ZOOM TECHNOLOGIES INC
Form 10-Q
August 16, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2004

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 0-18672

ZOOM TECHNOLOGIES, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	51-0448969
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
207 South Street, Boston, Massachusetts	02111
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, Including Area Code: (617) 423-1072

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 an accelerated filer (as defined in Exchange Act Rule 12b-2). YES [ ] NO [X]

The number of shares outstanding of the registrant's Common Stock, $.01 Par Value, as of August 4, 2004 was 8,786,191 shares.

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PART I - FINANCIAL INFORMATION

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
Consolidated Balance Sheets
(unaudited)

	June 30, 2004	December 31, 200
Assets		
Current assets:		
Cash and cash equivalents	$ 10,553,371	$ 9,904,384
Accounts receivable, net of reserves for doubtful accounts, returns, and allowances of $1,700,822 at June 30, 2004 and $1,790,205 at December 31, 2003	3,313,985	3,944,699
Inventories, net	5,105,662	4,771,216
Prepaid expenses and other current assets	421,866	434,694
Total current assets	19,394,884	19,054,993
Property, plant and equipment, net	2,763,348	2,918,985
Total assets	$ 22,158,232	$ 21,973,978

Liabilities and Stockholders' Equity

Current liabilities:		
Current portion of long-term debt	$ 228,897	$ 223,833
Accounts payable	1,648,779	2,172,028
Accrued expenses	1,305,175	1,011,910
Total current liabilities	3,182,851	3,407,771
Long-term debt, less current portion	4,982,650	5,095,986
Total liabilities	8,165,501	8,503,757
Stockholders' equity:		
Common stock, $0.01 par value. Authorized 25,000,000 shares; issued 8,638,541 shares and outstanding 8,630,141 shares at June 30, 2004 and issued 8,084,616 shares and outstanding 8,076,216 shares at December 31, 2003	86,385	80,846
Additional paid-in capital	30,058,762	28,500,421
Retained earnings (accumulated deficit)	(16,575,760)	(15,438,333)
Accumulated other comprehensive income (loss)	430,666	334,609
Treasury stock, at cost	(7,322)	(7,322)
Total stockholders' equity	13,992,731	13,470,221
Total liabilities and stockholders' equity	$ 22,158,232	$ 21,973,978

See accompanying notes to consolidated financial statements.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
Consolidated Statements of Operations
(Unaudited)

	Three Months Ended June 30,		Six Month
	2004	2003	2004
Net sales	$ 8,091,470	$ 7,536,664	$ 15,883,
Costs of goods sold	5,841,074	5,776,863	11,320,
Gross profit	2,250,396	1,759,801	4,562,
Operating expenses:			
Selling	1,171,054	1,226,966	2,397,
General and administrative	1,063,384	843,039	2,016,
Research and development	665,442	742,969	1,343,
Total operating expenses	2,899,880	2,812,974	5,757,
Operating income (loss)	(649,484)	(1,053,173)	(1,194,
Other income (expense):			
Interest income	25,425	23,272	49,
Interest (expense)	(53,510)	(40,452)	(106,
Other, net	97,704	79,238	114,
Total other income (expense), net	69,619	62,058	57,

Income (loss) before income tax expense	(579,865)	(991,115)	(1,137,
Income tax expense (benefit)	-	-	
Net income (loss)	$ (579,865)	$ (991,115)	$ (1,137,
Earnings (loss) per common share:			
Basic	$ (.07)	$ (.13)	$ (
Diluted	$ (.07)	$ (.13)	$ (
Weighted average common and common equivalent shares:			
Basic	8,466,356	7,852,466	8,332,
Diluted	8,466,356	7,852,466	8,332,

See accompanying notes to consolidated financial statements.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
Consolidated Statements of Cash Flows
(Unaudited)

	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
Cash flows from operating activities:		
Net income (loss)	$ (1,137,427)	$ (1,830,683
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Non-operating gain on refund of deposit	-	(40,237
Depreciation and amortization	225,399	369,496
Changes in operating assets and liabilities:		
Accounts receivable, net	728,692	184,908
Inventories, net	(334,446)	2,315,295
Prepaid expenses and other assets	12,828	598,293
Accounts payable and accrued expenses	(229,984)	(671,583
Net cash provided by (used in) operating activities	(734,938)	925,489
Cash flows from investing activities:		
Additions to property, plant and equipment	(69,762)	(14,626
Net cash provided by (used in) investing activities	(69,762)	(14,626
Cash flows from financing activities:		
Principal payments on long-term debt	(108,272)	(105,076
Proceeds from exercise of stock options	1,563,880	-
Purchase of Treasury stock	-	(5,126
Net cash provided by (used in) financing activities	1,455,608	(110,202
Effect of exchange rate changes on cash and cash equivalents	(1,921)	3,706
Net increase (decrease) in cash and cash equivalents	648,987	804,367

Cash and cash equivalents - beginning of period	9,904,384	7,612,274
Cash and cash equivalents - end of period	$ 10,553,371	$ 8,416,641
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 106,158	$ 111,306
Income taxes	$ -	$ -

See accompanying notes to consolidated financial statements.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements
(Unaudited)

(1) Summary of Significant Accounting Policies

(a) Basis of Presentation and Principles of Consolidation

The consolidated financial statements of Zoom Technologies, Inc. (the "Company") presented herein have been prepared pursuant to the rules of the Securities and Exchange Commission for quarterly reports on Form 10-Q and do not include all of the information and footnote disclosures required by accounting principles generally accepted in the United States of America. These statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2003 included in the Company's 2003 Annual Report on Form 10-K.

The consolidated balance sheet as of June 30, 2004, the consolidated statements of operations for the three months and six months ended June 30, 2004 and 2003, and the consolidated statements of cash flows for the six months ended June 30, 2004 and 2003 are unaudited, but, in the opinion of management, include all adjustments (consisting of normal, recurring adjustments) necessary for a fair presentation of results for these interim periods.

The consolidated financial statements include the accounts and operations of the Company's wholly-owned subsidiary, Zoom Telephonics, Inc., a Delaware corporation. All significant intercompany accounts and transactions have been eliminated in consolidation.

The results of operations for the periods presented are not necessarily indicative of the results to be expected for the entire year ended December 31, 2004.

(b) Stock-Based Compensation

The Company accounts for its stock option plans under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees, and Related Interpretations." No stock-based compensation expense is reflected in net income (loss) for these plans, as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net loss and loss per share if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board (FASB) Statement No. 123, "Accounting for Stock Based Compensation", to stock based compensation:

	FOR THE THREE MONTHS ENDED JUNE 30, (UNAUDITED)		FOR THE SIX MONTHS ENDED JUNE 30, (UNAUDITED)	
	2004	2003	2004	200
Net loss, as reported..............	$ (579,865)	$ (991,115)	$(1,137,427)	$(1,830
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects...........	(172,724)	(105,545)	(346,592)	(222,
Pro forma net loss....................	$ (752,589)	$(1,096,660)	$(1,484,019)	$(2,053,
Loss per share:				
Basic and diluted - as reported........	$ (.07)	$ (0.13)	$ (0.14)	$ (
Basic and diluted - pro forma..........	$ (.09)	$ (0.14)	$ (0.18)	$ (

(c) RECENTLY ISSUED ACCOUNTING STANDARDS

In March 2004, the FASB indicated that they will require stock-based employee compensation to be recorded as a charge to earnings pursuant to an exposure draft they have published for comment, which they believe will become effective for fiscal years ending on or after December 15, 2004. The Company will continue to monitor the progress on the issuance of this standard and the impact it may have on the Company's consolidated financial statements.

(2) Liquidity

On December 31, 2003 Zoom had cash and cash equivalents of approximately $9.9 million. On June 30, 2004 Zoom had cash and cash equivalents of approximately $10.6 million. Currently the Company does not have a debt facility from which it can borrow. The Company is currently reviewing a non-binding proposal from a lender for a one-year $2 million line of credit; however, there can be no assurance that the Company will accept such proposal or that the parties will be able to agree on a definitive agreement.

To conserve cash and manage its liquidity, the Company implemented expense reductions throughout 2002, 2003 and the first six months of 2004. The employee headcount was 185 at December 31, 2002 and 155 at June 30, 2004. The Company will continue to assess its cost structure as it relates to its revenues and cash position in 2004, and may make further reductions if these actions are deemed necessary.

Management believes it has sufficient resources to fund its planned operations over the next 12 months. However, if over time the Company continues to incur losses or does not raise capital, the Company's longer-term ability to continue as a going concern and achieve its intended business objectives could be adversely affected. See "Risk Factors" below, for further information with respect to events and uncertainties that could harm the Company's business, operating results, and financial condition.

(3) Earnings Per Share

The reconciliation of the numerators and denominators of the basic and diluted net earnings (loss) per share computations for the Company's reported net income (loss) is as follows:

	Three Months Ended June 30,		Six Months Ended June 3	
	2004	2003	2004	200
Basic:				
Net income (loss)	$ (579,865)	$ (991,115)	$(1,137,427)	$(1,830
Weighted average shares outstanding	8,466,356	7,852,466	8,332,599	7,852
Net income (loss) per share	$ (.07)	$ (.13)	$ (.14)	$
Diluted:				
Net income (loss)	$ (579,865)	$ (991,115)	$(1,137,427)	$(1,830
Weighted average shares outstanding	8,466,356	7,852,466	8,332,599	7,852
Net effect of dilutive stock options based on the Treasury stock method using average market price	--	--	--	
Weighted average shares outstanding	8,466,356	7,852,466	8,332,599	7,852
Net income (loss) per share	$ (.07)	$ (.13)	$ (.14)	$

Potential common shares for which inclusion would have the effect of increasing diluted earnings per share (i.e., antidilutive) are excluded from the computations. Options to purchase 1,277,825 and 1,658,400 shares of common stock at June 30, 2004 and 2003, respectively, were outstanding but not included in the computations of diluted earnings per share for the three and six months ended June 30, 2004 and 2003, as their effect would be antidilutive.

(4) Inventories

Inventories consist of the following:	June 30, 2004	December 31, 2003
Raw materials	$ 1,931,972	$ 1,754,850
Work in process	1,069,753	639,425
Finished goods	2,109,937	2,376,941
	$ 5,105,662	$ 4,771,216

During the three months ended June 30, 2004 and June 30, 2003 the Company recorded lower of cost or market write-downs of zero and $257,384, respectively, related to broadband and wireless inventory. During the six months ended June 30, 2004 and June 30, 2003, the Company recorded lower of cost or market write-downs of $0 and $495,099, respectively, related to broadband and wireless inventory.

(5) Comprehensive Income (Loss)

Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income" establishes rules for the reporting and display of comprehensive income (loss) and its components; however, it has no impact on the Company's net income (loss). SFAS No. 130 requires all changes in equity from non-owner sources to be included in the determination of comprehensive income (loss).

The components of comprehensive income (loss), net of tax, are as follows:

	Three Months Ended June 30,		Six Months End
	2004	2003	2004
Net income (loss)	$ (579,865)	$ (991,115)	$(1,137,427)
Foreign currency translation adjustment	(16,139)	33,326	96,057
Net unrealized holding gain on investment securities	--	--	--
Comprehensive income (loss)	$ (596,004)	$ (957,789)	$(1,041,370)

At June 30, 2004 and December 31, 2003, Accumulated other comprehensive income (loss) as reported on the Company's balance sheet is comprised solely of foreign currency translation adjustments.

(6) Long-Term Debt

On January 10, 2001 the Company obtained a mortgage loan for $6 million secured by the real estate property located at 201 and 207 South Street, Boston, Massachusetts. This is a 20-year direct reduction mortgage with a five-year balloon due January 10, 2006. As of June 30, 2004, our indebtedness was $5.2 million. This real estate was appraised on July 24, 2002 at $9.3 million and generally the real estate market in Boston has appreciated since then. The interest rate on the mortgage is fixed for one year, based on the one year Federal Home Loan Bank rate plus 2.5% per annum. The interest rate is adjusted on January 10th of each calendar year commencing on January 10, 2002. Zoom's interest rate was adjusted to 3.99% on January 10, 2004.

(7) Commitments

During the six month period ended June 30, 2004 there were no material changes to the capital commitments and contractual obligations of the Company from those disclosed in the Form 10-K for the year ended December 31, 2003.

(8) Segment and Geographic Information

The Company's operations are classified into one reportable segment. The Company's United States and international net sales for the three and six months ended June 30, 2004 and 2003, respectively, were comprised as follows

	Three Months Ended June 30, 2004	% of Total	Three Months Ended June 30, 2003	% of Total	Six Months Ended June 30, 2004	% of Total

United States	$ 3,840,234	47%	$ 4,317,123	57%	$ 7,617,444	48%
International-UK	1,915,023	24%	2,402,007	32%	4,384,336	28%
Other International	2,336,213	29%	817,534	11%	3,881,295	24%
Total	$ 8,091,470	100%	$ 7,536,664	100%	$15,883,075	100%

(9) Customer Concentrations

Three customers accounted individually for more than 10% of total net sales in the second quarter and first six months of 2004, and collectively for approximately 44% of total net sales in the second quarter of 2004 and approximately 36% of total net sales in the first six months of 2004. One of the three customers is included in each of these geographic categories: Other International, the UK, and the United States. As disclosed in the Company's Form 10-Q for the first quarter of 2004, the Company's fourth largest customer in the first quarter of 2004, Best Buy, advised the Company in the first quarter of 2004 that they planned to discontinue the sale of the Company's dial-up modems around June 2004, coincident with their reduction of shelf space for the category and their introduction of a house brand modem. The Company's last volume shipments to Best Buy were in April, 2004. Total net sales to Best Buy in the second quarter of 2004 were $139,584, or 1.7% of net sales, and total net sales to Best Buy in the six months ended June 30, 2004 were $651,792, or 4.1% of net sales. Total net sales to Best Buy in the second quarter of 2003 were $970,134, or 12.9% of net sales, and total net sales to Best Buy in the six months ended June 30, 2003 were $2,163,118, or 14.3% of net sales.

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

The following discussion and analysis should be read in conjunction with the safe harbor statement and the risk factors contained herein and set forth in our Annual Report on Form 10-K for the year ended December 31, 2003. Readers should also be cautioned that results of any reported period are often not indicative of results for any future period.

OVERVIEW

Zoom primarily sells communication products, principally dial-up and ADSL modems, to retailers, distributors, Internet Service Providers (ISPs), and Original Equipment Manufacturers (OEMs). We sell our products to these customers through our direct sales force and through commissioned sales representatives. The majority of our employees work in Boston, Massachusetts, either in our corporate-owned headquarters or our leased production facility. We also have a sales and support office in the United Kingdom and a support center in Boca Raton, Florida.

Historically most of Zoom's sales have resulted from the after-market sale of dial-up modems through retailers to end-users for use in the home or business. These end-user customers typically either wanted to add a modem to a computer that did not have a modem, needed to replace a defective modem, or wanted to upgrade to a modem with a higher speed or more advanced features. Since the vast majority of retail personal computers now come with 56K modems installed, and since 56K is the highest speed dial-up modem available, the upgrade market has steadily declined over the past few years. This decline, coupled with competition from broadband access devices like ADSL and cable modems and lower selling prices for dial-up modems, has resulted in a corresponding decline in Zoom's dial-up modem sales.

As a vehicle for potential growth, Zoom has made significant investments in broadband and other technologies. The broadband market has grown rapidly over the past few years and is expected to continue to grow quickly. So far Zoom has been more successful in the ADSL modem market than in the cable modem market.

Zoom's product philosophy emphasizes quality, reliability, and low cost. We therefore continually seek to optimize our product designs and lower our cost of goods through intelligent design, aggressive outsourcing, and the use of new technology. Most of our products use modem or other chipsets purchased from outside vendors. This allows us to take advantage of the extensive research and development capabilities and competitiveness of our chipset suppliers and reduces our development time and the associated costs and risks of bringing new products to market. As a result of this approach, Zoom is able to quickly develop new and innovative products while keeping its research and development expense relatively small as a percentage of sales.

Zoom also out-sources most of its board-level manufacturing, allowing us to take advantage of the competitive worldwide market for contract manufacturing services. This contract manufacturing frees us from the capital equipment cost and the inflexibility, expense, and management burden associated with maintaining a dedicated workforce for electronics assembly operations. Packaging, testing and shipping are typically done at our Boston, Massachusetts manufacturing facility. This helps to reduce shipping costs from our contract assemblers and gives us the opportunity to monitor manufacturing quality and to efficiently customize products for our customers.

In recent years Zoom has benefited from purchase discount programs with our major chipset suppliers. These agreements have resulted in reduced unit costs for our dial-up modems. From the first quarter of 2002 through the second quarter of 2004, we realized significant benefits to our Cost of Goods Sold as a result of these agreements. The benefit to Cost of Goods Sold from these purchase discount agreements will end in the fourth quarter of 2004. Zoom hopes to replace these agreements, but our ability to negotiate favorable terms will depend on a number of factors including our projected volumes, our ability to reach those volumes, and the competitive landscape in the chipset market. The failure to obtain new favorable discount programs could increase our Cost of Goods Sold and could have a significant adverse effect on the gross profit of our products that use chipsets covered by our previous agreements.

In the first and second quarter of 2004 and the fourth quarter of 2003, respectively, our net sales for the quarter were up 3.4%, 7.4%, and 11.5% over the comparable quarter in the prior year. The main reason for these increases was the growth in ADSL modem sales, which more than offset our declining dial-up modem sales. While we remain optimistic about continued success in the ADSL modem area, our ADSL sales are currently concentrated with a small number of customers, so there is no predictable uniformity for our quarterly ADSL sales and our sales may fluctuate significantly. We are continuing our efforts to expand our ADSL customer base and to use our strength in ADSL to expand our ADSL product line and enter new markets later this year. One new product will incorporate "Voice over Internet Protocol" or "VoIP" capability into an ADSL modem. We also plan to introduce our own VoIP (Voice over Internet Protocol) telephone service called "Global Village(TM)" to offer free IP-to-IP phone service, low-cost calling to virtually anyone worldwide, and the option for home users of unlimited fixed price domestic calling.

During the past few years, to conserve cash and manage our liquidity we implemented expense reductions, including reductions in employee headcount. Our employee headcount was 185 at December 31, 2002 which has been reduced to 155 at June 30, 2004. We will continue to assess our cost structure as it relates to our revenues and cash position in 2004, and may make further reductions if these actions are deemed necessary.

Our cash and cash equivalents balance at June 30, 2004 was $10.6 million, up from $9.9 million at December 31, 2003. This improvement resulted primarily from cash received from the exercise of employee stock options, partially offset by a reduction of cash from operating activities.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The following is a discussion of what we view as our more significant accounting policies and estimates. These policies and estimates are also described in the notes to our audited consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2003. As described below, management judgments and estimates must be made and used in connection with the preparation of our consolidated financial statements. Where noted, material differences could result in the amount and timing of our net sales, costs, and expenses for any period if we made different judgments or used different estimates.

REVENUE (NET SALES) RECOGNITION. We currently sell hardware products to our customers. These products include dial-up modems, embedded modems, cable modems, PC cameras, ISDN and ADSL modems, telephone dialers, and wireless and wired networking equipment. While we generally have not sold software or services, we plan to offer phone service to VoIP customers under our Global Village brand. We currently derive our net sales primarily from the sale of hardware products to four types of customers:

o computer product retailers,
o computer product distributors,
o Internet Service Providers (ISPs), and
o original equipment manufacturers (OEMs).

We recognize net sales for all four types of customers at the point when the customer takes legal ownership of the delivered products. Legal ownership passes from Zoom to the customer based on the contractual FOB point specified in signed contracts and purchase orders, which are both used extensively. Many of our customer contracts or purchase orders specify FOB destination. We verify the delivery date on all significant FOB destination shipments made during the last 10 business days of each quarter.

Our net sales to computer products retailers are reduced by certain events that are characteristic of sales of hardware to computer products retailers. These events are product returns, certain sales and marketing incentives, price protection refunds, and consumer and in-store mail-in rebates. Each of these is accounted for as a reduction to net sales based on detailed management estimates, which are reconciled to actual customer or end-consumer credits on a monthly or quarterly basis.

Product Returns. Products are returned by retail stores and distributors for inventory balancing, contractual stock rotation privileges, and warranty repair or replacements. We estimate the sales and cost value of expected future product returns of previously sold products. Our estimates for product returns are based on recent historical trends plus estimates for returns prompted by, among other things, new product introductions, announced stock rotations and announced customer store closings, etc. Management reviews historical returns, current economic trends, and changes in customer demand and acceptance of our products when estimating sales return allowances. The estimate for future returns is recorded as a reserve against accounts receivable, a reduction of net sales, and the corresponding change to inventory and cost of sales. The relationship of quarterly physical product returns to quarterly product sales has remained relatively stable for many years.

Price Protection Refunds. We have a policy of offering price protection to certain of our retailer and distributor customers for some or all their inventory. Under the price protection policies, when we reduce our prices for a product, the customer receives a credit for the difference between the original purchase price and our reduced price for their unsold inventory of that product. Our estimates for price protection refunds are based on a detailed understanding and tracking by customer and by sales program. Estimated price protection refunds are recorded in the same period as the announcement of a pricing change. Information from customer inventory-on-hand reports or from direct communications with the customers is used to estimate the refund, which is recorded as a reduction of net sales and a reserve against accounts receivable.

Sales and Marketing Incentives. Many of our retail customers require sales and marketing support funding, usually set as a percentage of our sales in their stores. The percentages are taken from our customer contracts.

Consumer Mail-In and In-Store Rebates and Store Rebates. Our estimates for consumer mail-in rebates are based on a detailed understanding and tracking by customer and by sales program, supported by actual rebate claims processed by the rebate redemption centers plus an accrual for an estimated lag in processing at the redemption centers. Our estimates for store rebates are comprised of actual credit requests from the eligible customers. The estimate for mail-in and store rebates is recorded as a reserve against accounts receivable and a reduction of net sales in the same period that the rebate obligation was triggered.

To ensure that the sales, discounts, and marketing incentives are recorded in the proper period, we perform extensive tracking and documenting by customer, by period, and by type of marketing event. This tracking includes reconciliation to the accounts receivable records for deductions taken by our customers for these discounts and incentives.

ACCOUNTS RECEIVABLE VALUATION. We establish accounts receivable reserves equal to the above-discussed net sales adjustments for estimates of product returns, price protection refunds, and consumer and store rebates. These reserves are drawn down as actual credits are issued to the customer's accounts.

Our bad-debt write-offs have not been significant during the last three years.

INVENTORY VALUATION AND COST OF GOODS SOLD. Inventory is valued on a standard cost basis where the material standards are periodically updated for current material pricing. Reserves for obsolete inventory are established by management based on usability reviews performed each quarter. Our reserves against the inventory of a particular product range from 0% to 100%, based on management's estimate of the probability that the material will not be consumed. In the second half of 2000, when industry expectations were very high for expansion of the broadband and wireless markets, we purchased parts to support our aggressive forecast for a ramp-up of sales of cable modems, ADSL modems, and wireless networking products. The subsequent slow down in the industry resulted in a significant excess inventory position of materials. During 2001, the market selling prices for the broadband and wireless products declined significantly because of an industry-wide oversupply. Starting in 2001 and to a lesser extent in 2002 and 2003, the sales prices for some of the products dropped below our cost and, accordingly, we then valued our inventory on a "lower of cost or market" basis. Our valuation process is to compare our cost to the selling prices each quarter, less cost to sell or dispose, and if the selling price of a product is less than the "if completed" cost of our inventory, we write-down the inventory on a "lower of cost or market" basis.

In 2002 we entered into supply arrangements with suppliers of some components that include price and other concessions, including no-charge components, for meeting certain purchase requirements or commitments. Under one of these arrangements, we committed to purchase approximately $8.0 million of components over a period of approximately 30-months that commenced on January 1, 2002, provided that those components were offered at competitive terms and prices. We believe that at June 30, 2004, we are on track to meet the $8.0 million commitment in 2004. In connection with this arrangement, we became entitled to receive at least $3.0 million of no-charge components, based upon the supplier's market price for the components in late 2001 and early 2002, and other pricing concessions based on our purchase volumes. We received $1.2 million of these no-charge components in the fourth quarter of 2001. We received the remainder of the no-charge components in the first quarter of 2002. The favorable impact to our statement of operations has been calculated as a purchase discount over the estimated total number of components acquired through the approximate 30 month supply agreement and recognized on a delayed basis as the products employing the acquired components involved in the supply arrangement are sold. This method of accounting has been consistent each year. The benefit to our statement of operations for the delayed recognition of the $3.0 million of no-charge components is expected to end in the fourth quarter of 2004.

VALUATION AND IMPAIRMENT OF DEFERRED TAX ASSETS. As part of the process of preparing our consolidated financial statements we are required to estimate our income tax expense and deferred income tax position. This process involves the estimation of our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the statement of operations.

Significant management judgment is required in determining our provision for income taxes and any valuation allowance recorded against our net deferred tax assets. In 2001, we recorded a $3.8 million income tax charge to reflect an additional increase in our deferred tax asset valuation allowance. Management's decision to record the valuation allowance was based on the uncertain recoverability of our deferred tax asset balance. In our first quarter ended March 31, 2002, we recorded an additional $2.0 million income tax charge and valuation reserve, which reduced our net deferred tax asset balance to zero. This additional reserve reflected our decision to discontinue our specific tax planning strategy to sell our headquarters building in Boston in light of the less favorable market conditions for the sale of such building. At June 30, 2004, we currently have a 100% valuation allowance against our deferred tax assets. It is management's estimate that, after considering all the available objective evidence, historical and prospective, with greater weight given to historical evidence, it is more likely than not that these assets will not be realized. If we establish a record of continuing profitability, at some point we will be required to reverse the valuation allowance and restore the deferred asset value to the balance sheet, recording an equal income tax benefit which will increase net income in that period(s).

Results of Operations

SUMMARY. Net sales were $8.1 million for the second quarter ended June 30, 2004, up 7.4% from $7.5 million for the second quarter of 2003. We had a net loss of $0.6 million for the second quarter of 2004, compared to a net loss of $1.0 million for the second quarter of 2003. Loss per diluted share was $0.07 for the first quarter of 2004 compared to a loss per diluted share of $.13 for the first quarter of 2003. Net sales were $15.9 million for the six months ended June 30, 2004, up 5.4% from $15.1 million for the six months ended June 30, 2003. We had a net loss of $1.1 million for the six months ended June 30, 2004, compared to a net loss of $1.8 million for the six months ended June 30, 2003. Loss per diluted share for the six month period in 2004 was $.14 compared to a loss per diluted share of $.23 for the six month period in 2003.

NET SALES. Our net sales were $8.1 million for the second quarter ended June 30, 2004, up 7.4% from $7.5 million for the second quarter of 2003. Net sales were $15.9 million for the six months ended June 30, 2004, up 5.4% from $15.1 million for the six months ended June 30, 2003. The increases for the first quarter and the first six months of 2004 were primarily due to increases in ADSL modem sales and positive currency translation impacts from converting sales transactions in Euros and British Pounds to US dollars, partially offset by the decline in dial-up modem sales. Dial-up modem sales declined due to a decrease of both dial-up modem unit sales and, to a lesser extent, declining dial-up modem average selling prices, primarily resulting from the continued decline of the dial-up modem after-market, due in part to the trend toward faster connection speeds and broadband access products. The increase in ADSL modem sales in the second quarter of 2004 represented our eleventh straight quarterly net sales increase in this product category.

Our net sales in the United States declined from $4.3 million in the second quarter of 2003 to $3.8 million in the second quarter of 2004. Our net sales in the United States declined from $8.9 million in the first six months of 2003 to $7.6 million in the first six months of 2004. Our international net sales increased from $3.3 million in the second quarter of 2003 to $4.2 million in the second quarter of 2004. Our international net sales increased from $6.2 million in the first six months of 2003 to $8.3 million in the first six months of 2004. These changes reflect our declining sales of dial-up modems worldwide, our relatively strong ADSL sales in the international markets, and the positive currency impact on a significant portion of our international sales. The positive currency impact on our total net sales was $.2 million for the second quarter of 2004 compared to the second quarter of 2003, and $.5 million for the first six months of 2004 compared to the first six months of 2003. Three customers accounted individually for more than 10% of total net sales in the second quarter and first six months of 2004, and collectively for approximately 44% of total net sales in the second quarter of 2004 and approximately 36% of total net sales in the first six months of 2004. Our net sales and operating income could fluctuate significantly due to, among other things, approvals and delays in the deployment by service providers of ADSL and cable service in these countries, changes in political or economic conditions, or the loss, reduction of business, or less favorable terms for any of our significant customers.

GROSS PROFIT. Our gross profit increased to $2.3 million for the second quarter of 2004 from $1.8 million for the second quarter of 2003. Our gross profit as a percentage of net sales improved to 27.8% for the second quarter of 2004 from 23.3% for the second quarter of 2003. Our gross profit increased to $4.6 million for the first six months of 2004 from $3.9 million for the first six months of 2003. Our gross profit as a percentage of net sales improved to 28.7% for the first six months of 2004 from 25.9% for the first six months of 2003. The improvement in gross profit percentage resulted primarily from lower retail price rebates and the favorable exchange rate impact on our international sales. We recorded a benefit to our gross profit as a result of discount purchase agreements for chipsets, which are expected to end in the fourth quarter of 2004. If we are unable to obtain new favorable discount programs, our costs for chipsets could increase and our gross profit could be adversely affected. In the second quarter of 2004, the chipset discounts contributed 2.1% of gross profit.

OPERATING EXPENSE. Our operating expense increased by $0.1 million to $2.9 million or 35.8% of net sales for the second quarter of 2004 from $2.8 million or 37.3% of net sales for the second quarter of 2003. Our operating expense decreased by $.1 million to $5.8 million or 36.2% of net sales for six months ended June 30, 2004 from $5.9 million or 39.0% of net sales for the six months ended June 30, 2003.

Selling Expense. Selling expense decreased approximately $.05 million to $1.2 million or 14.5% of net sales in the second quarter of 2004 from $1.2 million or 16.3% of net sales in the second quarter of 2003. Selling expense decreased $.2 million to $2.4 million or 15.1% of net sales in the first six months of 2004 from $2.6 million or 12.0% of net sales in the first six months of 2003. Selling expense was slightly lower primarily because of lower personnel costs resulting from employee headcount reductions, reduced commissions, and reduced product delivery expense.

General and Administrative Expense. General and administrative expense increased $.2 million to $1.1 million or 13.1% of net sales in the second quarter of 2004 from $.8 million or 11.2% of net sales in the second quarter of 2003. General and administrative expense in the second quarter of 2004 included $.3 million ($250,000) of acquisition-related expense for an acquisition that was not consummated. General and administrative expense increased $.2 million to $2.0 million or 12.7% of net sales in the six months ended June 30, 2004 from $1.8 million or 12.0% of net sales in the six months ended June 30, 2003. General and administrative expense in the six months ended 2004 included $.3 million ($286,000) of the acquisition-related expense. General and administrative expense increased $.2 million in the quarter and the six month period due primarily to the acquisition-related expenses, partially offset by reduced depreciation and real estate expenses.

Research and Development Expense. Research and development expense decreased $.1 million to $0.7 million or 8.2% of net sales in the second quarter of 2004 from $0.7 million or 9.9% of net sales in the second quarter of 2003. Research and development expense decreased $.2 million to $1.3 million or 8.5% of net sales in the first six months of 2004 from $1.5 million or 9.9% of net sales in the first six months of 2003. Research and development costs decreased primarily as a result of reduced personnel costs and product approval fees. Development and support continues on all of our major product lines, with particular emphasis on VoIP hardware, the Global Village phone service, ADSL modems, and dial-up modems.

OTHER INCOME (EXPENSE), NET. Other income (expense), net improved to a gain of $.07 million in the second quarter of 2004 compared to a gain of $.06 million in the second quarter of 2003, primarily due to higher rental income from leasing vacant space at our headquarters facility. Other income (expense), net decreased to a gain of $.06 million in the first six months of 2004 compared to a gain of $.15 million in the first six months of 2003, primarily due to increased losses realized on foreign currency exchange.

INCOME TAX EXPENSE (BENEFIT). We did not record any income tax benefit in the three and six months ended June 30, 2004 or the three and six months ended June 30, 2003. The net deferred tax asset balance at June 30, 2004 is zero. This accounting treatment is described in further detail under the caption CRITICAL ACCOUNTING POLICIES AND ESTIMATES above.

Liquidity and Capital Resources

On June 30, 2004 we had working capital of $16.2 million, including $10.6 million in cash and cash equivalents.

In the six months ended June 30, 2004 operating activities used $.7 million in cash. Our net loss in the six months ended June 30, 2004 was $1.1 million. Adjustments to reconcile our net loss of $1.1 million to our net cash used in operating activities of $.7 million include favorable adjustments of $.7 million for our decrease of accounts receivable and $.2 million for depreciation and amortization. Unfavorable adjustments include our increase of inventory of $.3 million and our reduction of accounts payable and accrued expenses of $.2

million. Our accounts receivable balance decreased primarily due to faster collections of customer sales. Our inventory increased to support our increased ADSL sales.

In the six months ended June 30, 2004, investing activities used $.1 million in cash for additions to our property, plant, and equipment.

In the six months ended June 30, 2004 financing activities provided $1.5 million of cash, due primarily to receipt of $1.6 million cash from the exercise of employee stock options, partially offset by $.1 million in cash used for monthly principal payments of our $6.0 million mortgage.

Currently we do not have a debt facility from which we can borrow. We are, however, currently reviewing a non-binding proposal from a lender for a one-year $2 million line of credit. There can be no assurance that we will accept such proposal or that the parties will be able to agree on definitive documentation.

To conserve cash and manage our liquidity, we implemented expense reductions throughout 2002, 2003 and in the first six months of 2004. Our employee headcount was 185 at December 31, 2002 which has been reduced to 155 at June 30, 2004. We will continue to assess our cost structure as it relates to our revenues and cash position in 2004, and we may make further reductions if the actions are deemed necessary.

Management believes we have sufficient resources to fund our planned operations over the next 12 months. However, if over time we continue to incur losses or do not raise capital, our longer-term ability to continue as a going concern and achieve our intended business objectives could be adversely affected. See "Risk Factors" below, for further information with respect to events and uncertainties that could harm our business, operating results, and financial condition.

Commitments

During the six months ended June 30, 2004, there were no material changes to our capital commitments and contractual obligations from those disclosed in the Form 10-K for the year ended December 31, 2003.

RECENTLY ISSUED ACCOUNTING STANDARDS

In March 2004, the FASB indicated that they will require stock-based employee compensation to be recorded as a charge to earnings pursuant to an exposure draft they have published for comment, which they believe will become effective for fiscal years ending on or after December 15, 2004. We will continue to monitor their progress on the issuance of this standard and the impact it may have on our consolidated financial statements.

"Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995.

Some of the statements contained in this report are 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. These statements involve known and unknown risks, uncertainties and other factors which may cause our or our industry's actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Forward-looking statements include, but are not limited to statements regarding: Zoom's plans, expectations and intentions, including statements relating to Zoom's prospects and plans relating to sales of our dial-up, cable and ADSL modems and VoIP products; the anticipated development and timing and growth of new product introductions; the consolidation in and the decline of the dial-up modem market; the anticipated development of Zoom's markets and sales channels; the level of demand for Zoom's products; Zoom's ability to obtain debt or equity financing; the anticipated impact of Zoom's cost-cutting initiatives, and Zoom's financial condition or results of operations.

In some cases, you can identify forward-looking statements by terms such as "may," "will," "should," "could," "would," "expects," "plans," "anticipates," "believes," "estimates," "projects," "predicts," "potential" and similar expressions intended to identify forward-looking statements. These statements are only predictions and involve known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by such forward-looking statements. Given these uncertainties you should not place undue reliance on these forward-looking statements. Also, these forward-looking statements represent our estimates and assumptions only as of the date of this report. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained in this report to reflect any change in our expectations or any change in events, conditions or circumstances on which any of our forward-looking statements are based. Factors that could cause or contribute to differences in our future financial results include those discussed in the risk factors set forth below as well as those discussed elsewhere in this report and in our filings with the Securities and Exchange Commission. We qualify all of our forward-looking statements by these cautionary statements.

RISK FACTORS

This report contains forward-looking statements that involve risks and uncertainties, such as statements of our objectives, expectations and intentions. The cautionary statements made in this report should be read as applicable to all forward-looking statements wherever they appear in this report. Our actual results could differ materially from those discussed herein. Factors that could cause or contribute to such differences include those discussed below, as well as those discussed elsewhere in this report.

WE MAY CONTINUE TO INCUR NET LOSSES IF WE ARE UNABLE TO INCREASE SALES OF OUR BROADBAND MODEMS.

Our net sales continue to decline primarily due to the decline in the dial-up modem market, decreases in average selling prices of dial-up modems, and the trend toward faster connection speeds and broadband access products. Despite numerous cost reductions over the last few years, we have continued to incur significant net losses primarily due to our continuous decline in net sales from dial-up modems. We believe that the future of our business is largely dependent on the success of our broadband modems and other products, such as our VoIP products and services which are expected to be released during 2004. Although we believe that we have sufficient resources to fund our planned operations over the next year, if we fail to increase our net sales of our broadband modems and other products, our longer-term ability to stay in business and to achieve our intended business objectives could be adversely effected. Our continuing losses could also adversely affect our ability to fund the growth of our business should our strategies prove successful.

TO STAY IN BUSINESS WE MAY REQUIRE FUTURE ADDITIONAL FUNDING WHICH WE MAY BE UNABLE TO OBTAIN ON FAVORABLE TERMS, IF AT ALL.

Over the next twelve months, we may require additional financing for our operations either to fund losses beyond those we anticipate or to fund an increase of our inventory should growth occur. We currently do not have a debt facility from which we can borrow and may not be able to obtain one on acceptable terms unless we have a change in circumstances. We currently have a non-binding proposal from a lender for a one-year $2 million line of credit. There can be no assurance, however, that we will accept such proposal or that the parties will be able to agree on a definitive agreement. Additional financing may not be available to us on a timely basis if at all, or on terms acceptable to us. If we fail to obtain acceptable additional financing when needed, we may be required to further reduce planned expenditures or forego business opportunities, which could reduce our net sales, increase our losses, and harm our business. Moreover, additional equity financing could dilute the per share value of our common stock held by current shareholders, while additional debt financing could restrict our ability to make capital expenditures or incur additional indebtedness, all of which would impede our ability to succeed.

OUR CUSTOMER BASE IS CONCENTRATED, AND THE RECENT LOSS OF A SIGNIFICANT CUSTOMER WILL REDUCE REVENUES AND THE PROFIT CONTRIBUTION OF OUR DIAL-UP MODEM BUSINESS.

Three customers accounted individually for more than 10% of total net sales in the second quarter and first six months of 2004, and collectively for approximately 44% of total net sales in the second quarter of 2004 and approximately 36% of total net sales in the first six months of 2004. One of the three customers is included in each of our geographic categories: Other International, the UK, and the United States. Our fourth largest customer in the first quarter of 2004, Best Buy, discontinued the sales of our dial-up modems around June 2004. This action was taken to reduce the amount of Best Buy shelf space allocated to dial-up modems and to increase Best Buy's house-brand share of their modem category. In the first quarter of 2004, Best Buy accounted for 6.6% of our total net sales. In the second quarter of 2004, our net sales to Best Buy were reduced to approximately $140,000, or 1.7% of total net sales, and no further net sales are expected at this time. The loss of Best Buy as a customer has reduced net sales and negatively impacted our dial-up modem business. Sales of our ADSL modems are concentrated in a relatively few customers primarily in Turkey, the UK and other European countries. Our sales could fluctuate significantly due to, among other things, approvals and delays in the deployment by service providers of ADSL and cable service in these countries, changes in the political or economic conditions, or the loss, reduction of business or less favorable terms for any of our significant customers. The loss, reduction of business or less favorable terms of sale for any other of our significant customers, may further reduce revenues and negatively impact our business.

OUR NET SALES AND OPERATING RESULTS HAVE BEEN ADVERSELY AFFECTED BECAUSE OF A DECLINE IN AVERAGE SELLING PRICES FOR OUR DIAL-UP MODEMS AND BECAUSE OF THE DECLINE IN THE RETAIL MARKET FOR DIAL-UP MODEMS.

The dial-up modem industry has been characterized by declining average selling prices and a declining retail market. The decline in average selling prices is due to a number of factors, including technological change, lower component costs, and competition. The decline in the size of the retail market for dial-up modems is primarily due to the inclusion of dial-up modems in most new PCs, and alternatives to dial-up modems including broadband modems. Less advantageous terms of sales, decreasing average selling prices and reduced demand for our dial-up modems have resulted and may in the future result in decreased net sales for dial-up modems, which has been our primary source of net sales. If we fail to replace declining revenue from the sales of dial-up modems with the sales of our other products, including our broadband modems, our business and results of operation will be harmed.

WE BELIEVE THAT OUR FUTURE SUCCESS WILL DEPEND IN LARGE PART ON OUR ABILITY TO MORE SUCCESSFULLY PENETRATE THE BROADBAND MODEM MARKETS, WHICH HAVE BEEN CHALLENGING MARKETS WITH SIGNIFICANT BARRIERS TO ENTRY.

With the shrinking of the dial-up modem market, we believe that our future success will depend in large part on our ability to more successfully penetrate the ADSL modem, VoIP, and cable modem markets. These markets have been challenging, with significant barriers to entry that have adversely affected our sales to these markets. Although some ADSL and cable modems are sold at retail, in most countries the high volume purchases of these modems are concentrated in a relatively few large cable, telecommunications, and Internet service providers which offer broadband modem services to their customers. These customers typically also have extensive and varied approval processes for modems to be approved for use on their network. These approvals can be expensive and time consuming. Successfully penetrating the broadband modem market therefore presents a number of challenges including:

- the current limited retail market for broadband modems;
- the relatively small number of cable, telecommunications and Internet service provider customers that make up a substantial part of the market for broadband modems in most countries;
- the significant bargaining power of these large volume purchasers;
- the time consuming, expensive, uncertain and varied approval process of the various cable service providers; and
- the strong relationships with service providers enjoyed by incumbent some equipment providers.

Our sales of broadband products have been adversely affected by all of these factors. Sales of our broadband products in Turkey, the United States, the United Kingdom and other European countries have fluctuated and may continue to fluctuate due to approvals and delays in the deployment by service providers of cable and ADSL service in these countries. We cannot assure that we will be able to successfully penetrate these markets.

OUR INTERNATIONAL OPERATIONS ARE SUBJECT TO A NUMBER OF RISKS INHERENT IN INTERNATIONAL ACTIVITIES.

Our international sales continue to represent an increasingly significant portion of our sales. International sales have increased from 38% of net sales in 2001 to approximately 52% of our net sales in the second quarter of 2004. Currently our operations are significantly dependent on our international operations, and may be materially and adversely affected by many factors including:

- international regulatory and communications requirements and policy changes;
- political and economic changes and disruptions;
- pricing of Internet and voice services;
- bundling of discounted or free equipment with services;
- favoritism toward local suppliers;
- delays in the rollout of broadband services by cable and ADSL service providers;
- local language and technical support requirements;
- difficulties in inventory management, accounts receivable collection and the management of distributors or representatives;
- difficulties in staffing and managing foreign operations;
- governmental currency controls;
- shipping costs;
- currency exchange rate fluctuations; and
- tariff regulations.

We anticipate that our international sales will continue to account for a significant percentage of our net sales and, in particular, our net sales of ADSL products. If foreign markets for our current and future products develop more slowly than currently expected, our sales and our future results of operations may be harmed.

OUR EXISTING INDEBTEDNESS COULD MAKE IT MORE DIFFICULT FOR US TO OBTAIN ADDITIONAL FINANCING, WHICH COULD HARM OUR LIQUIDITY.

In January 2001 we obtained a $6 million, 20 year direct reduction mortgage from a bank, secured by our owned real estate in Boston, Massachusetts. As of June 30, 2004, our outstanding indebtedness was $5.2 million. This mortgage has a balloon payment due in January 2006. This real estate was appraised on July 24, 2002 at $9.3 million, and generally the real estate market in Boston has appreciated since then. Our outstanding indebtedness could adversely affect our ability to obtain additional financing for working capital, acquisitions, or other purposes. Our existing indebtedness could also make us more vulnerable to economic downturns and competitive pressures, make it more difficult to obtain additional debt financing, and adversely affect our liquidity. In the event of a cash shortfall, we could be forced to reduce other expenditures to meet our requirements with respect to our outstanding debt. Our ability to meet our obligations will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations. Many of these factors are beyond our control. If we are unable to generate sufficient cash flow from operations in the future to service our debt, we may be required to refinance all or a portion of these obligations or obtain additional financing in order to stay in business.

OUR FAILURE TO MEET CHANGING CUSTOMER REQUIREMENTS AND EMERGING INDUSTRY STANDARDS WOULD ADVERSELY IMPACT OUR ABILITY TO SELL OUR PRODUCTS.

The market for communications products and high-speed broadband access products is characterized by aggressive pricing practices, continually changing customer demand patterns, rapid technological advances, emerging industry standards and short product life cycles. In the past some of our product developments and enhancements have taken longer than planned and have delayed the availability of our products, which adversely affected our sales and profitability in the past. Any significant delays in the future may adversely impact our ability to sell our products, and our results of operations and financial condition may be adversely affected. Our future success will depend in large part upon our ability to:

- identify and respond to emerging technological trends in the market;
- develop and maintain competitive products that meet changing customer demands;
- enhance our products by adding innovative features that differentiate our products from those of our competitors;
- bring products to market on a timely basis;
- introduce products that have competitive prices;
- manage our product transitions, inventory levels and manufacturing processes efficiently; and
- respond effectively to new technological changes or new product announcements by others.

Our product cycles tend to be short, and we may incur significant non-recoverable expenses or devote significant resources to sales that do not occur when anticipated. Therefore the resources we devote to product development, sales, and marketing may not generate material net sales for us. In addition, short product cycles have resulted in and may in the future result in excess and obsolete inventory, which has had and may in the future have an adverse affect on our results of operations. In an effort to develop innovative products and technology, we have incurred and may in the future incur substantial development, sales, marketing, and inventory costs. If we are unable to recover these costs, our financial condition and operating results could be adversely affected. In addition, if we sell our products at reduced prices in anticipation of cost reductions and we still have higher cost products in inventory, our business would be harmed and our results of operations and financial condition would be adversely affected.

OUR OPERATING RESULTS HAVE BEEN ADVERSELY AFFECTED BECAUSE OF PRICE PROTECTION PROGRAMS.

Our operating results have been adversely affected by reductions in average selling prices because of credits given to some of our customers as a result of contractual price protection guarantees. Specifically, when we reduce the price for a product, the customer receives a credit for the difference between the customer's most recent purchase price and our reduced price for the product, for all unsold product at the time of the price reduction. If the amount of credits we give to our customers increases by a material amount, our operating results could be adversely affected.

WE MAY BE SUBJECT TO PRODUCT RETURNS RESULTING FROM DEFECTS, OR FROM OVERSTOCKING OF OUR PRODUCTS. PRODUCT RETURNS COULD RESULT IN THE FAILURE TO ATTAIN MARKET ACCEPTANCE OF OUR PRODUCTS, WHICH WOULD HARM OUR BUSINESS.

If our products contain undetected defects, errors, or failures, we could face:

- delays in the development of our products;
- numerous product returns; and
- other losses to us or to our customers or end users.

Any of these occurrences could also result in the loss of or delay in market acceptance of our products, either of which would reduce our sales and harm our business. We are also exposed to the risk of product returns from our customers as a result of contractual stock rotation privileges and our practice of assisting some of our customers in balancing their inventories. Overstocking has in the past led and may in the future lead to higher than normal returns.

OUR FAILURE TO EFFECTIVELY MANAGE OUR INVENTORY LEVELS COULD MATERIALLY AND ADVERSELY AFFECT OUR LIQUIDITY AND HARM OUR BUSINESS.

In the past, we built up our inventory for our broadband access products in response to shortages of components for these products at the time. We have also had difficulty in generating significant orders for some of our products, particularly broadband products, and as a result, we experienced a significant increase in our inventory. Although we have since been able to reduce our inventory levels of broadband products as a result of sales, raw material returns to suppliers, and the write-down of value of some of our inventory, our failure to effectively manage our inventory may adversely affect our liquidity and increases the risk of inventory obsolescence, a decline in market value of the inventory, or losses from theft, fire, or other casualty.

WE MAY BE UNABLE TO PRODUCE SUFFICIENT QUANTITIES OF OUR PRODUCTS BECAUSE WE DEPEND ON THIRD PARTY MANUFACTURERS. IF THESE THIRD PARTY MANUFACTURERS FAIL TO PRODUCE QUALITY PRODUCTS IN A TIMELY MANNER, OUR ABILITY TO FULFILL OUR CUSTOMER ORDERS WOULD BE ADVERSELY IMPACTED.

We use contract manufacturers to manufacture our products. We use these third party manufacturers to help ensure low costs, rapid market entry, and reliability. Any manufacturing disruption could impair our ability to fulfill orders, and failure to fulfill orders would adversely affect our sales. Although we currently use four contract manufacturers for the bulk of our purchases, in some cases a given product is only provided by one of these companies. The loss of the services of any of our significant third party manufacturers or a material adverse change in the business of or our relationships with any of these manufacturers could harm our business. Since third parties manufacture our products and we expect this to continue in the future, our success will depend, in part, on the ability of third parties to manufacture our products cost effectively and in sufficient quantities to meet our customer demand.

We are subject to the following risks because of our reliance on third party manufacturers:

- o reduced management and control of component purchases;
- o reduced control over delivery schedules;
- o reduced control over quality assurance;
- o reduced control over manufacturing yields;
- o limited warranties on products supplied to us;
- o potential increases in prices;
- o interruption of supplies from assemblers as a result of a fire, natural calamity, strike or other significant event; and
- o misappropriation of our intellectual property.

WE MAY BE UNABLE TO PRODUCE SUFFICIENT QUANTITIES OF OUR PRODUCTS BECAUSE WE OBTAIN KEY COMPONENTS FROM, AND DEPEND ON, SOLE OR LIMITED-SOURCE SUPPLIERS.

We obtain certain key parts, components, and equipment from sole or limited sources of supply. For example, we purchase dial-up and broadband modem chipsets from Conexant Systems and Agere Systems. Integrated circuit product areas covered by one or both companies include dial-up modems, ADSL modems, cable modems, networking, routers, and gateways. In the past, we have experienced delays in receiving shipments of modem chipsets from our sole source suppliers. We may experience similar delays in the future. In addition, some products may have other components that are available from only one source. The market for some components, including memory components, has recently experienced shortages, increased lead times, and higher prices. If we are unable to obtain a sufficient supply of components from our current sources, we could experience difficulties in obtaining alternative sources or in altering product designs to use alternative components. Resulting delays or reductions in product shipments could damage relationships with our customers and our customers could decide to purchase products from our competitors. Inability to meet our customers' demand or a decision by one or more of our customers to purchase products from our competitors could harm our operating results.

OUR FAILURE TO OBTAIN NEW CHIPSET PURCHASE PROGRAMS WITH CHIPSET SUPPLIERS COULD REDUCE OUR GROSS PROFIT.

Our primary dial-up modem chipset purchase agreement, which includes price and other concessions for meeting minimum purchase requirements or commitments, is expected to expire in 2004. If we are unable to replace this agreement with an equally favorable chipset purchase agreement, our chipset costs could increase significantly and our gross profit could be adversely affected.

THE MARKET FOR HIGH-SPEED COMMUNICATIONS PRODUCTS AND SERVICES HAS MANY COMPETING TECHNOLOGIES AND, AS A RESULT, THE DEMAND FOR OUR PRODUCTS AND SERVICES IS UNCERTAIN.

The market for high-speed communications products and services has a number of competing technologies. For instance, Internet access can be achieved by:

- o using a standard telephone line and appropriate service for dial-up modems, ISDN modems, or ADSL modems, possibly in combination;
- o using a cable modem with a cable TV line and cable modem service;
- o using a router and some type of modem to service the computers connected to a local area network; or
- o other approaches, including wireless links to the Internet.

Although we currently sell products that include many of these technologies, the market for high-speed communication products and services is fragmented and evolving. The introduction of new products by competitors, market acceptance of products based on new or alternative technologies, or the emergence of new industry standards could render and have in the past rendered our products less competitive or obsolete. If any of these events occur, we may be unable to sustain or grow our business. Industry analysts believe that the market for our dial-up modems will continue to decline. If we are unable to increase demand for and sales of our broadband modems, we may be unable to sustain or grow our business.

WE FACE SIGNIFICANT COMPETITION, WHICH COULD RESULT IN DECREASED DEMAND FOR OUR PRODUCTS OR SERVICES.

We may be unable to compete successfully. A number of companies have developed, or are expected to develop, products that compete or will compete with our products. Furthermore, many of our current and potential competitors have significantly greater resources than we do. Intense competition, rapid technological change and evolving industry standards could result in less favorable selling terms to our customers, decrease demand for our products or make our products obsolete.

CHANGES IN CURRENT OR FUTURE LAWS OR GOVERNMENTAL REGULATIONS THAT NEGATIVELY IMPACT OUR PRODUCTS AND TECHNOLOGIES COULD HARM OUR BUSINESS.

The jurisdiction of the Federal Communications Commission, or the FCC, extends to the entire United States communications industry including our U.S. customers and their products and services that incorporate our products. Our products are also required to meet the regulatory requirements of other countries throughout the world where our products are sold. Obtaining government regulatory approvals is time-consuming and very costly. In the past, we have encountered delays in the introduction of our products. as a result of government certifications and other certifications. We may face further delays if we are unable to comply with governmental regulations and other certifications. Delays caused by the time it takes to comply with regulatory requirements and other certifications may result in cancellations or postponements of product orders or purchases by our customers, which would harm our business

FLUCTUATIONS IN THE FOREIGN CURRENCY EXCHANGE RATES IN RELATION TO THE U.S. DOLLAR COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR OPERATING RESULTS.

Changes in currency exchange rates that increase the relative value of the U.S. dollar may make it more difficult for us to compete with foreign manufacturers on price, or may otherwise have a material adverse effect on our sales and operating results. A significant increase in our foreign currency denominated sales would increase our risk associated with foreign currency fluctuations.

OUR FUTURE SUCCESS WILL DEPEND ON THE CONTINUED SERVICES OF OUR EXECUTIVE OFFICERS AND KEY RESEARCH AND DEVELOPMENT PERSONNEL WITH EXPERTISE IN HARDWARE AND SOFTWARE DEVELOPMENT.

The loss of any of our executive officers or key research and development personnel, the inability to attract or retain qualified personnel in the future or delays in hiring skilled personnel could harm our business. Competition for skilled personnel is significant. We may be unable to attract and retain all the personnel necessary for the development of our business. In addition, the loss of Frank B. Manning, our president and chief executive officer, or Peter Kramer, our executive vice president, some other member of the management team, a key engineer, or other key contributors, could harm our relations with our customers, our ability to respond to technological change, and our business.

OUR BUSINESS MAY BE HARMED BY ACQUISITIONS WE MAY COMPLETE IN THE FUTURE.

We may pursue acquisitions of related businesses, technologies, product lines, or products. Our identification of suitable acquisition candidates involves risk inherent in assessing the values, strengths, weaknesses, risks and profitability of acquisition candidates, including the effects of the possible acquisition on our business, diversion of our management's attention, risk of increased leverage, shareholder dilution, risk associated with unanticipated problems, and risks associated with liabilities we assume. If we pursue any such transaction, we cannot assure that we would be able to successfully negotiate the terms of such transaction, finance such transaction, or integrate such business, products or technologies into our existing business and products.

WE MAY HAVE DIFFICULTY PROTECTING OUR INTELLECTUAL PROPERTY.

Our ability to compete is heavily affected by our ability to protect our intellectual property. We rely primarily on trade secret laws, confidentiality procedures, patents, copyrights, trademarks, and licensing arrangements to protect our intellectual property. The steps we take to protect our technology may be inadequate. Existing trade secret, trademark and copyright laws offer only limited protection. Our patents could be invalidated or circumvented. We have more intellectual property assets in some countries than we do in others. In addition, the laws of some foreign countries in which our products are or may be developed, manufactured or sold may not protect our products or intellectual property rights to the same extent as do the laws of the United States. This may make the possibility of piracy of our technology and products more likely We cannot assure that the steps that we have taken to protect our intellectual property will be adequate to prevent misappropriation of our technology.

WE COULD INFRINGE THE INTELLECTUAL PROPERTY RIGHTS OF OTHERS.

Particular aspects of our technology could be found to infringe on the intellectual property rights or patents of others. Other companies may hold or obtain patents on inventions or may otherwise claim proprietary rights to technology necessary to our business. We cannot predict the extent to which we may be required to seek licenses. We cannot assure that the terms of any licenses we may be required to seek will be reasonable. We are often indemnified by our suppliers relative to certain intellectual property rights; but these indemnifications do not cover all possible suits, and there is no guarantee that a relevant indemnification will be honored by the indemnifying company.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We own financial instruments that are sensitive to market risks as part of our investment portfolio. The investment portfolio is used to preserve our capital until it is required to fund operations, including our research and development activities. None of these market-risk sensitive instruments are held for trading purposes. We do not own derivative financial instruments in our investment portfolio. The investment portfolio contains instruments that are subject to the risk of a decline in interest rates.

Investment Rate Risk - Our investment portfolio consists entirely of money market funds, which are subject to interest rate risk. Due to the short duration and conservative nature of these instruments, we do not believe that it has a material exposure to interest rate risk. The 20 year mortgage of our headquarters building is a variable rate loan with the interest rate adjusted annually. A 1% change in the interest rate would result in a decrease or increase of approximately $53,000 of interest expense per year.

Item 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance 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.

As of June 30, 2004 we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in enabling us to record, process, summarize and report information required to be included in our periodic SEC filings within the required time period.

There have been no changes in our internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 4. Zoom Technologies, Inc. held its Annual Meeting of Stockholders on June 18, 2004. At the meeting, the stockholders approved the re-election of the Board of Directors of Zoom Technologies, Inc.

Election of Directors:

Nominee	For	Against	Abstain
Frank B. Manning	8,051,730	0	32,892
Peter R. Kramer	8,082,831	0	31,791
Bernard Furman	8,049,443	0	35,179
J. Ronald Woods	8,051,631	0	32,991
L. Lamont Gordon	8,049,348	0	35,274

Item 6. Exhibits and reports on Form 8-K

(a) Exhibits

31.1 CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 CFO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 CEO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 CFO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Form 8-K

On April 30, 2004, the Company furnished a Current Report on Form 8-K relating to its financial information for the quarter ended March 31, 2004, as presented in a press release dated April 30, 2004.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ZOOM TECHNOLOGIES, INC.

Date: August 13, 2004   By: /s/ Frank B. Manning

Frank B. Manning, President

Date: August 13, 2004   By: /s/ Robert Crist

Robert Crist, Vice President of Finance and Chief Financial Officer (Principal Financial and Accounting Officer)

EXHIBIT INDEX

Exhibit No.	Description
31.1	CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	CFO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	CEO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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