

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

FRANKLIN WIRELESS CORP  
Form 10-Q  
February 17, 2009

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 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, 2008

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934 (NO FEE REQUIRED)

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

COMMISSION FILE NUMBER: 0-11616

FRANKLIN WIRELESS CORP.  
(Exact name of Registrant as specified in its charter)

NEVADA  
(State or other jurisdiction of incorporation or  
organization)

95-3733534  
(I.R.S. Employer  
Identification Number)

5440 MOREHOUSE DRIVE, SUITE 1000,  
SAN DIEGO, CALIFORNIA  
(Address of principal executive offices)

92121  
(Zip code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (858) 623-0000

Indicated 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 by check mark whether the Registrant is a large accelerated filer, an  
accelerated filer, a non-accelerated filer, or a smaller reporting company. See  
the definitions of "large accelerated filer," "accelerated filer" and "smaller  
reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

The Registrant has 13,231,491 shares of common stock outstanding as of February 17, 2009

1

FRANKLIN WIRELESS CORP.  
INDEX TO QUARTERLY REPORT ON FORM 10-Q  
FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2008

	PAGE
	----
PART I- FINANCIAL INFORMATION	
-----	
Item 1:	Financial Statements 3
Item 2:	Management's Discussion and Analysis of Financial Condition and Results of Operations 15
Item 3:	Quantitative and Qualitative Disclosures About Market Risk 22
Item 4T:	Controls and Procedures 22
PART II- OTHER INFORMATION	
-----	
Item 1:	Legal Proceedings 22
Item 1A:	Risk Factors 22
Item 2:	Unregistered Sales of Equity Securities and Use of Proceeds 25
Item 3:	Defaults Upon Senior Securities 25
Item 4:	Submission of Matters to a Vote of Security Holders 25
Item 5:	Other Information 26
Item 6:	Exhibits 26
Signatures	27

2

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

FRANKLIN WIRELESS CORP.  
BALANCE SHEETS

-----  
(UNAUDITED)  
DECEMBER 31,      JUNE 30,  
2008                      2008  
-----

ASSETS

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

Current Assets:		
Cash and cash equivalents	\$ 7,228,820	\$ 6,172,569
Accounts receivable	1,509,802	4,534,069
Prepaid income tax	2,912	355,393
Inventories	33,394	72,162
Prepaid expenses	12,324	23,430
	-----	-----
Total current assets	8,787,252	11,157,623
Property and equipment, net	72,903	68,012
Other assets	15,536	15,411
	-----	-----
TOTAL ASSETS	\$ 8,875,691	\$11,241,046
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:		
Accounts payable	\$ 2,023,526	\$ 4,047,651
Advanced payment from customers	--	390,000
Accrued liabilities	60,925	875,046
Deferred rent payable	17,432	--
Notes payable to a stockholder	--	334,000
	-----	-----
Total current liabilities	2,101,883	5,646,697
	-----	-----
Stockholders' Equity:		
Preferred stock, par value of \$0.001 per share, authorized 10,000,000 shares; No preferred stock issued and outstanding as of December 31, 2008 and June 30, 2008	--	--
Common stock, par value of \$0.001 per share, authorized 50,000,000 shares; Common stock of 13,231,491 issued and outstanding as of December 31, 2008 and June 30, 2008	13,232	13,232
Additional paid-in capital	5,016,161	5,016,161
Retained earnings	1,744,415	564,956
	-----	-----
Total stockholders' equity	6,773,808	5,594,349
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 8,875,691	\$11,241,046
	=====	=====

See accompanying notes to unaudited financial statements.

FRANKLIN WIRELESS CORP.  
STATEMENTS OF OPERATIONS  
(UNAUDITED)

	THREE MONTHS ENDED		SIX MONTHS EN
	DECEMBER 31,		DECEMBER 31
	-----		-----
	2008	2007	2008
	-----	-----	-----

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

Net sales	\$	4,617,140	\$	7,858,549	\$	10,868,308	\$
Cost of goods sold		3,512,995		5,940,668		7,907,119	
		-----		-----		-----	
Gross profit		1,104,145		1,917,881		2,961,189	
		-----		-----		-----	
Operating expenses:							
Selling, general, and administrative		530,622		874,736		1,617,334	
		-----		-----		-----	
Total operating expenses		530,622		874,736		1,617,334	
		-----		-----		-----	
Income from operations		573,523		1,043,145		1,343,855	
Other income (expense):							
Interest income		27,169		38,675		56,369	
Forgiveness of debt		33,400		--		33,400	
Other income (expense)		510		18,495		223	
		-----		-----		-----	
Total other income (expense), net		61,079		57,170		89,992	
		-----		-----		-----	
Net income before income taxes		634,602		1,100,315		1,433,847	
Provision for income taxes		111,610		30,891		254,388	
		-----		-----		-----	
Net income	\$	522,992	\$	1,069,424	\$	1,179,459	\$
		=====		=====		=====	
Basic earnings per share	\$	0.04	\$	0.08	\$	0.09	\$
Diluted earnings per share	\$	0.04	\$	0.08	\$	0.09	\$
Weighted average common shares outstanding - basic		13,231,491		13,231,491		13,231,491	
Weighted average common shares outstanding - diluted		13,231,491		13,231,491		13,231,491	

See accompanying notes to unaudited financial statements.

4

FRANKLIN WIRELESS CORP.  
STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	SIX MONTHS ENDED DECEMBER 31,	
	2008	2007
	-----	-----
CASH FLOWS FROM OPERATIONS ACTIVITIES:		
Net income	\$ 1,179,459	\$ 2,452,5
Adjustments to reconcile net income to net cash provided		

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

by operating activities:		
Depreciation	7,966	4,2
Amortization of intangible assets	--	28,5
Bad debt	315	2,2
Forgiveness of debt	(33,400)	
Changes in operating assets and liabilities:		
Accounts receivable	3,023,952	(531,9
Inventory	38,768	(9,4
Prepaid expense	11,106	6,6
Prepaid income tax	352,481	
Other assets	(125)	
Accounts payable	(2,024,125)	383,6
Advance payment from customers	(390,000)	(354,5
Accrued liabilities	(814,121)	(53,3
Deferred rent payable	17,432	
Net cash provided by operating activities	1,369,708	1,928,5
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(12,857)	(5,4
Net cash used in investing activities	(12,857)	(5,4
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of note payable	(300,600)	11,3
Net cash provided by (used in) financing activities	(300,600)	11,3
Net increase in cash and cash equivalents	1,056,251	1,934,5
Cash and cash equivalents, beginning of period	6,172,569	2,477,5
Cash and cash equivalents, end of period	\$ 7,228,820	\$ 4,412,1
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	\$ --	\$
Income taxes	\$ 939,388	\$ 56,2

See accompanying notes to unaudited financial statements.

FRANKLIN WIRELESS CORP.  
NOTES TO UNAUDITED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and are presented in accordance with the requirements of Form 10-Q. The balance sheet is unaudited as of December 31, 2008 and

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

audited as of June 30, 2008. The statement of operations is unaudited for the three months and six months ended December 31, 2008 and 2007. The statement of cash flows is unaudited for the six months ended December 31, 2008 and 2007. In the opinion of management, the unaudited financial statements included herein contain all adjustments, including normal recurring adjustments, considered necessary to present fairly the financial position, the results of operations and cash flows of the Company for the periods presented. These unaudited interim financial statements should be read in conjunction with the financial statements and notes thereto for the fiscal year ended June 30, 2008 included in the Company's Form 10-K, filed on September 26, 2008.

The operating results or cash flows of the interim periods presented herein are not necessarily indicative of the results to be expected for any other interim period or the full year.

### NOTE 2 - BUSINESS OVERVIEW

The Company designs and sells broadband high speed wireless data communication products such as third generation ("3G") and fourth generation ("4G") wireless modules and modems. The Company focuses on wireless broadband USB modems, which provide a flexible way for wireless subscribers to connect to the wireless broadband network with any laptop, tablet PC or desktop USB port without a PC card slot. The broadband wireless data communication products are positioned at the convergence of wireless communications, mobile computing and the Internet, each of which the Company believes represents a growing market.

The Company markets its products through two channels: directly to wireless operators, and indirectly through strategic partners and distributors. The Company's customer base extends from the United States to the Caribbean and South American countries. The Company's Universal Serial Bus ("USB") modems are certified by Sprint, Cellular South, NTELOS and ACS in the United States, by IUSACELL in Mexico, by Telefonica and Movilnet in Venezuela, and by TSTT in Trinidad and Tobago. The Company has strategic marketing relationships with several of these customers.

### NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### SEGMENT REPORTING

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," requires public companies to report financial and descriptive information about their reportable operating segments. The Company identifies its operating segments based on how management internally evaluates separate financial information, business activities and management responsibility. The Company operates in a single business segment consisting of sale of wireless access products.

6

#### ESTIMATES

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. Significant estimates include useful lives of intangible and long-lived assets.

### CASH AND CASH EQUIVALENTS

For purposes of the statements of cash flow, the Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

### REVENUE RECOGNITION

The Company recognizes revenue from product sales when persuasive evidence of an arrangement exists, the price is fixed or determinable, collection is reasonably assured and delivery of products has occurred or services have been rendered. Accordingly, the Company recognizes revenues from product sales upon shipment of the product to the customers. The Company does not allow the right of return on product sales but warrant the products over one year from the shipment. The Company may maintain an allowance for doubtful accounts for potentially estimated losses related to customer receivable balances. Estimates are developed by using standard quantitative measures based on historical losses, adjusting for current economic conditions and, in some cases, evaluating specific customer accounts for risk of loss. The establishment of reserves requires the use of judgment and assumptions regarding the potential for losses on receivable balances. Though the Company considers these balances adequate and proper, changes in economic conditions in specific markets in which the Company operates could have a material effect on reserve balances required.

### SHIPPING AND HANDLING COST

Most of shipping and handling costs are paid by the customers directly to the shipping companies. As a result, the Company does not collect nor incur shipping and handling costs.

### INVENTORIES

The Company's inventories are made up of finished goods and are stated at the lower of cost or market, cost being determined on a first-in, first-out basis. The Company assesses the inventory carrying value and reduces it, if necessary, to its net realizable value based on customer orders on hand, and internal demand forecasts using management's best estimates given information currently available. The Company's customer demand is highly unpredictable, and can fluctuate significantly caused by factors beyond the control of the Company. The Company may maintain an allowance for inventories for potential excess and obsolete inventories and inventories that are carried at costs that are higher than their estimated net realizable values.

### PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. The Company provides for depreciation using the straight-line method over the estimated useful lives as follows:

Computers and software	5 years
Machinery and equipment	5 years
Furniture and fixtures	7 years

Expenditures for maintenance and repairs are charged to operations as incurred while renewals and betterments are capitalized. Gains or losses on the sale of property and equipment are reflected in the statements of operations.

#### VALUATION ON LONG-LIVED ASSETS

In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for Impairment on Disposal of Long-lived Assets", the Company reviews for impairment of long-lived assets and certain identifiable intangibles whenever events or circumstances indicate that the carrying amount of assets may not be recoverable. The Company considers the carrying value of assets may not be recoverable based upon its review of the following events or changes in circumstances: the asset's ability to continue to generate income from operations and positive cash flow in future periods; loss of legal ownership or title to the assets; significant changes in the Company's strategic business objectives and utilization of the asset; or significant negative industry or economic trends. An impairment loss would be recognized when estimated future cash flows expected to result from the use of the asset is less than its carrying amount.

As of December 31, 2008, the Company is not aware of any events or changes in circumstances that would indicate that the long-lived assets are impaired.

#### WARRANTIES

The Company does not allow the right of return on product sales but provides a factory warranty for one year from the shipment, which is covered by its vendor. These products are shipped directly from its vendor to customers. As a result, the Company does not accrue any warranty expenses.

#### INCOME TAXES

The Company adopted the provisions of FASB interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes -- an interpretation of FASB statement No. 109," which prescribes a recognition threshold and measurement process for recording in the financial statements, uncertain tax positions taken or expected to be taken in a tax return. Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained.

The Company accounts for income taxes under the asset and liability method of accounting. 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



## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

the Company will be able to realize all or a portion of its deferred tax assets. The Company incurred significant losses in the previous years. These losses have been carried over to off-set any future taxable income.

Income tax provision from continuing operations for the six months ended December 31, 2008 and 2007 consists of the following:

8

	(UNAUDITED)	(UNAUDITED)
	DECEMBER 31, 2008	DECEMBER 31, 2007
Current income taxes expense:		
Federal	\$ 201,895	\$ 42,256
State	52,493	13,948
	254,388	56,204
Deferred income taxes expense (benefits):	--	--
PROVISION FOR INCOME TAXES	\$ 254,388	\$ 56,204

Deferred income taxes reflect the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the deferred tax assets at December 31, 2008 and June 30, 2008 consisted of the following:

	(UNAUDITED)	
	DECEMBER 31, 2008	JUNE 30, 2008
Current deferred tax asset (liabilities):		
Net operating losses	\$ 135,622	\$ 170,883
Other, net	(16,493)	16,493
Non-current deferred tax assets (liabilities):		
Net operating losses	1,911,272	2,011,633
Credit	--	30,196
Other, net	(13,932)	(4,477)
Total deferred tax assets	2,016,469	2,224,728
Less valuation allowance	(2,016,469)	(2,224,728)
Net deferred tax asset	\$ --	\$ --

The significant component of the deferred tax asset (liability) at December 31, 2008 and June 30, 2008 was federal net operating loss carry-forward in the amount of approximately \$1,898,000 and \$2,034,000, respectively, based on federal tax rate of 34%. SFAS No. 109 requires a valuation allowance to be recorded when it is more likely than not that some or all of the deferred tax assets will not be realized. At December 31, 2008 and June 30, 2008, management believes that it is

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

more likely than not that most of the deferred tax assets will not be realized, and valuation allowances for the full amount of the net deferred tax asset were established to reduce the deferred tax assets to zero based on the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible.

As of December 31, 2008, the Company has federal net operating loss carryforwards of approximately \$5,584,000, and state net operating loss carryforwards of approximately \$1,676,000, for income tax purposes, with application of the IRC Section 382 limitation on net operating losses as result of the Company's ownership change in a prior period. The Federal and state net operating loss carryforwards will begin to expire from 2009 to 2026 and 2009 to 2016, respectively.

### CONCENTRATION OF RISK

The Company extends credit to its customers and performs ongoing credit evaluations of such customers. The Company evaluates its accounts receivable on a regular basis for collectability and provides for an allowance for potential credit losses as deemed necessary.

Substantially all of the Company's revenues are derived from sales of wireless data products. Any significant decline in market acceptance of its products or in the financial condition of its existing customers could impair the Company's ability to operate effectively.

9

A significant portion of the Company's revenue is derived from a small number of customers. Three customers accounted for 32.0%, 16.0%, and 14.0% of revenues during the six months ended December 31, 2008, and had related accounts receivable of \$1,268,230, or 84.0% of the total accounts receivable, at December 31, 2008.

The Company purchases its wireless products from one design and manufacturing company located in South Korea. If the design and manufacturing company were to experience delays, capacity constraints or quality control problems, product shipments to the Company's customers could be delayed, or its customers could consequently elect to cancel the underlying product purchase order, which would negatively impact the Company's revenue. However, there were no significant delays, capacity constraints, or quality control problems that negatively impacted the Company's revenue for the six months ended December 31, 2008 and 2007. For those periods, the Company purchased approximately \$7,698,041 and \$12,638,000, respectively, and had related accounts payable of \$1,285,970 and \$38,475 at December 31, 2008 and 2007, respectively.

The Company maintains its cash accounts with established commercial banks. Such cash deposits periodically exceed the Federal Deposit Insurance Corporation insured limit of \$250,000 per each depositor, per insured bank. As of December 31, 2008, the Company has two deposits that exceeded the insured limit of \$250,000 by approximately \$6,652,651 and \$76,170, respectively. However, the Company does not anticipate any loss on excess deposits.

NOTE 4 - BALANCE SHEET DETAILS

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

### ACCOUNT RECEIVABLE

Accounts receivable at December 31, 2008 and June 30, 2008, consisted of receivables from customers in the amounts of \$1,509,802 and \$4,534,069, respectively.

### PREPAID EXPENSES

Prepaid expenses at December 31, 2008 and June 30, 2008 consisted of the following:

	(UNAUDITED)	
	DECEMBER 31, 2008	JUNE 30, 2008
Prepaid insurance	\$ 2,000	\$ 2,725
Prepaid marketing fee	8,786	11,600
Prepaid professional fee	1,538	--
Prepaid office lease fee	--	9,105
TOTAL	\$ 12,324	\$ 23,430

### PREPAID INCOME TAX

Prepaid income tax at December 31, 2008 and June 30, 2008 consisted of the following:

10

	(UNAUDITED)	
	DECEMBER 31, 2008	JUNE 30, 2008
Federal	\$ --	\$ 296,535
State	2,912	58,858
TOTAL	\$ 2,912	\$ 355,393

### PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2008 and June 30, 2008 consisted of the following:

	(UNAUDITED)	
	DECEMBER 31, 2008	JUNE 30, 2008
Computers and software	\$ 58,248	\$ 48,827
Furniture and fixtures	56,330	52,894

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

	114,578	101,721
Less accumulated depreciation	(41,675)	(33,709)
	-----	-----
TOTAL	\$ 72,903	\$ 68,012
	=====	=====

Depreciation expense associated with property and equipment was \$7,966 and \$4,288 for the six months ended December 31, 2008 and 2007, respectively.

OTHER ASSETS

Other assets at December 31, 2008 and June 30, 2008 consisted of the following:

	(UNAUDITED)	
	-----	-----
	DECEMBER 31,	JUNE 30,
	2008	2008
	-----	-----
Lease deposit, corporate housing	\$ 709	\$ 709
Lease deposit, administrative office	9,833	14,003
Utility deposit	282	282
Other deposit	417	417
Loan to employee	4,295	--
	-----	-----
TOTAL	\$ 15,536	\$ 15,411
	=====	=====

ACCRUED LIABILITIES

Accrued liabilities at December 31, 2008, and June 30, 2008, consisted of the following:

	(UNAUDITED)	
	-----	-----
	DECEMBER 31,	JUNE 30,
	2008	2008
	-----	-----
Salaries payable	\$ 27,900	\$ 135,000
Income tax payable	--	689,421
Accrued professional fees payable	5,000	31,500
Sales commission payable	8,900	--
Marketing development fund payable	19,125	19,125
	-----	-----
TOTAL	\$ 60,925	\$ 875,046
	=====	=====

11

DEFERRED RENT PAYABLE

Deferred Rent Payable at December 31, 2008, and June 30, 2008, consisted of the following:

	(UNAUDITED)	
	-----	-----
	DECEMBER 31,	JUNE 30,

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

	2008	2008
	-----	-----
Deferred rent payable	\$ 17,432	\$ --
	-----	-----
TOTAL	\$ 17,432	\$ --
	=====	=====

Deferred rent payable is the sum of the difference between a monthly rent payment and the monthly rent expense of an operating lease of the Company that contains escalated payments in future periods. The rent expense is the sum of all rent payments over the term of the lease divided by the number of periods contained in the lease otherwise known as straight-line amortization. This rent expense amount differs from the monthly rent payments, which is deferred rent payable.

NOTES PAYABLE TO STOCKHOLDERS

Notes payable at December 31, 2008, and June 30, 2008, consisted of the following:

	(UNAUDITED)	
	-----	-----
	DECEMBER 31, 2008	JUNE 30, 2008
	-----	-----
Non-interest bearing note	\$ --	\$ 334,000
	-----	-----
Total	--	334,000
Less current portion	--	(334,000)
	=====	=====
TOTAL	\$ --	\$ --
	=====	=====

The Company's Korea-based subsidiary, ARG, has been inactive since August 2003. On October 30, 2007, the Board of Directors approved the dissolution of ARG, and the Company assumed a note payable of ARG of \$434,000 as a part of the dissolution. The remaining balance of the note amounted to \$334,000 as of June 30, 2008, and the Company paid in full the note of \$300,600, net of a 10% discount of \$33,400, for the three months ended December 31, 2008, and the discount of \$33,400 was presented as a forgiveness of debt.

NOTE 5 - COMMITMENTS AND CONTINGENCIES

OPERATING LEASE

The Company leases its administrative facilities under a non-cancelable operating lease that expires on August 31, 2011. In addition to the minimum annual rental commitments, the lease provides for periodic cost of living increases in the base rent and payment of common area costs. Rent expense related to the operating lease was \$53,852 and \$31,129 for the six months ended December 31, 2008 and 2007, respectively.

The Company leases its corporate housing facility under a non-cancelable operating lease that expires on April 30, 2009 for its vendor. Rent expense related to the operating lease was \$9,322 and \$8,727 for the six months ended December 31, 2008 and 2007, respectively.

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

The Company leases one automobile under an operating lease that expires on July 22, 2009. Lease expense was \$3,226 and \$3,226 for the six months ended December 31, 2008 and 2007, respectively.

### 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 any material adverse effect on its financial condition.

### CO-DEVELOPMENT, CO-OWNERSHIP AND SUPPLY AGREEMENT

The Company's facility is located in San Diego, California. Manufacturing of the Company's products has been contracted out to C-Motech Co. Ltd. ("C-Motech"), located in South Korea.

In January 2005, the Company entered into an agreement with C-Motech for the manufacture of the products. Under the manufacturing and supply agreement, C-Motech provides the Company with services including all licenses, component procurement, final assembly, testing, quality control, fulfillment and after-sale service. The Agreement provides exclusive rights to market and sell CDMA wireless data products in countries in North America, the Caribbean, and South America. Furthermore, the Agreement provides that the Company is responsible for marketing, sales, field testing, and certifications of these products to wireless service operators and other commercial buyers within a designated territory, and C-Motech is responsible for design, development, testing, certification, and completion of these products. Under the Agreement, products include all access devices designed with Qualcomm's MSM 5100, 5500, 6500, and 6800 chipset solutions provided or designed by C-Motech or both companies. Both companies own the rights to the products: USB modems, Card Bus, PCI Bus and Module designed with MSM 5500 dual band products. On January 30, 2007, C-Motech also certified that the Company has the exclusive right to sell CDU-680 EVDO USB modems directly and indirectly in these territories.

The initial term of the Agreement was for two years, commencing on January 5, 2005. The agreement automatically renews for successive one year periods unless either party provides a written notice to terminate at least sixty days prior to the end of the term. This agreement may be amended or supplemented by mutual agreement of the parties, as is necessary to document the addition of any new products. As of February 17, 2009, the agreement is still valid for an additional one year period.

### NOTE 6 - EARNINGS PER SHARE

The Company reports earnings per share in accordance with Statement of Financial Accounting Standards No. 128, "Earnings Per Share". Basic earnings per share are computed using the weighted average number of shares outstanding during the year. Diluted earnings per share include the potentially dilutive effect of outstanding common stock options and warrants which are convertible to common shares.

On January 8, 2008, a 1 for 70 reverse stock split was implemented in connection with the reincorporation, under which each shareholder received one share for each 70 shares held. As result of the reverse

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

stock split, a conversion was made to the weighted average number of shares outstanding for the fiscal year 2008 that took into consideration the effect of a reverse split on the total number of shares outstanding, in order to compare the current weighted average number of shares outstanding to its historical numbers in a consistent form of valuation. In order to adjust a weighted average number of shares outstanding of the Company, the pre-split outstanding shares were divided by the split ratio.

13

### NOTE 7 - RECENT ACCOUNTING PRONOUNCEMENTS

In March 2008, the Financial Accounting Standards Board ("FASB") issued Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133" ("SFAS 161"). SFAS 161 requires entities that utilize derivative instruments to provide qualitative disclosures about their objectives and strategies for using such instruments, as well as any details of credit-risk-related contingent features contained within derivatives. SFAS 161 also requires entities to disclose additional information about the amounts and location of derivatives located within the financial statements, how the provisions of SFAS 133 have been applied, and the impact that hedges have on an entity's financial position, financial performance, and cash flows. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company believes that SFAS 161 has no effect on the Company's financial statements at this time.

In May 2008, the FASB issued SFAS 162, "The Hierarchy of Generally Accepted Accounting Principles." SFAS 162 sets forth the level of authority to a given accounting pronouncement or document by category. Where there might be conflicting guidance between two categories, the more authoritative category will prevail. SFAS 162 will become effective 60 days after the SEC approves the PCAOB.'S amendments to AU Section 411 of the AICPA Professional Standards. The Company believes that SFAS 162 has no effect on the Company's financial statements at this time.

In May 2008, the FASB issued SFAS 163, "Accounting for Financial Guarantee Insurance Contracts-and interpretation of FASB Statement No. 60." SFAS 163 clarifies how SFAS 60 applies to financial guarantee insurance contracts, including the recognition and measurement of premium revenue and claims liabilities. This statement also requires expanded disclosures about financial guarantee insurance contracts. SFAS 163 is effective for fiscal years beginning on or after December 15, 2008, and interim periods within those years. The Company believes that SFAS 163 has no effect on the Company's financial statements at this time.

In June 2008, the FASB issued an exposure draft of a proposed amendment to SFAS 133. As proposed, this amendment would make several significant changes to the way in which entities account for hedging activities involving derivative instruments. The FASB has not yet issued a final Statement.

In June 2008, the FASB issued FASB Staff Position EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities ("EITF 03-6-1"). EITF 03-6-1 addresses whether instruments granted in share-based payment

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

transactions are participating securities prior to vesting, and therefore need to be included in the computation of earnings per share under the two-class method as described in SFAS 128, "Earnings per Share." EITF 03-6-1 is effective for financial statements issued for fiscal years beginning on or after December 15, 2008 and earlier adoption is prohibited.

In June 2008, the FASB issued EITF Issue 07-5 Determining whether an Instrument (or Embedded Feature) is indexed to an Entity's Own Stock ("EITF 07-5"). EITF 07-5 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application is not permitted. Paragraph 11(a) of SFAS 133 - Accounting for Derivatives and Hedging Activities, specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company's own stock and (b) classified in stockholders' equity in the statement of financial position would not be considered a derivative financial instrument. EITF 07-5 provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer's own stock and thus able to qualify for the SFAS No. 133 paragraph 11(a) scope exception. The Company believes that EITF 07-5 has no effect on the Company's financial statements at this time.

In October 2008, the FASB issued Staff Position No. FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active" (FSP 157-3). FSP 157-3 clarifies the application of SFAS 157. The Company believes that FSP 157-3 has no effect on the Company's financial statements at this time.

There are no other accounting standards issued as of February 17, 2009 that are expected to have a material impact on the Company's financial statements.

14

### NOTE 8 - RELATED PARTY TRANSACTIONS

The Company purchased CDMA wireless data products in the amount of \$7,698,041, or 97.8% of total purchases, from C-Motech Co. Ltd., for the six months ended December 31, 2008 and had related accounts payable of \$1,285,970 as of December 31, 2008. C-Motech owns 3,370,356 shares, or 25.5%, of the Company's outstanding Common Stock and Jaeman Lee, Chief Executive Officer of C-Motech Co. Ltd., has served as a director of the Company since September 2006.

### NOTE 9 - SUBSEQUENT EVENTS

None.

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the financial statements and notes thereto included in Item 1 of this filing and the financial statements and notes thereto and Management's Discussion and Analysis or results of Operations contained in the Company's Form 10-K filed on September 22, 2008, for the year ended June 30, 2008.



## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

### BUSINESS OVERVIEW

Franklin Wireless Corp. designs and sells broadband high speed wireless data communication products such as third generation ("3G") and fourth generation ("4G") wireless modules and modems. The Company focuses on wireless broadband USB modems, which provide a flexible way for wireless subscribers to connect to the wireless broadband network with any laptop, tablet PC or desktop USB port without a PC card slot. The broadband wireless data communication products are positioned at the convergence of wireless communications, mobile computing and the Internet, each of which the Company believes represents a growing market.

The Company's wireless products are based on Evolution Data Optimized technology ("EV-DO technology") of Code Division Multiple Access ("CDMA"), High-Speed Packet Access technology ("HSPA technology") of Wideband Code Division Multiple Access ("WCDMA"), and Worldwide Interoperability for Microwave Access ("WIMAX") based on the IEEE 802.16 standard, which enable end users to send and receive email with large file attachments, play interactive games, receive, send and download high resolution picture, video, and music contents.

Since the Company launched CDMA Revision A USB modem CDU-680, CDMA Revision 0 CDU-650 USB modem, and CDMA Revision 0 CDX-650 Express Card modem in 2007, the Company has continued to add new features and functionality to its products to enhance value and ease of use that its products provide to customers and end users. In 2008, the Company launched the CGU-628A HSDPA USB modem and CGU-720A HSUPA, which provide a flexible way for users to connect to high-speed downlink and uplink packet access networks, the CDM-650 Stand-alone Revision 0 USB modem, which provides internet connection in remote locations without cable or DSL services, and the CMU-300 WIMAX plus CDMA USB modem.

The Company markets its products through two channels: directly to wireless operators, and indirectly through strategic partners and distributors. The Company's global customer base extends from the United States to the Caribbean and South American countries. The Company's Universal Serial Bus ("USB") modems are certified by Sprint, Cellular South, NTELOS and ACS in the United States, by IUSACELL in Mexico, by Telefonica and Movilnet in Venezuela, and by TSTT in Trinidad and Tobago. The Company has strategic marketing relationships with several of these customers.

15

### SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company believes the following critical accounting policies affect the Company's more significant judgments and estimates used in the preparation of the financial statements.

### ESTIMATES

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. Significant estimates include useful lives of intangible and long-lived assets.

### REVENUE RECOGNITION

The Company recognizes revenue from product sales when persuasive evidence of an arrangement exists, the price is fixed or determinable, collection is reasonably

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

assured and delivery of products has occurred or services have been rendered. Accordingly, the Company recognizes revenues from product sales upon shipment of the product to the customers. The Company does not allow the right of return on product sales but warrant the products over one year from the shipment. The Company may maintain an allowance for doubtful accounts for potentially estimated losses related to customer receivable balances. Estimates are developed by using standard quantitative measures based on historical losses, adjusting for current economic conditions and, in some cases, evaluating specific customer accounts for risk of loss. The establishment of reserves requires the use of judgment and assumptions regarding the potential for losses on receivable balances. Though the Company considers these balances adequate and proper, changes in economic conditions in specific markets in which the Company operates could have a material effect on reserve balances required.

### SHIPPING AND HANDLING COST

Most of shipping and handling costs are paid by the customers directly to the shipping companies. As a result, the Company does not collect nor incur shipping and handling costs.

### VALUATION ON LONG-LIVED ASSETS

In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for Impairment on Disposal of Long-lived Assets", the Company reviews for impairment of long-lived assets and certain identifiable intangibles whenever events or circumstances indicate that the carrying amount of assets may not be recoverable. The Company considers the carrying value of assets may not be recoverable based upon its review of the following events or changes in circumstances: the asset's ability to continue to generate income from operations and positive cash flow in future periods; loss of legal ownership or title to the assets; significant changes in the Company's strategic business objectives and utilization of the asset; or significant negative industry or economic trends. An impairment loss would be recognized when estimated future cash flows expected to result from the use of the asset is less than its carrying amount.

As of December 31, 2008, the Company is not aware of any events or changes in circumstances that would indicate that the long-lived assets are impaired.

16

### WARRANTIES

The Company does not allow the right of return on product sales but provides a factory warranty for one year from the shipment, which is covered by its vendor. These products are shipped directly from its vendor to customers. As a result, the Company does not accrue any warranty expenses.

### INCOME TAXES

The Company adopted the provisions of FASB interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes -- an interpretation of FASB statement No. 109," which prescribes a recognition threshold and measurement process for recording in the financial statements, uncertain tax positions taken or expected to be taken in a tax return. Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained.

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

The Company accounts for income taxes under the asset and liability method of accounting. 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. The Company incurred significant losses in the previous years. These losses have been carried over to off-set any future taxable income.

Income tax provision from continuing operations for the six months ended December 31, 2008 and 2007 consists of the following:

	(UNAUDITED)	(UNAUDITED)
	DECEMBER 31, 2008	DECEMBER 31, 2007
Current income taxes expense:		
Federal	\$ 201,895	\$ 42,256
State	52,493	13,948
	254,388	56,204
Deferred income taxes expense (benefits):	--	--
PROVISION FOR INCOME TAXES	\$ 254,388	\$ 56,204

Deferred income taxes reflect the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the deferred tax assets at December 31, 2008 and June 30, 2008 consisted of the following:

17

	(UNAUDITED)	
	DECEMBER 31, 2008	JUNE 30, 2008
Current deferred tax asset (liabilities):		
Net operating losses	\$ 135,622	\$ 170,883
Other, net	(16,493)	16,493
Non-current deferred tax assets (liabilities):		
Net operating losses	1,911,272	2,011,633
Credit	--	30,196
Other, net	(13,932)	(4,477)
Total deferred tax assets	2,016,469	2,224,728
Less valuation allowance	(2,016,469)	(2,224,728)
Net deferred tax asset	\$ --	\$ --

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

=====

The significant component of the deferred tax asset (liability) at December 31, 2008 and June 30, 2008 was federal net operating loss carry-forward in the amount of approximately \$1,898,000 and \$2,034,000, respectively, based on a federal tax rate of 34%. SFAS No. 109 requires a valuation allowance to be recorded when it is more likely than not that some or all of the deferred tax assets will not be realized. At December 31, 2008 and June 30, 2008, management believes that it is more likely than not that most of the deferred tax assets will not be realized, and valuation allowances for the full amount of the net deferred tax asset were established to reduce the deferred tax assets to zero based on the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible.

As of December 31, 2008, the Company has federal net operating loss carryforwards of approximately \$5,584,000, and state net operating loss carryforwards of approximately \$1,676,000, for income tax purposes, with application of IRC Section 382 limitation on net operating losses as result of the Company's ownership change in a prior period. The Federal and state net operating loss carryforwards will begin to expire from 2009 to 2026 and 2009 to 2016, respectively.

RESULTS OF OPERATIONS

The following table sets forth, for the three and six months ended December 31, 2008 and 2007, selected statements of operations data expressed as a percentage of sales:

	THREE MONTHS ENDED DECEMBER 31,		SIX MONTHS ENDED DECEMBER 31,	
	2008	2007	2008	2007
Net Sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	76.1%	75.6%	72.8%	76.5%
Gross profit	23.9%	24.4%	27.2%	23.5%
Operating expenses:				
Selling, general and administrative expenses	11.5%	11.1%	14.8%	8.9%
Total operating expenses	11.5%	11.1%	14.8%	8.9%
Income from operations	12.4%	13.3%	12.4%	14.6%
Other income (expense), net	1.3%	0.7%	0.8%	0.6%
Net income before income taxes	13.7%	14.0%	13.2%	15.2%
Provision for income taxes	2.4%	0.4%	2.3%	0.3%
Net income	11.3%	13.6%	10.9%	14.9%

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

18

The results of the interim periods are not necessarily indicative of results for the entire fiscal year.

THREE MONTHS ENDED DECEMBER 31, 2008  
COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2007

### NET SALES

Net sales decreased by \$3,241,409, or 41.2%, to \$4,617,140 for the three months ended December 31, 2008 from \$7,858,549 for the corresponding period of 2007. The overall decrease in sales was primarily due to a mix of decreased sales and sales price for the Company's "EV-DO technology" products, and increased market competition. The decrease in sales volume in Caribbean and South American countries was approximately \$4,646,000, or 69.4%, for the three months ended December 31, 2008 compared to the corresponding period of 2007.

### GROSS PROFIT

Gross profit decreased by \$813,736, or 42.4%, to \$1,104,145 for the three months ended December 31, 2008 from \$1,917,881 for the corresponding period of 2007. The decrease was primarily due to the change in net sales as discussed above. The gross profit in terms of net sales percentage was 23.9% for the three months ended December 31, 2008 compared to 24.4% for the corresponding period of 2007.

### SELLING, GENERAL, AND ADMINISTRATIVE

Selling, general, and administrative expenses decreased by \$344,114, or 39.3%, to \$530,622 or 11.5% of net sales for the three months ended December 31, 2008 from \$874,736 or 11.1% of net sales for the corresponding period of 2007. The decrease was the net effect of a decrease of approximately \$409,000 in marketing expenses, and an increase of approximately \$40,000 in salary and related expenses.

### OTHER INCOME (EXPENSE), NET

Other income increased by \$3,909, or 6.8%, to \$61,079 for the three months ended December 31, 2008 from \$57,170 for the corresponding period of 2007.

SIX MONTHS ENDED DECEMBER 31, 2008  
COMPARED TO SIX MONTHS ENDED DECEMBER 31, 2007

### NET SALES

Net sales decreased by \$5,634,934, or 34.1%, to \$10,868,308 for the six months ended December 31, 2008 from \$16,503,242 for the corresponding period of 2007. The overall decrease in sales was primarily due to a mix of decreased sales and sales price for the Company's "EV-DO technology" products, and intensively increased market competition. The decreases in sales volume in the United States as well as in Caribbean and South American countries were approximately \$1,465,000, or 23.8%, and \$4,167,000, or 40.3%, respectively for the six months ended

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

December 31, 2008 compared to the corresponding period of 2007.

### GROSS PROFIT

19

Gross profit decreased by \$913,513, or 23.6%, to \$2,961,189 for the six months ended December 31, 2008 from \$3,874,702 for the corresponding period of 2007. The decrease was primarily due to the change in net sales as discussed above. The gross profit in terms of net sales percentage was 27.2% for the six months ended December 31, 2008 compared to 23.5% for the corresponding period of 2007. The percentage increase was primarily due to the discontinued sales to a carrier customer in the United States, which had a lower gross profit margin in terms of net sales percentage of 18.8%, for the six months ended December 31, 2008, whereas the customer accounted for 28.0% of net sales for the corresponding period of 2007.

### SELLING, GENERAL, AND ADMINISTRATIVE

Selling, general, and administrative expenses increased by \$157,964, or 10.8%, to \$1,617,334 or 14.9% of net sales for the six months ended December 31, 2008 from \$1,459,370, or 8.8% of net sales, for the corresponding period of 2007. The increase was the net effect of an increase of approximately \$278,000 in salary and related expenses, a decrease of approximately \$82,000 in marketing expenses, and a decrease of approximately \$29,000 in amortization expense for the six months ended December 31, 2008.

### OTHER INCOME (EXPENSE), NET

Other income decreased by \$3,405, or 3.6%, to \$89,992 for the six months ended December 31, 2008 from \$93,397 for the corresponding period of 2008. The overall decrease was the net effect of a decrease of approximately \$18,000 in interest income due to a decreased commercial interest rate and an increase of approximately \$15,000 in other income for the six months ended December 31, 2008.

### LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents increased by \$1,056,251 to \$7,228,820 as of December 31, 2008 compared to \$6,172,569 as of June 30, 2008. The increase was primarily from the net income of \$1,179,459.

### OPERATING ACTIVITIES

Net cash provided by operating activities was \$1,369,708 and \$1,928,575 for the six months ended December 31, 2008, and 2007, respectively. The decrease from the prior period is primarily due to the decrease in net income.

### INVESTING ACTIVITIES

Net cash used in investing activities was \$12,857 and \$5,405 for the six months ended December 31, 2008, and 2007, respectively, consisting of capital expenditures.

### FINANCING ACTIVITIES

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

Net cash used by financing activities was \$300,600, which was the net amount of the note paid in full to a stockholder, after a 10% discount of \$33,400 represented as a forgiveness of debt, for the six months ended December 31, 2008. Net cash provided by financing activities was \$11,395, which consisted of receipt of a stock subscription receivable, for the six months ended December 31, 2007.

### CONTRACTUAL OBLIGATIONS AND OTHER COMMITMENTS

The Company's material off-balance sheet contractual commitments are operating lease obligations. The Company excluded these items from the balance sheet in accordance with GAAP. The Company does not maintain any other off-balance sheet arrangements, transactions, obligations or other relationships with unconsolidated entities that would be expected to have a material current or future effect upon its financial condition or results of operations. The Company's principal future obligations and commitments at December 31, 2008, include the following:

20

#### OPERATING LEASE

The Company leases its administrative facilities under a non-cancelable operating lease that expires on August 31, 2011. In addition to the minimum annual rental commitments, the lease provides for periodic cost of living increases in the base rent and payment of common area costs. Rent expense related to the operating lease was \$53,852 and \$31,129 for the six months ended December 31, 2008 and 2007, respectively.

The Company leases its corporate housing facility under a non-cancelable operating lease that expires on April 30, 2009 for its vendors. Rent expense related to the operating lease was \$9,322 and \$8,727 for the six months ended December 31, 2008 and 2007, respectively.

The Company leases one automobile under an operating lease that expires on July 22, 2009. Lease expense was \$3,226 and \$3,226 for the six months ended December 31, 2008 and 2007, respectively.

#### 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 any material adverse effect on its financial condition.

#### CO-DEVELOPMENT, CO-OWNERSHIP AND SUPPLY AGREEMENT

The Company's facility is located in San Diego, California. Manufacturing of the Company's products has been contracted out to C-Motech Co. Ltd. ("C-Motech"), located in South Korea.

In January 2005, the Company entered into an agreement with C-Motech for the manufacture of the products. Under the manufacturing and supply agreement, C-Motech provides the Company with services including all licenses, component procurement, final assembly, testing, quality control, fulfillment and after-sale service. The Agreement provides exclusive rights to market and sell CDMA wireless data products in countries in North America, the Caribbean, and South America.

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

Furthermore, the Agreement provides that the Company is responsible for marketing, sales, field testing, and certifications of these products to wireless service operators and other commercial buyers within a designated territory, and C-Motech is responsible for design, development, testing, certification, and completion of these products. Under the Agreement, products include all access devices designed with Qualcomm's MSM 5100, 5500, 6500, and 6800 chipset solutions provided or designed by C-Motech or both companies. Both companies own the rights to the products: USB modems, Card Bus, PCI Bus and Module designed with MSM 5500 dual band products. On January 30, 2007, C-Motech also certified that the Company has the exclusive right to sell CDU-680 EVDO USB modems directly and indirectly in these territories.

The initial term of the Agreement was for two years, commencing on January 5, 2005. The agreement automatically renews for successive one year periods unless either party provides a written notice to terminate at least sixty days prior to the end of the term. This agreement may be amended or supplemented by mutual agreement of the parties, as is necessary to document the addition of any new products. As of February 17, 2009, the agreement is still valid for an additional one year period.

21

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

As the Company is a "smaller reporting company," this Item is inapplicable.

### ITEM 4. CONTROLS AND PROCEDURES.

The Company maintains disclosure controls and procedures as defined under the Securities Exchange Act of 1934. They are designed to help ensure that material information is: (1) gathered and communicated to its management, including its principal executive and financial officers, in a manner that allows for timely decisions regarding required disclosures; and (2) recorded, processed, summarized, reported and filed with the SEC as required under the Securities Exchange Act of 1934 and within the time periods specified by the SEC.

The Company's management, with the participation of its Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of its disclosure controls and procedures as of June 30, 2008. Based on such evaluation, the Company's Chief Executive officer and Chief Financial Officer concluded that its disclosure controls and procedures were effective as of December 31, 2008.

There were no changes in the Company's internal control over financial reporting during its most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS.

The Company is not currently involved in any material legal proceedings. The



## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

Company is, from time to time, involved in routine legal proceedings and claims arising in the ordinary course of business.

### ITEM 1A: RISK FACTORS.

An investment in the Company's shares is highly speculative and involves a significant degree of risk. Prospective investors should carefully consider the following risk factors, in addition to the other information set forth in this Quarterly Report or in any material accompanying this report. The following summary of risk factors does not purport to be a complete explanation of the risks involved in the Company's business.

THE COMPANY HAS EXPERIENCED LOSSES IN THE PAST. The Company has experienced significant operating losses and negative cash flows from operating activities in the past, including the fiscal year ended June 30, 2006. If the Company's sales do not continue to improve and operating expenses are not reduced and monitored, it may incur additional significant net losses and negative cash flows from operations.

THE COMPANY RELIES ON A SINGLE SOURCE FOR THE MANUFACTURE OF ITS PRODUCTS. The Company relies solely on C-Motech Co., Ltd., a company located in South Korea, to design, manufacture and supply its products, which exposes the Company to a number of risks and uncertainties outside its control. The Company's agreement with C-Motech is renewable annually, and it cannot be certain it will be renewed each year. Thus, the Company relies solely on C-Motech to manufacture and deliver all its products. If the Company was unable to purchase products from C-Motech for any reason, it would be forced to seek an alternative source of supply, which may not be available. Any significant changes in C-Motech, such as a change in ownership, operations or financial status may cause difficulties in its ability to deliver products to customers on a timely basis.

22

THE COMPANY OPERATES IN AN INTENSIVELY COMPETITIVE MARKET. The wireless broadband data access market is highly competitive, and it may be unable to compete effectively. Many of its competitors or potential competitors have significantly greater financial, technical and marketing resources than it does. To survive and be competitive, the Company will need to continuously invest in research and development, sales and marketing, and customer support. Increased competition could result in price reductions and smaller customer orders. The failure to compete effectively could seriously impair its business.

THE COMPANY OPERATES IN THE HIGH-RISK TELECOM SECTOR. The Company is in a volatile industry. In addition, its revenue model is evolving and relies substantially on the assumption that the Company will be able to successfully complete the development and sales of its products and services in the marketplace. The Company's prospects must be considered in the light of the risks, uncertainties, expenses and difficulties frequently encountered by companies in the early stages of development and marketing. In order to be successful in the market, the Company must, among other things:

- o Complete development and introduction of functional and attractive products and services;
- o Attract and maintain customer loyalty;
- o Establish and increase awareness of its brand;
- o Provide desirable products and services to customers at attractive prices;
- o Establish and maintain strategic relationships with partners and

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

- affiliates;
- o Rapidly respond to competitive and technological developments;
- o Build operations and customer service infrastructure to support its business; and
- o Attract, retain, and motivate qualified personnel.

The Company cannot guarantee that it will be able to achieve these goals, and its failure to achieve them could adversely affect its business, results of operations, and financial condition. Moreover, there can be no assurance that the Company will be able to obtain additional funding if its financial resources are depleted. The Company expects that revenues and operating results will fluctuate in the future. If the Company's efforts are unsuccessful or other unexpected events occur, purchasers of its shares could lose their entire investment.

THE COMPANY OPERATES IN A FIELD WITH RAPIDLY CHANGING TECHNOLOGY. Since the Company's products and services are new, it cannot be certain that these products and services will function as anticipated or be desirable to its intended markets. The Company's current or future products and services may fail to function properly, and if its products and services do not achieve and sustain market acceptance, its business, results of operations and profitability may suffer. If the Company is unable to predict and comply with evolving wireless standards, its ability to introduce and sell new products will be adversely affected. If the Company fails to develop and introduce products on time, it may lose customers and potential product orders.

THE COMPANY DEPENDS ON THE DEMAND FOR WIRELESS NETWORK CAPACITY. The demand for the Company's products is completely dependent on the demand for broadband wireless access to networks. If wireless operators do not deliver acceptable wireless service, its product sales may dramatically decline. Thus, if wireless operators experience financial or network difficulties, it will likely reduce demand for its products.

THE COMPANY DEPENDS ON COLLABORATIVE ARRANGEMENTS. The development and commercialization of its products and services depend in large part upon its ability to selectively enter into and maintain collaborative arrangements with developers, distributors, service providers, network systems providers, core wireless communications technology providers and manufacturers, among others.

THE LOSS OF ANY OF THE COMPANY'S MATERIAL CUSTOMERS COULD ADVERSLY AFFECT ITS REVENUES AND PROFITABILITY, AND THEREFORE SHAREHOLDER VALUE. The Company depends on a small number of customers for a significant portion of its revenues. For the six months ended December 31, 2008, three customers accounted for 32.0%, 16.0%, and 14.0% of revenues. If any of these customers reduce their business with the Company or suffer from business failure, its revenues and profitability could decline, perhaps materially.

23

THE COMPANY'S PRODUCT DELIVERIES ARE SUBJECT TO LONG LEAD TIMES. Due to its limited capital resources, it is experiencing long-lead times to ship products to its customers, often in excess of 45 days. This could cause it to lose customers, who may be able to secure faster delivery times from its competitors, and require it to maintain higher levels of working capital.

THE COMPANY'S PRODUCT-TO-MARKET CHALLENGE IS CRITICAL. The Company's success depends on its ability to quickly enter the market and establish an early mover advantage. It must implement an aggressive sales and marketing campaign to solicit customers and strategic partners. Any delay could seriously affect its ability to establish and effectively exploit an early-to-market-strategy.

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

AS BUSINESS EXPANDS INTERNATIONALLY, THE COMPANY WILL BE EXPOSED TO ADDITIONAL RISKS RELATING TO INTERNATIONAL OPERATIONS. The Company's expansion into international operations exposes it to additional risks unique to such international markets, including the following:

- o Increased credit management risks and greater difficulties in collecting accounts receivable;
- o Unexpected changes in regulatory requirements, wireless communications standards, exchange rates, trading policies, tariffs and other barriers;
- o Uncertainties of laws and enforcement relating to the protection of intellectual property;
- o Language barriers; and
- o Potential adverse tax consequences.

Furthermore, if the Company is unable to further develop distribution channels in countries in North America, the Caribbean and South America, it may not be able to grow its international operations, and its ability to increase its revenue will be negatively impacted.

THE COMPANY MAY INFRINGE THE INTELLECTUAL PROPERTY RIGHTS OF OTHERS. The industry in which the Company operates has many participants that own, or claim to own, proprietary intellectual property. In the past it has received, and in the future may receive, claims from third parties alleging that the Company, and possibly its customers, violate their intellectual property rights. Rights to intellectual property can be difficult to verify and litigation may be necessary to establish whether or not the Company has infringed the intellectual property rights of others. In many cases, these third parties are companies with substantially greater resources than the Company, and they may be able to, and may choose to, pursue complex litigation to a greater degree than the Company could. Regardless of whether these infringement claims have merit or not, the Company may be subject to the following:

- o It may be liable for substantial damages, liabilities and litigation costs, including attorneys' fees;
- o It may be prohibited from further use of the intellectual property and may be required to cease selling its products that are subject to the claim;
- o It may have to license the third party intellectual property, incurring royalty fees that may or may not be on commercially reasonable terms. In addition, there is no assurance that it will be able to successfully negotiate and obtain such a license from the third party;
- o It may have to develop a non-infringing alternative, which could be costly and delay or result in the loss of sales. In addition, there is no assurance that it will be able to develop such a non-infringing alternative;
- o The diversion of management's attention and resources;
- o Its relationships with customers may be adversely affected; and
- o It may be required to indemnify its customers for certain costs and damages they incur in such a claim.

In the event of an unfavorable outcome in such a claim and its inability to either obtain a license from the third party or develop a non-infringing alternative, then its business, operating results and financial condition may be materially adversely affected, and it may have to restructure its business.

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

Absent a specific claim for infringement of intellectual property, from time to time, the Company has and expects to continue to license technology, intellectual property and software from third parties. There is no assurance that it will be able to maintain its third party licenses or obtain new licenses when required and this inability could materially adversely affect its business and operating results and the quality and functionality of its products. In addition, there is no assurance that third party licenses the Company executes will be on commercially reasonable terms.

Under purchase orders and contracts for the sale of its products, the Company may provide indemnification to its customers for potential intellectual property infringement claims for which it may have no corresponding recourse against its third party licensors. This potential liability, if realized, could materially adversely affect its business, operating results and financial condition.

GOVERNMENT REGULATION COULD RESULT IN INCREASED COSTS AND INABILITY TO SELL ITS PRODUCTS. The Company's products are subject to certain mandatory regulatory approvals in the United States and other regions in which it operates. In the United States, the Federal Communications Commission regulates many aspects of communications devices. Although it has obtained all the necessary Federal Communications Commission and other required approvals for the products it currently sells, it may not obtain approvals for future products on a timely basis, or at all. In addition, regulatory requirements may change, or the Company may not be able to obtain regulatory approvals from countries other than the United States in which it may desire to sell products in the future.

THE COMPANY MAY NEED ADDITIONAL FINANCING DUE TO LIMITED RESOURCES. The Company's financial resources are limited, and the amount of funding that is required to develop and commercialize its products and technologies is highly uncertain. Adequate funds may not be available when needed or on terms satisfactory to us. Lack of funds may cause the Company to delay, reduce and/or abandon certain or all aspects of its development and commercialization programs. If it seeks additional financing through the issuance of equity or convertible debt securities, the percentage ownership of its stockholders will be reduced, stockholders may experience additional dilution, and such securities may have rights, preferences and privileges senior to those of its Common Stock. There can be no assurance that additional financing will be available on terms favorable to it or at all. If adequate funds are not available or are not available on acceptable terms, it may not be able to fund its expansion, take advantage of desirable acquisition opportunities, develop or enhance services or products or respond to competitive pressures. Such inability could have a materially adverse effect on its business, results of operations and financial conditions.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

None.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

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

None.

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Acting Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of Acting Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

26

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 Wireless Corp.

By: /s/ OC Kim

-----  
OC Kim  
President and Acting Chief Financial Officer

Dated: February 17, 2009

27