FULLNET COMMUNICATIONS INC
Form 10-Q
August 14, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015

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

For the transition period from __________ to __________

Commission File Number: 000-27031

FULLNET COMMUNICATIONS, INC.

(Exact name of registrant as specified in its charter)

OKLAHOMA	**73-1473361**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

201 Robert S. Kerr Avenue, Suite 210

Oklahoma City, Oklahoma 73102

(Address of principal executive offices)

(405) 236-8200

(Registrant's telephone number)

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer o Accelerated filer o Non-accelerated filer o Smaller reporting company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

As of August 14, 2015, 9,118,161 shares of the registrant's common stock, $0.00001 par value, were outstanding.

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FullNet Communications, Inc. and Subsidiaries

CONDENSED CONSOLIDATED BALANCE SHEETS

	JUNE 30, 2015 (Unaudited)	DECEMBER 31, 2014
ASSETS		
CURRENT ASSETS		
Cash	$ 15,265	$ 14,614
Accounts receivable, net	14,664	12,389
Prepaid expenses and other current assets	15,420	9,377
Total current assets	45,349	36,380
PROPERTY AND EQUIPMENT, net	104,223	109,288
OTHER ASSETS AND INTANGIBLE ASSETS	7,862	8,661
TOTAL ASSETS	$ 157,434	$ 154,329
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Accounts payable	$ 232,245	$ 214,917
Accrued and other liabilities	539,050	486,961
Convertible notes payable, related party - current portion	46,811	46,811
Deferred revenue	353,223	354,967
Total current liabilities	1,171,329	1,103,656
CONVERTIBLE NOTES PAYABLE, related party - less current portion	183,809	199,063
Total liabilities	1,355,138	1,302,719
STOCKHOLDERS' DEFICIT		
Preferred stock — $.001 par value; authorized, 10,000,000 shares; Series A convertible; issued and outstanding, 987,102 shares in 2015 and 2014	517,804	490,905
Common stock — $.00001 par value; authorized, 40,000,000 shares; issued and outstanding, 9,118,161 shares in 2015 and 2014	91	91
Additional paid-in capital	8,663,820	8,678,869

Accumulated deficit	(10,379,419)	(10,318,255)
Total stockholders' deficit	(1,197,704)	(1,148,390)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 157,434	$ 154,329

See accompanying notes to unaudited condensed consolidated financial statements.

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FullNet Communications, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended		Six Months Ended	
	June 30, 2015	**June 30, 2014**	**June 30, 2015**	**June 30, 2014**
REVENUES				
	$	$	$	$
Access service revenues	19,082	19,279	39,365	43,068
Co-location and other revenues	449,279	438,454	878,152	838,442
Total revenues	468,361	457,733	917,517	881,510
OPERATING COSTS AND EXPENSES				
Cost of access service revenues	21,401	22,503	42,894	49,717
Cost of co-location and other revenues	76,216	88,978	148,998	174,395
Selling, general and administrative expenses	397,256	356,300	759,448	701,994
Depreciation and amortization	10,990	10,915	19,189	18,830
Total operating costs and expenses	505,863	478,696	970,529	944,936
LOSS FROM OPERATIONS	(37,502)	(20,963)	(53,012)	(63,426)
INTEREST EXPENSE	(4,011)	(3,996)	(8,152)	(8,091)
	$	$	$	$
NET LOSS	(41,513)	(24,959)	(61,164)	(71,517)
Preferred stock dividends	(13,450)	(15,131)	(26,899)	(30,262)
	$	$	$	$
Net loss available to common stockholders	(54,963)	(40,090)	(88,063)	(101,779)
Net loss per common share	$	$	$	$
Basic and diluted	(.01)	(.00)	(.01)	(.01)
Weighted average common shares outstanding				
Basic and diluted	9,118,161	9,118,161	9,118,161	9,118,161

See accompanying notes to unaudited condensed consolidated financial statements.

FullNet Communications, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT (UNAUDITED)

Six Months Ended June 30, 2015

	Common stock		Preferred stock		Additional paid-in	Accumulated	
	Shares	Amount	Shares	Amount	capital	deficit	Total
Balance at January 1, 2015	9,118,161	$ 91	987,102	$ 490,905	$ 8,678,869	$ (10,318,255)	$ (1,148,390)
Stock options compensation	-	-	-	-	11,850	-	11,850
Amortization of increasing dividend rate preferred stock discount	-	-	-	26,899	(26,899)	-	-
Net loss	-	-	-	-	-	(61,164)	(61,164)
Balance at June 30, 2015 – (unaudited)	9,118,161	$ 91	987,102	$ 517,804	$ 8,663,820	$ (10,379,419)	$ (1,197,704)

See accompanying notes to unaudited condensed consolidated financial statements.

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FullNet Communications, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended	
	June 30, 2015	**June 30, 2014**
CASH FLOWS FROM OPERATING ACTIVITIES	$	$
Net loss	(61,164)	(71,517)
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation and amortization	19,189	18,830
Stock options compensation	11,850	11,324
Provision for uncollectible accounts receivable	3,168	(9,938)
Net (increase) decrease in		
Accounts receivable	(5,443)	13,300
Prepaid expenses and other current assets	(6,043)	(5,476)
Net increase (decrease) in		
Accounts payable	17,328	11,533
Accrued and other liabilities	52,089	38,765
Deferred revenue	(1,744)	37,332
Net cash provided by operating activities	29,230	44,153
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(13,325)	(56,266)
Net cash used in investing activities	(13,325)	(56,266)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on borrowings under notes payable – related party	(15,254)	(13,563)
Net cash used in financing activities	(15,254)	(13,563)
NET INCREASE (DECREASE) IN CASH	651	(25,676)
Cash at beginning of period	14,614	30,072
Cash at end of period	$ 15,265	$ 4,396
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid for interest	$ 8,152	$ 8,091
NON-CASH INVESTING AND FINANCING ACTIVITIES		

Property and equipment purchased on accounts	$ -	$ 38,532
Amortization of increasing dividend rate preferred stock discount	$ 26,899	$ 30,262

See accompanying notes to the unaudited condensed consolidated financial statements.

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FullNet Communications, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. UNAUDITED INTERIM FINANCIAL STATEMENTS

The unaudited condensed consolidated financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. The accompanying unaudited condensed consolidated financial statements and related notes should be read in conjunction with the audited consolidated financial statements of the Company and notes thereto for the year ended December 31, 2014.

The information furnished reflects, in the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results of the interim periods presented. Operating results of the interim period are not necessarily indicative of the amounts that will be reported for the year ending December 31, 2015.

2. GOING CONCERN AND MANAGEMENT'S PLANS

At June 30, 2015, current liabilities exceed current assets by $1,125,980. The Company does not have a line of credit or credit facility to serve as an additional source of liquidity. Historically the Company has relied on shareholder loans as an additional source of funds. These factors raise substantial doubts about the Company's ability to continue as a going concern.

The ability of the Company to continue as a going concern is dependent upon continued operations of the Company that in turn is dependent upon the Company's ability to meet its financing requirements on a continuing basis, to maintain present financing, to achieve the objectives of its business plan and to succeed in its future operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

The Company's business plan includes, among other things, expansion through mergers and acquisitions and the development of its co-location and advanced voice and data solutions. Execution of the Company's business plan will require significant capital to fund capital expenditures, working capital needs and debt service. Current cash balances will not be sufficient to fund the Company's current business plan beyond the next few months. As a consequence, the Company is currently focusing on revenue enhancement and cost cutting opportunities as well as working to sell non-core assets and to extend vendor payment terms. The Company continues to seek additional convertible debt or equity financing as well as the placement of a credit facility to fund the Company's liquidity. There can be no assurance that the Company will be able to obtain additional capital on satisfactory terms, or at all, or on terms that will not dilute the shareholders' interests.

3. CONVERTIBLE NOTES PAYABLE RELATED PARTY

At December 31, 2014 the Company had a secured convertible promissory note from a shareholder with a balance of $198,363. The interest rate of this note was 6% through December 31, 2014 and is 7% through December 31, 2015, 8% through December 31, 2016, 8.5% through December 31, 2017, and 9% through May 31, 2018, with fixed monthly payments of $3,301 and matures May 31, 2018, at which time the remaining balance of principal and all accrued interest shall be due and payable. This convertible promissory note is secured by all tangible and intangible assets of the Company. The note holder has the right to convert the note, in its entirety or in part, into common stock of the Company at the rate of $1.00 per share. During the six months ended June 30, 2015, the Company made principal and interest payments totaling $19,804. The secured convertible promissory note had a balance of $185,313 at June 30, 2015 of which $39,611 is short-term and $145,702 is long-term.

At December 31, 2014 the Company had a secured convertible promissory note from a shareholder with a balance of $47,511. The interest rate of this note is 6%, required monthly installments of interest only through May 31, 2014, then requires monthly installments of $600 including principal and interest and matures May 31, 2023. This convertible promissory note is secured by certain equipment of the Company. The note holder has the right to convert the note, in its entirety or in part, into common stock of the Company at the rate of $1.00 per share. During the six months ended June 30, 2015, the Company made principal and interest payments totaling $3,602. The secured convertible promissory note had a balance of $45,307 at June 30, 2015 of which $7,200 is short-term and $38,107 is long-term.

STOCK BASED COMPENSATION

4.

The following table summarizes the Company's employee stock option activity for the six months ended June 30, 2015:

	Options	**Weighted average exercise price**	**Weighted average remaining contractual life (yrs)**	**Aggregate intrinsic value**
Options outstanding, December 31, 2014	3,295,382	$ 0.029	8.20	
Options exercisable, December 31, 2014	1,933,549	$ 0.025	7.84	$ 50,788
Options granted during the period	177,000	$ 0.043		
Options expired during the period	(3,000)	$ 0.080		
Options forfeited during the period	(155,500)	$ 0.040		

Options outstanding, June 30, 2015	3,313,882	$ 0.030	7.73	
Options exercisable, June 30, 2015	2,051,215	$ 0.025	7.39	$ 54,328

During the six months ended June 30, 2015, 177,000 nonqualified employee stock options were granted with exercise prices ranging from $0.040 to $0.065 and 149,000 of those options were forfeited. The options were valued using Black-Scholes option pricing model on the respective date of issuance and the fair value of the shares was determined to be $7,524 of which $239 was recognized as stock-based compensation expense for the six months ended June 30, 2015. The remaining 28,000 stock options will vest one-third on each annual anniversary date of the grant and will expire ten years from the date of the grant. During the six months ended June 30, 2015, 6,500 employee stock options were forfeited that were related to options granted in prior years.

Stock-based compensation expense for the three and six months ended June 30, 2015 was $5,719 and $11,850, respectively.

Stock-based compensation is measured at the grant date, based on the calculated fair value of the option, and is recognized as an expense on a straight-line basis over the requisite employee service period (generally the vesting period of the grant).

The Black-Scholes option pricing model was used with the following weighted-average assumptions for options granted during the six months ended June 30, 2015:

Risk-free interest rate 1.38% - 1.61%

Expected option life 5years

Expected volatility 215% - 218%

Expected dividend yield 0%

5. SERIES A CONVERTIBLE PREFERRED STOCK

On March 31, 2015 the Company’s board of directors made the determination that it was in the best interest of the Company and its stockholders to conserve the Company’s working capital at this time and not make the annual dividend payment for the year ending December 31, 2014. As a result, pursuant to the Certificate of Designations, Preferences, and Rights of the Series A Convertible Preferred Stock, each share of the Series A Convertible Preferred Stock shall hereafter be entitled to two votes upon any matter that the holders of the Company’s common stock are entitled to vote.

The amortization of the increasing dividend rate preferred stock discount for the three and six months ended June 30, 2015 was $13,450 and $26,899, respectively. The amortization of the increasing dividend rate preferred stock discount for the three and six months ended June 30, 2014 was $15,131 and $30,262, respectively.

6. PROPERTY AND EQUIPMENT

During the six months ended June 30, 2015, $13,325 was paid for property and equipment. During the three and six months ended June 30, 2015, $10,590 and $18,390 was recorded as depreciation expense.

7. CHANGE IN ESTIMATE

As a result of a change in management's estimation of a contingent liability arising from the acquisition of certain business assets in 2012, the Company recorded an additional expense in the amount of $32,749 during the three months ended June 30, 2015.

8. SUBSEQUENT EVENTS

In July 2015, the Company granted 3,000 employee stock options to one employee with an exercise price of $.050. The stock options shall vest one-third each year starting from July 6, 2016, and shall expire on July 6, 2025.

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

The following discussion is qualified in its entirety by the more detailed information in our 2014 Annual Report on Form 10-K and the financial statements contained therein, including the notes thereto, and our other periodic reports filed with the Securities and Exchange Commission since December 31, 2014 (collectively referred to as the "Disclosure Documents"). Certain forward-looking statements contained in this Report and in the Disclosure Documents regarding our business and prospects are based upon numerous assumptions about future conditions which may ultimately prove to be inaccurate and actual events and results may materially differ from anticipated results described in such statements. Our ability to achieve these results is subject to certain risks and uncertainties, including those inherent risks and uncertainties generally in the Internet service provider and competitive local exchange carrier industries, the impact of competition and pricing, changing market conditions, and other risks. Any forward-looking statements contained in this Report represent our judgment as of the date of this Report. We disclaim, however, any intent or obligation to update these forward-looking statements. As a result, the reader is cautioned not to place undue reliance on these forward-looking statements. References to us in this report include our subsidiaries: FullNet, Inc. ("FullNet"), FullTel, Inc. ("FullTel"), FullWeb, Inc. ("FullWeb") and CallMultiplier, Inc. ("CallMultiplier").

Overview

We are an integrated communications provider offering integrated communications and Internet connectivity to individuals, businesses, organizations, educational institutions and government agencies. Through our subsidiaries, we provide high quality, reliable and scalable Internet access, web hosting, equipment co-location, traditional telephone services as well as advanced voice and data solutions.

Our principal executive offices are located at 201 Robert S. Kerr Avenue, Suite 210, Oklahoma City, Oklahoma 73102, and our telephone number is (405) 236-8200. We also maintain Internet sites on the World Wide Web ("WWW") at www.fullnet.net, www.fulltel.com and www.callmultiplier.com. Information contained on our Web sites is not and should not be deemed to be a part of this Report.

Company History

We were founded in 1995 as CEN-COM of Oklahoma, Inc., an Oklahoma corporation, to bring dial-up Internet access and education to rural locations in Oklahoma that did not have dial-up Internet access. We changed our name to FullNet Communications, Inc. in December 1995. Today we are a total solutions provider to individuals and companies seeking a "one-stop shop" in Oklahoma.

Our current business strategy is to become a successful integrated communications provider in Oklahoma. We expect to grow through the acquisition of additional customers for our carrier-neutral co-location space and advanced voice and data solutions.

We market our carrier neutral co-location solutions in our network operations center to other competitive local exchange carriers, Internet service providers and web-hosting companies. Our co-location facility is carrier neutral, allowing customers to choose among competitive offerings rather than being restricted to one carrier. Our facility is Telco-grade and provides customers a high level of operative reliability and security. We offer flexible space arrangements for customers and 24-hour onsite support with both battery and generator backup.

Through FullTel, our wholly owned subsidiary, we are a fully licensed competitive local exchange carrier or CLEC in Oklahoma. FullTel activates local access telephone numbers for the cities in which we market, sell and operate our retail FullNet Internet service provider brand, wholesale dial-up Internet service; our business-to-business network design, connectivity, domain and Web hosting businesses; and traditional telephone services as well as advanced voice and data solutions. At June 30, 2015 FullTel provided us with local telephone access in approximately 232 cities.

Our common stock trades on the OTC QB marketplace under the symbol FULO. While our common stock trades on the OTC QB marketplace, it is very thinly traded, and there can be no assurance that our stockholders will be able to sell their shares should they so desire. Any market for the common stock that may develop, in all likelihood, will be a limited one, and if such a market does develop, the market price may be volatile.

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Results of Operations

The following table sets forth certain statement of operations data as a percentage of revenues for the three and six months ended June 30, 2015 and 2014:

	Three Months Ended June 30, 2015	Six Months Ended