VERAMARK TECHNOLOGIES INC
Form 10-Q
November 14, 2005

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FORM 10-Q
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Quarterly Report Under Section 13 or 15 (d)
of the Securities Exchange Act of 1934
For Quarter Ended September 30, 2005
Commission File Number 0-13898
Veramark Technologies, Inc.
(Exact name of registrant as specified in its charter)

Delaware	16-1192368
(State or other jurisdiction of Incorporation or Organization)	(IRS Employer Identification Number)

3750 Monroe Avenue, Pittsford, NY 14534

(Address of principal executive offices)(Zip Code)
(585) 381-6000

(Registrant s telephone number, including area code)
N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirement for the past 90 days.

YES þ NO o

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

YES o NO þ

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

YES o NO þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of September 30, 2005

Common stock, par value $.10	8,820,500 shares

This report consists of 28 pages.

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PART I FINANCIAL INFORMATION

VERAMARK TECHNOLOGIES, INC.
CONDENSED BALANCE SHEETS

	(Unaudited) September 30, 2005	December 31, 2004
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 859,545	$ 722,020
Investments	397,384	381,237
Accounts receivable, trade (net of allowance for doubtful accounts of $27,580 and $24,000, respectively)	1,398,681	1,276,204
Inventories, net	41,617	30,717
Prepaid expenses and other current assets	150,544	109,809
Total Current Assets	2,847,771	2,519,987
PROPERTY AND EQUIPMENT		
Cost	5,755,891	5,740,535
Less accumulated depreciation	(4,972,680)	(4,846,475)
Property and Equipment (Net)	783,211	894,060
OTHER ASSETS:		
Software development costs (net of accumulated amortization of $2,110,566 and $1,506,777, respectively)	2,831,725	2,518,482
Pension and related assets	2,898,985	2,778,482
Deposits and other assets	797,745	797,745
Total other assets	6,528,455	6,094,709
TOTAL ASSETS	$ 10,159,437	$ 9,508,756

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

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VERAMARK TECHNOLOGIES, INC.
CONDENSED BALANCE SHEETS

	(Unaudited) September 30, 2005	December 31, 2004
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 209,432	$ 298,063
Accrued compensation and related taxes	408,042	557,805
Deferred revenue	2,972,435	2,572,120
Other accrued liabilities	118,224	187,977
Total Current Liabilities	3,708,133	3,615,965
Pension obligation	4,922,299	4,439,398
Total Liabilities	8,630,432	8,055,363
STOCKHOLDERS EQUITY:		
Common Stock, par value $.10; shares authorized, 40,000,000; shares issued and outstanding. 8,900,725 and 8,749,179	890,073	874,918
Additional paid-in capital	21,686,467	21,744,969
Accumulated deficit	(20,679,098)	(20,795,128)
Treasury stock (80,225 shares, at cost)	(385,757)	(385,757)
Accumulated other comprehensive income	17,320	14,391
Total Stockholders Equity	1,529,005	1,453,393
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 10,159,437	$ 9,508,756

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
NET SALES				
Product Sales	$ 963,216	$ 1,079,564	$ 2,797,851	$ 2,817,021
Service Sales	1,705,605	1,702,422	5,158,698	5,206,262
Total Net Sales	2,668,821	2,781,986	7,956,549	8,023,283
COSTS AND OPERATING EXPENSES:				
Cost of sales	454,053	486,782	1,333,988	1,342,901
Engineering and software development	265,597	330,476	746,384	1,142,177
Selling, general and administrative	2,001,741	1,996,384	5,770,737	6,068,131
Total Costs and Operating Expenses	2,721,391	2,813,642	7,851,109	8,553,209
INCOME (LOSS) FROM OPERATIONS	(52,570)	(31,656)	105,440	(529,926)
NET INTEREST INCOME (EXPENSE)	4,163	(2,103)	10,590	319
INCOME (LOSS) BEFORE INCOME TAXES	(48,407)	(33,759)	116,030	(529,607)
INCOME TAXES				
NET INCOME (LOSS)	$ (48,407)	$ (33,759)	$ 116,030	$ (529,607)
NET INCOME (LOSS) PER SHARE				
Basic	$ (0.01)	$ 0.00	$ 0.01	$ (0.06)
Diluted	$ (0.01)	$ 0.00	$ 0.01	$ (0.06)

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

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

	Nine Months Ended September 30,	
	2005	**2004**
OPERATING ACTIVITIES:		
Net income (loss)	$ 116,030	$ (529,607)
Adjustments to reconcile net income (loss) to net cash flows provided by operating activities		
Depreciation and amortization	805,961	621,777
Provision for bad debts	(2,776)	(5,086)
Loss on disposal of fixed assets		(1,983)
Compensation expense-stock options	(113,545)	(27,136)
Increase in cash surrender value of company-owned life insurance policies	(120,503)	(141,615)
Changes in assets and liabilities		
Accounts receivable	(119,701)	143,504
Inventories	(10,900)	157
Prepaid expenses and other current assets	(40,735)	21,954
Deposits and other assets		40,930
Accounts payable	(88,631)	68,462
Accrued compensation and related taxes	(149,763)	(35,194)
Deferred revenue	400,315	(271,192)
Other accrued liabilities	(69,753)	(33,788)
Pension obligation	482,901	306,653
Net cash flows provided by operating activities	1,088,900	157,836
INVESTING ACTIVITIES:		
Sale (purchase) of investments	(13,218)	531,802
Capitalized software development costs	(917,032)	(926,829)
Additions to property and equipment	(91,323)	(122,185)
Proceeds from sale of equipment		13,531
Net cash flows used by investing activities:	(1,021,573)	(503,681)
FINANCING ACTIVITY:		
Exercise of stock options	63,841	48,554
Repayment of capital lease obligation		(2,472)
Proceeds from employee stock purchase plan	6,357	7,455
Net cash flows provided by financing activities	70,198	53,537
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	137,525	(292,308)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	722,020	644,005

CASH AND CASH EQUIVALENTS, END OF PERIOD	$	859,545	$	351,697

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	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash Transactions:		
Income taxes paid, net	$ 4,756	$ 34,624
Interest paid	$ 20	$ 755

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

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NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited)

(1) GENERAL

The accompanying unaudited financial statements include all adjustments of a normal and recurring nature which, in the opinion of Company s management, are necessary to present fairly the Company s financial position as of September 30, 2005, the results of its operations for the three and nine months ended September 30, 2005 and 2004, and cash flows for the nine months ended September 30, 2005 and 2004.

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, 2004.

The results of operations and cash flows for the three and nine months ended September 30, 2005 are not necessarily indicative of the results to be expected for the full year s operation.

(2) PROPERTY AND EQUIPMENT

The major classifications of property and equipment at September 30, 2005, and December 31, 2004 were:

	September 30, 2005	December 31, 2004
Machinery and equipment	$ 794,314	$ 794,314
Computer hardware and software	1,951,341	1,935,985
Furniture and fixtures	1,627,677	1,627,677
Leasehold improvements	1,382,559	1,382,559
	$ 5,755,891	$ 5,740,535

For the three and nine months ended September 30, 2005, the Company recorded depreciation expense of $66,973 and $202,172. Depreciation expense for the three and nine months ended September 30, 2004 was $68,057 and $209,369.

(3) STOCK-BASED COMPENSATION

In 2002, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. This standard provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. Additionally, the standard also requires prominent disclosures in

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the Company s financial statements about the method of accounting used for stock-based employee compensation, and the effect of the method used when reporting financial results.

The Company accounts for stock-based compensation in accordance with SFAS No. 123, Accounting for Stock-Based Compensation. As permitted by SFAS No. 123, the Company continues to measure compensation for such plans using the intrinsic value based method of accounting, prescribed by Accounting Principles Board (APB), Opinion No. 25, Accounting for Stock Issued to Employees. Had compensation cost for the Company s stock-based compensation plans been determined based on the fair value at the grant dates for awards consistent with the method of SFAS No. 123, the Company s net income (loss) and net income (loss) per common share would have been adjusted to the pro forma amounts indicated below:

		Three Months Ended September 30,		Nine Months Ended September 30,	
		2005	**2004**	**2005**	**2004**
Net income (loss)	As reported	$(48,407)	$ (33,759)	$ 116,030	$(529,607)
Add: total stock-based compensation expense included in net income, net of forfeitures and related tax effects		(15,506)	(36,337)	(113,545)	(27,136)
Deduct: total stock-based compensation expense determined under fair value, net of forfeitures and related tax effects		(15,724)	113,771	(51,729)	(70,944)
	Pro forma	$(79,637)	$ 43,675	$ (49,244)	$(627,687)
Net income (loss) per common share	As reported				
	Basic	$ (0.01)	$ 0.00	$ 0.01	$ (0.06)
	Diluted	$ (0.01)	$ 0.00	$ 0.01	$ (0.06)
	Pro forma				
	Basic	$ (0.01)	$ 0.01	$ (0.01)	$ (0.07)
	Diluted	$ (0.01)	$ 0.01	$ (0.01)	$ (0.07)

For purposes of the disclosure above, the fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 2005 and 2004:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Dividend yield				
Expected volatility	151.33%	146.14%	151.33%	145.05%
Risk-free interest rate	N/A	3.33%	N/A	3.29%
Expected life	5 years	5 years	5 years	5 years

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For the nine months ended September 30, 2005, no stock options have been granted.

(4) TOTAL COMPREHENSIVE INCOME (LOSS)

Total comprehensive income (loss) for the three and nine months ended September 30, 2005 and 2004 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income (loss)	$ (48,407)	$ (33,759)	$ 116,030	$ (529,607)
Accumulated other comprehensive income (loss)	(2,443)	10,852	2,929	9,324
Total comprehensive income (loss)	$ (50,850)	$ (22,907)	$ 118,959	$ (520,283)

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

SFAS 128 Earnings Per Share requires the Company to calculate net income (loss) per share based on basic and diluted net income (loss) per share, as defined. Basic EPS excludes dilution and is computed by dividing net income (loss) by the weighted average number of shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The dilutive effect of outstanding options issued by the Company are reflected in diluted EPS using the treasury stock method. Under the treasury stock method, options will only have a dilutive effect when the average market price of common stock during the period exceeds the exercise price of the options.

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Calculations of Earnings (Loss) Per Share

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Basic				
Net income (loss)	$ (48,407)	$ (33,759)	$ 116,030	$ (529,607)
Weighted average common shares outstanding	8,793,951	8,637,328	8,733,267	8,592,863
Net income (loss) per common share	$ (0.01)	$ 0.00	$ .01	$ (.06)
Diluted				
Net income (loss)	$ (48,407)	$ (33,759)	$ 116,030	$ (529,607)
Weighted average common shares outstanding	8,793,951	8,637,328	8,733,267	8,592,863
Additional dilutive effect of stock options and warrants after application of treasury stock method	(1)	(1)	652,450	(1)
Weighted average dilutive shares outstanding	8,793,951	8,637,328	9,385,717	8,592,863
Net income (loss) per common share assuming full obligation	$ (0.01)	$ 0.00	$ 0.01	$ (0.06)

(1) There were no dilutive effects of stock options, as the effect would have been anti-dilutive due to the net loss 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 September 30, 2005 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.

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(7) BENEFIT PLANS

The Company sponsors an employee incentive savings plan under Section 401(k) for all eligible employees. The Company s contributions to the plan are discretionary. There were no contributions to the plan for the nine months ended September 30, 2005 and 2004.

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 expense for the three and nine months ended September 30, 2005 and 2004 consisted of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Current Service Cost	$114,244	$ 74,693	$342,736	$224,079
Amortization of Prior Service Cost	22,650	21,721	67,950	65,163
Interest Cost	65,605	47,337	196,815	142,011
Pension Expense	$202,499	$143,751	$607,501	$431,253

The Company paid pension obligations of $124,600 for both the nine months ended September 30, 2005 and 2004. The discount rate used in determining the actuarial present value of the projected benefit obligation was 6% for the three and nine months ended September 30, 2005 and 2004.

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 the pension obligation. The total death benefit associated with these policies is $10.2 million, with an associated accumulated cash surrender value of approximately $2,334,000 at September 30, 2005. The accumulated cash surrender values of these policies at December 31, 2004 was approximately $2,214,000.

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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 w similar meaning in conjunction with, among other things, discussions of future operations, financial performance, the Company s strategy for growth, product development, regulatory approvals, market position and expenditures. Forward-looking statements are based on management s expectations as of the date of this report. The Company cannot guarantee that any forward-looking statement will be accurate, although the Company believes that it has been reasonable in its expectations and assumptions. Forward-looking statements are subject to the risks identified in Issues and Risks and elsewhere in this report. Readers are cautioned not to place undue reliance on forward-looking statements and are advised to review the risks identified in Issues and Risks and elsewhere in this report. The Company has no obligation to update forward-looking statements.

Overview

Sales for the Company s third quarter ended September 30, 2005 of $2,669,000 compared with sales of $2,782,000 for the third quarter ended September 30, 2004. For the nine months ended September 30, 2005 sales of $7,957,000 decreased 1% from sales of $8,023,000 for the first nine months of 2004.

Our net loss incurred for the three months ended September 30, 2005 of $48,000, or $0.01 per share, compared with net loss of $34,000, or $0.00 per share, for the same three months of 2004. For the nine months ended September 30, 2005 the net income of $116,000, or $0.01 per diluted share, represents an improvement of $646,000 in net income when compared with the net loss of $530,000, or $0.06 per share, incurred for the same nine month period of 2004. The improvement in net income results from a 9% reduction in operating expenses for the first nine months of 2005, or approximately $700,000, as compared with the same period a year ago. The decrease in operating expenses is a result of lower employment levels in 2005 versus 2004, which has reduced salary, benefit, travel and facility expenses significantly.

Orders booked for the quarter ended September 30, 2005 of $2,856,000 increased 5% from orders booked for the second quarter of 2005, and includes a 15% increase in orders for the Company s VeraSMART enterprise level product from the prior quarter. Major VeraSMART orders were received during the third quarter from North Carolina Baptist Hospital, NCS Pearson, CVS, American Intercontinental, and the California County of Ventura.

For the quarter ended September 30, 2005 we generated a positive cash flow of $176,000, and the September 30, 2005 cash position of $1,257,000 is $446,000, or 51% higher than the cash position at September 30, 2004. The increase in cash was primarily a result of increases in deferred revenues related to maintenance contracts generated from sales of the eCAS product.

Sales

For the three months ended September 30, 2005 sales derived from our enterprise product offerings which include VeraSMART in addition to the ongoing maintenance revenue stream from Quantum, VeraSMART s

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predecessor product, decreased 2% from the same quarter of 2004. For the nine months ended September 30, 2005 enterprise level sales have increased 4% from the prior year and account for 34% of total sales revenues. On September 26, we announced the general availability of VeraSMART 4.0, which introduces SMART Work Order, a module that provides flexible workflow and helpdesk management tools. With this latest release the VeraSMART platform now includes integrated modules for Directory, Allocation, Call Accounting, Invoice Management, Work Order, Wireless management, and Online Directory, all of which enable an enterprise to design a solution that accommodates their specific business needs. Additionally the continued expansion of the VeraSMART platform allows Veramark to address business environments outside of the telemanagement related applications that we have traditionally addressed.

Sales and service revenues provided by eCAS our telemanagement product, decreased 4% and 2% respectively, for the three and nine month periods ended September 30, 2005 as compared to the same three and nine month periods of 2004, primarily due to a decrease in direct sales to Avaya, Inc. We have continued, however, to increase sales to Avaya s master distributor channels, which have increased 6% for the first nine months of 2005 from prior year levels, but that increase has not been sufficient to offset the decrease in direct sales to Avaya.

Revenues generated from our Outsourced Solutions Group for the first nine months of 2005 have been adversely impacted by the first quarter loss of a major client through a merger/consolidation, and as a result are 19% less than the revenues achieved for the first nine months of 2004. During the third quarter we added a new client to our Outsourced Group, Sony Corporation of America. Veramark will perform all server administration and data collection for Sony as well as provide application modules which will allow Sony to manage their call accounting, allocation, invoice management, on-line directory and work order requirements. The initial contract is for a three year term with a minimum of $175,000 of revenue guaranteed over the term of the agreement.

Cost of Sales

For the three months ended September 30, 2005 gross margin (defined as sales minus cost of sales) was 83% of sales, up from 82% of sales for the same three month period of 2004. For both the nine months ended September 30, 2005 and 2004 gross margins were 83% of sales. Cost of sales includes both the direct and indirect product costs associated with current sales revenues in addition to the amortization expense associated with software developments costs capitalized in prior periods.

Operating Expenses

Engineering and software development expenses of $266,000, net of capitalization, decreased 20% or $64,000 for the three months ended September 30, 2005 from $330,000 for the same three months of 2004. For the nine months ended September 30, 2005 net engineering and software development expenses of $746,000 decreased 35% from the same nine month period of 2004. The decrease in expense is attributable to lower payroll costs in 2005 resulting from a reduction in overall staffing levels required. The table below summarizes gross expenditures for engineering and software development expenses, costs capitalized, costs amortized, and the resulting impact on the Company s statements of operations for both the three and nine months ended September 30, 2005 and 2004.

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	Three Months Ended September 30		Nine Months Ended September 30,	
	2005	2004	2005	2004
Gross expenses for engineering and software development	$ 526,010	$ 668,244	$ 1,663,416	$ 2,069,006
Less: Software development costs capitalized	(260,413)	(337,768)	(917,032)	(926,829)
Net expenses for engineering and software development included in the Company s statements of operations	265,597	330,476	746,384	1,142,177
Plus: Software development costs amortized and charged to cost of sales	201,263	165,089	603,789	412,767
Total Expense Recognized	$ 466,860	$ 495,565	$ 1,350,173	$ 1,554,944

Throughout the balance of 2005 and moving forward into 2006 we will continue to focus our engineering and development efforts on the continued expansion of the VeraSMART and eCAS platforms in terms of additional features and functionality.

Selling, general and administrative expenses of $2,002,000 for the three months ended September 30, 2005 were virtually unchanged from the $1,996,000 of selling, general and administrative expenses incurred for the three months ended September 30, 2004. For the nine months ended September 30, 2005, selling, general and administrative expenses of $5,771,000 decreased $297,000, or 5% from the total expense of $6,068,000 for the first nine months of 2004. The decrease in year to date expenses versus the prior year is primarily due to 23% reductions in both marketing, and customer service and support costs from prior year levels.

Liquidity and Capital Resources

The Company s net cash position (which includes cash in the bank plus the value of short term investments) of $1,257,000 at September 30, 2005 increased 16% from the June 30, 2005 balance of $1,081,000, and is 14% higher than the cash balance of $1,103,000 at December 31, 2004. The increased cash position includes a deposit of $86,000 received in the third quarter from a single customer for product to be delivered in 2006.

Accounts receivable at September 30, 2005 total $1,399,000, an increase of 10% from the December 31, 2004 balance of $1,276,000. The reserve for bad debts at September 30, 2005 is $27,580 which compares with a reserve balance of $25,000 at December 31, 2004. We continue to experience an excellent credit history with our customers as evidenced by total write-offs for the first nine months of 2005 amounting to less than $3,000.

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Prepaid expenses of $151,000 at September 30, 2005 representing primarily the unutilized portion of business insurances and maintenance contracts have increased from $109,000 at December 31, 2004. The value of prepaid expenses is expected to decrease during the fourth quarter as the economic value of these policies and contracts expire.

For the quarter ended September 30, 2005 we purchased $42,000 of new capital equipment, primarily computer equipment and related accessories. For the nine months ended September 30, 2005 we have purchased $91,000 of capital equipment.

During the quarter ended September 30, 2005 we capitalized $260,000 of software development costs, bringing year to date capitalization to $917,000. In addition we amortized $201,000 of costs previously capitalized. For the nine months ended September 30, 2005 we have now amortized $604,000 of development costs all of which has been charged to cost of sales. As a result, software development costs capitalized and carried on the company s balance sheet at September 30, 2005 total $2,832,000, an increase of $314,000 from the December 31, 2004 total.

Pension and related assets at September 30, 2005 are $2,899,000 versus $2,778,000 at December 31, 2004. The change is attributable to an increase in the cash surrender values of Company-owned life insurance policies. The death benefit and accumulated cash values of these policies are intended to fund future pension obligations of the company. The cash surrender values of these policies, which approximates $2,334,000 at September 30 2005 is also available to fund current operations in the event that should become necessary. Management has no current plans, nor anticipates the need in the near future, to access these funds to meet operating requirements.

Current liabilities of $3,708,000 at September 30, 2005 have increased 3% from the December 31, 2004 balance of $3,616,000. The change in liabilities results from an increase of $400,000 in the value of deferred revenues from $2,572,000 at December 31, 2004 to $2,972,000 at September 30, 2005. Deferred revenue consists of services such as training, installation, and maintenance and support for which the company has billed customers, but for which it has not yet performed the actual service. The largest component of the increase in deferred revenues is derived from maintenance contracts generated from sales of the eCAS product. The increase in deferred revenues offset decreases of $89,000 in accounts payable, $150,000 in accrued compensation, and $70,000 in other accrued liabilities.

The September 30, 2005 Stockholder s equity total of $1,529,000 compares with stockholders equity of $1,453.000 at December 31, 2004. The change in equity for the nine months ended September 30, 2005 includes the year to date net income of $116,000, proceeds received from the exercise of 142,950 employee stock options totaling $64,000, and proceeds received from the purchase of 8,596 shares of stock through the employee stock purchase plan.

It is management s opinion that, given our current cash position, the access to cash surrender values of company-owned life insurance policies, current operating expense levels, and the absence of debt, the Company has sufficient liquidity to fund operation and development schedules for the next twelve months and beyond.

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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 consolidated 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), which replaces SFAS 123, Accounting for Stock-Based Compensation , and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS 123(R) requires compensation costs relating to share-based payment transactions be recognized in financial statements. The pro forma disclosure previously permitted under SFAS 123 will no longer be an acceptable alternative to recognition of expenses in the financial statements. SFAS 123(R) is effective as of the beginning of the first annual reporting period that begins after June 15, 2005, with early adoption encouraged. We currently measure compensation costs related to share-based payments under APB 25, as allowed by SFAS 123, and provide disclosure in notes to financial statements as required by SFAS 123. We are required to adopt SFAS 123(R) starting from the first fiscal quarter of 2006. The adoption of SFAS 123(R) is not expected to have an adverse impact on our net income and net income per share.

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 is not expected to 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. As such, the Company is required to adopt these provisions at the beginning of the fiscal year ended December 31, 2006. The Company does not expect that the adoption of SFAS 154 to have a significant impact on it s financial statements.

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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 2005 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.

Revenue Recognition

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

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

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

Capitalization of Software Development Costs

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.

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 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.

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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. In addition, Veramark sometimes use click-wrap licenses, under which it licenses its products, which may be unenforceable under the laws of certain jurisdictions. Also, 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.

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, for such products or services, operating margins may not be as high as the margins historically experienced by Veramark.

Declines in Demand for Software

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

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Item 3 Quantitative and Qualitative Disclosures About Market Risk

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

Item 4 Controls and Procedures

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

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

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PART II OTHER INFORMATION

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

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

Item 6: Exhibits and Reports on Form 8-K

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

(I) Registrant s Condensed Financial Statements for the three and nine months ended September 30, 2005 and 2004 are set forth in Part I, Item 1 of this Quarterly Report on Form 10-Q.

(II) Calculation of income (loss) per share for the three and nine months ended September 30, 2005 and 2004, as set forth as Exhibit II .

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

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

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

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

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

(1) On August 11, 2005, the Company filed a current report on Form 8-K reporting that the Company issued a press release announcing the company s financial results for the quarter ended June 30, 2005. A copy of such press release, was attached as Exhibit 99.1.

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SIGNATURES

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

VERAMARK TECHNOLOGIES, INC.
REGISTRANT

Date: November 14, 2005

/s/ David G. Mazzella

David G. Mazzella
President and CEO
Date: November 14, 2005

/s/ Ronald C. Lundy

Ronald C. Lundy
Treasurer (Chief Accounting
Officer)