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

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For Quarter ended December 31, 2000

Commission File No. -14841

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

Pennsylvania
(State or other jurisdiction of
incorporation or organization)

22-2476703
(I.R.S. Employer
Identification No.)

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

08016-4907
(Zip Code)

Registrant's telephone number (609) 386-2500

Indicate by check mark whether Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceeding 12 months (or for such shorter period that Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

COMMON STOCK OUTSTANDING AS OF
DECEMBER 31, 2000 - 7,952,882 SHARES

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

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ASSETS

CURRENT ASSETS:

Cash and cash equivalents
Accounts receivable, less allowance for doubtful accounts of \$1,216 and \$850
Inventories
Income tax receivable
Prepays and other assets

TOTAL CURRENT ASSETS

PROPERTY AND EQUIPMENT

OTHER ASSETS:

Deferred income tax asset
Trademark, less accumulated amortization of \$1,652 and \$1,360
Advance royalties and licenses
Software development costs
Other assets

TOTAL OTHER ASSETS

TOTAL ASSETS

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:

Accounts payable and accrued expenses
Notes payable
Current portion of long-term liabilities - Other

TOTAL CURRENT LIABILITIES

LONG-TERM LIABILITIES

Notes payable
Revolving credit facility
Other liabilities

TOTAL LONG-TERM LIABILITIES

SHAREHOLDERS' EQUITY:

Preferred stock, \$2.50 par value, authorized 10,000,000 shares none
issued or outstanding
Common stock, no par value, authorized 50,000,000 shares, issued
and outstanding, 7,952,882 and 7,914,940 shares
Retained earnings (deficit)
Foreign currency translation adjustment

TOTAL SHAREHOLDERS' EQUITY

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY

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See notes to consolidated financial statements.

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FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED
AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS
(in thousands, except for per share data)
(unaudited)

	Three Months Ended		Nine Months Ended	
	December 31,		December 31,	
	2000	1999	2000	1999
SALES	\$ 22,278	\$ 31,248	\$ 59,577	\$ 81,267
COST OF SALES	12,795	19,183	34,086	53,912
GROSS MARGIN	9,483	12,065	25,491	27,355
EXPENSES:				
Sales and marketing	5,448	5,727	12,731	17,395
Research and development	798	946	2,791	3,294
General and administrative	2,271	2,297	7,042	8,718
Total operating expenses	8,517	8,970	22,564	29,407
OPERATING INCOME (LOSS)	966	3,095	2,927	(2,052)
Interest expense	(440)	(837)	(1,254)	(2,635)
Interest and investment income	16	89	158	305
Other, net	(18)	(287)	(666)	(489)
Gain on sale of REX	--	--	--	8,072
INCOME BEFORE INCOME TAXES	524	2,060	1,165	3,201
INCOME TAX PROVISION	--	--	--	--
NET INCOME	\$ 524	\$ 2,060	\$ 1,165	\$ 3,201
NET INCOME PER SHARE:				
Basic	\$ 0.07	\$ 0.26	\$ 0.15	\$ 0.41
Diluted	\$ 0.06	\$ 0.26	\$ 0.14	\$ 0.41
WEIGHTED AVERAGE SHARES:				
Basic	7,941	7,853	7,924	7,845
Diluted	8,282	7,912	8,265	7,884

See notes to consolidated financial statements.

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

	Common Stock		Re E
	Shares	Amount	
BALANCE - MARCH 31, 2000	7,914,940	\$ 49,138	\$
Issuance of common shares under employee stock option plan	37,942	244	
Issuance of shares and amortization of deferred compensation expense for shares issued for services (unearned portion \$32)	-	42	
Income for the period	-	-	
Foreign currency translation adjustment	-	-	
BALANCE - DECEMBER 31, 2000 (unaudited)	7,952,882	\$ 49,424	\$

* Comprehensive income, i.e., net income (loss), plus, or less, other comprehensive income, totaled \$745 for the nine months ended December 31, 2000.

See notes to consolidated financial statements.

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

	Nine Months Ended December 31,	
	2000	1999
CASH FLOWS FROM OPERATING ACTIVITIES:		
NET INCOME	\$ 1,165	\$ 3,201
ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Depreciation and amortization	3,659	4,251
Provision for losses on accounts receivable	327	1,072
Loss on disposal of property and equipment	4	60
Stock issued for services	26	-
Gain on sale of REX	-	(8,072)
Provision for inventory revaluation	-	2,350

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Source (use) of cash from change in operating assets and liabilities:		
Accounts receivable	(6,205)	(4,333)
Inventories	(6,933)	4,225
Prepays and other assets	(838)	4,466
Accounts payable and accrued expenses	4,379	(4,426)
Other, net	28	10
	-----	-----
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	(4,388)	2,804
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(740)	(1,018)
Proceeds from sale of property and equipment	-	33
Software development costs	(2,446)	(1,125)
Proceeds from sale of REX line	-	12,619
Redemption of investments in limited partnerships	-	6,045
Change in other assets	(334)	(631)
	-----	-----
NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES	(3,520)	15,923
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payment of Senior Notes	-	(26,000)
Proceeds from revolving credit facility	3,737	5,119
Principal payments of mortgage	-	(3,479)
Proceeds from issuance of common shares	244	-
Other liabilities	(67)	43
	-----	-----
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	3,914	(24,317)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(420)	(419)
	-----	-----
DECREASE IN CASH AND CASH EQUIVALENTS	(4,414)	(6,009)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	6,899	12,870
	-----	-----
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 2,485	\$ 6,861
	=====	=====

See notes to consolidated financial statements.

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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, 2000.

The financial statements for the periods ended December 31, 2000 and 1999 are unaudited and include all adjustments necessary to a fair statement 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 fiscal year.

OPERATIONS

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

Product Sales	Three Months Ended		
	December 31,		
	2000	1999	2000
Reference	\$16,941	\$23,777	\$48,515
Rolodex	5,272	6,888	10,847
REX	-	-	-
Rocket eBook	-	340	-
Other	65	243	215
Total Sales	\$22,278	\$31,248	\$59,577

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

Approximate foreign sources of revenues including export sales were as follows:

Product Sales	Three Months Ended		
	December 31,		
	2000	1999	2000
Europe	\$6,138	\$7,039	\$16,192
Other International	3,196	2,746	5,534

For the three and nine month periods ended December 31, 2000 and 1999, no customer accounted for more than 10% of the Company's revenues.

SALE OF REX PRODUCT LINE

On September 27, 1999 the Company realized a gain of \$8,072 on the sale of its REX product line for \$13,250 and the assumption of related liabilities. The

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assets sold consisted primarily of inventory with a carrying value of approximately \$5,000 and the Company's trademarks, copyrights, contract rights and other assets used in connection with the REX business.

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

RESULTS OF OPERATIONS

Three months ended December 31, 2000 as compared with December 31, 1999:

Net Sales

Sales for the quarter ended December 31, 2000 were \$22,278,000, a decrease of \$8,970,000 from sales of \$31,248,000 in the same quarter last year. The decrease was the result of softening demand for electronic products as the result of the slowdown in the domestic economy. The Company's line of ROLODEX(R) Electronics organizers remained under pressure as shelf space continues to be reduced and price points continue to move down. The quarter-to-quarter comparison was also adversely affected by continuing weakness in foreign currencies and the inclusion in the prior period of revenues of \$1,480,000 in connection with the extension of a technology license. Sales by Voice Powered Technology International, Inc. ("VPTI"), an 82% owned subsidiary of the Company, decreased from \$243,000 last year to \$65,000 this year.

Gross Margin

While gross margin dollars decreased to \$9,483,000 in the current year from \$12,065,000 in the prior year, gross margin percentage increased from 39% to 43% year to year. The improved margin percentage resulted from the impact of the lower cost of components purchased in the first six months of calendar year 2000, which affects the current quarter's gross margin because of the 60 - 90 day lead time in the purchase of components and the use of the first-in, first-out method of accounting for inventory which results in the passage of several months between the time the components are ordered and the time their costs are reflected in operating results.

Operating Expenses

Total operating expenses decreased to \$8,517,000 from \$8,970,000 last year. Sales and marketing expenses decreased to \$5,448,000 (24% of sales) from last year's level of \$5,727,000 (18% of sales) as lower costs of \$1,157,000 primarily commissions, advertising, payroll and freight costs in the Company's core business were partially offset by costs of \$879,000 associated with the development of the Company's new eBookMan platform. Research and development expenses decreased by \$148,000 to \$798,000 (4% of sales) from \$946,000 (3% of sales) in the prior year as the Company deferred \$852,000 of research and development costs, primarily related to the development of its new eBookMan platform, compared with a deferral of \$375,000 in the prior period. General and administrative expenses remained relatively unchanged at \$2,271,000 (10% of sales) in the current year compared with \$2,297,000 (7% of sales) in the year earlier period.

Other/Income Expense

Interest expense was \$440,000 compared with \$837,000 last year due to lower debt levels. Interest and investment income was down from \$89,000 to \$16,000. In the quarter, the Company incurred currency transaction losses of \$18,000 compared

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with \$287,000 in the prior year.

Net Income

For the quarter ended December 31, 2000 the Company reported net income of \$524,000, or \$.07 per share, after absorbing expenses of \$1,388,000, or \$.17 per share, in connection with development of its new eBookMan product line. For the same quarter last year the Company earned \$2,060,000, or \$.26 per share, which included \$1,300,000 or \$.17 per share, in connection with the extension of a technology license.

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Because of net operating loss carryforwards, no income taxes have been provided for by the Company during the current period.

Nine months ended December 31, 2000 as compared with December 31, 1999:

Net Sales

Sales of \$59,577,000 for the nine months ended December 31, 2000 were 27% lower than sales of \$81,267,000 for the same period last year. Sales were higher in the year earlier period because of the inclusion of \$7,769,000 of sales of product lines that have since been divested or discontinued and non-recurring revenues of \$2,276,000 related to technology licenses, softening demand in the current year for electronic products in the United States and the United Kingdom, the impact of weakened foreign currencies, and component shortages that impacted product deliveries during the present period. Sales by VPTI decreased from \$865,000 last year to \$215,000 in the current year.

Gross Margin

While gross margin dollars decreased to \$25,491,000 in the current year from \$27,355,000 in the prior year, gross margin percentage increased from 34% to 43% year to year. Gross margin in the prior year reflected an inventory write down and price protection costs of \$2,600,000 in connection with the discontinued Rocket eBook product and costs in connection with the transition to new upgraded reference and ROLODEX(R) Electronics product lines which impacted the June 1999 quarter. The margin percentage in the current year also benefited from a shift in the Company's product mix from lower margin organizer products to higher margin reference products. The reference product line accounted for 81% of total sales in the nine months ended December 31, 2000 compared with 70% of total sales in the prior year.

Operating Expenses

Total operating expenses decreased to \$22,564,000 from \$29,407,000 last year. Sales and marketing expenses decreased to \$12,731,000 (21% of sales) from last year's level of \$17,395,000 (21% of sales) primarily due to a decrease in packaging, promotion and variable selling costs of \$2,108,000, reductions in telephone and product support costs of \$230,000 and \$122,000 respectively, lower payroll expense of \$453,000 and costs absorbed in the prior year of \$1,100,000 in connection with the development of the Company's website. Research and development expenses decreased by \$503,000 to \$2,791,000 (5% of sales) from \$3,294,000 (4% of sales) in the prior year as the Company deferred \$2,218,000 of research and development costs, primarily related to the development of its new eBookMan platform, compared with a deferral of \$1,125,000 in the prior period. General and administrative expenses decreased to \$7,042,000 (12% of sales) from \$8,718,000 (11% of sales) last year primarily as a result of a decrease of \$659,000 in bad debt provisions and a reduction in VPTI's expenses of \$337,000.

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Other Income/Expense

Interest expense for the nine months ended December 31, 2000 was \$1,254,000 compared with \$2,635,000 last year due to lower debt levels. For the nine months, the Company incurred currency transaction losses of \$666,000 compared with \$489,000 in the prior year.

Net Income

For the nine months ended December 31, 2000 the Company had net income of \$1,165,000, or \$.15 per share, after absorbing expenses of \$2,675,000, or \$.34 per share, in connection with the eBookMan product line. In the same period last year the Company had earnings of \$3,201,000, or \$.41 per share, which included a gain of \$8,072,000, or \$1.03 per share, in connection with the divestiture of its REX product line in

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September 1999 and income of \$1,300,000 in connection with the aforesaid technology license.

Changes In Financial Condition

Inventories increased from \$13,735,000 at March 31, 2000 to \$20,668,000 at the end of the December quarter reflecting \$7,354,000 of inventory costs relating to the Company's new eBookMan platform. Accounts receivable increased from \$10,889,000 to \$16,767,000 because of seasonally higher sales in the December quarter. Accounts payable and accrued expenses increased from \$10,076,000 to \$14,365,000 as the Company incurred assembly and component costs related to eBookMan. Cash and cash equivalents of \$2,485,000 at December 31, 2000 were lower than cash of \$6,899,000 at March 31, 2000 as a result of the company's investment in inventory and development costs for its new eBookMan line.

Liquidity And Capital Resources

As of December 31, 2000, the Company had invested approximately \$12,692,000 in development, marketing and inventory costs for its new multimedia eBook platform, eBookMan. The Company anticipates making additional development, marketing, and working capital investments of approximately \$4,000,000 related to eBookMan during the remainder of the 2001 fiscal year. Shipments of eBookMan products to retailers commenced in February 2001.

In December 1999, the Company entered into a \$25,000,000 secured financing facility with a commercial lender. The financing facility expires on December 7, 2002. Borrowings under the facility bear interest at the bank's prime rate plus 3/8% and are subject to certain financial covenants and restrictions on indebtedness, dividend payments, business combinations, and other related items. As of December 31, 2000, the Company had outstanding borrowings of \$3,737,000 under this facility. As of December 31, 2000 the Company had a balance of \$12,239,000 outstanding under its Senior Notes. A principal payment of \$2,000,000 is due under the Senior Notes on March 31, 2001. Management believes that cash flow from operations and the secured financing facility will be adequate to provide for the Company's liquidity and capital needs for the foreseeable future. The Company has committed to the installation of a new enterprise resource system during the next year at an approximate cost of \$2,500,000. The Company has no other material commitments for capital expenditures in the next twenty-four months.

PART II.

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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, including the class action litigation identified above, is likely, individually or in the aggregate, to have a material adverse effect on the financial condition of the Company.

ITEM 2. CHANGES IN SECURITIES - NONE

ITEM 3. DEFAULT UPON SENIOR SECURITIES - NONE

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

ITEM 5. OTHER INFORMATION - ROLODEX (R) is a registered trademark of Berol Corporation, a subsidiary of Newel Rubbermaid Inc. Rocket eBook is a trademark of NuvoMedia Inc.

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SIGNATURES

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

FRANKLIN ELECTRONIC PUBLISHERS,
INCORPORATED
Registrant

February 13, 2000

Date

/s/ Barry J. Lipsky

Barry J. Lipsky
President and Chief Executive Officer
(Duly Authorized Officer)

February 13, 2000

Date

/s/ Arnold D. Levitt

Arnold D. Levitt
Senior Vice President
Principal Financial and Accounting Officer
(Duly Authorized Officer)

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