

VERAMARK TECHNOLOGIES INC  
Form 10-Q  
November 13, 2008

**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, 2008**  
**Commission File Number 0-13898**  
**Veramark Technologies, Inc.**

(Exact name of registrant as specified in its charter)

Delaware

16-1192368

(State or other jurisdiction of Incorporation or Organization)

(IRS Employer Identification Number)

3750 Monroe Avenue, Pittsford, NY

14534

(Address of principal executive offices)

(Zip Code)

(585) 381-6000

(Registrant's telephone number, including area code)

N/A

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO   
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.   
Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, 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 September 30, 2008 was 9,702,988.

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

	<b>(Unaudited) September 30, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 551,913	\$ 713,342
Investments	998,998	1,492,288
Accounts receivable, trade (net of allowance for doubtful accounts of \$40,000 and \$30,000, respectively)	1,333,237	1,303,240
Inventories, net	39,863	31,764
Prepaid expenses and other current assets	346,185	254,274
<b>Total Current Assets</b>	<b>3,270,196</b>	<b>3,794,908</b>
<b>PROPERTY AND EQUIPMENT</b>		
Cost	3,805,218	5,955,064
Less accumulated depreciation	(3,365,726)	(5,433,650)
<b>Property and Equipment (Net)</b>	<b>439,492</b>	<b>521,414</b>
<b>OTHER ASSETS:</b>		
Software development costs (net of accumulated amortization of \$3,030,975 and \$2,179,290, respectively)	2,822,214	3,038,410
Pension assets	3,206,189	3,210,204
Deposits and other assets	905,761	830,756
<b>Total Other Assets</b>	<b>6,934,164</b>	<b>7,079,370</b>
<b>TOTAL ASSETS</b>	<b>\$ 10,643,852</b>	<b>\$ 11,395,692</b>

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

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

	<b>(Unaudited)</b> <b>September 30,</b> <b>2008</b>	<b>December 31,</b> <b>2007</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 265,967	\$ 317,127
Accrued compensation and related taxes	589,444	934,387
Deferred revenue	3,628,082	3,369,324
Current portion of pension obligation	474,059	440,084
Other accrued liabilities	164,462	270,524
Total Current Liabilities	5,122,014	5,331,446
Pension obligation	4,946,612	5,072,447
Total Liabilities	10,068,626	10,403,893
<b>STOCKHOLDERS EQUITY:</b>		
Common Stock, par value \$.10; shares authorized, 40,000,000; shares issued and outstanding, 9,783,213 and 9,169,093	978,321	916,909
Additional paid-in capital	22,255,704	22,171,341
Accumulated deficit	(22,097,880)	(21,607,785)
Treasury stock (80,225 shares, at cost)	(385,757)	(385,757)
Accumulated other comprehensive income	(175,162)	(102,909)
Total Stockholders Equity	575,226	991,799
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 10,643,852</b>	<b>\$ 11,395,692</b>

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

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>NET SALES</b>				
Product sales	\$ 777,691	\$ 799,167	\$ 1,931,852	\$ 2,364,184
Service sales	1,946,605	2,129,073	6,002,373	6,960,781
Total Net Sales	2,724,296	2,928,240	7,934,225	9,324,965
 <b>COSTS AND OPERATING EXPENSES:</b>				
Cost of sales	721,239	704,853	2,144,146	2,442,632
Engineering and software development	385,836	322,887	1,017,937	870,334
Selling, general and administrative	1,682,512	1,980,160	5,325,415	6,319,178
Total Costs and Operating Expenses	2,789,587	3,007,900	8,487,498	9,632,144
LOSS FROM OPERATIONS	(65,291)	(79,660)	(553,273)	(307,179)
NET INTEREST INCOME	29,032	19,593	63,178	44,480
LOSS BEFORE INCOME TAXES	(36,259)	(60,067)	(490,095)	(262,699)
<b>INCOME TAXES</b>				
NET LOSS	\$ (36,259)	\$ (60,067)	\$ (490,095)	\$ (262,699)
 <b>NET LOSS PER SHARE</b>				
Basic	\$ 0.00	\$ (0.01)	\$ (0.05)	\$ (0.03)
Diluted	\$ 0.00	\$ (0.01)	\$ (0.05)	\$ (0.03)

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

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

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>OPERATING ACTIVITIES:</b>		
Net income (loss)	(490,095)	(262,699)
Adjustments to reconcile net income (loss) to net cash flows provided by operating activities		
Depreciation and amortization	1,067,467	876,737
Bad debt expense	11,333	3,486
Share based compensation expense	76,882	289,000
Pension assets	4,015	(120,503)
Loss on disposal of fixed assets	17,623	
Unrealized loss on sale of investments	(29,879)	
Changes in assets and liabilities		
Accounts receivable	(41,329)	268,284
Inventories	(8,099)	2,089
Prepaid expenses and other current assets	(91,911)	(47,144)
Deposits and other assets	(75,005)	(42,222)
Accounts payable	(51,160)	(49,636)
Accrued compensation and related taxes	(344,943)	162,694
Deferred revenue	258,758	(44,663)
Other accrued liabilities	(106,062)	(131,903)
Pension obligation	(134,234)	331,200
Net cash flows provided by operating activities	63,361	1,234,720
<b>INVESTING ACTIVITIES:</b>		
Sale (purchase) of investments	493,290	(706,030)
Capitalized software development costs	(635,488)	(703,124)
Additions to property and equipment	(151,485)	(79,970)
Net cash flows used by investing activities:	(293,683)	(1,489,124)
<b>FINANCING ACTIVITY:</b>		
Exercise of stock options	57,150	98,979
Proceeds from employee stock purchase plan	11,743	7,041
Net cash flows provided by financing activities	68,893	106,020
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(161,429)</b>	<b>(148,384)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>713,342</b>	<b>845,384</b>

CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 551,913	\$ 697,000
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SUPPLEMENTAL CASH FLOW INFORMATION

Cash Transactions:

Income taxes paid, net	\$ 13,129	\$ 4,042
Interest paid	\$ 553	\$ 1,075

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

**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, 2008, the results of its operations for the three and nine months ended September 30, 2008 and 2007, and cash flows for the nine months ended September 30, 2008 and 2007.

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, 2007.

The results of operations and cash flows for the three and nine months ended September 30, 2008 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, 2008, and December 31, 2007 were:

	<b>September 30, 2008</b>	<b>December 31, 2007</b>
Machinery and equipment	\$ 128,390	\$ 795,905
Computer hardware and software	1,249,519	2,093,026
Furniture and fixtures	1,041,512	1,677,783
Leasehold improvements	1,385,797	1,388,350
	<b>\$ 3,805,218</b>	<b>\$ 5,955,064</b>

For the nine months ended September 30, 2008, the Company recorded depreciation expense of \$215,783. Depreciation expense for the nine months ended September 30, 2007 was \$190,862.

**(3) STOCK-BASED COMPENSATION**

The Company's share-based compensation consists of restricted stock and stock options, generally vesting over periods ranging from one to four years. For the nine months ended September 30, 2008, the company awarded restricted stock grants totaling 470,000 shares vesting over three years and 140,500 stock options generally vesting over four years. During the first nine months of 2007 the Company granted 532,485 stock options to employees.



A summary of the status of the Company's stock option plan as of September 30, 2008 is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Grant-Date Fair Value	Remaining Contractual Term (Yrs)	Intrinsic Value
Outstanding as of December 31, 2007	2,257,943	\$ 1.60	\$ 1.32	5.1	\$ 548,550
Granted	140,500	\$ 0.64			
Exercised	(119,000)	0.48			(10,150)
Canceled	(373,860)	3.19			(192,125)
Outstanding as of September 30, 2008	1,905,583	\$ 1.28	\$ 1.07	5.0	\$ 346,275
Options exercisable at September 30, 2008	1,768,583	\$ 1.33	\$ 1.11	4.6	\$ 346,275

As of September 30, 2008, there was \$60,858 of total unrecognized compensation cost related to non-vested stock options granted under the Plan and \$250,708 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 1.8 years. The compensation costs of restricted stock will be recognized over a weighted-average period of 1.3 years.

#### (4) TOTAL COMPREHENSIVE INCOME (LOSS)

Total comprehensive income (loss) for the three and nine months ended September 30, 2008 and 2007 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net loss	\$ (36,259)	\$ (60,067)	\$ (490,095)	\$ (262,699)
Reclassification to net periodic benefit cost	22,122	15,700	66,367	47,100
Unrealized change pension	(36,247)		(108,741)	
Unrealized change on investments	(36,947)	12,390	(29,879)	11,267
Total comprehensive loss	\$ (87,331)	\$ (31,977)	\$ (562,348)	\$ (204,332)

#### (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.



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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Basic</b>				
Net Loss	\$ (36,259)	\$ (60,067)	\$ (490,095)	\$ (262,699)
Weighted average common shares outstanding	9,620,814	9,004,789	9,490,905	8,933,593
Net loss per common share	\$ 0.00	\$ (0.01)	\$ (0.05)	\$ (0.03)
<b>Diluted</b>				
Net loss	\$ (36,259)	\$ (60,067)	\$ (490,095)	\$ (262,699)
Weighted average common shares outstanding	9,620,814	9,004,789	9,490,905	8,933,593
Additional dilutive effect of stock options and warrants after application of treasury stock method				
Weighted average dilutive shares outstanding	9,620,814	9,004,789	9,490,905	8,933,593
Net loss per common share assuming full obligation	\$ 0.00	\$ (0.01)	\$ (0.05)	\$ (0.03)

There were no dilutive effects of stock options from the three and nine months ended September 30, 2008 and 2007, 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, 2008 we had not experienced any material losses related to these indemnification obligations and no material claims with respect thereto were outstanding. We do not expect significant claims related to these indemnification obligations, and consequently, we have not established any related reserves.

**(7) BENEFIT PLANS**

The Company sponsors an employee incentive savings plan under Section 401(k) for all eligible employees. The Company's contributions to the plan are discretionary. There were no contributions to the plan for the three and nine months ended September 30, 2008 and 2007.

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 months and nine months ended September 30, 2008 and 2007 consists of the following:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Current Service Cost	\$ (38,063)	\$ 68,180	\$ (13,355)	\$ 204,540
Amortization of Prior Service Cost	22,122	15,700	66,367	47,100
Interest Cost	82,688	78,720	248,064	236,160
Unrealized change	(36,247)		(108,741)	
Pension Expense	\$ 30,500	\$ 162,600	\$ 192,335	\$ 487,800

The Company paid pension obligations of \$326,569 for the nine months ended September 30, 2008 and \$156,600 for the nine months ended September 30, 2007.

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, 2008 and 2007.

The Company maintains life insurance covering certain key employees under its Supplemental Executive Retirement Program with the Company named as beneficiary. The Company intends to use the death benefits of these policies, as well as loans against the accumulating cash surrender value of the policies, to fund future pension obligations. The total death benefit associated with these policies is \$10.2 million, with an associated accumulated cash surrender value of approximately \$3,206,000 at September 30, 2008. The accumulated cash surrender values of these policies at December 31, 2007 was approximately \$3,210,000.

The projected pension benefits paid or expected to be paid under this plan are as follows, assuming retirement at 65 and a life expectancy of 80 years for all participants:

**Period Ending December 31, Unless Stated Otherwise,**

Q4 2008	113,514
2009	498,192
2010	498,192
2011	468,058
2012	513,842
2013 2016	2,717,021

The Company has a contractual obligation to maintain certain health benefits for two of its former executive officers. These benefits are accounted for as Post Retirement Healthcare Benefits, ( PRHB ). Periodic PRHB expensed and paid for the three and nine months ended September 30, 2008 and 2007 consists of the following:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Current Service Cost	\$ 1,892	\$ 1,130	\$ 5,676	\$ 3,390
Interest Cost	1,521	620	4,563	1,860
PRHB Expense	\$ 3,413	\$ 1,750	\$ 10,239	\$ 5,250

The projected PRHB paid or expected to be paid are as follows:

**Period Ending December 31, Unless Stated Otherwise,**

Q4 2008	3,410
2009	13,649
2010	13,649
2011	13,649
2012	13,649
2013 2016	37,096

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

### **Results of Operations**

Management's Discussion and Analysis contains statements that are forward-looking. Such statements are identified by the use of words like plans, expects, intends, believes, will, anticipates, estimates and other words having that 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 three months ended September 30, 2008 of \$2,724,000 decreased 7% from sales of \$2,928,000 for the three months ended September 30, 2007, but represented a 7% increase from sales achieved for the second quarter of 2008 of \$2,538,000. Sales for the nine months ended September 30, 2008 were \$7,934,000, which compares with sales of \$9,325,000 for the nine months ended September 30, 2007.

Veramark incurred a net loss of \$36,000, or less than \$0.01 per share, for the three months ended September 30, 2008, an improvement from both the net loss of \$260,000, or \$0.03 per share, for the second quarter of 2008, and the net loss of \$60,000, or \$0.01 per share for the third quarter of 2007. For the nine months ended September 30, 2008, the net loss of \$490,000 or \$0.05 per share, compares with a net loss of \$263,000, or \$0.03 per share for the nine months ended September 30, 2007.

Orders received from customers for the nine months ended September 30, 2008 of \$7,828,000 are virtually identical to orders received of \$7,818,000 for the first nine months of 2007. Year to date orders for VeraSMART have increased 47% from the prior year, while orders for eCAS and other products have decreased 10% on a year to date basis.

#### **Sales**

Sales of VeraSMART products and services for the three and nine months ended September 30, 2008 increased 28% and 17%, respectively, from the same three and nine month periods of 2007. During the third quarter, major installations of VeraSMART were completed at AAA-Florida, The Marine Corp Air Station-Miramar, Mercy Health Partners, Metro Health Systems, and Toyota. VeraSMART products and services accounted for 33% of total revenues for the first nine months of 2008, up from 24% of total sales during the same period in 2007.

Revenues generated from managed service contracts decreased 34% for the three months ended September 30, 2008 and 36% for the nine months ended September 30, 2008 as compared with results for the same three and nine month periods of 2007. The decrease in year to date revenues from the prior periods results from a non-recurring portion of our managed service contract with Sears Holding Corporation (SHC) recorded in the first quarter of 2007. Recurring revenues from managed service contracts, exclusive of SHC, increased 26% for the first nine months of 2008 as compared with the same nine months of 2007.

Sales of the eCAS products and services for the third quarter of 2008 decreased 8% from the third quarter of 2007, and 12% for the nine months ended September 30, 2008 from the same nine months of 2007. eCAS sales continue to be impacted by a continued slow decline in orders received from the Company's largest channel of distribution for eCAS, Avaya Inc and Avaya's master distribution partners.

#### Cost of Sales

As a result of lower sales volumes achieved thus far in 2008 versus 2007, gross margins (defined as sales minus cost of sales) for the three and nine months ended September 30, 2008 of \$2,003,000, and \$5,790,000, decreased from gross margins of \$2,223,000 and \$6,882,000 respectively, for the three and nine months ended September 30, 2007. As a percentage of sales, the gross margin for the nine months ended September 30, 2008 represents 73% of sales, which compares to 74% of sales for the nine months ended September 30, 2007.

#### Operating Expenses

Engineering and software development expenses, net of software capitalization, of \$386,000 for the three months ended September 30, 2008 and \$1,018,000 for the nine months ended September 30, 2008, increased 20% and 17% respectively, from expenses levels of \$323,000 and \$870,000 for the same three and nine month periods of 2007. During the third quarter, \$223,000 of software development costs were capitalized, up from \$178,000 of development costs capitalized in the third quarter of 2007. For the nine months ended September 30, 2008, capitalized development costs totaled \$636,000, a 9% decrease from development costs capitalized during the first nine months of 2007. The chart below summarizes total costs incurred for engineering and software development, development costs capitalized, and the resulting expense charged against operations for the three and nine months ended September 30, 2008 and 2007.

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Gross expenditures for engineering & software development	\$ 609,000	\$ 501,000	\$ 1,654,000	\$ 1,573,000
Less: Software development costs capitalized	(223,000)	(178,000)	(636,000)	(703,000)
Net expense for engineering and software	\$ 386,000	\$ 323,000	\$ 1,018,000	\$ 870,000

Selling, general, and administrative (SG&A) expenses of \$1,683,000 for the three months ended September 30, 2008 decreased \$297,000, or 15%, from \$1,980,000 for the three months ended September 30, 2007. For the nine months ended September 30, 2008, SGA expenses of \$5,325,000 decreased 16% from the \$6,319,000 incurred for the first nine months of September 30, 2007, a reduction of \$994,000. The reduction in SG&A expense reflects ongoing restructuring efforts designed not only to reduce costs, but also to increase and streamline operating efficiencies. Total employment has been reduced from 2007 levels, which combined with other organizational efforts have reduced expenses by nearly \$1 million, primarily in the form of payroll and administrative costs.

### **Liquidity and Capital Resources**

Cash and short term investments totaled \$1,551,000 at September 30, 2008, a decrease of \$655,000 from the December 31, 2007 balance of \$2,206,000. A third quarter reduction in cash balances was anticipated in the Company's annual operating plan and is partially attributable to a reduction in accrued compensation costs at December 31, 2007, which were liquidated in 2008.

Accounts receivable at September 30, 2008 of \$1,333,000 increased \$30,000 from the December 31, 2007 balance of \$1,303,000. The reserve for bad debts of \$40,000 at September 30, 2008 increased from \$30,000 at December 31, 2007 due to a receivable from a single customer currently ninety days past due. Payment on this account is expected during the fourth quarter.

Prepaid expenses and other current assets of \$346,000 at September 30, 2008 increased from \$254,000 at December 31, 2007. The increase reflects the renewal of key business insurance policies during the first half of 2008, the economic value of which extend through 2008 and beyond, and an increase in the utilization of consulting and other professional services to be rendered over future quarters.

Capital equipment purchases for the nine months ended September 30, 2008 totaled \$151,000, which compares with capital equipment purchases of \$80,000 for the first nine months of 2007. Through September 30, 2008, we have disposed of approximately \$2 million of obsolete computer equipment, office furnishings and furniture, the majority of which had been fully depreciated. The residual book value of those assets, totaling \$18,000, has been charged against current operations. We expect to invest approximately \$200,000 in capital improvements during the fourth quarter of 2008 to update infrastructure.

Software development costs capitalized and included on the balance sheet at September 30, 2008 of \$2,822,000 have been reduced \$216,000, or 7% from the December 31, 2007 total of \$3,038,000. For the nine months ended September 30, 2008 developments costs capitalized of \$636,000 were \$67,000 less than development costs capitalized for the first nine months of 2007. The amortization of development costs capitalized in prior periods and charged to cost of sales, increased 24%, from \$686,000 for the first nine months of 2007 to \$852,000 for the first nine months of 2008.

Pension assets, representing the cash surrender value of company-owned life insurance policies intended to fund future pension obligations, total \$3,206,000 at September 30, 2008 as compared with \$3,210,000 at December 31, 2007. These cash surrender values are also readily available to fund current operations in the event that is deemed necessary.

Total current liabilities at September 30, 2008 of \$5,122,000 decreased 4%, or \$209,000, from \$5,331,000 at December 31, 2007, resulting primarily from a \$345,000 reduction in accrued compensation costs. The decrease in accrued compensation includes the settlement of contractual obligations with the Company's former CEO and a reduction in accrued salary and benefit costs realized from restructuring and organizational changes undertaken throughout 2008. Accounts payable and other accrued liabilities as of September 30, 2008 decreased \$51,000 and \$106,000, respectively, from December 31, 2007 balances. Offsetting these reductions was an increase in deferred revenues of \$259,000 from \$3,369,000 at December 31, 2007 to \$3,628,000 at September 30, 2008. Deferred revenues, representing a major component of our current backlog, consist of orders received from customers for a variety of services, including maintenance, training, and implementation service, which have not yet been provided, and therefore have not been recognized as revenue in the Statement of Operations. It is expected that the majority of those services will be performed during the next twelve months and the associated revenues recorded.

Stockholders Equity of \$575,000 at September 30, 2008 compares with equity of \$992,000 at December 31, 2007 primarily reflecting the net loss for the nine months ended September 30, 2008 of \$490,000. During 2008, 119,000 stock options were exercised and employees purchased 25,120 shares of common stock utilizing the Company's employee stock purchase plan. Total proceeds from those transactions totaled \$69,000.

In light of the Company's total cash and investment position, combined with current operating expense levels and the absence of debt, it is management's opinion that more than sufficient resources exist to fund operations and carry out strategic initiatives for the next twelve months and beyond.





### Recent Accounting Pronouncements

- 1) In December 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ( SFAS ) No. 141(R), *Business Combinations* . SFAS 141(R) establishes principles and requirements for how the acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree, recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. As such, the Company is required to adopt these provisions at the beginning of the fiscal year ending December 31, 2009. The Company does not expect adoption of SFAS 141(R) to have a material effect on its financial statements.
- 2) In December 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ( SFAS ) No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* . SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. As such, the Company is required to adopt these provisions at the beginning of the fiscal year ending December 31, 2009. The Company does not expect SFAS 160 to have a material effect on its financial statements.
- 3) In December 2007, the SEC issued Staff Accounting Bulletin No. 110 ( SAB 110 ). SAB 110 permits companies to continue to use the simplified method, under certain circumstances, in estimating the expected term of plain vanilla options beyond December 31, 2007. SAB 110 updates guidance provided in SAB 107 that previously stated that the Staff would not expect a company to use the simplified method for share option grants after December 31, 2007. Adoption of SAB 110 did not have a material impact on the Company's financial statements.
- 4) In March 2007, the Financial Accounting Standards Board ratified Emerging Issues Task Force ( EITF ) Issue No. 06-10, *Accounting for Collateral Assignment Split-Dollar Life Insurance Agreements* . EITF 06-10 provides guidance for determining a liability for the postretirement benefit obligation as well as recognition and measurement of the associated asset on the basis of the terms of the collateral assignment agreement. EITF 06-10 is effective for fiscal years beginning after December 15, 2007. As such, the Company adopted these provisions at the beginning of the fiscal year ending December 31, 2008. Adoption of EITF 06-10 did not have a material impact on the Company's financial statements.
- 5) In March 2008, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standard ( SFAS ) No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* . SFAS 161 requires enhanced disclosures about an entity's derivative and hedging activities. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008 with early application encouraged. As such, the Company is required to adopt these provisions at the beginning of the fiscal year ended December 31, 2009. The Company is currently evaluating the impact of SFAS 161 on its financial statements, but does not expect it to have a material effect.

- 6) In May 2008, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard ( SFAS ) No. 162, *The Hierarchy of Generally Accepted Accounting Principles* . SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States. SFAS 162 is effective 60 days following the SEC 's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. The Company is currently evaluating the impact of SFAS 162 on its financial statements, but does not expect it to have a material effect.
- 7) In May 2008, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standard ( SFAS ) No. 163, *Accounting for Financial Guarantee Insurance Contracts an interpretation of FASB Statement No. 60* ( SFAS 163 ). SFAS 163 interprets Statement 60 and amends existing accounting pronouncements to clarify their application to the financial guarantee insurance contracts included within the scope of that Statement. SFAS 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years. As such, the Company is required to adopt these provisions at the beginning of the fiscal year ended December 31, 2009. The Company is currently evaluating the impact of SFAS 163 on its financial statements, but does not expect it to have a material effect.

### **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 include:

- Revenue recognition
- Capitalization of software development costs
- Allowance for Doubtful Accounts
- Pension liability

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

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

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

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

Service revenues such as training, installation and implementation are recognized when the service is complete and acknowledged by the customer, regardless as to whether the sale is on a direct basis or through a reseller arrangement. Fees charged to customers for post-contract Customer Support are recognized ratably over the term of the contract. Costs related to maintenance obligations are expensed as incurred.

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

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

The Company believes its revenue recognition policies are appropriate, in all circumstances, and that its policies are reflective of complexities arising from customer arrangements involving such features as maintenance, warranty agreements, license agreements, and other normal course of business arrangements.

The Company capitalizes software development costs when technological feasibility has been established for the software in accordance with SFAS No. 86, Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed. Such capitalized costs are amortized on a product-by-product basis over their economic life or the ratio of current revenues to current and anticipated revenues from such software, whichever provides the greater amortization. The Company periodically reviews the carrying value of capitalized software development costs and impairments are recognized in the results of operations when the expected future undiscounted operating cash flow derived from the capitalized software is less than its carrying value. Should the Company inaccurately determine when a product reaches technological feasibility or the economic life of a product, results could differ materially from those reported. Veramark uses what it believes are reasonable assumptions and where applicable, established valuation techniques in making its estimates.

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

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

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

### **Issues and Risks**

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

#### **Intellectual Property Rights**

Veramark regards its software as proprietary and attempts to protect it with a combination of copyright, trademark and trade secret protections, employee and third-party non-disclosure agreements and other methods of protection. Despite those precautions, it may be possible for unauthorized third parties to copy certain portions of Veramark's products, reverse engineer or obtain and use information that Veramark regards as proprietary. The laws of some foreign countries do not protect Veramark's proprietary rights to the same extent as the laws of the United States. Any misappropriation of Veramark's intellectual property could have a material adverse effect on its business and results of operations. Furthermore, although Veramark 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, if such products or services are profitable, operating margins may not be as high as the margins historically experienced by Veramark.

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

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

#### **Product Development Schedule**

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

#### **Competition**

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

#### **Marketing and Sales**

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

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

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

**Item 4 Controls and Procedures**

Based upon an evaluation as of the end of the period covered by this report, the Company's Chief Executive Officer and 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.

**PART II OTHER INFORMATION**

**Item 5: Items Required to be Disclosed on Form 8-K**

Revolving Demand Note Agreement

On October 31, 2008, Veramark Technologies, Inc. (the Registrant ) entered into a Revolving Demand Note Agreement (the Agreement ), effective as of October 31, 2008, with Manufacturers and Traders Trust Company (the Bank ) to provide working capital in the ordinary course of business. As of the date of this Report, no funds have been borrowed under this Agreement.

The material terms of the Agreement include:

The maximum outstanding principal balance under the Agreement is Four Hundred Thousand Dollars (\$400,000).

The Registrant may borrow against the Agreement, from time to time, an amount less than or equal to, but not greater than the available balance of the Note.

The outstanding principal balance shall bear interest at a per annum rate equal to One-Half Percent (0.5%) above the Prime Rate.

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

**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, 2008 and 2007 are set forth in Part I, Item 1 of this Quarterly Report on Form 10-Q.

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

(31.2) CFO 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) CFO Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



**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 13, 2008

/s/ Anthony C. Mazzullo  
Anthony C. Mazzullo  
President and Chief Executive Officer

Date: November 13, 2008

/s/ Ronald C. Lundy  
Ronald C. Lundy  
Vice President of Finance and Chief Financial  
Officer

**EXHIBIT INDEX**

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