VERAMARK TECHNOLOGIES INC
Form 10-Q
August 16, 2010

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

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

o **Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
For Quarter Ended June 30, 2010
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 þ NO o

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

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 o	Accelerated filer o	Non-accelerated filer o	Smaller Reporting Company 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

The number of shares of Common Stock, $.10 par value, outstanding on June 30, 2010 was 9,954,770.

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

	(Unaudited) June 30, 2010	December 31, 2009
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 310,797	$ 488,381
Short-Term Investments	470,430	457,520
Accounts receivable, trade (net of allowance for doubtful accounts of $36,000 and $24,000, respectively)	1,855,546	1,314,986
Inventories, net	12,802	13,510
Prepaid expenses	367,191	389,267
Other current assets	483,215	509,590
Total Current Assets	3,499,981	3,173,254
PROPERTY AND EQUIPMENT		
Cost	3,650,530	3,520,903
Less accumulated depreciation	(3,298,254)	(3,207,550)
Property and Equipment (Net)	352,276	313,353
OTHER ASSETS:		
Software development costs (net of accumulated amortization of $1,783,912 and $2,497,948, respectively)	2,840,747	2,906,505
Pension assets	3,057,028	2,995,657
Intagible assets, net	966,000	
Goodwill	336,219	
Deposits and other assets	1,037,988	995,766
Total Other Assets	8,237,982	6,897,928
TOTAL ASSETS	$ 12,090,239	$ 10,384,535
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 345,260	$ 325,204
Accrued compensation	657,906	457,332
Deferred revenue	3,786,054	3,790,856
Bank debt current portion	300,000	

Pension obligation current portion	502,059	502,059
Contingent liabilities current portion	803,276	
Other accrued liabilities	603,024	632,061
Total Current Liabilities	6,997,579	5,707,512
Long-term portion of contingent liabilities net of current portion	276,550	
Pension obligation	4,556,841	4,674,071
Total Liabilities	11,830,970	10,381,583
STOCKHOLDERS EQUITY:		
Common Stock, par value $.10; shares authorized, 40,000,000; shares issued and outstanding, 10,034,995 and 10,028,952	1,003,499	1,002,895
Additional paid-in capital	22,528,115	22,398,110
Accumulated deficit	(22,990,482)	(23,179,337)
Treasury stock (80,225 shares, at cost)	(385,757)	(385,757)
Accumulated other comprehensive income	103,894	167,041
Total Stockholders Equity	259,269	2,952
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 12,090,239	$ 10,384,535

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 June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
NET REVENUES				
Product sales	$ 662,304	$ 382,259	$ 1,194,710	$ 850,528
Service sales	2,504,887	2,097,131	4,754,210	4,151,541
Total Net Sales	3,167,191	2,479,390	5,948,920	5,002,069
COSTS AND OPERATING EXPENSES:				
Cost of sales	892,088	677,651	1,628,146	1,321,870
Engineering and software development	374,752	278,648	694,791	573,164
Selling, general and administrative	1,778,243	2,049,105	3,454,587	3,822,732
Total Costs and Operating Expenses	3,045,083	3,005,404	5,777,524	5,717,766
INCOME (LOSS) FROM OPERATIONS	122,108	(526,014)	171,396	(715,697)
NET INTEREST INCOME	236	(15,918)	17,459	(6,354)
INCOME (LOSS) BEFORE INCOME TAXES	122,344	(541,932)	188,855	(722,051)
INCOME TAXES				
NET INCOME (LOSS)	$ 122,344	$ (541,932)	$ 188,855	$ (722,051)
NET INCOME (LOSS) PER SHARE				
Basic	$ 0.01	$ (0.05)	$ 0.02	$ (0.07)
Diluted	$ 0.01	$ (0.05)	$ 0.02	$ (0.07)

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

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

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
OPERATING ACTIVITIES:		
Net Income (Loss)	$ 188,855	$ (722,051)
Adjustments to reconcile net income or loss to net cash flows provided by operating activities		
Depreciation and amortization	766,195	773,896
Bad debt expense	14,881	(11,339)
Share based compensation expense	60,327	61,933
Pension assets	(61,371)	(10,840)
Loss on disposal of fixed assets	989	20
Unrealized gain (losses) on investments	(4,347)	229
Changes in assets and liabilities:		
Accounts receivable	(452,815)	185,031
Inventories	708	8,467
Prepaid expenses and other current assets	48,451	(132,908)
Deposits and other assets	(42,222)	(90,005)
Accounts payable	20,056	7,581
Accrued compensation and related taxes	200,574	92,509
Deferred revenue	(4,802)	(321,291)
Other accrued liabilities	(29,037)	(8,097)
Pension obligation	(176,030)	(5,029)
Change in contingent liability stock	(6,980)	
Net cash provided (used) by operating activities	523,432	(171,894)
INVESTING ACTIVITIES:		
Acquisitions	(300,000)	
Purchase sale of investments	(12,910)	338,674
Capitalized software development costs	(572,914)	(636,833)
Additions to property and equipment	(128,474)	(134,597)
Net cash flows used by investing activities	(1,014,298)	(432,756)
FINANCING ACTIVITIES		
Bank borrowing	300,000	
Transfer of surender values		310,000
Proceeds employee stock purchase plan	13,282	14,281
Net cash provided by financing activities	313,282	324,281
NET DECREASE IN CASH AND CASH EQUIVALENTS	(177,584)	(280,369)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	488,381	1,014,669

CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 310,797	$ 734,300

	2010	2009
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash Transactions:		
Income taxes paid, net	$ 1,850	$ 4,350
Interest paid	$ 1,605	$ (202)

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Supplemental Disclosure of Investing Activities

Acquisitions

FMV of Assets Acquired	$ (993,000)
Goodwill	(336,219)
Short-term Increase in Contingent Liabilities	806,936
Long-term Increase in Contingent Liabilities	279,870
Increase in Capital Assets	(11,961)
Increase in Equity	57,000
Accounts Receivable	(102,626)
	$ (300,000)

NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(1) GENERAL
The accompanying unaudited financial statements include all adjustments of a normal and recurring nature which, in the opinion of Company s management, are necessary to present fairly the Company s financial position as of June 30, 2010, the results of its operations for the three and six months ended June 30, 2010 and 2009, and cash flows for the six months ended June 30, 2010 and 2009.
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, 2009.
The results of operations and cash flows for the three and six months ended June 30, 2010 are not necessarily indicative of the results to be expected for the full year s operation.

(2) PROPERTY AND EQUIPMENT

The major classifications of property and equipment at June 30, 2010, and December 31, 2009 were:

	June 30, 2010	December 31, 2009
Machinery and equipment	$ 117,541	$ 117,541
Computer hardware and software	1,285,301	1,164,431
Furniture and fixtures	861,891	853,134
Leasehold improvements	1,385,797	1,385,797
	$ 3,650,530	$ 3,520,903

For the six months ended June 30, 2010 and 2009, the Company recorded depreciation expense of $100,523 and $173,393, respectively.

(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 six months ended June 30, 2010, the Company awarded 23,000 stock options vesting over four years, cancelled 41,775 stock options, and cancelled 120,000 shares of restricted stock previously granted. During the same six months of 2009, the Company awarded 99,000 restricted shares vesting over three years, 35,500 stock options vesting over four years, and cancelled 122,915 stock options.

A summary of the status of the Company s stock option plan as of June 30, 2010 is presented below:

	Shares	Average Exercise Price	Average Grant-Date Fair Value	Remaining Contractual Term (Yrs)	Intrinsic Value
Outstanding as of December 31, 2009	1,740,793	$ 0.94	$ 0.84	4.2	$ 201,626
Granted	23,000	$ 0.49			
Exercised					
Canceled	(41,775)	4.39			(31,102)
Outstanding as of June 30, 2010	1,722,018	$ 0.85	$ 0.77	3.7	$ 170,524
Options exercisable at June 30, 2010	1,629,143	$ 0.86	$ 0.79	3.5	$ 170,524

As of June 30, 2010, there was $35,575 of total unrecognized compensation cost related to non-vested stock options granted under the Plan and $79,708 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 1.0 years. The compensation costs of restricted stock will be recognized over a weighted-average period of 0.7 years.

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(4) TOTAL COMPREHENSIVE INCOME (LOSS)

Total comprehensive income (loss) for the first quarter of 2010 and 2009 was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	**2009**	**2010**	**2009**
Net income (loss)	$ 122,344	$ (541,932)	$ 188,855	$ (722,051)
Unrealized change pension	(29,400)	80,000	(58,800)	183,317
Unrealized change on investments	9,200	5,580	(4,347)	229
Total comprehensive income (loss)	$ 102,144	$ (456,352)	$ 125,708	$ (538,505)

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

ASC 260-10 (SFAS 128) Earnings Per Share as amended in September 2009, 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.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	**2009**	**2010**	**2009**
Basic				
Net Income (Loss)	$ 122,344	$ (541,932)	$ 188,855	$ (722,051)
Weighted average common shares outstanding	9,954,770	9,869,026	9,891,749	9,826,878
Net Income (Loss) per common share	$ 0.01	$ (0.05)	$ 0.02	$ (0.07)
Diluted				
Net Income (Loss)	$ 122,344	$ (541,932)	$ 188,855	$ (722,051)
Weighted average common shares outstanding	9,954,770	9,869,026	9,891,749	9,826,878
Additional dilutive effect of stock options and warrants after application of treasury stock method	108,474		63,662	
Weighted average dilutive shares outstanding	10,063,244	9,869,026	9,955,411	9,826,878
Net Income (Loss) per common share assuming full dilution	$ 0.01	$ (0.05)	$ 0.02	$ (0.07)

There were no dilutive effects of stock options for the three and six months ended June 30, 2009, 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 June 30, 2010 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. During the first quarter of 2010 the Company contributed $24,644 to employee s 401k accounts. During the first quarter of 2009 the Company s contribution to employee 401k accounts totaled $23,868.

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 six months ended June 30, 2010 and 2009 consists of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Interest Cost	41,901	55,000	133,800	46,683
Unrealized Change-Pension	(29,400)	80,000	(58,800)	183,317
Pension Expense	$ 12,501	$ 135,000	$ 75,000	$ 230,000

The Company paid pension obligations of $251,030 for the six months ended June 30, 2010 and $235,030 for the six months ended June 30, 2009.

The discount rate used in determining the actuarial present value of the projected benefit obligation was 5.5% for the six months ended June 30, 2010 and 6.0% for the six months ended June 30, 2009.

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 $3,057,000 at June 30, 2010. The accumulated cash surrender values of these policies at December 31, 2009 was approximately $2,996,000.

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,	
Q3 Q4 2010	251,029
2011	471,925
2012	477,005
2013	487,166
2014	487,166
2015 2019	2,329,859

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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 six months ended June 30, 2010 and 2009 consists of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	**2009**	**2010**	**2009**
Current Service Cost	$ 2,125	$ 2,005	$ 4,250	$ 4,010
Interest Cost	1,287	1,407	2,574	2,814
PRHB Expense	$ 3,412	$ 3,412	$ 6,824	$ 6,824

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

Period Ending December 31, Unless Stated Otherwise,	
Q3 Q4 2010	6,825
2011	13,649
2012	13,649
2013	13,649
2014	10,149
2015 2019	33,245

(8) ACQUISITION

On June 18, 2010 we acquired the enterprise telecom expense management (TEM) consulting business of privately held Source Loop, LLC, based in Alpharetta, Georgia. The aggregate purchase price paid for those assets is up to $1.5 million, plus the issuance of up to 500,000 shares of Veramark s common stock. At closing, $300,000 in cash was paid and 100,000 shares of Veramark common stock issued to the principals of Source Loop. In addition, Source Loop retained $300,000 in accounts receivable and cash on hand prior to the acquisition date, leaving contingent consideration of $900,000 and 400,000 shares of Veramark common stock that can be earned, subject to attaining certain revenue and employee retention parameters through December 31, 2011.

We have recorded total contingent liabilities of $1,080,000, consisting of a short-term portion of $803,000, and a long-term portion of $277,000, reflecting management s current estimate of the expected future consideration to be paid.

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Under the purchase method of accounting, the contingent stock consideration (400,000 shares) is treated as a financial derivative, and recorded as a liability, as it does not have a fixed settlement provision. This liability will vary in a mark-to-market fashion with the value of the Company s stock, until the settlement amount is known. Increases in the Company s stock price will result in an accounting expense, and any decrease in the Company stock price will be recorded as income. Both the initial stock transferred (100,000 shares) and the contingent shares (400,000) were initially valued as $0.57 per share, representing the weighted average share price of the Company s stock for the five trading days preceding and five trading days subsequent to the closing date of the transaction.

The effect of the acquisition was to increase second quarter revenues by $109,000, and decrease net income by $67,000, including transaction costs. The unaudited financial information in the table below summarizes the combined results of operations on a pro-forma basis, as if we had acquired Source Loop on January 1, 2009.

	Three Months Ended June 30,		Six Months Ended June 30,	
Unaudited (In 000s)	**2010**	**2009**	**2010**	**2009**
Revenue	$ 3,735	$ 3,032	$ 6,916	$ 5,898
Income (Loss)	$ 125	$ (556)	$ 168	$ (871)
Earnings Per Share	$ 0.01	$ (0.06)	$ 0.02	$ (0.09)

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(9) OTHER INTANGIBLE ASSETS AND GOODWILL

Under the acquisition method of accounting, we allocated the fair value of the total consideration expected to be transferred, to the tangible and identifiable intangible assets acquired from Source Loop based on their estimated fair values on the date of acquisition. The fair values assigned to the identifiable intangible assets were based on estimates and assumptions determined by management. See the table below.

Amortization of Intangible Assets Acquired in Source Loop Acquisition
(In 000s except for years)

Intangible Asset Class	Weighted Avg Life Years	FMV at Acquisition Date	Accumulated Amortization at 06/30/10	Net Value by Asset Class at 06/30/10
Customer Contracts	3.1	526	11	515
Customer Relationships	2.6	260	7	253
Key Employee Agreements	1.4	177	7	170
Other	0.7	30	2	28
Sub-Total Intangibles Subject to Amortization	2.6	993	27	966
Goodwill		336		
Total Intangible Assets Acquired		1,329		

Expected Future Amortization

Intangible Asset Class	Q3 2010	Q4 2010	2011	2012	2013	2014	2015
Customer Contracts	34	34	112	88	67	60	51
Customer Relationships	21	22	73	42	31	25	19
Key Employee Agreements	21	22	46	42	39		
Other	4	5	10	5	3	1	
Sub-Total Intangibles Subject to Amortization	80	83	241	177	140	86	70

All customer contracts are subject to renewal or extension by December 31, 2011. Management expects the renewal or extension of all of the customer contracts included in the table above.

Goodwill represents the excess of the purchase price paid over the fair value of assets acquired. Goodwill is not amortized and is subject to an impairment test that will be conducted on an annual basis, or more frequently if a change in circumstances or the occurrence of events indicates that potential impairment exists. Through June 30, 2010, there has been no impairment of Goodwill associated with the Source Loop acquisition.

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(10) FACILITIES RELOCATION

On May 10, 2010 the Company entered into an agreement with Eagles Landing 1 LLC, for the lease of approximately 22,878 square feet of office space at the Eagles Landing Business Park located at 1565 Jefferson Road, Building 1, Suite 120 in the town of Henrietta, New York. The initial term of the lease is November 1, 2010 through March 31, 2018. The lease includes two options to extend the initial term for an additional five years each. The company s lease agreement for its current facility expires October 31, 2010. The company expects the move to the new location to reduce facility costs by approximately $200,000 per year.

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

Overview

Revenues for the three months ended June 30, 2010 of $3,167,000, increased 28% from revenues of $2,479,000 for the three months ended June 30, 2009. For the six months ended June 30, 2010, revenues of $5,949,000 increased 19% from revenues of $5,002,000 for the first six months of 2009.

Net income for the three months ended June 30, 2010 of $122,000, or $0.01 per share, compares with a net loss of $542,000, or $0.05 per share for the same quarter of 2009. Net income of $189,000 or $0.02 per share, for the first six months of 2010 compares with a net loss of $722,000, or $0.07 per share, for the first six months of 2009.

On June 18, 2010, the Company acquired substantially all of the assets of the enterprise telecom expense management (TEM) and consulting businesses of privately held Source Loop LLC, a leading provider of such services, based in Alpharetta, Georgia. Source Loop s service capabilities acquired include a full suite of professional and managed services for enterprise-class TEM, including telecom cost elimination programs, telecom assessments, sourcing, auditing, benchmarking and network optimization. Veramark s headquarters will remain in Pittsford, NY, and Source Loop s Alpharetta office will serve as an additional Veramark location. The aggregate purchase price to be paid for those assets is $1.5 million, plus the issuance of up to 500,000 shares of Veramark common stock, both subject to adjustment based on financial performance measures. At closing, principals of Source Loop received, as a group, $300,000 in cash and 100,000 shares of Veramark common stock and retained $300,000 of Source Loop s accounts receivable and cash on hand immediately prior to the acquisition date.

Embedded revenue, which represents the value of orders received for products and services to be provided in future periods, increased to approximately $8.4 million at June 30, 2010, or 12% from the December 31, 2009 total of $7.5 million. Embedded revenues at June 30, 2010 include $1.2 million attributable to TEM contracts assigned to Veramark pursuant to the acquisition discussed above.

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Revenues

Revenues recognized for TEM and Business Process Outsourcing (BPO) services increased 46% for the quarter ended June 30, 2010, and 53% for the six months ended June 30, 2010, from the same three and six month periods of 2009. Included in second quarter 2010 TEM /BPO revenues is $109,000 attributable to the acquisition of Source Loop. Revenues derived from the sale of software licenses and services increased 65% for the three months ended June 30, 2010 and 25% for the six month ended June 30, 2010 from the same three and six month period of 2009. Throughout the first half of 2010 we have experienced increased revenues from our largest channel for call accounting products, Avaya Inc., and its master distribution partners, as well as from new partners developed during that past two years. Revenues recognized from the provisioning of maintenance contracts on software products increased 2% for the three months ended June 30, 2010, and 1% for the six months ended June 30, 2010, from prior year results.

Gross Margin

Gross margins (sales less cost of sales) of $2,275,000 and $4,321,000 for the three and six months ended June 30, 2010, increased 26% and 17%, respectively, from gross margins of $1,802,000 and $3,680,000 for the three and six months ended June 30, 2009. Gross margin as a percentage of revenues was 73% for the six months ended June 30, 2010, which compares with a gross margin percentage of 74% for the first six months of 2009.

Operating Expenses

Engineering and software developments costs, net of the effects of capitalization, of $375,000 for the three months ended June 30, 2010 and $695,000 for the six months ended June 30, 2010, increased 34% and 21%, respectively, from the same three and six month periods of 2009. The increase in net expense for both periods results primarily from a reduction in the amount of software development costs capitalized in 2010 as compared with 2009. The chart below summarizes gross spending for engineering and software development, software development costs capitalized, and the resulting net effect on the Company s statement of operations for the three and six month periods ended June 30, 2010 and 2009.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	**2009**	**2010**	**2009**
Gross expenditures for engineering & software development	$ 645,000	$ 618,000	$ 1,268,000	$ 1,210,000
Less: Software development costs capitalized	(270,000)	(339,000)	(573,000)	(637,000)
Net expense for engineering and software	$ 375,000	$ 279,000	$ 695,000	$ 573,000

Selling, general and administrative (SG&A) expenses of $1,778,000 for the three months ended June 30, 2010, decreased $271,000, or 13%, from $2,049,000 for the three months ended June 30, 2009. For the six months ended June 30, 2010, SG&A expenses of $3,455,000 decreased 10% from the 2009 expenses of $3,823,000. The reduction in SG&A expense for both the three and six months ended June 30, 2010 include the effect of a permanent cap placed on future pension benefits in the fourth quarter of 2008. Additionally, the Company has seen a reduction in its selling and marketing costs in 2010 as compared with the prior year.

Liquidity and Capital Resources

The Company s total cash position, (cash on hand plus the value of short term investments), of $781,000 at June 30, 2010 decreased from a total cash position of $946,000 at December 31, 2009. The Company borrowed $300,000 against its existing line of credit arrangement in June in conjunction with the acquisition of Source Loop.

Accounts receivable at June 30, 2010 of $1,856,000 increased 41% from the December 31, 2009 balance of $1,315,000. The current balance includes $192,000 from customers acquired as part of the Source Loop acquisition. The reserve for bad debts has been increased from $24,000 at December 31, 2009 to $36,000 at June 30, 2010, in response to the higher accounts receivable balance, however, we have not experienced any change in the payment patterns of our customers and do not foresee any significant credit issues associated with current customer balances, including those acquired from Source Loop.

Prepaid expenses of $367,000 at June 30, 2010 decreased $22,000 from the December 31, 2009 balance of $389,000, due to reduction in prepaid commissions due our sales force for orders received.

Property and equipment, net of accumulated depreciation of $352,000 at June 30, 2010, compares with net property and equipment of $313,000 at December 31, 2009. Capital expenditures of $128,000 for the first six months of 2010 were slightly below the $135,000 of capital expenditures for the same period of 2009. Through the first six months of 2010, depreciation expense totaled $101,000 versus depreciation expense of $173,000 for the first six months of 2009. Property and equipment at June 30, 2010 includes $12,000 of acquired fixed assets, representing the net book value of assets acquired from Source Loop.

Capitalized software development costs of $2,841,000 at June 30, 2010, decreased $66,000, or 2%, from the December 31, 2009 total of $2,907,000. Software development costs capitalized for the first six months of 2010 of $573,000, decreased from $637,000 of development costs capitalized for the first six months of 2009. Amortization of previously capitalized costs totaled $639,000 for the first six months of 2010, up from $601,000 for the first six months of 2009. The amortization of software development costs are charged to cost of sales.

Pension assets of $3,057,000 represent the current cash surrender values of Company owned life insurance policies, the cash surrender values and associated death benefits of which are intended to fund current and future pension obligations. Pension assets totaled $2,996,000 at December 31, 2009. Cash surrender values are available at the Company s discretion to fund current operations.

Total liabilities of $11,831,000 at June 30, 2010, increased $1,449,000 from the December 31, 2009 balance of $10,382,000 reflecting the acquisition of Source Loop and utilization of the Company s line of credit agreement as discussed above. We have recorded total contingent liabilities of $1,080,000, consisting of a short term portion of $803,000 and a long term portion of $277,000, reflecting managements current estimate of the expected additional future consideration to be paid for the acquisition of Source Loop. The final consideration paid will be determined pursuant to specific revenue and employee retention metrics to be measured over the next 18 months, and therefore cannot be determined with certainty at this time.

Accounts payable at June 30, 2010 of $345,000 increased $20,000 from $325,000 at December 31, 2009, reflecting merely the timing of payments to vendors and suppliers, rather than a change in our normal payment patterns.

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Accrued compensation of $457,000 at December 31, 2009 increased $201,000 to $658,000 at June 30, 2010. The increase is entirely attributable to the timing of the Company s bi-weekly payroll, with the final two weeks of accrued salaries for June being paid subsequent to the end of the quarter.

Deferred revenues, which include the value of maintenance, training, installation and other contracted services, for which customers have been billed, but the service has not yet been performed, totaled $3,786,000 at June 30, 2010, relatively unchanged from the December 31, 2009 total of $3,791,000. The vast majority of these services will be performed over the next twelve months at which time the corresponding revenue will be recognized in the statement of operations.

Long-term pension obligations of $4,556,000 decreased 3% from the December 31, 2009 total of $4,674,000. Future pension obligations are expected to be funded utilizing the cash surrender values and death benefits provided by a series of Company-owned life insurance policies.

Stockholders equity of $259,000 at June 30, 2010 has increased $256,000 from total stockholders equity of $3,000 at December 31, 2010, primarily due to the net income of $189,000 earned for the first six months of 2010. Included in stockholders equity at June 30, 2010 is 100,000 shares of common stock issued, in total, to the four principal members of Source Loop, and approximately 26,000 shares purchased by employees through the Company s employee stock purchase plan.

Management has reviewed its current cash and investment positions, operating expense levels and access to additional capital, and concluded that more than sufficient resources are available to fully fund operations and strategic objectives for the next twelve months and beyond.

Accounting Pronouncements

In October 2009, the FASB issued Accounting Standards Update No. 2009-13, *Multiple-Deliverable Revenue Arrangements,* which amends existing revenue recognition accounting pronouncements that are currently within the scope of FASB Codification Subtopic 605-25 (previously included within EITF Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*, or EITF 00-21). The consensus to EITF Issue No. 08-01, *Revenue Arrangements with Multiple Deliverables*, or EITF 08-01, provides accounting principles and application guidance on whether multiple deliverables exist, how the arrangement should be separated, and the consideration allocated. This guidance eliminates the requirement to establish the fair value of undelivered products and services and instead provides for separate revenue recognition based upon management s estimate of the selling price for an undelivered item when there is no other means to determine the fair value of that undelivered item. EITF 00-21 previously required that the fair value of the undelivered item be the price of the item either sold in a separate transaction between unrelated third parties or the price charged for each item when the item is sold separately by the vendor. This was difficult to determine when the product was not individually sold because of its unique features. Under EITF 00-21, if the fair value of all of the elements in the arrangement was not determinable, then revenue was deferred until all of the items were delivered or fair value was determined. This new approach is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company will have to evaluate the impact of this standard on future revenue arrangements that we may enter into.

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In January 2010, the FASB issued Accounting Standards Update No. 2010-06, topic 820, *Fair Value Measurements and Disclosures*, which amends existing fair value disclosure pronouncements. This update provides amendments to Subtopic 820-10 that require new disclosures as follows:

1. Transfers in and out of Levels 1 and 2. A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers.
2. Activity in Level 3 fair value measurements. In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number).

This update also provides amendments to Subtopic 820-10 that clarify existing disclosures as follows:

1. Level of disaggregation. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities.
2. Disclosures about inputs and valuation techniques. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3.

This update also includes conforming amendments to the guidance on employers disclosures about postretirement benefit plan assets (Subtopic 715-20). The conforming amendments to Subtopic 715-20 change the terminology from *major categories* of assets to *classes* of assets and provide a cross reference to the guidance of Subtopic 820-10 on how to determine appropriate classes to present fair value disclosures.

This update is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years.

In April 2010, the FASB issued Accounting Standards Update No. 2010-13, topic 718, *Compensation Stock Compensation*, which adds clarification that an employee share-based award with an exercise price denominated in the currency of a market in which a substantial portion of the entity s equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as an equity. This update is effective for fiscal years, and interim periods within those fiscal years beginning on or after December 15, 2010. The Company does not expect this to have a material effect on the Company s financial statements.

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In April 2010, the FASB issued Accounting Standards Update No. 2010-17, topic 605, *Revenue Recognition Milestone Method*, which provides guidance on the criteria that should be met for determining whether the milestone method of revenue recognition is appropriate. A vendor can recognize consideration that is contingent upon achievement of a milestone in its entirety as revenue in the period in which the milestone is achieved only if the milestone meets all criteria to be considered substantive. This update is effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010. The Company is currently evaluating the impact this update may have on the Company s financial statements.

In July 2010, the FASB issued Accounting Standards Update No. 2010-20, topic 310, *Receivables*, which requires disclosures about the credit quality of financing receivables and the allowance for credit losses. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The Company does not expect this to have a material effect on the Company s financial statements.

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 as described below. 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 ASC 985-605, formerly 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 , and under ASC 605-25, formerly 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. The Company uses 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 the Company 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

The Company capitalizes software development costs when technological feasibility has been established for the software in accordance with ASC 985-20, formerly 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. The Company 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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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 Finance 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 1A Risk Factors

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

Intellectual Property Rights

The Company regards its products as proprietary and attempts to protect them with a combination of copyright, trademark and trade secret protections, employee and third-party non-disclosure agreements and other methods of protection. Despite those precautions, it may be possible for unauthorized third parties to copy certain portions of the Company s products, reverse engineer or obtain and use information that the Company 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 the Company s intellectual property could have a material adverse effect on its business and results of operations. Furthermore, although the Company 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 the Company in the future with respect to current or future products. Any such assertion could require the Company to enter into royalty arrangements or result in costly litigation.

Existing Customer Base

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

Product Development

The Company has made significant investments in research, development and marketing for new products, services and technologies, including the VeraSMART software offering and its hosted or managed solutions. Significant revenue from new product and service investments may not be achieved for a number of years, if at all. Moreover, if such products or services are profitable, operating margins may not be as high as the margins historically experienced by the Company. The development of software products is a complex and time-consuming process. New products and enhancements to existing products can require long development and testing periods. Significant delays in new product releases or significant problems in creating new products, particularly any delays in future releases of the VeraSMART suite of products or services, could adversely affect the Company s revenues.

Declines in Demand for Software

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

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New Products and Services

The Company is in the process of transforming it s business model from a company providing largely premise based software products and services to one offering hosted solutions providing a wide variety of TEM processes, such as wireless management, invoice processing, and reporting as managed services under multi year arrangements. The effect of this transformation will be a reduction in the amount of revenues recognized initially on any given contract than would be realized from a one- time sale of software, but higher embedded future revenues over the life of the contract. Since major components of the Company s cost structure including personnel and facility costs are relatively fixed based on anticipated revenues, period to period comparisons of the Company s operating results should not be relied upon as an indicator of future performance.

Competition

The Company experiences intense competition across all markets for its products and services. Some competing firms have greater name recognition and more financial, marketing and technological resources than the Company. 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

The Company 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 the Company to their specific specifications, while others resell the Company s products. Any loss of the continued availability of those relationships could have a material adverse effect on the Company s business and results of operations.

Security and Privacy Breaches in the Company Systems May Damage Client Relations and Inhibit our Growth

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

Stock Price Volatility

The acquisition of Source Loop has resulted in a contingent liability, comprised in part by shares of Company stock that may be issued in the future, as partial consideration of the acquisition. The value of the stock liability could vary based upon several factors, including changes in the Company s stock price through December 31, 2011. Under ASC 805, the Company is required to record the change in the value of the stock liability, if any, through the statement of operations.

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Item 5 Other Information

None

Item 6 Exhibits

(a) Financial Statements as set forth under Item 1 of this report on Form 10-Q

(b) Exhibits required to be filed by Item 601 of Regulation S-K

3.1	Restated Certificate of Incorporation (incorporated by reference to Exhibit 4.1 to the Company s Registration Statement on Form S-18 (File No. 2-96787) filed on March 22, 1985)
3.2	Bylaws (incorporated by reference to Exhibit 3 to the Company s Registration Statement on Form S-8 filed on October 5, 1992)
10.1	Letter Agreement dated as of March 29, 2007 by and between the Company and David G. Mazzella (incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on April 3, 2007)
10.2*	Amended and Restated Board of Directors Deferred Compensation Plan (incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on November 26, 2007)
10.3*	Employment Agreement dated as of December 17, 2007 by and between the Company and Anthony C. Mazzullo (incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on December 19, 2007)
10.4*	Restricted Stock Award Agreement dated as of January 1, 2008 by and between the Company and Anthony C. Mazzullo (incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on March 25, 2008)
10.5*	2008 Incentive Plan for Management and Key Employees (incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on April 2, 2008)
10.6*	2008 Employee Stock Purchase Plan (incorporated by reference to Exhibit F to the Company s Proxy Statement for its 2008 Annual Meeting of Shareholders filed on April 29, 2008)
10.7*	Description of non-employee director compensation (incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on August 18, 2008)
10.8*	Amended Salary Continuation Agreement dated as of October 10, 2008 by and between the Company and Ronald C. Lundy (incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on October 17, 2008)
10.9*	Form of 2008 Employee Stock Purchase Plan Enrollment Agreement (incorporated by reference to Exhibit 4.2 to the Company s Registration Statement on Form S-8 (File No. 333-155286) filed on November 12, 2008)

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10.10*	2010 Bonus Compensation Plan dated as of March 1, 2010 by and between the Company and Anthony C. Mazzullo (incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on March 5, 2010)
10.11*	2010 Incentive Plan for Management and Key Employees (incorporated by reference to Exhibit 10.2 to the Company s Current Report on Form 8-K filed on March 5, 2010)
14	Code of Business Conduct and Ethics (incorporated by reference to Exhibit E to the Company s Proxy Statement for its 2008 Annual Meeting of Shareholders filed on April 29, 2008)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Management contract or compensatory plan or arrangement

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

none

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

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SIGNATURES

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

VERAMARK TECHNOLOGIES, INC.
REGISTRANT

Date: August 13, 2010

/s/ Anthony C. Mazzullo

Anthony C. Mazzullo
President and CEO

Date: August 13, 2010

/s/ Ronald C. Lundy

Ronald C. Lundy
Vice President of Finance and CFO