COGNITRONICS CORP
Form 10-Q
November 14, 2003

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, 2003

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of September 30, 2003.

Common Stock, par value $0.20 per share 5,568,611 shares

Part I, Item 1.

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

	September 30, 2003 (Unaudited)	December 31, 2002
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 3,155	$ 2,732
Marketable securities	5,712	8,387
Accounts receivable, net	2,822	2,038
Inventories	3,234	3,687
Taxes recoverable	2,028	2,028
Other current assets including loans to officers of $1,921 and $1,906	1,991	1,982
TOTAL CURRENT ASSETS	18,942	20,854
PROPERTY, PLANT AND EQUIPMENT, NET	1,082	1,315
GOODWILL, NET	319	319
OTHER ASSETS	195	324
	$20,538	$22,812
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 1,095	$ 952
Accrued compensation and benefits	1,332	1,252
Current maturities of debt		26
Other accrued expenses	1,191	835
TOTAL CURRENT LIABILITIES	3,618	3,065
OTHER NON-CURRENT LIABILITIES	1,467	2,413
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	12,346	12,374
Retained earnings	4,852	6,969
Cumulative other comprehensive income	(244)	(298)
Unearned compensation	(337)	(512)
	17,790	19,706
Less cost of 294,618 and 298,988 shares in treasury	(2,337)	(2,372)
TOTAL STOCKHOLDERS' EQUITY	15,453	17,334
	$20,538	$22,812

See Note to Condensed Consolidated Financial Statements.

COGNITRONICS CORPORATION AND SUBSIDIARIES

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
NET SALES	$3,498	$2,378	$ 8,442	$ 8,876
COST AND EXPENSES:				
Cost of products sold	1,638	1,986	4,674	5,815
Research and development	675	849	1,994	2,597
Selling, general and administrative	1,676	1,604	4,806	4,757
Amortization of goodwill				
Other (income), net	(40)	(71)	(126)	(163)
Gain on termination of post-retirement benefit plan			(834)	
	3,949	4,368	10,514	13,006
Loss before income taxes	(451)	(1,990)	(2,072)	(4,130)
PROVISION(BENEFIT) FOR INCOME TAXES	15	(739)	45	(1,450)
NET LOSS	(466)	(1,251)	(2,117)	(2,680)
Currency translation adjustment	8	52	54	53
COMPREHENSIVE LOSS	$(458)	$ (1,199)	$(2,063)	$(2,627)
NET INCOME LOSS PER SHARE:				
Basic	$(.08)	$(.23)	$(.37)	$(.49)
Diluted	$(.08)	$(.23)	$(.37)	$(.49)
Weighted average number of outstanding shares:				
Basic	5,764,423	5,441,617	5,705,929	5,424,624
Diluted	5,764,423	5,441,617	5,705,929	5,424,624

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, 2003	Nine Months Ended September 30, 2002
NET CASH USED BY OPERATIONS	$(2,103)	$(1,104)
INVESTING ACTIVITIES		
Purchases of marketable securities	(2,328)	(15,245)
Sales of marketable securities	4,919	12,087
Loans to employees		(341)
Additions to property, plant and equipment, net	(66)	(336)
NET CASH PROVIDED(USED) BY INVESTING ACTIVITIES	2,525	(3,835)
FINANCING ACTIVITIES		
Repurchase of 1,500 shares for treasury		(5)
Principal payment of debt	(26)	(29)
Shares issued pursuant to stock plans, 4,370 and 3,448 shares	18	5
NET CASH PROVIDED(USED) BY FINANCING ACTIVITIES	(8)	(29)
EFFECT OF EXCHANGE RATE DIFFERENCES	9	16
INCREASE(DECREASE) IN CASH AND CASH EQUIVALENTS	423	(4,952)
CASH AND CASH EQUIVALENTS- BEGINNING OF PERIOD	2,732	7,731
CASH AND CASH EQUIVALENTS - END OF PERIOD	$ 3,155	$ 2,779
INCOME TAXES PAID	$ 63	$ 3
INTEREST EXPENSE PAID	$ 5	$ 17

See Note to Condensed Consolidated Financial Statements.

NOTE TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2003

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 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 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 nine-month periods ended September 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003. The balance sheet at December 31, 2002 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, 2002.

Inventories (in thousands):

	September 30, 2003	December 31, 2002
Finished and in process	$2,278	$2,273
Materials and purchased parts	956	1,414
	$3,234	$3,687

Other Non-Current Liabilities (in thousands):

	September 30, 2003	December 31, 2002
Accrued supplemental pension plan	$ 433	$ 466
Accrued deferred compensation	238	254
Deferred directors' fees	379	332
Accrued pension expense	677	777
Accrued post-retirement benefit	22	856
	1,749	2,685
Less current portion	282	272
	$1,467	$2,413

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.

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 plan 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 September 30,		Nine Months Ended September 30,	
		2003	2002	2003	2002
Net loss as reported		$(466)	$(1,251)	$(2,117)	$(2,680)
Add: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects.		(67)	(71)	(256)	(210)
Pro forma		$(533)	$(1,322)	$(2,373)	$(2,890)
Net loss per share					
As reported	Basic	$(.08)	$(.23)	$(.37)	$(.49)
	Diluted	$(.08)	$(.23)	$(.37)	$(.49)
Pro forma	Basic	$(.09)	$(.24)	$(.42)	$(.53)
	Diluted	$(.09)	$(.24)	$(.42)	$(.53)

The fair value of stock options used to compute pro forma net loss and net loss per share disclosures was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions: dividend yield of 0% for 2003 and 2002; expected volatility factor of .76% for 2003 and .62% for 2002; average risk-free interest rate of 3.38% for 2003 and 2.28% for 2002; and an expected option holding period of 7.5 years for 2003 and 2002.

Operations by Industry Segments and Geographic Areas:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Net Sales				
United States	$ 1,979	$ 959	$ 4,298	$ 4,549
Europe	1,519	1,419	4,144	4,327
Intercompany eliminations				
	$ 3,498	$2,378	$ 8,442	$ 8,876
Operating Income\(Loss)				
United States	$ 35	$(1,687)	$(1,738)	$(3,192)
Europe	(146)	(40)	(236)	(84)
Intercompany eliminations		2		8
	(111)	(1,725)	(1,974)	(3,268)
General Corporate Expense	380	336	1,058	1,025
Other (income), net	(40)	(71)	(126)	(163)
Gain on termination of post-retirement benefit plan			(834)	

Loss before income taxes	$ (451)	$(1,990)	$(2,072)	$(4,130)
Total Assets				
United States			$17,927	$24,052
Europe			2,622	2,682
Intercompany eliminations			(11)	(17)
			$20,538	$26,717

Item 2.

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

Results of Operations

The net loss was $466,000 and $2,117,000, respectively, for the three and nine-month periods ended September 30, 2003 versus a net loss of $1,251,000 and $2,680,000, respectively, in the prior year periods. Included in the nine-month period ended September 30, 2003 was a non-cash gain on termination of the post-retirement benefit plan of $834,000.

Consolidated sales for the quarter ended September 30, 2003 increased $1.1 million (47%) to $3.5 million due to sales increases in both the domestic and UK distributorship operations. The sales in the domestic operations increased $1 million (106%) to $2.0 million due to an increase of $1.2 million in sales to a large telecommunication service provider, offset, in part, by decreased sales to equipment manufacturers. Sales of the Company's UK distributorship operations increased $.1 million (7%) due to a favorable exchange rate. Consolidated sales for the nine months ended September 30, 2003 decreased $.4 million (5%) primarily due to sales decreases in both the domestic and UK distributorship operations. The domestic operations' sales decreased $.2 million (6%) in spite of an increase in sales of $1.2 million to a large telecommunication service provider due to the continuing soft demand in the Company's announcer business. In the Company's UK distributorship operations, sales decreased $.2 million (4%) in spite of an 8% favorable exchange rate fluctuation, due to lower volume. In the three and nine-month periods ended September 30, 2003, the Company's domestic operations had increased sales to a large telecommunication service provider. While management believes that this increased volume of sales will continue in the future, this favorable variance may not occur in the fourth quarter.

Gross margin percentage was 53% for the three months and 45% for the nine months ended September 30, 2003 and 16% and 34%, respectively, in the comparable 2002 periods. The improvement in gross margin percentage for the quarter ended September 30, 2003 versus the prior year quarter was primarily due to the higher sales volume in the domestic operations with the concomitant greater absorption of fixed cost. The improvement for the nine months ended September 30, 2003 versus the prior year period is due to favorable product mix and lower fixed costs in the domestic operations and favorable impact of exchange rate on the UK distributorship operations.

Research and development expenses decreased $174,000 (20%) and $603,000 (23%), respectively, in the three-month and nine-month periods ended September 30, 2003 versus the comparable periods in 2002 primarily due to lower consultancy expenses and personnel costs.

Selling, general and administrative expenses increased $72,000 (4%) and $49,000 (1%), respectively, for the three and nine-month periods ended September 30, 2003 from the comparable prior year periods. Included in both current year periods are $220,000 for the estimated settlement of a rent dispute in the UK distributorship operations, offset by the release of a reserve of $86,000. With regard to the UK rent dispute, the Company has a potential claim against a third party for which no benefit has been recorded.

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 nine months ended September 30, 2003.

No tax benefits were recorded for losses incurred in 2003 since the Company cannot determine that the realization of net deferred tax assets is more likely than not.

Liquidity and Sources of Capital

Net cash used by operations for the nine months ended September 30, 2003 increased to $2,103,000 primarily due to an increase in accounts receivable and lower reduction of inventory. The cash provided by investing activities in 2003 primarily reflects the net decrease in marketable securities.

Working capital and the ratio of current assets to current liabilities were $15.3 million and 5.2:1 at September 30, 2003 compared to $17.8 million and 6.8:1 at December 31, 2002. The decrease in working capital in 2003 is mainly due to the results of operations.

During the remainder of 2003, 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.

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 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.

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, 2003, the UK distributorship operations had net assets of $1.3 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 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	Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) One report on Form 8-K was filed during the current quarter.

On August 15, 2003, the Company filed a Current Report on Form 8-K pursuant to Item 9 (Regulation FD Disclosures) to furnish a press release reporting results of our second quarter of 2003.

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, 2003 By /s/ Garrett Sullivan
Garrett Sullivan, Treasurer
and Chief Financial Officer