

VERAMARK TECHNOLOGIES INC

Form 10-Q

May 14, 2012

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**FORM 10-Q**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

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

.. **Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**  
**For Quarter Ended March 31, 2012**

Commission File Number 0-13898

**Veramark Technologies, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of

Incorporation or Organization)

1565 Jefferson Road, Suite 120 Rochester, NY 14623

(Address of principal executive offices)(Zip Code)

(585) 381-6000

**16-1192368**  
(IRS Employer

Identification Number)

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(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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

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 on March 31, 2012 was 10,616,771.

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

	(Unaudited)	
	March 31, 2012	December 31, 2011
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 669,695	\$ 679,405
Investments	120,005	161,949
Accounts receivable, trade (net of allowance for doubtful accounts of \$35,000 for both periods)	1,914,318	1,711,171
Prepaid expenses	543,327	434,357
Other current assets	823,536	873,975
<b>Total Current Assets</b>	<b>4,070,881</b>	<b>3,860,857</b>
<b>PROPERTY AND EQUIPMENT</b>		
Cost	2,626,095	2,601,535
Less accumulated depreciation	(2,066,567)	(2,033,766)
<b>Property and Equipment (net)</b>	<b>559,528</b>	<b>567,769</b>
<b>OTHER ASSETS:</b>		
Software development costs (net of accumulated amortization of \$2,115,904 and \$1,892,938)	2,682,468	2,736,572
Pension assets	3,336,523	3,320,073
Intangibles, net	518,750	563,000
Goodwill	336,219	336,219
Deposits and other assets	1,120,839	1,121,738
<b>Total Other Assets</b>	<b>7,994,799</b>	<b>8,077,602</b>
<b>TOTAL ASSETS</b>	<b>\$ 12,625,208</b>	<b>\$ 12,506,228</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 282,233	\$ 300,878
Accrued compensation	855,127	740,947
Deferred revenue	4,472,148	4,276,071
Current portion of pension obligation	552,310	538,159
Contingent liability	0	140,828
Short term debt	316,667	316,667
Other accrued liabilities	936,419	992,052
<b>Total Current Liabilities</b>	<b>7,414,904</b>	<b>7,305,602</b>
Long-Term debt	38,888	55,555
Long-Term portion of pension obligation	5,454,865	5,534,531
Other long-term liabilities	101,807	103,237
<b>Total Liabilities</b>	<b>13,010,464</b>	<b>12,998,925</b>
<b>STOCKHOLDERS EQUITY:</b>		
Common Stock, par value \$.10; shares authorized, 40,000,000; 10,696,996 shares issued	1,069,699	1,069,699
Additional paid-in capital	22,935,709	22,906,932
Accumulated deficit	(24,010,743)	(24,091,174)

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Treasury stock (80,225 shares, at cost)	(385,757)	(385,757)
Accumulated other comprehensive income	5,836	7,603
Total Stockholders Equity	(385,256)	(492,697)
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 12,625,208	\$ 12,506,228

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

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
<b>NET REVENUES</b>		
Product revenues	\$ 380,174	\$ 374,571
Service revenues	3,225,115	3,011,752
Total Net Revenues	3,605,289	3,386,323
<b>COSTS AND OPERATING EXPENSES:</b>		
Cost of revenues	1,546,222	1,368,568
Engineering and software development	292,827	307,627
Selling, general and administrative	1,701,499	1,538,180
Litigation expenses & settlement costs	0	139,058
Total Costs and Operating Expenses	3,540,548	3,353,433
<b>INCOME FROM OPERATIONS</b>	<b>64,741</b>	<b>32,890</b>
<b>NET INTEREST INCOME</b>	<b>15,691</b>	<b>20,072</b>
<b>INCOME BEFORE TAXES</b>	<b>80,432</b>	<b>52,962</b>
<b>INCOME TAXES</b>	<b>0</b>	<b>0</b>
<b>NET INCOME</b>	<b>\$ 80,432</b>	<b>\$ 52,962</b>
<b>NET INCOME PER SHARE</b>		
Basic	\$ 0.01	\$ 0.01
Diluted	\$ 0.01	\$ 0.01

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

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

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
Net Income	\$ 80,432	\$ 52,962
Unrealized Change - Investments, net of tax	(1,767)	(4,844)
Total Comprehensive Income	\$ 78,665	\$ 48,118

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

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

	Three Months Ended March 31,	
	2012	2011
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 80,432	\$ 52,962
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	316,015	367,318
Change in acquisition liabilities	0	18,700
Compensation expense - equity grants	28,777	22,015
Changes in assets and liabilities:		
Accounts receivable	(203,147)	(67,869)
Prepaid expenses and other current assets	(108,970)	(429,231)
Pension assets	(16,450)	(3,789)
Deposits and other assets	51,338	0
Accounts payable	(18,645)	32,447
Accrued compensation and related taxes	114,180	(107,103)
Deferred revenue	196,077	132,476
Other accrued liabilities	(55,633)	358,373
Prepaid rent liability	(1,432)	55,193
Pension obligation	(65,515)	(65,514)
Net cash provided by operating activities	317,027	365,978
<b>INVESTING ACTIVITIES:</b>		
Acquisition of Source Loop	(140,828)	(300,000)
Sale of investments	40,177	19,626
Additions to property and equipment	(40,558)	(68,109)
Capitalized software development costs	(168,862)	(179,376)
Net cash flows used by investing activities	(310,071)	(527,859)
<b>FINANCING ACTIVITY:</b>		
Borrowing (repayment) - line of credit	0	(180,000)
Bank borrowing - repayment of term loan	(16,666)	(16,667)
Exercise of stock options	0	640
Net cash used by financing activities	(16,666)	(196,027)
Net change in cash and cash equivalents	(9,710)	(357,908)
Cash and cash equivalents, beginning of year	679,405	1,236,375
Cash and cash equivalents, end of quarter	\$ 669,695	\$ 878,467
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Income taxes paid (refunded)	\$ (14,301)	\$ 800
Interest paid	\$ 1,329	\$ 3,309

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





**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 March 31, 2012, the results of its operations for the three months ended March 31, 2012 and 2011, and cash flows for the three months ended March 31, 2012 and 2011.

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, 2011.

The results of operations and cash flows for the three months ended March 31, 2012 are not necessarily indicative of the results to be expected for the full year's operation. Certain prior period amounts have been reclassified to conform to the current period presentation.

**(2) PROPERTY AND EQUIPMENT**

The major classifications of property and equipment at March 31, 2012, and December 31, 2011 were:

	<b>March 31, 2012</b>	<b>December 31, 2011</b>
Machinery and equipment	\$ 116,385	\$ 116,385
Computer hardware and software	1,320,095	1,301,043
Furniture and fixtures	1,189,615	1,184,107
	\$ 2,626,095	\$ 2,601,535

For the three months ended March 31, 2012 and 2011, the Company recorded depreciation expense of \$48,799 and \$53,186, respectively.

**(3) STOCK-BASED COMPENSATION**

The Company's share-based compensation consists of restricted stock and stock options, vesting over periods ranging from one to four years. For the three months ended March 31, 2012, the Company awarded 67,000 stock options vesting over four years. During the first three months of 2011, the Company awarded 169,375 stock options vesting over four years.

A summary of the status of the Company's stock option plan as of March 31, 2012, is presented below:

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	Shares	Weighted Average Exercise Price	Weighted Average Grant-Date Fair Value	Average Remaining Contractual Term (Yrs)	Intrinsic Value
Outstanding as of December 31, 2011	1,422,443	\$ 0.68	\$ 0.64	6.2	\$ 32,080
Granted	67,000	0.44	0.43		
Exercised					
Canceled	(19,250)	0.57			(1,460)
Outstanding as of March 31, 2012	1,470,193	\$ 0.67	\$ 0.63	6.2	\$ 30,620
Options exercisable at March 31, 2012	997,536	\$ 0.71	\$ 0.66	4.8	\$ 30,620

As of March 31, 2012, there was \$174,672 of total unrecognized compensation cost related to non-vested stock options granted under the Plan, and \$14,075 of unrecognized compensation cost related to non-vested restricted stock grants. The compensation cost for stock options will be recognized over a weighted-average period of 1.5 years. The compensation costs of restricted stock will be recognized over a weighted-average period of 0.7 years.

**(4) NET INCOME PER SHARE (EPS)**

ASC 260-10 Earnings Per Share requires the Company to calculate net income per share based on basic and diluted net income per share, as defined. Basic EPS excludes dilution and is computed by dividing net income 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 Per Share	
	Three Months Ended	
	2012	March 31, 2011
<b>Basic</b>		
Net Income	\$ 80,432	\$ 52,962
Weighted average common shares outstanding	10,616,771	10,092,860
Net Income per common share	\$ 0.01	\$ 0.01
<b>Diluted</b>		
Net Income	\$ 80,432	\$ 52,962
Weighted average common shares outstanding	10,616,771	10,092,860
Additional dilutive effect of stock options and warrants after application of treasury stock method	16,989	346,280
Weighted average dilutive shares outstanding	10,633,760	10,439,140
Net Income per common share assuming full dilution	\$ 0.01	\$ 0.01

**(5) INDEMNIFICATION OF CUSTOMERS**

Our agreements with customers generally require us to indemnify the customer against claims that our software infringes third party patent, copyright, trademark or other proprietary rights. Such indemnification obligations are generally limited in a variety of industry-standard respects, including our right to replace an infringing product. As of March 31, 2012 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.

**(6) 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. During the second quarter of 2012 the Company will contribute approximately \$31,000 to employee's 401(k) accounts. During the first quarter of 2011 the Company's contribution to employee 401(k) accounts totaled \$26,589.

The Company also sponsors an unfunded Supplemental Executive Retirement Program ( SERP ), which is a non-qualified plan that provides certain former employees, and one current employee defined pension benefits. Periodic pension expense for the three months ended March 31, 2012 and 2011 consisted of the following:

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	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2012</b>	<b>2011</b>
Interest Cost	60,000	60,000

The Company paid pension obligations of \$125,515 for both the three months ended March 31, 2012 and March 31, 2011.

The discount rate used in determining the actuarial present value of the projected benefit obligation was 4.5% for the three months ended March 31, 2012 and 5.0% for the three months ended March 31, 2011.

The Company maintains life insurance covering certain current and former 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 \$3,337,000 at March 31, 2012. The accumulated cash surrender values of these policies at December 31, 2011 was approximately \$3,320,000.

The projected pension benefits paid or expected to be paid under this plan are as follows, assuming retirement at age 65 and life expectancies based on IRS mortality tables:

<b>Period Ending December 31, Unless Stated Otherwise,</b>	
Q2 - Q4 2012	412,644
2013	558,660
2014	490,660
2015	449,060
2016	454,340
2017 - 2021	2,547,478

**Table of Contents****(7) INTANGIBLE ASSETS AND GOODWILL**

Under the purchase method of accounting, we allocated the fair value of the total consideration expected to be transferred, to the tangible and identifiable intangible assets acquired from Source Loop in June 2010, based on their estimated fair values on the date of acquisition. The fair values assigned to the identifiable intangible assets were based on estimates and assumptions determined by management. The table below summarizes the fair values assigned to the identifiable intangible assets by asset class at the time of acquisition, and the subsequent amortization through March 31, 2012 of those intangible assets.

## Amortization of Intangible Assets Acquired in Source Loop Acquisition

(In 000s except weighted avg life in years)

Intangible Asset Class	Weighted Avg Life Years	FMV at Acquisition Date	Current Year Amortization	Accumulated Amortization at 3/31/12	Net Value by Asset Class at 3/31/12
Customer Contracts	3	\$ 526	\$ 22	\$ 212	\$ 314
Customer Relationships	3	260	10	133	127
Key Employee Agreements	1	177	11	107	70
Other	1	30	1	22	8
<b>Sub-Total Intangibles Subject to Amortization</b>	<b>3</b>	<b>993</b>	<b>\$ 44</b>	<b>\$ 474</b>	<b>\$ 519</b>
Goodwill		336			
<b>Total Intangible Assets Acquired</b>		<b>\$ 1,329</b>			

## Expected Future Amortization

Intangible Asset Class	Q2-Q4 2012	2013	2014	2015	2016
Customer Contracts	\$ 66	\$ 67	\$ 60	\$ 51	\$ 42
Customer Relationships	32	31	25	19	15
Key Employee Agreements	31	39	0	0	0
Other	4	3	1	0	0
<b>Sub-Total Intangibles Subject to Amortization</b>	<b>\$ 133</b>	<b>\$ 140</b>	<b>\$ 86</b>	<b>\$ 70</b>	<b>\$ 57</b>

Goodwill represents the excess of the purchase price paid over the fair value of assets acquired. Goodwill is not amortized and is subject to an impairment test conducted in December of each year, or more frequently if a change in circumstances or the occurrence of events indicates that potential impairment exists. Through March 31, 2012, there has been no impairment of goodwill associated with the Source Loop acquisition.

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**(8) COMMITMENTS AND CONTINGENCIES**

On June 16, 2011 the Company entered into a Nonexclusive Patent License and settlement agreement relating to an action brought by Asentinel LLC, against Veramark, AnchorPoint - a division of MTS, and CASS Information Systems, alleging infringement of two patents held by Asentinel concerning systems and methods for identifying and processing billing exceptions in telecommunications invoices.

Material terms of the agreement included:

Asentinel waived all claims for damages for prior infringement and agreed not to make claims for future infringement of its patents.

The Company agreed to pay Asentinel \$500,000. Of that amount \$250,000 was paid upon execution of the agreement, and \$250,000 is payable without interest, on June 16, 2012, and is represented by the Company's promissory note.

The lawsuit was dismissed against the Company.

**(9) REVOLVING DEMAND NOTE AGREEMENT**

On October 31, 2008, Veramark Technologies, Inc. entered into a Revolving Demand Note Agreement (the Agreement), with Manufacturers and Traders Trust Company (the Bank) to provide working capital in the ordinary course of business. This Agreement was amended in October 2010 increasing the amount available under the agreement from \$400,000 to \$750,000. At March 31, 2012, the Company did not have any outstanding balance under this Agreement.

The material terms of the Agreement include:

The maximum outstanding principal balance under the Agreement is Seven Hundred Fifty Thousand Dollars (\$750,000).

Veramark may borrow under the Agreement, from time to time, an amount less than or equal to, but not greater than the available balance.

The outstanding principal balance will bear interest at a per annum rate equal to LIBOR rate plus 3.5% with a minimum rate of 4.0%.

The Bank may demand payment of the outstanding principal balance at any time.

**(10) TERM NOTE AGREEMENT**

On October 29, 2010, the Company entered into an agreement with Manufacturers and Traders Trust Company to provide a three year term loan in the amount of \$200,000, the proceeds of which were used to purchase furnishings and fixtures for the Company's new headquarters facility. The loan bears an interest rate of LIBOR plus 4.0%, with a minimum interest rate of 4.5%. At March 31, 2012, the remaining balance of the term loan was \$105,555.

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

Management's Discussion and Analysis contains statements that are forward-looking. Such statements are identified by the use of words like plans, expects, intends, believes, will, anticipates, estimates and other words of 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**

Revenues of \$3,605,000 for our first quarter ended March 31, 2012 increased 6% from revenues of \$3,386,000 for the first quarter of 2011. Net income of \$80,000 for the quarter ended March 31, 2012 increased 51% from net income of \$53,000 for the first quarter of 2011, both representing \$0.01 per share.

Orders for the first quarter of 2012 of \$4.4 million increased 4% from \$4.2 million for the same quarter of 2011. Our backlog of recurring revenues increased to \$13.3 million at March 31, 2012 up 27% from \$10.4 million at March 31, 2011.

#### **Revenues**

The Company's revenues are earned by providing Telecom Expense Management (TEM) products and services, through the direct sale of licensed software, or under multi-year managed service contracts offered by means of Software as a Service. Our solutions allow enterprises to reduce operational expenses associated with their mobile and fixed communication networks and optimize network efficiency. For the quarter ended March 31, 2012 revenues generated from managed multi-year solutions increased 39% from the same quarter of 2011, while revenues derived from the sale of licensed software, including associated maintenance revenues and services, increased 4% from the same quarter of 2011.

#### **Gross Margin**

Gross margin (revenues less cost of revenues) of \$2,059,000, or 57% of revenues increased 2% from gross margin of \$2,018,000, or 60% of revenues for the first quarter of 2011. The decrease in gross margin, as a percentage of revenues from 2012 to 2011 results from an increasing percentage of revenues being earned from managed service contracts, which typically produce lower margins as a percentage of revenues as opposed to the sale of licensed software. Managed service contracts, however, yield a recurring revenue stream and generally produce higher revenues and margin dollars over the term of the associated contract.

#### **Engineering and Software Development Costs**

Engineering and software development expenses, net of the capitalization of software development costs, of \$293,000 for the quarter ended March 31, 2012 decreased 5% from net engineering and software development expenses of \$308,000 for the same quarter of 2011. Gross engineering and software development expenses, prior to the capitalization of development costs also decreased 5% from \$487,000 for the first quarter of 2011 to \$462,000 for the quarter ended March 31, 2012. The below chart summarizes gross expenses, amounts capitalized and the resulting expense charged to the Statement of Operations for the quarters ended March 31, 2012 and 2011.

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	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
Gross expenditures for engineering & software development	\$ 462,000	\$ 487,000
Less: Software development costs capitalized	(169,000)	(179,000)
<b>Net expense for engineering and software development</b>	<b>\$ 293,000</b>	<b>\$ 308,000</b>

**Selling, General, and Administrative Costs**

SG&A expenses of \$1,701,000 for the quarter ended March 31, 2012 increased 11% or \$163,000 from SG&A expenses of \$1,538,000 for the quarter ended March 31, 2011. The higher expense reflects increases in direct selling costs (\$93,000) resulting from an expansion of our sales force, and marketing costs (\$88,000), attributable to attending tradeshows and greater use of professional services. Those expenses were partially offset by a reduction in administrative expenses.

**Liquidity and Capital Resources**

Cash and short-term investments at March 31, 2012 totaled \$790,000, which compared to a balance of \$841,000 at December 31, 2011. During the first quarter of 2012 we paid \$148,000 in connection with the 2010 acquisition of Source Loop pursuant to the asset purchase agreement governing that transaction. That payment finalized all consideration related to that transaction and no further liability remains. The Company maintains a \$750,000 line of credit arrangement with a local bank, against which it had no outstanding balance at March 31, 2012.

Accounts receivable at March 31, 2012 of \$1,914,000 increased 12% from the December 31, 2011 balance of \$1,711,000. An analysis of customer payment patterns and the aging of the customer accounts determined that no increase was required in the bad debt reserve, which was \$35,000 at December 31, 2011.

Capital expenditures of \$41,000 for the first quarter of 2012 were \$27,000 less than the \$68,000 of capital expenditures made during the first quarter of 2011. Depreciation expense of \$49,000 for the quarter ended March 31, 2012 compared with depreciation expense of \$53,000 for the same quarter a year ago.

The value of capitalized development costs included in the Company's balance sheet at March 31, 2012 of \$2,682,000 decreased 2%, or \$55,000, from the balance of \$2,737,000 at December 31, 2011. During the first quarter of 2012 we capitalized \$169,000 of software development costs and amortized \$223,000 of previously capitalized costs. The amortization of development costs are charged to cost of revenues. A year ago, we capitalized \$179,000 of software development costs in the first quarter and recorded amortization of \$254,000.

Pension Assets, representing the accumulated cash surrender values of a series of company- owned life insurance policies designed to fund pension obligations, increased from \$3,320,000 at December 31, 2011 to \$3,337,000 at March 31, 2012. These cash surrender values can also be utilized to fund current operations if required.



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Intangible assets of \$519,000 at March 31, 2012 represent the remaining unamortized portion of the fair market values assigned to the assets acquired from Source Loop in 2010. Those assets and current carrying values are detailed in note 7 to the financial statements. We expect to amortize those assets at a rate of approximately \$44,000 per quarter for the balance of 2012.

Total current liabilities of \$7,415,000 at March 31, 2012 increased \$109,000 from the December 31, 2011 total of \$7,306,000 due to increases in accrued compensation costs and deferred revenues, partially offset by a decrease in the contingent liability payment associated with the Source Loop acquisition. The increase in accrued compensation relates primarily to the timing of Company payrolls and is expected to decline during the second quarter. Deferred revenues represent the portion of customer orders for services such as maintenance, training, consulting and installation and implementation services that will be performed in future periods and recognized as revenue at that time. A significant portion of the deferred revenues, which form a component of our recurring revenues referenced earlier, will be recognized as revenue over the next four quarters.

Other accrued liabilities of \$936,000 at March 31, 2012 include \$810,000 of payments to be made on behalf of clients who have selected the bill pay option of our TEM suite of services. This amount is offset by an identical balance in other current assets which represents the cash provided by those clients to make those payments.

Short term debt at March 31, 2012 of \$317,000 includes the current portion of a term loan with a local bank (\$66,667) and a note payable of \$250,000 stemming from the Company's settlement of a patent infringement lawsuit in 2011. That note will be paid in the second quarter of this year.

The long-term pension liability of \$5,455,000 at March 31, 2012 decreased \$80,000 from the December 31, 2011 balance of \$5,535,000. The Company suspended future growth or participation in this plan in 2008. Pension obligations are expected to be funded utilizing the cash surrender values and death benefits of company-owned life insurance policies, the cash surrender values of which are included in Pension Assets, described earlier. The corresponding death benefits of those policies, which are not included on our balance sheet, total \$10.2 million.

The other long term liability (\$102,000) consists entirely of a prepaid rent liability associated with the Company's move to a new facility in 2010. Accounting rules require that rent expense for operating leases with rent-free periods be accounted for on a straight line basis over the term of the lease. Our financial statements will therefore, include a lease liability during the term of our current lease, which at the end of each reporting period will represent the difference between the amount of rent expense recognized and the amount of rent paid through the reporting period.

Stockholders equity of a negative \$385,000 at March 31, 2012 compares with Stockholders equity of negative \$493,000 at December 31, 2011. Changes for the quarter include the addition of our first quarter 2012 net income of \$80,000 and \$29,000 of equity compensation expense included in first quarter operating results.

In management's opinion, given current cash and investment balances, a fully available line of credit agreement and current cash flow projections, more than sufficient resources exist to fund operation for the next twelve months and beyond.

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### Accounting Pronouncements

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, topic 820, *Fair Value Measurement*, to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with United States GAAP and International Financial Reporting Standards. Some of the amendments clarify the Board's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. Specifically, the guidance requires additional disclosures for fair value measurements that are based on significant unobservable inputs. The updated guidance is to be applied prospectively and became effective for the Company's interim and annual periods beginning January 1, 2012. The adoption of this guidance does not have a material impact on the Company's consolidated financial statements.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, topic 220, *Comprehensive Income*. The objective of this Update is to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. To increase the prominence of items reported in other comprehensive income and to facilitate convergence of U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS), the FASB decided to eliminate the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity, among other amendments in this Update.

The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. The amendments in this update should be applied retrospectively, and became effective for the Company's interim and annual periods beginning after December 15, 2011. The Company chose to present two separate statements.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, topic 350, *Intangibles - Goodwill and Other*, to simplify how entities test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The amendments in this Update became effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. This update does not have a material effect on the Company's financial statements.

In December 2011, the FASB issued Accounting standards Update No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*, which defers the requirement to disclose the effect of items that are reclassified out of accumulated comprehensive income separately in the statement of operations. This requirement is deferred until such time as the FASB can reconsider the relevant paragraphs of that update. The deferral is effective for public companies for fiscal years and interim periods beginning after December 15, 2011.

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### **Critical Accounting Policies**

**Revenue Recognition** - The Company's revenue consists of revenues from the licensing of software to resellers and end user customers; fees for services rendered including installation, training, implementation, and customer maintenance contracts; and the outsourcing or hosting of services, commonly referred to as Software as a Service (SaaS).

The Company recognizes software license revenue under ASC 985-605, formerly Statement of Position No 97-2 Software Revenue Recognition, Statement of Position No. 98-9, Software Revenue Recognition With Respect to Certain Transactions, and under ASC 605-25, formerly Emerging Issues Task Force 00-21, Revenue Arrangements with Multiple Deliverables, and related interpretations, as amended.

Licensed software may be sold as a stand-alone element, with other software elements, or in conjunction with supplemental services. When an order consists of more than one element, it is considered to be a multiple element arrangement (MEA). When sold as a stand-alone element, the revenue is recognized upon shipment. When sold as part of a MEA, revenue from the licensed software is recognized when each element is activated at the customer site, via the entry of a software key-code. This typically occurs at the same time that installation occurs. Service revenues such as training, installation and implementation, are recognized when the service is complete, and acknowledged by the customer.

For either a single element transaction or a MEA, Veramark allocates consideration to all deliverables based on their relative stand-alone selling prices. Amendments to ASC 605-25, which became effective January 1, 2011, establish a hierarchy to determine the stand-alone selling price as follows:

Vendor Specific Objective Evidence of the fair value (VSOE),

Third Party Evidence (TPE)

Best Estimate of the Selling Price (ESP)

Sales which constitute a MEA are accounted for by determining whether the elements can be accounted for as separate accounting units, and if so, by applying values to those units, per the hierarchy above. If VSOE is not available, management estimates the fair selling price using historical pricing for similar items, in conjunction with current pricing and discount policies.

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. Additionally, revenue is only recognized when a selling price is fixed or determinable, and collectability of the receivable is deemed to be probable.

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

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 the Company through the date of cancellation are due and payable under the contract terms.

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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.

**Capitalization of Software Development** - The Company capitalizes software development costs when technological feasibility has been established for the software in accordance with ASC 985-20, *Costs of software to be sold, leased, or 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.

**Allowance for Doubtful Accounts** - 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.

**Pension Liability** - The Company sponsors an unfunded Supplemental Executive Retirement Program (SERP), which is a nonqualified plan that provides certain 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 the determination of 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 projected pension liabilities.

During the fourth quarter of 2011, Veramark retrospectively changed its method of accounting for pension and other postretirement benefits. Historically, Veramark has recognized actuarial gains and losses as a component of equity in its consolidated balance sheets on an annual basis. These gains and losses were amortized into operating results generally over the following year. Veramark elected to immediately recognize actuarial gains and losses in its operating results in the year in which the gains and losses occur. This change is intended to improve the transparency of Veramark's operational performance by recognizing the effects of current economic and interest rate trends on plan assumptions, during the year in which they occur. Accordingly, the financial data for all periods presented has been adjusted to reflect the effect of this accounting change.

**Goodwill and Intangibles** - Goodwill represents the excess of the purchase price paid over the fair value of assets acquired. Goodwill is not amortized and as per ASC 350-20, is subject to an impairment test conducted on an annual basis, or more frequently if a change in circumstances or the occurrence of events indicates that potential impairment exists. Through December 2011, there has been no impairment of goodwill associated with the Source Loop acquisition.

In determining whether it is necessary to impair intangible assets other than goodwill, the Company follows the guidance provided under ASC 360-10, *Property, Plant and Equipment*. The Company considers factors such as, but not limited to, estimated useful life, amortization policies, and legal regulations related to the intangible asset. No impairment charges were recorded in 2011, 2010, or 2009.

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**Item 3 Quantitative and Qualitative Disclosures About Market Risk**

On October 29, 2010 the Company entered into an agreement with Manufacturers and Traders Trust Company to provide a three year term note in the amount of \$200,000, the proceeds of which were used to purchase furnishings and fixtures for the Company's new headquarters facility. The loan bears an interest rate of LIBOR plus 4.0%, with a minimum interest rate of 4.5%. At March 31, 2012, the remaining balance of the term loan was \$105,555.

**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 Chief Financial 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 1 Legal Proceedings**

On June 16, 2011 the Company entered into a Nonexclusive Patent License and settlement agreement relating to an action brought by Asentinel LLC, against Veramark, AnchorPoint - a division of MTS, and CASS Information Systems, alleging infringement of two patents held by Asentinel concerning systems and methods for identifying and processing billing exceptions in telecommunications invoices.

Material terms of the agreement included:

Asentinel waived all claims for damages for prior infringement and agreed not to make claims for future infringement of its patents.

The Company agreed to pay Asentinel \$500,000. Of that amount \$250,000 was paid upon execution of the agreement and \$250,000 is payable, without interest on June 16, 2012, and is represented by the Company's promissory note.

The lawsuit was dismissed against the Company.

#### **Item 1A Risk Factors**

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 this report: economic, competitive, governmental and technological factors, increased operating costs, failure to obtain necessary financing, risks related to natural disasters and financial market fluctuations. Such factors also include:

#### **Intellectual Property Rights**

Veramark regards its products as proprietary and attempts to protect them 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 takes 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.

#### **Existing Customer Base**

We derive a significant portion of our revenues from multi-year Managed Service contracts. As a result, if we lose a major customer, or if a Managed Service contract is delayed, reduced, or cancelled, our revenues could be adversely affected. In addition, customers who have accounted for significant revenues in the past may not generate the same amount of revenues in future periods.

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### **Product Development**

Veramark has made significant investments in research, development and marketing for new products, services and technologies, including the VeraSMART software offering and its hosted or managed 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. 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 or services, could adversely affect Veramark revenues.

### **Declines in Demand for Software**

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

### **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.

### **Security and Privacy Breaches in our Systems May Damage Client Relations and Inhibit our Growth**

The uninterrupted operation of our hosted solutions and the confidentiality of third party information that resides on our systems is critical to our business. We have what we believe to be sufficient security in place to prevent major interruptions in service and to prevent unauthorized access. Any failure in our security and privacy measures could have a material adverse impact on our financial position and results of operations.

### **Loss of Key Employees**

Veramark's delivery of quality products and services requires the experience and knowledge of our staff. The loss of key employees could hinder our ability to deliver services, possibly resulting in loss of customers or loss of revenue. Any loss of key employees could have a material adverse effect on Veramark's business and results of operations.

### **Changing Market**

Veramark serves the highly dynamic telecommunications market characterized by continuous technological enhancements and choices that affect the costs incurred versus benefit received by our customers. Veramark staff must remain current otherwise the quality and value of our services could be diminished and competition could offer better value. The failure to remain current could have a material adverse effect on Veramark's business and results of operations.

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### **Access to Capital**

Veramark may not have the access to the capital necessary to maintain a competitive software product, to hire the experienced staff, to fund growth or to fund acquisitions. This could cause Veramark to fall behind market growth rates and have an adverse effect on Veramark's business.

### **A Failure of our Information Technology systems could materially Adversely Affect our Business.**

A failure or prolonged interruption in our information technology systems that compromises our ability to meet our customers' needs, or impairs our ability to record, process and report accurate information to the SEC could have a material adverse effect on our financial condition.

### **A Breach of our Cyber Security Systems Could Materially Adversely Affect Our Business.**

A breach that compromises proprietary customer data, our ability to meet our customers' needs or impairs our ability to record, process and report accurate information could have a material adverse effect on our financial condition.

### **Public Company**

Veramark is one of only a few TEM companies that has a publicly traded stock. In addition, Veramark's revenue is small relative to most public companies and the cost of compliance is relatively high when compared with revenue and earnings. This reduces the capital available to run operations and to invest in innovation which could have an adverse effect on business.

### **Item 4 Mine Safety Disclosures**

Not Applicable.



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**Item 5: Other Information**

None

**Item 6: Exhibits, Consolidated Financial Statement Schedule and Reports on Form 8-K**

- (a) Financial Statements as set forth under Item 8 of this report on Form 10-K
  
- (b) Exhibits required to be filed by Item 601 of Regulation S-K
  
- 3.1 Restated Certificate of Incorporation (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-18 (File No. 2-96787) filed on March 22, 1985)
- 3.2 Bylaws (incorporated by reference to Exhibit 3 to the Company's Registration Statement on Form S-8 filed on October 5, 1992)
- 10.1 Letter Agreement dated as of March 29, 2007 by and between the Company and David G. Mazzella (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 3, 2007)
- 10.2\* Amended and Restated Board of Directors Deferred Compensation Plan (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on November 26, 2007)
- 10.3\* Employment Agreement dated as of December 17, 2007 by and between the Company and Anthony C. Mazzullo (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 19, 2007)
- 10.4\* Letter Agreement dated as of February 4, 2008 by and between the Company and Douglas F. Smith (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 4, 2008)
- 10.5\* Restricted Stock Award Agreement dated as of January 1, 2008 by and between the Company and Anthony C. Mazzullo (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 25, 2008)
- 10.6\* 2008 Employee Stock Purchase Plan (incorporated by reference to Exhibit F to the Company's Proxy Statement for its 2008 Annual Meeting of Shareholders filed on April 29, 2008)
- 10.7\* Description of non-employee director compensation (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 18, 2008)
- 10.8\* Amended Salary Continuation Agreement dated as of October 10, 2008 by and between the Company and Ronald C. Lundy (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 17, 2008)
- 10.9\* Form of 2008 Employee Stock Purchase Plan Enrollment Agreement (incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-8 (File No. 333-155286) filed on November 12, 2008)
- 14 Code of Business Conduct and Ethics (incorporated by reference to Exhibit E to the Company's Proxy Statement for its 2008 Annual Meeting of Shareholders filed on April 14, 2011)

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18	Preferability Letter from Independent Registered Public Accounting Firm Regarding Change in Accounting Principle (incorporated by reference to Exhibit 18 of the Company's Annual Report on Form 10-K, filed on March 26, 2012.)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Extension Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.LAB	XBRL Labels Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

\* Management contract or compensatory plan or arrangement

(c) Schedules required to be filed by Regulation S-X

(99) Valuation and Qualifying Accounts

All other schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

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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: May 11, 2012

/s/ Anthony C. Mazzullo  
Anthony C. Mazzullo  
President and CEO  
Date: May 11, 2012

/s/ Ronald C. Lundy  
Ronald C. Lundy  
Vice President of Finance and CFO