

FRANKLIN TELECOMMUNICATIONS CORP  
Form 10-Q  
February 14, 2002

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2001

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  
(State or other jurisdiction of  
incorporation or organization)

95-3733534  
(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

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  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 12, 2002
Common Stock, no par value	43,809,231

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Franklin Telecommunications Corp.

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FRANKLIN TELECOMMUNICATIONS CORP. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
DECEMBER 31, 2001 (UNAUDITED) AND JUNE 30, 2001

	DECEMBER 31, 2001	JUNE 30, 2001
	-----	-----
	(unaudited)	
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 15,000	\$ 49,000
Account Receivable, less allowance for doubtful accounts of \$0, and \$122,000	37,000	21,000

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Other Receivables	1,000	1,000
Inventories, less allowance for obsolescence of \$0 and \$2,377,000	265,000	325,000
Prepaid Expenses	5,000	15,000
	-----	-----
Total Current Assets	323,000	411,000
	-----	-----
Property and Equipment,		
Computers and software	1,230,000	1,230,000
Furniture and fixtures	882,000	882,000
Machinery and equipment	170,000	223,000
	-----	-----
	2,282,000	2,335,000
Less accumulated depreciation	1,793,000	1,746,000
	-----	-----
Total Property and Equipment	489,000	589,000
	-----	-----
Licenses, Net	239,000	391,000
Other Assets	44,000	44,000
	-----	-----
Total Assets	\$1,095,000	\$1,435,000
	=====	=====

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

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FRANKLIN TELECOMMUNICATIONS CORP. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
DECEMBER 31, 2001 (UNAUDITED) AND JUNE 30, 2001

	DECEMBER 31, 2001	JUNE 30, 2001
	-----	-----
	(unaudited)	
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Convertible Promissory notes payable	\$ 191,000	\$ 122,000
Current Portion of capital lease obligations	28,000	28,000
Account Payable	1,861,000	1,554,000
Accrued Liabilities	1,361,000	1,379,000
	-----	-----
Total Current Liabilities	3,441,000	3,083,000
Note Payable-related party	686,000	686,000
	-----	-----

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Total Liabilities	4,127,000	3,769,000
	-----	-----
Contingencies		
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 43,808,321 (unaudited) and 43,808,321 shares issued and outstanding	35,907,000	35,850,000
Common Stock committed, no par value 74,716 (unaudited) and 74,716 Shares committed but not yet issued	82,000	82,000
Options and Warrants	100,000	-
Accumulated Deficit	(39,121,000)	(38,266,000)
	-----	-----
Total Shareholders' Equity (deficit)	(3,032,000)	(2,334,000)
	-----	-----
Total Liabilities and Shareholders' Equity	\$ 1,095,000	\$ 1,435,000
	=====	=====

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 THREE & SIX MONTHS ENDED DECEMBER 30, 2001 AND 2000 (UNAUDITED)

	THREE MONTHS ENDED DECEMBER 31,		SIX MONTHS ENDED DECEMBER 31,	
	2001	2000	2001	2000
	-----	-----	-----	-----
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Sales:				
Product	\$ 76,000	\$ 191,000	133,000	300,000
Telephone and internet services	43,000	290,000	87,000	500,000
	-----	-----	-----	-----
Total Sales	119,000	481,000	220,000	800,000
Cost of Sales:				
Product	30,000	296,000	60,000	500,000
Telephone and internet services	150,000	364,000	300,000	700,000
	-----	-----	-----	-----
Total Cost of Sales	180,000	660,000	360,000	1,200,000

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Gross Profit (Loss)	(61,000)	(179,000)	(140,000)	(3,629,000)
Operating Expenses				
Research and development	-	445,000	-	8,629,000
Selling, general and administrative	312,000	1,099,000	704,000	2,312,000
Total Operating Expenses	312,000	1,544,000	704,000	3,212,000
Loss from Operations	(373,000)	(1,723,000)	(844,000)	(3,629,000)
Other Income (Expense)				
Interest Income	-	8,000	-	
Interest Expense	(7,000)	(1,000)	(14,000)	
Loss and disposal of property & equip	-	(3,000)	-	
Other Income (Expense)	-	1,000	3,000	
Total Other Income (Expense)	(7,000)	5,000	(11,000)	
Net Loss	\$ (380,000)	(1,718,000)	(855,000)	(3,629,000)
Basic and Diluted Net loss per common share	(0.01)	(0.04)	(0.02)	
Weighted Average Common Shares Outstanding used to compute basic				
Loss per common share	43,659,408	40,614,645	42,996,131	37,900,000

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

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FRANKLIN TELECOMMUNICATIONS CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR SIX MONTHS ENDED DECEMBER 31, 2001 AND 2000 (UNAUDITED)

	SIX MONTHS ENDED DECEMBER 31,	
	2001 (unaudited)	2000 (unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Loss	\$ (855,000)	\$ (3,629,000)
Adjustments to reconcile net loss to net cash Used in operating activities		
Depreciation and Amortization	252,000	376,000
Provision for Loss on Obsolete Inventory	-	193,000
Provision for Loss on Doubtful Accounts	-	9,000
Stock issued for services rendered	-	225,000

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Gain on sale of equipment	(3,000)	-
(Increase) decrease in		
Account Receivable	(16,000)	(24,000)
Other Receivables	-	(1,000)
Inventories	60,000	104,000
Prepaid Expenses	10,000	9,000
Increase (Decrease) in		
Account Payable	307,000	(187,000)
Accrued Liabilities	82,000	(110,000)
	-----	-----
Net Cash Used in Operating Activities	(163,000)	(3,035,000)
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of Property and Equipment	-	(75,000)
Proceeds from sale of equipment	3,000	(3,000)
Other Assets	-	(25,000)
	-----	-----
Net Cash Used in Investing Activities	3,000	(103,000)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from Convertible Notes Payable	69,000	-
Proceeds from Exercise of Stock Options and Warrants	-	4,000
Proceeds from Sale of Company Stock	57,000	2,485,000
Payments on capital lease obligation	-	(18,000)
	-----	-----
Net Cash Provided by Financing Activities	126,000	2,471,000
	-----	-----
Net Increase ( Decrease) in Cash	(34,000)	(667,000)
Cash and Cash Equivalents, Beg of Period	49,000	1,275,000
	-----	-----
Cash and Cash Equivalents, End of Period	15,000	608,000
	=====	=====

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FRANKLIN TELECOMMUNICATIONS CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR SIX MONTHS ENDED DECEMBER 31, 2001 AND 2000 (UNAUDITED)

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

	THREE MONTHS ENDED DECEMBER 31	
	2001 (unaudited)	2000 (unaudited)
	-----	-----
Interest paid	-	\$ 2,000
	=====	=====

SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES

During the six months ended DECEMBER 31, 2001, the Company issued options to

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employees in lieu of accrued Wages of approximately \$100,000. (unaudited)

During the six months ended December 30, 2000, the Company issued 200,000 shares (unaudited) of common stock for services valued at \$225,000 (unaudited).

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

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### 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 wide-area networks which 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 and some overseas.

##### 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 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, 2001. The results of operations for the three and six months ended December 31, 2001 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2002.

##### 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 inter-company 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 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 year ended June 30, 2001, many assets were considered impaired and the carrying amounts were reduced

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significantly. During the six months ended December 31, 2001, the Company determined that no assets were further impaired.

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 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 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:

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 statements carrying amounts of existing 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 portion of its deferred tax assets.

NOTE 2

Inventories consisted of the following:	December 30, 2001 (unaudited)	June 30, 2001
Raw materials	\$ 0	\$ 1,360,000
Work in process	0	201,000
Finished goods	265,000	1,141,000
Reserve for obsolescence	0	(2,377,000)
	-----	-----
	\$ 265,000	\$ 325,000
	=====	=====

NOTE 3 ACCRUED LIABILITIES

Accrued Liabilities consisted of the following:		
Salaries and related expenses	\$1,000,000	\$1,025,000
Accrued legal	165,000	165,000
Other	196,000	189,000
	-----	-----
	\$1,361,000	\$1,379,000
	-----	-----

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### NOTE 4 COMMITMENTS AND CONTINGENCIES

#### Litigation

The Company is involved in certain legal proceedings 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 six months ended December 31, 2001, the Company sold 25,000 units to a current shareholder of the Company for \$25,000. A unit consisted of 20 shares of common stock of the Company plus a warrant to purchase 10 shares of common stock for \$.001, exercisable after March 25, 2002 if the ten day average of the stock price is under \$.25 per share.

The Company also received \$50,000 in exchange for a convertible note from its Executive Chairman. The note bears interest at 6% and can be converted at \$.05 per share.

An employee of the Company has an option to purchase 900,000 shares at \$0.05 per share in lieu of salary for the period ending 12-31-01.

Two directors of the Company have options to purchase 1,000,000 shares each at \$0.05 per share.

The Company has agreed to issue options to the Executive Chairman in lieu of salary. The Chairman's stated annual salary is \$150,000. He will receive 750,000 options at \$.05 per share in lieu of salary for the period ending 12-31-01.

The Company believes all such sales were exempt from registration under the Securities Act of 1933 by reason of Section 4(2) thereof and Regulation D thereunder.

**FORWARD-LOOKING STATEMENTS.** Certain statements constitute "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. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance, or achievements of the Company to be materially different from any future results, performance or achievements, expressed or implied by such forward-looking statements.

### RESULTS OF OPERATIONS

THREE MONTHS ENDED DECEMBER 31, 2001 COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2000

**NET SALES.** Net sales decreased by \$362,000 or 75%, from \$481,000 in the three months ended December 31, 2000 to \$119,000 in the three months ended December 31, 2001. 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, 2001 consisted of 36% Telephone and Internet services revenue and 64% hardware product sales.

**GROSS LOSS.** Gross loss increased as a percentage of net sales to a loss of 51% for the three months ended December 31, 2001, from a gross loss of 37% of net sales for the corresponding period of 2000. The gross loss percentage increase can be attributed to fixed hardware and service overhead expenses

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spread over a smaller sales base.

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OPERATING EXPENSES. Operating expenses decreased by \$1,234,000, or 80%, from \$1,544,000 in the three months ended December 31, 2000 to \$310,000 in the three months ended December 31, 2001. The decrease was primarily attributable to reduced salaries.

OTHER INCOME (EXPENSE). Interest income decreased by \$8,000, from \$8,000 in the three months ended December 31, 2000 to zero in the three months ended December 31, 2001, due to decreased cash balances available to earn interest. Interest expense was \$7,000 for the three months ended December 31, 2001, with \$1,000 interest during the same period in 2000. Other components of other income (expense) were immaterial and were due to various non operating items.

SIX MONTHS ENDED DECEMBER 31, 2001 COMPARED TO SIX MONTHS ENDED DECEMBER 31, 2000

NET SALES. Net sales decreased by \$692,000, or 76%, from \$ 912,000 in the six months ended December 31, 2000 to \$220,000 in the six months ended December 31, 2001. The decrease is due both to a reduction of DVG hardware systems sales and reduced service revenue. The revenue mix for the six months ended December 31, 2001 consisted of 70% Telephone and Internet services revenue and 30% hardware product sales.

GROSS LOSS. Gross loss increased as a percentage of net sales to a loss of 64% for the six months ended December 31, 2001, from a gross loss of 41% of net sales for the corresponding period of 2000. 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 \$2,551,000, or 78%, from \$3,255,000 in the six months ended December 31, 2000 to \$704,000 in the six months ended December 31, 2001. The decrease was primarily attributable to reduced salaries and a reduction of facilities.

OTHER INCOME (EXPENSE). Interest income decreased by \$15,000, from \$15,000 in the six months ended December 31, 2000 to zero in the six months ended December 31, 2001, due to decreased cash balances available to earn interest. Interest expense increased by \$12,000, from (\$2,000) in the six months ended December 31, 2000 to (\$14,000) in the six months ended December 31, 2001. Other components of other income (expense) were immaterial and were due to various non operating items.

### LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents totaled \$15,000 as of December 31, 2001. The sources of cash were provided primarily by issuance of equity securities, and to a lesser extent, collections of sales revenues. The Company has relied on sales of new shares and the exercise of warrants and options to supplement the funding of operations for an extended period of time.

Both Franklin Telecom and FNet have continued to experience losses. The Company has not currently been able to raise sufficient capital from sales of additional shares. Audit opinions for the past two fiscal years have advised that the Company may not be able to continue as a going concern.

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The Company is currently in a survival mode. As of January 31, 2002 it held \$23,000 of cash or cash equivalents. Current monthly cash consumption is approximately \$50,000. Sales from FTC and the FNet division are approximately \$25,000 per month. Management is currently deferring salary or taking options in lieu of salary. Recent non-operating cash funding has been contributed by the Company's chairman in the form of convertible debt.

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The Company believes that existing cash and cash equivalents and cash flow from operations will not be sufficient to meet the Company's presently anticipated working capital needs during the next twelve months and the foreseeable future. Although the Company continues the effort to raise cash through sales of existing inventory and anticipates future private placements of its securities, there is no assurance that this effort will be successful.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk generally represents the risk that losses may occur in the values of financial instruments as a result of movements in interest rates, foreign currency exchange rates and commodity prices. The Company is exposed to changes in financial market conditions in the normal course of its business due to its use of certain financial instruments as well as transacting in various foreign currencies.

Interest rate risk. At December 30, 2001, the Company's cash equivalents and short-term investments totaled approximately \$15,000. Since the Company typically does not purchase fixed-income securities, its cash and cash equivalents are not subject to significant interest rate risk. The Company places substantially all of its interest bearing investments with major financial institutions and by policy limits the amount of credit exposure to any one financial institution. Additionally, the Company does not hold or issue financial instruments for trading, profit or speculative purposes.

Equity Price Risk The Company does not invest in available-for-sale equity securities, and is not subject to significant equity price risk.

Foreign Exchange Rate Risk The Company operates internationally and sometimes receives payments in local currencies. This can expose the Company to market risk from changes in foreign exchange rates to the extent that transactions are not denominated in the U.S. dollar. As a result the Company faces the risk that the foreign currencies may decline in value as compared to the U.S. dollar, resulting in a foreign currency translation loss.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

In November 2001, NEC filed a lawsuit against the Company alleging breach of contract for \$40,000 still due on a lease for a PBX. This action is still pending.

In November 2001, two former employees filed a claim with the California labor board, claiming certain vacation and overtime was not paid to them. In January 2002, the labor board issued a judgment in the amount of \$79,115. The Company has appealed the ruling and intends to contest it vigorously.

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ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

During the three months ended December 31, 2001, the Company sold 25,000 units to a current shareholder of the Company for \$25,000. A unit consisted of 20 shares of common stock of the Company plus a warrant to purchase 10 shares of common stock for \$.001, exercisable after March 25, 2002 if the ten day average of the stock price is under \$.25 per share.

The Company also received \$50,000 in exchange for a convertible note from its Executive Chairman. The note bears interest at 6% and can be converted at \$.05 per share.

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An employee of the Company has an option to purchase 900,000 shares at \$0.05 per share in lieu of salary for the period ending 12-31-01.

Two directors of the Company have options to purchase 1,000,000 shares each at \$0.05 per share.

The Company has agreed to issue options to the Executive Chairman in lieu of salary. The Chairman's stated annual salary is \$150,000. He is to receive options to purchase 750,000 shares at \$.05 per share in lieu of salary for the three months ending 12-31-01.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

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

None

ITEM 5. OTHER INFORMATION

Not applicable

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

- (a) Exhibits
- (b) Reports on Form 8-K  
None

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/ MARTIN S. ALBERT

-----  
Martin S. Albert  
Chief Executive Officer

By /s/ FRANK W. PETERS

-----  
Frank W. Peters  
Acting Chief Financial Officer

Dated: February 14, 2002