VERAMARK TECHNOLOGIES INC
Form 10-Q
November 13, 2006

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
Quarterly Report Under Section 13 or 15 (d)
of the Securities Exchange Act of 1934
For Quarter Ended September 30, 2006
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 Exchange 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 requirements for the past 90 days.

YES þ NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

YES o NO þ

The number of shares of Common Stock, $.10 par value, outstanding as of September 30, 2006 was 8,847,273.

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PART I FINANCIAL INFORMATION

VERAMARK TECHNOLOGIES, INC.
CONDENSED BALANCE SHEETS

	(Unaudited) September 30, 2006	December 31, 2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 666,942	$ 911,310
Investments	834,417	600,324
Accounts receivable, trade (net of allowance for doubtful accounts of $33,000 and $32,000, respectively)	1,300,584	1,522,190
Inventories, net	12,918	31,724
Prepaid expenses and other current assets	259,628	161,127
Total Current Assets	3,074,489	3,226,675
PROPERTY AND EQUIPMENT		
Cost	5,841,849	5,796,427
Less accumulated depreciation	(5,172,506)	(5,025,761)
Property and Equipment (Net)	669,343	770,666
OTHER ASSETS:		
Software development costs (net of accumulated amortization of $1,055,167 and $2,373,896, respectively)	3,134,800	2,826,644
Pension assets	2,644,712	2,501,636
Deposits and other assets	789,534	797,745
Total Other Assets	6,569,046	6,126,025
TOTAL ASSETS	$ 10,312,878	$ 10,123,366

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

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VERAMARK TECHNOLOGIES, INC.
CONDENSED BALANCE SHEETS

	(Unaudited) September 30, 2006	December 31, 2005
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 325,251	$ 275,756
Accrued compensation and related taxes	480,430	565,096
Deferred revenue	3,198,198	2,936,466
Other accrued liabilities	125,161	135,430
Total Current Liabilities	4,129,040	3,912,748
Pension obligation	4,794,704	4,424,304
Total Liabilities	8,923,744	8,337,052
STOCKHOLDERS EQUITY:		
Common Stock, par value $.10; shares authorized, 40,000,000; shares issued and outstanding 8,927,498 and 8,917,840	892,750	891,784
Additional paid-in capital	21,715,524	21,686,152
Accumulated deficit	(20,850,797)	(20,413,395)
Treasury stock (80,225 shares, at cost)	(385,757)	(385,757)
Accumulated other comprehensive income	17,414	7,530
Total Stockholders Equity	1,389,134	1,786,314
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 10,312,878	$ 10,123,366

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 September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
NET SALES				
Product sales	$ 876,781	$ 963,216	$ 2,445,467	$ 2,797,851
Service sales	1,712,856	1,705,605	5,194,647	5,158,698
Total Net Sales	2,589,637	2,668,821	7,640,114	7,956,549
COSTS AND OPERATING EXPENSES:				
Cost of sales	562,431	454,053	1,660,863	1,333,988
Engineering and software development	185,202	265,597	536,212	746,384
Selling, general and administrative	2,025,219	2,001,741	5,906,613	5,770,737
Total Costs and Operating Expenses	2,772,852	2,721,391	8,103,688	7,851,109
INCOME (LOSS) FROM OPERATIONS	(183,215)	(52,570)	(463,574)	105,440
INTEREST INCOME	10,342	4,163	26,172	10,590
INCOME (LOSS) BEFORE INCOME TAXES	(172,873)	(48,407)	(437,402)	116,030
INCOME TAXES				
NET INCOME (LOSS)	$ (172,873)	$ (48,407)	$ (437,402)	$ 116,030
NET INCOME (LOSS) PER SHARE				
Basic	$ (0.02)	$ (0.01)	$ (0.05)	$ 0.01
Diluted	$ (0.02)	$ (0.01)	$ (0.05)	$ 0.01

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

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VERAMARK TECHNOLOGIES, INC.
CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)

	Nine Months Ended September 30, 2006	2005
OPERATING ACTIVITIES:		
Net Income (loss)	$ (437,402)	$ 116,030
Adjustments to reconcile net income (loss) to net cash flows provided by operating activities:		
Depreciation and amortization	943,810	805,961
Expense (recovery) of bad debts	1,494	(2,776)
Compensation expense-stock options (net of forfeitures)	24,700	(113,545)
Increase in cash surrender value of company-owned life insurance policies	(143,076)	(120,503)
Realized (gain) loss on sale of investments	(2,922)	220
Changes in assets and liabilities		
Accounts receivable	220,112	(119,701)
Inventories	18,806	(10,900)
Prepaid expenses and other current assets	(98,501)	(40,735)
Deposits and other assets	8,211	
Accounts payable	49,495	(88,631)
Accrued compensation and related taxes	(84,666)	(149,763)
Deferred revenue	261,732	400,315
Other accrued liabilities	(10,269)	(69,753)
Pension obligation	370,400	482,901
Net cash flows provided by operating activities:	1,121,924	1,089,120
INVESTING ACTIVITIES:		
Purchase of investments	(221,287)	(13,438)
Capitalized software development costs	(1,053,693)	(917,032)
Additions to property and equipment	(96,950)	(91,323)
Net cash flows used by investing activities:	(1,371,930)	(1,021,793)
FINANCING ACTIVITY:		
Exercise of stock options	932	63,841
Proceeds from employee stock purchase plan	4,706	6,357
Net cash flows provided by financing activities:	5,638	70,198
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(244,368)	137,525
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	911,310	722,020
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 666,942	$ 859,545

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	Nine Months Ended September 30,	
	2006	**2005**
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash Transactions:		
Income taxes paid	$17,141	$4,756
Interest paid	$ 619	$ 20

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 September 30, 2006, the results of its operations for the three and nine months ended September 30, 2006 and 2005, and cash flows for the nine months ended September 30, 2006 and 2005.

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, 2005.

The results of operations and cash flows for the three and nine months ended September 30, 2006 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 September 30, 2006, and December 31, 2005 were:

	September 30, 2006	December 31, 2005
Machinery and equipment	$ 794,749	$ 794,314
Computer hardware and software	1,995,456	1,991,877
Furniture and fixtures	1,669,085	1,627,677
Leasehold improvements	1,382,559	1,382,559
	$ 5,841,849	$ 5,796,427

For the three and nine months ended September 30, 2006, the Company recorded depreciation expense of $64,549 and $198,273. Depreciation expense for the three and nine months ended September 30, 2005 were $66,973 and $202,172.

(3) STOCK-BASED COMPENSATION

In December 2004, the FASB issued SFAS No. 123R, Share-Based Payment. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized as compensation expense in the financial statements based on their fair values. That expense will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period). We adopted SFAS No. 123R effective beginning January 1, 2006, using the Modified Prospective Application. SFAS No. 123R applies to the new awards modified, repurchased or cancelled after the effective date. The impact of adopting SFAS No. 123R was an increase of $24,700 to operating expenses for the nine months ended September 30, 2006. For the three and nine months ended September 2005, the following table includes disclosures required by SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, and illustrates the effect on net earnings and net earnings per share as if we had applied the fair value recognition provisions of SFAS No. 123:

		Three Months Ended September 30, 2005		Nine Months Ended September 30, 2005	
Net Income (Loss)	As reported	$	(48,407)	$	116,030
Add: total stock-based compensation expense included in net income, net of forfeitures and related tax effects			(15,506)		(113,545)
Deduct: total stock-based compensation expense determined under fair value, net of forfeitures and related tax effects			(15,724)		(51,729)
	Pro forma	$	(79,637)	$	(49,244)
Net loss per common share	As reported				
	Basic	$	(0.01)	$	0.01
	Diluted	$	(0.01)	$	0.01
	Pro forma				
	Basic	$	(0.01)	$	(0.01)
	Diluted	$	(0.01)	$	(0.01)

Currently, the Company s primary type of share-based compensation consists of stock options, generally vesting over four years. For the nine months ended September 30, 2006, the company issued 10,000 stock options.

A summary of the status of the Company s stock option plan as of September 30, 2006 is presented below:

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	Shares	Average Exercise Price	Average Grant-Date Fair Value	Remaining Contractual Term (Yrs)	Intrinsic Value
Outstanding as of December 31, 2005	2,865,028	$ 2.37	$ 1.93	4.3	$ 1,198,974
Granted	10,000	$ 0.55			
Exercised	(1,750)	0.53			(170)
Canceled	(83,000)	2.82			(41,179)
Outstanding as of September 30, 2006	2,790,278	$ 2.35	$ 1.92	3.6	$ 1,157,625
Options exercisable at September 30, 2006	2,723,503	$ 2.39	$ 1.95	3.5	$ 1,150,856

As of September 30, 2006, there was $22,609 of total unrecognized compensation cost related to non-vested share-based compensation arrangements related to stock options granted under the Plan. That cost is expected to be recognized over a weighted-average period of 1.0 years.

(4) TOTAL COMPREHENSIVE INCOME (LOSS)

Total comprehensive loss for the three and nine months ended September 30, 2006 and 2005 was as follows:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2006	**2005**	**2006**	**2005**
Net income (loss)	$ (172,873)	$ (48,407)	$ (437,402)	$ 116,030
Accumulated other comprehensive income (loss)	16,241	(2,443)	9,884	2,929
Total comprehensive income (loss)	$ (156,632)	$ (50,850)	$ (427,518)	$ 118,959

(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.

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Calculations of Earnings (Loss) Per Share

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Basic				
Net Income (loss)	$ (172,873)	$ (48,407)	$ (473,402)	$ 116,030
Weighted average common shares outstanding	8,847,273	8,793,951	8,841,699	8,733,267
Net Income (loss) per common share	$ (0.02)	$ (0.01)	$ (0.05)	$ 0.01
Diluted				
Net Income (loss)	$ (172,873)	$ (48,407)	$ (473,402)	$ 116,030
Weighted average common shares outstanding	8,847,273	8,793,951	8,841,699	8,733,267
Additional dilutive effect of stock options and warrants after application of treasury stock method				652,450
Weighted average dilutive shares outstanding	8,847,273	8,793,951	8,841,699	9,385,717
Net Income (loss) per common share assuming full dilution	$ (0.02)	$ (0.01)	$ (0.05)	$ 0.01

There have been no dilutive effects of stock options for the three and nine months ended September 30, 2006 as the effect would have been anti-dilutive.

(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 September 30, 2006 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 nine months ended September 30, 2006 and 2005.

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

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expense for the three and nine months ended September 30, 2006 and 2005 consists of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Current Service Cost	$ 69,503	$ 114,244	$ 208,509	$ 342,736
Amortization of Prior Service Cost	22,123	22,650	66,369	67,950
Interest Cost	73,374	65,605	220,122	196,815
Pension Expense	$ 165,000	$ 202,499	$ 495,000	$ 607,501

The Company paid pension obligations of $124,600 for both the nine months ended September 30, 2006 and 2005.

The discount rate used in determining the actuarial present value of the projected benefit obligation was 6% for the six months ended September 30, 2006 and 2005.

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 future pension obligations. The total death benefit associated with these policies is $10.2 million, with an associated accumulated cash surrender value of approximately $2,645,000 at September 30, 2006. The accumulated cash surrender values of these policies at December 31, 2005 was approximately $2,502,000.

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 w 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.

Overview

Sales of $2,590,000 for the three months ended September 30, 2006 and $7,640,000 for the nine months ended September 30, 2006 compare with sales of $2,669,000 and $7,957,000 respectively, for the three and nine month periods ended September 30, 2005.

Our net loss of $173,000, or $0.02 per share, for the three months ended September 30, 2006 compares with a net loss of $48,000, or $0.01 per share for the three months ended September 30, 2005. For the nine months ended September 30, 2006 the net loss incurred is $437,000, or $0.05 per share. For the nine months ended September 30, 2005 we reported a net income of $116,000, or $0.01 per diluted share.

Orders booked for the quarter ended September 30, 2006 of $2,977,000, represented an increase of 13% from orders booked of $2,625,000 for the second quarter ended June 30, 2006. For the first nine months of 2006 we have experienced an increase in orders booked for each of our three major product categories as compared to the first nine months of 2005. Orders for eCAS products and services have increased 6%, orders for VeraSMART product and services have increased 15%, and orders for Managed Services have increased 72% from the prior year. In late September the company announced the signing of a three year managed service contract with a large national beverage company valued in excess of $200,000 over the term of the contract. This new client will utilize our Call Accounting module to perform departmental bill back of telecom charges in addition to employing Veramark s Invoice Management module to perform carrier bill management and allocate usage charges from multiple wireless and wire-line carriers.

Gross operating expenses of $2,574,000 and $7,496,000 for the three and nine months ended September 30, 2006 increased 2% and 1% respectively from expenses levels of $2,529,000 and $7,435,000 for the three and nine months ended September 30, 2005.

Sales

Sales of eCAS products and services increased 2% for the both three and nine months ended September 30, 2006 as compared with the same three and nine month periods of 2005, accounting for 65% of sales revenues in 2006, up from 62% of total revenues in 2005.

Sales of VeraSMART, our enterprise level product offering, decreased 1% for the three months ended September 30, 2006 as compared the same quarter a year ago, but have increased 6% for the nine months ended September 30, 2006 from the same nine month period of 2005. During the third quarter we received eight new orders for VeraSMART spanning the healthcare, government, publishing, and retail markets. Based upon the scheduled installation and implementation dates, portions of the revenues associated with several of these orders are expected to be recognized during the fourth quarter and beyond.

Revenues derived from our Managed Services Group (formerly Outsourced Solutions) increased 20% for the three months ended September 30, 2006 and 8% for the nine months ended September 30, 2006 from the same three and nine month periods a year ago. We offer hosted services in a variety of scenarios ranging from full service to Application Service Provider (ASP) modules. Utilizing the same telemanagement tools developed for our premise based solutions our Managed Service Group can remotely poll, process, and report on telecommunication and work flow activities and provide comprehensive reports and analysis in a variety of formats. With the addition of the new client referred to in the overview section of this report, Veramark now manages service arrangements with eight clients. Revenues for this latest client are expected to commence in the fourth quarter.

Offsetting the year to date increases in sales of eCAS, VeraSMART, and Managed Services is a 32% reduction in Quantum maintenance revenues. New sales of Quantum, Vera Smart s predecessor product were discontinued in April 2003 with the initial introduction of the VeraSMART platform. We have continued our maintenance support of Quantum since that time, however are now in the process of phasing out that support, with maintenance for Quantum no longer being offered beyond December 31, 2007.

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Cost of Sales

Gross margins (defined as sales less cost of sales) of 78% of sales for both the three and nine months ended September 30, 2006 decreased from gross margins of 83% for both the three and nine months ended September 30, 2005. The lower margins reflect higher direct product costs attributable to multi site VeraSMART implementations, and an increase in amortization costs associated with previously capitalized software development costs.

Operating Expenses

Net expenses for engineering and software development of $185,000 for the three months ended September 30, 2006 decreased 30% from net engineering and software development expenses of $266,000 for the same three month period of 2005. For the nine months ended September 30, 2006 net engineering and software development expenses of $536,000 decreased 28% from expenses of $746,000 for the nine months ended September 30, 2005. The reduction in net expenses for both periods is attributable to increases in the amount of software development costs capitalized. The table below summarizes gross expenses for engineering and software development, costs capitalized, and the resulting net engineering and software development expenses recorded in the Statement of Operations the three and nine months ended September 30, 2006 and 2005.

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2006	**2005**	**2006**	**2005**
Gross expenditures for engineering & software development	$ 550,000	$ 526,000	$ 1,590,000	$ 1,663,000
Less: Software development costs capitalized	(365,000)	(260,000)	(1,054,000)	(917,000)
Net expense for engineering and software	$ 185,000	$ 266,000	$ 536,000	$ 746,000

Our development efforts during 2006 have been focused on the development of VeraSMART 5.0, the release of which was announced October 5, 2006. VeraSMART 5.0 introduces an Asset Management Module to the VeraSMART suite. The Asset Management Module is completely integrated with our Work Order/Help Desk, Allocation, and Directory modules allowing VeraSMART to offer a complete stand-alone work flow and facilities management solution, and allow enterprises to manage, track and optimize both their tangible and non-tangible assets throughout their life cycle.

Selling, general and administrative expenses of $2,025,000 for the three months ended September 30, 2006 increased 1% from expenses of $2,002,000 for the three months ended September 30, 2005. For the nine months ended September 30, 2006 selling, general and administrative expenses of $5,907,000 increased 2% from expenses of $5,771,000 for the nine months ended September 30, 2005. The increase in operating expenses results from higher salary, benefit, and travel expenses attributable to the addition of personnel to strengthen our direct sales force presence and marketing capabilities.

Liquidity and Capital Resources

As of September 30, 2006 Veramark total cash balance position (cash plus short-term investments) of $1,501,000, decreased from $1,631,000 at June 30, 2006, yet remains relatively unchanged from the December 31, 2005 total cash position of $1,511,000. The company does not foresee significant variations in total cash position during the fourth quarter of 2006.

Accounts receivable of $1,301,000 at September 30, 2006 decreased 15% from the December 31, 2005 balance of $1,522,000, however increased 11% from the June 30, 2006 balance of $1,177,000. The reserve for bad debts is $33,000 at September 30, 2006 up from $32,000 at December 31, 2005. We have seen no significant change in the percentage of past due accounts during 2006, nor have we experienced significant write-offs of accounts during the first nine months of 2006.

Prepaid expenses consisting primarily 2006 business insurance renewals and prepaid rent, total $260,000 at September 30, 2006, up from $161,000 at December 31, 2005. Prepaid expenses will decrease during the fourth quarter as the economic benefit associated with the prepaid insurance premiums are realized and charged against income.

During the first nine months of 2006 capital equipment purchases total $97,000, primarily for new equipment utilized in our software development and managed services operations, but also include an upgrade to our telephone and voicemail systems. During 2006 we have disposed of approximately $52,000 of obsolete equipment, all of which had been fully depreciated.

Software development costs capitalized and included on our Balance Sheet at September 30, 2006 of $3,135,000 have increased $308,000, or 11% from the December 31, 2005 balance of $2,827,000. During the first nine months of 2006 we capitalized $1,054,000 of software development costs, versus $917,000 of capitalization for the first nine months of 2005. The amortization expense associated with previously capitalized development costs, and charged to cost of sales, totaled $746,000 for the first nine months of 2006, up from $604,000 for the first nine months of 2005.

Pension assets which consist of the cash surrender value of company owned life insurance policies designed to fund future pension obligations, total $2,645,000 at September 30, 2006, an increase of 6% from cash surrender values of $2,502,000 at December 31, 2005. These cash surrender values are available to the company to fund current operations in the event that became necessary, though management does not envision that need in the near future. Not included on the company s balance sheet is the aggregate death benefit attached to the company owned policies, which totals $10.2 million.

Current liabilities total $4,129,000 at September 30, 2006, representing an increase of 6% from total current liabilities of $3,913,000 at December 31, 2005. The increase in current liabilities results from an increase of $262,000 in the value of deferred revenues from $2,936,000 at December 31, 2005 to $3,198,000 at September 30, 2006. Deferred revenues consist of services such as training, installation, maintenance and support, and consulting fees for which the company has billed customers, but have not yet provided the contracted service, and therefore have not yet recognized the revenue associated with those services. Virtually all of the services currently included in deferred revenues are expected to be performed and converted to revenue during the next twelve months.

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Stockholders Equity at September 30, 2006 is $1,389,000, a reduction of $397,000 from the December 31, 2005 balance of $1,786,000. The reduction in equity include the loss of $437,000 incurred for the nine months ended September 30, 2006, partially offset by proceeds received from the exercise of employee stock options and the purchase of Company stock by employees under the company s employee stock purchase plan.
In management s opinion, given our current cash and investment position, current operating expense levels, and the absence of debt, sufficient resources are available to fully fund operations for the next twelve months and beyond.

Accounting Pronouncements

1) In December 2003, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition, which updates the guidance in SAB No. 101, integrates the related set of Frequently Asked Questions, and recognizes the role of EITF 00-21. The adoption of SAB No. 104 did not have a material effect on the Company s financial statements.

2) In November 2002, the Emerging Issues Task Force reached a consensus on Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. Issue 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of Issue 00-21 applied to revenue arrangements entered into in periods beginning after June 15, 2003. The adoption of Issue 00-21 did not have a material effect on the Company s financial position or results of operations.

3) In December 2004, the FASB issued SFAS 123(R), Share-Based Payment , which establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. This standard requires an issuer to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award and the recording of such expense in the consolidated financial statements. This eliminates the exception to account for such awards using the intrinsic value method previously allowable under Accounting Principles Board (APB) Opinion No. 25. Pro forma disclosure of fair value recognition will no longer be an alternative. In addition, the adoption of SFAS No. 123(R) will require additional accounting related to the income tax effects and disclosure regarding the cash flow effects resulting from share-based payment arrangements.

SFAS 123(R) permits public companies to adopt its requirements using one of two methods:
Modified prospective method: Compensation cost is recognized beginning with the effective date of adoption (a) based on the requirements of SFAS No. 123(R) for all share-based payments granted after the effective date of adoption and (b) based on the requirements of SFAS 123 for all awards granted to employees prior to the effective date of adoption that remain unvested on the date of adoption.
Modified retrospective method: Includes the requirements of the modified prospective method described above, but also permits restatement using amounts previously disclosed under the pro forma provisions of SFAS No. 123 either for (a) all periods presented or (b) prior interim periods of the year of adoption. In March 2005, the SEC released Staff Accounting Bulletin (SAB) 107, Share-Based Payment , which expresses views of the SEC Staff about the application of SFAS No. 123(R). In April 2005, the SEC issued a rule that SFAS

No. 123(R) will be effective for annual reporting periods beginning on or after June 15, 2005.

SFAS 123(R) became effective for our fiscal year 2006 and we utilized the modified prospective method. We have selected the Black-Scholes option-pricing model as the most appropriate fair-value method for our awards and will recognize compensation cost on a straight-line basis over our awards vesting periods. Although the adoption of SFAS No. 123(R) had no adverse impact on our balance sheet or total cash flows, it is expected to negatively impact our net income and earnings per share for 2006 by less than $50,000. The actual effects of adopting SFAS No. 123(R) will depend on numerous factors including the amounts of share-based payments granted in the future, our stock price volatility, estimated forfeiture rates and employee stock option exercise behavior.

4) In December 2004, FASB issued SFAS 153, Exchanges of Nonmonetary Assets an amendment to APB Opinion No. 29. This statement amends APB 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. Adoption of this statement did not have a material impact on our results of operations or financial condition.

5) In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3 (SFAS 154). SFAS 154 changes the requirements for the accounting for and reporting of a change in accounting principle. These requirements apply to all voluntary changes and changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. SFAS 154 is effective for fiscal years beginning after December 15, 2005. Adoption of this statement did not have a material impact on our results of operations or financial condition.

6) In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 157, Fair Value Measurements . SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 is effective as of the beginning of the first fiscal year that begins after November 15, 2007. As such, the Company is required to adopt these provisions at the beginning of the fiscal year ended December 31, 2008. The Company is currently evaluating the impact of SFAS 157 on its consolidated financial statements.

7) In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS 158). SFAS 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. SFAS 158 is effective for an employer with publicly traded equity securities as of the end of the first fiscal year ending after December 15, 2006, SFAS 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, effective for fiscal years ending after December 15, 2008 As such, the Company is required to recognize the funded status of its defined benefit postretirement plan and to provide the required

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disclosures at the beginning of the fiscal year ended December 31, 2006. The Company is currently evaluating the impact of SFAS 158 on its consolidated financial statements.

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 2006 include:

Revenue recognition

Capitalization of software development costs

Allowance for Doubtful Accounts

Pension liability

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

The Company s revenue consists of revenues from the licensing of software to resellers and end user customers; fees for services rendered to include installation, training, implementation, and customer maintenance contracts; and the outsourcing or hosting of services.

The Company recognizes software license revenue under Statement of Position No 97-2 Software Revenue Recognition as amended by Statement of Position No. 98-9, Software Revenue Recognition With Respect to Certain Transactions , Emerging Issues Task Force 00-21, Revenue Arrangements with Multiple Deliverables , and related interpretations.

Sales of licensed software sold directly to an end user customer are recognized as revenue upon delivery and installation of the software at the customer site. Sales of licensed software to a reseller are recognized as revenue when delivery is made to the reseller. Regardless of the form of sale no revenue is recognized without persuasive evidence of an arrangement existing. Persuasive evidence is determined to be a signed purchase order received from the customer or an equivalent form for those customers lacking a formalized purchase order system. In the case of VeraSMART sales, a software license agreement signed by both parties is often required in addition to a purchase order or equivalent. Additionally, revenue is only recognized when a selling price is fixed or determinable and collectibility of the receivable is deemed to be probable.

Service revenues such as training, installation and implementation are recognized when the service is complete and acknowledged by the customer, regardless as to whether the sale is on a direct basis or through a reseller arrangement.

Fees charged to customers for post-contract customer support are recognized ratably over the term of the contract. Costs related to maintenance obligations are expensed as incurred.

Sales which constitute a multiple-element arrangement are accounted for by determining if the elements can be accounted for as separate accounting units, and if so, by applying values to those units for which there is vendor specific objective evidence of their fair value. We use the residual method to apply any remaining balance to the remaining elements of the arrangement. More specifically, this methodology applies when there is embedded maintenance (post-contract customer support) involved in the sale of a software license, or when the sale of a software license is made in conjunction with installation services. In the latter case, the recognition of the software license is deferred until installation is completed.

The Company s revenues generated through hosting solutions are recognized using the proportional performance method. Revenues are recognized in the month services are rendered and earned under service agreements with clients where service fees are fixed or determinable. Contracts can be terminated with 90 days written notice. All services provided by us through the date of cancellation are due and payable under the contract terms.

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 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. The Company periodically reviews the carrying value of capitalized software development costs and impairments are recognized in the results of operations when the expected future undiscounted operating cash flow derived from the capitalized software is less than its carrying value. 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. Veramark uses what it believes are reasonable assumptions and where applicable, established valuation techniques in making its estimates.

The Company maintains allowances for doubtful accounts for estimated losses resulting from the potential inability of its customers to make required payments. Management specifically analyzes accounts receivable, historical bad debts, credit concentrations and customer payment terms when evaluating the adequacy of the allowance for doubtful accounts.

The Company sponsors an unfunded Supplemental Executive Retirement Program (SERP), which is a nonqualified plan that provides certain key employees a defined pension benefit. In order to properly record the net present value of future pension obligations a number of assumptions are required to be made by Company s management. These assumptions include years of service, life expectancies, and projected future salary increases for each participant. In addition, management must make assumptions with regard to the proper long-term interest and liability discount rates to be applied to these future obligations.

Should the Company need to alter any of these assumptions, there is the potential for significant adjustments to future projected pension liabilities.

Issues and Risks

The following factors, among others discussed herein and in the Company s filings under the Act, could cause actual results and future events to differ materially from those set forth or contemplated in the forward-looking statements: economic, competitive, governmental and technological factors, increased operating costs, failure to obtain necessary outside financing, risks related to natural disasters and financial market fluctuations. Such factors also include:

Intellectual Property Rights

Veramark regards its software as proprietary and attempts to protect it with a combination of copyright, trademark and trade secret protections, employee and third-party non-disclosure agreements and other methods of protection. Despite those precautions, it may be possible for unauthorized third parties to copy certain portions of Veramark s products, reverse engineer or obtain and use information that Veramark regards as proprietary. The laws of some foreign countries do not protect Veramark s proprietary rights to the same extent as the laws of the United States. Any misappropriation of Veramark s intellectual property could have a material adverse effect on its business and results of operations. Furthermore, although Veramark take steps to prevent unlawful infringement of other s intellectual property, there can be no assurance that third parties will not assert infringement claims against Veramark in the future with respect to current or future products. Any such assertion could require Veramark to enter into royalty arrangements or result in costly litigation.

New Products and Services

Veramark has made significant investments in research, development and marketing for new products, services and technologies, including the VeraSMART® software offering and its managed service solutions. Significant revenue from new product and service investments may not be achieved for a number of years, if at all. Moreover, if such products or services are profitable, operating margins may not be as high as the margins historically experienced by Veramark.

Declines in Demand for Software

If overall market demand for software and computer devices generally, as well as call accounting software or enterprise level products specifically, declines, or corporate spending for such products declines, Veramark s revenue will be adversely affected. Additionally, Veramark s revenues would be unfavorably impacted if customers reduce their purchases of new software products or upgrades to existing products.

Product Development Schedule

The development of software products is a complex and time-consuming process. New products and enhancements to existing products can require long development and testing periods. Significant delays in new product releases or significant problems in creating new products, particularly any delays in future releases of the VeraSMART® suite of products, could adversely affect Veramark revenues.

Competition

Veramark experiences intense competition across all markets for its products and services. Some competing firms have greater name recognition and more financial, marketing and technological resources than Veramark. These competitive pressures may result in decreased sales volumes, price reductions, and/or increased operating costs, such as for marketing and sales incentives, resulting in lower revenues, gross margins and operating income.

Marketing and Sales

Veramark s marketing and distribution strategy is founded on building mutually beneficial relationships with companies that have established distribution networks. Some sell privately labeled, customized products developed and manufactured by Veramark to their specific specifications, while others resell Veramark s products. Any loss of the continued availability of those relationships could have a material adverse effect on Veramark s business and results of operations.

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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 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 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.

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PART II OTHER INFORMATION

Item 5: Certification of Chief Executive Officer and Chief Accounting Officer

The Company s Chief Executive Officer and the Company s 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.

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Item 6: Exhibits

(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, 2006 and 2005 are set forth in Part I, Item 1 of this Quarterly Report on Form 10-Q.
(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.

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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 10, 2006

/s/ David G. Mazzella

David G. Mazzella
President and CEO

Date: November 10, 2006

/s/ Ronald C. Lundy

Ronald C. Lundy
Treasurer (Chief Accounting Officer)