

VERAMARK TECHNOLOGIES INC

Form 10-Q

November 14, 2011

**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**  
**or**

**Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**  
For the quarterly period ended September 30, 2011

**For Quarter Ended September 30, 2011**  
**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)

1565 Jefferson Road, Suite 120 Rochester, NY 14623

(Address of principal executive offices)(Zip Code)

(585) 381-6000

(Registrant's telephone number, including area code)

N/A

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting  
Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES  NO

The number of shares of Common Stock, \$.10 par value, outstanding on September 30, 2011 was 10,479,933.

**INDEX**

	Page
<b><u>PART I FINANCIAL INFORMATION</u></b>	
<b><u>Item 1 Financial Statements</u></b>	
<u>Condensed Balance Sheets - September 30, 2011 (Unaudited) and December 31, 2010</u>	3
<u>Condensed Statements of Operations (Unaudited) Three and Nine Months ended September 30, 2011 and 2010</u>	4
<u>Condensed Statements of Cash Flows (Unaudited) Nine Months Ended September 30, 2011 and 2010</u>	5
<u>Notes To Condensed Financial Statements (Unaudited)</u>	6 - 12
<u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	13 - 22
<u>Item 3 Quantitative and Qualitative Disclosures About Market Risk</u>	22
<u>Item 4 Controls and Procedures</u>	23
<b><u>PART II OTHER INFORMATION</u></b>	
<u>Item 1 Legal Proceedings</u>	24
<u>Item 1A Risk Factors</u>	24 - 26
<u>Item 5 Other Information</u>	27
<u>Item 6 Exhibit Index</u>	27 - 28
<u>Exhibit 31.1</u>	
<u>Exhibit 31.2</u>	
<u>Exhibit 32.1</u>	
<u>Exhibit 32.2</u>	
<u>EX-101 INSTANCE DOCUMENT</u>	
<u>EX-101 SCHEMA DOCUMENT</u>	
<u>EX-101 CALCULATION LINKBASE DOCUMENT</u>	
<u>EX-101 LABELS LINKBASE DOCUMENT</u>	
<u>EX-101 PRESENTATION LINKBASE DOCUMENT</u>	

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

	<b>(Unaudited) September 30, 2011</b>	<b>December 31, 2010</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 594,343	\$ 1,236,375
Investments	161,621	265,962
Accounts receivable, trade (net of allowance for doubtful accounts of \$26,000 and \$33,000)	1,736,394	1,911,693
Prepaid expenses	464,524	294,090
Other current assets	909,048	290,762
<b>Total Current Assets</b>	<b>3,865,930</b>	<b>3,998,882</b>
<b>PROPERTY AND EQUIPMENT</b>		
Cost	2,598,143	2,512,162
Less accumulated depreciation	(2,027,165)	(1,909,965)
<b>Property and Equipment (net)</b>	<b>570,978</b>	<b>602,197</b>
<b>OTHER ASSETS:</b>		
Software development costs (net of accumulated amortization of \$3,016,803 and \$2,245,268)	2,819,342	2,961,617
Pension assets	3,199,422	3,107,952
Intangibles, net	623,250	804,000
Goodwill	336,219	336,219
Deposits and other assets	1,104,374	1,062,152
<b>Total Other Assets</b>	<b>8,082,607</b>	<b>8,271,940</b>
<b>TOTAL ASSETS</b>	<b>\$ 12,519,515</b>	<b>\$ 12,873,019</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 277,334	\$ 360,382
Accrued compensation	736,609	667,062
Deferred revenue	4,516,813	4,250,933
Current portion of pension obligation	522,739	502,059
Contingent liability	210,000	899,400
Short term bank debt	66,667	246,667
Short term note payable	250,000	0
Other accrued liabilities	956,746	415,459
<b>Total Current Liabilities</b>	<b>7,536,908</b>	<b>7,341,962</b>

Edgar Filing: VERAMARK TECHNOLOGIES INC - Form 10-Q

Long-Term debt	176,889	174,555
Long-Term portion of pension obligation	4,697,533	4,914,757
Total Liabilities	12,411,330	12,431,274
STOCKHOLDERS EQUITY:		
Common Stock, par value \$.10; shares authorized, 40,000,000; 10,560,158 shares and 10,190,595 shares issued	1,056,015	1,019,059
Additional paid-in capital	22,834,645	22,661,405
Accumulated deficit	(23,100,789)	(22,568,440)
Treasury stock (80,225 shares, at cost)	(385,757)	(385,757)
Accumulated other comprehensive income	(295,929)	(284,522)
Total Stockholders Equity	108,185	441,745
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 12,519,515	\$ 12,873,019

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

**Table of Contents**

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>NET REVENUES</b>				
Product revenues	\$ 400,612	\$ 586,848	\$ 1,242,181	\$ 1,781,557
Service revenues	3,028,727	3,041,479	8,820,124	7,795,690
Total Net Revenues	3,429,339	3,628,327	10,062,305	9,577,247
<b>COSTS AND OPERATING EXPENSES:</b>				
Cost of revenues	1,164,118	1,005,638	3,341,506	2,633,784
Engineering and software development	227,350	385,292	828,097	1,080,083
Selling, general and administrative	1,961,512	2,053,339	5,604,014	5,507,926
Litigation expenses & settlement costs	0	0	862,995	0
Total Costs and Operating Expenses	3,352,980	3,444,269	10,636,612	9,221,793
<b>INCOME (LOSS) FROM OPERATIONS</b>	<b>76,359</b>	<b>184,058</b>	<b>(574,307)</b>	<b>355,454</b>
<b>NET INTEREST INCOME</b>	<b>9,182</b>	<b>29,760</b>	<b>41,958</b>	<b>47,219</b>
<b>INCOME (LOSS) BEFORE TAXES</b>	<b>85,541</b>	<b>213,818</b>	<b>(532,349)</b>	<b>402,673</b>
<b>INCOME TAXES</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>NET INCOME (LOSS)</b>	<b>\$ 85,541</b>	<b>\$ 213,818</b>	<b>\$ (532,349)</b>	<b>\$ 402,673</b>
<b>NET INCOME (LOSS) PER SHARE</b>				
Basic	\$ 0.01	\$ 0.02	\$ (0.05)	\$ 0.04
Diluted	\$ 0.01	\$ 0.02	\$ (0.05)	\$ 0.04

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

**Table of Contents**

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

	<b>Nine Months Ended September</b>	
	<b>30,</b>	
	<b>2011</b>	<b>2010</b>
<b>OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ (532,349)	\$ 402,673
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,122,836	1,118,126
Increase (decrease) in bad debt reserve	(7,000)	23,500
Change in acquisition liabilities	(239,400)	(47,730)
Compensation expense equity grants	36,523	103,804
Loss on disposal of fixed assets	39	2,347
Changes in assets and liabilities:		
Accounts receivable	182,299	(1,232,481)
Prepaid expenses and other current assets	(788,720)	340,054
Pension assets	(91,470)	(98,898)
Deposits and other assets	(42,222)	(209,168)
Accounts payable	(83,048)	177,363
Accrued compensation and related taxes	69,547	257,773
Deferred revenue	265,880	302,908
Other accrued liabilities	541,287	(287,251)
Note payable	250,000	0
Prepaid rent liability	52,334	0
Pension obligation	(196,544)	(169,045)
Net cash provided by operating activities	539,992	683,975
<b>INVESTING ACTIVITIES:</b>		
Acquisition cash paid	(450,000)	(300,000)
Sale of investments	92,934	160,794
Additions to property and equipment	(120,306)	(154,934)
Capitalized software development costs	(648,325)	(839,372)
Net cash flows used by investing activities	(1,125,697)	(1,133,512)
<b>FINANCING ACTIVITY:</b>		
Borrowing (repayment) line of credit	(180,000)	300,000
Bank borrowing repayment of term loan	(50,000)	0
Exercise of stock options	161,259	0
Employee stock purchase plan	12,414	13,282
Net cash provided (used) by financing activities	(56,327)	313,282
Net change in cash and cash equivalents	(642,032)	(136,255)
Cash and cash equivalents, beginning of year	1,236,375	488,381

Cash and cash equivalents, end of quarter	\$	594,343	\$	352,126
---	----	---------	----	---------

**CONDENSED STATEMENTS OF CASH FLOWS**

		<b>2011</b>		<b>2010</b>
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>				
Cash Transactions:				
Net Income taxes paid (refunded)	\$	(8,306)	\$	2,873
Net Interest paid	\$	9,446	\$	5,691

*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 September 30, 2011, the results of its operations for the three and nine months ended September 30, 2011 and 2010, and cash flows for the nine months ended September 30, 2011 and 2010.

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, 2010.

The results of operations and cash flows for the three and nine months ended September 30, 2011 are not necessarily indicative of the results to be expected for the full year's operation. Certain prior period amounts have been reclassified to conform to the current period presentation.

**(2) PROPERTY AND EQUIPMENT**

The major classifications of property and equipment at September 30, 2011, and December 31, 2010 were:

	<b>September 30, 2011</b>	<b>December 31, 2010</b>
Machinery and equipment	\$ 116,385	\$ 117,541
Computer hardware and software	1,298,051	1,216,120
Furniture and fixtures	1,183,707	1,178,501
	<b>\$ 2,598,143</b>	<b>\$ 2,512,162</b>

For the nine months ended September 30, 2011 and 2010, the Company recorded depreciation expense of \$151,486 and \$148,556, respectively.

**(3) STOCK-BASED COMPENSATION**

The Company's share-based compensation consists of restricted stock and stock options, vesting over periods ranging from one to four years. For the nine months ended September 30, 2011, the Company awarded 301,875 stock options vesting over four years, cancelled 107,896 stock options, cancelled 53,333 restricted shares granted in previous periods, and exercised 398,554 options. During the first nine months of 2010, the Company awarded 98,000 stock options and 54,000 restricted shares. The Company cancelled 259,650 stock options, and 135,194 shares of restricted stock previously granted during the same period.

**Table of Contents**

A summary of the status of the Company's stock option plan as of September 30, 2011, is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Grant-Date Fair Value	Average Remaining Contractual Term (Yrs)	Intrinsic Value
Outstanding as of December 31, 2010	1,557,768	\$ 0.62	\$ 0.58	4.1	\$ 79,154
Granted	301,875	0.69	0.67		0
Exercised	(398,554)	0.43			(31,914)
Canceled	(107,896)	0.51			(8,160)
Outstanding as of September 30, 2011	1,353,193	\$ 0.70	\$ 0.70	6.1	\$ 39,080
Options exercisable at September 30, 2011	993,693	\$ 0.72	\$ 0.72	4.9	\$ 39,080

As of September 30, 2011, there was \$140,948 of total unrecognized compensation cost related to non-vested stock options granted under the Plan, and \$26,422 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 1.2 years. The compensation costs of restricted stock will be recognized over a weighted-average period of 0.8 years.

**(4) COMPREHENSIVE INCOME**

Total comprehensive income for the three and nine months ended September 30 of 2011 and 2010 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net income (loss)	\$ 85,541	\$ 213,818	\$ (532,349)	\$ 402,673
Unrealized change - pension	0	(29,400)	0	(88,200)
Unrealized change - investments	(1,342)	(25,212)	(11,407)	(29,559)
Total comprehensive income	\$ 84,199	\$ 159,206	\$ (543,756)	\$ 284,914

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

ASC 260-10 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.

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>Basic</b>				
Net Income (loss)	\$ 85,541	\$ 213,818	\$ (532,349)	\$ 402,673
Weighted average common shares outstanding	10,426,311	9,945,611	10,234,239	9,909,703
Net Income (loss) per common share	\$ 0.01	\$ 0.02	\$ (0.05)	\$ 0.04
<b>Diluted</b>				
Net Income (loss)	\$ 85,541	\$ 213,818	\$ (532,349)	\$ 402,673
Weighted average common shares outstanding	10,426,311	9,945,611	10,234,239	9,909,703
Additional dilutive effect of stock options and warrants after application of treasury stock method	57,080	180,947	0	102,757
Weighted average dilutive shares outstanding	10,483,391	10,126,558	10,234,239	10,012,460
Net Income (loss) per common share assuming full dilution	\$ 0.01	\$ 0.02	\$ (0.05)	\$ 0.04

There were no dilutive effects of stock options for the nine months ended September 30, 2011 as the effect would have been anti-dilutive due to the net loss incurred for that period.

**(6) INDEMNIFICATION OF CUSTOMERS**

Our agreements with customers generally require us to indemnify the customer against claims that our software infringes third party patent, copyright, trademark or other proprietary rights. Such indemnification obligations are generally limited in a variety of industry-standard respects, including our right to replace an infringing product. As of September 30, 2011 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. During the first quarter of 2011 and for the year 2011 to date the Company contributed \$26,589 to employee's 401(k) accounts. During the first quarter of 2010, and for the first three quarters of 2010, the Company's contribution to employee 401(k) accounts totaled \$24,644.

**Table of Contents**

The Company also sponsors an unfunded Supplemental Executive Retirement Program ( SERP ), which is a non-qualified plan that provides certain key employees defined pension benefits. Periodic pension expense for the three and nine months ended September 30, 2011 and 2010 consists of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Interest Cost	60,000	161,899	180,000	295,699
Unrealized Actuarial Gain	0	(29,400)	0	(88,200)
Pension Expense	\$ 60,000	\$ 132,499	\$ 180,000	\$ 207,499

The Company paid pension obligations of \$376,544 for both the nine months ended September 30, 2011 and the nine months ended September 30, 2010.

The discount rate used in determining the actuarial present value of the projected benefit obligation was 5.0% for the nine months ended September 30, 2011 and 5.5% for the nine months ended September 30, 2010.

The Company maintains life insurance covering certain current and former employees under its Supplemental Executive Retirement Program with the Company named as beneficiary. The Company intends to use the death benefits of these policies, as well as loans against the accumulating cash surrender value of the policies, to fund future pension obligations. The total death benefit associated with these policies is \$10.2 million, with an associated accumulated cash surrender value of approximately \$3,199,000 at September 30, 2011. The accumulated cash surrender values of these policies at December 31, 2010 was approximately \$3,108,000.

The projected pension benefits paid or expected to be paid under this plan are as follows, assuming retirement at age 65 and a life expectancy of 80 - 83 years for all participants:

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

Q4 2011	125,514
2012	538,159
2013	558,660
2014	460,526
2015	418,926
2016 - 2020	2,401,241

**Table of Contents****(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 was 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 were 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 could be earned, subject to attaining certain revenue and employee retention parameters through December 31, 2011. Through September 30, 2011 we have paid the Principals of Source Loop \$450,000 and issued 100,000 shares of common stock against performance targets for 2010 and 2011 contained in the asset purchase agreement.

As of September 30, 2011, based on management's projections of actual performance against targets contained in the asset purchase agreement for 2011, the estimated remaining contingent liability is \$210,000 in cash and common stock. Under the purchase method of accounting, the remaining contingent stock consideration (300,000 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 decreases in the Company's stock price will be recorded as income.

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, 2010.

Unaudited (In 000s)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2011	2010	2011	2010
Revenue	\$ 3,429	\$ 3,628	\$ 10,062	\$ 10,145
Income (Loss)	\$ 86	\$ 214	\$ (532)	\$ 367
Earnings Per Share	\$ 0.01	\$ 0.02	\$ (0.05)	\$ 0.04

**(9) INTANGIBLE ASSETS AND GOODWILL**

Under the purchase method of accounting, we allocated the fair value of the total consideration expected to be transferred, to the tangible and identifiable intangible assets acquired from Source Loop based on their estimated fair values on the date of acquisition. The fair values assigned to the identifiable intangible assets were based on estimates and assumptions determined by management. The table below summarizes the fair values assigned to the identifiable intangible assets by asset class at the time of acquisition, and the subsequent amortization through September 30, 2011 of those intangible assets.

**Table of Contents**

## Amortization of Intangible Assets Acquired in Source Loop Acquisition

(In 000s except weighted ave life in years)

<b>Intangible Asset Class</b>	<b>Weighted Avg Life Years</b>	<b>FMV at Acquisition Date</b>	<b>Current Year Amortization</b>	<b>Accumulated Amortization at 9/30/11</b>	<b>Net Value by Asset Class at 9/30/11</b>
Customer Contracts	3	\$ 526	\$ 84	\$ 162	\$ 364
Customer Relationships	3	260	54	104	156
Key Employee Agreements	1	177	36	86	91
Other	1	30	7	18	12
Sub-Total Intangibles Subject to Amoritization	3	993	\$ 181	\$ 370	\$ 623
Goodwill		336			
Total Intangible Assets Acquired		\$ 1,329			

## Expected Future Amoritization

<b>Intangible Asset Class</b>	<b>Q4 2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
Customer Contracts	\$ 28	\$ 88	\$ 67	\$ 60	\$ 51
Customer Relationships	19	42	31	25	19
Key Employee Agreements	10	42	39	0	0
Other	3	5	3	1	0
Sub-Total Intangibles Subject to Amoritization	\$ 60	\$ 177	\$ 140	\$ 86	\$ 70

Goodwill represents the excess of the purchase price paid over the fair value of assets acquired. Goodwill is not amortized and is subject to an impairment test conducted in December of each year, or more frequently if a change in circumstances or the occurrence of events indicates that potential impairment exists. Through September 30, 2011, there has been no impairment of goodwill associated with the Source Loop acquisition.

**(10) COMMITMENTS AND CONTINGENCIES**

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

Material terms of the agreement included:

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

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

The lawsuit was dismissed against the Company.



**Table of Contents**

**(11) REVOLVING DEMAND NOTE AGREEMENT**

On October 31, 2008, Veramark Technologies, Inc. entered into a Revolving Demand Note Agreement (the Agreement ), effective as of October 31, 2008, with Manufacturers and Traders Trust Company (the Bank ) to provide working capital in the ordinary course of business. This Agreement was amended in October 2010 increasing the amount available under the agreement from \$400,000 to \$750,000. At September 30, 2011, the Company did not have any outstanding balance under this Agreement.

The material terms of the Agreement include:

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

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

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

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

**(12) TERM NOTE AGREEMENT**

On October 29, 2010, the Company entered into an agreement with Manufacturers and Traders Trust Company to provide a three year term loan in the amount of \$200,000, the proceeds of which were used to purchase furnishings and fixtures for the Company s new headquarters facility. The loan bears an interest rate of LIBOR plus 4.0%, with a minimum interest rate of 4.5%. At September 30, 2011, the remaining balance of the term loan was \$138,889.



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

**Overview**

Revenues of \$3,429,000 for the quarter ended September 30, 2011 decreased 5% from revenues of \$3,628,000 for the same quarter of 2010. For the nine months ended September 30, 2011 revenues of \$10,062,000 increased 5% from revenues of \$9,577,000 for the first nine months of 2010.

Net income of \$86,000, or \$0.01 per share for the quarter ended September 30, 2011 compares with a net income of \$214,000, or \$0.02 per share, for the same quarter of 2010. For the nine months ended September 30, 2011 we have incurred a net loss of \$532,000, which includes \$863,000 legal and settlement costs expensed in the first and second quarters of 2011 in connection with a patent infringement complaint filed by Asentinel LLC, against Veramark and two other defendants in October 2010. Absent those one-time costs, net income for the nine months ended September 30, 2011 would have been \$331,000, or \$0.03 per share. For the nine months ended September 30, 2010 we reported net income of \$403,000, or \$0.04 per share.

Orders booked for the quarter ended September 30, 2011 of \$4.9M increased 14% from orders of \$4.3 million for the same quarter of 2010, and orders booked of \$12.9 million for the nine months ended September 30, 2011 increased 33% from \$9.7 million for the first nine months of 2010. Recurring revenues, representing our backlog of orders and services to be provided, and recognized as revenue in future periods, increased 26% from the December 31, 2010 total of \$9.6 million, to \$12.1 million at September 30, 2011. Of that amount, approximately \$7.8 million will be recognized over the next 12 months.

**Non-GAAP Financial Measures**

Removing the one-time settlement and litigation costs referenced above, net income for the nine months ended September 30, 2011 would have been \$331,000, or \$0.03 per share, versus \$403,000, or \$0.04 per share for the first nine months of 2010, as depicted in the table below.

**Table of Contents****Reconciliation of GAAP Net Income to Non-GAAP Net Income**

Unaudited (In 000s)	Q-1 2011	Q-2 2011	Q-3 2011	Nine Months Ended September 2011
GAAP Net Income (Loss)	\$ 53	\$ (671)	\$ 86	\$ (532)
Legal Expenses	139	224	0	363
Settlement Amount	0	500	0	500
Adjusted Net Income (Non-GAAP)	\$ 192	\$ 53	\$ 86	\$ 331
Fully Diluted EPS (Non-GAAP)	\$ 0.02	\$ 0.00	\$ 0.01	\$ 0.03

	Q-1 2010	Q-2 2010	Q-3 2010	Nine Months Ended September 2010
GAAP Net Income	\$ 67	\$ 122	\$ 214	\$ 403
Fully Diluted EPS	\$ 0.01	\$ 0.01	\$ 0.02	\$ 0.04

**Revenues**

Our revenues are earned by providing Telecom Expense Management (TEM) products and services, which include call accounting, either through the direct sale of licensed software, or under multi-year managed service contracts offered by means of Software as a Service (SaaS). Throughout 2011 we have observed an increasing market preference for the SaaS option. For the three and nine months ended September 30, 2011, revenues from TEM Managed Service contracts increased 16% and 23%, respectively, from the three and nine months ended September 30, 2010. Revenues generated from the direct sale of TEM products and services, including maintenance revenues from our installed base, decreased 11% and 7% for the quarter and nine months ended September 30, 2011, respectively, as compared with the same periods of 2010.

**Gross Margin**

Gross margin (revenues less cost of revenues) of \$2,265,000, or 66% of revenues, for the quarter ended September 30, 2011 decreased \$357,000, or 14% from gross margin of \$2,622,000, or 72% of revenues, for the same quarter of 2010. For the nine months ended September 30, 2011 gross margin of \$6,721,000, representing 67% of revenue decreased 3% from \$6,943,000, or 72% of revenues, for the first nine months of 2010. The lower margins reflect the higher percentage of managed service revenues in the overall product mix, as discussed above. Multi-year managed service contracts typically yield lower margins as a percentage of monthly revenues than those earned from the one-time sale of a software license, however, generally return greater revenue and margin dollars over the life of the contact.

**Table of Contents****Engineering and Software Development Costs**

Engineering and software development expenses, net of the capitalization of software development costs, totaled \$227,000 for the quarter ended September 30, 2011 and \$828,000 for the nine months ended September 30, 2011. For the same three and nine month periods of 2010, net expenses for engineering and software development totaled \$385,000 and \$1,080,000, respectively. The reduction in year to date expenses is attributable to lower facility costs (\$83,000) arising from the move to our new facility in late 2010 and lower compensation costs (\$267,000). The chart below summarizes gross engineering and software development expenses, costs capitalized, and the resulting impact on the Company's Statement of Operations for the three and nine months ended September 30, 2011 and 2010.

	<b>Three Months Ended September 30, 2011</b>		<b>Nine Months Ended September 30, 2011</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Gross expenditures for engineering & software development	\$ 496,000	\$ 652,000	\$ 1,476,000	\$ 1,919,000
Less: Software development costs capitalized	(269,000)	(267,000)	(648,000)	(839,000)
Net expense for engineering and software development	\$ 227,000	\$ 385,000	\$ 828,000	\$ 1,080,000

**Selling, General, and Administrative Costs**

SG&A expenses of \$1,962,000 for the quarter ended September 30, 2011 decreased 4% from the same quarter of 2010. For the nine months ended September 30, 2011 SG&A expenses of \$5,604,000 increased 2% from \$5,508,000 for the first nine months of 2010. The increase in year to date 2011 expenses from the prior year is due to an expansion of the Company's direct sales force which added approximately \$175,000 to expenses, mostly in the form of compensation. This was partially offset by lower marketing and facility expenses.

**Litigation Expense and Settlement Costs**

On June 16, 2011 the Company settled a patent litigation complaint brought by Asentinel LLC, which also named CASS Information Systems and AnchorPoint, a division of MTS as defendants, alleging the infringement of two telecom expense management (TEM) patents held by Asentinel. Under the terms of the settlement, the Company agreed to pay Asentinel \$500,000 in return for a waiver of all known claims for past infringement of the Asentinel patents, an agreement not to make claims for future infringement of those patents and dismissal of the lawsuit. Of the settlement amount, \$250,000 was paid on the date of settlement, with the remaining \$250,000 represented by a note payable with a maturity date of June 16, 2012. The entire settlement amount of \$500,000 and legal fees of \$224,000 pertaining to this action were charged to the Statement of Operations for the quarter ended June 30, 2011. Additionally the Company expensed \$139,000 of legal fees associated with this action in the first quarter of 2011.

**Liquidity and Capital Resources**

Cash and short-term investments totaled \$756,000 at September 30, 2011, which compared with a cash and short-term investment position of \$1,502,000 at December 31, 2010. For the third quarter of 2011 we generated a positive cash flow of \$127,000. Major cash outlays in 2011 have included the patent litigation claim against the Company referred to above, \$450,000 attributable to the 2010 acquisition of Source Loop and the repayment of \$180,000 borrowed against the Company's line of credit agreement at December 31, 2010. As of September 30, 2011 we have no outstanding balance against our line of credit agreement, which provides for up to \$750,000 of working capital.

**Table of Contents**

Accounts receivable at September 30, 2011 totaled \$1,736,000, net of a reserve for bad debts of \$26,000. At December 31, 2010 accounts receivable totaled \$1,912,000, net of a \$33,000 reserve for bad debts. There have been no significant write-offs of customer balances during the first nine months of 2011.

Prepaid expenses of \$465,000 at September 30, 2011 increased 58% from the December 31, 2010 total of \$294,000. Prepaid expenses consist of payments made prior to the end of the current period for economic benefits to be realized in future periods, including items such as maintenance contracts, business insurances and prepaid commissions. The increase for the nine months ended September 30, 2011 includes increases in the prepaid portions of business insurance (\$77,000) and prepaid commissions (\$55,000).

Other current assets at September 30, 2011 of \$909,000 include \$885,000 of funds held by the Company on the behalf of clients utilizing our bill-pay service as a component of their managed TEM agreements. That portion of the asset is offset by a compensating balance in other accrued liabilities.

Capital equipment purchases for the first nine months of 2011 totaled \$120,000, which compares to capital purchases of \$155,000 for the first nine months of 2010. We do not expect capital outlays in the fourth quarter of 2011 to vary appreciably from that experienced during the first three quarters of the year.

Software development costs capitalized and included on our balance sheet at September 30, 2011 of \$2,819,000 have decreased 5% from the December 31, 2010 balance of \$2,962,000. For the nine months ended September 30, 2011 we have capitalized \$648,000 of development costs while amortizing \$791,000 of development costs previously capitalized. For the first nine months of 2010 we had capitalized \$839,000 of development costs and amortized \$862,000. The amortization of capitalized software costs is charged directly to cost of revenues in the Company's Statements of Operations.

The intangible asset of \$623,000 at September 30, 2011 represents the unamortized portion of the fair market value of assets acquired from Source Loop in June 2010. Those assets continue to perform as expected at the time of acquisition and are currently being amortized at approximately \$60,000 per quarter.

Accounts payable of \$277,000 has been reduced by \$83,000 from the December 31, 2010 balance of \$360,000, and \$316,000 from the June 30, 2011 balance of \$593,000. The decrease in the third quarter of 2011 reflects the payment of legal fees incurred in connection with the patent litigation discussed above.

Deferred revenues of \$4,517,000 have increased \$266,000 for the first nine months of 2011 from the December 31, 2010 balance of \$4,251,000. Deferred revenues are a component of total embedded revenues referred to in the overview section of the report, and represent the unrecognized portion of customer orders for services such as maintenance, training, consulting and installation that will be performed in future periods and recognized as revenues at that time.

The contingent liability of \$210,000 at September 30, 2011 reflects management's current estimate of the remaining consideration to be paid in cash and common stock to the principals of Source Loop, LLC, acquired by Veramark in June 2010. The actual amount ultimately paid is dependent upon the achievement of specific revenue goals for 2011 contained in the asset purchase agreement governing the transaction. During July of 2011, \$150,000 was paid based upon specific employee retention goals specified in that agreement.

**Table of Contents**

Short term debt of \$317,000 at September 30, 2011 includes the current portion (\$67,000) due on a three year term loan, the proceeds of which were used to purchase furnishings and fixtures for the Company's new headquarters facility and the \$250,000 note due Asentinel in June 2012 in connection with the patent litigation settlement.

Long- term debt of \$177,000 includes the non-current portion of the term loan referenced above (\$72,000) and a long-term rent liability (\$105,000) associated with the lease of our current facility, which provided a five month rent-free period at the inception of the lease. Accounting rules require that our balance sheet include a liability over the term of the lease (7 years) equal to the difference between the amount of rent expense recorded and the amount of rent paid through the reporting period.

Stockholders' equity of \$108,000 at September 30, 2011 decreased from stockholders equity of \$442,000 at December 31, 2010 as a result of the loss incurred for the first nine months of 2011. During 2011 employees of the Company have exercised 398,554 stock options and purchased 24,342 shares of common stock through the Company's Employee Stock Purchase Plan.

It is management's opinion that given the current cash and investment position, a fully available credit line, as well as access to other sources of capital, that more than sufficient financial resources exist to fully fund operations and strategic initiatives for the next twelve months and beyond.

**Table of Contents**

**Accounting Pronouncements**

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. This update does not have a material effect on the Company's financial statements.

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. This update does not have a material effect on the Company's financial statements.

**Table of Contents**

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. This update does not have a material effect 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. This update does not have a material effect on the Company's financial statements.

In December 2010, the FASB issued Accounting Standards Update No. 2010-28, topic 350, *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*. For those reporting units with zero or negative carrying value, step 2 of the impairment test is required to be performed, even if step 1 indicates it is not necessary. This update does not have a material effect on the Company's financial statements.

In December 2010, the FASB issued Accounting Standards Update No. 2010-29, topic 805, *Disclosure of Supplementary Pro Forma Information for Business Combinations*, to clarify diversity in practice of applying this topic. Paragraph 805-10-50-2(h) requires a public entity to disclose pro forma information for business combinations that occurred in the current reporting period. The disclosures include pro forma revenue and earnings of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period. If comparative financial statements are presented, the pro forma revenue and earnings of the combined entity for the comparable prior reporting period should be reported as though the acquisition date for all business combinations that occurred during the current year had been as of the beginning of the comparable prior annual reporting period. The Company properly reports such supplementary information in its filings.

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

## **Table of Contents**

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

The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. The amendments in this Update should be applied retrospectively, and are effective for the Company's interim and annual periods beginning after December 15, 2011. The Company does not expect this update to have a material effect on the Company's financial statements.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, topic 350, *Intangibles Goodwill and Other*, to simplify how entities test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The amendments in this Update are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company does not expect this update 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 involves 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 including installation, training, implementation, and customer maintenance contracts; and the outsourcing or hosting of services, commonly referred to as Software as a Service (SaaS).

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



**Table of Contents**

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

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

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

Third Party Evidence (TPE)

Best Estimate of the Selling Price (ESP)

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

Regardless of the form of sale, no revenue is recognized without persuasive evidence of an arrangement existing. Persuasive evidence is determined to be a signed purchase order received from the customer, or an equivalent form for those customers lacking a formalized purchase order system. Additionally, revenue is only recognized when a selling price is fixed or determinable, and collectability of the receivable is deemed to be probable.

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

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

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.

**Table of Contents**

**Capitalization of Software Development**

The Company capitalizes software development costs when technological feasibility has been established for the software in accordance with ASC 985-20, Costs of to be Sold, Leased, or Marketed. Such capitalized costs are amortized on a product-by-product basis over their economic life or the ratio of current revenues to current and anticipated revenues from such software, whichever provides the greater amortization. The Company periodically reviews the carrying value of capitalized software development costs and impairments are recognized in the results of operations when the expected future undiscounted operating cash flow derived from the capitalized software is less than its carrying value. Should the Company inaccurately determine when a product reaches technological feasibility or the economic life of a product, results could differ materially from those reported. 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, and life expectancies. 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.

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

On October 29, 2010 the Company entered into an agreement with Manufacturers and Traders Trust Company to provide a three year term note in the amount of \$200,000, the proceeds of which were used to purchase furnishings and fixtures for the Company's new headquarters facility. The loan bears an interest rate of LIBOR plus 4.0%, with a minimum interest rate of 4.5%. At September 30, 2011 the remaining balance of the term loan was \$138,889.

**Table of Contents**

**Item 4 Controls and Procedures**

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

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

**Table of Contents**

**PART II OTHER INFORMATION**

**Item 1 Legal Proceedings**

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

Material terms of the agreement included:

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

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

The lawsuit was dismissed against the Company.

**Item 1A Risk Factors**

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

**Intellectual Property Rights**

Veramark regards its products as proprietary and attempts to protect them with a combination of copyright, trademark and trade secret protections, employee and third-party non-disclosure agreements and other methods of protection. Despite those precautions, it may be possible for unauthorized third parties to copy certain portions of Veramark's products, reverse engineer or obtain and use information that Veramark regards as proprietary. The laws of some foreign countries do not protect Veramark's proprietary rights to the same extent as the laws of the United States. Any misappropriation of Veramark's intellectual property could have a material adverse effect on its business and results of operations. Furthermore, although Veramark takes steps to prevent unlawful infringement of other's intellectual property, there can be no assurance that third parties will not assert infringement claims against Veramark in the future with respect to current or future products. Any such assertion could require Veramark to enter into royalty arrangements or result in costly litigation.

**Existing Customer Base**

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

**Table of Contents**

**Product Development**

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

**Declines in Demand for Software**

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

**Competition**

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

**Marketing and Sales**

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

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

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

**Loss of Key Employees**

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

**Changing Market**

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

**Table of Contents**

**Access to Capital**

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

**Public Company**

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

**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.

**Table of Contents**

**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 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)
- 10.6\* 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)
- 10.7\* 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)
- 10.8\* 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)
- 10.9\* 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)





**Table of Contents**

10.10	Asset Purchase Agreement dated as of June 15, 2010 among the Company, Source Loop, LLC, a Delaware limited liability company, and Joseph Foster, Christopher Lee, Daren Moore, and Roberto Morson, who are all of the members of Source Loop, LLC (incorporated by reference to exhibit 2.1 to the Company's Current Report on Form 8-K filed August 31, 2010)
10.11*	Employment Agreement dated as of January 1, 2011 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 January 27, 2011)
10.12*	2011 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 March 8, 2011)
10.13*	Amendment to Employee Agreement between Josh Bouk and the Company, dated March 31, 2011 (incorporated by reference to Exhibit 10.12 to the Company's Quarterly Report on Form 10-Q filed on August 12, 2011)
10.14*	Amendment to Employee Agreement between Thomas McAlees and the Company, dated March 31, 2011 (incorporated by reference to Exhibit 10.13 to the Company's Quarterly Report on Form 10-Q filed on August 12, 2011)
10.15	Nonexclusive Patent License and Settlement Agreement between Asentinel LLC and the Company, dated June 16, 2011 (incorporated by reference to Exhibit 10.14 to the Company's Quarterly Report on Form 10-Q filed on August 12, 2011)
10.16	Promissory Note between Asentinel LLC and the Company, dated June 16, 2011. (incorporated by reference to Exhibit 10.15 to the Company's Quarterly Report on Form 10-Q filed on August 12, 2011)
14	Code of Business Conduct and Ethics (incorporated by reference to Exhibit E to the Company's Proxy Statement for its 2011 Annual Meeting of Shareholders filed on April 14, 2011)
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.

**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: November 10, 2011

/s/ Anthony C. Mazzullo

Anthony C. Mazzullo

President and CEO

Date: November 10, 2011

/s/ Ronald C. Lundy

Ronald C. Lundy

Vice President of Finance and CFO