COGNITRONICS CORP
Form 10-Q
August 05, 2004

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 quarterly period ended June 30, 2004

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 1-8496

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 the past 90 days. Yes x No

Indicate by check mark whether the registrant is an accelerated filer (as defined in 12b-2 of the Exchange Act).
Yes No x

The Registrant has 5,716,548 shares of Common Stock, $.20 par value per share outstanding at June 30, 2004.
Part I, Item 1.

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

	June 30, 2004 (Unaudited)	December 31, 2003
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 2,757	$ 2,877
Marketable securities	5,759	5,956
Accounts receivable, net	3,406	1,183
Inventories	3,328	2,987
Taxes recoverable		2,028
Other current assets including loans to officers of $1,946 and $1,931	2,164	2,312
TOTAL CURRENT ASSETS	17,414	17,343
PROPERTY, PLANT AND EQUIPMENT, NET	997	1,087
GOODWILL, NET	319	319
OTHER ASSETS	100	149
	$18,830	$18,898
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 1,403	$ 778
Accrued compensation and benefits	1,466	1,297
Other accrued expenses	1,186	1,125
TOTAL CURRENT LIABILITIES	4,055	3,200
OTHER NON-CURRENT LIABILITIES	1,202	1,474
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	11,532	11,750
Retained earnings	2,444	3,419
Cumulative other comprehensive loss	(20)	(98)
Unearned compensation	(393)	(509)
	14,736	15,735
Less cost of 146,681 and 190,431 common shares in treasury	1,163	1,511
TOTAL STOCKHOLDERS' EQUITY	13,573	14,224
	$18,830	$18,898

See Note to Condensed Consolidated Financial Statements.

COGNITRONICS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND
COMPREHENSIVE INCOME (LOSS) (UNAUDITED)
(dollars in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
NET SALES	$4,243	$2,448	$6,504	$ 4,944
COST AND EXPENSES:				
Cost of products sold	1,744	1,458	3,257	3,036
Research and development	635	646	1,230	1,319
Selling, general and administrative	1,505	1,521	3,025	3,130
Other (income), net	(32)	(47)	(63)	(86)
Gain on termination of post-retirement benefit plan		(834)		(834)
	3,852	2,744	7,449	6,565
Income(loss) before income taxes	391	(296)	(945)	(1,621)
PROVISION FOR INCOME TAXES	15	30	30	30
NET INCOME (LOSS)	376	(326)	(975)	(1,651)
Currency translation adjustment	(10)	29	78	46
COMPREHENSIVE INCOME(LOSS)	$ 366	$ (297)	$ (897)	$(1,605)
NET INCOME(LOSS)PER SHARE:				
Basic	$ .07	$(.06)	$(.17)	$(.30)
Diluted	$ .06	$(.06)	$(.17)	$(.30)
Weighted average number of outstanding shares:				
Basic	5,742,442	5,552,338	5,714,372	5,531,520
Diluted	6,278,219	5,552,338	5,714,372	5,531,520

See Note to Condensed Consolidated Financial Statements.

COGNITRONICS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(dollars in thousands)

	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
NET CASH USED BY OPERATIONS	$ (19)	$(2,694)
INVESTING ACTIVITIES		
Purchases of marketable securities	(4,463)	(1,328)
Sales of marketable securities	4,660	2,506
Additions to property, plant and equipment, net	(84)	(35)
NET CASH PROVIDED(USED) BY INVESTING ACTIVITIES	(113)	1,143
FINANCING ACTIVITIES		
Shares issued pursuant to employee stock plans	14	
Principal payment of debt		(26)
NET CASH USED BY FINANCING ACTIVITIES	14	(26)
EFFECT OF EXCHANGE RATE DIFFERENCES	(2)	9
DECREASE IN CASH AND CASH EQUIVALENTS	(120)	(1,568)
CASH AND CASH EQUIVALENTS- BEGINNING OF PERIOD	2,877	2,732
CASH AND CASH EQUIVALENTS - END OF PERIOD	$ 2,757	$ 1,164
INCOME TAXES PAID	$ 63	$ 63
INTEREST PAID	$ 5	$ 5

See Note to Condensed Consolidated Financial Statements.

NOTE TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2004

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-Q and Rule 10-01 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 of America 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 six-month periods ended June 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. The balance sheet at December 31, 2003 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, 2003.

Inventories (in thousands):

	June 30, 2004	December 31, 2003
Finished and in process	$2,209	$2,172
Materials and purchased parts	1,119	815
	$3,328	$2,987

Other Non-Current Liabilities (in thousands):

	June 30, 2004	December 31, 2003
Accrued supplemental pension plan	$ 397	$ 419
Accrued deferred compensation	221	232
Deferred directors' fees	321	411
Accrued pension expense	536	664
Accrued post-retirement benefit	4	11
	1,479	1,737
Less current portion	277	263
	$1,202	$1,474

In June 2003, the Board of Directors voted to terminate the Company's post-retirement health benefits plan (the "Plan") and notified the effected retirees. Termination of the Plan resulted in a non-cash gain of $834,000 which was recorded in the quarter ended June 30, 2003.

Income Per Share

In computing basic earnings per share, the dilutive effect of stock options and warrants are excluded; whereas, for dilutive earnings per share, they are included.

Stock Based Compensation

The Company grants stock options for a fixed number of shares to employees with an exercise price equal to the fair value at the date of grant. The Company accounts for stock option grants in accordance with Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees", and therefore recognizes no compensation expense for stock options granted.

The Company applies the disclosure only provisions of Financial Accounting Standards Board Statement ("SFAS") No. 123, "Accounting for Stock-based Compensation" and SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" for employee stock option awards. Had compensation cost for the Company's stock option plans been determined in accordance with the fair value-based method prescribed under SFAS 123, the Company's net loss and basic and diluted net loss per share would have approximated the pro forma amounts indicated below (dollars in thousands except per share amounts):

		Three Months Ended June 30,		Six Months Ended June 30,	
		2004	2003	2004	2003
Net income(loss)		$ 376	$(326)	$ (975)	$(1,651)
Add: Stock-based compensation Expense included therein		96	96	192	192
Deduct: Total stock-based compensation expense determined under the fair value based method		(171)	(171)	(400)	(381)
Pro forma net income (loss)		$ 301	$(401)	$(1,183)	$(1,840)
Net income(loss) per share					
As reported	Basic	$ .07	$(.06)	$(.17)	$(.30)
	Diluted	$ .06	$(.06)	$(.17)	$(.30)
Pro forma	Basic	$ .05	$(.07)	$(.21)	$(.33)
	Diluted	$ .05	$(.07)	$(.21)	$(.33)

There were no options granted in the periods ended June 30, 2004 and 2003.

Pension Plan

The Company and its domestic subsidiaries have a defined benefit pension plan. No additional service cost benefits were earned subsequent to June 30, 1994. The Company's funding policy is to contribute amounts to the plan sufficient to meet the minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974, plus such additional amounts as the Company may determine to be appropriate from time to time.

The components of net periodic benefit cost of the plan for the three and six months ended June 30 are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Interest cost on projected benefit obligation	$23	$29	$46	$58
Expected return on plan assets	(15)	(16)	(28)	(32)
Amortization of net loss	2	3	5	7

Net periodic pension cost	$10	$16	$23	$33

The Company expects the funding requirement to be $240,000 in 2004 of which $156,000 was funded during the six months ended June 30, 2004.

Operations by Industry Segments and Geographic Areas:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net Sales				
United States	$2,568	$1,639	$ 2,999	$ 2,319
Europe	1,675	809	3,505	2,625
	$4,243	$2,448	$ 6,504	$ 4,944
Operating Profit(Loss)				
United States	$ 577	$ (563)	$ (638)	$(1,773)
Europe	93	(279)	277	(90)
	670	(842)	(361)	(1,863)
General Corporate Expense	311	335	647	678
Other (income), net	(32)	(47)	(63)	(86)
Gain on termination of post-retirement benefit plan		(834)		(834)
Income(loss) before income taxes	$ 391	$ (296)	$ (945)	$(1,621)
Total Assets				
United States			$15,757	$18,163
Europe			3,073	2,048
Intercompany eliminations				(11)
			$18,830	$20,200

Item 2.

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

Certain Factors That May Affect Future Results

The following information, including, without limitation, the Quantitative and Qualitative Disclosures About Market Risk that are not historical facts, may be forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements generally are characterized by the use of terms such as "believe", "expect" and "may". Although the Company believes that the expectations reflected in such forward-looking statements are based upon reasonable assumptions, the Company's actual results could differ materially from those set forth in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, variability of sales volume from quarter to quarter, product demand, pricing, market acceptance, litigation, risk of dependence on significant customers and third party suppliers, 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.

Results of Operations

The Company reported net income of $376,000 for the three months ended June 30, 2004 and a net loss of $975,000 for the six months ended June 30, 2004 versus net losses of $326,000 and $1,651,000, respectively, in the prior year periods. Included in the three-month and six-month periods ended June 30, 2003 was a non-cash gain on termination of the post-retirement benefit plan of $834,000.

Consolidated sales for the quarter ended June 30, 2004 increased $1.8 million (73%) to $4.2 million due to sales increases in both the domestic and the UK distributorship operations. The sales in the domestic operations increased $.9 million (57%) to $2.5 million due to higher volume. In the three-month period ended June 30, 2004 the Company had sales of $1.7 million to a large telecommunication service provider, an increase of $.6 million from the prior year period. Sales of the Company's UK distributorship operations increased $.9 million (107%) due to higher volume and a favorable exchange rate fluctuation. Consolidated sales for the six months ended June 30, 2004 increased $1.6 million (32%) primarily due to a sales increase of $.7 million (29%)in the domestic operations and an increase of $.9 million (34%) in its UK distributorship operations due to the reasons stated above.

Gross margin percentage was 59% for the three months and 50% for the six months ended June 30, 2004 and 40% and 39%, respectively, in the comparable 2003 periods. The three-month period ended June 30, 2004 versus the prior year period was favorably impacted by higher sales and the concomitant higher absorption of fixed costs and a decrease in obsolete inventory expense of $150,000. The improvement for the six-month period was due to favorable product mix, lower obsolete inventory expense and cost reductions.

In June 2003, the Board of Directors voted to terminate the Company's post-retirement health benefits plan (the "Plan") and notified the effected retirees. Termination of the Plan resulted in a non-cash gain of $834,000 which was recorded in the quarter ended June 30, 2003.

Liquidity and Sources of Capital

Net cash used by operations for the six months ended June 30, 2004 decreased to $19,000. In 2004, the Company received tax refunds of approximately $2 million. This was offset by an increase in accounts receivable due to higher sales in the second quarter of 2004. The increase in current liabilities is primarily due to a large purchase of inventory items, at a discount, at the end of the second quarter of 2004.

Working capital and the ratio of current assets to current liabilities were $13.4 million and 4.3:1 at June 30, 2004 compared to $14.1 million and 5.4:1 at December 31, 2003. The decrease in working capital in 2003 is mainly due to the results of operations.

During the remainder of 2004, the Company may repurchase up to an additional 253,792 shares of its common stock and anticipates purchasing $.2 million of equipment. Management believes that its cash and cash equivalents and marketable securities will be sufficient to meet these needs.

Item 3. Quantitative and Qualitative Disclosures About 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 June 30, 2004, the UK distributorship operations had net assets of $1.7 million. The Company does not hedge this foreign currency net asset exposure.

Item 4. Controls and Procedures

Cognitronics Corporation's management, including the Chief Executive Officer and Chief Financial Officer, have conducted an evaluation of the effectiveness of disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective in ensuring that all material information required to be filed in this quarterly report has been made known to them in a timely fashion. There have been no significant changes in internal controls, or in factors that could significantly affect internal controls, subsequent to the date the Chief Executive Officer and Chief Financial Officer completed their evaluation.

PART II

Item 4. Submission of Matters to a Vote of Security Holders

(a) The Registrant's Annual Meeting of Stockholders was held on May 13, 2004.

(c) The following matters were voted upon by stockholders:

	For	Withheld or Against	Abstain	Broker Non-votes
1. Election of five Directors -				
John T. Connors	5,077,130	160,827		157,166
Brian J. Kelley	5,210,574	27,383		157,166
Jack Meehan	5,206,974	30,983		157,166
William A. Merritt	5,206,974	30,983		157,166
William J. Stuart	5,224,074	13,883		157,166
2. To approve the selection of Carlin, Charron & Rosen, LLP as independent auditors	5,216,564	4,430	16,963	157,166

Item 6. Exhibits and reports on Form 8-K

(a) Index to Exhibits

Exhibit

31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification Pursuant to Section 302 of the

Sarbanes-Oxley Act of 2002.

32.1 Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Three reports on Form 8-K were filed during the current quarter.

On April 1, 2004, the Company filed a Current Report on Form 8-K pursuant to Item 9 (Regulation FD Disclosures) and Item 12 (Results of Operations and Financial Condition) to furnish a press release reporting results of the Company's fourth quarter and year end results for 2003, on May 14, 2004, the Company filed a Current Report on Form 8-K pursuant to Item 9 and Item 12 to furnish a press release reporting results of the Company's first quarter results for 2004, and on June 16, 2004, the Company filed a Current Report on Form 8-K pursuant to Item 9 to furnish a press release reporting its receipt of purchase orders aggregating $1.2 million.

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: August 5, 2004 By /s/ Garrett Sullivan
Garrett Sullivan, Treasurer
and Chief Financial Officer