COGNITRONICS CORP
Form 10-Q
November 12, 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 September 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 5,726,142 shares of Common Stock, $.20 par value per share outstanding at September 30, 2004.
Part I, Item 1.

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

	September 30, 2004	December 31, 2003

	(Unaudited)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 3,644	$ 2,877
Marketable securities	5,134	5,956
Accounts receivable, net	1,310	1,183
Inventories	3,293	2,987
Taxes recoverable		2,028
Other current assets including loans to officers of $1,957 and $1,931	2,137	2,312
TOTAL CURRENT ASSETS	15,518	17,343
PROPERTY, PLANT AND EQUIPMENT, NET	925	1,087
GOODWILL, NET	319	319
OTHER ASSETS	131	149
	$16,893	$18,898
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 697	$ 778
Accrued compensation and benefits	1,453	1,297
Other accrued expenses	1,332	1,125
TOTAL CURRENT LIABILITIES	3,482	3,200
OTHER NON-CURRENT LIABILITIES	1,144	1,474
STOCKHOLDERS' EQUITY		
Common Stock, par value $.20 a share, authorized 20,000,000 shares; issued 5,863879 AND 5,863,229 shares	1,173	1,173
Additional paid-in capital	11,445	11,750
Retained earnings	1,096	3,419
Cumulative other comprehensive loss	(29)	(98)
Unearned compensation	(345)	(509)
	13,340	15,735
Less cost of 137,737 and 190,431 common shares in treasury	1,073	1,511
TOTAL STOCKHOLDERS' EQUITY	12,267	14,224
	$16,893	$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 September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003

NET SALES	$1,889	$3,498	$ 8,393	$ 8,442
COST AND EXPENSES:				
Cost of products sold	1,176	1,638	4,433	4,674
Research and development	620	675	1,850	1,994
Selling, general and administrative	1,466	1,676	4,491	4,806
Other (income), net	(40)	(40)	(103)	(126)
Gain on termination of post-retirement benefit plan				(834)
	3,222	3,949	10,671	10,514
Loss before income taxes	(1,333)	(451)	(2,278)	(2,072)
PROVISION FOR INCOME TAXES	15	15	45	45
NET LOSS	(1,348)	(466)	(2,323)	(2,117)
Currency translation adjustment	(9)	8	69	54
COMPREHENSIVE LOSS	$(1,357)	$ (458)	$(2,254)	$(2,063)
NET LOSS PER SHARE:				
Basic	$(.23)	$(.08)	$(.40)	$(.38)
Diluted	$(.23)	$(.08)	$(.40)	$(.38)
Weighted average number of outstanding shares:				
Basic	5,808,997	5,593,012	5,748,129	5,550,427
Diluted	5,808,997	5,593,012	5,748,129	5,550,427

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,	
	2004	2003
NET CASH USED BY OPERATIONS	$ (17)	$(2,103)
INVESTING ACTIVITIES		
Purchases of marketable securities	(4,733)	(2,328)
Sales of marketable securities	5,555	4,919
Additions to property, plant and		

equipment, net	(92)	(66)
NET CASH PROVIDED BY INVESTING ACTIVITIES	730	2,525
FINANCING ACTIVITIES		
Shares issued pursuant to stock option plans 25,348 and 4,370	19	18
Principal payment of debt		(26)
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	19	(8)
EFFECT OF EXCHANGE RATE DIFFERENCES	35	9
INCREASE IN CASH AND CASH EQUIVALENTS	767	423
CASH AND CASH EQUIVALENTS- BEGINNING OF PERIOD	2,877	2,732
CASH AND CASH EQUIVALENTS - END OF PERIOD	$ 3,644	$ 3,155
INCOME TAXES PAID	$ 63	$ 63
INTEREST PAID	$ 7	$ 5

See Note to Condensed Consolidated Financial Statements.

NOTE TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 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 nine-month periods ended September 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):

	September 30, 2004	December 31, 2003
Finished and in process	$2,210	$2,172
Materials and purchased parts	1,083	815

	$3,293	$2,987

Other Non-Current Liabilities (in thousands):

	September 30, 2004	December 31, 2003
Accrued supplemental pension plan	$ 386	$ 419
Accrued deferred compensation	215	232
Deferred directors' fees	332	411
Accrued pension expense	486	664
Accrued post-retirement benefit	3	11
	1,422	1,737
Less current portion	278	263
	$1,144	$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 nine months ended September 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 September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net loss, as reported	$(1,348)	$(466)	$(2,323)	$(2,117)
Add: Stock-based compensation expense included therein	85	95	277	287
Deduct: Total stock-based compensation expense determined under the fair value based method	(145)	(162)	(545)	(543)

Pro forma net loss		$(1,408)	$(533)	$(2,591)	$(2,373)
Net loss per share					
As reported	Basic	$(.23)	$(.08)	$(.40)	$(.38)
	Diluted	$(.23)	$(.08)	$(.40)	$(.38)
Pro forma	Basic	$(.24)	$(.10)	$(.45)	$(.43)
	Diluted	$(.24)	$(.10)	$(.45)	$(.43)

On August 1, 2004 and 2003, the Company granted 30,000 and 36,000 stock options, respectively, with an exercise price of $3.50 and $2.11, respectively.

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 nine months ended September 30 are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Interest cost on projected benefit obligation	$23	$28	$69	$86
Expected return on plan assets	(15)	(16)	(43)	(48)
Amortization of net loss	3	3	8	10
Settlement expense		43		43
Net periodic pension cost	$11	$58	$34	$91

The Company expects the funding requirement to be $240,000 in 2004 of which $215,000 was funded during the nine months ended September 30, 2004.

Operations by Industry Segments and Geographic Areas:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net Sales				
United States	$ 771	$1,979	$ 3,770	$ 4,298
Europe	1,118	1,519	4,623	4,144
	$1,889	$3,498	$ 8,393	$ 8,442
Operating Profit(Loss)				
United States	$ (929)	$ 35	$(1,567)	$(1,738)
Europe	(160)	(146)	117	(236)
	(1,089)	(111)	(1,450)	(1,974)
General Corporate Expense	284	380	931	1,058
Other (income), net	(40)	(40)	(103)	(126)
Gain on termination of post-				

retirement benefit plan				(834)
Loss before income taxes	$(1,333)	$ (451)	$(2,278)	$(2,072)
Total Assets				
United States			$14,099	$17,927
Europe			2,794	2,622
Intercompany eliminations				(11)
			$16,893	$20,538

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 losses of $1,348,000 and $2,323,000 for the three months and nine months ended September 30, 2004 versus net losses of $466,000 and $2,117,000, 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, 2004 decreased $1.6 million (46%) to $1.9 million due to sales decreases in both the domestic and the UK distributorship operations. The sales in the domestic operations decreased $1.2 million (61%) to $.8 million due to lower volume. In the three-month period ended September 30, 2004, the Company's sales to a large telecommunication service provider decreased $1.1 million from the prior year period. The Company's domestic operations continues to experience wide fluctuations from quarter to quarter. Sales of the Company's UK distributorship operations decreased $.4 million (26%) due to lower volume, offset, in part, by a favorable exchange rate fluctuation. While consolidated sales for the nine months ended September 30, 2004 were essentially unchanged from the prior year period, sales of the domestic operations decreased $.5 million (12%) primarily due to lower sales to a large telecommunication service provider and large telecommunication equipment manufacturer and sales of the UK distributorship operations increased $.5 million (12%) primarily due to favorable foreign exchange fluctuations.

Gross margin percentage was 38% for the three months and 47% for the nine months ended September 30, 2004 and 53% and 45%, respectively, in the comparable 2003 periods. The three-month period ended September 30, 2004 versus the prior year period was unfavorably impacted by lower sales and the concomitant lower absorption of fixed costs.

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.

Liquidity and Sources of Capital

Net cash used by operations for the nine months ended September 30, 2004 decreased to $17,000 due to the receipt of tax refunds of approximately $2 million offset by continued losses, an increase in inventory and a decrease in non-current liabilities. Working capital and the ratio of current assets to current liabilities were $12.0 million and 4.5:1 at September 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 September 30, 2004,the UK distributorship operations had net assets of $1.6 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.

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

On July 28, 2004, the Company filed a Current Report on Form 8-K pursuant to Item 12 (Results of Operations and Financial Condition) to furnish a press release reporting second quarter results for 2004.

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 12, 2004 By /s/ Garrett Sullivan
Garrett Sullivan, Treasurer
and Chief Financial Officer