FULLNET COMMUNICATIONS INC
Form 10-Q
November 13, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2009

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission File Number: 000-27031
FULLNET COMMUNICATIONS, INC.
(Exact name of registrant as specified in its charter)

OKLAHOMA	**73-1473361**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

201 Robert S. Kerr Avenue, Suite 210
Oklahoma City, Oklahoma 73102
(Address of principal executive offices)
(405) 236-8200
(Registrant s telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o	Smaller reporting company þ

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

As of November 12, 2009, 7,425,565 shares of the registrant s common stock, $0.00001 par value, were outstanding.

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Exhibit 32.2

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FullNet Communications, Inc. and Subsidiaries
CONDENSED CONSOLIDATED BALANCE SHEETS

	SEPTEMBER 30, 2009 (Unaudited)		DECEMBER 31, 2008 (Derived from Audited Statements)	
ASSETS				
CURRENT ASSETS				
Cash	$	12,200	$	11,753
Accounts receivable, net		17,482		11,318
Prepaid expenses and other current assets		37,782		36,785
Total current assets		67,464		59,856
PROPERTY AND EQUIPMENT, net		166,962		324,227
INTANGIBLE ASSETS, net		1,458		8,782
OTHER ASSETS		5,250		5,250
TOTAL	$	241,134	$	398,115
LIABILITIES AND STOCKHOLDERS DEFICIT				
CURRENT LIABILITIES				
Accounts payable, current portion	$	202,416	$	210,211
Accrued and other current liabilities, current portion		1,539,050		1,216,687
Notes payable, current portion		804,436		557,036
Deferred revenue		113,859		128,548
Total current liabilities		2,659,761		2,112,482
ACCOUNTS PAYABLE, less current portion		248,685		252,178
ACCRUED AND OTHER LIABILITIES, less current portion		2,181		174,155
NOTES PAYABLE, less current portion				247,500
Total liabilities		2,910,627		2,786,315
STOCKHOLDERS DEFICIT				
Common stock $.00001 par value; authorized, 10,000,000 shares; issued and outstanding, 7,355,308 shares in 2009 and 2008		74		74

Common stock issuable, 70,257 shares in 2009 and 2008		57,596		57,596
Additional paid-in capital		8,381,981		8,378,467
Accumulated deficit		(11,109,144)		(10,824,337)
Total stockholders deficit		(2,669,493)		(2,388,200)
TOTAL	$	241,134	$	398,115

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2009	**September 30, 2008**	**September 30, 2009**	**September 30, 2008**
REVENUES				
Access service revenues	$ 99,640	$ 137,027	$ 328,905	$ 417,265
Co-location and other revenues	344,138	341,919	1,045,684	1,016,577
Total revenues	443,778	478,946	1,374,589	1,433,842
OPERATING COSTS AND EXPENSES				
Cost of access service revenues	48,013	62,678	152,126	179,663
Cost of co-location and other revenues	99,376	78,929	296,239	238,690
Selling, general and administrative expenses	321,334	337,035	975,952	1,035,536
Depreciation and amortization	52,835	61,635	168,714	191,441
Total operating costs and expenses	521,558	540,277	1,593,031	1,645,330
LOSS FROM OPERATIONS	(77,780)	(61,331)	(218,442)	(211,488)
INTEREST EXPENSE	(23,672)	(23,120)	(66,365)	(70,439)
NET LOSS	$ (101,452)	$ (84,451)	(284,807)	(281,927)
Net loss per share basic	$ (.01)	$ (.01)	$ (.04)	$ (.04)
Net loss per share assuming dilution	$ (.01)	$ (.01)	$ (.04)	$ (.04)
Weighted average shares outstanding basic	7,425,565	7,425,565	7,425,565	7,242,372
Weighted average shares outstanding assuming dilution	7,425,565	7,425,565	7,425,565	7,242,372

See accompanying notes to condensed consolidated financial statements.

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FullNet Communications, Inc. and Subsidiaries
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS DEFICIT (UNAUDITED)
Nine Months Ended September 30, 2009

	Common stock Shares	Common stock Amount	Common Stock Issuable	Additional Paid In Capital	Accumulated Deficit	Total
Balance at January 1, 2009	7,355,308	$ 74	$ 57,596	$ 8,378,467	$ (10,824,337)	$ (2,388,200)
Warrant extension granted in settlement of liabilities				3,445		3,445
Stock compensation expense				69		69
Net loss					(284,807)	(284,807)
Balance at September 30, 2009	7,355,308	$ 74	$ 57,596	$ 8,381,981	$ (11,109,144)	$ (2,669,493)

See accompanying notes to the condensed consolidated financial statements.

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

	Nine Months Ended September 30, 2009	September 30, 2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$ (284,807)	$ (281,927)
Adjustments to reconcile net loss to net cash provided by operating Activities		
Depreciation and amortization	168,714	191,441
Stock compensation	69	129
Provision for uncollectible accounts receivable	2,703	3,446
Net (increase) decrease in		
Accounts receivable	(8,867)	6,683
Prepaid expenses and other current assets	(997)	42,486
Net increase (decrease) in		
Accounts payable	(7,843)	9,376
Accrued and other liabilities	150,389	72,073
Deferred revenue	(14,689)	(4,202)
Net cash provided by operating activities	4,672	39,505
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(4,125)	(45,587)
Net cash used in investing activities	(4,125)	(45,587)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on borrowings under notes payable	(100)	(23,200)
Proceeds from exercise of options		28,049
Net cash (used in) provided by financing activities	(100)	4,849
Net increase (decrease) in cash	447	(1,233)
Cash at beginning of period	11,753	15,369
Cash at end of period	$ 12,200	$ 14,136

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid for interest	$	3,566	$	26,666
Warrant extension granted in settlement of liabilities		3,445		

See accompanying notes to the condensed consolidated financial statements.

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FullNet Communications, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. UNAUDITED INTERIM FINANCIAL STATEMENTS

The unaudited condensed consolidated financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. The accompanying unaudited condensed consolidated financial statements and related notes should be read in conjunction with the audited consolidated financial statements of the Company and notes thereto for the year ended December 31, 2008.

The information furnished reflects, in the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results of the interim periods presented. Operating results of the interim period are not necessarily indicative of the amounts that will be reported for the year ending December 31, 2009. Certain reclassifications have been made to prior period balances to conform with the presentation for the current period. These reclassifications did not impact the net loss.

2. MANAGEMENT S PLANS

At September 30, 2009, current liabilities exceed current assets by $2,592,297. The Company does not have a line of credit or credit facility to serve as an additional source of liquidity. Historically the Company has relied on shareholder loans as an additional source of funds. The Company is in default on various loans (see Note 9. Notes Payable). These factors raise substantial doubts about the Company s ability to continue as a going concern.

During September 2005, the Company received an invoice from AT&T (formerly SBC) of approximately $230,000 for services alleged to have been rendered to it between June 1, 2004 and June 30, 2005. Since then, the Company has received a number of additional invoices from AT&T which cover services through February 2007 and total approximately $7,970,000. AT&T then stopped invoicing the Company for these monthly services and simply sent monthly Inter Company Billing Statements reflecting the balance of approximately $7,970,000 with no further additions. The last Inter Company Billing Statement received by the Company was dated December 15, 2007 and reflected a balance of approximately $7,970,000. The alleged services were eventually identified by AT&T as Switched Access services. The Company formally notified AT&T in writing that it disputes these invoices and requested that AT&T withdraw and/or credit all of these invoices in full. AT&T has not responded to the Company s written dispute. The Company believes AT&T has no basis for these charges. Therefore, the Company has not recorded any expense or liability related to these billings. An adverse outcome regarding this claim could have a materially adverse effect on the Company s ability to continue as a going concern.

The ability of the Company to continue as a going concern is dependent upon continued operations of the Company that in turn is dependent upon the Company s ability to meet its financing requirements on a continuing basis, to maintain present financing, to achieve the objectives of its business plan and to succeed in its future operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

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The Company s business plan includes, among other things, expansion of its Internet access services through mergers and acquisitions and the development of its web hosting, co-location, and traditional telephone services. Execution of the Company s business plan will require significant capital to fund capital expenditures, working capital needs and debt service. Current cash balances will not be sufficient to fund the Company s current business plan beyond the next few months. As a consequence, the Company is currently focusing on revenue enhancement and cost cutting opportunities as well as working to sell non-core assets and to extend vendor payment terms. The Company continues to seek additional convertible debt or equity financing as well as the placement of a credit facility to fund the Company s liquidity. There can be no assurance that the Company will be able to raise additional capital on satisfactory terms or at all.

3. USE OF ESTIMATES

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

4. LOSS PER SHARE

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

	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
Numerator:				
Net loss	$ (101,452)	$ (84,451)	$ (284,807)	$ (281,927)
Denominator:				
Weighted average shares outstanding basic	7,425,565	7,425,565	7,425,565	7,242,372
Effect of dilutive stock options				
Effect of dilutive warrants				
Weighted average shares outstanding assuming dilution	7,425,565	7,425,565	7,425,565	7,242,372
Net loss per share basic	$ (.01)	$ (.01)	$ (.04)	$ (.04)
Net loss per share assuming dilution	$ (.01)	$ (.01)	$ (.04)	$ (.04)

Basic and diluted loss per share was the same for the three and nine months ended September 30, 2009 and 2008 because there was a net loss for each period.

5. ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

	September 30, 2009	December 31, 2008
Accounts receivable	$ 207,825	$ 198,958
Less allowance for doubtful accounts	(190,343)	(187,640)

	$	17,482	$	11,318

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6. PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	September 30, 2009	December 31, 2008
Computers and equipment	$ 1,475,077	$ 1,470,952
Leasehold improvements	966,915	966,915
Software	57,337	57,337
Furniture and fixtures	28,521	28,521
	2,527,850	2,523,725
Less accumulated depreciation	(2,360,888)	(2,199,498)
	$ 166,962	$ 324,227

Depreciation expense for the three months ended September 30, 2009 and 2008 was $51,504 and $57,306, respectively. Depreciation expense for the nine months ended September 30, 2009 and 2008 was $161,390 and $178,208, respectively.

7. INTANGIBLE ASSETS

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

Amortization expense for the three months ended September 30, 2009 and 2008 relating to intangible assets was $1,331 and $4,329, respectively. Amortization expense for the nine months ended September 30, 2009 and 2008 relating to intangible assets was $7,324 and $13,233, respectively.

8. ACCRUED AND OTHER CURRENT LIABILITIES

Accrued and other current liabilities consist of the following:

	September 30, 2009	December 31, 2008
Accrued interest	$ 691,956	$ 630,892
Accrued deferred compensation	666,169	567,305
Accrued other liabilities	183,106	192,645
	1,541,231	1,390,842
Less current portion	1,539,050	1,216,687

	$	2,181	$	174,155

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9. NOTES PAYABLE

Notes payable consist of the following:

	September 30, 2009	December 31, 2008
Interim loan from a shareholder, interest at 10%, requires payments equal to 50% of the net proceeds received by the Company from its private placement of convertible promissory notes, matured December 2001; unsecured (1)	$ 293,800	$ 293,900
Convertible promissory notes; interest at 12.5% of face amount, payable quarterly; these notes are unsecured and matured at December 31, 2006 (convertible into approximately 1,003,659 shares at September 30, 2009 and December 31, 2008) (2)	510,636	510,636
	804,436	804,536