FRANKLIN TELECOMMUNICATIONS CORP
Form 10-Q
February 12, 2001

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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 DECEMBER 31, 2000

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OF 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 0-11616

FRANKLIN TELECOMMUNICATIONS CORP.
(Exact Name of Registrant as Specified in its Charter)

California	95-3733534
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

733 Lakefield Road, Westlake Village, California 91361
(Address of Principal Executive Offices) (Zip Code)
Registrant's Telephone Number, Including Area Code: (805) 373-8688

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange
Common stock, without par value	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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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 (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate the number of shares outstanding of each of the issuer's class of common stock, as of the latest practicable date:

TITLE OF EACH CLASS OF COMMON STOCK	OUTSTANDING AT FEBRUARY 09, 2001

Common Stock, no par value	42,480,796

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Franklin Telecommunications Corp.

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Item 1. Financial Statements

FRANKLIN TELECOMMUNICATIONS CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2000 (UNAUDITED) AND JUNE 30, 2000

	DECEM 2 ----- (UNAU
ASSETS	
Current assets	
Cash and cash equivalents	$
Accounts receivable, less allowance for doubtful accounts of $40,000 (unaudited) and $50,000, respectively	
Other receivables	

Note receivable (a portion due from a related party)	
Inventories (Note 2)	2,
Prepaid expenses	

Total current assets	3,

Property and equipment	
Machinery and equipment	1,
Furniture and fixtures	
Computers and software	1,

	3,
Less accumulated depreciation	1,

Total property and equipment	1,

Other assets	

Total assets	$ 5,
	=====

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities	
Current portion of capital lease obligations	$
Accounts payable	
Accrued liabilities (Note 3)	

Total current liabilities	1,
Long-term debt, (majority due to a related party)	
Capital lease obligations, net of current portion	

Total liabilities	1,

Contingencies (Note 4)	
Shareholders' equity	
Preferred stock, no par value 10,000,000 shares authorized, Convertible Series C -0- (unaudited) and -0- shares issued and outstanding	
Common stock, no par value 90,000,000 shares authorized 42,206,080 (unaudited) and 34,247,013 shares issued and outstanding	34,
Common stock committed, no par value 74,716 (unaudited) and 74,716 shares committed but not yet issued	
Accumulated deficit	(31,

Total shareholders' equity	3,

Total liabilities and shareholders' equity	$ 5,
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The accompanying notes are an integral part of these financial statements.

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FRANKLIN TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS AND SIX MONTHS ENDED DECEMBER 31, 2000 AND 1999 (UNAUDITED)

	THREE MONTHS ENDED DECEMBER 31,		
	2000	1999	
	(UNAUDITED)	(UNAUDITED)	(U
Sales			
Product	$ 191,000	$ 245,000	$
Telephone and Internet services	290,000	641,000	
Total sales	481,000	886,000	
Cost of sales			
Product	296,000	286,000	
Telephone and Internet services	364,000	893,000	
Total cost of sales	660,000	1,179,000	
Gross profit (loss)	(179,000)	(293,000)	
Operating expenses			
Research and development expenses	445,000	410,000	
Selling, general, and administrative Expenses	1,099,000	1,179,000	
Total operating expenses	1,544,000	1,589,000	
Loss from operations	(1,723,000)	(1,882,000)	(
Other income (expense)			
Interest income	8,000	6,000	
Interest expense	(1,000)	--	
Loss on disposal of property and equipment...	(3,000)	(6,000)	
Other income (expense)	1,000	4,000	
Total other income (expense)	5,000	4,000	
Net loss	$ (1,718,000)	$ (1,878,000)	$ (
Basic and diluted net loss per common share	$ (.04)	$ (.07)	$
Weighted average common shares Outstanding used to compute basic loss per common share	40,614,645	28,629,848	3

The accompanying notes are an integral part of these financial statements.

FRANKLIN TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED DECEMBER 31, 2000 AND 1999 (UNAUDITED)

SIX MONTHS ENDED

	DECEMBER 31, 2000 (UNAUDITED)	DECEMBER 31, 1999 (UNAUDITED)
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$(3,629,000)	$(4,913,000)
Adjustments to reconcile net loss to net cash Used in operating activities		
Depreciation and amortization	376,000	352,000
Provision for loss on obsolete inventory	193,000	--
Provision for loss on doubtful accounts	9,000	--
Stock issued for services rendered	225,000	82,000
Loss on disposal of property and equipment	--	24,000
Write-off of accounts receivable	--	1,529,000
(Increase) decrease in		
Accounts receivable	(24,000)	86,000
Other receivables	(1,000)	66,000
Inventories	104,000	(90,000)
Prepaid expenses	9,000	(14,000)
Increase (decrease) in		
Accounts payable	(187,000)	(103,000)
Accrued liabilities	(110,000)	(741,000)
Net cash used in operating activities	(3,035,000)	(3,722,000)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(75,000)	(579,000)
Disposal of property and equipment	(3,000)	16,000
Other assets	(25,000)	(104,000)
Net cash used in investing activities	(103,000)	(667,000)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from convertible notes payable	--	2,500,000
Proceeds from exercise of stock options and warrants	4,000	(69,000)
Proceeds from sale of Company stock	2,485,000	2,080,000
Payments on notes payable	(18,000)	--
Proceeds from sale of minority stock in consolidated subsidiary	--	53,000
Net cash provided by financing activities	2,471,000	4,564,000
Net increase (decrease) in cash	(667,000)	175,000
Cash and cash equivalents, beginning of the period	1,275,000	1,637,000
Cash and cash equivalents, end of the period	$ 608,000	$ 1,812,000

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

	2000 (unaudited)	1999 (unaudited)
Interest paid	$ 2,000	$ --

SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES

During the six months ended December 31, 2000, the Company issued 200,000 shares (unaudited) of common stock for services valued at $225,000 (unaudited).

During the six months ended December 31, 1999, The Company repossessed equipment from a customer who was in arrears on payments for said equipment at a cost of $868,000 (unaudited).

The accompanying notes are an integral part of these financial statements.

FRANKLIN TELECOMMUNICATIONS CORP. AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

NOTE 1--GENERAL AND SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Business and Organization

Franklin Telecommunications Corp. ("Franklin") and its subsidiaries (collectively the "Company") manufacture and distribute data and telephony communications, access and connectivity products for IP Telephony networks, T-1 and X.25 wide-area networks and provide IP Telephony and Internet services through its majority-owned subsidiary, FNet Corp. ("FNet"). The Company's customers are located predominantly in the United States, Canada, Australia, South America and parts of Europe in a wide range of industries including financial services, government, telephone services and manufacturing.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in conformity with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and 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 normal, recurring adjustments considered necessary for a fair presentation have been included. The financial statements should be read in conjunction with the audited financial statements included in the Company's annual report on Form 10-K for the fiscal year ended June 30, 2000. The results of operations for the six months ended December 31, 2000 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2001.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Franklin Telecommunications Corp. and its wholly-owned or majority owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

Impairment of Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to future net cash flows expected to be generated by the assets. If the assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount exceeds the fair value of the assets. During the six months ended December 31, 2000, the Company determined that no assets were impaired.

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Loss Per Common Share

The Company calculates loss per common share in accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share." Basic loss per share is computed by dividing the loss available to common shareholders by the weighted-average number of common shares outstanding. Diluted loss per share is computed similar to basic loss per share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. The following potential common shares have been excluded from the computation of diluted net loss per share for all periods presented because the effect would have been anti-dilutive:

	For the Six Months Ended December 31,	
	2000	1999
	(unaudited)	(unaudited)
Options outstanding under the Company's stock option plans	1,940,250	3,295,626
Options granted outside the Company's stock option plans	3,755,000	1,112,500
Convertible notes payable	200,000	--
Warrants issued in conjunction with convertible notes payable	1,000,000	1,000,000
Warrants issued in conjunction with various private placements	5,800,267	224,375
Warrants issued as offering costs for convertible notes payable	100,000	100,000

Income Taxes

The Company accounts for income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is required when it is less likely than not that the Company will be able to realize all or a portion of its deferred tax assets.

NOTE 2--INVENTORIES

Inventories consisted of the following:

	DECEMBER 31,	JUNE 30,

	2000	2000
	(UNAUDITED)	
Raw materials.......	$1,359,000	$1,314,000
Work in process.....	212,000	222,000
Finished goods......	830,000	1,162,000
Total..........	$2,401,000	$2,698,000

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NOTE 3--ACCRUED LIABILITIES

Accrued liabilities consisted of the following:

	DECEMBER 31, 2000	JUNE 30, 2000
	(UNAUDITED)	
Salaries and related expense	$ 581,000	$ 690,000
Customer deposits	24,000	80,000
License payable	--	100,000
Other accrued liabilities	313,000	158,000
Total	$ 918,000	$1,028,000

NOTE 4--COMMITMENTS AND CONTINGENCIES

Service Agreement

During the six months ended December 31, 2000, FNet entered into a five-year service agreement with a satellite service provider to operate uplink and downlink earth stations between the United States and the Balkan region. The estimated fee for the project is $1,236,000 (unaudited).

Litigation

The Company is involved in certain legal proceedings and claims which arise in the normal course of business. Management does not believe that the outcome of these matters will have a material adverse effect on the Company's consolidated financial position or results of operations.

NOTE 5--RECENT SALE OF EQUITY SECURITIES

During the three months ended December 31, 2000, the Company completed the following significant common stock transactions of previously unissued common shares:

Issued 7,500 shares of common stock in connection with the exercise of stock options for cash of $3,300.

In connection with a private placement in March 2000, the Company issued warrants to the investors that were designed to protect the investors against short-term declines in the value of the Company's common stock during the period between the date of the purchase and the effective date of a Registration Statement covering the shares sold. The warrants are triggered if the market price of the Company's shares is below $1.50 on the effective date. If the warrants are triggered, the investors would be entitled to acquire additional shares for $0.01 per share. The registration statement for the shares became effective in November 2000, at which time the market price of the Company's common stock was below $1.50. As a result, warrants for 2,011,350 shares became exercisable. In addition, 1,927,797 shares of common stock were issued by the Company in a cashless exercise of the warrants, and 50,000 shares of common stock were issued for cash of $500.

In connection with a private placement in March 2000, the Company was obligated to effect the registration of the shares within a specified time period, with penalties due to the investors if the deadline was not met. As the deadline was not met, the Company became obligated to pay the penalties, and it had the option to pay the penalties in shares of common stock. Accordingly, the Company issued a total of 480,812 shares to these investors in November 2000.

In connection with a private placement, the Company issued 850,000 shares for gross proceeds of $425,000. The Company paid fees and expenses of $13,140 in connection with the private placement.

NOTE 6--SUBSEQUENT EVENT

On February 1, 2001, the Company announced that its subsidiary FNet Corp. is shutting down its satellite telephone network in the Balkan region. The closure is a cost-saving measure, in that rising costs kept the operation from achieving the level of profitability that had been forecast.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

Franklin Telecommunications Corp. ("Company") designs, manufactures and sells Internet Telephony equipment, also called Voice Over Internet Protocol equipment ("VOIP") and other high speed communications products and subsystems. Our products are marketed through Original Equipment Manufacturers ("OEMs") and distributors, as well as directly to end users. In addition, through our majority-owned subsidiary, FNet Corp. ("FNet"), we provide traditional switched network and Internet Protocol telephony services, and Internet access to businesses and individuals. The Company's customers are located throughout the world in a wide range of industries including financial services, government, telephone services and manufacturing.

The Company offers a suite of Internet Telephony solutions that enable business communications over data networks. From the small office home office (SOHO) to the branch office and headquarters operations of medium to large scale corporations, the Company offers a cost-effective call handling solution. From the enterprise to the carrier market, the Company offers converged network solutions; managing the connectivity and integration of voice, data, fax and video. Where ever possible, the Company offers a turnkey solution that can be "owned" by its customers. When equipment sales are not in the best interest of a particular customer's business communications solution, the Company plans to provide that solution as a "service" that can be leased. The Company aims to be a leading edge supplier of Internet Telephony solutions as a result of its flexibility in providing on net and off net business communication solutions as customer owned equipment or Franklin provided services on a global basis. The Company's products and services enable connectivity and e-commerce.

The Company is both an equipment supplier and a service provider, offering turn-key business communications solutions to both the carrier and enterprise segments of the Internet Telephony market. The Company produces gateways, gatekeepers and edge servers that provide advanced packet switching solutions that significantly reduce the infrastructure costs associated with communications networks. The Company's products are designed, developed and manufactured by the Company.

In addition to manufactured solutions, the Company maintains a Network Operations Center that provides both "on-net" and "off-net" connectivity for the Company's equipment customers. The Network Operations Center interconnects the Company's customers on a global basis. The Network Operations Center includes Internet access facilities and a Class 4 circuit switch. The center interconnects with three International Record Carriers and is capable of completing a voice call to any phone in the world. The Company's equipment and services customers will in the future be offered the opportunity to access the circuit switched facilities and to interconnect with each other, using the Company to enable "settlement" between the networks. This interconnection can be either "free" through the Internet, or delivered through private leased lines.

As a result of the Company's expertise in network operations, the Company is also able to provide additional assistance to its customers by offering design, installation and network management services. The company believes that this strategy of combining network operations and equipment design is a significant product differentiation strategy, uniquely positioning the Company. Many of the Company's customers elect to interconnect with the Network Operations center. Much like the Internet, the Company is growing with each additional gateway sale.

Forward-looking statements in this Management's Discussion and Analysis of Financial Condition and Results of Operations, including statements regarding the Company's entrance into the Telephone and Internet business, newly introduced products, development of "VOIP" service capabilities over the Internet, net sales, gross profit, operating expenses, other income and expenses, liquidity and cash needs and the Company's plans and strategies are all based on current expectations, and the Company assumes no obligation to update this information. Numerous factors could cause actual results to differ from those described in the forward-looking statements.

As with any line of business, there can be no assurance that the DVG VOIP products will gain widespread market acceptance or be profitable. In addition, there can be no assurance that new hardware products and services developed by others will not render the Company's hardware products and services noncompetitive or obsolete.

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RESULTS OF OPERATIONS

Three Months Ended December 31, 2000 Compared To Three Months Ended December 31, 1999

Net Sales. Net sales decreased by $405,000, or 46%, from $886,000 in the three months ended December 31, 1999 to $481,000 in the three months ended December 31, 2000. The decrease is due both to a reduction of DVG hardware systems sales and reduced service revenue, primarily from the Balkan operation. The revenue mix for the three months ended December 31, 2000 consisted of 60% Telephone and Internet services revenue and 40% hardware product sales.

Gross Loss. Gross loss increased as a percentage of net sales to a loss of 37% for the three months ended December 31, 2000, from a gross loss of 33% of net sales for the corresponding period of 1999. The gross loss percentage increase can be attributed to fixed hardware and service overhead expenses spread over a smaller sales base.

Operating Expenses. Operating expenses decreased by $45,000, or 3%, from $1,589,000 in the three months ended December 31, 1999 to $1,544,000 in the three months ended December 31, 2000. The decrease was primarily attributable to reduced salaries.

Other Income (Expense). Interest income increased by $2,000, or 33%, from $6,000 in the three months ended December 31, 1999 to $8,000 in the three months ended December 31, 2000, due to increased cash balances available to earn interest. Interest expense was $1,000 for the three months ended December 31, 2000, with no interest during the same period in 1999. Other components of other income (expense) were immaterial and were due to various non operating items.

Six Months Ended December 31, 2000 Compared To Six Months Ended December 31, 1999

Net Sales. Net sales decreased by $749,000, or 45%, from $1,661,000 in the six months ended December 31, 1999 to $912,000 in the six months ended December 31, 2000. The decrease is due both to a reduction of DVG hardware systems sales and reduced service revenue, primarily from the Balkan operation. The revenue mix for the six months ended December 31, 2000 consisted of 66% Telephone and Internet services revenue and 34% hardware product sales.

Gross Loss. Gross loss increased as a percentage of net sales to a loss of 41% for the six months ended December 31, 2000, from a gross loss of 12% of net sales for the corresponding period of 1999. The gross loss percentage increase can be attributed to fixed hardware and service overhead expenses spread over a smaller sales base.

Operating Expenses. Operating expenses decreased by $1,447,000, or 31%, from $4,702,000 in the six months ended December 31, 1999 to $3,255,000 in the six months ended December 31, 2000. The decrease was primarily attributable to a one time bad debt expense of $1,284,000 occurring in the six month period ending December 31, 1999.

Other Income (Expense). Interest income increased by $1,000, or 7%, from $14,000 in the six months ended December 31, 1999 to $15,000 in the six months ended December 31, 2000, due to increased cash balances available to earn interest. Interest expense increased by $1,000, from $1,000 in the six months ended December 31, 1999 to $2,000 in the six months ended December 31, 2000. Other components of other income (expense) were immaterial and were due to various non operating items.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents and net working capital totaled $608,000 and $2,135,000, respectively, as of December 31, 2000. The primary source of cash has been net proceeds generated from equity and debt financings. The Company has relied on sales of new shares, loan proceeds and the exercise of warrants and options to fund operations for an extended period of time. The Company received $10,589,000 and $2,471,000 in equity financing for the year ended June 30, 2000, and the six months ended December 31, 2000, respectively. Its subsidiary, FNet, raised $53,000 for the year ended June 30, 2000 and $-0- for the six months ended December 31, 2000. The Company and its subsidiary FNet have continued to experience losses due to low sales results.

The Company anticipates that its primary uses of working capital in future periods will be for increases in product development, expansion of its marketing plan, general working capital and funding of increases in accounts receivable.

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The Company believes that existing cash and cash equivalents, cash flow from operations and cash raised through future anticipated private placements will be sufficient to meet the Company's presently anticipated working capital needs for at least the next twelve months and the foreseeable future. The Company is currently having difficulty raising additional capital due to the low trading price of its common shares. If the Company is unable to obtain sufficient private placement financing, it may be unable to continue as a going concern. To the extent the Company uses its cash resources for acquisitions, the Company may be required to obtain additional funds, if available, through borrowings or equity financings. There can be no assurance that such capital will be available on acceptable terms.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not applicable

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

Not applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable

ITEM 5. OTHER INFORMATION

Not applicable

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

None

(b) Reports on Form 8-K

None

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SIGNATURES

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.

FRANKLIN TELECOMMUNICATIONS CORP.

By /s/ THOMAS L. RUSSELL

Thomas L. Russell
Vice President
Chief Financial Officer

Dated: February 12, 2001