FRANKLIN ELECTRONIC PUBLISHERS INC
Form 10-Q
August 14, 2008
**Table of Contents**

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D. C. 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: June 30, 2008**

**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 No. 001-13198**

# FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED

**(Exact Name of Registrant as Specified in Its Charter)**

| | |
|---|---|
| **Pennsylvania**<br>**(State or other Jurisdiction of**<br><br>**Incorporation or Organization)** | **22-2476703**<br>**(I.R.S. Employer**<br><br>**Identification No.)** |
| **One Franklin Plaza, Burlington, New Jersey**<br>**(Address of Principal Executive Office)** | **08016-4907**<br>**(Zip Code)** |

**(609) 386-2500**

**(Registrant s Telephone Number, Including Area Code)**

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 x 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 definition of accelerated filer , large 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 x

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

NUMBER OF SHARES OF COMMON STOCK, PAR VALUE $0.01 PER SHARE

OUTSTANDING AS OF AUGUST 1, 2008: **8,268,621**

**Table of Contents**

**FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED**

**FORM 10-Q**

**FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2008**

**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED**

**AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

**(in thousands, except share data)**

**(unaudited)**

| | June 30, 2008 | March 31, 2008 |
|---|---|---|
| **ASSETS** | | |
| **CURRENT ASSETS:** | | |
| Cash and cash equivalents | $ 9,444 | $ 11,824 |
| Accounts receivable, less allowance for doubtful accounts of $353 and $649 | 7,888 | 6,100 |
| Inventories | 10,384 | 9,262 |
| Prepaids and other assets | 1,093 | 1,017 |
| **TOTAL CURRENT ASSETS** | 28,809 | 28,203 |
| **PROPERTY AND EQUIPMENT** | 1,032 | 1,167 |
| **OTHER ASSETS:** | | |
| Deferred income tax asset | 5,700 | 5,700 |
| Trademark and goodwill | 2,839 | 2,265 |
| Software development costs | 1,962 | 2,052 |
| Other assets | 2,169 | 2,531 |
| **TOTAL OTHER ASSETS** | 12,670 | 12,548 |
| **TOTAL ASSETS** | $ 42,511 | $ 41,918 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| **CURRENT LIABILITIES:** | | |
| Accounts payable and accrued expenses | $ 9,777 | $ 7,896 |
| Current portion of long-term liabilities - Other | 126 | 103 |
| **TOTAL CURRENT LIABILITIES** | 9,903 | 7,999 |
| **OTHER LIABILITIES** | 1,067 | 1,219 |
| **DEFERRED REVENUE** | 364 | 451 |
| **DEFERRED GAIN ON SALE AND LEASEBACK** | 3,475 | 3,587 |
| **SHAREHOLDERS EQUITY:** | | |
| Common stock, $0.01 par value, authorized 50,000,000 shares, issued and outstanding, 8,270,196 and 8,265,196 shares | 83 | 83 |
| Additional paid in capital | 51,059 | 50,978 |

| | | |
|---|---|---|
| Retained earnings (deficit) | (23,247) | (22,084) |
| Foreign currency translation adjustment | (193) | (315) |
| **TOTAL SHAREHOLDERS EQUITY** | 27,702 | 28,662 |
| **TOTAL LIABILITIES AND SHAREHOLDERS EQUITY** | $ 42,511 | $ 41,918 |

See notes to consolidated financial statements.

Table of Contents

**FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED**

**AND SUBSIDIARIES**

**CONSOLIDATED STATEMENT OF OPERATIONS**

**(in thousands, except for per share data)**

**(unaudited)**

| | Three Months Ended June 30, 2008 | Three Months Ended June 30, 2007 |
|---|---|---|
| **SALES** | $ 11,993 | $ 13,675 |
| **COST OF SALES** | 6,129 | 6,878 |
| **GROSS MARGIN** | 5,864 | 6,797 |
| **EXPENSES:** | | |
| Sales and marketing | 3,559 | 4,048 |
| Research and development | 980 | 924 |
| General and administrative | 1,684 | 1,675 |
| Severance | 348 | |
| Total operating expenses | 6,571 | 6,647 |
| **OPERATING INCOME (LOSS)** | (707) | 150 |
| Interest income, net | 6 | 44 |
| Loss on Investment | (370) | |
| Other, net | (41) | (118) |
| **INCOME (LOSS) BEFORE INCOME TAXES** | (1,112) | 76 |
| **INCOME TAX PROVISION** | 51 | 8 |
| **NET INCOME (LOSS)** | (1,163) | 68 |
| **INCOME (LOSS) PER COMMON SHARE:** | | |
| Basic | $ (0.14) | $ 0.01 |
| Diluted | $ (0.14) | $ 0.01 |
| **WEIGHTED AVERAGE COMMON SHARES:** | | |
| Basic | 8,270 | 8,218 |
| Diluted | 8,380 | 8,403 |

See notes to consolidated financial statements.

Table of Contents

**FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED**

**AND SUBSIDIARIES**

**CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY**

**(in thousands, except for share data)**

| | Common Stock Shares | Common Stock Amount | Additional Paid in Capital | Retained Earnings | Accumulated Other Comprehensive Income * | Total Shareholders Equity |
|---|---|---|---|---|---|---|
| **BALANCE - MARCH 31, 2008** | 8,265,196 | $ 83 | $ 50,978 | $ (22,084) | $ (315) | $ 28,662 |
| Amortization of deferred compensation expense for shares and options issued for services | | | 75 | | | 75 |
| Issuance of common shares under employee stock option plan | 5,000 | | 6 | | | 6 |
| Income for the period | | | | (1,163) | | (1,163) |
| Foreign currency translation adjustment | | | | | 122 | 122 |
| **BALANCE - JUNE 30, 2008 (unaudited)** | 8,270,196 | $ 83 | $ 51,059 | $ (23,247) | $ (193) | $ 27,702 |

* Comprehensive income, i.e., net income (loss), plus, or less, the change in foreign currency balance sheet translation adjustments, totaled ($1,041) for the three months ended June 30, 2008.

See notes to consolidated financial statements.

5

Table of Contents

**FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED**

**AND SUBSIDIARIES**

**CONSOLIDATED STATEMENT OF CASH FLOWS**

**(in thousands)**

**(unaudited)**

| | Three Months Ended June 30, 2008 | Three Months Ended June 30, 2007 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | |
| NET INCOME (LOSS) | $ (1,163) | $ 68 |
| ADJUSTMENTS TO RECONCILE NET INCOME (LOSS) TO | | |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | | |
| Depreciation and amortization | 715 | 850 |
| Provision for losses on accounts receivable | 32 | 39 |
| Loss on disposal of property and equipment | | 1 |
| Non Cash Compensation | 75 | 56 |
| Source (use) of cash from change in operating assets and liabilities: | | |
| Accounts receivable | (1,819) | (2,853) |
| Inventories | (1,122) | (3,728) |
| Prepaids and other assets | (76) | (146) |
| Accounts payable and accrued expenses | 1,311 | 3,964 |
| Deferred revenue | (86) | (81) |
| Other, net | (1) | (5) |
| NET CASH USED IN OPERATING ACTIVITIES | (2,134) | (1,835) |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | |
| Purchase of property and equipment | (41) | (183) |
| Proceeds from sale of property and equipment | | 12 |
| Software development costs | (255) | (255) |
| Short term investments | | (17) |
| Change in other assets | (52) | (96) |
| NET CASH USED IN INVESTING ACTIVITIES | (348) | (539) |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | |
| Proceeds from issuance of common shares | 6 | 3 |
| Other liabilities | (27) | (34) |
| NET CASH USED IN FINANCING ACTIVITIES | (21) | (31) |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH | 123 | 98 |
| DECREASE IN CASH AND CASH EQUIVALENTS | (2,380) | (2,307) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 11,824 | 6,314 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $ 9,444 | $ 4,007 |

See notes to consolidated financial statements.

**Table of Contents**

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED

AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited, in thousands)

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, 2008.

The financial statements for the periods ended June 30, 2008 and 2007 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

Information regarding segments is presented in accordance with (SFAS No. 131), Disclosure about Segments of an Enterprise and Related Information. Based on the criteria outlined in SFAS No. 131, the Company s operating results are reported by geographical segments. The Company s profit and loss segments are reviewed by the chief operating decision maker of the Company. The assets are reported as one segment, and reported on an aggregate basis. The profit and loss information is provided below:

| **Quarter ended June 30, 2008** | **North America** | **Europe** | **Other International** | **Other Domestic** | **Corporate** | **Consolidated** |
|---|---|---|---|---|---|---|
| Sales | $ 6,618 | $ 3,992 | $ 1,252 | $ 131 | $ | $ 11,993 |
| Cost of sales | 3,137 | 1,805 | 557 | 28 | 602 | 6,129 |
| Gross margin | 3,481 | 2,187 | 695 | 103 | (602) | 5,864 |
| Operating expenses: | | | | | | |
| Sales and marketing | 1,707 | 836 | 231 | 100 | 685 | 3,559 |
| Research and development | | | | 103 | 877 | 980 |
| General and administrative | 59 | 284 | 105 | | 1,236 | 1,684 |
| Severance | 154 | | | | 194 | 348 |
| Total expense | 1,920 | 1,120 | 336 | 203 | 2,992 | 6,571 |
| Operating income (loss) | $ 1,561 | $ 1,067 | $ 359 | $ (100) | $ (3,594) | $ (707) |

| **Quarter ended June 30, 2007** | **North America** | **Europe** | **Other International** | **Other Domestic** | **Corporate** | **Consolidated** |
|---|---|---|---|---|---|---|
| Sales | $ 8,142 | $ 4,052 | $ 1,217 | $ 264 | $ | $ 13,675 |
| Cost of sales | 3,964 | 1,841 | 636 | 26 | 411 | 6,878 |
| Gross margin | 4,177 | 2,211 | 581 | 238 | (411) | 6,797 |
| Operating expenses: | | | | | | |
| Sales and marketing | 2,123 | 941 | 347 | 103 | 534 | 4,048 |
| Research and development | | | | 60 | 864 | 924 |
| General and administrative | 172 | 228 | 95 | | 1,180 | 1,675 |
| Total expense | 2,295 | 1,169 | 442 | 163 | 2,578 | 6,647 |

| Quarter ended June 30, 2007 | North America | Europe | Other International | Other Domestic | Corporate | Consolidated |
|---|---|---|---|---|---|---|
| Operating income (loss) | $ 1,882 | $ 1,042 | $ 139 | $ 75 | $ (2,989) | $ 150 |

For the three months ended June 30, 2008 and June 30, 2007 no customer accounted for more than 10% of the Company s revenue.

For the quarter ended June 30, 2008, three suppliers each accounted for more than 10% of the Company s purchases of inventory. The three suppliers individually accounted for 39%, 27% and 14% of inventory purchases.

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED

AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited, in thousands)

For the quarter ended June 30, 2007, three suppliers accounted for more than 10% of the Company s purchases of inventory. The three suppliers individually accounted for 27%, 26% and 16% of inventory purchases.

STOCK OPTIONS

Effective April 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment, which establishes accounting for stock-based awards exchanged for employee services. Under the provisions of SFAS No. 123(R), share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the employee s requisite service period (generally the vesting period of the equity grant). The Company amortizes stock-based compensation by using the straight-line method. The Company elected to adopt the modified prospective transition method as provided by SFAS No. 123(R). In accordance with the requirements of the modified prospective transition method, consolidated financial statements for prior year periods have not been restated to reflect the fair value method of expensing share-based compensation.

The fair value of each stock option award is estimated on the date of grant using the Black-Scholes option valuation model. The Black-Scholes model incorporates assumptions as to dividend yield, volatility, an appropriate risk-free interest rate and the expected life of the option. Many of these assumptions require management s judgment. The Company s volatility is based upon historical volatility of the Company s stock.

The results of operations for the three months ended June 30, 2008 include non-cash compensation expense of approximately $75 for the amortization of stock option expense.

ADOBE SYSTEMS INCORPORATED CONTRACT RENEWAL

On August 6, 2008 our Proximity Technology Division ( Proximity ) announced that Adobe Systems, Inc. ( Adobe ), the leading provider of graphic design and publishing software worldwide, has extended the term of its long standing license for four years beginning October 1, 2008 for Proximity s spelling error detection and correction, hyphenation, and thesaurus software. The Company will recognize revenue of $6.3 million over the initial four year extension. The agreements provide Adobe with a two year renewal option that if exercised would result in recognition of an additional $3.8 million in revenue over the two year extension period.

**Table of Contents**

LEGAL PROCEEDINGS

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

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED

AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited, in thousands)

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157 Fair Value Measurements ( SFAS 157 ). SFAS 157 provides a new single authoritative definition of fair value and provides enhanced guidance for measuring the fair value of assets and liabilities and requires additional disclosures related to the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company does not believe that SFAS 157 will have a material impact on its financial position, results of operations, or cash flows.

In February 2007, the FASB issued SFAS No. 159 ( SFAS 159 ), The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of SFAS No. 115 . SFAS 159 which allows measurement at fair value of eligible financial assets and liabilities that are not otherwise measured at fair value. If the fair value option for an eligible item is elected, unrealized gains and losses for that item shall be reported in current earnings at each subsequent reporting date. SFAS No. 159 also establishes presentation and disclosure requirements designed to draw comparison between the different measurements attributes the Company elects for similar types of assets and liabilities. This statement is effective for fiscal years beginning after November 15, 2007. The Company does not believe that SFAS No. 159 will have a material impact on its financial position, results of operations, or cash flows.

In December 2007, the FASB issued SFAS No. 141(R), Business Combination ( SFAS 141(R)). SFAS 141(R) requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. This statement is effective for fiscal years beginning after December 15, 2008. The Company does not believe that SFAS No. 141(R) will have a material impact on its financial position, results of operations, or cash flows.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interest In Consolidated Financial Statements (SFAS 160). SFAS 160 requires all entities to report noncontrolling (minority) interests in subsidiaries in the same way as equity in the consolidated financial statements. Moreover, SFAS 160 eliminates the diversity that currently exists in accounting for transactions between an entity and noncontrolling interests by requiring they be treated as equity transactions. This statement is effective for fiscal years beginning after December 15, 2008. The Company does not believe that SFAS No. 160 will have a material impact on its financial position, results of operations, or cash flows.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (SFAS 161). This statement is intended to improve transparency in financial reporting by requiring enhanced disclosures of an entity s derivative instruments and hedging activities and their effects on the entity s financial position, financial performance, and cash flows. SFAS 161 applies to all derivative instruments within the scope of SFAS 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133) as well as related hedged items, bifurcated derivatives, and nonderivative instruments that are designated and qualify as hedging instruments. Entities with instruments subject to SFAS 161 must provide more robust qualitative disclosures and expanded quantitative disclosures. SFAS 161 is effective prospectively for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application permitted. The Company does not believe that SFAS 161 will have a material impact on its financial positions, results of operations, or cash flows.

Table of Contents

**ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (in thousands)**

This 2008 Quarterly Report on Form 10-Q may contain statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Those statements include statements regarding the intent and belief or current expectations of Franklin and its management team. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those projected in the forward-looking statements. Such risks and uncertainties include, among other things, the timely availability and acceptance of new electronic books and other electronic products, changes in technology, the successful integration of any acquisitions, the impact of competitive electronic products, the management of inventories, dependence on key licenses, titles and products, dependence on sales to a small group of customers, dependence on third party component suppliers and manufacturers, including those that provide Franklin-specific parts, credit risk and other risks and uncertainties that may be detailed herein, and from time-to-time, in Franklin s reports filed with the Securities and Exchange Commission. Franklin undertakes no obligation to publicly update any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

**RESULTS OF OPERATIONS**

**Overview**

For the quarter ended June 30, 2008, net income decreased by $1,231 to a loss of $1,163 from a profit of $68 in the same period last year. The decrease is primarily due to lower sales in our U.S. consumer division partially offset by decreased operating expense of $76 as well as to one time charges totaling $718 relating to separation pay from our cost cutting initiative of $348 earlier in the 2008 quarter and an investment loss of $370 resulting from the liquidation by its sponsor of a short-term fixed income fund.

**Three months ended June 30, 2008 compared with three months ended June 30, 2007:**

**Net Sales**

Sales for the quarter ended June 30, 2008 decreased to $11,993 compared to $13,675 for the same quarter last year. Sales in our North American division decreased by $1,524 or 19% primarily due to the slowdown in consumer spending from the declining economic situation in the U.S., a decline by one customer who did not purchase from us in the current quarter and a voluntary reduction of shipments to a significant customer due to credit issues and the unavailability of credit insurance with respect to such customer.

**Gross Margin**

Gross margin dollars decreased by $933 to $5,864 in the current quarter from $6,797 in the prior year period with $824 attributable to lower year-over-year sales and a decrease in gross margin percentage of 1% accounting for an additional $108.

**Operating Expenses**

Total operating expenses decreased by $76 to $6,571 in the current quarter from $6,647 in the same period last year. Sales and marketing expenses decreased by $489 to $3,559 (30% of sales) from $4,048 (30% of sales) primarily due to decreased variable marketing, advertising and freight expenses of $436. Consulting fees increased by $77 partially offset by a decrease in shows and exhibitions of $73. Research and development expenses increased by $56 to $980 (8% of sales) from $924 (7% of sales)

Table of Contents

last year. The increase resulted from higher outside engineering of $93 partially offset by the reduction of personnel expense of $67. General and administrative expenses increased by $9 to $1,684 (14% of sales) from $1,675 (12% of sales) last year. The increase is due to corporate development expenses of approximately $258 to establish strategic growth initiatives and operational efficiencies and legal fees of $105 partially offset by a reduction in personnel, consulting, temporary labor and overhead allocation expense of $121, $51, $33 and $148 respectively.

In May 2008, we eliminated 10 percent of our U.S. workforce to reduce our operating expenses. These workforce reductions transitioned some U.S. based positions to our Hong Kong facility and outsourced certain others in order to increase efficiencies and bottom line profitability. The current quarter reflects a charge of $348 to cover the associated separation expenses.

**Interest Income, net**

In the current period net interest income decreased to $6 compared with net interest income of $44 in the prior year period. The decline is due to lower returns on interest bearing accounts as interest rates declined and the mix of investments changed year over year.

**Loss on Investment**

The current year expense was the result of an investment loss of $370 resulting from the liquidation by its sponsor of a short-term fixed income fund.

**Other, net**

Other, net was a loss of $41 for the quarter ended June 30, 2008 compared with a loss of $118 in the same period last year. For the current quarter we recorded a small gain of $1 on our program of selling euros at current rates for future settlement compared with a loss of $64 in the same quarter last year. We recorded a loss of $42 on the repatriation of funds from our foreign subsidiaries in the quarter ended June 30, 2008, compared with a loss of $54 in the same period last year.

**Net Income**

For the quarter ended June 30, 2008, net income decreased by $1,231 to a loss of $1,163 from a gain of $68 in the same period last year. The decrease is primarily due to lower sales in our U.S. consumer division partially offset by decreased operating expenses of $76 as well as to one time charges totaling $718 relating to separation pay from our cost cutting initiative of $348 earlier in the 2008 quarter and an investment loss of $370 resulting from the liquidation by its sponsor of a short-term fixed income fund.

We have operations in a number of foreign countries and have sales and incur expenses in various foreign currencies. As the values of these currencies fluctuate from year to year against the US dollar, our revenues, operating expenses and results of operations are impacted. For the quarter ended June 30, 2008, approximately 35% of our sales were denominated in currencies other than the US dollar. For the quarter ended June 30, 2008, our sales and gross margin benefited by approximately $543 from the year over year change in exchange rates for the various currencies (primarily the euro) in which we operate, while our operating expenses increased by approximately $224 due to the fluctuations in exchange rates. The net effect of the year over year fluctuations in exchange rates on our results of operations for the quarter ended June 30, 2008 was an increase in income of approximately $310.

**Changes in Financial Condition**

Accounts receivable increased by $1,788 to $7,888 at June 30, 2008 from $6,100 at March 31, 2008 primarily because of customer mix and a seasonal increase in sales of $610 during the quarter ended June 30, 2008 compared with the quarter ended March 31, 2008. Inventory increased by $1,122 to

$10,384 on June 30, 2008 from $9,262 on March 31, 2008 due to normal seasonal increases as we build inventory for the back to school and holiday selling seasons. Accounts payable and accrued expenses increased by $1,881.

**Liquidity and Capital Resources**

We had cash and cash equivalents of $9,444 at June 30, 2008 compared with cash and cash equivalents of $11,824 as of March 31, 2008.

On May 19, 2008, we entered into an amendment (the Amendment ) to the Revolving Credit and Security Agreement (the Credit Agreement ) with PNC Bank, National Association ( PNC ) dated December 7, 2004, as amended by a First Amendment to Revolving Credit and Security Agreement dated December 29, 2005, an Amendment to Loan Documents dated December 22, 2006, an Amendment to Loan Documents dated March 30, 2007, an Amendment to Loan Documents dated as of December 7, 2007, Letter of Extension dated March 4, 2008 and Letter of Extension dated May 6, 2008.

The Amendment modifies the Credit Agreement with PNC by providing for a $20,000 revolving credit facility with sublimits of $1,000 for Letters of Credit, $500 for foreign currency borrowings and $10,000 for acquisitions by the Company (the Loans ). Loans under the Credit Agreement are secured by all of the assets of the Company. The term of the Credit Agreement has been amended to December 7, 2010 (the Term ). At the Company s option, Loans under the Credit Agreement will be either Domestic Rate Loans based on PNC s Base Rate with the interest rate varying from the PNC Base Rate minus 50 basis points to the PNC Base Rate plus 50 basis points or LIBOR Rate Loans with the interest rate varying from LIBOR plus 100 basis points to LIBOR plus 225 basis points in each case depending upon the ratio of the Company s Funded Debt to EBITDA and the composition of collateral provided. The Loans under the Credit Agreement are payable in full on the last day of the Term.

The Credit Agreement contains certain financial covenants and restrictions on indebtedness, business combinations and other related items. We were in compliance with all covenants of the amended Credit Agreement as of June 30, 2008. As of June 30, 2008, we had no borrowings under the Credit Agreement.

We rely primarily on our operating cash flow to support our operations. Over the last three fiscal years we generated cash flow from operations of $9,696. This operating cash flow is supplemented by our Credit Agreement to meet seasonal financing needs. We believe our cash flow from operations, available borrowing under our Credit Agreement and existing cash and short-term investment balances will be adequate to satisfy our cash needs for the next twelve months. The amount of credit available under the facility at any time is based upon a formula applied to our accounts receivable and inventory. As of June 30, 2008, we had credit available of $9,228. Our credit availability and borrowings under the facility fluctuate during the year because of the seasonal nature of our business. During the year ended March 31, 2008, maximum availability and borrowings under our Credit Agreement approximated $12,635 and $1,000, respectively. We do not have any significant capital leases and anticipate that depreciation and amortization for fiscal 2009 will exceed planned capital expenditures.

**Seasonality**

The back to school season (August to mid-September) and Christmas selling season (October, November and December) are the strongest selling periods at retail for our products.

**Future Income Tax Benefits**

We have income tax benefits of $16,900 which can be utilized against future earnings and have provided an income tax valuation allowance of $11,200 against these tax assets. The remaining $5,700 balance is carried as an asset on our balance sheet and is based upon our estimate of taxes that would be due and offset against our net operating loss carried forward, based upon our estimate of future earnings.

Table of Contents

**Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements.

**Critical Accounting Policies and Estimates**

Management s Discussion and Analysis of Financial Condition and Results of Operations is based upon our consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures. On an ongoing basis, we evaluate these estimates and judgments based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. We annually review our financial reporting and disclosure practices and accounting policies to ensure that our financial reporting and disclosures provide accurate and transparent information relative to the current economic and business environment. There have been no changes in critical accounting policies and estimates from those enumerated in our annual report on Form 10-K for the year ended March 31, 2008.

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

N/A

**ITEM 4. CONTROLS AND PROCEDURES**

As of June 30, 2008 (the end of the period covered by this report), our management carried out an evaluation, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective.

In designing and evaluating our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934), management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurances of achieving the desired control objectives, as ours are designed to do, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. We believe that our disclosure controls and procedures provide such reasonable assurance.

No change occurred in our internal controls concerning financial reporting during the quarter ended June 30, 2008 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

**PART II - OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The Company is subject to litigation from time to time arising 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 1A. RISK FACTORS**

There have been no material changes from the risk factors enumerated in our annual report on Form 10-K for the year ended March 31, 2008.

Table of Contents

**ITEM 5. OTHER INFORMATION**

ROLODEX® is a registered trademark of Berol Corporation, a subsidiary of Newell Rubbermaid, Inc. Seiko® is registered trademark of Seiko, Inc.

**ITEM 6. EXHIBITS**

**(a) Exhibits**

| | |
|---|---|
| 31.1* | Chief Executive Officer s Certificate, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2* | Chief Financial Officer s Certificate, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1** | Chief Executive Officer s Certificate, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2** | Chief Financial Officer s Certificate, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

* Filed herewith
** Furnished herewith

**Table of Contents**

## 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 |
| Date: August 14, 2008 | /s/ Barry J. Lipsky<br>Barry J. Lipsky<br>President and Chief Executive Officer<br>(Duly Authorized Officer) |
| Date: August 14, 2008 | /s/ Frank A. Musto<br>Frank A. Musto<br>Vice President,<br>Chief Financial Officer, and Treasurer<br>(Principal Financial and Accounting Officer) |