VERAMARK TECHNOLOGIES INC
Form 10-Q
May 13, 2005

Table of Contents

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 March 31, 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 the number of shares outstanding of each of the issuer s classes of common stock, as of March 31, 2005

Common stock, par value $.10	8,694,954 shares

This report consists of 26 pages.

INDEX

Table of Contents

PART I FINANCIAL INFORMATION

VERAMARK TECHNOLOGIES, INC.

CONDENSED BALANCE SHEETS

	(Unaudited) March 31, 2005	December 31, 2004
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 590,902	$ 722,020
Investments	387,360	381,237
Accounts receivable, trade (net of allowance for doubtful accounts of $25,000 and $24,000, respectively)	1,350,159	1,276,204
Inventories, net	36,385	30,717
Prepaid expenses and other current assets	145,467	109,809
Total Current Assets	2,510,273	2,519,987
PROPERTY AND EQUIPMENT		
Cost	5,743,894	5,740,535
Less accumulated depreciation	(4,893,000)	(4,846,475)
Property and Equipment (Net)	850,894	894,060
OTHER ASSETS:		
Software development costs (net of accumulated amortization of $1,708,040 and $1,506,777, respectively)	2,597,673	2,518,482
Pension and related assets	2,802,304	2,778,482
Deposits and other assets	797,745	797,745
Total other assets	6,197,722	6,094,709
TOTAL ASSETS	$ 9,558,889	$ 9,508,756

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

Table of Contents

VERAMARK TECHNOLOGIES, INC.

CONDENSED BALANCE SHEETS

	(Unaudited) March 31, 2005	December 31, 2004
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 278,059	$ 298,063
Accrued compensation and related taxes	447,750	557,805
Deferred revenue	2,676,591	2,572,120
Other accrued liabilities	171,330	187,977
Total Current Liabilities	3,573,730	3,615,965
Pension obligation	4,600,367	4,439,398
Total Liabilities	8,174,097	8,055,363
STOCKHOLDERS EQUITY:		
Common Stock, par value $.10; shares authorized, 40,000,000; shares issued and outstanding 8,775,179 and 8,749,179	877,518	874,918
Additional paid-in capital	21,757,517	21,744,969
Accumulated deficit	(20,880,414)	(20,795,128)
Treasury stock (80,225 shares, at cost)	(385,757)	(385,757)
Accumulated other comprehensive income	15,928	14,391
Total Stockholders Equity	1,384,792	1,453,393
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 9,558,889	$ 9,508,756

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

Table of Contents

VERAMARK TECHNOLOGIES, INC.

CONDENSED STATEMENTS OF OPERATIONS (Unaudited)

	Three Months Ended March 31,	
	2005	**2004**
NET SALES		
Product Sales	$ 954,583	$ 943,099
Service Sales	1,671,789	1,730,599
Total Net Sales	2,626,372	2,673,698
COSTS AND OPERATING EXPENSES:		
Cost of sales	440,051	380,487
Engineering and software development	301,792	238,048
Selling, general and administrative	1,971,107	2,039,191
Total Costs and Operating Expenses	2,712,950	2,657,726
INCOME (LOSS) FROM OPERATIONS	(86,578)	15,972
NET INTEREST INCOME	1,292	9,566
INCOME (LOSS) BEFORE INCOME TAXES	(85,286)	25,538
INCOME TAXES		
NET INCOME (LOSS)	$ (85,286)	$ 25,538
NET INCOME (LOSS) PER SHARE		
Basic	$ (0.01)	$ 0.00
Diluted	$ (0.01)	$ 0.00

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

Table of Contents

VERAMARK TECHNOLOGIES, INC.

CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)

	Three Months Ended March 31,	
	2005	**2004**
OPERATING ACTIVITIES:		
Net income (loss)	$ (85,286)	$ 25,538
Adjustments to reconcile net income (loss) to net cash flows provided by operating activities		
Depreciation and amortization	269,018	171,911
Provision for bad debts	(5,512)	(12,207)
Loss on disposal of fixed assets		11,548
Compensation expense-stock options	4,043	15,248
Increase in cash surrender value of company-owned life insurance policies	(23,822)	(23,823)
Changes in assets and liabilities		
Accounts receivable	(68,443)	90,282
Inventories	(5,668)	(27,711)
Prepaid expenses and other current assets	(35,658)	19,349
Deposits and other assets		39,930
Accounts payable	(20,004)	147,888
Accrued compensation and related taxes	(110,055)	(28,480)
Deferred revenue	104,471	(149,114)
Other accrued liabilities	(16,647)	(67,642)
Pension obligation	160,969	102,218
Net cash flows provided by operating activities	167,406	314,935
INVESTING ACTIVITIES:		
Sale (purchase) of investments	(4,586)	18,114
Capitalized software development costs	(280,454)	(458,476)
Additions to property and equipment	(24,589)	(53,786)
Net cash flows used by investing activities:	(309,629)	(494,148)
FINANCING ACTIVITY:		
Exercise of Stock Options	11,105	
Repayment of capital lease obligation		(1,842)
Net cash flows provided (used) by financing activities	11,105	(1,842)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(131,118)	(181,055)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	722,020	644,005

CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 590,902	$ 462,950

Table of Contents

	Three Months Ended March 31,			
	2005		2004	
SUPPLEMENTAL CASH FLOW INFORMATION				
Cash Transactions:				
Income taxes paid (received), net	$	(3,000)	$	25,123
Interest paid	$		$	53

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

Table of Contents

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

(1) GENERAL

The accompanying unaudited financial statements include all adjustments of a normal and recurring nature which, in the opinion of Company s management, are necessary to present fairly the Company s financial position as of March 31, 2005 and the results of its operations and cash flows for the three months ended March 31, 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 months ended March 31, 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 March 31, 2005, and December 31, 2004 were:

	March 31, 2005	December 31, 2004
Machinery and equipment	$ 794,314	$ 794,314
Computer hardware and software	1,939,344	1,935,985
Furniture and fixtures	1,627,677	1,627,677
Leasehold improvements	1,382,559	1,382,559
	$ 5,743,894	$ 5,740,535

For the quarter ended March 31, 2005, the Company recorded depreciation expense of $67,755. Depreciation expense for the quarter ended March 31, 2004 was $68,697.

(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 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.

Table of Contents

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 March 31, 2005	Three Months Ended March 31, 2004
Net income (loss)	As reported	$ (85,286)	$ 25,538
Add: total stock-based compensation expense included in net income, net of related tax effects		4,044	15,248
Deduct: total stock-based compensation expense determined under fair value, net of related tax effects		(35,546)	(106,986)
	Pro forma	$ (116,788)	$ (66,200)
Net income (loss) per common share	As reported		
	Basic	$ (0.01)	$ 0.00
	Diluted	$ (0.01)	$ 0.00
	Pro forma		
	Basic	$ (0.01)	$ (0.01)
	Diluted	$ (0.01)	$ (0.01)

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:

	2005	2004
Dividend yield		
Expected volatility	147.56%	144.43%
Risk-free interest rate	3.89%	3.27%
Expected life	5 years	5 years

During the quarter ending March 31, 2005, no options were granted

(4) TOTAL COMPREHENSIVE INCOME (LOSS)

Total comprehensive income (loss) for the first quarter of 2005 and 2004 was as follows:

Table of Contents

	Three Months Ended March 31, 2005	2004
Net income (loss)	$ (85,286)	$ 25,538
Accumulated other comprehensive income	1,537	4,665
Total comprehensive income (loss)	$ (83,749)	$ 30,203

(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

	Three Months Ended March 31, 2005	2004
Basic		
Net income (loss)	$ (85,286)	$ 25,538
Weighted average common shares outstanding	8,673,998	8,562,829
Net income (loss) per common share	$ (0.01)	$ 0.00
Diluted		
Net income (loss)	$ (85,286)	$ 25,538
Weighted average common shares outstanding	8,673,998	8,562,829
Additional dilutive effect of stock options and warrants after application of treasury stock method	(1)	1,254,428
Weighted average dilutive shares outstanding	8,673,998	9,817,257

Net income (loss) per common share assuming full obligation	$	(0.01)	$	0.00

(1) There were no dilutive effects of stock options in 2005, as the effect would be anti-dilutive due to the net loss incurred.

Table of Contents

(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 March 31, 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.

(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 months ended March 31, 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 months ended March 31, 2005 and 2004 consists of the following:

	Three Months Ended March 31,	
	2005	**2004**
Current Service Cost	$ 114,248	$ 74,693
Amortization of Prior Service Cost	22,650	21,721
Interest Cost	65,605	47,337
Pension Expense	$ 202,503	$ 143,751

The Company paid pension obligations of $41,534 for both the three months ended March 31, 2005 and 2004.

The discount rate used in determining the actuarial present value of the projected benefit obligation was 6% for the three months ended March 31, 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 $2,237,000 at March 31, 2005. The accumulated cash surrender values of these policies at December 31, 2004 was approximately $2,214,000.

Table of Contents

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 v 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.

Sales for Veramark s first quarter ended March 31, 2005 were $2,626,000 a decrease of 2% from sales of $2,674,000 for the first quarter of 2004. The net loss incurred for the quarter ended March 31, 2005 was $85,000 or $0.01 per share, which compares with a net profit of $26,000, or $0.00 per diluted share for the quarter ended March 31, 2004.

The change in net income for the quarter ended March 31, 2005, versus the prior year, is primarily attributable to a reduction in the amounts of engineering and development expenses capitalized. For the quarter ended March 31, 2005, we capitalized $281,000 of development costs as opposed to $459,000 of capitalization for the same quarter of 2004. Amounts capitalized for the second and third quarters of 2005 are expected to increase as we continue the development efforts of VeraSMART® version 4.0, currently scheduled for release in the third quarter of this year.

While recent reports state that general economic conditions appear favorable, we remain concerned with the current levels of capital equipment spending particularly in the Telecom Industry. We continue to see a significant number of customers delaying major purchases, and/or upgrades to their telecommunication networks, the result of which has impacted sales of VeraSMART, our enterprise-level product.

For the quarter ended March 31, 2005, sales of VeraSMART and its predecessor product, Quantum Series ® decreased 9% from the quarter ended March 31, 2004. In addition, although new proposal activity remains strong, the sales cycle, from initial proposal to final implementation, continues to lengthen. For example, a number of new orders, that we had anticipated receiving during the first quarter of 2005, were delayed to at least the second quarter of the year.

In January of 2005, we released VeraSMART version 3.0. This most recent version of VeraSMART incorporates a series of invoice management tools that allows companies to collect their billing data from a wide range of service providers, and once collected, allows them to review, approve and budget more efficiently.

Sales of telemanagement products and their associated services have been less affected by economic conditions. For the quarter ended March 31, 2005 revenues generated by eCAS the Company s core telemanagement product, increased 2% from the same quarter of 2004, accounting for 63% of total sales versus 61% of total sales a year ago.

Table of Contents

Additionally, we realized a 5% increase in sales generated by our Outsourced Solutions Group for the first quarter of 2005 from the same quarter a year ago. A number of new outsourcing proposals were made during the quarter, which we have hopes of finalizing during the second and third quarters of 2005. Revenues from Outsourced Solutions accounted for 5% of total sales for the quarter ended March 31, 2005, up from 4% for the first quarter of 2004.

The Company earned a gross margin (defined as sales less cost of sales) of $2,186,000, or 83% of sales for the quarter ended March 31, 2005. For the same period a year ago, we earned a gross margin of $2,293,000 or 86% of sales. The lower margin is attributable to an $87,000 increase in the amortization of previously capitalized software development costs, attributable to VeraSMART versions 2.0 and 3.0. These amortization costs are charged directly to cost of sales.

Net engineering and development expenses of $302,000 for the quarter ended March 31, 2005 increased 27% from the first quarter of 2004 due to the reduced level of software capitalization referred to earlier, which offset a reduction of $115,000 in actual gross expenses for engineering and development from the prior year. The table below details gross expenses incurred in engineering and development, amounts capitalized and amortized, and the overall impact of engineering and development efforts on the Company s Statement of Operations for the quarters ended March 31, 2005 and 2004.

	Three Months Ended March 31,	
	2005	**2004**
Gross expenditures for engineering and software development	$ 582,246	$ 696,524
Less: Software development costs capitalized	(280,454)	(458,476)
Net expenses for engineering and software development included in the Company s statement of operations	301,792	238,048
Plus: Software development costs amortized and charged to cost of sales	201,263	103,214
Total Expense Recognized	$ 503,055	$ 341,262

During the first quarter of 2005, our engineering and development team began work on VeraSMART version 4.0. This version of VeraSMART will contain additional functionality to our operational support modules, and a new module for work orders. The addition of these improvements will compliment the billing elements currently available in VeraSMART and allow us to enter markets outside of our traditional telecom environment.

Selling, general, and administrative expenses incurred of $1,971,000 for the quarter ended March 31, 2005 decreased 3% from $2,039,000 for the quarter ended March 31, 2004. The reduction in expense was attributable to lower payroll and benefit expenses incurred as a result of a lower average employment level from a year ago, particularly in the marketing and customer support functions. We do, however, continue to expand our direct sales force in an effort to reach additional VeraSMART opportunities, as well as expand our penetration of new and existing distribution channels associated with sales of our core telemanagement products.

Table of Contents

Liquidity and Capital Resources

For the quarter ended March 31, 2005, net cash decreased by $125,000 from $1,103,000 at December 31, 2004 to $978,000 at March 31, 2005. Net cash consists of cash and cash equivalents plus short-term investments. The reduction in net cash primarily resulted from reducing our trade accounts payable and the payment of accrued compensation due to employees from December 31, 2004 balances.

Accounts receivable at March 31, 2005 of $1,350,000 increased 6% from the December 31, 2004 balance of $1,276,000. The increase in receivables is a function of the timing of payments from customers and does not reflect any change in the historical payment patterns of major customers.

Prepaid expenses of $145,000 increased from $110,000 at December 31, 2004 due to the first quarter renewal of the Company s general business insurance policies for 2005. It is expected that prepaid expenses will increase again in the second quarter as the remaining policies pertaining for 2005 coverages come up for renewal.

During the quarter ended March 31, 2005, the Company purchased $25,000 of capital equipment largely related to upgrades to our internal communication network infrastructure. Additionally we wrote off approximately $22,000 of obsolete equipment during the quarter, all of which had been fully depreciated in past years.

The carrying value of capitalized software related to the Company s software development efforts increased from $2,518,000 at December 31, 2004 to $2,598,000 at March 31, 2005. During the first quarter of 2005, we capitalized $280,000 of current software development costs, all related to further VeraSMART® expansion, and amortized $201,000 of development costs capitalized in previous years.

Pension and related assets increased $24,000 during the first quarter of 2005 to $2,802,000, reflecting 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 accumulated cash surrender values, referred to above, are also available to fund current operations of the Company in the event that should become necessary.

Accounts payable were reduced by $20,000 during the quarter to $278,000, from $298,000 at December 31, 2004. There have been no significant changes in our payment policies with vendors and suppliers, and it is expected that the level of accounts payable will remain stable throughout the balance of the year.

Accrued compensation at March 31, 2005 is $448,000, down $110,000 from $558,000 at December 31, 2004. The reduction is the result of the January 2005 payment of $105,000 in sales commissions and incentives earned by members of our sales force during the fourth quarter of 2004.

Total stockholders equity of $1,385,000 at March 31, 2005 decreased from $1,453,000 at December 31, 2004. The change in equity includes the first quarter 2005 loss of $85,000, partially offset by $11,000 of proceeds received from employees of the Company from the exercise of 26,000 stock options.

The Company believes, given current cash and investment levels, combined with the access to cash surrender values of company-owned life insurance policies, that more than sufficient liquidity exists to fund operations for the next twelve months and beyond.

Table of Contents

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

Table of Contents

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 reporting period that begins after June 15, 2006, 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. We expect the adoption of SFAS 123(R) will have a material adverse impact on our net income and net income per share. We are currently in the process of evaluating the extent of such impact.

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.

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.

The Company recognizes revenue in accordance with SOP 97-2, Software Revenue Recognition, and related interpretations. Our software licensing with customers typically have terms and conditions that are described in signed orders. Revenue from perpetual licenses is recognized upon delivery of the licensed product, provided that acceptance has occurred and a signed contractual obligation has been received, the price is fixed and determinable, and collectibility of the receivable is probable.

Service revenues consist principally of software installation, implementation, upgrades, and customer training, as well as software maintenance agreements that include both customer support and the right to upgrades. The Company estimates the value of post-contract customer support sold together with perpetual licenses by reference to published price lists which generally represent the prices at which customers could

Table of Contents

purchase renewal contracts for such services. Revenue from maintenance contracts is recognized ratably over the term of the contract, usually one year. Revenue from training, support and other services is recognized as the services are performed.

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. In addition, Veramark sometimes use click-wrap licenses, under which it license 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.

Table of Contents

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.

Table of Contents

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 months ended March 31, 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 months ended March 31, 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 January 19, 2005, the Company filed a current report on Form 8-K reporting that the Company had modified the method of compensation to be paid to non-executive directors. A copy of such plan detailing non-executive director compensation was attached at Exhibit 10.1.

(2) On February 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 and year ended December 31, 2004. A copy of such press release, was attached as Exhibit 99.1.

Table of Contents

(3) On March 17, 2005, the Company filed a current report on Form 8-K announcing that the Company s Board of Directors had adopted a Directors Deferred Compensation Plan. A copy of such plan was attached as Exhibit 10.1.

(4) On March 31, 2005, the Company filed a current report on Form 8-K announcing that the Company had entered into an Amended and Restated Employment Agreement with David G. Mazzella, effective as of January 31, 2005. A copy of such plan was attached as Exhibit 10.1

Table of Contents

SIGNATURES

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

VERAMARK TECHNOLOGIES, INC.

REGISTRANT

Date: May 13, 2005

/s/ David G. Mazzella

David G. Mazzella
President and CEO

Date: May 13, 2005
/s/ Ronald C. Lundy

Ronald C. Lundy
Treasurer (Chief Accounting
Officer)