FULLNET COMMUNICATIONS INC
Form 10-Q
August 14, 2008

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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, 2008

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 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 12, 2008, 7,425,565 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, 2008 (Unaudited)	DECEMBER 31, 2007 (Derived from Audited Statements)
ASSETS		
CURRENT ASSETS		
Cash	$ 11,901	$ 15,369
Accounts receivable, net	15,657	25,968
Prepaid expenses and other current assets	27,644	62,271
Total current assets	55,202	103,608
PROPERTY AND EQUIPMENT, net	431,357	507,968
INTANGIBLE ASSETS, net	16,648	25,553
OTHER ASSETS	5,250	5,250
TOTAL	$ 508,457	$ 642,379
LIABILITIES AND STOCKHOLDERS DEFICIT		
CURRENT LIABILITIES		
Accounts payable trade	$ 214,562	$ 176,014
Accounts payable related party, current portion	5,988	5,988
Accrued and other current liabilities	1,059,245	1,017,223
Accrued interest related party, current portion	34,800	34,800
Notes payable, current portion	510,636	510,636
Notes payable related party, current portion	34,800	34,800
Deferred revenue	116,563	112,586
Total current liabilities	1,976,594	1,892,047
ACCOUNTS PAYABLE related party, less current portion	255,172	264,154
ACCRUED INTEREST related party, less current portion	176,550	181,397
NOTES PAYABLE related party, less current portion	264,900	285,200
OTHER LIABILITIES	29,454	44,452
Total liabilities	2,702,670	2,667,250

STOCKHOLDERS DEFICIT		
Common stock $.00001 par value; authorized, 10,000,000 shares; issued and outstanding, 7,355,308 and 6,670,878 shares in 2008 and 2007, respectively	75	68
Common stock issuable, 70,257 shares in 2008 and 2007	57,596	57,596
Additional paid-in capital	8,378,381	8,350,254
Accumulated deficit	(10,630,265)	(10,432,789)
Total stockholders deficit	(2,194,213)	(2,024,871)
TOTAL	$ 508,457	$ 642,379

See accompanying notes to condensed consolidated financial statements.

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FullNet Communications, Inc. and Subsidiaries
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
REVENUES				
Access service revenues	$ 136,891	$ 163,800	$ 280,238	$ 325,653
Co-location and other revenues	330,821	310,329	674,658	610,447
Total revenues	467,712	474,129	954,896	936,100
OPERATING COSTS AND EXPENSES				
Cost of access service revenues	60,466	56,014	116,985	109,879
Cost of co-location and other revenues	78,237	82,653	159,761	160,781
Selling, general and administrative expenses	332,367	318,419	698,501	659,467
Depreciation and amortization	61,312	74,834	129,806	149,426
Total operating costs and expenses	532,382	531,920	1,105,053	1,079,553
LOSS FROM OPERATIONS	(64,670)	(57,791)	(150,157)	(143,453)
INTEREST EXPENSE	(23,855)	(24,362)	(47,319)	(49,024)
NET LOSS	$ (88,525)	$ (82,153)	$ (197,476)	$ (192,477)
Net loss per share basic	$ (.01)	$ (.01)	$ (.03)	$ (.03)
Net loss per share assuming dilution	$ (.01)	$ (.01)	$ (.03)	$ (.03)
Weighted average shares outstanding basic	7,425,565	6,741,135	7,147,991	6,741,135
Weighted average shares outstanding assuming dilution	7,425,565	6,741,135	7,147,991	6,741,135

See accompanying notes to condensed consolidated financial statements.

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FullNet Communications, Inc. and Subsidiaries
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS DEFICIT (UNAUDITED)
Six Months Ended June 30, 2008

	Common stock Shares	Common stock Amount	Common Stock Issuable	Additional Paid In Capital	Accumulated Deficit	Total
Balance at January 1, 2008	6,670,878	$ 68	$ 57,596	$ 8,350,254	$ (10,432,789)	$ (2,024,871)
Stock compensation expense				85		85
Options exercise	684,430	7		28,042		28,049
Net loss					(197,476)	(197,476)
Balance at June 30, 2008	7,355,308	$ 75	$ 57,596	$ 8,378,381	$ (10,630,265)	$ (2,194,213)

See accompanying notes to the 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, 2008	June 30, 2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$ (197,476)	$ (192,477)
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation and amortization	129,806	149,426
Stock compensation	85	77
Provision for uncollectible accounts receivable	1,477	1,768
Net (increase) decrease in		
Accounts receivable	8,834	8,790
Prepaid expenses and other current assets	34,627	2,908
Net increase (decrease) in		
Accounts payable trade	38,548	(14,940)
Accounts payable related party	(8,982)	36,530
Accrued and other liabilities	27,025	72,812
Accrued interest related party	(4,847)	15,869
Deferred revenue	3,977	9,899
Net cash provided by operating activities	33,074	90,662
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(44,291)	(40,842)
Acquisition of assets		(910)
Net cash used in investing activities	(44,291)	(41,752)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on borrowings under notes payable		(49,487)
Principal payments on borrowings under notes payable related party	(20,300)	
Proceeds from exercise of options	28,049	
Net cash provided by (used in) financing activities	7,749	(49,487)
NET DECREASE IN CASH	(3,468)	(577)
Cash at beginning of period	15,369	16,007
Cash at end of period	$ 11,901	$ 15,430

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION				
Cash paid for interest	$	22,033	$	6,660

See accompanying notes to the 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, 2007.

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, 2008. Certain reclassifications have been made to prior period balances to conform with the presentation for the current period.

2. MANAGEMENT S PLANS

At June 30, 2008, current liabilities exceed current assets by $1,921,392. 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. The Company is in default on various loans (see Note 9. Notes Payable). These factors raise substantial doubts about the Company s ability to continue as a going concern.

During September 2005, the Company received a back billing from AT&T (formerly SBC) of approximately $230,000. Since then, the Company has received a number of additional back billings from AT&T that total in excess of $7,900,000. The Company believes AT&T has no basis for these charges, has reviewed these billings with its attorneys and is vigorously disputing the charges. Therefore, the Company has not recorded any expense or liability related to these billings.

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 of its Internet access services through mergers and acquisitions and the development of its web hosting, co-location, and traditional telephone services. 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 raise additional capital on satisfactory terms or at all.

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3. USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures; accordingly, actual results could differ from those estimates.

4. LOSS PER SHARE

Loss per share basic is calculated by dividing net loss by the weighted average number of shares of stock outstanding during the period, including shares issuable without additional consideration. Loss per share assuming dilution is calculated by dividing net loss by the weighted average number of shares outstanding during the period adjusted for the effect of dilutive potential shares calculated using the treasury stock method.

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Numerator:				
Net loss	$ (88,525)	$ (82,153)	$ (197,476)	$ (192,477)
Denominator:				
Weighted average shares outstanding basic	7,425,565	6,741,135	7,147,991	6,741,135
Effect of dilutive stock options				
Effect of dilutive warrants				
Weighted average shares outstanding assuming dilution	7,425,565	6,741,135	7,147,991	6,741,135
Net loss per share basic	$ (.01)	$ (.01)	$ (.03)	$ (.03)
Net loss per share assuming dilution	$ (.01)	$ (.01)	$ (.03)	$ (.03)

Basic and diluted losses per share were the same for the three and six months ended June 30, 2008 and 2007 because there was a net loss for each period.

5. ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

	June 30, 2008	December 31, 2007
Accounts receivable	$ 204,882	$ 213,716
Less allowance for doubtful accounts	(189,225)	(187,748)
	$ 15,657	$ 25,968

6. PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	June 30, 2008	December 31, 2007
Computers and equipment	$ 1,464,468	$ 1,420,177
Leasehold improvements	965,864	965,864
Software	57,337	57,337
Furniture and fixtures	28,521	28,521
	2,516,190	2,471,899
Less accumulated depreciation	(2,084,833)	(1,963,931)
	$ 431,357	$ 507,968

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Depreciation expense for the three months ended June 30, 2008 and 2007 was $57,188 and $68,915, respectively. Depreciation expense for the six months ended June 30, 2008 and 2007 was $120,902 and $137,197, respectively.

7. INTANGIBLE ASSETS

Intangible assets consist primarily of acquired customer bases and covenants not to compete and are carried net of accumulated amortization. Upon initial application of Statement of Financial Accounting Standard (SFAS) No. 142, *Goodwill and Intangible Assets,* as of January 1, 2002, the Company reassessed useful lives and began amortizing these intangible assets over their estimated useful lives and in direct relation to any decreases in the acquired customer bases to which they relate. Management believes that such amortization reflects the pattern in which the economic benefits of the intangible asset are consumed or otherwise used.

Amortization expense for the three months ended June 30, 2008 and 2007 relating to intangible assets was $4,124 and $5,919, respectively. Amortization expense for the six months ended June 30, 2008 and 2007 relating to intangible assets was $8,904 and $12,229, respectively.

8. ACCRUED AND OTHER CURRENT LIABILITIES

Accrued and other current liabilities consist of the following:

	June 30, 2008	December 31, 2007
Accrued interest	$ 378,390	$ 349,561
Accrued deferred compensation	505,670	506,990
Accrued other liabilities	175,185	160,672
	$ 1,059,245	$ 1,017,223

9. NOTES PAYABLE

Notes payable consist of the following: