

FRANKLIN WIRELESS CORP  
Form 10-Q  
February 14, 2014

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

**FORM 10-Q**

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

**For the quarterly period ended December 31, 2013**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_ .**

**Commission file number: 001-14891**

**FRANKLIN WIRELESS CORP.**

(Exact name of Registrant as specified in its charter)

**Nevada**

**95-3733534**

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification Number)

**6205 Lusk Blvd.**

**92121**

**San Diego, California**

(Zip code)

(Address of principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate 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  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 Rule 12b-2 of the Exchange Act).  
Yes  No

The Registrant has 10,386,369 shares of common stock outstanding as of February 14, 2014.

**FRANKLIN WIRELESS CORP.**

**INDEX TO CONSOLIDATED QUARTERLY REPORT ON FORM 10-Q**

**FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2013**

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## **NOTE ON FORWARD LOOKING STATEMENTS**

You should keep in mind the following points as you read this Report on Form 10-Q:

The terms “we,” “us,” “our,” “Franklin,” “Franklin Wireless,” or the “Company” refer to Franklin Wireless Corp.

This Report on Form 10-Q contains statements which, to the extent they do not recite historical fact, constitute “forward looking” statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward looking statements are used under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operation,” and elsewhere in this Quarterly Report on Form 10-Q. You can identify these statements by the use of words like “may,” “will,” “could,” “should,” “project,” “believe,” “anticipate,” “expect,” “plan,” “estimate,” “forecast,” “potential,” “intend,” “continue,” and variations of these or comparable words. Forward looking statements do not guarantee future performance and involve risks and uncertainties. Actual results may differ substantially from the results that the forward looking statements suggest for various reasons, including those discussed under the caption “Risk Factors” in Item 1A of our Annual Report on Form 10-K for the year ended June 30, 2013. These forward looking statements are made only as of the date of this Report on Form 10-Q. We do not undertake to update or revise the forward looking statements, whether as a result of new information, future events or otherwise.

**PART I – FINANCIAL INFORMATION****ITEM 1. Financial Statements****FRANKLIN WIRELESS CORP.****CONSOLIDATED BALANCE SHEETS**

	December 31, 2013 (unaudited)	June 30, 2013
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 10,194,158	\$ 10,431,474
Accounts receivable	3,804,925	5,321,803
Other receivables, net	125,140	96,401
Inventories	559,774	262,567
Loan to employee and third party	21,994	117,422
Prepaid expenses and other current assets	152,860	10,725
Prepaid income taxes	1,292,141	1,203,960
Deferred tax assets, current	41,701	41,701
Advance payments to vendors	64,534	110,278
Total current assets	16,257,227	17,596,331
Property and equipment, net	584,182	631,225
Intangible assets, net	2,961,624	3,073,745
Deferred tax assets, non-current	1,919,756	1,459,756
Goodwill	273,285	273,285
Other assets	134,846	125,225
<b>TOTAL ASSETS</b>	<b>\$22,130,920</b>	<b>\$23,159,567</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable	\$4,264,107	\$4,214,348
Advance payments from customers	231,988	75,369
Accrued liabilities	348,733	584,447
Marketing funds payable	1,545,002	1,633,806
Short-term borrowings	139,134	139,134
Total current liabilities	6,528,964	6,647,104

Total liabilities	6,528,964	6,647,104
<b>Commitments and contingencies (Note 8)</b>		
<b>Stockholders' equity</b>		
Parent Company stockholders' equity		
Preferred stock, par value \$0.001 per share, authorized 10,000,000 shares; No preferred stock issued and outstanding as of December 31, 2013 and June 30, 2013	—	—
Common stock, par value \$0.001 per share, authorized 50,000,000 shares; 10,374,369 shares issued and outstanding as of December 31, 2013 and June 30, 2013	13,646	13,646
Additional paid-in capital	7,120,484	6,989,952
Retained earnings	12,606,439	13,573,119
Treasury stock, 3,342,286 shares as of December 31, 2013 and June 30, 2013	(4,279,479 )	(4,279,479 )
Accumulated other comprehensive (loss)	(112,152 )	(21,275 )
Total Parent Company stockholders' equity	15,348,938	16,275,963
Non-controlling interests	253,018	236,500
Total stockholders' equity	15,601,956	16,512,463
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$22,130,920</b>	<b>\$23,159,567</b>

See accompanying notes to consolidated financial statements.

**FRANKLIN WIRELESS CORP.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(Unaudited)**

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Net sales	\$7,553,845	\$5,355,369	\$8,960,948	\$18,492,447
Cost of goods sold	5,345,315	4,487,317	6,755,610	14,444,453
Gross profit	2,208,530	868,052	2,205,338	4,047,994
Operating expenses:				
Selling, general and administrative	1,455,833	1,316,035	2,378,098	2,528,975
Research and development	700,534	818,466	1,379,143	1,528,022
Total operating expenses	2,156,367	2,134,501	3,757,241	4,056,997
Income (loss) from operations	52,163	(1,266,449 )	(1,551,903 )	(9,003 )
Other income (loss), net:				
Interest income	3,380	4,396	7,240	10,900
Other income (loss), net	158,162	(4,035 )	134,501	(62,083 )
Total other income (loss), net	161,542	361	141,741	(51,183 )
Income (loss) before provision (benefit) for income taxes	213,705	(1,266,088 )	(1,410,162 )	(60,186 )
Income tax provision (benefit)	(7,000 )	(404,880 )	(460,000 )	159,120
Net income (loss)	220,705	(861,208 )	(950,162 )	(219,306 )
Non-controlling interests in net loss (income) of subsidiary at 48.2%	(93,761 )	144,473	(16,518 )	241,155
Net income (loss) attributable to Parent Company	\$126,944	\$(716,735 )	\$(966,680 )	\$21,849
Basic earnings (loss) per share attributable to Parent Company stockholders	\$0.02	\$(0.07 )	\$(0.09 )	\$0.00
Diluted earnings (loss) per share attributable to Parent Company stockholders	\$0.02	\$(0.07 )	\$(0.09 )	\$0.00
Weighted average common shares outstanding – basic	10,374,369	10,345,688	10,374,369	11,084,899
Weighted average common shares outstanding – diluted	10,584,435	10,345,688	10,374,369	11,290,154
Comprehensive income (loss)				
Net income (loss)	\$220,705	\$(861,208 )	\$(950,162 )	\$(219,306 )
Translation adjustments	(57,888 )	(61,681 )	(90,877 )	(75,137 )
Comprehensive income (loss)	162,817	(922,889 )	(1,041,039 )	(294,443 )
Comprehensive loss (income) attributable to non-controlling interest	(93,761 )	144,473	(16,518 )	241,155

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Comprehensive income (loss) attributable to controlling interest	\$69,056	\$(778,416 )	\$(1,057,557 )	\$(53,288 )
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See accompanying notes to consolidated financial statements.

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**FRANKLIN WIRELESS CORP.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	Six Months Ended December 31,	
	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$(950,162 )	\$(219,306 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	126,610	112,711
Amortization of intangible assets	610,932	658,743
Deferred tax (benefit) provision	(460,000 )	104,621
Share-based compensation	130,532	150,532
Gain from forgiven debt	(130,054 )	-
Increase (decrease) in cash due to change in:		
Accounts receivable	1,488,139	10,955,998
Inventories	(297,207 )	1,087,628
Prepaid expense and other current assets	(142,135 )	43,319
Prepaid income taxes	(88,181 )	(27,323 )
Advance payment to vendor	45,744	148,967
Other assets	(9,621 )	(9,512 )
Accounts payable	141,009	(6,230,934 )
Advance payment from customers	156,619	82
Accrued liabilities	(235,714 )	(423,396 )
Other liabilities	-	(185,980 )
Net cash provided by operating activities	386,511	6,166,150
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(79,567 )	(292,796 )
Payments for capitalized development costs	(521,068 )	(358,630 )
Purchases of intangible assets	(27,743 )	(615,279 )
Receipt of loan repayments from third party	95,428	-
Loan to employee	-	(2,340 )
Net cash used in investing activities	(532,950 )	(1,269,045 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repurchase of common stock	-	(2,406,414 )
Issuance of stock related to stock options exercised	-	22,500
Net cash used in financing activities	-	(2,383,914 )
Effect of foreign currency translation	(90,877 )	(75,137 )
Net (decrease) increase in cash and cash equivalents	(237,316 )	2,438,054

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Cash and cash equivalents, beginning of period	10,431,474	9,419,441
Cash and cash equivalents, end of period	\$10,194,158	\$11,857,495
Supplemental disclosure of cash flow information:		
Cash paid during the periods for:		
Interest	\$6,402	\$6,191
Income taxes	\$-	\$226,289

See accompanying notes to unaudited consolidated financial statements.

**FRANKLIN WIRELESS CORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**NOTE 1 – BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements of Franklin Wireless Corp. (“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. In the opinion of management, the financial statements included herein contain all adjustments, including normal recurring adjustments, considered necessary to present fairly the financial position, the results of operations and comprehensive income (loss) and cash flows of the Company for the periods presented. These financial statements and notes hereto should be read in conjunction with the financial statements and notes thereto for the fiscal year ended June 30, 2013 included in the Company’s Form 10-K filed on September 30, 2013. The operating results or cash flows for 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**

We are engaged in the design, manufacture and sale of broadband high speed wireless data communication products such as third generation (“3G”) and fourth generation (“4G”) wireless modules and modems. We focus primarily on wireless broadband Universal Serial Bus (“USB”) modems, which provide a flexible way for consumers to connect to wireless broadband networks from laptop or desktop computers. Our broadband wireless data communication products are positioned at the convergence of wireless communications, mobile computing and the Internet, each of which we believe represents a growing market.

Our wireless products are based on Evolution Data Optimized technology (“EV-DO technology”) of Code Division Multiple Access (“CDMA”), High-Speed Packet Access (“HSPA”) technology of Wideband Code Division Multiple Access (“WCDMA”), Worldwide Interoperability for Microwave Access (“WiMAX”) based on the IEEE 802.16 standard and Long Term Evolution (LTE) which enable end users to send and receive email with large file attachments, play interactive games, receive, send and download high resolution pictures, videos and music content.

We market our products directly to wireless operators, and indirectly through strategic partners and distributors. Our global customer base extends primarily from the United States to South American and Caribbean countries and Asia.

### **NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and a subsidiary with a majority voting interest of 51.8% (48.2% is owned by non-controlling interests) as of December 31, 2013 and June 30, 2013. In the preparation of consolidated financial statements of the Company, intercompany transactions and balances are eliminated and net earnings are reduced by the portion of the net earnings of subsidiaries applicable to non-controlling interests.

#### **Non-controlling Interest in a Consolidated Subsidiary**

As of December 31, 2013, the non-controlling interest was \$253,018, which represents a \$16,518 increase from \$236,500 as of June 30, 2013. The increase was due to the net income of subsidiary of \$34,241 for the six months ended December 31, 2013, of which 48.2% was attributable to the non-controlling interests.

#### **Segment Reporting**

Accounting Standards Codification (“ASC”) Topic 280, “Segment Reporting,” requires public companies to report financial and descriptive information about their reportable operating segments. We identify our operating segments based on how management internally evaluates separate financial information, business activities and management responsibility. We have one reportable segment, consisting of the sale of wireless access products.

We generate revenues from four geographic areas, consisting of the United States, the Caribbean and South America, Europe, the Middle East and Africa (“EMEA”) and Asia. The following enterprise wide disclosure is prepared on a basis consistent with the preparation of the consolidated financial statements. The following table contains certain financial information by geographic area:

	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
Net sales:	2013	2012	2013	2012
United States	\$4,002,728	\$5,063,619	\$5,082,241	\$17,015,711
Caribbean and South America	1,836,500	628	1,839,080	746,928
Europe, the Middle East and Africa (“EMEA”)	461,521	–	760,137	–
Asia	1,253,096	291,122	1,279,490	729,808
Totals	\$7,553,845	\$5,355,369	\$8,960,948	\$18,492,447

Long-lived assets, net:	December 31, 2013	June 30, 2013
United States	\$2,574,736	\$2,595,094
Asia	971,070	1,109,876
Totals	\$3,545,806	\$3,704,970

### Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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 revenues and expenses during the reporting period. Actual results could materially differ from those estimates.

### Fair Value of Financial Instruments

The carrying amounts of financial instruments such as assets, cash equivalents, accounts receivable, accounts payable and debt approximate the related fair values due to the short-term maturities of these instruments. We invest our excess cash into financial instruments which are readily convertible into cash, such as money market funds.

### **Allowance for Doubtful Accounts**

Based upon our review of our collection history as well as the current balances associated with all significant customers and associated invoices, we do not believe an allowance for doubtful accounts was necessary as of December 31, 2013 and June 30, 2013.

### **Revenue Recognition**

We recognize revenue in accordance with ASC 605, "Revenue Recognition," 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, we recognize revenues from product sales upon shipment of the products to the customers or when the products are received by the customers in accordance with shipping or delivery terms.

### **Cost of Goods Sold**

All costs associated with our contract manufacturers, as well as distribution, fulfillment and repair services, are included in our cost of goods sold. Cost of goods sold also includes amortization expense associated with capitalized product development costs associated with completed technology.

### **Capitalized Product Development Costs**

Accounting Standards Codification (“ASC”) Topic 350, “Intangibles – Goodwill and Other” includes software that is part of a product or process to be sold to a customer and is accounted for under Subtopic 985-20. Our products contain embedded software internally developed by our Korea-based subsidiary, Franklin Technology Inc. (“FTI”), which is an integral part of these products because it allows the various components of the products to communicate with each other and the products are clearly unable to function without this coding.

The costs of product development that are capitalized once technological feasibility is determined (noted as Technology in progress in the Intangible Assets table) include payroll, employee benefits, and other headcount-related expenses associated with product development. We determine that technological feasibility for our products is reached after all high-risk development issues have been resolved. Once the products are available for general release to our customers, we cease capitalizing the product development costs and any additional costs, if any, are expensed. The capitalized product development costs are amortized on a product-by-product basis using the greater of straight-line amortization or the ratio of the current gross revenues to the current and anticipated future gross revenues. The amortization begins when the products are available for general release to the Company’s customers.

As of December 31, 2013 and June 30, 2013, capitalized product development costs in progress were \$65,000 and \$32,500, respectively, and these amounts are included in intangible assets in our consolidated balance sheets. During the three and six months ended December 31, 2013, we incurred \$139,000 and \$521,068, respectively, in capitalized product development costs, and such amounts are primarily comprised of certifications and licenses. All expenses incurred before technological feasibility is reached are expensed and included in our consolidated statements of comprehensive income (loss).

### **Research and Development Costs**

Costs associated with research and development are expensed as incurred. Research and development costs were \$700,534 and \$818,466 for the three months ended December 31, 2013 and 2012, respectively, and \$1,379,143 and \$1,528,022 for the six months ended December 31, 2013 and 2012, respectively.

### **Warranties**

We provide a factory warranty for one year which is covered by our vendors and manufacturers under purchase agreements between the Company and the vendors. In general, these products are shipped directly from our vendors to

our customers. As a result, we do not have warranty exposure and do not accrue any warranty expenses. Historically, the Company has not experienced any material net warranty expenditures.

### **Shipping and Handling Costs**

Costs associated with product shipping and handling are expensed as incurred. Shipping and handling costs, which are included in selling, general and administrative expenses on the consolidated statements of comprehensive income (loss), were \$112,026 and \$51,279 for the three months ended December 31, 2013 and 2012, respectively, and \$133,162 and \$171,690 for the six months ended December 31, 2013 and 2012, respectively.

### **Cash and Cash Equivalents**

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

### **Inventories**

Our inventories consist of finished goods and are stated at the lower of cost or market, cost being determined on a first-in, first-out basis. We assess the inventory carrying value and reduce 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. Our customer demand is highly unpredictable, and can fluctuate significantly caused by factors beyond the control of the Company. We may write down our inventory value for potential obsolescence and excess inventory. However, as of December 31, 2013 and June 30, 2013, we believe our inventory needs no such reserves and have recorded no inventory reserves.



## Property and Equipment

Property and equipment are recorded at cost. Significant additions or improvements extending useful lives of assets are capitalized. Maintenance and repairs are charged to expense as incurred. Depreciation is computed using the straight-line method over the estimated useful lives as follows:

Machinery	6 years
Office equipment	5 years
Molds	3 years
Vehicles	5 years
Computers and software	5 years
Furniture and fixtures	7 years
Facilities	5 years

## Goodwill and Intangible Assets

Goodwill and certain intangible assets were recorded in connection with the FTI acquisition and are accounted for in accordance with ASC 805, "Business Combinations." Goodwill represents the excess of the purchase price over the fair value of the tangible and intangible net assets acquired. Intangible assets are recorded at their fair value at the date of acquisition. Goodwill and other intangible assets are accounted for in accordance with ASC 350, "Goodwill and Other Intangible Assets." Goodwill and other intangible assets are tested for impairment at least annually and any related impairment losses are recognized in earnings when identified. No impairment was noted as of December 31, 2013 and June 30, 2013.

The definite lived intangible assets consisted of the following as of December 31, 2013:

Definite lived intangible assets:	Expected Life	Average Remaining Life	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
Complete technology	3 years	-	\$490,000	\$ 490,000	\$-
Complete technology	3 years	-	1,517,683	1,517,683	-
Complete technology	3 years	1.0 years	281,714	198,216	83,498
Complete technology	3 years	1.5 years	361,249	210,741	150,508
Complete technology	3 years	1.8 years	174,009	72,504	101,505
Complete technology	3 years	2.0 years	909,962	278,044	631,918
Supply and development agreement	8 years	3.8 years	1,121,000	595,531	525,469
		-	65,000	-	65,000

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Technology	Not				
In progress	Applicable				
Software	5 years	2.6 years	196,795	93,680	103,115
Patent	10 years	8.3 years	51,025	641	50,384
Certifications & licenses	3 years	1.9 years	1,818,398	568,171	1,250,227
Total as of December 31, 2013			\$6,986,835	\$ 4,025,211	\$2,961,624

The definite lived intangible assets consisted of the following as of June 30, 2013:

Definite lived intangible assets:	Expected Life	Average Remaining life	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
Complete technology	3 years	-	\$490,000	\$ 490,000	\$-
Complete technology	3 years	-	1,517,683	1,517,683	-
Complete technology	3 years	1.5 years	281,714	151,264	130,450
Complete technology	3 years	2.0 years	361,249	150,532	210,717
Complete technology	3 years	2.3 years	174,009	43,502	130,507
Complete technology	3 years	2.5 years	909,962	126,384	783,578
Supply and development agreement Technology	8 years	4.3 years	1,121,000	525,469	595,531
In progress	Not Applicable	-	32,500	-	32,500
Software	5 years	2.9 years	169,595	75,965	93,630
Patent	10 years	8.7 years	50,482	517	49,965
Certifications & licenses	3 years	2.2 years	1,379,830	332,963	1,046,867
Total as of June 30, 2013			\$6,488,024	\$ 3,414,279	\$3,073,745

Amortization expense recognized during the three months ended December 31, 2013 and 2012 was \$312,630 and \$280,806, respectively, and during the six months ended December 31, 2013 and 2012 was \$610,932 and \$658,743, respectively.

### Long-lived Assets

In accordance with ASC 360, "Property, Plant, and Equipment," we review 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. We consider the carrying value of assets may not be recoverable based upon our 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 asset; significant changes in our 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 are less than its carrying amount.

As of December 31, 2013, we are not aware of any events or changes in circumstances that would indicate that the long-lived assets are impaired.

## Income Taxes

We follow ASC 740, Income Taxes, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates, applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

Based on the assessment, management believes that the Company is more likely than not to fully realize our deferred tax assets. As such, no valuation allowance has been established for the Company's deferred tax assets. However, the Company may need to establish a valuation allowance should it incur taxable losses in the future.

We adopted ASC 740-10-25 on January 1, 2007, which provides criteria for the recognition, measurement, presentation and disclosure of uncertain tax position. We must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. We did not recognize any additional liabilities for uncertain tax positions as a result of the implementation of ASC 740-10-25.

As of December 31, 2013, we have no material unrecognized tax benefits. We recorded an income tax benefit and an increase in deferred tax assets of \$7,000 for the three months ended December 31, 2013 and an income tax benefit and an increase in deferred tax assets of \$460,000 for the six months ended December 31, 2013.

### **Concentrations of Credit Risk**

We extend credit to our customers and perform ongoing credit evaluations of such customers. We evaluate our accounts receivable on a regular basis for collectability and provide for an allowance for potential credit losses as deemed necessary. No reserve was required or recorded for any of the periods presented.

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

A significant portion of our revenue is derived from a small number of customers. For the six months ended December 31, 2013, sales to our five largest customers accounted for 21%, 18%, 14%, 13% and 12% of our consolidated net sales and 0%, 42%, 21%, 5%, and 27% of our accounts receivable balance as of December 31, 2013. In the same period in 2012, sales to our two largest customers accounted for 43% and 35% of our consolidated net sales and 81% and 0% of our accounts receivable balance as of December 31, 2012. No other customers accounted for more than ten percent of total net sales for the six months ended December 31, 2013 and 2012.

For the six months ended December 31, 2013, we purchased the majority of our wireless data products from two manufacturing companies located in Asia. If these manufacturing companies were to experience delays, capacity constraints or quality control problems, product shipments to our customers could be delayed, or our customers could consequently elect to cancel the underlying product purchase order, which would negatively impact the Company's revenue. For the six months ended December 31, 2013, we purchased wireless data products from these suppliers in the amount of \$5,010,027, or 77% of total purchases, and had related accounts payable of \$2,364,079 as of December 31, 2013. For the six months ended December 31, 2012, we purchased wireless data products from one supplier in the amount of \$10,603,422, or 83% of total purchases, and had related accounts payable of \$2,356,744 as of December 31, 2012.

We maintain our cash accounts with established commercial banks. Such cash deposits exceed the Federal Deposit Insurance Corporation insured limit of \$250,000 for each account. However, the Company does not anticipate any losses on excess deposits.

### **NOTE 4 – PROPERTY AND EQUIPMENT**

Property and equipment consisted of the following as of:

	December 31, 2013	June 30, 2013
Machinery and facility	\$288,487	\$288,487
Office equipment	354,736	351,447
Molds	646,820	617,543
Vehicle	9,843	9,843
Construction in progress	60,048	13,047
	1,359,934	1,280,367
Less accumulated depreciation	(775,752 )	(649,142 )
Total	\$584,182	\$631,225

Depreciation expense associated with property and equipment was \$126,610 and \$112,711 for the six months ended December 31, 2013 and 2012, respectively.

#### **NOTE 5 - ACCRUED LIABILITIES**

Accrued liabilities consisted of the following as of:

	December 31, 2013	June 30, 2013
Accrued salaries, incentives	\$-	\$29,900
Accrued salaries, severance	206,862	232,307
Accrued salaries, payroll deductions owed to government entities	12,890	172,520
Accrued vacation	94,437	104,584
Payroll taxes	5,487	1,208
Other accrued liabilities	29,057	43,928
Total	\$348,733	\$584,447

**NOTE 6 – SHORT-TERM BORROWINGS FROM BANKS**

Short-term borrowings from banks consisted of the following as of:

	December 31, 2013	June 30, 2013
Loan dated June 2011, due to a financial institution, with principal and monthly interest payments (interest rate of 8.90% per annum), and the original remaining balance due September 2013, which was extended to March 2014 (interest rate of 10.55% per annum as extended)	\$ 139,134	\$ 139,134

The short-term borrowings from banks of \$139,134 as of December 31, 2013 and June 30, 2013 resulted from the consolidation of FTI’s debt.

**NOTE 7 – EARNINGS (LOSS) PER SHARE**

We report earnings per share in accordance with ASC 260, “Earnings Per Share.” Basic earnings (loss) per share are computed using the weighted average number of shares outstanding during the period. Diluted earnings per share represent basic earnings per share adjusted to include the potentially dilutive effect of outstanding stock options.

For the six months ended December 31, 2013, we were in a net loss position and have excluded 1,078,170 stock options from the calculation of diluted net loss per share because these securities are anti-dilutive. The weighted average number of shares outstanding used to compute earnings per share is as follows:

	Three Months ended		Six Months Ended	
	December 31, 2013	2012	December 31, 2013	2012
Net income (loss) attributable to Parent Company	\$ 126,944	\$(716,735)	\$ (966,680)	\$ 21,849

Weighted-average shares of common stock outstanding:				
Basic shares outstanding	10,374,369	10,345,688	10,374,369	11,084,899
Dilutive effect of common stock equivalents arising from stock options	210,066	–	–	205,255
Diluted shares outstanding	10,584,435	10,345,688	10,374,369	11,290,154
Basic earnings (loss) per share	\$0.02	\$(0.07)	\$(0.09)	\$0.00
Diluted earnings (loss) per share	\$0.02	\$(0.07)	\$(0.09)	\$0.00

## NOTE 8 - COMMITMENTS AND CONTINGENCIES

### Leases

We lease approximately 11,318 square feet of office space in San Diego, California, at a monthly rent of \$16,576, and the lease expires on August 31, 2015. In addition to monthly rent, the lease provides for periodic cost of living increases in the base rent. Rent expense related to the operating leases was \$49,728 for the three months ended December 31, 2013 and 2012, and \$99,456 for the six months ended December 31, 2013 and 2012. Our facility is covered by an appropriate level of insurance and we believe it to be suitable for our use and adequate for our present needs.

Our Korea-based subsidiary, Franklin Technology, Inc. (“FTI”), leases approximately 10,000 square feet of office space in Seoul, Korea, at a monthly rent of approximately \$8,000, and the lease expires on September 1, 2015. In addition to monthly rent, the lease provides for periodic cost of living increases in the base rent and payment of common area costs. The facility is covered by an appropriate level of insurance and we believe it to be suitable for our use and adequate for our present needs. Rent expense related to the operating lease was approximately \$24,000 for the three months ended December 31, 2013 and 2012, and approximately \$48,000 for the six months ended December 31, 2013 and 2012.



We lease two corporate housing facilities for our vendors and employees who travel, under non-cancelable operating leases that expire on September 13, 2014, and July 31, 2014, respectively. Rent expense related to the operating leases was \$5,488 and \$5,460 for the three months ended December 31, 2013 and 2012, respectively, and \$10,932 and \$10,807 for the six months ended December 31, 2013 and 2012, respectively.

## **Contingency**

On July 27, 2010, we entered into a Common Stock Repurchase Agreement with C-Motech (the "Agreement"), under which we agreed to repurchase 3,370,356 shares of our Common Stock from C-Motech for \$3,500,000. A total of 1,803,684 shares were repurchased on the date of the Agreement in exchange for non-cash consideration in the amount of \$1,873,065, which represented amounts owed to the Company by C-Motech for certain marketing funds as well as the settlement of a price dispute for products previously purchased by the Company from C-Motech. Under the Agreement, the remaining 1,566,672 shares were to be repurchased by us upon payment of the balance, \$1,626,935, on or before December 31, 2010.

On January 28, 2011 (the "Amendment Date") the Agreement was amended to reflect (1) a change in the date the 1,566,672 shares were to be repurchased from C-Motech from December 31, 2010 to March 31, 2011, and (2) a change to the non-cash consideration of \$1,873,065. In exchange for the 1,803,684 shares, we were to pay cash to C-Motech (in the same amount) for the shares, by March 31, 2011. In addition, in a separate agreement dated January 28, 2011, C-Motech agreed to pay us \$1,873,065, for amounts owed, by March 31, 2011. The purpose of these revisions was to more clearly differentiate each party's payment obligations to the other with respect to this transaction. Following the Amendment Date, we paid C-Motech \$1,873,065 in exchange for the 1,803,684 shares previously transferred to us by C-Motech, and C-Motech paid us \$1,873,065 for amounts owed, of which \$1,581,457 was booked to other income and \$291,608 was booked to cost of goods sold. The repurchase of the remaining 1,566,672 shares has not been completed. We have provided formal notification to C-Motech that it is in breach of its obligations and we have also provided a demand to sell the shares back to us. We have attempted to tender payment for the shares without results, and we are unable to determine whether or not this repurchase will take place. We have been advised that there are two individuals who claim to have purchased the shares from C-Motech through its former CEO; however, the authority of the former CEO to agree to the sale of the shares is being disputed by C-Motech. It is our understanding that this matter is currently being adjudicated in U.S. and Korean courts. As of the date of this Report, C-Motech is the registered owner of certificates representing 1,566,672 shares, which were issued by the Company in C-Motech's name. On May 7, 2013, we filed a lawsuit against C-Motech in the Superior Court of California for the County of San Diego for breach of the Agreement and breach of other contracts between the parties relating to indemnification and other obligations.

As of December 31, 2013, C-Motech owns 1,566,672 shares, or 15%, of our outstanding Common Stock.

## **Litigation**

We are from time to time involved in certain legal proceedings and claims arising in the ordinary course of business.

On December 10, 2010, Novatel Wireless, Inc. filed a complaint in the United States District Court for the Southern District of California, against us and one other defendant. The complaint alleges that certain products, including, but not limited to, mobile data hot spots and data modems, infringe on U.S. Patent Nos. 5,129,098; 7,318,225; 7,574,737 and 7,319,715. On April 13, 2012, the plaintiff filed a Second Amended Complaint which amended certain claims and added U.S. Patent No. 7,944,901 to the original complaint. On April 27, 2012, we filed a Motion to Dismiss the Second Amended Complaint as to certain of the claims. On July 6, 2012, the Court held oral argument on the Motion to Dismiss and on July 19, 2012, the Court issued an order granting in part and denying in part the Motion to Dismiss. On August 2, 2012, we answered the complaint and an Early Neutral Evaluation Conference took place on October 31, 2012 and a follow-up Settlement Conference was held on June 12, 2013. This matter is currently in the discovery phase. Due to the preliminary nature of these proceedings, we do not believe an amount of loss, if any, can be reasonably estimated for this matter. We intend to vigorously defend ourselves against these allegations.

On May 7, 2013, we filed a lawsuit against C-Motech Co., Ltd. in the Superior Court of California for the County of San Diego for breach of a Common Stock Repurchase Agreement we entered into with C-Motech On July 27, 2010. Under that Agreement we agreed to repurchase 3,370,356 shares of our Common Stock from C-Motech for \$3,500,000. A total of 1,803,684 shares were repurchased on the date of the Agreement in exchange for non-cash consideration in the amount of \$1,873,065, and the remaining 1,566,672 shares were to be repurchased by us upon payment of the balance, \$1,626,935, on or before December 31, 2010. This date was extended to March 31, 2011 and certain other changes made by an Amendment to the Agreement, as more particularly described in Item 13 below. However, the repurchase of the remaining 1,566,672 shares was not completed, notwithstanding our formal demand to C-Motech to sell the shares back to us and our attempt to tender payment for the shares. Accordingly, the action seeks damages, specific performance and declaratory relief for breach of the Common Stock Repurchase Agreement. The action also seeks indemnification from C-Motech for breach of other contracts between the parties relating to indemnification and intentional interference with certain other contracts.

On December 14, 2011, our officers and directors were named as defendants in an action filed by Sherman Capital Group LLC, Singer Children's Management Trust, David S. Oros, Milfam NG LLC and Lloyd I. Miller-Trust C (the "Sherman Group") in the Superior Court of the State of California for the County of San Diego. The complaint seeks damages and declaratory relief for alleged breaches of fiduciary duty by our officers and directors in the management of the Company. The complaint does not specify an amount of damages. Our officers and directors are entitled to indemnity from the Company under the Company's bylaws. On January 20, 2012, we filed a Notice of Removal from the Superior Court of the State of California for the County of San Diego to the United States District Court for the Southern District of California. Following several motions and filings submitted to the Court by both parties, we answered the complaint in the United States District Court on April 10, 2012 and an Early Neutral Evaluation Conference took place on June 11, 2012.

On September 19, 2012, we entered into a Stock Repurchase Agreement and a Standstill Agreement, each with Sherman Capital Group, LLC; Karen Singer, Trustee Of Singer Children's Management Trust; David S. Oros; Milfam NG LLC; and PNC Trust Company of Delaware, Trustee of Lloyd I. Miller – Trust C (the "Sherman Group"). Under the terms of the Stock Repurchase Agreement, we agreed to repurchase 1,538,602 shares of our Common Stock from the members of the Sherman Group for a purchase price of \$2,831,028, or \$1.84 per share, representing a premium of \$440,000 from the market price on the date of the Agreement, which was recorded in operating expenses in the period ended June 30, 2012. In addition to the purchase price, a commission of \$15,386 associated with this repurchase was recorded as a reduction of capital. Under the terms of the Standstill Agreement, the members of the Sherman Group agreed that they will not (i) acquire any Common Stock or other securities of the Company, (ii) make any tender offer with respect to securities of the Company, (iii) participate in any solicitation of proxies with respect to the Company, (iv) form, join or in any way participate in a "group" (within the meaning of Section 13(d)(3) of the Exchange Act and Rule 13d-5(b) thereunder) with respect to the securities of the Company, or (v) act, alone or in concert with others, to seek to control or influence the management, Board of Directors or policies of the Company. On September 27, 2012, we completed the repurchase of the shares of our Common Stock from the Sherman Group.

On September 19, 2012, we entered into a Settlement Agreement and Release with the Sherman Group. Under the terms of this Agreement, the parties agreed to file a request with the Court to dismiss this action, which was filed on October 2, 2012. On October 3, 2012, the U.S. District Court for the Southern District of California issued an Order approving the voluntary dismissal, with prejudice, of the action filed by the Sherman Group.

### **Change of Control Agreements**

On September 21, 2009 we entered into Change of Control Agreements with OC Kim, our President and Acting Chief Financial Officer, Yun J. (David) Lee, our Chief Operating Officer, and Yong Bae Won, our Vice President, Engineering. Each Change of Control Agreement provides for a lump sum payment to the officer in case of a change of control of the Company. The term includes the acquisition of Common Stock of the Company resulting in one person or company owning more than 50% of the outstanding shares, a significant change in the composition of the Board of Directors of the Company during any 12-month period, a reorganization, merger, consolidation or similar transaction resulting in the transfer of ownership of more than fifty percent (50%) of the Company's outstanding

Common Stock, or a liquidation or dissolution of the Company or sale of substantially all of the Company's assets.

The Change of Control Agreement with Mr. Kim is for three years and calls for a payment of \$5 million upon a change of control; the agreement with Mr. Lee is for two years and calls for a payment of \$2 million upon a change of control; and the agreement with Mr. Won is for two years and calls for a payment of \$1 million upon a change of control.

On September 16, 2011, the Board of Directors approved extending the Change of Control Agreements with OC Kim, our President and Acting Chief Financial Officer, Yun J. (David) Lee, our Chief Operating Officer, and Yong Bae Won, our Vice President, Engineering for an additional three years. Following this approval, the Change of Control Agreement with Mr. Kim will expire on September 21, 2015 and the Change of Control Agreements with Messrs. Lee and Won will expire on September 21, 2014.

**NOTE 9 – LONG-TERM INCENTIVE PLAN AWARDS**

We apply the provisions of ASC 718, “Compensation – Stock Compensation,” using a modified prospective application, and the Black-Scholes model. Under this application, we are required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption. Compensation costs will be recognized over the period that an employee provides service in exchange for the award.

We adopted the 2009 Stock Incentive Plan (“2009 Plan”) on June 11, 2009, which provided for the grant of incentive stock options and non-qualified stock options to our employees and directors. Options granted under the 2009 Plan generally have a term of ten years and generally vest and become exercisable at the rate of 33% after one year and 33% on the second and third anniversaries of the option grant dates. Historically, some stock option grants have included shorter vesting periods ranging from one to two years.

The estimated forfeiture rate considers historical turnover rates stratified into employee pools in comparison with an overall employee turnover rate, as well as expectations about the future. We periodically revise the estimated forfeiture rate in subsequent periods if actual forfeitures differ from those estimates. Compensation expense recorded under this method for the three and six months ended December 31, 2013 was \$65,266 and \$130,532, respectively, and reduced operating income and income before income taxes by the same amount by increasing compensation expense recognized in selling and administrative expense. The recognized tax benefit related to the compensation expense for the six months ended December 31, 2013 was approximately \$30,000.

A summary of the status of our stock options is presented below:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value
Outstanding as of June 30, 2013	1,153,170	\$ 1.16	5.49	\$ 627,422
Granted	–			
Exercised	–			
Cancelled	–			
Forfeited or Expired	(75,000 )	\$ 1.34	8.45	
Outstanding as of December 31, 2013	1,078,170	\$ 1.14	4.79	\$ 546,513

Exercisable as of December 31, 2013	811,499	\$ 1.08	3.95	\$463,845
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The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based upon the Company's closing stock price of \$1.65 as of December 31, 2013, which would have been received by the option holders had all option holders exercised their options as of that date. The weighted-average grant-date fair value of stock options outstanding as of December 31, 2013 in the amount of 1,092,978 shares was \$1.01 per share.

As of December 31, 2013, there was \$312,129 of total unrecognized compensation cost related to non-vested stock options granted. That cost is expected to be recognized over a weighted-average period of 0.96 years.

## NOTE 10 – RELATED PARTY TRANSACTIONS

We purchased wireless data products in the amounts of \$0 and \$8,800 from C-Motech, for the six months ended December 31, 2013 and 2012, respectively, and had related accounts payable of \$0 as of December 31, 2013 and 2012. As of December 31, 2013, C-Motech owns 1,566,672 shares, or 15%, of our outstanding Common Stock.

On July 27, 2010, we entered into a Common Stock Repurchase Agreement with C-Motech (the “Agreement”), under which we agreed to repurchase 3,370,356 shares of our Common Stock from C-Motech for \$3,500,000. A total of 1,803,684 shares were repurchased on the date of the Agreement in exchange for non-cash consideration in the amount of \$1,873,065, which represented amounts owed to the Company by C-Motech for certain marketing funds as well as the settlement of a price dispute for products previously purchased by the Company from C-Motech. Under the Agreement, the remaining 1,566,672 shares were to be repurchased by us upon payment of the balance, \$1,626,935, on or before December 31, 2010.

On January 28, 2011 (the “Amendment Date”) the Agreement was amended to reflect (1) a change in the date the 1,566,672 shares are to be repurchased from C-Motech from December 31, 2010 to March 31, 2011, and (2) a change to the non-cash consideration of \$1,873,065. In exchange for the 1,803,684 shares, we were to pay cash to C-Motech (in the same amount) for the shares, by March 31, 2011. In addition, in a separate agreement dated January 28, 2011, C-Motech agreed to pay us \$1,873,065, for amounts owed, by March 31, 2011. The purpose of these revisions was to more clearly differentiate each party’s payment obligations to the other with respect to this transaction. Following the Amendment Date, we paid C-Motech \$1,873,065 in exchange for the 1,803,684 shares previously transferred to us by C-Motech, and C-Motech paid us \$1,873,065 for amounts owed, of which \$1,581,457 was booked to other income and \$291,608 was booked to cost of goods sold. The repurchase of the remaining 1,566,672 shares has not been completed. We have provided formal notification to C-Motech that it is in breach of its obligations and we have also provided a demand to sell the shares back to us. We have attempted to tender payment for the shares without results, and as of the date of this filing, we are unable to determine whether or not this repurchase will take place. We have been advised that there are two individuals who claim to have purchased the shares from C-Motech through its former CEO; however, the authority of the former CEO to agree to the sale of the shares is being disputed by C-Motech. It is our understanding that this matter is currently being adjudicated in U.S. and Korean courts. As of the date of this Report, C-Motech is the registered owner of certificates representing 1,566,672 shares, which were issued by the Company in C-Motech’s name. On May 7, 2013, we filed a lawsuit against C-Motech in the Superior Court of California for the County of San Diego for breach of the Agreement and breach of other contracts between the parties relating to indemnification and other obligations.





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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our financial statements and related notes included elsewhere in this report. This report contains certain forward-looking statements relating to future events or our future financial performance. These statements are subject to risks and uncertainties which could cause actual results to differ materially from those discussed in this report. You are cautioned not to place undue reliance on this information, which speaks only as of the date of this report. We are not obligated to publicly update this information, whether as a result of new information, future events or otherwise, except to the extent we are required to do so in connection with our obligation to file reports with the SEC. For a discussion of the important risks to our business and future operating performance, see the discussion under the caption "Item 1A. Risk Factors" and under the caption "Factors That May Influence Future Results of Operations" in the Company's Form 10-K for the year ended June 30, 2013, filed on September 30, 2013. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this report might not occur.

### **BUSINESS OVERVIEW**

We are engaged in the design, manufacture and sale of broadband high speed wireless data communication products such as third generation ("3G") and fourth generation ("4G") wireless modules and modems. We focus primarily on wireless broadband Universal Serial Bus ("USB") modems, which provide a flexible way for consumers to connect to wireless broadband networks from laptop or desktop computers. Our broadband wireless data communication products are positioned at the convergence of wireless communications, mobile computing and the Internet, each of which we believe represents a growing market.

Our wireless products are based on Evolution Data Optimized technology ("EV-DO technology") of Code Division Multiple Access ("CDMA"), High-Speed Packet Access ("HSPA") technology of Wideband Code Division Multiple Access ("WCDMA"), Worldwide Interoperability for Microwave Access ("WiMAX") based on the IEEE 802.16 standard and Long Term Evolution (LTE) which enable end users to send and receive email with large file attachments, play interactive games, receive, send and download high resolution pictures, videos and music content.

We market our products directly to wireless operators, and indirectly through strategic partners and distributors. Our global customer base extends primarily from the United States to South American and Caribbean countries. Our USB modems are certified by Sprint, C-Spire Wireless, and other wireless operators located in the United States as well as Caribbean and South American countries and Asia.

### **FACTORS THAT MAY INFLUENCE FUTURE RESULTS OF OPERATIONS**

We believe that our revenue growth will be influenced largely by (1) the successful maintenance of our existing customers, (2) the rate of increase in demand for wireless data products, (3) customer acceptance of our new products, (4) new customer relationships and contracts, and (5) our ability to meet customers' demands.

We have entered into and expect to continue to enter into new customer relationships and contracts for the supply of our products, and this may require significant demands on our resources, resulting in increased operating, selling, and marketing expenses associated with such new customers.

### **CRITICAL ACCOUNTING POLICIES**

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of these financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. Management evaluates these estimates and assumptions on an ongoing basis. Our estimates and assumptions have been prepared on the basis of the most current reasonably available information. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates under different assumptions and conditions.

We have several critical accounting policies, which were described in our Annual Report on Form 10-K for the year ended June 30, 2013, that are both important to the portrayal of our financial condition and results of operations and require management's most difficult, subjective and complex judgments. Typically, the circumstances that make these judgments difficult, subjective and complex have to do with making estimates about the effect of matters that are inherently uncertain. There were no material changes to our critical accounting policies during the three months ended December 31, 2013.

**RESULTS OF OPERATIONS**

The following table sets forth, for the three and six months ended December 31, 2013 and 2012, our statements of operations including data expressed as a percentage of sales:

	Three Months Ended		Six Months Ended	
	December 31, 2013	2012	December 31, 2013	2012
Net Sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	70.8%	83.8%	75.4%	78.1%
Gross profit	29.2%	16.2%	24.6%	21.9%
Operating expenses	28.5%	39.9%	41.9%	21.9%
Income (loss) from operations	0.7%	(23.7% )	(17.3% )	0.0%
Other income (expense), net	2.1%	0.0%	1.6%	(0.3% )
Net income (loss) before income taxes	2.8%	(23.7% )	(15.7% )	(0.3% )
Income tax provision (benefit)	(0.1% )	(7.6% )	5.1%	0.9%
Net income (loss)	2.9%	(16.1% )	(10.6% )	(1.2% )
Non-controlling interest in net loss (income) of subsidiary	(1.2% )	2.7%	(0.2% )	1.3%
Net income (loss) attributable to parent company stockholders	1.7%	(13.4% )	(10.8% )	0.1%

**THREE MONTHS ENDED DECEMBER 31, 2013 COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2012**

**NET SALES** - Net sales increased by \$2,198,476, or 41.1%, to \$7,553,845 for the three months ended December 31, 2013 from \$5,355,369 for the corresponding period of 2012. For the three months ended December 31, 2013, net sales by geographic regions, consisting of South America and the Caribbean, the United States, EMEA (Europe, the Middle East and Africa) and Asia, were \$1,836,500 (24.3% of net sales), \$4,002,728 (53.0% of net sales), \$461,521 (6.1% of net sales) and \$1,253,096 (16.6% of net sales), respectively. For the three months ended December 31, 2012, net sales by geographic regions, consisting of South America and the Caribbean, the United States, EMEA (Europe, the Middle East and Africa) and Asia, were \$628 (0.0% of net sales), \$5,063,619 (94.6% of net sales), \$0 (0.0% of net sales) and \$291,122 (5.4% of net sales), respectively.

Net sales in the South American and Caribbean regions increased by \$1,835,872, to \$1,836,500 for the three months ended December 31, 2013 from \$628 for the corresponding period of 2012. The increase in net sales was primarily due to the general nature of sales in these regions, which often fluctuate significantly from period to period due to timing of orders placed by a relatively small number of customers. Net sales in the United States decreased by \$1,060,891, or 21.0%, to \$4,002,728 for the three months ended December 31, 2013 from \$5,063,619 for the corresponding period of 2012. The decrease in net sales was primarily due to lower market demand for USB modems. Net sales in EMEA increased by \$461,521 to \$461,521 for the three months ended December 31, 2013 from \$0 for the corresponding period of 2012. The increase in net sales was due to the addition of a new carrier customer in Africa. Net sales in Asia increased by \$961,974, or 330.4%, to \$1,253,096 for the three months ended December 31, 2013 from \$291,122 for the corresponding period of 2012. The increase in net sales was primarily due to the higher product and component sales generated by FTI, which typically vary from period to period.

**GROSS PROFIT** – Gross profit increased by \$1,340,478, or 154.4%, to \$2,208,530 for the three months ended December 31, 2013 from \$868,052 for the corresponding period of 2012. The increase was primarily due to a sale in South America that had a high margin relative to other sales. In addition, the increase in net sales as indicated above had a favorable effect on gross profit. The gross profit in terms of net sales percentage was 29.2% for the three months ended December 31, 2013 compared to 16.2% for the corresponding period of 2012. The increase in gross profit in terms of net sales percentage was due to the sale in South America as well as variations in customer and product mix, competitive selling prices and product costs which generally vary from period to period and region to region. In addition, because certain fixed costs relating to amortization of intangible assets are included in cost of goods sold, the gross profit for the quarter ending December 31, 2013 was favorably affected by this due to higher net sales compared to the quarter ending December 31, 2012.

**OPERATING EXPENSES** - Operating expenses increased by \$21,866, or 1.0%, to \$2,156,367 for the three months ended December 31, 2013 from \$2,134,501 for the corresponding period of 2012. Increases in commissions paid to third parties and shipping expense due to higher sales volumes were partially offset by decreases in research and development, payroll and payroll related costs and share-based compensation expense.

**OTHER INCOME (LOSS), NET** - Other income (loss), net increased by \$161,181 to \$161,542 for the three months ended December 31, 2013 from \$361 for the corresponding period of 2012. The increase was primarily due to the reversal of expenses associated with certain marketing related activities that were accrued in prior periods which expired during the three months ended December 31, 2013.

**SIX MONTHS ENDED DECEMBER 31, 2013 COMPARED TO SIX MONTHS ENDED DECEMBER 31, 2012**

**NET SALES** - Net sales decreased by \$9,531,499, or 51.5%, to \$8,960,948 for the six months ended December 31, 2013 from \$18,492,447 for the corresponding period of 2012. For the six months ended December 31, 2013, net sales by geographic regions, consisting of South America and the Caribbean, the United States, EMEA (Europe, the Middle East and Africa) and Asia, were \$1,839,080 (20.5% of net sales), \$5,082,241 (56.7% of net sales), \$760,137 (8.5% of net sales) and \$1,279,490 (14.3% of net sales), respectively. For the six months ended December 31, 2012, net sales by geographic regions, consisting of South America and the Caribbean, the United States, EMEA (Europe, the Middle East and Africa) and Asia, were \$746,928 (4.0% of net sales), \$17,015,711 (92.0% of net sales), \$0 (0.0% of net sales) and \$729,808 (4.0% of net sales), respectively.

Net sales in the South American and Caribbean regions increased by \$1,092,152, or 146.2%, to \$1,839,080 for the six months ended December 31, 2013 from \$746,928 for the corresponding period of 2012. The increase was primarily due to the general nature of sales in these regions, which often fluctuate significantly from period to period due to timing of orders placed by a relatively small number of customers. Net sales in the United States decreased by \$11,933,470, or 70.1%, to \$5,082,241 for the six months ended December 31, 2013 from \$17,015,711 for the corresponding period of 2012. The decrease in net sales was due to several factors including lower market demand for USB modems, and the discontinuation of a chipset used as a component in one of the Company's products, which negatively affected sales during the six months ended December 31, 2013. In addition, a large customer who purchased one of the Company's products during the six months ended December 31, 2012, did not make any repeat purchases during the same period in 2013. Net sales in EMEA increased by \$760,137 to \$760,137 for the six months ended December 31, 2013 from \$0 for the corresponding period of 2012. The increase in net sales was due to the addition of a new carrier customer in Africa. Net sales in Asia increased by \$549,682, or 75.3%, to \$1,279,490 for the six months ended December 31, 2013 from \$729,808 for the corresponding period of 2012. The increase in net sales was primarily due to higher product and component sales generated by FTI, which typically vary from period to period.

**GROSS PROFIT** - Gross profit decreased by \$1,842,656, or 45.5%, to \$2,205,338 for the six months ended December 31, 2013 from \$4,047,994 for the corresponding period of 2012. The decrease was primarily due to the change in net sales as indicated above. The gross profit in terms of net sales percentage was 24.6% for the six months ended December 31, 2013 compared to 21.9% for the corresponding period of 2012. The increase in gross profit in terms of net sales percentage was due to variations in customer and product mix, competitive selling prices and product costs which generally vary from period to period and region to region.

**OPERATING EXPENSES** - Operating expenses decreased by \$299,756, or 7.4%, to \$3,757,241 for the six months ended December 31, 2013 from \$4,056,997 for the corresponding period of 2012. The decrease was due to several factors including lower shipping costs (due to lower sales volumes) and expenses relating to employee compensation

and third party product development.

**OTHER INCOME (LOSS), NET** - Other income (loss), net increased by \$192,994 to \$141,741 for the six months ended December 31, 2013 from (\$51,183) for the corresponding period of 2012. The increase was primarily due to the reversal of expenses associated with certain marketing related activities that were accrued in prior periods which expired during the three months ended December 31, 2013. The increase was also due to lower miscellaneous expenses incurred by FTI.

## **LIQUIDITY AND CAPITAL RESOURCES**

Our historical operating results, capital resources and financial position, in combination with current projections and estimates, were considered in management's plan and intentions to fund our operations over a reasonable period of time, which we define as the twelve month period ending December 31, 2014. For purposes of liquidity disclosures, we assess the likelihood that we have sufficient available working capital and other principal sources of liquidity to fund our operating activities and obligations as they become due.

Our principal source of liquidity as of December 31, 2013 consisted of cash and cash equivalents of \$10,194,158. We believe we have sufficient available capital to cover our existing operations and obligations through at least December 31, 2014. Our long-term future cash requirements will depend on numerous factors, including our revenue base, profit margins, product development activities, market acceptance of our products, future expansion plans and ability to control costs. If we are unable to achieve our current business plan or secure additional funding that may be required, we would need to curtail our operations or take other similar actions outside the ordinary course of business in order to continue to operate as a going concern.

**OPERATING ACTIVITIES** – Net cash provided by operating activities for the six months ended December 31, 2013 and 2012 was \$386,511 and \$6,166,150, respectively.

The \$386,511 in net cash provided by operating activities for the six months ended December 31, 2013 was primarily due to the decrease in accounts receivable of \$1,488,139, which was partially offset by the increases in inventory and prepaid expenses of \$297,207 and \$142,135, respectively, and the decrease in accrued liability of \$235,714. The \$6,166,150 in net cash provided by operating activities for the six months ended December 31, 2012 was primarily due to the decreases in accounts receivable and inventory of \$10,955,998 and \$1,087,628, respectively, and the non-cash charge for amortization \$658,743, which were partially offset by the decrease in accounts payable of \$6,230,934.



**INVESTING ACTIVITIES** – Net cash used in investing activities for the six months ended December 31, 2013 and 2012 was \$532,950 and \$1,269,045, respectively.

The \$532,950 in net cash used in investing activities for the six months ended December 31, 2013 was primarily due to payments for capitalized development costs of \$521,068, which was partially offset by the repayment of a loan from a third party of \$95,428. We capitalize product development and certification costs because such products are expected to be sold in future periods and provide economic benefit to the Company. We capitalize product development and certification costs because such products are expected to be sold in future periods and provide economic benefit to the Company.

The \$1,269,045 in net cash used in investing activities for the six months ended December 31, 2012 was primarily due to the payments for capitalized product development and purchases of intangible assets (primarily for new product certification efforts) of \$358,630 and \$615,279, respectively, and the purchase of fixed assets of \$292,796.

**FINANCING ACTIVITIES** – Net cash used in financing activities for the six months ended December 31, 2013 and 2012 was \$0 and \$2,383,914.

The \$2,383,914 in net cash used in financing activities for the six months ended December 31, 2012 was primarily due to the repurchase of our Common Stock from the Sherman Group in the amount of \$2,406,414. Under the terms of the Stock Repurchase Agreement, we agreed to repurchase 1,538,602 shares of our Common Stock from the members of the Sherman Group for a purchase price of \$2,831,028, or \$1.84 per share, representing a premium of \$440,000 from the market price on the date of the Agreement, which was recorded in operating expenses in the period ending June 30, 2012. In addition to the purchase price, a commission of \$15,386 associated with this repurchase was recorded as a reduction of capital.

## **CONTRACTUAL OBLIGATIONS AND OTHER COMMITMENTS**

### **Leases**

We lease approximately 11,318 square feet of office space in San Diego, California, at a monthly rent of \$16,576, and the lease expires on August 31, 2015. In addition to monthly rent, the lease provides for periodic cost of living increases in the base rent. Rent expense related to the operating leases was \$49,728 for the three months ended



December 31, 2013 and 2012, and \$99,456 for the six months ended December 31, 2013 and 2012. Our facility is covered by an appropriate level of insurance and we believe it to be suitable for our use and adequate for our present needs.

Our Korea-based subsidiary, Franklin Technology, Inc. (“FTI”), leases approximately 10,000 square feet of office space in Seoul, Korea, at a monthly rent of approximately \$8,000, and the lease expires on September 1, 2015. In addition to monthly rent, the lease provides for periodic cost of living increases in the base rent and payment of common area costs. The facility is covered by an appropriate level of insurance and we believe it to be suitable for our use and adequate for our present needs. Rent expense related to the operating lease was approximately \$24,000 for the three months ended December 31, 2013 and 2012, and approximately \$48,000 for the six months ended December 31, 2013 and 2012.

We lease two corporate housing facilities for our vendors and employees who travel, under non-cancelable operating leases that expire on September 13, 2014, and July 31, 2014, respectively. Rent expense related to the operating leases was \$5,488 and \$5,460 for the three months ended December 31, 2013 and 2012, respectively, and \$10,932 and \$10,807 for the six months ended December 31, 2013 and 2012, respectively.

## Contingency

On July 27, 2010, we entered into a Common Stock Repurchase Agreement with C-Motech (the “Agreement”), under which we agreed to repurchase 3,370,356 shares of our Common Stock from C-Motech for \$3,500,000. A total of 1,803,684 shares were repurchased on the date of the Agreement in exchange for non-cash consideration in the amount of \$1,873,065, which represented amounts owed to the Company by C-Motech for certain marketing funds as well as the settlement of a price dispute for products previously purchased by the Company from C-Motech. Under the Agreement, the remaining 1,566,672 shares were to be repurchased by us upon payment of the balance, \$1,626,935, on or before December 31, 2010.

On January 28, 2011 (the “Amendment Date”) the Agreement was amended to reflect (1) a change in the date the 1,566,672 shares are to be repurchased from C-Motech from December 31, 2010 to March 31, 2011, and (2) a change to the non-cash consideration of \$1,873,065. In exchange for the 1,803,684 shares, we were to pay cash to C-Motech (in the same amount) for the shares, by March 31, 2011. In addition, in a separate agreement dated January 28, 2011, C-Motech agreed to pay us \$1,873,065, for amounts owed, by March 31, 2011. The purpose of these revisions was to more clearly differentiate each party’s payment obligations to the other with respect to this transaction. Following the Amendment Date, we paid C-Motech \$1,873,065 in exchange for the 1,803,684 shares previously transferred to us by C-Motech, and C-Motech paid us \$1,873,065 for amounts owed, of which \$1,581,457 was booked to other income and \$291,608 was booked to cost of goods sold. The repurchase of the remaining 1,566,672 shares has not been completed. We have provided formal notification to C-Motech that it is in breach of its obligations and we have also provided a demand to sell the shares back to us. We have attempted to tender payment for the shares without results, and as of the date of this filing, we are unable to determine whether or not this repurchase will take place. We have been advised that there are two individuals who claim to have purchased the shares from C-Motech through its former CEO; however, the authority of the former CEO to agree to the sale of the shares is being disputed by C-Motech. It is

our understanding that this matter is currently being adjudicated in U.S. and Korean courts. As of the date of this Report, C-Motech is the registered owner of certificates representing 1,566,672 shares, which were issued by the Company in C-Motech's name. On May 7, 2013, we filed a lawsuit against C-Motech in the Superior Court of California for the County of San Diego for breach of the Agreement and breach of other contracts between the parties relating to indemnification and other obligations.

As of December 31, 2013, C-Motech owns 1,566,672 shares, or 15%, of our Common Stock.

## **Change of Control Agreements**

On September 21, 2009 we entered into Change of Control Agreements with OC Kim, our President and Acting Chief Financial Officer, Yun J. (David) Lee, our Chief Operating Officer, and Yong Bae Won, our Vice President, Engineering. Each Change of Control Agreement provides for a lump sum payment to the officer in case of a change of control of the Company. The term includes the acquisition of Common Stock of the Company resulting in one person or company owning more than 50% of the outstanding shares, a significant change in the composition of the Board of Directors of the Company during any 12-month period, a reorganization, merger, consolidation or similar transaction resulting in the transfer of ownership of more than fifty percent (50%) of the Company's outstanding Common Stock, or a liquidation or dissolution of the Company or sale of substantially all of the Company's assets.

The Change of Control Agreement with Mr. Kim is for three years and calls for a payment of \$5 million upon a change of control; the agreement with Mr. Lee is for two years and calls for a payment of \$2 million upon a change of control; and the agreement with Mr. Won is for two years and calls for a payment of \$1 million upon a change of control.

On September 15, 2011, the Board of Directors approved extending the Change of Control Agreements with OC Kim, our President and Acting Chief Financial Officer, Yun J. (David) Lee, our Chief Operating Officer, and Yong Bae Won, our Vice President, Engineering for an additional three years. Following this approval, the Change of Control Agreement with Mr. Kim will expire on September 21, 2015 and the Change of Control Agreements with Messrs. Lee and Won will expire on September 21, 2014.

## **OFF-BALANCE SHEET ARRANGEMENTS**

None.

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

As a "smaller reporting company," the Company is not required to respond to this item.

## **ITEM 4. CONTROLS AND PROCEDURES**

### Disclosure Controls and Procedures

The Company's President and Acting Chief Financial Officer has concluded, based on an evaluation of the Company's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15(d)-15(e)), that such disclosure controls and procedures were effective as of the end of the period covered by this report.

### Changes in Internal Control Over Financial Reporting

There has been no change in the Company's internal control over financial reporting during the three months ended December 31, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II – OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

We have provided information about legal proceedings in which we are involved in Note 8 of the notes to consolidated financial statements for the six months ended December 31, 2013, contained within this Quarterly Report on Form 10-Q.

### **ITEM 1A. RISK FACTORS**

Our Annual Report on Form 10-K for the fiscal year ended June 30, 2013, filed with the SEC on September 30, 2013 (the "Annual Report"), includes a detailed discussion of our risk factors under the heading "PART I, ITEM 1A – RISK FACTORS." You should carefully consider the risk factors discussed in our Annual Report, as well as other information in this quarterly report. Any of these risks could cause our business, financial condition, results of operations and future growth prospects to suffer. We are not aware of any material changes from the risk factors previously disclosed.

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

None.

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**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

None.

**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.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Schema Document
- 101.CAL XBRL Calculation Linkbase Document
- 101.DEF XBRL Definition Linkbase Document
- 101.LAB XBRL Label Linkbase Document
- 101.PRE XBRL Presentation Linkbase Document

**SIGNATURES**

In accordance with Section 13 of 15(d) of the Exchange Act, the registrant 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 14, 2014

