COGNITRONICS CORP
Form 10-Q
November 15, 2002

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CONFORMED

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, 2002

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, 2002.

Common Stock, par value $0.20 per share 5,419,241 shares

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Part I, Item 1.

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

	September 30, 2002 (Unaudited)	December 31, 2001
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 2,779	$ 7,731
Marketable securities	9,558	6,400
Accounts receivable, net	1,772	2,035
Inventories	4,679	5,682
Deferred income taxes	1,261	1,110
Other current assets including loans to officers of $1,921 and $1,532	3,766	2,431
TOTAL CURRENT ASSETS	23,815	25,389
PROPERTY, PLANT AND EQUIPMENT, NET	1,451	1,514
GOODWILL, NET	319	319
DEFERRED INCOME TAXES	735	812
OTHER ASSETS	397	539
	$26,717	$28,573
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 1,225	$ 871
Accrued compensation and benefits	1,289	1,109
Income taxes payable	363	290
Current maturities of debt	35	46
Other accrued expenses	506	319
TOTAL CURRENT LIABILITIES	3,418	2,635
LONG-TERM DEBT	8	26
OTHER NON-CURRENT LIABILITIES	2,185	2,314
STOCKHOLDERS' EQUITY		
Common Stock, par value $.20 a share, authorized 10,000,000 shares; issued 5,863,229 shares	1,173	1,173
Additional paid-in capital	13,300	13,322
Retained earnings	10,734	13,413
Cumulative other comprehensive income	(207)	(260)
Unearned compensation	(372)	(506)
	24,628	27,142
Less cost of 443,988 and 445,936 shares in treasury	(3,522)	(3,544)
TOTAL STOCKHOLDERS' EQUITY	21,106	23,598
	$26,717	$28,573

See Note to Condensed Consolidated Financial Statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
NET SALES	$2,378	$4,807	$ 8,876	$15,594
COST AND EXPENSES:				
Cost of products sold	1,986	2,612	5,815	8,216
Research and development	849	1,069	2,597	2,688
Selling, general and administrative	1,604	1,836	4,757	5,494
Amortization of goodwill		83		249
Other (income), net	(71)	(115)	(163)	(425)
	4,368	5,485	13,006	16,222
Income(loss) before income taxes	(1,990)	(678)	(4,130)	(628)
PROVISION(BENEFIT) FOR INCOME TAXES	(739)	(250)	(1,450)	(235)
NET INCOME(LOSS)	(1,251)	(428)	(2,680)	(393)
Currency translation adjustment	52	40	53	
COMPREHENSIVE INCOME(LOSS)	$(1,199)	$ (388)	$(2,627)	$ (393)
NET INCOME(LOSS) PER SHARE:				
Basic	$(.23)	$(.08)	$(.49)	$(.07)
Diluted	$(.23)	$(.08)	$(.49)	$(.07)
Weighted average number of outstanding shares:				
Basic	5,441,617	5,356,975	5,424,624	5,417,044
Diluted	5,441,617	5,356,975	5,424,624	5,417,044

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, 2002	Nine Months Ended September 30, 2001
NET CASH (USED)PROVIDED BY OPERATIONS	$(1,099)	$2,842
INVESTING ACTIVITIES		
Purchases of marketable securities	(15,245)	(3,800)
Sales of marketable securities	12,087	6,400
Loans to employees	(341)	(483)
Additions to property, plant and equipment, net	(336)	(457)
Purchase of software licenses		(192)
NET CASH PROVIDED(USED) BY INVESTING ACTIVITIES	(3,835)	1,468
FINANCING ACTIVITIES		
Repurchase of 1,500 and 232,450 shares for treasury	(5)	(1,576)
Principal payment of debt	(29)	(34)
Shares issued pursuant to employee stock option plans, 1,275 shares		7
NET CASH (USED) BY FINANCING ACTIVITIES	(34)	(1,603)
EFFECT OF EXCHANGE RATE DIFFERENCES	16	(5)
(DECREASE)INCREASE IN CASH AND CASH EQUIVALENTS	(4,952)	2,702
CASH AND CASH EQUIVALENTS- BEGINNING OF PERIOD	7,731	3,499
CASH AND CASH EQUIVALENTS - END OF PERIOD	$2,779	$6,201
INCOME TAXES PAID	$ 3	$ 538
INTEREST EXPENSE PAID	$ 17	$ 9

See Note to Condensed Consolidated Financial Statements.

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NOTE TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 30, 2002

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles 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 generally accepted accounting principles 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, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. The balance sheet at December 31, 2001 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, 2001.

Inventories (in thousands):

	September 30, 2002	December 31, 2001
Finished and in process	$3,034	$3,455
Materials and purchased parts	1,645	2,227
	$4,679	$5,682

Other Non-Current Liabilities (in thousands):

	September 30, 2002	December 31, 2001
Accrued supplemental pension plan	$ 482	$ 511
Accrued deferred compensation	259	274
Deferred directors' fees	320	269
Accrued pension expense	536	658
Accrued post-retirement benefit	844	843
	2,441	2,555
Less current portion	256	241
	$2,185	$2,314

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.

Adoption of Financial Accounting Standard 142 ("FAS 142")

Effective January 1, 2002, the Company adopted FAS 142. Under FAS 142, goodwill is no longer amortized, rather it is subject to a periodic impairment test based on its fair value. The Company has performed the transitional goodwill impairment test (as of January 1, 2002) on its applicable reporting units. As the estimated fair values of these reporting units exceeded their respective net book values, including goodwill, no impairment charge was recognized. If FAS 142 was effective as of January 1,

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2001, then the pro forma results of operations for the periods ended September 30, 2001 would have been as follows (dollars in thousands):

	As Reported	Adjustment	Pro Forma
Three Months			

Pretax Loss	$(678)	$83	$(595)
Net Loss	$(428)	$76	$(352)
Loss per share:			
Basic	$(.08)		$(.07)
Diluted	$(.08)		$(.07)
Nine Months			
Pretax Loss	$(628)	$249	$(379)
Net Loss	$(393)	$228	$(165)
Loss per share:			
Basic	$(.07)		$(.03)
Diluted	$(.07)		$(.03)

Operations by Industry Segments and Geographic Areas:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Net Sales				
United States	$ 959	$3,454	$4,549	$10,697
Europe	1,419	1,353	4,327	4,897
Intercompany eliminations				
	$ 2,378	$4,807	$8,876	$15,594
Operating Profit(Loss)				
United States	$(1,687)	$ (24)	$(3,192)	$ 506
Europe	(40)	(378)	(84)	(565)
Intercompany eliminations	2	20	8	26
	(1,725)	(382)	(3,268)	(33)
General Corporate Expenses	336	411	1,025	1,020
Other (income), net	(71)	(115)	(163)	(425)
Income(loss) before income taxes	$(1,990)	$ (678)	$(4,130)	$ (628)
Total Assets				
United States			$24,052	$26,459
Europe			2,682	3,945
Intercompany eliminations			(17)	(35)
			$26,717	$30,369

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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 $1.2 million and $2.5 million, respectively, for the three and nine-month periods ended September 30, 2002 versus a net loss of $.4 million in each of the comparable prior year periods.

Consolidated sales for the quarter ended September 30, 2002 decreased $2.4 million (51%) to $2.4 million versus the prior year period. Domestic sales decreased $2.5 million (72%), reflecting the continuing reduction in infrastructure buildout, particularly by CLECs, and reduction in capital expenditures by major telecommunication providers, as previously noted by the Company. Sales by the UK distributorship operations increased by $.1 million. Consolidated sales for the nine months ended September 30, 2002 decreased $6.7 million (43%) from the prior year period; sales of the domestic operations decreased $6.1 million (57%) 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 operation decreased $.6 million (12%) from the prior year period primarily due to lower sales to its principal customer. For the past several years, the Company's UK distributorship operation has experienced significant decreases in sales to its principal customer. The Company is unable to determine whether this trend will continue.

The gross margin percentages were 16% and 34%, respectively, for the three months and nine months ended September 30, 2002 and 46% and 47%, respectively, in the comparable 2001 periods. The decreases in the current year periods versus the prior year periods are primarily due to the lower volume in the US operations and the concomitant reduction in the absorption of fixed overhead. Reflecting the decrease in the level of sales, the Company recorded an increase of $325,000 in the provision for inventory in the three and nine-month periods of 2002 as compared to 2001. If the level of sales does not increase or decreases further, additional charges will be required. Included in cost of sales for the three and nine-month periods ended September 30, 2002 was severance related expense of $26,000.

Research and development expenses decreased $220,000 (21%) and $91,000 (3%), respectively, in the three-month and nine-month periods ended September 30, 2002 when compared to the prior year periods. The decrease in the third quarter of 2002 versus the prior year period is due to lower purchased parts, recruiting expense and contracted engineering services. Included in research and development expense for the three and nine-month periods ended September 30, 2002 was $34,000 of severance related expense.

Selling, general and administrative expenses decreased $232,000 (13%) and $737,000 (13%), respectively, for the three and nine months ended September 30, 2002, when compared to the prior year periods. These decreases are attributable to decreases of $67,000 (11%) and $651,000 (26%), respectively, in the Company's UK distributorship operations due to lower personnel costs. In addition, the US operations recorded lower sales commissions of $56,000 and $103,000 for the three and nine-month periods ended September 30, 2002, respectively, when compared to the prior year periods. Included in selling, general and administrative expense for the three and nine months ended

September 30, 2002 was $56,000 of severance related expense.

Other (income) decreased due to lower interest rates on cash balances and marketable securities in the three and nine-month periods ended September 30, 2002.

The Company's effective tax rate for the three-month and nine-month periods ended September 30, 2002 were 37% and 35%, respectively, versus 37% in each of the 2001 periods.

Liquidity and Sources of Capital

Net cash flow used by operations for the nine months ended September 30, 2002 was $1.1 million versus net cash flow provided by operations of $2.8 million in 2001. The negative net cash flow from operations in 2002 is due to the Company's operating loss. The net cash used by investing activities in 2002 primarily reflects a realignment of the Company's investment portfolio to corporate bonds from other securities. The net cash used for financing activities in the 2001 period primarily reflects the repurchase of shares for treasury.

Working capital and the ratio of current assets to current liabilities were $20.4 million and 7.0:1 at September 30, 2002 compared to $22.8 million and 9.6:1 at December 31, 2001. The decrease in working capital in 2002 is mainly due to the results of operations.

During the remainder of 2002, the Company may repurchase up to an additional 253,792 shares of its common stock and anticipates purchasing $.1 million of equipment. Management believes that its cash and cash equivalents and marketable securities in 2002 will be sufficient to meet its 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,

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2002, 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

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

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

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, 2002 By /s/ Garrett Sullivan
Garrett Sullivan, Treasurer
and Chief Financial Officer

CERTIFICATION

I, Brian J. Kelley certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cognitronics Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all

material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002
/s/ Brian J. Kelley
Brian J. Kelley
Chief Executive Officer

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CERTIFICATION

I, Garrett Sullivan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cognitronics Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this

quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controlsand procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of thiS quarterly report (the "Evaluation Date"); and
c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002
/s/ Garrett Sullivan
Garrett Sullivan
Chief Financial Officer