Item 5: The Company's Chief Executive Officer and Chief Accounting Officer have provided the certifications with respect to this Form 10-Q that are required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002. These certifications have been filed as Exhibits 31.1 and 31.2 and Exhibits 32.1 and 32.2, respectively.

Item 6: Exhibits and Reports on Form 8-K

(a) Exhibits required by Item 601 of Regulation S-K

(I) Registrant's Condensed Financial Statements for the three and nine months ended September 30, 2003 and 2002 are set forth in Part I, Item 1 of this Quarterly Report on Form 10-Q.

(II) Calculation of income (loss) per share for the three and nine months ended September 30, 2003 and 2002, as set forth as Exhibit II .

(31.1) CEO Certification Pursuant to Rule 13a-14(a) and 15d-14(a), As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

(31.2) Treasurer Certification Pursuant to Rule 13a-14(a) and 15d-14(a), As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

(32.1) CEO Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(32.2) Treasurer Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports filed on 8-K during quarter for which report is filed

(1) On August 15, 2003, the Company filed a Current Report on Form 8-K reporting that the Company issued a press release announcing the Company's financial results for the second fiscal quarter ended June 30, 2003, a copy of such press release, which was attached as Exhibit 99.1.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

VERAMARK TECHNOLOGIES, INC.

REGISTRANT

Date: November 13, 2003

/s/ David G. Mazzella

David G. Mazzella

Chairman and Chief Executive Officer

Date: November 13, 2003

/s/ Ronald C. Lundy

Ronald C. Lundy

Treasurer and Chief Accounting Officer

Table of Contents

Exhibit II

VERAMARK TECHNOLOGIES, INC.

Calculations of Income (Loss) Per Common Share

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|---------------|
| | 2003 | 2002 | 2003 | 2002 |
| <u>Basic</u> | | | | |
| Net Income (Loss) | \$109,528 | \$(627,806) | \$(171,001) | \$(1,595,028) |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| Weighted Average Common Shares Outstanding | 8,461,134 | 8,360,825 | 8,415,394 | 8,337,156 |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| Net Income (Loss) Per Common Share | \$0.01 | \$(0.07) | \$(0.02) | \$(0.19) |
| | | | | |
| | | | | |
| | | | | |
| | | | | |

Diluted

Edgar Filing: VERAMARK TECHNOLOGIES INC - Form 10-Q

Net Income (Loss)

\$109,528 \$(627,806) \$(171,001) \$(1,595,028)

Weighted Average Common Shares Outstanding

8,461,134 8,360,825 8,415,934 8,337,156

Additional Dilutive Effect of Stock Options and Warrants after
Application of Treasury Stock Method

933,524

Weighted Average Common Shares Outstanding Assuming
Dilution

9,394,658 8,360,825 8,415,394 8,337,156

Net Income (Loss) per Common Share

\$0.01 \$(0.07) \$(0.02) \$(0.19)
