COGNITRONICS CORP
Form 10-Q
November 14, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the period ended September 30, 2001

or

[ ] Transition Report Pursuant to Section 13 or 15(d) of the

Securities Exchange Act of 1934

For the Transition Period from to

Commission file number 0-3035

COGNITRONICS CORPORATION
(Exact name of registrant as specified in its charter)

NEW YORK	13-1953544
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3 Corporate Drive, Danbury, Connecticut	06810-4130
(Address of principal executive offices)	(Zip Code)

(203) 830-3400
Registrant's telephone number, including area code

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, and (2) has been subject to such filing requirements for at least the past 90 days. Yes x No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of September 30, 2001.

Common Stock, par value $0.20 per share - 5,408,004 shares

Part I, Item 1.

COGNITRONICS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(dollars in thousands)

	September 30, 2001 (Unaudited)	December 31, 2000
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 6,201	$ 3,499
Marketable securities	6,800	9,400
Accounts receivable, net	3,863	7,760
Inventories	6,846	6,557
Deferred income taxes	725	746
Other current assets including loans to officers of $1,545 and $1,062	2,753	1,783
TOTAL CURRENT ASSETS	27,188	29,745
PROPERTY, PLANT AND EQUIPMENT, NET	1,484	1,373
GOODWILL, NET	402	651
DEFERRED INCOME TAXES	781	762
OTHER ASSETS	514	467
	$30,369	$32,998
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 1,236	$ 1,560
Accrued compensation and benefits	881	1,128
Income taxes payable	342	532
Current maturities of debt	35	43
Other accrued expenses	707	652
TOTAL CURRENT LIABILITIES	3,201	3,915
LONG-TERM DEBT	21	47
OTHER NON-CURRENT LIABILITIES	1,972	2,048
STOCKHOLDERS' EQUITY		
Common Stock, par value $.20 a share, authorized 20,000,000 shares; issued 5,863,229 shares	1,173	1,173
Additional paid-in capital	13,835	14,123
Retained earnings	14,825	15,218
Cumulative other comprehensive income	(182)	(182)
Unearned compensation	(571)	(332)
	29,080	30,000
Less cost of 455,225 and 300,550 shares in treasury	(3,905)	(3,012)
TOTAL STOCKHOLDERS' EQUITY	25,175	26,988
	$30,369	$32,998

See Note to Condensed Consolidated Financial Statements.
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COGNITRONICS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND
COMPREHENSIVE INCOME (UNAUDITED)
(dollars in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
NET SALES	$4,807	$8,404	$15,594	$22,766
COST AND EXPENSES:				
Cost of products sold	2,612	3,774	8,216	10,226
Research and development	1,069	595	2,688	1,784
Selling, general and administrative	1,836	1,802	5,494	5,405
Amortization of goodwill	83	83	249	249
Other (income), net	(115)	(189)	(425)	(424)
	5,485	6,065	16,222	17,240
Income(loss) before income taxes	(678)	2,339	(628)	5,526
PROVISION(BENEFIT) FOR INCOME TAXES	(250)	834	(235)	2,030
NET INCOME(LOSS)	(428)	1,505	(393)	3,496
Currency translation adjustment	40	(74)		(248)
COMPREHENSIVE INCOME(LOSS)	$ (388)	$1,431	$ (393)	$ 3,248
NET INCOME(LOSS) PER SHARE:				
Basic	$(.08)	$.26	$(.07)	$.60
Diluted	$(.08)	$.25	$(.07)	$.57
Weighted average number of outstanding shares:				
Basic	5,356,975	5,730,585	5,417,044	5,798,452
Diluted	5,356,975	6,111,467	5,417,044	6,168,835

See Note to Condensed Consolidated Financial Statements.

COGNITRONICS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(dollars in thousands)

	Nine Months Ended September 30, 2001	Nine Months Ended September 30, 2000
NET CASH PROVIDED BY OPERATIONS	$2,842	$3,868
INVESTING ACTIVITIES		
Purchases of marketable securities	(3,800)	(2,000)
Sales of marketable securities	6,400	2,600
Loans to employees	(483)	(638)
Additions to property, plant and equipment, net	(457)	(276)
Purchase of software licenses	(192)	
NET CASH PROVIDED(USED) BY INVESTING ACTIVITIES	1,468	(314)
FINANCING ACTIVITIES		
Repurchase of 232,450 and 166,880 shares for treasury	(1,576)	(1,681)
Principal payment of debt	(34)	(36)
Shares issued pursuant to employee stock option plans, 1,275 and 26,376 shares	7	105
NET CASH (USED) BY FINANCING ACTIVITIES	(1,603)	(1,612)
EFFECT OF EXCHANGE RATE DIFFERENCES	(5)	(37)
INCREASE IN CASH AND CASH EQUIVALENTS	2,702	1,905
CASH AND CASH EQUIVALENTS- BEGINNING OF PERIOD	3,499	3,992
CASH AND CASH EQUIVALENTS - END OF PERIOD	$6,201	$5,897
INCOME TAXES PAID	$ 538	$2,272
INTEREST EXPENSE PAID	$ 9	$ 15

See Note to Condensed Consolidated Financial Statements.

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NOTE TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2001

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month and nine-month periods ended September 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001. The balance sheet at December 31, 2000 has been derived from the audited financial statements at that date. For further information, refer to the consolidated financial statements and footnotes thereto and the quarterly financial data included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

Inventories (in thousands):

	September 30, 2001	December 31, 2000
Finished and in process	$4,497	$4,320
Materials and purchased parts	2,349	2,237
	$6,846	$6,557

Other Non-Current Liabilities (in thousands):

	September 30, 2001	December 31, 2000
Accrued supplemental pension plan	$ 524	$ 553
Accrued deferred compensation	278	291
Accrued pension	525	568
Accrued other post-employment benefit	834	825
	2,161	2,237
Less current portion	189	189
	$1,972	$2,048

Common Stock

During the nine months ended September 30, 2001 and September 30, 2000, the company granted 76,500 and 26,000 shares of common stock under the Restricted Stock Plan and recorded $382,500 and $236,000 of unearned compensation expense, respectively.

Income Per Share

In computing basic earnings per share, the dilutive effect of stock options and restricted stock are excluded; whereas, for dilutive earnings per share, the dilutive effect, if any, is included.

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Recent Pronouncements

In October 2001, the Financial Accounting Standards Board (FASB) issued Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which provides a single accounting model for long-lived assets to be disposed of. In August 2001, the FASB issued SFAS No. 143, "Accounting for Assets Retirement

Obligations", which focuses on accounting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. In June 2001, the FASB issued SFAS No. 141, "Business Combinations", and No. 142, "Goodwill and Other Intangible Assets". Under SFAS Nos. 141 and 142, all acquisitions subsequent to June 30, 2001 must be accounted for under the purchase method of accounting, and purchased goodwill will no longer be amortized over its useful life. Rather, goodwill will be subject to a periodic impairment test based upon its fair value. SFAS Nos. 142 and 144 are effective in 2002 and SFAS No. 143 is effective in 2003. During the three months and nine months ended September 30, 2001, the Company recognized goodwill amortization expense of $83,000 and $249,000, respectively. With the exception of the impact on the Company's amortization of goodwill, these Statements are not expected to have a material impact on the Company's financial condition or results of operations.

Operations by Industry Segments and Geographic Areas:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
Net Sales				
United States:				
Unaffiliated Customers (North America)	$3,454	$6,321	$10,697	$17,022
Intercompany transfers				55
	3,454	6,321	10,697	17,077
Europe	1,353	2,083	4,897	5,744
Intercompany eliminations				(55)
	$4,807	$8,404	$15,594	$22,766
Operating Profit (Loss)				
United States	$ (24)	$2,477	$ 506	$ 6,220
Europe	(378)	(15)	(565)	(129)
Intercompany eliminations	20	69	26	27
	(382)	2,531	(33)	6,118
General Corporate Expense	411	381	1,020	1,016
Other (income), net	(115)	(189)	(425)	(424)
Income (loss) before taxes	$ (678)	$2,339	$ (628)	$ 5,526
Total Assets				
United States			$26,459	$29,515
Europe			3,945	4,121
Intercompany eliminations			(35)	(37)
			$30,369	$33,599

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Item 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

The Company reported a net loss of $428,000 and $393,000, respectively, for the three and nine-month periods ended September 30, 2001 versus net income of $1,505,000 and $3,496,000, respectively, in the prior year periods.

Consolidated sales for the quarter ended September 30, 2001 decreased $3.6 million (43%) to $4.8 million versus the prior year period. In the third quarter, domestic sales decreased $2.9 million (45%), reflecting the continued decreased spending in the telecommunication industry. Sales by the UK distributorship operations decreased by $.7 million due to lower sales to its principal customer. Consolidated sales for the nine months ended September 30, 2001 decreased $7.2 million (32%) from the prior year period. Sales of the domestic operations decreased $6.3 million (37%) due to the previously mentioned decreased spending in the telecommunication industry. The demand in the U.S. for telecommunication equipment continues to be soft and the Company is unable to determine when the telecommunication equipment market will improve. The sales of the Company's UK distributorship operations decreased $.8 million (15%) from the prior year period primarily due to lower sales to its principal customer. For the past two years, the company's UK distributorship operations has experienced significant decreases in sales to its principal customer. The Company is unable to determine whether this trend will continue.

Gross margin percentage was 46% and 47%, respectively, for the three months and nine months ended September 30, 2001 and 55% in each of the comparable 2000 periods. The decreases in the current year periods versus the prior year periods are primarily due to the lower volume in the US operations.

Research and development expenses increased $474,000 (80%) and $904,000 (51%), respectively, in the three-month and nine-month periods ended September 30, 2001 when compared to the prior year periods. The increases are due to contracted engineering services expenses, increased salaries attributable to increased headcount and wage rates, higher purchased parts and increased overhead expenses. The Company's increased research and development efforts reflect work on next generation equipment. The Company anticipates the continuance of this level of expenditures.

Selling, general and administrative expenses increased $34,000 (2%) and $89,000 (2%), respectively, for the three and nine months ended September 30, 2001, when compared to the prior year periods. These increases are attributable to increases of $26,000 (3.3%) and $184,000 (8%), respectively, in the Company's UK distributorship operations. Included in both the three-month and nine-month periods is $77,000 related to termination expenses at the Company's UK distributorship operations.

Other (income) decreased due to lower interest rates on cash balances and marketable securities in the three month period ended September 30, 2001.

Liquidity and Sources of Capital

Net cash flow from operations for the nine months ended September 30, 2001 was $2.8 million versus $3.9 million in 2000. In 2000, cash flow from

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operations was adversely impacted by a reduction of $3.2 million in accounts payable. The increase in cash provided by investing activities reflects the net decrease in marketable securities offset by an increase in employee loans and purchase of property, plant and equipment and software licenses. The net cash used for financing activities in both periods presented primarily reflects the repurchase of shares for treasury.

Working capital and the ratio of current assets to current liabilities were $24 million and 8.5:1 at September 30, 2001 compared to $25.8 million and 7.6:1 at December 31, 2000. The decrease in working capital in 2001 is mainly due to the repurchase of treasury shares.

During the remainder of 2001, the Company may repurchase up to an additional 330,550 shares of its common stock and anticipates purchasing $.3 million of equipment and incurring increased research and development expenditures. Management believes that its cash and cash equivalents, marketable securities and the cash flow from operations in 2001 will be sufficient to meet these needs.

Certain Factors That May Affect Future Results

From time to time, information provided by the Company, statements made by its employees or information included in its filings with the Securities and Exchange Commission (including this Form 10-Q) may contain statements which are not historical facts, so-called "forward-looking statements". These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The Company's actual future results may differ significantly from those stated in any forward-looking statements. Forward-looking statements involve a number of risks and uncertainties, including, but not limited to, variability of sales volume quarter to quarter, product demand, pricing, market acceptance, litigation, risk of dependence on significant customers, third party suppliers and intellectual property rights, risks in product and technology development and other risk factors detailed in this Quarterly Report on Form 10-Q and in the Company's other Securities and Exchange Commission filings.

Item 3. Market Risk

The Company does not use derivative financial instruments. The Company has Marketable Securities, which are exposed to changes in interest rates. Due to the term of these securities and/or their variable rate provisions, a change in interest rates would not have a material impact on their value.

Exchange rate fluctuations will impact the results of operations and the net assets of the Company's UK distributorship operations. At September 30, 2001, the UK distributorship operations had net assets of $1.6 million. The Company does not hedge this foreign currency net asset exposure.

PART II

Item 6. Exhibits and reports on Form 8-K

No exhibits or reports on Form 8-K were filed during the current quarter.
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SIGNATURE

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.

COGNITRONICS CORPORATION
Registrant

Date: November 14, 2001 By /s/ Garrett Sullivan
Garrett Sullivan, Treasurer
and Chief Financial Officer