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COGNITRONICS CORP
Form 10-Q
August 14, 2002

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CONFORMED

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the period ended June 30, 2002

or

Transition Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

For the Transition Period from _____ to _____

Commission file number 0-3035

COGNITRONICS CORPORATION
(Exact name of registrant as specified in its charter)

NEW YORK
(State or other jurisdiction of
incorporation or organization)

13-1953544
(I.R.S. Employer
Identification No.)

3 Corporate Drive, Danbury, Connecticut
(Address of principal executive offices)

06810-4130
(Zip Code)

(203) 830-3400
Registrant's telephone number, including area code

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, and (2) has been subject to such filing requirements
for at least the past 90 days. Yes x No

Indicate the number of shares outstanding of each of
the issuer's classes of common stock, as of June 30, 2002.

Common Stock, par value \$0.20 per share 5,415,793 shares

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Part I, Item 1.

COGNITRONICS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(dollars in thousands)

	June 30, 2002 ----- (Unaudited)	December 31, 2001 -----
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 5,529	\$ 7,731
Marketable securities	7,620	6,400
Accounts receivable, net	2,255	2,035
Inventories	4,979	5,682
Deferred income taxes	1,115	1,110
Other current assets including loans to officers of \$1,600 and \$1,516	3,005	2,431
	-----	-----
TOTAL CURRENT ASSETS	24,503	25,389
PROPERTY, PLANT AND EQUIPMENT, NET	1,543	1,514
GOODWILL, NET	319	319
DEFERRED INCOME TAXES	762	812
OTHER ASSETS	466	539
	-----	-----
	\$27,593	\$28,573
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 1,002	\$ 871
Accrued compensation and benefits	1,121	1,109
Income taxes payable	383	290
Current maturities of debt	35	46
Other accrued expenses	408	319
	-----	-----
TOTAL CURRENT LIABILITIES	2,949	2,635
LONG-TERM DEBT	4	26
OTHER NON-CURRENT LIABILITIES	2,366	2,314
STOCKHOLDERS' EQUITY		
Common Stock, par value \$.20 a share, authorized 10,000,000 shares; issued 5,863,229 shares	1,173	1,173
Additional paid-in capital	13,322	13,322
Retained earnings	11,984	13,413
Cumulative other comprehensive loss	(259)	(260)
Unearned compensation	(397)	(506)
	-----	-----
	25,823	27,142
Less cost of 447,436 and 445,936 common shares in treasury	(3,549)	(3,544)
	-----	-----
TOTAL STOCKHOLDERS' EQUITY	22,274	23,598
	\$27,593	\$28,573
	=====	=====

See Note to Condensed Consolidated Financial Statements.

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COGNITRONICS CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND
 COMPREHENSIVE INCOME (LOSS) (UNAUDITED)
 (dollars in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2002	2001	2002	2001
NET SALES	\$3,356	\$5,848	\$6,498	\$10,787
COST AND EXPENSES:				
Cost of products sold	1,889	2,981	3,829	5,604
Research and development	890	915	1,748	1,619
Selling, general and administrative	1,509	1,923	3,153	3,658
Amortization of goodwill		83		166
Other (income), net	(43)	(141)	(92)	(310)
	4,245	5,761	8,638	10,737
Income (loss) before income taxes	(889)	87	(2,140)	50
PROVISION (BENEFIT) FOR INCOME TAXES	(274)	29	(711)	15
NET INCOME (LOSS)	(615)	58	(1,429)	35
Currency translation adjustment	18	(40)	1	(40)
COMPREHENSIVE INCOME (LOSS)	\$ (597)	\$ 18	\$ (1,428)	\$ (5)
NET INCOME (LOSS) PER SHARE:				
Basic	\$ (.11)	\$.01	\$ (.26)	\$.01
Diluted	\$ (.11)	\$.01	\$ (.26)	\$.01
Weighted average number of outstanding shares:				
Basic	5,416,999	5,365,157	5,414,757	5,442,719
Diluted	5,416,999	5,502,900	5,414,757	5,613,941

See Note to Condensed Consolidated Financial Statements

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COGNITRONICS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(dollars in thousands)

	Six Months Ended June 30,	
	2002	2001
	-----	-----
NET CASH (USED) PROVIDED BY OPERATIONS	\$ (575)	\$4,124
	-----	-----
INVESTING ACTIVITIES		
Purchases of marketable securities	(7,620)	(1,200)
Sales of marketable securities	6,400	2,400
Loans to employees	(84)	(383)
Additions to property, plant and equipment, net	(301)	(247)
Purchase of software licenses		(192)
	-----	-----
NET CASH (USED) PROVIDED BY INVESTING ACTIVITIES	(1,605)	378
	-----	-----
FINANCING ACTIVITIES		
Repurchase of 1,500 and 206,650 shares for treasury	(5)	(1,461)
Principal payment of debt	(33)	(46)
Common stock issued pursuant to employee stock plans, 900 shares		6
	-----	-----
NET CASH USED BY FINANCING ACTIVITIES	(38)	(1,501)
	-----	-----
EFFECT OF EXCHANGE RATE DIFFERENCES	16	(5)
	-----	-----
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(2,202)	2,996
CASH AND CASH EQUIVALENTS- BEGINNING OF PERIOD	7,731	3,499
	-----	-----
CASH AND CASH EQUIVALENTS - END OF PERIOD	\$5,529	\$6,495
	=====	=====
INCOME TAXES PAID	\$ 3	\$ 536
	=====	=====
INTEREST PAID	\$ 15	\$ 13
	=====	=====

See Note to Condensed Consolidated Financial Statements.

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NOTE TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2002

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The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month and six-month periods ended June 30, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. The balance sheet at December 31, 2001 has been derived from the audited financial statements at that date. For further information, refer to the consolidated financial statements and footnotes thereto and the quarterly financial data included in the Company's Annual Report on Form 10-K for the year ended December 31, 2001.

Inventories (in thousands):

	June 30, 2002	December 31, 2001
	-----	-----
Finished and in process	\$3,249	\$3,455
Materials and purchased parts	1,730	2,227
	-----	-----
	\$4,979	\$5,682
	=====	=====

Other Non-Current Liabilities (in thousands):

	June 30 2002	December 31, 2001
	-----	-----
Accrued supplemental pension plan	\$ 526	\$ 511
Accrued deferred compensation	264	274
Deferred directors' fees	309	269
Accrued pension expense	646	658
Accrued post-retirement benefit	844	843
	-----	-----
	2,554	2,555
Less current portion	223	241
	-----	-----
	\$2,366	\$2,314
	=====	=====

Income Per Share

In computing basic earnings per share, the dilutive effect of stock options and warrants are excluded, whereas for dilutive earnings per share they are included.

Adoption of Financial Accounting Standard 142 ("FAS 142")

Effective January 1, 2002, the Company adopted FAS No. 142. Under FAS 142, goodwill is no longer amortized, rather it is subject to a periodic impairment test based on its fair value. The Company has performed the transitional goodwill impairment test (as of January 1, 2002) on its

6 applicable reporting units. As the estimated fair values of these reporting units exceeded their respective net book values, including goodwill, no impairment charge was recognized. If FAS 142 was effective as of January 1, 2001, then the pro forma results of operations for the periods ended June 30, 2001 would have been as follows (dollars in thousands):

As Reported Adjustment Pro Forma

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	-----	-----	-----
Three Months			
Pretax Income	\$ 87	\$83	\$170
	=====	====	=====
Net Income	\$ 29	\$76	\$105
	=====	====	=====
Earnings per share:			
Basic	\$.01		\$.02
	=====		=====
Diluted	\$.01		\$.02
	=====		=====
Six Months			
Pretax Income	\$ 50	\$166	\$216
	=====	====	=====
Net Income	\$ 35	\$152	\$187
	=====	====	=====
Earnings per share:			
Basic	\$.01		\$.03
	=====		=====
Diluted	\$.01		\$.03
	=====		=====

Operations by Industry Segments and Geographic Areas:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2002	2001	2002	2001
	----	----	----	----
Net Sales				
United States	\$2,033	\$4,144	\$ 3,590	\$ 7,243
Europe	1,323	1,704	2,908	3,544
Intercompany eliminations	-----	-----	-----	-----
	\$3,356	\$5,848	\$ 6,498	\$10,787
	=====	=====	=====	=====
Operating Profit (Loss)				
United States	\$ (537)	\$ 447	\$ (1,505)	\$ 530
Europe	(58)	(177)	(44)	(187)
Intercompany eliminations	3	3	6	6
	-----	-----	-----	-----
	(592)	273	(1,543)	349
General Corporate Expense	340	327	689	609
Other (income), net	(43)	(141)	(92)	(310)
	-----	-----	-----	-----
Income (loss) before income taxes	\$ (889)	\$ 87	\$ (2,140)	\$ 50
	=====	=====	=====	=====
Total Assets				
United States			\$25,135	\$27,327
Europe			2,477	3,229
Intercompany eliminations			(19)	(38)
			-----	-----
			\$27,593	\$30,518
			=====	=====

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Item 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

Net loss was \$615,000 and \$1,429,000, respectively, for the three and six-month periods ended June 30, 2002 versus net income of \$58,000 and

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\$35,000, respectively, in the prior year periods.

Consolidated sales for the quarter ended June 30, 2002 decreased \$2.5 million (43%) to \$3.4 million primarily due to sales decreases in the domestic operations of \$2.1 million (51%) due to the continuing reduction in infrastructure buildout, particularly by CLECs and reduction in capital expenditures by major telecommunication providers as previously noted by the Company. Sales of the Company's UK distributorship operations decreased \$.4 million (22%) due to lower volume to its largest customer. Consolidated sales for the six months ended June 30, 2002 decreased \$4.3 million (40%) primarily due to a sales decrease of \$3.7 million (50%) in the domestic operations and a decrease of \$.6 million (18%) in its UK distributorship operations due to the reasons stated above.

Gross margin percentage was 44% for the three months and 41% for the six months ended June 30, 2002 and 49% and 48%, respectively, in the comparable 2001 periods. The three and six-month periods ended June 30, 2002 versus the prior year periods were adversely impacted by lower sales and the concomitant lower absorption of fixed costs offset, in part, by favorable product mix in the US operations.

Research and development expenses increased \$129,000 (8%) in the six-month period ended June 30, 2002 versus the comparable period in 2001 primarily due to higher consultancy expenses.

Other (income) decreased due to lower interest earned on cash balances and marketable securities due to lower interest rates.

The Company's effective tax rate for the three and six-month periods ended June 30, 2002 were 31% and 33%, respectively, versus 33% and 30%, respectively, for the 2001 periods.

Subsequent to June 30, 2002, the Company instituted cost reduction programs. In the quarter ending September 30, 2002 the Company will incur severance expense of approximately \$110,000, reduce consultancy expense and reduce the work week for certain positions. These steps, once implemented, will reduce quarterly expenses by approximately \$250,000. In addition, the Company is continuing to review all expenses to determine where further reductions can be made.

Liquidity and Sources of Capital

Net cash used by operations for the six months ended June 30, 2002 was \$575,000 primarily due to loss from operations versus net cash provided of \$4.1 million in 2001. The cash used by investing activities in 2002 primarily reflects the net increase in marketable securities and purchase of property, plant and equipment. In 2001, the net cash provided by investing activities reflects a net decrease in marketable securities offset, in part, by purchases of property plant and equipment and software licenses and employee loans. The net cash used for financing activities in 2002 primarily represents scheduled paydown of debt and in 2001 primarily

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reflects the repurchase of shares for treasury.

Working capital and the ratio of current assets to current liabilities were \$21.6 million and 8.3:1 at June 30, 2002 compared to \$22.8 million and 9.6:1 at December 31, 2001. The decrease in working capital in 2002 is mainly due to the results of operations.

During the remainder of 2002, the Company may repurchase up to an additional 253,792 shares of its common stock and anticipates purchasing \$.2 million of equipment. Management believes that its cash and cash equivalents,

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marketable securities and the cash flow from operations in 2002 will be sufficient to meet these needs.

Certain Factors That May Affect Future Results

From time to time, information provided by the Company, statements made by its employees or information included in its filings with the Securities and Exchange Commission (including this Form 10-Q) may contain statements which are not historical facts, so-called "forward-looking statements". These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The Company's actual future results may differ significantly from those stated in any forward-looking statements. Forward-looking statements involve a number of risks and uncertainties, including, but not limited to, variability of sales volume quarter to quarter, product demand, pricing, market acceptance, litigation, risk of dependence on significant customers and third party suppliers, intellectual property rights, risks in product and technology development and other risk factors detailed in this Quarterly Report on Form 10-Q and in the Company's other Securities and Exchange Commission filings.

Item 3. Market Risk

The Company does not use derivative financial instruments. The Company has Marketable Securities, which are exposed to changes in interest rates. Due to the term of these securities and/or their variable rate provisions, a change in interest rates would not have a material impact on their value.

Exchange rate fluctuations will impact the results of operations and the net assets of the Company's UK distributorship operations. At June 30, 2002, the UK distributorship operations had net assets of \$1.3 million. The Company does not hedge this foreign currency net asset exposure.

PART II

Item 4. Submission of Matters to a Vote of Security Holders

- (a) The Registrant's Annual Meeting of Stockholders was held on May 9, 2002.

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- (c) The following matters were voted upon by stockholders:

	For	Withheld or Against	Abstain	Broker Non-votes
1. Election of six Directors -				
John T. Connors	4,543,066	276,009		222,018
Edward S. Davis	4,537,542	281,533		222,018
Brian J. Kelley	4,507,116	311,959		222,018
Jack Meehan	4,541,761	277,314		222,018

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William A. Merritt	4,538,992	280,083		222,018
William J. Stuart	4,544,416	274,659		222,018
2. To approve a proposal to amend the Company's 1990 Stock Option Plan	4,346,626	456,223	17,301	222,018
3. To approve a proposal to amend the Company's Restricted Stock Plan	4,365,629	437,820	16,701	222,018
4. To approve the selection of Ernst & Young LLP as independent auditors	4,761,908	46,367	11,875	222,018

Item 6. Exhibits and reports on Form 8-K

(a) Index to Exhibits

Exhibit

- 10.1 1990 Stock Option Plan, as amended (attached as Exhibit 10.1 to this Quarterly Report on Form 10-Q).
- 10.2 Cognitronics Corporation Restricted Stock Plan, as amended (attached as Exhibit 10.2 to this Quarterly Report on Form 10-Q).
- 99.1 Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) No reports on Form 8-K were filed during the current quarter.

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SIGNATURE

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.

COGNITRONICS CORPORATION
Registrant

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Date: August 14, 2002

By /s/ Garrett Sullivan
Garrett Sullivan, Treasurer
and Chief Financial Officer