FRANKLIN ELECTRONIC PUBLISHERS INC
Form 10-Q
August 13, 2001

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For Quarter ended June 30, 2001 Commission File No. 0-14841

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED
(Exact name of registrant as specified in its charter)

Pennsylvania	22-2476703
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One Franklin Plaza, Burlington, New Jersey 08016-4907
(Address of principal executive office)

Registrant's telephone number (609) 386-2500

Indicate by check mark whether 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 Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ___

COMMON STOCK OUTSTANDING AS OF
JUNE 30, 2001 - 7,949,082 SHARES

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

June 30,
2001

(Unaudited)

ASSETS

CURRENT ASSETS:	
Cash and cash equivalents	$ 3,571
Accounts receivable, less allowance for doubtful accounts of $1,095 and $1,161	10,109
Preferred stock subscriptions receivable	--
Inventories	23,109
Income tax receivable	568
Prepaids and other assets	2,481
TOTAL CURRENT ASSETS	39,838
PROPERTY AND EQUIPMENT	7,544
OTHER ASSETS:	
Deferred income tax asset	5,700
Trademark, less accumulated amortization of $1,846 and $1,749	13,701
Advance royalties and licenses	1,247
Software development costs	6,547
Other assets	2,871
TOTAL OTHER ASSETS	30,066
TOTAL ASSETS	$ 77,448

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:	
Accounts payable and accrued expenses	$ 13,473
Notes payable	2,000
Current portion of long-term liabilities - Other	406
TOTAL CURRENT LIABILITIES	15,879
LONG-TERM LIABILITIES	
Notes payable	8,329
Revolving credit facility	2,735
Other liabilities	2,009
TOTAL LONG-TERM LIABILITIES	13,073
SHAREHOLDERS' EQUITY:	
Preferred stock, $2.50 par value, authorized 10,000,000 shares 3,500 issued and outstanding	3,500
Preferred stock subscribed	--
Common stock, no par value, authorized 50,000,000 shares, issued and outstanding, 7,949,082 and 7,952,882 shares	49,803
Retained earnings (deficit)	(3,309)
Foreign currency translation adjustment	(1,498)
TOTAL SHAREHOLDERS' EQUITY	48,496
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 77,448

========

See notes to consolidated financial statements

2

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED
AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS
(in thousands, except for per share data)
(unaudited)

	Three Months Ended June 30, 2001	Three Months Ended June 30, 2000
SALES	$ 16,009	$ 17,052
COST OF SALES	9,362	9,592
GROSS MARGIN	6,647	7,460
EXPENSES:		
Sales and marketing	4,853	3,331
Research and development	970	767
General and administrative	2,281	2,324
Total operating expenses	8,104	6,422
OPERATING INCOME (LOSS)	(1,457)	1,038
Interest expense	(374)	(404)
Interest and investment income	37	88
Other, net	(163)	(289)
INCOME (LOSS) BEFORE INCOME TAXES	(1,957)	433
INCOME TAX BENEFIT	--	--
NET INCOME (LOSS)	(1,957)	433
PREFERRED STOCK DIVIDEND	88	--
NET INCOME (LOSS) APPLICABLE TO COMMON STOCK	$ (2,045)	$ 433
NET INCOME (LOSS) PER COMMON SHARE:		
Basic	$ (0.26)	$ 0.05
Diluted	$ (0.26)	$ 0.05

WEIGHTED AVERAGE COMMON SHARES:		
Basic	7,953	7,914
Diluted	7,953	8,146

See notes to consolidated financial statements

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED
AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(in thousands, except for share data)

	Common Stock		Preferred Stock		Ret Ea
	Shares	Amount	Shares	Amount	
BALANCE - MARCH 31, 2001	7,952,882	$ 49,658	3,500	$ 3,500	$
Issuance of shares and amortization of deferred compensation expense for shares issued for services (unearned portion $21)	(3,800)	5	--	--	
Value of stock options granted	--	140			
Loss for the period	--	--	--	--	
Foreign currency translation adjustment	--	--	--	--	
BALANCE - JUNE 30, 2001 (unaudited)	7,949,082	$ 49,803	3,500	$ 3,500	$

* Comprehensive income, i.e., net income (loss), plus, or less, other comprehensive income, totaled ($1,927) for the three months ended June 30, 2001.

See notes to consolidated financial statements

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED
AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
(in thousands)
(unaudited)

	Three Months Ended June 30,	
	2001	2000

CASH FLOWS FROM OPERATING ACTIVITIES:		
NET INCOME (LOSS)	$(1,957)	$ 433
ADJUSTMENTS TO RECONCILE NET INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Depreciation and amortization	1,538	1,283
Provision for losses on accounts receivable	22	44
Stock issued for services	140	--
Source (use) of cash from change in operating assets and liabilities:		
Accounts receivable	2,009	(3,779)
Inventories	(2,229)	(638)
Prepaids and other assets	243	(328)
Accounts payable and accrued expenses	75	2,930
Other, net	41	9
NET CASH USED IN OPERATING ACTIVITIES	(118)	(46)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(230)	(263)
Software development costs	(1,395)	(567)
Change in other assets	(176)	(98)
NET CASH USED IN INVESTING ACTIVITIES	(1,801)	(928)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from revolving credit facility	(1,329)	--
Proceeds from issuance of preferred shares	3,500	--
Other liabilities	454	(16)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	2,625	(16)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	30	(129)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	736	(1,119)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	2,835	6,899
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 3,571	$ 5,780

See notes to consolidated financial statements

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Reference is made to the financial statements included in the Company's annual Report (Form 10-K) filed with the Securities and Exchange Commission for the year ended March 31, 2001.

The financial statements for the periods ended June 30, 2001 and 2000 are unaudited and include all adjustments necessary to a fair presentation of the results of operations for the periods then ended. All such adjustments are of a normal recurring nature. The results of the Company's operations for any interim period are not necessarily indicative of the results of the Company's operations for a full year.

OPERATIONS

The Company adopted FAS No. 131, "Disclosure about Segments of an Enterprise and Related Information", at March 31, 1999. FAS No. 131 establishes annual and interim reporting standards for an enterprise's operating segments and related disclosures about its products, services, geographic areas and major customers. Under FAS No. 131, the Company's operations are treated as one operating segment as it only reports profit and loss information on an aggregate basis to the chief operating decision maker of the Company. Information about the Company's product sales are as follows (in thousands):

	June 30,	
Product Sales	2001	2000
Reference	$11,857	$14,679
Rolodex	1,942	2,312
eBookMan	2,210	-
Other	-	61
Total Sales	$16,009	$17,052

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Approximate foreign sources of revenues including export sales were as follows (in thousands):

	June 30,	
Product Sales	2001	2000
Europe	$3,936	$5,929
Other International	1,095	1,098

For the three month periods ended June 30, 2001 and 2000, no customer accounted for more than 10% of the Company's revenues.

ISSUANCE OF PREFERRED STOCK

In April 2001, Dr. James H. Simons, the Company's Chairman of the Board, paid $3,500,000 for 3,500 shares of the Company's Series A 10% Convertible Preferred Stock for which he had subscribed in March 2001. For additional information regarding the Preferred Stock issue, refer to the financial statements included in the Company's annual Report (Form 10-K) for the year ended March 31, 2001

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142). SFAS No. 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. The provisions of this statement are required to be applied starting with fiscal years beginning after December 15, 2001 and applied to all goodwill and other intangible assets recognized in its financial statements at that date. The Company expects to adopt this standard for its fiscal year commencing April 1, 2002 and is currently evaluating the impact of SFAS 142 on its financial results.

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

RESULTS OF OPERATIONS

Three months ended June 30, 2001 compared with three months ended June 30, 2000:

Net Sales

Sales of $16,009,000 for the quarter ended June 30, 2001 were 6% lower than sales of $17,052,000 for the same quarter one year earlier. The decline resulted primarily from lower sales of reference products in Europe and lower sales to OEM customers, partially offset by sales of the eBookMan(R) product line which was launched in February 2001.

Gross Margin

Gross margin decreased to $6,647,000, or 42%, from $7,460,000, or 44%, last year as the Company's sales mix shifted from the higher margin reference product line to the lower margin ROLODEX(R) Electronics and eBookMan product lines. Reference products accounted for 74% of the Company's sales in the current quarter compared with 86% of sales last year.

Operating Expenses

Total operating expenses increased to $8,104,000 from $6,422,000 last year. Sales and marketing expenses increased to $4,853,000 (30% of sales) from last year's level of $3,331,000 (20% of sales) primarily as a result of costs associated with the launch of the Company's eBookMan product line including advertising and trade show expense, which increased to $1,994,000 from $953,000 last year, and personnel costs which increased to $1,616,000 in the current year from $1,290,000 last year. Research and development expenses increased to $970,000 (6% of sales) compared with $767,000 (4% of sales) in the prior year mainly due to increased expenses related to the eBookMan product line. General and administrative expenses were relatively unchanged at $2,281,000 (14% of sales) compared with $2,324,000 (14% of sales) last year. Interest expense declined to $374,000 from $404,000 in the prior year due to lower average borrowing levels during the quarter. In the current quarter, the Company incurred currency transaction losses of $163,000 compared with $289,000 last year.

Net Income

The Company reported a net loss of $1,957,000, or $0.26 per share, compared with income of $433,000, or $.05 per share last year. The loss resulted primarily from additional expenditures in connection with the eBookMan product line in anticipation of higher sales which did not meet projected levels.

Changes in Financial Condition

Inventories increased to $23,109,000 at end of the June quarter from $20,879,000 at March 31, 2001 in anticipation of higher sales in the seasonally active second and third quarters. Cash and cash equivalents amounted to $3,571,000 at June 30, 2001 compared with cash of $2,835,000 at March 31, 2001. Accounts receivable decreased to $10,109,000 from $12,094,000 at March 31 primarily due to the early receipt of payments from two of the Company's larger customers.

Liquidity and Capital Resources

In December 1999, the Company entered into a $25,000,000 secured financing facility with a commercial lender. The financing facility expires on December 7, 2002. Borrowings under the facility bear interest at the bank's prime rate plus 3/8% and are subject to certain financial covenants and restrictions on indebtedness, dividend payments, business combinations, and other related items. As of June 30, 2001, the Company had outstanding borrowings of $2,735,000 under this facility. As of June 30, 2001 the Company had a balance of $10,239,000 outstanding under its Senior Notes. A principal payment of $2,000,000 is due under the Senior Notes on March 31, 2002.

In March 2001, Dr. James H. Simons, the Company's Chairman of the Board, subscribed for 3,500 shares of the Company's Series A 10% Convertible Preferred Stock ("Convertible Preferred Stock") in consideration for the payment of $3,500,000. Each share of the Convertible Preferred Stock has a stated value ("Stated Value") of $1,000. The payment of $3,500,000 was received in April 2001.

Management believes that cash flow from operations and the secured financing facility will be adequate to provide for the Company's liquidity and capital needs for the foreseeable future. The Company has no material commitments for capital expenditures in the next twenty-four months.

PART II

ITEM 1. LEGAL PROCEEDINGS

The Company is subject to litigation from time to time in the ordinary course of its business. The Company does not believe that any such litigation is likely, individually or in the aggregate, to have a material adverse effect on the financial condition of the Company.

ITEM 2. CHANGES IN SECURITIES - NONE

ITEM 3. DEFAULT UPON SENIOR SECURITIES - NONE

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS - NONE

ITEM 5. OTHER INFORMATION - NONE

ROLODEX(R) is a registered trademark of Berol Corporation, a subsidiary of Newell Rubbermaid, Inc. Rocket eBook(TM) is a trademark of NuvoMedia, Inc.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K - NONE

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the

Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FRANKLIN ELECTRONIC PUBLISHERS,
INCORPORATED
Registrant

August 14, 2000	/s/ Barry J. Lipsky
Date	Barry J. Lipsky, President and Chief Executive Officer (Duly Authorized Officer)
August 14, 2000	/s/ Arnold D. Levitt
Date	Arnold D. Levitt, Senior Vice President, Chief Financial Officer, and Treasurer (Principal Financial and Accounting Officer)