

FRANKLIN WIRELESS CORP  
Form 10-Q  
May 15, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2017

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: 001-14891

**FRANKLIN WIRELESS CORP.**

(Exact name of Registrant as specified in its charter)

Nevada

95-3733534

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification Number)

9707 Waples Street

92121

**Suite 150**

(Zip code)

**San Diego, California**

(Address of principal executive offices)

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 ☒ No ☐

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 ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer ☐ Accelerated filer ☐  
Non-accelerated filer ☐ Smaller reporting company ☒  
Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

The Registrant has 10,520,203 shares of common stock outstanding as of May 15, 2017.



**FRANKLIN WIRELESS CORP.**

**FORM 10-Q**

**FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2017**

**INDEX**

	Page
PART I – Financial Information	
Item 1: <u>Consolidated Financial Statements (unaudited)</u>	
<u>Consolidated Balance Sheets as of March 31, 2017 (unaudited) and June 30, 2016</u>	4
<u>Consolidated Statements of Comprehensive Income (unaudited) for the three and nine months ended March 31, 2017 and 2016</u>	5
<u>Consolidated Statements of Cash Flows (unaudited) for the nine months ended March 31, 2017 and 2016</u>	6
<u>Notes to Consolidated Financial Statements</u>	7
Item 2: <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	17
Item 3: <u>Quantitative and Qualitative Disclosures About Market Risk</u>	21
Item 4: <u>Controls and Procedures</u>	21
PART II – Other Information	
Item 1: <u>Legal Proceedings</u>	22
Item 1A: <u>Risk Factors</u>	22
Item 2: <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	22
Item 3: <u>Defaults Upon Senior Securities</u>	22
Item 4: <u>Mine Safety Disclosures</u>	22
Item 5: <u>Other Information</u>	22
Item 6: <u>Exhibits</u>	22
<u>Signatures</u>	23

## NOTE ON FORWARD LOOKING STATEMENTS

You should keep in mind the following points as you read this Report on Form 10-Q:

The terms “we,” “us,” “our,” “Franklin,” “Franklin Wireless,” or the “Company” refer to Franklin Wireless Corp.

This Report on Form 10-Q contains statements which, to the extent they do not recite historical fact, constitute “forward looking” statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward looking statements are used under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operation,” and elsewhere in this Quarterly Report on Form 10-Q. You can identify these statements by the use of words like “may,” “will,” “could,” “should,” “project,” “believe,” “anticipate,” “expect,” “plan,” “estimate,” “forecast,” “potential,” “intend,” “continue,” and variations of these or comparable words. Forward looking statements do not guarantee future performance and involve risks and uncertainties. Actual results may differ substantially from the results that the forward looking statements suggest for various reasons, including those discussed under the caption “Risk Factors” in Item 1A of our Annual Report on Form 10-K for the year ended June 30, 2016. These forward looking statements are made only as of the date of this Report on Form 10-Q. We do not undertake to update or revise the forward looking statements, whether as a result of new information, future events or otherwise.

**PART I – FINANCIAL INFORMATION****ITEM 1. Financial Statements****FRANKLIN WIRELESS CORP.****CONSOLIDATED BALANCE SHEETS**

	March 31, 2017 (unaudited)	June 30, 2016
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 12,477,332	\$ 13,156,754
Accounts receivable	9,507,880	12,341,419
Other receivables, net	89,082	41,870
Inventories, net	1,250,712	2,285,254
Prepaid expenses and other current assets	15,497	11,838
Prepaid income taxes	30,866	30,866
Deferred tax assets, current	308,417	292,622
Advance payments to vendors	178,241	8,382
Total current assets	23,858,027	28,169,005
Property and equipment, net	249,126	317,764
Intangible assets, net	1,010,757	1,126,887
Deferred tax assets, non-current	1,726,114	1,726,114
Goodwill	273,285	273,285
Other assets	139,129	136,074
<b>TOTAL ASSETS</b>	<b>\$ 27,256,438</b>	<b>\$ 31,749,129</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 7,200,217	\$ 13,276,125
Advance payments from customers	304,330	1,901
Accrued liabilities	300,779	247,302
Income tax payable	355,380	—
Total current liabilities	8,160,706	13,525,328
Total liabilities	8,160,706	13,525,328
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Parent Company stockholders' equity	—	—

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Preferred stock, par value \$0.001 per share, authorized 10,000,000 shares; No preferred stock issued and outstanding as of March 31, 2017 and June 30, 2016		
Common stock, par value \$0.001 per share, authorized 50,000,000 shares; 10,520,203 and 10,442,203 shares issued and outstanding as of March 31, 2017 and June 30, 2016, respectively	13,922	13,844
Additional paid-in capital	7,375,322	7,295,580
Retained earnings	15,833,419	14,972,062
Treasury stock, 3,472,286 shares as of March 31, 2017 and June 30, 2016	(4,513,479 )	(4,513,479 )
Accumulated other comprehensive loss	(605,668 )	(648,127 )
Total Parent Company stockholders' equity	18,103,516	17,119,880
Non-controlling interests	992,216	1,103,921
Total stockholders' equity	19,095,732	18,223,801
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$27,256,438	\$31,749,129

See accompanying notes to consolidated financial statements.

**FRANKLIN WIRELESS CORP.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Unaudited)**

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2017	2016	2017	2016
Net sales	\$9,748,910	\$14,146,310	\$36,806,346	\$46,258,257
Cost of goods sold	7,798,910	11,674,481	29,697,400	38,660,515
Gross profit	1,950,000	2,471,829	7,108,946	7,597,742
Operating expenses:				
Selling, general and administrative	1,142,211	1,332,285	3,609,423	3,743,967
Research and development	892,430	693,540	2,589,889	2,209,718
Total operating expenses	2,034,641	2,025,825	6,199,312	5,953,685
Income (loss) from operations	(84,641 )	446,004	909,634	1,644,057
Other income, net:				
Interest income	2,202	2,407	6,752	8,115
Other income, net	40,731	120,218	173,716	99,990
Total other income, net	42,933	122,625	180,468	108,105
Income (loss) before provision for income taxes	(41,708 )	568,629	1,090,102	1,752,162
Income tax provision (benefit)	(54,730 )	254,806	340,450	404,795
Net income	13,022	313,823	749,652	1,347,367
Non-controlling interests in net loss (income) of subsidiary at 48.2%	60,456	77,547	111,705	(320,831 )
Net income attributable to Parent Company	\$73,478	\$391,370	\$861,357	\$1,026,536
Basic earnings per share attributable to Parent Company stockholders	\$0.01	\$0.04	\$0.08	\$0.10
Diluted earnings per share attributable to Parent Company stockholders	\$0.01	\$0.04	\$0.08	\$0.10
Weighted average common shares outstanding – basic	10,519,394	10,414,536	10,495,573	10,486,606
Weighted average common shares outstanding – diluted	10,785,279	10,630,453	10,761,458	10,702,523
Comprehensive income				
Net income	\$13,022	\$313,823	\$749,652	\$1,347,367
Translation adjustments	71,071	(21,057 )	42,459	(51,605 )
Comprehensive income	84,093	292,766	792,111	1,295,762
Comprehensive (income) loss attributable to non-controlling interest	60,456	77,547	111,705	(320,831 )



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Comprehensive income attributable to controlling interest	\$ 144,549	\$ 370,313	\$ 903,816	\$ 974,931
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See accompanying notes to consolidated financial statements.

**FRANKLIN WIRELESS CORP.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	<b>Nine Months Ended</b>	
	<b>March 31,</b>	
	<b>2017</b>	<b>2016</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 749,652	\$ 1,347,367
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation	113,837	138,683
Amortization of intangible assets	353,369	658,535
Deferred tax (benefit)	(15,795 )	73,897
Share-based compensation	(25,000 )	(37,500 )
Increase (decrease) in cash due to change in:		
Accounts receivable	2,786,327	(8,084,784 )
Inventories	1,034,542	(380,695 )
Prepaid expenses and other current assets	(3,659 )	48,708
Prepaid income taxes	—	1,055,788
Advance payments to vendors	(169,859 )	36,470
Other assets	(3,055 )	(5,785 )
Accounts payable	(6,075,908 )	5,084,515
Advance payments from customers	302,429	(585,463 )
Accrued liabilities	53,477	7,802
Income tax payable	355,380	341,912
Net cash used in operating activities	(544,263 )	(300,550 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(45,199 )	(82,370 )
Payments for capitalized development costs	(180,578 )	(663,800 )
Purchases of intangible assets	(56,661 )	(177,647 )
Net cash used in investing activities	(282,438 )	(923,817 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repurchase of common stock	—	(234,000 )
Issuance of stock related to stock options exercised	104,820	17,900
Principal repayment of short-term borrowings	—	(148,295 )
Net cash provided by (used in) financing activities	104,820	(364,395 )
Effect of foreign currency translation	42,459	(51,605 )
Net decrease in cash and cash equivalents	(679,422 )	(1,640,367 )

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Cash and cash equivalents, beginning of period	13,156,754	11,822,620
Cash and cash equivalents, end of period	\$12,477,332	\$10,182,253
Supplemental disclosure of cash flow information:		
Cash received (paid) during the periods for:		
Interest	\$—	\$8,114
Income taxes	\$(10,800	) \$1,067,681

See accompanying notes to consolidated financial statements.

**FRANKLIN WIRELESS CORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**NOTE 1 – BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements of Franklin Wireless Corp. (“the Company”) have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and are presented in accordance with the requirements of Form 10-Q. In the opinion of management, the financial statements included herein contain all adjustments, including normal recurring adjustments, considered necessary to present fairly the financial position, the results of operations and comprehensive income (loss) and cash flows of the Company for the periods presented. These financial statements and notes hereto should be read in conjunction with the financial statements and notes thereto for the fiscal year ended June 30, 2016 included in the Company’s Form 10-K filed on September 28, 2016. The operating results or cash flows for the interim periods presented herein are not necessarily indicative of the results to be expected for any other interim period or the full year.

**NOTE 2 - BUSINESS OVERVIEW**

We are a provider of intelligent wireless solutions including mobile hotspots, routers and modems as well as innovative hardware and software products that support machine-to-machine (M2M) applications and the Internet of Things (IoT). Our M2M and IoT solutions include embedded modules, modems and gateways built to deliver reliable always-on connectivity supporting a broad spectrum of applications. These products are designed to solve wireless connectivity challenges in a variety of vertical markets including video surveillance, digital signage, home security, oil and gas exploration, kiosks, fleet management, smart grid, vehicle diagnostics, telematics and many more.

We have a majority ownership position in Franklin Technology Inc. (“FTI”), a research and development company located in Seoul, South Korea. FTI primarily provides design and development services to us for our wireless products.

Our products are generally marketed and sold directly to wireless operators, and indirectly through strategic partners and distributors. Our global customer base extends primarily from the United States to countries in South America, the Caribbean, Europe, the Middle East and Africa (“EMEA”) and Asia.

### **NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and a subsidiary with a majority voting interest of 51.8% (48.2% is owned by non-controlling interests) as of March 31, 2017 and June 30, 2016. In the preparation of consolidated financial statements of the Company, intercompany transactions and balances are eliminated and net earnings are reduced by the portion of the net earnings of the subsidiary applicable to non-controlling interests.

#### **Non-controlling Interest in a Consolidated Subsidiary**

As of March 31, 2017, the non-controlling interest was \$992,216, which represents a \$111,705 decrease from \$1,103,921 as of June 30, 2016. The decrease was due to the net loss of subsidiary of \$231,562 for the nine months ended March 31, 2017, of which 48.2% was attributable to the non-controlling interests.

#### **Segment Reporting**

Accounting Standards Codification (“ASC”) 280, “Segment Reporting,” requires public companies to report financial and descriptive information about their reportable operating segments. We identify our operating segments based on how our chief operating decision maker internally evaluates separate financial information, business activities and management responsibility. We have one reportable segment, consisting of the sale of wireless access products.

We generate revenues from four geographic areas, consisting of the United States, the Caribbean and South America, EMEA and Asia. The following enterprise-wide disclosure is prepared on a basis consistent with the preparation of the consolidated financial statements. The following table contains certain financial information by geographic area:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2017	2016	2017	2016
Net sales:				
United States	\$9,407,328	\$14,145,611	\$35,943,763	\$39,616,528
Caribbean and South America	94,500	699	252,000	100,699
Europe, the Middle East and Africa (“EMEA”)	219,064	–	508,078	6,485,441
Asia	28,018	–	102,505	55,589
Totals	\$9,748,910	\$14,146,310	\$36,806,346	\$46,258,257

#### Long-lived

assets, net

(property and  
equipment and

intangible assets):

	March 31, 2017	June 30, 2016
United States	\$ 1,092,174	\$ 1,113,746
Asia	167,709	330,905
Totals	\$ 1,259,883	\$ 1,444,651

#### Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from those estimates.

#### Fair Value of Financial Instruments

The carrying amounts of financial instruments such as cash equivalents, accounts receivable, accounts payable and debt approximate the related fair values due to the short-term maturities of these instruments. We invest our excess cash into financial instruments which management believes are readily convertible into cash, such as money market funds and certificates of deposit.

### **Allowance for Doubtful Accounts**

Based upon our review of our collection history as well as the current balances associated with all significant customers and associated invoices, we do not believe an allowance for doubtful accounts was necessary as of March 31, 2017 and June 30, 2016.

### **Revenue Recognition**

We recognize revenue in accordance with Accounting Standards Codification ("ASC") 605, "Revenue Recognition," when persuasive evidence of an arrangement exists, the price is fixed or determinable, collection is reasonably assured and delivery of products has occurred or services have been rendered. Accordingly, we recognize revenues from product sales upon shipment of the products to customers or when the products are received by the customers in accordance with shipping or delivery terms. We provide a warranty for one year from the shipment date, which is covered by our vendors pursuant to purchase agreements. Any net warranty related expenditures made by us have not historically been material. Under our sales return policy, customers may generally return products that are under warranty for repair or replacement.

### **Cost of Goods Sold**

All costs associated with our contract manufacturers, as well as distribution, fulfillment and repair services are included in our cost of goods sold. Cost of goods sold also includes amortization expense associated with capitalized product development costs associated with complete technology.

### **Capitalized Product Development Costs**

ASC Topic 350, “Intangibles – Goodwill and Other” includes software that is part of a product or process to be sold to a customer and shall be accounted for under Subtopic 985-20. Our products contain embedded software internally developed by FTI, which is an integral part of these products because it allows the various components of the products to communicate with each other and the products are clearly unable to function without this coding.

The costs of product development that are capitalized once technological feasibility is determined (noted as Technology in progress in the Intangible Assets table) include certifications, licenses, payroll, employee benefits, and other headcount-related expenses associated with product development. We determine that technological feasibility for our products is reached after all high-risk development issues have been resolved. Once the products are available for general release to our customers, we cease capitalizing the product development costs and any additional costs, if any, are expensed. The capitalized product development costs are amortized on a product-by-product basis using the greater of straight-line amortization or the ratio of the current gross revenues to the current and anticipated future gross revenues. The amortization begins when the products are available for general release to our customers.

As of March 31, 2017 and June 30, 2016, capitalized product development costs in progress were \$232,154 and \$157,492, respectively, and these amounts are included in intangible assets in our consolidated balance sheets. During the three and nine months ended March 31, 2017, we incurred \$56,532 and \$180,578, respectively, in capitalized product development costs, and such amounts are primarily comprised of certifications and licenses. All costs incurred before technological feasibility is reached are expensed and included in our consolidated statements of comprehensive income.

### **Research and Development Costs**

Costs associated with research and development are expensed as incurred. Research and development costs were \$892,430 and \$693,540 for the three months ended March 31, 2017 and 2016, respectively, and \$2,589,889 and \$2,209,718 for the nine months ended March 31, 2017 and 2016, respectively.

### **Warranties**

We provide a warranty for one year which is covered by our vendors and manufacturers under purchase agreements between the Company and the vendors. As a result, we believe we do not have any net warranty exposure and do not



accrue any warranty expenses. Historically, the Company has not experienced any material net warranty expenditures.

### **Shipping and Handling Costs**

Costs associated with product shipping and handling are expensed as incurred. Shipping and handling costs, which are included in selling, general and administrative expenses on the consolidated statements of comprehensive income, were \$220,998 and \$435,500 for the three months ended March 31, 2017 and 2016, respectively, and \$1,100,610 and \$1,106,928 for the nine months ended March 31, 2017 and 2016, respectively.

### **Cash and Cash Equivalents**

For purposes of the consolidated statements of cash flow, we consider all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

### **Inventories**

Our inventories consist of finished goods and are stated at the lower of cost or market, cost being determined on a first-in, first-out basis. We assess the inventory carrying value and reduce it, if necessary, to its net realizable value based on customer orders on hand, and internal demand forecasts using management's best estimates given information currently available. Our customer demand is highly unpredictable, and can fluctuate significantly caused by factors beyond the control of the Company. We may write down our inventory value for potential obsolescence and excess inventory. As of March 31, 2017 and June 30, 2016, we have recorded an inventory reserve in the amounts of \$92,049 and \$88,907, respectively, for inventories that we have identified as obsolete or slow-moving.

## Property and Equipment

Property and equipment are recorded at cost. Significant additions or improvements extending useful lives of assets are capitalized. Maintenance and repairs are charged to expense as incurred. Depreciation is computed using the straight-line method over the estimated useful lives as follows:

Machinery	6 years
Office equipment	5 years
Molds	3 years
Vehicles	5 years
Computers and software	5 years
Furniture and fixtures	7 years
Facilities improvements	5 years or life of the lease, whichever is shorter

## Goodwill and Intangible Assets

Goodwill and certain intangible assets were recorded in connection with the FTI acquisition in October 2009, and are accounted for in accordance with ASC 805, "Business Combinations." Goodwill represents the excess of the purchase price over the fair value of the tangible and intangible net assets acquired. Intangible assets are recorded at their fair value at the date of acquisition. Goodwill and other intangible assets are accounted for in accordance with ASC 350, "Goodwill and Other Intangible Assets." Goodwill and other intangible assets are tested for impairment at least annually and any related impairment losses are recognized in earnings when identified. No impairment was recognized during the periods ended March 31, 2017 and June 30, 2016.

The definite lived intangible assets consisted of the following as of March 31, 2017:

Definite lived intangible assets:	Expected Life	Average Remaining life	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
Complete technology	3 years	–	\$3,799,617	\$ 3,799,617	\$–
Complete technology	3 years	1.0 years	2,402	1,801	601
Complete technology	3 years	1.3 years	6,405	4,270	2,135
Complete technology	3 years	3.0 years	18,397	–	18,397
Supply and development agreement	8 years	0.7 years	1,121,000	1,050,938	70,062

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Technology in progress	Not Applicable	–	232,154	–	232,154
Software	3 years	2.9 years	239,398	214,745	24,653
Patents	10 years	9.2 years	58,391	4,197	54,194
Certifications and licenses	3 years	1.5 years	2,609,936	2,001,375	608,561
Total as of March 31, 2017			\$8,087,700	\$ 7,076,943	\$1,010,757

The definite lived intangible assets consisted of the following as of June 30, 2016:

Definite lived intangible assets:	Expected Life	Average Remaining life	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
Complete technology	3 years	–	\$3,734,617	\$ 3,734,617	\$–
Complete technology	3 years	0.8 years	65,000	48,750	16,250
Complete technology	3 years	1.5 years	2,402	1,201	1,201
Complete technology	3 years	1.8 years	6,405	2,669	3,736
Complete technology	3 years	3.0 years	18,397	–	18,397
Supply and development agreement	8 years	1.2 years	1,121,000	945,844	175,156
Technology in progress	Not Applicable	–	157,492	–	157,492
Software	5 years	1.3 years	214,398	203,941	10,457
Patents	10 years	7.0 years	58,391	2,705	55,686
Certifications and licenses	3 years	2.0 years	2,472,359	1,783,847	688,512
Total as of June 30, 2016			\$7,850,461	\$ 6,723,574	\$1,126,887

Amortization expense recognized during the three months ended March 31, 2017 and 2016 was \$112,031 and \$174,488, respectively, and during the nine months ended March 31, 2017 and 2016 was \$353,369 and \$658,535, respectively.

### **Long-lived Assets**

In accordance with ASC 360, "Property, Plant, and Equipment," we review for impairment of long-lived assets and certain identifiable intangibles whenever events or circumstances indicate that the carrying amount of assets may not be recoverable. We consider the carrying value of assets may not be recoverable based upon our review of the following events or changes in circumstances: the asset's ability to continue to generate income from operations and positive cash flow in future periods; loss of legal ownership or title to the asset; significant changes in our strategic business objectives and utilization of the asset; or significant negative industry or economic trends. An impairment loss would be recognized when estimated future cash flows expected to result from the use of the asset are less than its carrying amount.

As of March 31, 2017, we are not aware of any events or changes in circumstances that would indicate that the long-lived assets are impaired.

### **Stock-based Compensation**

The Company's employee share-based awards result in a cost that is measured at fair value on an award's grant date, based on the estimated number of awards that are expected to vest. Stock-based compensation is recognized on a straight-line basis over the award's vesting period. The Company estimates the fair value of stock options using a Black-Scholes option pricing model. Transactions with non-employees in which goods or services are the consideration received for the issuance of equity instruments are accounted for based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more reliably measurable. The measurement date of the fair value of the equity instrument issued is the earlier of the date on which the counterparty's performance is complete or the date on which it is probable that performance will occur. Stock-based compensation costs are reflected in the accompanying consolidated statements of comprehensive income based upon the underlying recipients' roles within the Company.

### **Income Taxes**

The Company uses the asset and liability method of accounting for income taxes. Accordingly, deferred tax assets and liabilities are determined based on the difference between the financial statement and income tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance is recorded to reduce the carrying amount of deferred tax assets, unless it is more likely than not such assets will be realized. Current income taxes are based on the year's taxable income for federal and state income tax reporting purposes and the annual change in deferred taxes.

The Company assesses its income tax positions and records tax benefits based upon management's evaluation of the facts, circumstances, and information available at the reporting date. For those tax positions where it is more likely than not that a tax benefit will be sustained, the Company records the largest amount of tax benefit with a greater than 50% likelihood of being realized upon ultimate settlement with a taxing authority having full knowledge of all relevant information. For those income tax positions where it is not more likely than not that a tax benefit will be sustained, no tax benefit is recognized in the financial statements. The Company classifies interest and penalties associated with such uncertain tax positions as a component of income tax expense.

As of March 31, 2017, we have no material unrecognized tax benefits. We recorded an income tax benefit of \$54,730 for the three months ended March 31, 2017 and an income tax provision of \$340,450 for the nine months ended March 31, 2017. We also recorded a decrease in income tax payable of \$40,805 for the three months ended March 31, 2017 and an increase in income tax payable of \$355,380 for the nine months ended March 31, 2017.

### **Earnings per Share Attributable to Common Stockholders**

Earnings per share is calculated by dividing the net income by the weighted-average number of common shares that were outstanding for the period, without consideration for potential common shares. Diluted earnings per share is calculated by dividing the net income by the sum of the weighted-average number of dilutive potential common shares outstanding for the period determined using the treasury-stock method or the as-converted method. Potentially dilutive shares are comprised of common stock options outstanding under our stock plan.

## **Concentrations**

We extend credit to our customers and perform ongoing credit evaluations of such customers. We evaluate our accounts receivable on a regular basis for collectability and provide for an allowance for potential credit losses as deemed necessary. No reserve was required or recorded for any of the periods presented.

Substantially all of our revenues are derived from sales of wireless data products. Any significant decline in market acceptance of our products or in the financial condition of our existing customers could impair our ability to operate effectively.

A significant portion of our revenue is derived from a small number of customers. For the nine months ended March 31, 2017, sales to our two largest customers accounted for 67% and 30% of our consolidated net sales and 78% and 15% of our accounts receivable balance, as of March 31, 2017. In the same period in 2016, sales to our three largest customers accounted for 68%, 14% and 13% of our consolidated net sales and 45%, 46% and 1% of our accounts receivable balance as of March 31, 2016. No other customers accounted for more than ten percent of total net sales for the nine months ended March 31, 2017 and 2016 and no other customers accounted for more than ten percent of total accounts receivable as of March 31, 2017 and 2016.

For the nine months ended March 31, 2017, we purchased the majority of our wireless data products from one manufacturing company located in Asia. If this manufacturing company were to experience delays, capacity constraints or quality control problems, product shipments to our customers could be delayed, or our customers could consequently elect to cancel the underlying product purchase order, which would negatively impact the Company's revenue. For the nine months ended March 31, 2017, we purchased wireless data products from this manufacturer in the amount of \$27,336,612, or 97% of total purchases, and had related accounts payable of \$6,381,423 as of March 31, 2017. For the nine months ended March 31, 2016, we purchased wireless data products from one manufacturing company in the amount of \$38,325,448, or 99% of total purchases, and had related accounts payable of \$11,837,603 as of March 31, 2016.

We maintain our cash accounts with established commercial banks. Such cash deposits exceed the Federal Deposit Insurance Corporation insured limit of \$250,000 for each financial institution. However, we do not anticipate any losses on excess deposits.

## **Recently Issued Accounting Pronouncements**

In July 2015, the Financial Accounting Standards Board (“FASB”) issued ASU 2015-11, Inventory—Simplifying the Measurement of Inventory. ASU 2015-11 requires inventory to be subsequently measured using the lower of cost and net realizable value, thereby eliminating the market value approach. Net realizable value is defined as the “estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation.” ASU 2015-11 will be effective for us on July 1, 2017, and is applied prospectively. Early adoption is permitted. We are currently evaluating the impact that this guidance will have on our consolidated financial statements and disclosure.

In November 2015, the FASB issued Accounting Standards Update No. 2015-17, Balance Sheet Classification of Deferred Taxes (Topic 740) (ASU 2015-17), which amends existing standards for deferred taxes to present all deferred tax assets and liabilities as noncurrent. ASU 2015-17 will be effective for us beginning in our first quarter of fiscal 2018. Management does not expect that adoption of this update to materially impact the Company's consolidated financial statements given the limited current deferred tax items reported by the Company.

In March 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842) (ASU 2016-02), which amends existing standards for leases to increase transparency and comparability among organizations by requiring recognition of lease assets and liabilities on the balance sheet and requiring disclosure of key information about such arrangements. ASU 2016-02 will be effective for us beginning in our first quarter of fiscal 2020, and early adoption is permitted. We are currently evaluating the impact of adopting the new standard on our consolidated financial statements and the timing and presentation of our adoption.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, Compensation-Stock Compensation (Topic 718) (ASU 2016-09), which provides guidance improvements to employee share-based payment accounting. The standard amends several aspects of current employee share-based payment accounting including income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU 2016-09 will be effective for us beginning in our first quarter of fiscal 2018, and early adoption is permitted. Management does not expect the adoption of this update to materially impact the Company's consolidated financial statements given the Company's limited use of stock options.

In April 2016, the FASB issued Accounting Standards Update No. 2016-10, Revenue from Contracts with Customers (Topic 606)(ASU 2016-10), which amends and adds clarity to certain aspects of the guidance set forth in the upcoming revenue standard (ASU 2014-09) related to identifying performance obligations and licensing. In May 2016, the FASB issued Accounting Standards Update No. 2016-11, Revenue Recognition (Topic 605), which amends and rescinds certain revenue recognition guidance previously released within ASU 2014-09. In May 2016 the FASB issued Accounting Standards Update No. 2016-12, Revenue from Contracts with Customers (Topic 606) (ASU 2016-12), which provides narrow scope improvements and practical expedients related to ASU 2014-09. We are currently evaluating the impact of adopting these new standards on our consolidated financial statements. All of these new standards will be effective for us concurrently with ASU 2014-09, beginning in our first quarter of fiscal 2019, as early adoption is not permitted.

#### NOTE 4 – PROPERTY AND EQUIPMENT

Property and equipment consisted of the following as of:

	March 31, 2017	June 30, 2016
Machinery and facility	\$303,784	\$303,520
Office equipment	380,439	365,430
Molds	968,606	938,680
	1,652,829	1,607,630
Less accumulated depreciation	(1,403,703)	(1,289,866)
Total	\$249,126	\$317,764

Depreciation expense associated with property and equipment was \$37,621 and \$39,336 for the three months ended March 31, 2017 and 2016, respectively, and \$113,837 and \$138,683 for the nine months ended March 31, 2017 and 2016, respectively.



**NOTE 5 – ACCRUED LIABILITIES**

Accrued liabilities consisted of the following as of:

	March 31, 2017	June 30, 2016
Accrued salaries, severance	\$—	\$129,119
Accrued salaries, payroll deductions owed to government entities	42,911	10,133
Accrued vacation	46,789	45,031
Taxes	3,308	380
Other accrued liabilities	207,771	62,639
Total	\$300,779	\$247,302

**NOTE 6 – EARNINGS PER SHARE**

We report earnings per share in accordance with ASC 260, “Earnings Per Share.” Basic earnings per share are computed using the weighted average number of shares outstanding during the period. Diluted earnings per share represent basic earnings per share adjusted to include the potentially dilutive effect of outstanding stock options. The weighted average number of shares outstanding used to compute earnings per share is as follows:

	Three Months ended March 31,		Nine Months ended March 31,	
	2017	2016	2017	2016
Net income attributable to Parent Company	\$73,478	\$391,370	\$861,357	\$1,026,536
Weighted-average shares of common stock outstanding:				
Basic shares outstanding	10,519,394	10,414,536	10,495,573	10,486,606
Dilutive effect of common stock equivalents arising from stock options	265,885	215,917	265,885	215,917
Diluted shares outstanding	10,785,279	10,630,453	10,761,458	10,702,523
Basic earnings per share	\$0.01	\$0.04	\$0.08	\$0.10
Diluted earnings per share	\$0.01	\$0.04	\$0.08	\$0.10

**NOTE 7 - COMMITMENTS AND CONTINGENCIES****Leases**

We leased approximately 11,318 square feet of office space located in San Diego, California, at a monthly rent of \$16,576; although the lease expired on August 31, 2015, we continued to occupy the premises with the consent of the landlord through October 27, 2015. On September 9, 2015, we signed a lease for new office space consisting of approximately 12,775 square feet, also located in San Diego, California, at a monthly rent of \$23,115, which commenced on October 28, 2015. In addition to monthly rent, the new lease includes payment for certain common area costs. The term of the lease for the new office space is four years from the lease commencement date. Our facility is covered by an appropriate level of insurance and we believe it to be suitable for our use and adequate for our present needs. Rent expense related to these leases was \$69,344 for the three months ended March 31, 2017 and 2016, respectively, and \$208,033 and \$200,424 for the nine months ended March 31, 2017 and 2016, respectively.

Our Korea-based subsidiary, FTI, leases approximately 10,000 square feet of office space in Seoul, Korea, at a monthly rent of approximately \$8,000, and the lease expires on September 1, 2017. Beginning on June 12, 2015, FTI leased additional office space consisting of approximately 2,682 square feet, also located in Seoul, Korea, at a monthly rent of approximately \$2,700, and the lease expires on September 1, 2017. In addition to monthly rent, the

lease provides for periodic cost of living increases in the base rent and payment for certain common area costs. These facilities are covered by an appropriate level of insurance and we believe them to be suitable for our use and adequate for our present needs. Rent expense related to these leases was approximately \$32,100 for the three months ended March 31, 2017 and 2016, and approximately \$96,300 for the nine months ended March 31, 2017 and 2016.

We lease one corporate housing facility for our employees who travel, under a non-cancelable operating lease that expired on September 13, 2015 and was extended to September 5, 2017. Rent expense related to this lease was \$2,511 and \$2,371 for the three months ended March 31, 2017 and 2016, respectively, and \$7,499 and \$7,267 for the nine months ended March 31, 2017 and 2016, respectively.

### **Litigation**

We are from time to time involved in certain legal proceedings and claims arising in the ordinary course of business.

### **Novatel Wireless, Inc.**

On December 10, 2010, Novatel Wireless, Inc. and Novatel Wireless Solutions, Inc. ("Novatel") filed a complaint in the United States District Court for the Southern District of California, against us and one other defendant. The complaint alleges that certain products, including, but not limited to, mobile data hot spots and data modems, infringe on U.S. Patent Nos. 5,129,098; 7,318,225; 7,574,737 and 7,319,715. On April 13, 2012, the plaintiff filed a Second Amended Complaint which amended certain claims and added U.S. Patent No. 7,944,901 to the original complaint. On April 27, 2012, we filed a Motion to Dismiss the Second Amended Complaint as to certain of the claims. On July 6, 2012, the Court held oral argument on the Motion to Dismiss and on July 19, 2012, the Court issued an order granting in part and denying in part the Motion to Dismiss. On August 2, 2012, we answered the complaint and an Early Neutral Evaluation Conference took place on October 31, 2012 and a follow-up Settlement Conference was held on June 12, 2013. A claim construction hearing took place on October 9, 2014. On November 25, 2014, the Court granted plaintiff's Joint Motion to Joinder of Required Party, which added Nova Intellectual Solutions, LLC ("NIS") as a plaintiff to this litigation. Novatel had previously assigned the patents-in-suit to Strategic Intellectual Solutions, LLC, which is the parent company of NIS.

On April 24, 2015, NIS filed a complaint in the United States District Court for the Southern District of California, against us and FTL. The complaint alleges that one of the Company's products infringes on U.S. Patent No. 7,944,901.

On July 20, 2015, a Settlement Conference took place during which we and NIS agreed to settle this matter and an agreement governing the settlement was executed on October 20, 2015.

On October 1, 2015, we and Novatel filed a Joint Motion For Dismissal With Prejudice as to the patent infringement claims made by Novatel against us. On October 28, 2015, we and NIS filed a Joint Motion For Dismissal With Prejudice as to the patent infringement claims made by it against the Company and FTL.

### **Change of Control Agreements**

On September 21, 2009 we entered into Change of Control Agreements with OC Kim, our President, Yun J. (David) Lee, our Chief Operating Officer, and Yong Bae Won, our Vice President, Engineering. Each Change of Control Agreement provides for a lump sum payment to the officer in case of a change of control of the Company. The term includes the acquisition of Common Stock of the Company resulting in one person or company owning more than 50% of the outstanding shares, a significant change in the composition of the Board of Directors of the Company during any 12-month period, a reorganization, merger, consolidation or similar transaction resulting in the transfer of ownership of more than 50% of the Company's outstanding Common Stock, or a liquidation or dissolution of the

Company or sale of substantially all of the Company's assets.

The Change of Control Agreement with Mr. Kim calls for a payment of \$5 million upon a change of control; the agreement with Mr. Lee calls for a payment of \$2 million upon a change of control; and the agreement with Mr. Won was for two years and called for a payment of \$1 million upon a change of control.

The Board of Directors has approved extension of the Change of Control Agreements with Mr. Kim and Mr. Lee, through September 21, 2017. The Change of Control Agreement with Mr. Won expired on September 21, 2014 and was not renewed or extended.

#### **NOTE 8 – LONG-TERM INCENTIVE PLAN AWARDS**

We adopted the 2009 Stock Incentive Plan (“2009 Plan”) on June 11, 2009, which provided for the grant of incentive stock options and non-qualified stock options to our employees and directors. Options granted under the 2009 Plan generally have a term of ten years and generally vest and become exercisable at the rate of 33% after one year and 33% on the second and third anniversaries of the option grant dates. Historically, some stock option grants have included shorter vesting periods ranging from one to two years.

The estimated forfeiture rate considers historical turnover rates stratified into employee pools in comparison with an overall employee turnover rate, as well as expectations about the future. We periodically revise the estimated forfeiture rate in subsequent periods if actual forfeitures differ from those estimates. Compensation expense recorded under this method for the three and nine months ended March 31, 2017 was \$0 and (\$25,000), respectively. The expense credits for the nine months ended March 31, 2017 resulted from the reversal of expenses booked in prior periods for stock options for a small number of employees that were cancelled. This amount increased income from operations and income before provision for income taxes by the same amount by decreasing compensation expense recognized in selling, general and administrative expense.

A summary of the status of our stock options is presented below:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value
Outstanding as of June 30, 2016	812,003	\$ 1.25	3.35	\$869,740
Granted	—	—	—	—
Exercised	(78,000 )	(1.34 )	(3.01 )	(177,060 )
Cancelled	—	—	—	—
Forfeited or Expired	(15,000 )	(0.57 )	—	(34,050 )
Outstanding as of March 31, 2017	719,003	\$ 1.25	2.48	\$731,400
Exercisable as of March 31, 2017	719,003	\$ 1.25	2.48	\$731,400

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based upon the Company's closing stock price of \$2.27 as of March 31, 2017, which would have been received by the option holders had all option holders exercised their options as of that date. The weighted-average grant-date fair value of stock options outstanding as of March 31, 2017, in the amount of 719,003 shares, was \$1.11 per share.

As of March 31, 2017, there was no unrecognized compensation cost related to non-vested stock options granted.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our financial statements and related notes included elsewhere in this report. This report contains certain forward-looking statements relating to future events or our future financial performance. These statements are subject to risks and uncertainties which could cause actual results to differ materially from those discussed in this report. You are cautioned not to place undue reliance on this information, which speaks only as of the date of this report. We are not obligated to publicly update this information, whether as a result of new information, future events or otherwise, except to the extent we are required to do so in connection with our obligation to file reports with the SEC. For a discussion of the important risks to our business and future operating performance, see the discussion under the caption “Item 1A. Risk Factors” and under the caption “Factors That May Influence Future Results of Operations” in the Company’s Form 10-K for the year ended June 30, 2016, filed on September 28, 2016. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this report might not occur.

### **BUSINESS OVERVIEW**

We are a provider of intelligent wireless solutions including mobile hotspots, routers and modems as well as innovative hardware and software products that support machine-to-machine (M2M) applications and the Internet of Things (IoT). Our M2M and IoT solutions include embedded modules, modems and gateways built to deliver reliable always-on connectivity supporting a broad spectrum of applications. These products are designed to solve wireless connectivity challenges in a variety of vertical markets including video surveillance, digital signage, home security, oil and gas exploration, kiosks, fleet management, smart grid, vehicle diagnostics, telematics and many more.

We have a majority ownership position in FTI, a research and development company located in Seoul, South Korea. FTI primarily provides design and development services to us for our wireless products.

Our products are generally marketed and sold directly to wireless operators, and indirectly through strategic partners and distributors. Our global customer base extends primarily from the United States to countries in South America, the Caribbean, EMEA and Asia.

### **FACTORS THAT MAY INFLUENCE FUTURE RESULTS OF OPERATIONS**

We believe that our revenue growth will be influenced largely by (1) the successful maintenance of our existing customers, (2) the rate of increase in demand for wireless data products, (3) customer acceptance of our new products, (4) new customer relationships and contracts, and (5) our ability to meet customers' demands.

We have entered into and expect to continue to enter into new customer relationships and contracts for the supply of our products, and this may require significant demands on our resources, resulting in increased operating, selling, and marketing expenses associated with such new customers.

## **CRITICAL ACCOUNTING POLICIES**

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of these financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. Management evaluates these estimates and assumptions on an ongoing basis. Our estimates and assumptions have been prepared on the basis of the most current reasonably available information. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates under different assumptions and conditions.



We have several critical accounting policies, which were described in our Annual Report on Form 10-K for the year ended June 30, 2016, that are both important to the portrayal of our financial condition and results of operations and require management's most difficult, subjective and complex judgments. Typically, the circumstances that make these judgments difficult, subjective and complex have to do with making estimates about the effect of matters that are inherently uncertain. There were no material changes to our critical accounting policies during the three months ended March 31, 2017.

## RESULTS OF OPERATIONS

The following table sets forth, for the three months and nine months ended March 31, 2017 and 2016, our statements of comprehensive income including data expressed as a percentage of sales:

	Three Months Ended March 31, 2017		Nine Months Ended March 31, 2016	
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	80.0%	82.5%	80.7%	83.6%
Gross profit	20.0%	17.5%	19.3%	16.4%
Operating expenses	20.9%	14.3%	16.8%	12.8%
Income (loss) from operations	(0.9% )	3.2%	2.5%	3.6%
Other income, net	0.4%	0.9%	0.5%	0.2%
Net income (loss) before income taxes	(0.5% )	4.1%	3.0%	3.8%
Income tax provision (benefit)	(0.6% )	1.8%	1.0%	0.9%
Net income	0.1%	2.3%	2.0%	2.9%
Non-controlling interest in net (income) loss of subsidiary	0.7%	0.5%	0.3%	(0.7% )
Net income attributable to Parent Company	0.8%	2.8%	2.3%	2.2%

### THREE MONTHS ENDED MARCH 31, 2017 COMPARED TO THREE MONTHS ENDED MARCH 31, 2016

**NET SALES** - Net sales decreased by \$4,397,400, or 31.1%, to \$9,748,910 for the three months ended March 31, 2017 from \$14,146,310 for the corresponding period of 2016. For the three months ended March 31, 2017, net sales by geographic regions, consisting of the United States, South America and the Caribbean, EMEA and Asia, were \$9,407,328 (96.5% of net sales), \$94,500 (1.0% of net sales), \$219,064 (2.2% of net sales) and \$28,018 (0.3% of net sales), respectively. For the three months ended March 31, 2016, net sales by geographic regions, consisting of the United States, South America and the Caribbean, EMEA and Asia, were \$14,145,611 (100% of net sales), \$699 (0.0%

of net sales), \$0 (0.0% of net sales) and \$0 (0.0% of net sales), respectively.

Net sales in the United States decreased by \$4,738,283, or 33.5%, to \$4,738,283 for the three months ended March 31, 2017 from \$14,145,611 for the corresponding period of 2016. The decrease in net sales was primarily due to timing of orders placed by a carrier customer. Net sales in the South American and Caribbean regions increased by \$93,801 to \$94,500 for the three months ended March 31, 2017 from \$699 for the corresponding period of 2016. The increase in net sales was primarily due to the general nature of sales in these regions, which often fluctuate significantly from period to period due to timing of orders placed by a relatively small number of customers. Net sales in EMEA increased by \$219,064 to \$219,064 for the three months ended March 31, 2017 from \$0 for the corresponding period of 2016. The increase in net sales was due to timing of orders placed by a carrier customer in Africa. Net sales in Asia increased by \$28,018, to \$28,018 for the three months ended March 31, 2017 from \$0 for the corresponding period of 2016. The increase in net sales was primarily due to higher product and component sales generated by FTI, which typically vary from period to period.

**GROSS PROFIT** – Gross profit decreased by \$521,829, or 21.1%, to \$1,950,000 for the three months ended March 31, 2017 from \$2,471,829 for the corresponding period of 2016. The gross profit in terms of net sales percentage was 20.0% for the three months ended March 31, 2017 compared to 17.5% for the corresponding period of 2016. The decrease in gross profit was primarily due to the change in net sales as described above. The increase in gross profit in terms of net sales percentage was primarily due to variations in customer and product mix, competitive selling prices and product costs which generally vary from period to period and region to region.

**OPERATING EXPENSES** - Operating expenses increased by \$8,816, or 0.4%, to \$2,034,641 for the three months ended March 31, 2017 from \$2,025,825 for the corresponding period of 2016. The increase in operating expenses was primarily due to higher research and development expenses due to headcount growth and higher payroll expenses, which were partially offset by lower shipping and handling costs resulting from the volume decrease in product shipments to the United States.

**OTHER INCOME, NET** - Other income, net decreased by \$79,692, or 65.0%, to \$42,933 for the three months ended March 31, 2017 from \$122,625 for the corresponding period of 2016. The decrease in other income, net was primarily due to unfavorable changes in currency exchange rates, which was partially offset by product development funding received by FTI from a governmental entity.

#### **NINE MONTHS ENDED MARCH 31, 2017 COMPARED TO NINE MONTHS ENDED MARCH 31, 2016**

**NET SALES** - Net sales decreased by \$9,451,911, or 20.4%, to \$36,806,346 for the nine months ended March 31, 2017 from \$46,258,257 for the corresponding period of 2016. For the nine months ended March 31, 2017, net sales by geographic regions, consisting of the United States, South America and the Caribbean, EMEA and Asia, were \$35,943,763 (97.6% of net sales), \$252,000 (0.7% of net sales), \$508,078 (1.4% of net sales) and \$102,505 (0.3% of net sales), respectively. For the nine months ended March 31, 2016, net sales by geographic regions, consisting of the United States, South America and the Caribbean, EMEA and Asia, were \$39,616,528 (85.7% of net sales), \$100,699 (0.2% of net sales), \$6,485,441 (14.0% of net sales) and \$55,589 (0.1% of net sales), respectively.

Net sales in the United States decreased by \$3,672,765, or 9.3%, to \$35,943,763 for the nine months ended March 31, 2017 from \$39,616,528 for the corresponding period of 2016. The decrease in net sales was primarily due to timing of orders placed by a carrier customer, which was partially offset by the launch of the new product with a different carrier customer that took place in the second half of fiscal 2016. Net sales in the South American and Caribbean regions increased by \$151,301, or 150.3%, to \$252,000 for the nine months ended March 31, 2017 from \$100,699 for the corresponding period of 2016. The increase in net sales was primarily due to the general nature of sales in these regions, which often fluctuate significantly from period to period due to timing of orders placed by a relatively small number of customers. Net sales in EMEA decreased by \$5,977,363, or 92.2%, to \$508,078 for the nine months ended March 31, 2017 from \$6,485,441 for the corresponding period of 2016. The decrease in net sales was due to timing of orders placed by a carrier customer in Africa. Net sales in Asia increased by \$46,916, or 84.4%, to \$102,505 for the nine months ended March 31, 2017 from \$55,589 for the corresponding period of 2016. The increase in net sales was primarily due to higher product and component sales generated by FTI, which typically vary from period to period.

**GROSS PROFIT** – Gross profit decreased by \$488,796, or 6.4%, to \$7,108,946 for the nine months ended March 31, 2017 from \$7,597,742 for the corresponding period of 2016. The gross profit in terms of net sales percentage was 19.3% for the nine months ended March 31, 2017 compared to 16.4% for the corresponding period of 2016. The decrease in gross profit was primarily due to the change in net sales as described above. The increase in gross profit in terms of net sales percentage was primarily due to variations in customer and product mix, competitive selling prices and product costs which generally vary from period to period and region to region.

**OPERATING EXPENSES** - Operating expenses increased by \$245,627, or 4.1%, to \$6,199,312 for the nine months ended March 31, 2017 from \$5,953,685 for the corresponding period of 2016. The increase in operating expenses was

primarily due to higher research and development expenses due to headcount growth and higher payroll expenses, which were partially offset by lower expenses associated with third party contractors, travel, legal, depreciation and amortization.

**OTHER INCOME, NET** - Other income, net increased by \$72,363, or 66.9%, to \$180,468 for the nine months ended March 31, 2017 from \$108,105 for the corresponding period of 2016. The increase in other income, net was primarily due to product development funding received by FTI from a government entity as well as favorable changes in currency exchange rates.

## **LIQUIDITY AND CAPITAL RESOURCES**

Our historical operating results, capital resources and financial position, in combination with current projections and estimates, were considered in management's plan and intentions to fund our operations over a reasonable period of time, which we define as the twelve-month period ending March 31, 2018. For purposes of liquidity disclosures, we assess the likelihood that we have sufficient available working capital and other principal sources of liquidity to fund our operating activities and obligations as they become due.

Our principal source of liquidity as of March 31, 2017 consisted of cash and cash equivalents of \$12,477,332. We believe we have sufficient available capital to cover our existing operations and obligations through at least March 31, 2018. Our long-term future cash requirements will depend on numerous factors, including our revenue base, profit margins, product development activities, market acceptance of our products, future expansion plans and ability to control costs. If we are unable to achieve our current business plan or secure additional funding that may be required, we would need to curtail our operations or take other similar actions outside the ordinary course of business in order to continue to operate as a going concern.

**OPERATING ACTIVITIES** - Net cash used in operating activities for the nine months ended March 31, 2017 and 2016 were \$544,263 and \$300,550, respectively.

The \$544,263 in net used in operating activities for the nine months ended March 31, 2017 was primarily due to the decrease in accounts payable of \$6,075,908, which was partially offset by the decreases in accounts receivable and inventories of \$2,786,327 and \$1,034,542, respectively, as well as our operating results (net income adjusted for depreciation, amortization and other non-cash charges). The \$300,550 in net cash used in operating activities for the nine months ended March 31, 2016 was primarily due to the increase in accounts receivable \$8,084,784, which was partially offset by the increase in accounts payable of \$5,084,515, the decrease in prepaid income taxes of \$1,055,788 as well as our operating results (net income adjusted for depreciation, amortization and other non-cash charges).

**INVESTING ACTIVITIES** – Net cash used in investing activities for the nine months ended March 31, 2017 and 2016 were \$282,438 and \$923,817, respectively.

The \$282,438 in net cash used in investing activities for the nine months ended March 31, 2017 was primarily due to the payments for capitalized product development of \$180,578 and purchases of intangible assets and property and equipment of \$56,661 and \$45,199, respectively. The \$923,817 in net cash used in investing activities for the nine months ended March 31, 2016 was primarily due to the payments for capitalized product development of \$663,800 and purchases of intangible assets and property and equipment of \$177,647 and \$82,370, respectively.

**FINANCING ACTIVITIES** – Net cash provided by financing activities for the nine months ended March 31, 2017 was \$104,820, and net cash used in financing activities for the nine months ended March 31, 2016 was \$364,395.

The \$104,820 in net cash provided by financing activities for the nine months ended March 31, 2017 was due to the cash received from the exercise of stock options. The \$364,395 in net cash used in financing activities for the nine months ended March 31, 2016 was due to the repurchase of 130,000 shares of our common stock from a shareholder and the principal repayment of short-term borrowings of \$148,295, which were partially offset by the cash received from the exercise of stock options.

## **CONTRACTUAL OBLIGATIONS AND OTHER COMMITMENTS**

### **Leases**

We leased approximately 11,318 square feet of office space located in San Diego, California, at a monthly rent of \$16,576; although the lease expired on August 31, 2015, we continued to occupy the premises with the consent of the landlord through October 27, 2015. On September 9, 2015, we signed a lease for new office space consisting of approximately 12,775 square feet, also located in San Diego, California, at a monthly rent of \$23,115, which commenced on October 28, 2015. In addition to monthly rent, the new lease includes payment for certain common area costs. The term of the lease for the new office space is four years from the lease commencement date. Our facility is covered by an appropriate level of insurance and we believe it to be suitable for our use and adequate for our present needs. Rent expense related to these leases was \$69,344 for the three months ended March 31, 2017 and 2016, respectively, and \$208,033 and \$200,424 for the nine months ended March 31, 2017 and 2016, respectively.

Our Korea-based subsidiary, FTI, leases approximately 10,000 square feet of office space in Seoul, Korea, at a monthly rent of approximately \$8,000, and the lease expires on September 1, 2017. Beginning on June 12, 2015, FTI leased additional office space consisting of approximately 2,682 square feet, also located in Seoul, Korea, at a monthly rent of approximately \$2,700, and the lease expires on September 1, 2017. In addition to monthly rent, the lease provides for periodic cost of living increases in the base rent and payment for certain common area costs. These facilities are covered by an appropriate level of insurance and we believe them to be suitable for our use and adequate for our present needs. Rent expense related to these leases was approximately \$32,100 for the three months ended March 31, 2017 and 2016, and approximately \$96,300 for the nine months ended March 31, 2017 and 2016.

We lease one corporate housing facility for our employees who travel, under a non-cancelable operating lease that expired on September 13, 2015 and was extended to September 5, 2017. Rent expense related to this lease was \$2,511 and \$2,371 for the three months ended March 31, 2017 and 2016, respectively, and \$7,499 and \$7,267 for the nine months ended March 31, 2017 and 2016, respectively.

### **Recently Issued Accounting Pronouncements**

Refer to NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES in the Consolidated Financial Statements.

### **OFF-BALANCE SHEET ARRANGEMENTS**

None.

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

As a “smaller reporting company,” the Company is not required to respond to this item.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

Our management has evaluated, under the supervision and with the participation of our President and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, our President and our Chief Financial Officer have concluded that, as of March 31, 2017, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the SEC and (ii) accumulated and communicated to our management, including our principal executive and principal accounting officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

#### **Changes in Internal Control Over Financial Reporting**

There have been no changes in our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the three months ended March 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



## **PART II – OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

We have provided information about legal proceedings in which we are involved in Note 7 of the notes to consolidated financial statements for the nine months ended March 31, 2017, contained within this Quarterly Report on Form 10-Q.

### **ITEM 1A. RISK FACTORS**

Our Annual Report on Form 10-K for the fiscal year ended June 30, 2016, filed with the SEC on September 28, 2016 (the “Annual Report”), includes a detailed discussion of our risk factors under the heading “PART I, ITEM 1A – RISK FACTORS.” You should carefully consider the risk factors discussed in our Annual Report, as well as other information in this quarterly report. Any of these risks could cause our business, financial condition, results of operations and future growth prospects to suffer. We are not aware of any material changes from the risk factors previously disclosed.

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

### **ITEM 4. MINE SAFETY DISCLOSURES**

None.

### **ITEM 5. OTHER INFORMATION**

None.

## ITEM 6. EXHIBITS

- 31.1\* Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - 31.2\* Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - 32.1\* Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  - 32.2\* Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  - 101.INS\* XBRL Instance Document
  - 101.SCH\* XBRL Schema Document
  - 101.CAL\* XBRL Calculation Linkbase Document
  - 101.DEF\* XBRL Definition Linkbase Document
  - 101.LAB\* XBRL Label Linkbase Document
  - 101.PRE\* XBRL Presentation Linkbase Document
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\* Filed or furnished herewith.

SIGNATURES

In accordance with Section 13 of 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Franklin Wireless Corp.

/s/ OC Kim

By:

OC Kim

President

(Principal Executive Officer)

/s/ Richard T. Walker

By:

Richard T. Walker

Chief Financial Officer

(Principal Financial Officer)

Dated: May 15, 2017

