

VERAMARK TECHNOLOGIES INC

Form 10-Q

August 11, 2006

**Table of Contents**

**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 June 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**

NO

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.

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**

Accelerated filer  Non-accelerated filer

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

NO

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

**Table of Contents****INDEX**

	Page
<b><u>PART I</u></b>	
<b><u>FINANCIAL INFORMATION</u></b>	
Item 1	
Financial Statements	
<u>Condensed Balance Sheets -</u> <u>June 30, 2006 (Unaudited) and December 31, 2005</u>	3 - 4
<u>Condensed Statements of Operations (Unaudited)</u> <u>Three and Six Months Ended June 30, 2006 and 2005</u>	5
<u>Condensed Statements of Cash Flows (Unaudited)</u> <u>Six Months Ended June 30, 2006 and 2005</u>	6 - 7
<u>Notes To Condensed Financial Statements (Unaudited)</u>	8 - 12
Item 2	
<u>Management's Discussion and Analysis of</u> <u>Financial Condition and Results of Operations</u>	12 - 20
Item 3	
<u>Quantative and Qualitative Disclosures About Market Risk</u>	20
Item 4	
<u>Controls and Procedures</u>	20 - 21
<b><u>PART II</u></b>	
<b><u>OTHER INFORMATION</u></b>	
Item 4	
<u>Submission of Matters to a Vote of Security Holders</u>	21
Item 5	
<u>Certification of Chief Executive Officer and Chief Accounting Officer</u>	21
Item 6	
<u>Exhibits</u>	22
<u>Officers' Certifications and Signatures</u>	23 - 27
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	
<u>EX-32.2</u>	

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

	(Unaudited) June 30, 2006	December 31, 2005
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 921,653	\$ 911,310
Investments	709,949	600,324
Accounts receivable, trade (net of allowance for doubtful accounts of \$30,000 and \$32,000, respectively)	1,177,590	1,522,190
Inventories, net	49,869	31,724
Prepaid expenses and other current assets	231,623	161,127
Total Current Assets	3,090,684	3,226,675
<b>PROPERTY AND EQUIPMENT</b>		
Cost	5,844,023	5,796,427
Less accumulated depreciation	(5,129,050)	(5,025,761)
Property and Equipment (Net)	714,973	770,666
<b>OTHER ASSETS:</b>		
Software development costs (net of accumulated amortization of \$2,870,922 and \$2,373,896, respectively)	3,019,105	2,826,644
Pension assets	2,574,082	2,501,636
Deposits and other assets	789,534	797,745
Total Other Assets	6,382,721	6,126,025
<b>TOTAL ASSETS</b>	<b>\$ 10,188,378</b>	<b>\$ 10,123,366</b>

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

**Table of Contents**

**VERAMARK TECHNOLOGIES, INC.  
CONDENSED BALANCE SHEETS**

	<b>(Unaudited) June 30, 2006</b>	<b>December 31, 2005</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 187,370	\$ 275,756
Accrued compensation and related taxes	544,598	565,096
Deferred revenue	3,113,083	2,936,466
Other accrued liabilities	132,324	135,430
<b>Total Current Liabilities</b>	<b>3,977,375</b>	<b>3,912,748</b>
Pension obligation	4,671,237	4,424,304
<b>Total Liabilities</b>	<b>8,648,612</b>	<b>8,337,052</b>
<b>STOCKHOLDERS EQUITY:</b>		
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	21,709,524	21,686,152
Accumulated deficit	(20,677,924)	(20,413,395)
Treasury stock (80,225 shares, at cost)	(385,757)	(385,757)
Accumulated other comprehensive income	1,173	7,530
<b>Total Stockholders Equity</b>	<b>1,539,766</b>	<b>1,786,314</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 10,188,378</b>	<b>\$ 10,123,366</b>

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

**Table of Contents**

**VERAMARK TECHNOLOGIES, INC.**  
**CONDENSED STATEMENTS OF OPERATIONS (Unaudited)**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>NET SALES</b>				
Product sales	\$ 829,043	\$ 880,053	\$ 1,568,687	\$ 1,834,636
Service sales	1,777,238	1,781,303	3,481,790	3,453,092
<b>Total Net Sales</b>	<b>2,606,281</b>	<b>2,661,356</b>	<b>5,050,477</b>	<b>5,287,728</b>
<b>COSTS AND OPERATING EXPENSES:</b>				
Cost of sales	574,093	439,884	1,098,432	879,935
Engineering and software development	198,301	178,995	351,010	480,787
Selling, general and administrative	2,048,755	1,797,889	3,881,394	3,768,996
<b>Total Costs and Operating Expenses</b>	<b>2,821,149</b>	<b>2,416,768</b>	<b>5,330,836</b>	<b>5,129,718</b>
<b>INCOME (LOSS) FROM OPERATIONS</b>	<b>(214,868)</b>	<b>244,588</b>	<b>(280,359)</b>	<b>158,010</b>
<b>INTEREST INCOME</b>	<b>7,816</b>	<b>5,135</b>	<b>15,830</b>	<b>6,427</b>
<b>INCOME (LOSS) BEFORE INCOME TAXES</b>	<b>(207,052)</b>	<b>249,723</b>	<b>(264,529)</b>	<b>164,437</b>
<b>INCOME TAXES</b>				
<b>NET INCOME (LOSS)</b>	<b>\$ (207,052)</b>	<b>\$ 249,723</b>	<b>\$ (264,529)</b>	<b>\$ 164,437</b>
<b>NET INCOME (LOSS) PER SHARE</b>				
Basic	\$ (0.02)	\$ 0.03	\$ (0.03)	\$ 0.02
Diluted	\$ (0.02)	\$ 0.03	\$ (0.03)	\$ 0.02

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

**Table of Contents**

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

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>OPERATING ACTIVITIES:</b>		
Net Income (loss)	\$ (264,529)	\$ 164,437
Adjustments to reconcile net income (loss) to net cash flows provided by operating activities:		
Depreciation and amortization	630,749	537,725
Expense (recovery) of bad debts	(1,506)	(5,776)
Compensation expense-stock options (net of forfeitures)	18,700	(98,039)
Increase in cash surrender value of company-owned life insurance policies	(72,446)	(70,985)
Realized (gain) loss on sale of investments	(1,356)	1,191
Changes in assets and liabilities		
Accounts receivable	346,106	(101,402)
Inventories	(18,145)	(9,985)
Prepaid expenses and other current assets	(70,496)	(26,480)
Deposits and other assets	8,211	
Accounts payable	(88,386)	(63,537)
Accrued compensation and related taxes	(20,498)	(108,573)
Deferred revenue	176,617	100,621
Other accrued liabilities	(3,106)	(9,695)
Pension obligation	246,933	321,935
Net cash flows provided by operating activities:	886,848	631,437
<b>INVESTING ACTIVITIES:</b>		
Purchase of investments	(114,626)	(5,963)
Capitalized software development costs	(689,486)	(656,619)
Additions to property and equipment	(78,031)	(49,417)
Net cash flows used by investing activities:	(882,143)	(711,999)
<b>FINANCING ACTIVITY:</b>		
Exercise of stock options	932	47,461
Proceeds from employee stock purchase plan	4,706	
Net cash flows provided by financing activities:	5,638	47,461
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>10,343</b>	<b>(33,101)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>911,310</b>	<b>722,020</b>

CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 921,653	\$ 688,919
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**Table of Contents**

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Cash Transactions:		
Income taxes paid (received), net	\$ 4,500	\$ (3,000)
Interest paid	\$ 144	\$ 9
<i>The accompanying notes are an integral part of these financial statements.</i>		

7

**Table of Contents****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 June 30, 2006, the results of its operations for the three and six months ended June 30, 2006 and 2005, and cash flows for the six months ended June 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 six months ended June 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 June 30, 2006, and December 31, 2005 were:

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
Machinery and equipment	\$ 798,603	\$ 794,314
Computer hardware and software	1,998,912	1,991,877
Furniture and fixtures	1,663,949	1,627,677
Leasehold improvements	1,382,559	1,382,559
	<b>\$ 5,844,023</b>	<b>\$ 5,796,427</b>

For the three and six months ended June 30, 2006, the Company recorded depreciation expense of \$66,530 and \$133,724. Depreciation expense for the three and six months ended June 30, 2005 were \$67,444 and \$135,199.

**(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 \$18,700 to operating expenses for the six months ended June 30, 2006.

**Table of Contents**

For the three and six months ended June 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:

		<b>Three Months Ended June 30, 2005</b>	<b>Six Months Ended June 30, 2005</b>
Net Income	As reported	\$ 249,723	\$ 164,437
Add: total stock-based compensation expense included in net income, net of forfeitures and tax effects		(102,082)	(98,039)
Deduct: total stock-based compensation expense determined under fair value, net of forfeitures and related tax effects		(460)	(36,006)
	Pro forma	\$ 147,181	\$ 30,392
Net loss per common share	As reported		
	Basic	\$ 0.03	\$ 0.02
	Diluted	\$ 0.03	\$ 0.02
	Pro forma		
	Basic	\$ 0.02	\$ 0.00
	Diluted	\$ 0.02	\$ 0.00

Currently, the Company's primary type of share-based compensation consists of stock options, generally vesting over four years. For the six months ended June 30, 2006 and 2005, the company did not issue any stock options.

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

	Shares	Weighted Average Exercise Price	Weighted 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					
Exercised	(1,750)	0.53			(170)
Canceled	(102,400)	2.45			(44,175)
Outstanding as of June 30, 2006	2,760,878	\$ 2.37	\$ 1.93	3.8	\$ 1,154,629
Options exercisable at June 30, 2006	2,689,903	\$ 2.41	\$ 1.96	3.7	\$ 1,145,555



**Table of Contents**

As of June 30, 2006, there was \$28,702 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 six months ended June 30, 2006 and 2005 was as follows:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net Income (loss)	\$ (207,052)	\$ 249,723	\$ (264,529)	\$ 164,437
Accumulated other comprehensive income (loss)	(4,232)	3,835	(6,357)	5,372
Total comprehensive Income (loss)	\$ (211,284)	\$ 253,558	\$ 270,886	\$ 169,809

**(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.

**Table of Contents****Calculations of Earnings (Loss) Per Share**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Basic</b>				
Net Income (loss)	\$ (207,052)	\$ 249,723	\$ (264,529)	\$ 164,437
Weighted average common shares outstanding	8,839,452	8,731,852	8,838,913	8,702,925
Net Income (loss) per common share	\$ (0.02)	\$ 0.03	\$ (0.03)	\$ 0.02
<b>Diluted</b>				
Net Income (loss)	\$ (207,052)	\$ 249,723	\$ (264,529)	\$ 164,437
Weighted average common shares outstanding	8,839,452	8,731,852	8,838,913	8,702,925
Additional dilutive effect of stock options and warrants after application of treasury stock method		635,728		758,647
Weighted average dilutive shares outstanding	8,839,452	9,367,580	8,838,913	9,461,572
Net Income (loss) per common share assuming full dilution	\$ (0.02)	\$ 0.03	\$ (0.03)	\$ 0.02

There were no dilutive effects of stock options in 2006 as the effect would have been anti-dilutive due to the net losses incurred.

**(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 June 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 six months ended June 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

**Table of Contents**

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Current Service Cost	\$ 69,503	\$ 114,244	\$ 139,006	\$ 228,492
Amortization of Prior Service Cost	22,123	22,650	44,246	45,300
Interest Cost	73,374	65,605	146,748	131,210
Pension Expense	\$ 165,000	\$ 202,499	\$ 330,000	\$ 405,002

The Company paid pension obligations of \$83,067 for both the six months ended June 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 June 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 \$2,574,000 at June 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 words having 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**

For the three month ended June 30, 2006 sales of \$2,606,000 compared with sales of \$2,661,000 for the three months ended June 30, 2005. For the six months ended June 30, 2006 sales of \$5,050,000 compared with sales of \$5,288,000 for the first six months of 2005. The company's net loss for the three months ended June 30, 2006 was \$207,000, or \$0.02 per share. For the three months ended June 30, 2005 we had reported a net income of

**Table of Contents**

\$250,000, or \$0.03 per diluted share. For the first six months of 2006 the net loss incurred of \$265,000, or \$0.03 per share, compares with a net income of \$164,000, or \$0.02 per diluted share for the same six months of 2005. Despite slightly lower sales and the net loss incurred for the six months ended June 30, 2006 we continue to move forward with adding to our sales and marketing capabilities, a process we feel essential to improving future sales levels. Since March of this year we have added eight new people to our Sales and Marketing team, including a Director of Business Marketing and a Director of International Business Development. We will continue to actively recruit additional sales people as we move into the third quarter.

Orders booked for the three months ended June 30, 2006 were \$2,625,000 bringing total orders for the first six months of 2006 to \$5,268,000, an increase of 5% from orders of \$5,043,000 for the first six months of 2005. Most encouraging were the increases in order rates for our three major product and service categories. For the first six months of 2006 as compared with the first six months of 2005 eCAS orders increased 9%, VeraSMART orders increased 35% and orders generated from our Outsourced Solutions Group increased 28%. Offsetting these increases however, was a 40% reduction in orders for Quantum maintenance and support contracts for the first six months of 2006 versus 2005. New sales of Quantum, VeraSMART's predecessor product in the enterprise level space, were discontinued in April 2003 coinciding with the initial release of the VeraSMART platform. We have continued to offer maintenance and support services to Quantum customers since that date, but those services are now in the process of being phased out. No further support for the Quantum Series will be offered beyond December 31, 2007.

**Sales**

Sales of eCAS licenses and services which had been less than anticipated for the first quarter of 2006 increased 14% for the three months ended June 30, 2006 from the same three months of 2005. For the six months ended June 30, 2006 sales of eCAS licenses and services are 1% higher than for the first six months of 2005. The higher eCAS sales are attributable to an increase in direct sales to Avaya, Inc. which increased 31% and 2% respectively, for the three and six months ended June 30, 2006 as compared with the same three and six month periods of 2005.

Sales of VeraSMART, our enterprise level product decreased 1% for the three months ended June 30, 2006 from the same quarter of 2005. However, sales of VeraSMART have increased 10% for the six months ended June 30, 2006 from the same six months of 2005. During the second quarter Veramark received an order valued in excess of \$120,000 from a leading provider of healthcare products and services to deploy the VeraSMART solution for 20,000 extensions at twenty-three sites on voice networks comprising both VoIP and traditional telephone switches.

Installation of this order was completed in July 2006, therefore the licensing and installation revenue will be recognized during the third quarter of this year. Overall quote activity for VeraSMART has been strong and several potential contracts are currently in the active negotiation stage.

Revenues generated from our Outsourced Solutions Group increased 8% for the three months ended June 30, 2006 and 2% for the six months ended June 30, 2006 from the same periods a year ago. During the second quarter we added Coca-Cola Bottling to our list of outsourced solutions customers. Coca-Cola Bottling joins clients such as Sony Corporation of America, Lockheed Martin St Paul/Travelers Insurance, Cincinnati Bell, and Tech Data Corporation as Veramark customers. Veramark's ASP (Application Service Provider) model allows our customers easy web access to the full functionality of the VeraSMART suite of applications including Call Accounting, Allocation, Invoice Management, Online Directory and Work Order: without the need to install, host, and maintain a premise based solution. Coca-Cola Bottling will utilize our services



**Table of Contents**

primarily for security reporting at seven sites. The initial term of the contract is three years, with implementation expected to take place in the third quarter.

**Cost of Sales**

Gross margins (sales minus cost of sales) of \$2,032,000 and \$3,952,000 the three and six months ended June 30, 2006 represented 78% of sales. For the three and six months ended June 30, 2005 gross margins were \$2,222,000 and \$4,408,000, or 83% of sales for both periods. The lower margins result from an increase in direct product costs, in addition to higher amortization costs associated with previously capitalized software development efforts. Amortization costs charged to cost of sales will decrease in the fourth quarter of this year at which time the development costs of the eCAS product line will have been fully amortized.

**Operating Expenses**

Engineering and Software Development expenses, net of the effects of capitalization, totaled \$198,000 for the three months ended June 30, 2006, an increase of 11% from the net engineering and software development expenses of \$179,000 for the three months ended June 30, 2005. For the six months ended June 30, 2006, net engineering and software development expenses of \$351,000 were 27% lower than the net expenses of \$481,000 incurred for the first six months of 2005. The chart below summarizes gross engineering and software development expenses, developments costs capitalized, and the resulting net expense recognized in the Statements of Operations for the three and six months ended June 30, 2006 and 2005.

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Gross expenditures for engineering & software development	\$ 514,000	\$ 555,000	\$ 1,040,000	\$ 1,137,000
Less: Software development costs capitalized	(316,000)	(376,000)	(689,000)	(656,000)
Net expense for engineering and software	\$ 198,000	\$ 179,000	\$ 351,000	\$ 481,000

Amortization costs associated with previously capitalized software efforts totaled \$249,000 and \$497,000 for the three and six months ended June 30, 2006 as compared with \$201,000 and \$403,000 for the three and six months ended June 30, 2005.

Current development efforts continue on the next release of VeraSMART which will be a fully integrated Assets and Inventory module scheduled for a fourth quarter 2006 release.

Selling, general and administrative (SG&A) expenses increased for both the three and six months ended June 30, 2006, a direct result of the bolstering of our sales and marketing functions as noted in the overview section above. For the three months ended June 30, 2006 SG&A expense of \$2,049,000 increased 14% from expenses of \$1,798,000 for the three months ended June 30, 2005. SG&A expenses of \$3,881,000 for the six months ended June 30, 2006 increased 3% from expenses of \$3,769,000 for the same period of 2005. The higher spending levels will continue for the balance of 2006 due to the additional salary, benefit, and travel expenses associated with the additional staff members.

**Table of Contents**

**Liquidity and Capital Resources**

For the three months ended June 30, 2006 we generated a positive cash flow of \$195,000. Total cash, consisting of cash in the bank and the value of short term investments totaled \$1,631,000 at June 30, 2006, up from \$1,436,000 at March 31, 2006 and \$1,512,000 at December 31, 2005. The increased second quarter cash flows reflect a \$404,000 reduction in accounts receivable from the March 31, 2006 balance.

Accounts receivable were reduced from \$1,582,000 at March 31, 2006 to \$1,178,000 at June 30, 2006, a reduction of 26%. As a result, the reserve for bad debts was has been reduced to \$30,000 as compared to \$43,000 at March 31 2006 and \$32,000 at December 31, 2005.

Inventories of \$50,000 at June 30, 2006 have increased from \$32,000 at December 31, 2005. The Company maintains a stock of pollable storage devices utilized in multi-site applications to collect and store customer call records. These units are generally ordered as required, though a small stocking level is maintained. Though inventory balance will fluctuate from quarter to quarter, no significant long term inventory investment is required.

Prepaid expenses have increased from \$161,000 at December 31, 2005 to \$232,000 at June 30, 2006. The increase reflects primarily business insurance renewals during the first half of 2006, the economic benefit of which will extend through December 31, 2006.

Spending for capital equipment for the first six months of 2006 totaled \$78,000, up from \$49,000 for the first six months of 2005. Major 2006 expenditures included an upgrade to our telephone and voicemail systems, and the purchase computer hardware utilized throughout various departments within the company.

During the second quarter of 2006 we capitalized \$316,000 of software development costs and amortized \$249,000 of development costs capitalized in prior periods. For the first six months of 2006 we have capitalized \$689,000 of development efforts versus the amortization of \$497,000. Total cost capitalized and carried on the Company's balance sheet total \$3,019,000 at June 30, 2006, an increase of 7% from the December 31, 2005 total of \$2,827,000.

Pension assets which consist of the cash surrender value of company owned life insurance policies designed to fund future pension obligations total \$2,574,000 at June 30, 2006. At December 31, 2005 the cash values of these policies was \$2,502,000. The cash values associated with these policies are available to fund current operations if that should become necessary, though management does not envision that need in the near future.

Current liabilities of \$3,977,000 at June 30, 2006 have increased \$64,000, or 2% from the December 31, 2005 balance of \$3,913,000 due to an increase in deferred revenues of \$177,000. Deferred revenues consist of services such as training, installation, and maintenance and support contracts for which we have billed customers, but have not yet performed the contracted services, and therefore have not yet recognized the revenue associated with those activities. Essentially all of the currently deferred revenues are expected to be recognized as revenue over the next twelve months. The increase in deferred revenues has been partially offset by reductions in accounts payable and accrued compensation costs at June 30, 2006 versus the balances at December 31, 2005.

**Table of Contents**

Stockholders equity at June 30, 2006 of \$1,540,000 decreased from \$1,786,000 at December 31, 2005 reflecting the net loss of \$265,000 incurred for the first six months of the year. During June employees of the company purchased 7,908 share of company stock through our employee stock purchase plan for a total of \$4,700.

It is managements opinion, that in light of our current cash and investment position , the access to the cash surrender values of company owned insurance policies if required, and the absence of debt, that we have more than sufficient resources 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

**Table of Contents**

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 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.

**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

**Table of Contents**

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.

## **Table of Contents**

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 service bureau outsourced 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

**Table of Contents**

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 intensive 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.

**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

**Table of Contents**

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.

**PART II OTHER INFORMATION*****Item 4: Submission of Matters to a Vote of Security Holders***

The 2006 Annual Meeting of stockholders was held on May 1, 2006. The following matters were voted upon and received the votes set forth below:

A. **Election of Directors.** The individuals named below were re-elected to serve as members of the Board of Directors of the Company to serve until the next annual meeting of stockholders and until their successors shall have been elected and qualified:

Director	Votes Cast	
	For	Withheld Authority
Charles A. Constantino	7,899,551	521,329
John E. Gould	7,892,551	528,329
Andrew W. Moylan	7,883,051	537,829
David G. Mazzella	7,837,827	583,053
William J. Reilly	7,883,051	537,829

B. **Ratification of the appointment of independent auditors for the year ending December 31, 2006.** At the meeting the following votes and abstentions were cast with respect to the ratification of the appointment of Rotenberg & Co., LLP as independent auditors for the year ending December 31, 2006:

For:	8,127,508
Against:	24,972
Abstain	268,400

***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.



**Table of Contents**

***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 six months ended June 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.

**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: August 11, 2006

/s/ David G. Mazzella

David G. Mazzella

President and CEO

Date: August 11, 2006

/s/ Ronald C. Lundy

Ronald C. Lundy

Treasurer (Chief Accounting Officer)