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ZOOM TECHNOLOGIES INC
Form 10-K/A
June 12, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K/A

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2002
or
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number 0-18672

ZOOM TECHNOLOGIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

51-0448969

(State or Other Jurisdiction of
Incorporation or Organization)

(I.R.S. Employer
Identification No.)

207 South Street, Boston, Massachusetts
(Address of Principal Executive Offices)

02111
(Zip Code)

Registrant's Telephone Number, Including Area Code: (617) 423-1072
Securities Registered Pursuant to Section 12 (b) of the Act: None
Securities Registered Pursuant to Section 12 (g) of the Act:

Common Stock, \$.01 Par Value
(Title of Class)

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 a check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). YES NO

The aggregate market value of the common stock, \$0.01 par value, of the registrant held by non-affiliates of the registrant as of June 28, 2002 (computed by reference to the closing price of such stock on The Nasdaq Market on such date) was approximately \$6,288,693.

The number of shares outstanding of the registrant's common stock, \$0.01 par value, as of March 20, 2003 was 7,858,266 shares.

DOCUMENTS INCORPORATED BY REFERENCE

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Portions of the registrant's proxy statement for the registrant's 2003 annual meeting of shareholders to be filed with the SEC in April 2003 are incorporated by reference into Part III, Items 10-13 of this Form 10-K, as amended.

INTRODUCTORY NOTE

This Amendment No. 1 to Annual Report on Form 10-K is primarily being filed to amend and restate footnote 2(k) and footnote 11 of the Company's financial statements contained in Item 8 of Part II of the Company's Annual Report on Form 10-K for the year ended December 31, 2002, as filed by the Company on March 28, 2003, to correct the results of inadvertent errors made in the calculation of the pro forma effect on net income (loss) and earnings (loss) per share applying the fair value recognition provisions of FASB No. 123 to stock-based compensation included therein and the per share weighted average fair value of stock options granted. No other changes have been made to the financial statements or notes relating thereto. The Company is also filing additional exhibits.

The effect of the restatement of footnote 2(k) and footnote 11 on previously reported consolidated financial statements as of and for the years ended December 31, 2002, 2001 and 2000 is as follows:

As originally reported:

| | YEAR ENDED DECEMBER 31, | | |
|--|-------------------------|-----------------|----------------|
| | 2000 | 2001 | 2002 |
| Net income (loss), as reported..... | \$ (3,077,248) | \$ (18,328,922) | \$ (5,135,580) |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects..... | (837,541) | (683,521) | (225,230) |
| Pro forma net income (loss)..... | \$ (3,914,789) | \$ (19,012,443) | \$ (5,360,810) |
| Earnings (loss) per share: | | | |
| Basic -- as reported..... | \$ (0.40) | \$ (2.33) | \$ (0.60) |
| Basic - pro forma..... | \$ (0.50) | \$ (2.42) | \$ (0.60) |
| Diluted -- as reported..... | \$ (0.40) | \$ (2.33) | \$ (0.60) |
| Diluted - pro forma..... | \$ (0.50) | \$ (2.42) | \$ (0.60) |

Weighted-average assumptions: 2000 - expected dividend yield 0.0%, risk-free interest rate of 5.90%, volatility 110% and an expected life of 3.0 years; 2001 - expected dividend yield 0.0%, risk-free interest rate of 4.63%, volatility 101% and an expected life of 1.7 years; 2002 - expected dividend yield 0.00%, risk-free interest rate of 3.53%, volatility 140% and an expected life of 1.4 years.

On December 31, 2002 there were 845,446 additional shares available for issuance under all three stock option plans. The per share weighted-average fair value of stock options granted during 2000, 2001, and 2002 was \$6.84, \$2.70 and \$0.93, respectively, on the date of grant using the Black Scholes option-pricing model.

As restated:

YEAR ENDED DECEMBER 31,

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| | 2000 ----- | 2001 ----- | 2002 ----- |
|--|----------------|-----------------|---------------|
| Net income (loss), as reported..... | \$(3,077,248) | \$(18,328,922) | \$(5,135,58 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects..... | (1,616,219) | (1,834,280) | (1,109,00 |
| Pro forma net income (loss)..... | \$ (4,693,467) | \$ (20,163,202) | \$ (6,244,58 |
| Earnings (loss) per share: | | | |
| Basic -- as reported..... | \$ (0.40) | \$ (2.33) | \$ (0.6 |
| Basic - pro forma..... | \$ (0.61) | \$ (2.57) | \$ (0.7 |
| Diluted -- as reported..... | \$ (0.40) | \$ (2.33) | \$ (0.6 |
| Diluted - pro forma..... | \$ (0.61) | \$ (2.57) | \$ (0.7 |

Weighted-average assumptions: 2000 - expected dividend yield 0.0%, risk-free interest rate of 6.26%, volatility 90% and an expected life of 2.0 years; 2001 - expected dividend yield 0.0%, risk-free interest rate of 3.83%, volatility 102% and an expected life of 2.0 years; 2002 - expected dividend yield 0.00%, risk-free interest rate of 2.65%, volatility 106% and an expected life of 2.5 years.

On December 31, 2002 there were 845,446 additional shares available for issuance under all three stock option plans. The per share weighted-average fair value of stock options granted during 2000, 2001, and 2002 was \$3.48, \$1.47 and \$0.54, respectively, on the date of grant using the Black Scholes option-pricing model.

PART II

ITEM 8 - FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

ZOOM TECHNOLOGIES, INC.
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AND SCHEDULE

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Independent Auditors' Report

The Board of Directors and Stockholders
Zoom Technologies, Inc.:

We have audited the accompanying consolidated balance sheets of Zoom Technologies, Inc. and subsidiary as of December 31, 2001 and 2002, and the

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related consolidated statements of operations, stockholders' equity and comprehensive loss and cash flows for each of the years in the three-year period ended December 31, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Zoom Technologies, Inc. and subsidiary as of December 31, 2001 and 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America.

/s/ KPMG LLP

Boston, Massachusetts
February 11, 2003, except as to notes 3
and 7(c) which are as of March 28, 2003.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY CONSOLIDATED BALANCE SHEETS

| | December 31, | |
|---|---------------|---------------|
| Assets | 2001 | 2002 |
| Current assets: | | |
| Cash and cash equivalents | \$ 5,252,058 | \$ 7,612,274 |
| Accounts receivable, net of reserves for doubtful accounts, returns, and allowances \$2,816,449 in 2001 and \$2,646,408 in 2002 (note 13) | 5,652,035 | 3,714,202 |
| Inventories, net (note 5) | 11,083,143 | 6,782,550 |
| Prepaid expenses and other current assets | 999,662 | 1,037,733 |
| Total current assets | 22,986,898 | 19,146,759 |
| Property, plant and equipment, net (note 6) | 4,128,916 | 3,485,911 |
| Net deferred tax assets (note 12) | 2,012,844 | - |
| Other assets | 56,666 | - |
| Total assets | \$ 29,185,324 | \$ 22,632,670 |

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Liabilities and Stockholders' Equity

| | | |
|---|---------------|---------------|
| Current liabilities: | | |
| Accounts payable | \$ 2,750,174 | \$ 2,406,843 |
| Accrued expenses | 1,879,566 | 1,207,724 |
| Current portion of long term debt (note 10) | 139,201 | 191,550 |
| | ----- | ----- |
| Total current liabilities | 4,768,941 | 3,806,117 |
| Long-term debt, less current portion (note 10) | 5,745,368 | 5,342,057 |
| Other non-current liabilities (note 8) | 255,287 | - |
| | ----- | ----- |
| Total liabilities | 10,769,596 | 9,148,174 |
| | ----- | ----- |
| Stockholders' equity (note 11): | | |
| Common stock, no par value at December 31, 2001 and \$0.01 par value at December 31, 2002. Authorized 25,000,000 shares; issued 7,860,866 shares and outstanding 7,860,866 and 7,858,266 shares at December 31, 2001 and December 31, 2002, respectively. | | |
| | 28,245,215 | 282,452 |
| Additional paid-in capital | - | 27,962,763 |
| Retained earnings (accumulated deficit) | (9,634,692) | (14,770,278) |
| Accumulated other comprehensive income (loss) | (194,795) | 11,755 |
| Treasury stock, at cost | - | (2,196) |
| | ----- | ----- |
| Total stockholders' equity | 18,415,728 | 13,484,496 |
| | ----- | ----- |
| Total liabilities and stockholders' equity | \$ 29,185,324 | \$ 22,632,670 |
| | ===== | ===== |

See accompanying notes to consolidated financial statements.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
Years Ending December 31, 2000, 2001 and 2002

| | 2000 | 2001 | 2002 |
|--|---------------|---------------|---------------|
| | ----- | ----- | ----- |
| Net sales (notes 4, 13 and 17) | \$ 57,708,456 | \$ 41,570,276 | \$ 37,274,000 |
| Cost of goods sold (note 5) | 39,404,320 | 35,193,449 | 27,937,000 |
| | ----- | ----- | ----- |
| Gross profit | 18,304,136 | 6,376,827 | 9,336,000 |
| | ----- | ----- | ----- |
| Operating expenses: | | | |
| Selling | 10,672,025 | 7,480,297 | 5,848,000 |
| General and administrative (note 8) .. | 6,228,317 | 7,938,175 | 3,405,000 |
| Research and development | 6,249,092 | 5,327,968 | 3,526,000 |
| | ----- | ----- | ----- |
| Total operating expenses | 23,149,434 | 20,746,440 | 12,779,000 |
| | ----- | ----- | ----- |

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| | | | |
|---|----------------|-----------------|------------|
| Operating loss | (4,845,298) | (14,369,613) | (3,442, |
| Other income (expense): | | | |
| Interest income | 447,148 | 198,805 | 102, |
| Interest expense..... | - | (454,708) | (293, |
| Equity in losses of affiliate (note 14) | (215,834) | (145,165) | (56, |
| Other, net | 237,820 | 241,759 | 313, |
| Total other income (expense), net | 469,134 | (159,309) | 66, |
| Income (loss) before income taxes and extraordinary item | (4,376,164) | (14,528,922) | (3,376, |
| Income tax expense (benefit) (note 12) | (1,298,916) | 3,800,000 | 2,014, |
| Income (loss) before extraordinary item | (3,077,248) | (18,328,922) | (5,390, |
| Extraordinary gain on elimination of negative goodwill | - | - | 255, |
| Net Income (loss) | \$ (3,077,248) | \$ (18,328,922) | \$ (5,135, |
| Basic and diluted earnings (loss) per share (note 2): | | | |
| Loss before extraordinary item: | | | |
| Basic and diluted..... | \$ (.40) | \$ (2.33) | \$ (|
| Extraordinary gain on elimination of negative goodwill | \$ - | \$ - | \$ |
| Net loss: | | | |
| Basic and diluted..... | \$ (.40) | \$ (2.33) | \$ (|
| Weighted average common and common equivalent shares: | | | |
| Basic and diluted..... | 7,756,815 | 7,860,866 | 7,860, |

See accompanying notes to consolidated financial statements.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND
COMPREHENSIVE LOSS

| | Common Shares | Stock Amount | Additional Paid In Capital | Retained Earnings (accumulated deficit) | Accumulate Other Comprehensi Income (Los |
|--|------------------|-----------------|----------------------------------|--|---|
| | ----- | ----- | ----- | ----- | ----- |
| Balance at December 31, 1999 | 7,560,296 | 25,780,231 | - | 11,771,478 | (37,62 |
| Net profit (loss) | - | - | - | (3,077,248) | |
| Foreign currency translation adjustment | - | - | - | - | (80,78 |
| Unrealized holding gain on investments | - | - | - | - | 26,25 |

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| | | | | | |
|--|-----------|--------------|------------|-----------------|-----------|
| Comprehensive loss | - | - | - | - | - |
| Exercise of stock options (note 11) | 300,570 | 1,822,722 | - | - | - |
| Compensation expense related to issuance of restricted stock ... | - | 52,577 | - | - | - |
| Tax effect of exercises of non-qualified stock options (notes 11 and 12) | - | 489,845 | - | - | - |
| Balance at December 31, 2000 .. | 7,860,866 | \$28,145,375 | - | \$ 8,694,230 | \$ (92,1 |
| Net profit (loss) | - | - | - | (18,328,922) | |
| Foreign currency translation adjustment | - | - | - | - | (102,6 |
| Unrealized holding gain on investments | - | - | - | - | |
| Comprehensive loss | - | - | - | - | |
| Compensation expense related to issuance of restricted stock .. | - | 99,840 | - | - | |
| Balance at December 31, 2001 .. | 7,860,866 | \$28,245,215 | - | \$ (9,634,692) | \$ (194,7 |
| Net profit (loss) | - | - | - | (5,135,586) | |
| Foreign currency translation adjustment | - | - | - | - | 206,5 |
| Comprehensive loss | - | - | - | - | |
| Incorporation to Delaware corporation | - | (27,962,763) | 27,962,763 | - | |
| Purchase of treasury stock | - | - | - | - | |
| Balance at December 31, 2002 .. | 7,860,866 | \$ 282,452 | 27,962,763 | \$ (14,770,278) | \$ 11,7 |

See accompanying notes to consolidated financial statements.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ending December 31, 2000, 2001 and 2002

| | 2000 | 2001 | |
|--|----------------|-----------------|--------|
| | ---- | ---- | |
| Cash flows from operating activities: | | | |
| Net income (loss) | \$ (3,077,248) | \$ (18,328,922) | \$ (5, |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | | |
| Extraordinary gain on negative goodwill | - | - | (|
| Depreciation and amortization | 1,613,276 | 1,769,608 | |
| Impairment of goodwill | - | 2,294,881 | |
| Amortization of unearned compensation expense | 52,577 | 99,840 | |
| Equity in losses of affiliate | 215,834 | 145,165 | |
| Net deferred income taxes | (1,843,874) | 3,800,000 | 2, |
| Tax benefit from exercise of nonqualified stock options | 489,845 | - | |
| Changes in operating assets and liabilities, net of acquisitions | | | |
| Accounts receivable | (2,514,401) | 2,271,932 | 2, |
| Inventories | (7,593,276) | 10,813,740 | 4, |

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| | | | |
|--|--------------|--------------|-------|
| Prepaid expenses and other current assets | (106,651) | (296,655) | |
| Accounts payable and accrued expenses | 4,766,116 | (5,214,009) | (1,) |
| | ----- | ----- | ----- |
| Net cash provided by (used in) operating activities | (7,997,802) | (2,644,420) | 2, |
| | ----- | ----- | ----- |
| Cash flows from investing activities: | | | |
| Sales of investment securities, net | 3,215,329 | 53 | |
| Investment in affiliates | - | (141,665) | |
| Purchases of property, plant and equipment | (1,324,268) | (650,060) | (|
| | ----- | ----- | ----- |
| Net cash provided by (used in) investing activities | 1,891,061 | (791,672) | (|
| | ----- | ----- | ----- |
| Cash flows from financing activities: | | | |
| Proceeds from the issuance of long-term debt | - | 6,000,000 | |
| Repayment of long-term debt | - | (115,431) | (|
| Exercise of nonqualified stock options | 1,875,299 | - | |
| Payments to acquire treasury stock | - | - | |
| | ----- | ----- | ----- |
| Net cash provided by (used in) financing activities | 1,875,299 | 5,884,569 | (|
| | ----- | ----- | ----- |
| Effect of exchange rate changes on cash | (80,788) | (102,689) | |
| | ----- | ----- | ----- |
| Net increase (decrease) in cash and cash equivalents | (4,312,230) | 2,345,788 | 2, |
| | ----- | ----- | ----- |
| Cash and cash equivalents at beginning of year | 7,218,500 | 2,906,270 | 5, |
| | ----- | ----- | ----- |
| Cash and cash equivalents at end of year | \$ 2,906,270 | \$ 5,252,058 | \$ 7, |
| | ===== | ===== | ===== |

See accompanying notes to consolidated financial statements.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements
Years Ending December 31, 2000, 2001 and 2002

(1) Incorporation and Nature of Operations

Zoom Telephonics, Inc. (the "Company") was incorporated under the federal laws of Canada (Canada Business Corporations Act). Its principal business activity, the design, production, and marketing of faxmodems and other communication peripherals, is conducted through its wholly-owned subsidiary, Zoom Telephonics, Inc. ("Zoom US"), a Delaware corporation based in Boston, Massachusetts.

In February 2002, the Company completed a transaction in which it changed its jurisdiction of incorporation from Canada to the State of Delaware effective March 1, 2002. In connection with the change in jurisdiction, the Company changed its name to Zoom Technologies, Inc. These changes were accomplished through a process called a continuance under the laws of Canada and a domestication under the laws of the State of Delaware, and were approved by the Company's shareholders at a stockholders' meeting on February 15, 2002.

As part of the continuation, each share of Zoom Telephonics, Inc. was automatically converted into one share of Zoom Technologies, Inc.

(2) Summary of Significant Accounting Policies

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(a) Basis of Presentation and Use of Estimates

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and are stated in US dollars.

The preparation of financial statements in conformity with generally accepted accounting principles 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 revenue and expenses during the reporting period. Actual results may differ from those estimates. Significant estimates made by the Company include the useful lives of property, plant and equipment and goodwill, the recoverability of long-lived assets, the collectibility of accounts receivable, the valuation allowance for deferred tax assets, the valuation of sales returns and allowances, the reserves for obsolete and slow moving inventory, and the write-downs of inventory valuation for the lower cost of market.

(b) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Zoom US, and all of its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

(c) Cash and Cash Equivalents

The Company considers all investments with original maturities of less than 90 days to be cash equivalents. Included in cash and cash equivalents at December 31, 2002 and 2001 was a deposit for approximately \$241,000 and \$218,000, respectively, in a duty deferment account approved by H.M. Customs and Excise in the United Kingdom for the deferment of value added taxes for imports.

(d) Inventories

Inventories are stated at the lower of cost or market, cost being determined using the first-in, first-out (FIFO) method.

(e) Property, plant and equipment

Property, plant and equipment is stated and recorded at cost. Depreciation of property, plant and equipment is provided by using the straight-line method at rates sufficient to amortize the costs of the fixed assets over their estimated useful lives.

(f) Accounting for Impairment of Long-Lived Assets

The Company uses the provisions of Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

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

Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less cost to sell.

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(g) Income Taxes

The Company accounts for income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

(h) Earnings (Loss) Per Common Share

Basic earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted loss per share is computed by dividing net income by the weighted average number of common shares and dilutive potential common shares outstanding during the period. Under the treasury stock method, the unexercised options are assumed to be exercised at the beginning of the period or at issuance, if later. The assumed proceeds are then used to purchase common shares at the average market price during the period.

| | 2000 ---- | 2001 ---- | 2002 ---- |
|--|--------------|--------------|--------------|
| Basic weighted | | | |
| average shares outstanding | 7,756,815 | 7,860,866 | 7,860,650 |
| Net effect of dilutive potential | | | |
| common shares outstanding, based on the treasury stock method | - | - | - |
| | ----- | ----- | ----- |
| Diluted weighted | | | |
| average shares outstanding | 7,756,815 | 7,860,866 | 7,860,650 |
| | ===== | ===== | ===== |

Potential common shares for which inclusion would have the effect of increasing diluted earnings per share (i.e., antidilutive) are excluded from the computation. The dilutive effect of options to purchase 419,039, 13,870 and 3,814 shares of common stock at December 31, 2000, 2001, and 2002, respectively, were outstanding, but not included in the computation of diluted earnings per share as their effect would be antidilutive.

(i) Revenue Recognition

The Company sells hardware products to its customers. The products are dial-up modems, embedded modems, cable modems, PC cameras, ISDN and ADSL modems, telephone dialers, and wireless and wired networking equipment. The Company generally does not sell software or services. The Company earns a small amount of royalty revenue. The Company derives its revenue primarily from the sales of hardware products to three types of customers (1) computer peripherals retailers, (2) computer product distributors, and (3) original equipment manufacturers (OEMs). The Company sells a very small amount of its hardware products to direct consumers or to any customers via the Internet. As described below, management judgments and estimates must be made and used in connection with the revenue recognized in any accounting period. Material differences may result in the amount and timing of the Company's revenue for any period if its management makes different judgments or utilizes different estimates.

Revenue is recognized by the Company for all three types of customers at

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the point when the customers take legal ownership of the delivered products. Legal ownership passes from the Company to the customer

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

based on the contractual FOB point specified in signed contracts and purchase orders, which are both used extensively. Many of the Company's customer contracts or purchase orders specify FOB destination. Since it would be impractical to verify ownership change for each individual delivery to the FOB destination point, the Company estimates the day of delivery receipt by the customer based on its ship date and the carrier's published delivery schedule specific to the freight class and location.

The Company's revenues are reduced by certain events which are characteristic of hardware sales to computer peripherals retailers. These events are product returns, price protection refunds, store rebates, and consumer mail-in rebates. Each of these is accounted for as a reduction of revenue based on careful management estimates, which are reconciled to actual customer or end-consumer refunds and credits on a monthly or quarterly basis. The estimates for product returns are based on recent historical trends plus estimates for returns prompted by new product introductions, announced stock rotations, announced customer store closings, etc. Management analyzes historical returns, current economic trends, and changes in customer demand and acceptance of the Company's products when evaluating the adequacy of sales return allowances. The Company's estimates for price protection refunds require a detailed understanding and tracking by customer, by sales program. Estimated price protection refunds are recorded in the same period as the announcement of a pricing change. Information from customer inventory-on-hand reports or from direct communications with the customers is used to estimate the refund, which is recorded as a reserve against accounts receivable and a reduction of current period revenue. The Company's estimates for consumer mail-in rebates are comprised of actual rebate claims processed by the rebate redemption centers plus an accrual for an estimated lag in processing. The Company's estimates for store rebates are comprised of actual credit requests from the eligible customers.

(j) Financial Instruments

Financial instruments of the Company consist of cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, and borrowings. Due to the short term nature of these instruments of conversion to cash or the corresponding variable interest rate attached to the debt, the carrying amount of these financial instruments approximates fair value.

(k) Stock-Based Compensation

The Company accounts for stock based compensation under SFAS No. 123, "Accounting for Stock-Based Compensation" (SFAS 123). As permitted by SFAS 123, the Company measures compensation cost in accordance with Accounting Principles Board Opinion (APB) No. 25 (APB 25), "Accounting for Stock Issued to Employees," and FASB interpretation No. 44 (FIN 44). Accordingly, no accounting recognition is given to stock options granted at fair market value until they are exercised. Upon exercise, net proceeds, including tax benefits realized, if any, are credited to equity.

The following table illustrates the effect on net income (loss) and earnings (loss) per share if the Company had applied the fair value recognition provisions of FASB 123 to stock based compensation.

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| | YEAR ENDED DECEMBER 31, | | |
|--|-------------------------|-----------------|---------------|
| | 2000 | 2001 | 2002 |
| Net income (loss), as reported..... | \$ (3,077,248) | \$ (18,328,922) | \$ (5,135,58) |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects..... | (1,616,219) | (1,834,280) | (1,109,00) |
| Proforma net income (loss)..... | \$ (4,693,467) | \$ (20,163,202) | \$ (6,244,58) |
| Earnings (loss) per share: | | | |
| Basic -- as reported..... | \$ (0.40) | \$ (2.33) | \$ (0.6) |
| Basic -- proforma..... | \$ (0.61) | \$ (2.57) | \$ (0.7) |
| Diluted -- as reported..... | \$ (0.40) | \$ (2.33) | \$ (0.6) |
| Diluted -- proforma..... | \$ (0.61) | \$ (2.57) | \$ (0.7) |

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

Weighted-average assumptions: 2000 - expected dividend yield 0.0%, risk-free interest rate of 6.26%, volatility 90% and an expected life of 2.0 years; 2001 - expected dividend yield 0.0%, risk-free interest rate of 3.83%, volatility 102% and an expected life of 2.0 years; 2002 - expected dividend yield 0.00%, risk-free interest rate of 2.65%, volatility 106% and an expected life of 2.5 years.

(l) Advertising Costs

Advertising costs are expensed as incurred and reported in selling, general, and administrative expenses in the accompanying consolidated statements of operations and include costs of advertising, production, trade shows, and other activities designed to enhance demand for the Company's products. There are no deferred advertising costs in the accompanying consolidated balance sheets.

(m) Investments in Affiliates

Investments in which the Company has no significant influence over the investee are accounted for under the cost method of accounting. Investments in which the Company exercises significant influence but which the Company does not control are accounted for under the equity method of accounting. Under the equity method, investments are stated at cost and are adjusted for the Company's share of earnings and losses, contributions and distributions.

(n) Foreign Currencies

The Company generates a portion of its revenues in international markets and denominated in foreign currencies, which subjects its operations to exposure to foreign currency fluctuations. The impact of currency fluctuations can be positive or negative in any given period. During the years ending December 31, 2000, 2001, and 2002 foreign currency transaction activity, gains, and losses were not material. At December 31, 2002, the Company's foreign currency-denominated net assets were not material. The Company has no involvement with derivative financial instruments.

The Company considers the local currency to be the functional currency for its international subsidiary. Assets and liabilities denominated in

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foreign currencies are translated using the exchange rate of the balance sheet date. Revenues and expenses are translated at average exchange rates prevailing during the year. Translation adjustments resulting from this process are charged or credited to accumulated other comprehensive loss.

(o) Warranty Costs

The Company provides currently for the estimated costs that may be incurred under its standard warranty obligations.

(3) Liquidity

In 2002, the Company's net cash provided by operating activities was \$2.9 million and net cash used in investing activities was \$.2 million. In 2001, the Company obtained a mortgage on its corporate headquarters, which provided financing of \$6 million. On December 31, 2002 Zoom had cash and cash equivalents of approximately \$7.6 million. Currently the Company does not have a debt facility from which it can borrow, and it does not expect to obtain one on acceptable terms unless there is operating performance improvement.

To conserve cash and manage the Company's liquidity, the Company has implemented expense reductions throughout 2001 and 2002. The employee headcount was 313 at December 31, 2000, which has been reduced to 185 at December 31, 2002. The Company will continue to assess its cost structure as it relates to its revenues and cash position in 2003, and may make further reductions if these actions are deemed necessary.

Trends including the bundling, by PC manufacturers, of dial-up modems into computers and the increased popularity of broadband modems lower the total available market through our sales channels. Because of this, our dial-up modem sales are unlikely to grow unless the Company's market share grows, or the new V.92 and V.44 modem standards grow sales through the Company's channels. If the Company's dial-up modem sales do not grow, the Company's future success will depend in large part on its ability to successfully penetrate the broadband modem, networking, and dialer markets.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements (Continued)

The Company's cash position at December 31, 2002 was \$7.6 million. Management believes it has sufficient resources to fund its planned operations over the next 12 months. However, if the Company is unable to increase its revenues, reduce its expenses, or raise capital, the Company's longer-term ability to continue as a going concern and achieve its intended business objectives could be adversely affected.

(4) New Accounting Pronouncements

FASB Emerging Issues Task Force Issue No. 00-14 "Accounting for Certain Sales Incentives" addresses the recognition, measurement, and income statement classification for certain types of sales incentives. The application of the guidance in Issue No. 00-14 results in a change in the manner in which the Company records certain types of discounts and sales and marketing incentives that are provided to its customers. The Company has historically recorded certain types of these incentives as marketing expenses. Under Issue No. 00-14, the Company will record these discounts and incentives as reductions of revenue. In April 2001, the FASB Emerging Issues Task Force reached a consensus on Issue No. 00-25 "Accounting for Consideration from a Vendor to a Retailer in Connection with the Purchase or Promotion of the Vendor's Products". Issue No. 00-25 addresses whether certain consideration offered by a vendor to a distributor, including slotting fees, cooperative

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advertising arrangements and "buy-down" programs, should be characterized as operating expenses or reductions of revenue. The requirements of Issue No. 00-14 and 00-25 were implemented in the first fiscal quarter of 2002, at which time prior period reported amounts were reclassified to conform to the new presentation. There is no current year or historical impact on our consolidated balance sheets. EITF Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)," subsequently codified the guidance in Issue No. 00-14 and 00-25. Prior year reclassifications have been made to conform to current presentation and are as follows:

| | Years ending | December 31, | |
|--|---------------|---------------|--|
| | 2000 | 2001 | |
| | ----- | | |
| Revenues: | | | |
| As previously reported | \$ 59,750,187 | \$ 43,709,528 | |
| As reclassified | 57,708,456 | 41,570,276 | |
| Sales and Marketing expenses: | | | |
| As previously reported | 12,713,756 | 9,619,549 | |
| As reclassified | 10,672,025 | 7,480,297 | |

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" (SFAS 146). SFAS 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. This statement is effective for restructuring activities commencing after December 31, 2002. The Company does not believe that the impact of adopting SFAS 146 will have a material impact on its consolidated financial statements.

In November 2002, the FASB issued Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others", which clarifies disclosure and recognition/measurement requirements related to certain guarantees. The disclosure requirements are effective for financial statements issued after December 15, 2002 and the recognition/measurement requirements are effective on a prospective basis for guarantees issued or modified after December 31, 2002. The application of the requirements of FIN 45 did not have a material impact on the Company's financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148 "Accounting for Stock-Based Compensation -- Transition and Disclosure" (SFAS 148). SFAS 148 amends SFAS No. 123 "Accounting for Stock Based Compensation", to provide alternative methods of transition for a

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements (Continued)

voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition guidance and annual disclosure provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. As the Company did

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not make a voluntary change to the fair value based method of accounting for stock-based employee compensation in 2002, the adoption of SFAS 148 did not have a material impact on the Company's financial position and results of operations.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("VIEs"). This Interpretation addresses the consolidation of variable interest entities in which the equity investors lack one or more of the essential characteristics of a controlling financial interest or where the equity investment at risk is not sufficient for the entity to finance its activities without subordinated financial support from other parties. The Interpretation applies to VIEs created after January 31, 2003 and to VIEs in which an interest is acquired after that date. Effective July 1, 2003, it also applies to VIEs in which an interest is acquired before February 1, 2003. The Company may apply the Interpretation prospectively, with a cumulative effect adjustment as of July 1, 2003, or by restating previously issued financial statements with a cumulative effect adjustment as of the beginning of the first year restated. The Company is in the process of evaluating the effects of applying Interpretation No. 46 in 2003. Based on our preliminary analysis, the Company does not anticipate that adoption of Interpretation No. 46 will have a material effect on the Company's consolidated financial statements.

(5) Inventories

Inventories consist of the following at December 31:

| | 2001 | 2002 |
|-----------------|---------------|--------------|
| | ---- | ---- |
| Raw materials | \$ 6,276,480 | \$ 2,808,421 |
| Work in process | 462,389 | 673,275 |
| Finished goods | 4,344,274 | 3,300,854 |
| | ----- | ----- |
| Net Inventory | \$ 11,083,143 | \$ 6,782,550 |
| | ===== | ===== |

During 2001 and 2002 the Company recorded lower of cost or market write-downs of \$4.6 million and \$0.7 million, respectively, related to broadband and wireless inventory.

(6) Property, Plant and Equipment

Property, plant and equipment consists of the following at December 31:

| | 2001 | 2002 | Estimated useful lives |
|---|--------------|--------------|---------------------------|
| | ---- | ---- | ----- |
| Land | \$ 309,637 | \$ 309,637 | - |
| Buildings and improvements | 2,695,346 | 2,761,616 | 31.5 years |
| Leasehold improvements | 473,723 | 483,039 | 5 years |
| Computer hardware and software | 3,509,445 | 3,550,749 | 3 years |
| Machinery and equipment | 1,699,564 | 1,735,057 | 5 years |
| Molds, tools and dies | 1,489,484 | 1,532,064 | 5 years |
| Office furniture and fixtures | 275,516 | 275,516 | 5 years |
| | ----- | ----- | |
| | 10,452,715 | 10,647,678 | |
| Less accumulated depreciation and amortization | (6,323,799) | (7,161,767) | |
| | ----- | ----- | |
| | \$ 4,128,916 | \$ 3,485,911 | |
| | ===== | ===== | |

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY

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Notes to Consolidated Financial Statements (Continued)

(7) Commitments and Contingencies

(a) Lease Obligations

The Company leases a manufacturing and warehousing facility in Boston, Massachusetts, an office facility in Camberley, United Kingdom, and a technical support facility in Boca Raton, Florida. The Boston, Massachusetts lease expires in August 2006. In September 2002, we entered into a 5 year lease, as a tenant, for approximately 3,500 square feet at 950 Broken Sound Parkway NW, Boca Raton, Florida. In March 1999, the Company assumed an office lease from Hayes Microcomputer Products, Inc. at 430 Frimley Business Park, Camberley Surrey, U.K. We have an agreement in principle to extend this lease term to 2006. Total rent expense, under non-cancelable operating leases, was \$463,693, \$546,034 and \$782,000 for the years ending December 31, 2000, 2001 and 2002, respectively.

The Company's estimated future minimum rental payments, excluding executory costs, under these operating leases are set forth in the table below.

| Year | Total |
|------|------------|
| 2003 | \$ 739,836 |
| 2004 | 741,561 |
| 2005 | 743,286 |
| 2006 | 490,632 |
| 2007 | 41,389 |

(b) Purchase Commitments

The Company has entered into supply arrangements with suppliers of some components that include price and other concessions, including no-charge components, for meeting certain purchase requirements or commitments. Under these arrangements the Company is committed to purchase approximately \$8.0 million of components over a period of approximately 30-months that commenced on January 1, 2002, provided that those components were offered at competitive terms and prices. The Company believes that at December 31, 2002, it is on track to meet the \$8.0 million commitment. The Company is also required to purchase either a minimum percentage, as measured by unit purchases or dollar amount of components, from a supplier over a two-year period commencing on January 1, 2002, and the Company is currently exceeding that percentage. In connection with these arrangement, the Company was entitled to receive at least \$3.0 million of no-charge components, based upon the supplier's market price for the components in late 2001 and early 2002, and other pricing concessions based on our purchase volumes. The Company received \$1.2 million of these no-charge components in the fourth quarter of 2001. The Company received the remainder of the no-charge components in the first quarter of 2002. Through December 31, 2002, the Company consumed \$1.8 million of these chips in its manufacturing process and they were shipped in finished products to customers in 2002. In 2002, the Company purchased and paid approximately \$2 million less than would have expected without the no-charge components. Of the original \$3.0 million chip valuation, \$.3 million has been written down as a result of a decline in the market value of the free chips. The favorable impact to the statement of operations is being recognized on a delayed basis as a purchase discount over the total number of components acquired through the 30 month supply agreement. The Company expects that the remaining \$0.8 million total market value of "no charge" components will be consumed in its manufacturing process and shipped in finished products to customers in 2003.

(c) Contingencies

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During 2001, the Company entered into an agreement to purchase the ground lease for a manufacturing facility located at 27 Drydock Avenue in Boston, Massachusetts (the "Drydock Building"). In connection with the proposed purchase of the Drydock Building, the Company paid \$513,500 which was held in escrow as a deposit pending the closing of the transaction. Of this deposit, \$25,000 was nonrefundable. When Zoom was unable to obtain acceptable financing the Seller (the current leaseholder) retained the deposit pending resolution of some disputed facts concerning Zoom's withdrawal from the transaction under the terms of the Purchase and Sale Agreement. While Zoom believed that it was entitled to a return of the \$488,500 refundable portion of the deposit plus interest, the seller directed the escrow agent to hold the funds pending resolution of the dispute.

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

As an alternative to pursuing legal remedies to obtain a return of the deposit, Zoom pursued an arrangement to acquire the Drydock Building in partnership with the following individuals: Frank B. Manning, President and a director of Zoom; Peter R. Kramer, Executive Vice President and a director of Zoom; Bruce M. Kramer, Peter Kramer's brother; and a third party. Under this arrangement, these individuals, either directly or through entities controlled by them, joined together with us as of March 29, 2002 to form the Zoom Group LLC, a Massachusetts limited liability company ("Zoom Group") to purchase the Drydock Building. Zoom and each of the investors owned a 20% interest in the Zoom Group. The managers of the Zoom Group are Peter Kramer and the third party. There are no special allocations among the members of the Zoom Group, and each member is required to contribute his or its proportionate amount of capital in return for its 20% interest.

Effective as of March 29, 2002, the Company entered into a Reinstatement Agreement, Assignment Agreement and Second Amendment to Agreement of Purchase and Sale with the Zoom Group and the owner of the Drydock ground lease. Under this Reinstatement Agreement, the original purchase agreement for the Drydock Building was amended and reinstated, and the company assigned its rights under the purchase agreement to the Zoom Group, together with rights to the \$488,500 refundable portion of the deposit. In connection with this transaction, under a separate letter agreement, the other members of the Zoom Group paid us \$390,800 (\$97,700 each), representing their proportionate share of the deposit assigned to the Zoom Group.

Under the Reinstatement Agreement, the Zoom Group purchased the Drydock Building for a purchase price of \$6.1 million. The Zoom Group obtained a mortgage of \$4.2 million, less closing costs and legal fees. Each member of the Zoom Group contributed \$482,577 for their share of the investment plus initial working capital. These initial capital contributions include each member's share of the deposit.

Under the Zoom Group Operating Agreement, the Company had both the right to sell its interest in the Zoom Group to the other members of the Zoom Group by January 5, 2003 for the Company's original purchase price, and the right to purchase the other members' entire interests in the Zoom Group through December 31, 2005 in accordance with a predetermined formula. Effective January 5, 2003, we exercised our right to sell our interest in the Zoom Group to the other members of the Zoom Group. In March 2003, we received the proceeds from the sale of our interest from the remaining members of the Zoom Group, LLC to the value of \$.48 million, which represents the Company's investment amount less the non-refundable deposit and the negotiated share of

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losses in the Zoom Group, plus interest earned on the Company's original deposit. This action was taken to improve our liquidity position and to reduce our exposure to the Boston real estate market.

Additionally, the Company is party to various lawsuits and administrative proceedings arising in the ordinary course of business. The Company evaluates such lawsuits and proceedings on a case-by-case basis, and its policy is to vigorously contest any such claims which it believes are without merit. The Company's management believes that the ultimate resolution of such pending matters will not materially and adversely affect the Company's business, financial position, results of operations or cash flows. The Company had no Letters of Credit outstanding at December 31, 2002.

(d) Concentrations

The Company participates in the PC peripherals industry, which is characterized by aggressive pricing practices, continually changing customer demand patterns and rapid technological developments. The Company's operating results could be adversely affected should the Company be unable to successfully anticipate customer demand accurately; manage its product transitions, inventory levels and manufacturing process efficiently; distribute its product quickly in response to customer demand; differentiate its products from those of its competitors or compete successfully in the markets for its new products.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements (Continued)

The Company depends on many third-party suppliers for key components contained in its product offerings. For some of these components, the Company may only use a single source supplier, in part due to the lack of alternative sources of supply. If the supply of a key material component is delayed or curtailed, the Company's ability to ship the related product or solution in desired quantities and in a timely manner could be adversely affected, possibly resulting in reductions in net sales. In cases where alternative sources of supply are available, qualification of the sources and establishment of reliable supplies could result in delays and possible reduction in net sales.

In the event that the financial condition of the Company's third-party suppliers for key components was to erode, the delay or curtailment of deliveries of key material components could occur. Additionally, the Company's reliance on third-party suppliers of key material components exposes the Company to potential product quality issues that could affect the reliability and performance of its products and solutions. Any lesser ability to ship its products in desired quantities and in a timely manner due to a delay or curtailment of the supply of material components, or product quality issues arising from faulty components manufactured by third-party suppliers, could adversely affect the market for the Company's products and lead to a reduction in the Company's net sales.

(8) Impairment

In March 1999, the Company entered into a series of independent agreements to acquire most of the modem assets of Hayes Microcomputer Products, Inc. for \$5.0 million in cash. The purchase included the Hayes, Practical Peripherals, Accura, Optima, Century 2, and Cardinal brands and product rights for the USA, Canada, South & Central America, Europe, and the Middle East. In July 1999 the Company finalized the purchase of Hayes Asia Pacific for \$1.1 million in cash. The acquisitions were accounted for as purchases. The excess of cost

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over fair value of net assets acquired was being amortized on a straight-line method over five years.

The Company also recorded negative goodwill that resulted from the purchase of the Hayes U.K., business, where the value of the net assets acquired exceeded the cost. This transaction was independent of other Hayes purchases.

The Company recorded goodwill for two acquisitions, Tribe Computer Works, Inc. in 1996 and certain assets of Hayes Microcomputer Products, Inc. in 1998. The goodwill values for Tribe and Hayes were being amortized over 13 years and 5 years, respectively. In 2001, the Company determined that based on its history of negative cash flows from operations, a forecast of future positive cash flows could not be sufficiently relied upon to support retaining the remaining goodwill assets on the consolidated balance sheet. Therefore, the Company recorded an impairment charge of \$2.3 million in 2001 and on January 1, 2002, the Company recorded an extraordinary gain of \$0.3 million upon the adoption of SFAS No. 142. The gain resulted from the elimination of the remaining negative goodwill on the Company's consolidated balance sheet. As of December 31, 2002, the Company's net goodwill and negative goodwill balances on its consolidated balance sheet are zero.

Net loss before goodwill amortization, net of tax and related per share amounts for the years ended December 31, 2000, 2001, 2002 is as follows (in thousands, except per share amounts):

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

| | Year ended December 31, | | |
|---|-------------------------|-------------|------------|
| | 2000 | 2001 | 2002 |
| | ---- | ---- | ---- |
| Net loss as reported | \$ (3,077) | \$ (18,329) | \$ (5,136) |
| Add back: Goodwill amortization expense net of tax effect | 569 | 781 | - |
| | ----- | ----- | ----- |
| Adjusted net loss | \$ (2,508) | \$ (17,548) | \$ (5,136) |
| Basic and diluted loss per share, as reported | \$ (0.39) | \$ (2.33) | \$ (0.65) |
| Add back: Goodwill amortization expense net of tax effect | 0.07 | 0.10 | - |
| | ----- | ----- | ----- |
| Proforma basic and diluted loss per share | \$ (0.32) | \$ (2.23) | \$ (0.65) |

(9) Comprehensive Income (loss)

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

| | 2000 | 2001 | 2002 |
|--|----------------|-----------------|----------------|
| | ---- | ---- | ---- |
| Net income (loss) | \$ (3,077,248) | \$ (18,328,922) | \$ (5,135,586) |
| Foreign currency translation adjustment | (80,788) | (102,689) | 206,550 |
| Net unrealized holding gain on investment securities | 26,255 | 53 | - |
| | ----- | ----- | ----- |
| Comprehensive income (loss) | \$ (3,131,781) | \$ (18,431,558) | \$ (4,929,036) |
| | ===== | ===== | ===== |

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(10) Long-Term Debt

On January 10, 2001, the Company obtained a mortgage for \$6 million on the real estate property located at 201 and 207 South Street, Boston, Massachusetts. This is a 20-year direct reduction mortgage with a five-year balloon due January 10, 2006. The interest rate is fixed for one year, based on the one year Federal Home Loan Bank rate plus 2.5 % per annum. The rate is adjusted on January 10th of each calendar year commencing on January 10, 2002. The rate was adjusted to 3.81% on January 10, 2003. On September 24, 2002 the Company paid an additional principal payment of \$178,761 in compliance with a mortgage covenant. Future minimum principal payments are due as follows at December 31, 2002.

| Year | Total |
|-------|--------------|
| 2003 | \$ 191,550 |
| 2004 | 200,664 |
| 2005 | 211,776 |
| 2006 | 4,929,617 |
| | ----- |
| Total | \$ 5,533,607 |
| | ===== |

(11) Stock Option Plans

At December 31, 2002, the Company had three stock option plans, which are described below:

Employee Stock Option Plan

The Employee Stock Option Plan (the "Employee Stock Option Plan") is for officers and certain full-time and part-time employees of the Company. Non-employee directors of the Company are not entitled to participate under this plan. The Employee Stock Option Plan provides for the availability of 2,800,000 shares of common stock for issuance upon the exercise of stock options granted under the plan. Shares of common stock were registered for issuance under this plan in accordance with the Securities Act of 1933. Under this plan, stock options are granted at the discretion of the Stock Option Committee of the Board of Directors at an option price not less than the fair market value of the stock on the date of grant. The options are exercisable in accordance with terms specified by the Stock Option Committee not to exceed ten years from the date of grant. Options outstanding under this plan are as follows:

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

| | Number of shares | Weighted average exercise price |
|------------------------------|------------------|---------------------------------|
| Balance at December 31, 1999 | 1,031,467 | \$ 7.21 |
| Granted | 377,000 | 7.43 |
| Exercised | (196,181) | 7.09 |
| Expired | (254,675) | 10.67 |
| | ----- | ----- |
| Balance at December 31, 2000 | 957,611 | \$ 6.40 |
| Granted | 631,000 | 2.77 |
| Exercised | - | - |
| Expired | (550,611) | 5.85 |
| | ----- | ----- |
| Balance at December 31, 2001 | 1,038,000 | \$ 4.48 |
| Granted | 325,000 | 1.00 |
| Exercised | - | - |
| Expired | (115,000) | 4.84 |
| | ----- | ----- |
| Balance at December 31, 2002 | 1,248,000 | \$ 3.54 |

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The following table summarizes information about fixed stock options under the Employee Stock Option Plan outstanding on December 31, 2002:

| Range of Exercise Prices | Options Outstanding | | | Options Exercisable | |
|--------------------------|---------------------|---|---------------------------------|---------------------|---------------------------------|
| | Number Outstanding | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number Exercisable | Weighted Average Exercise Price |
| \$ 1.00 to \$ 1.75 | 325,000 | 2.40 | \$ 1.00 | - | - |
| 1.75 to 3.50 | 350,000 | 1.60 | 2.20 | 175,000 | - |
| 3.50 to 5.25 | 251,000 | 1.00 | 3.63 | 125,500 | - |
| 5.25 to 7.00 | 100,000 | .50 | 6.36 | 100,000 | - |
| 7.00 to 8.75 | 222,000 | .10 | 8.00 | 222,000 | - |
| ----- | ----- | ----- | ----- | ----- | ----- |
| \$ 1.00 to \$ 8.75 | 1,248,000 | 1.30 years | \$ 3.54 | 622,500 | - |
| ===== | ===== | ===== | ===== | ===== | ===== |

The Company recognized a tax benefit of \$489,845 in 2000 upon the exercise of nonqualified stock options under the Employee Stock Option Plan. This benefit has been recorded as an increase to the value of common stock.

1991 Director Stock Option Plan

In 1991, the Company established the Director Stock Option Plan (the "Directors Plan"). Shares of common stock were registered for issuance under this plan in accordance with the Securities Act of 1933. The Directors Plan was established for all directors of the Company except for any director who is a full-time employee or full-time officer of the Company. Under the Directors Plan, each eligible director is automatically granted an option to purchase 6,000 shares of common stock on July 10 and January 10 of each year, beginning July 10, 1991. The option price is the fair market value of the common stock on the date the option is granted. There are 198,000 shares authorized for issuance. Each option expires two years from the grant date. Options outstanding under this plan are as follows:

| | Number of shares | Weighted average exercise price |
|------------------------------|------------------|---------------------------------|
| Balance at December 31, 1999 | 72,000 | \$ 5.93 |
| Granted | 36,000 | 7.69 |
| Exercised | (42,000) | 5.99 |
| Expired | (6,000) | 7.75 |
| ----- | ----- | ----- |
| Balance at December 31, 2000 | 60,000 | \$ 6.76 |
| Granted | 36,000 | 3.26 |
| Exercised | - | - |
| Expired | (24,000) | 5.37 |
| ----- | ----- | ----- |
| Balance at December 31, 2001 | 72,000 | \$ 5.48 |
| Granted | 36,000 | 1.17 |
| Exercised | - | - |
| Expired | (36,000) | 7.69 |
| ----- | ----- | ----- |
| Balance at December 31, 2002 | 72,000 | \$ 2.21 |
| ===== | ===== | ===== |

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

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The following table summarizes information about fixed stock options under the Directors Plan on December 31, 2002:

| Range of Exercise Prices | Options Outstanding | | | Options Exer | |
|-----------------------------|-----------------------|---|------------------------------------|-----------------------|-----------|
| | Number Outstanding | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number Exercisable | Wei Ex |
| \$ 0.65 to \$ 1.75 | 36,000 | 1.300 | \$ 1.17 | 18,000 | |
| 1.75 to \$ 3.50 | 18,000 | 0.500 | 2.40 | 18,000 | |
| 3.50 to 5.25 | 18,000 | 0.000 | 4.13 | 18,000 | |
| \$ 0.65 to \$ 5.25 | 72,000 | .8 years | \$ 2.21 | 54,000 | |

1998 Employee Equity Incentive Stock Option Plan

The 1998 Employee Equity Incentive Stock Option Plan (the "1998 Plan") was adopted by the Board of Directors to attract and retain employees and provide an incentive for them to assist the Company to achieve long-range performance goals, and to enable them to participate in the long-term growth of the Company. Non-employee directors of the Company and certain officers of the Company are not entitled to participate under this plan. The authorized number of shares available for issuance under the 1998 Plan is 1,200,000 shares of common stock. Shares of common stock were registered for issuance under the 1998 Plan in accordance with the Securities Act of 1933. Under this plan, stock options may be granted at the discretion of the Stock Option Committee of the Board of Directors at an option price determined by the Stock Option Committee. In addition, in 1999, the Board of Directors authorized the Chief Executive Officer of the Company to grant up to an aggregate of 100,000 stock options to employees who are not executive officers or directors of the Company and in 2000, the Board of Directors authorized the Chief Executive Officer to grant to such persons stock options to purchase up to 100,000 shares in any fiscal quarter, not to exceed an aggregate of 350,000 stock options in any fiscal year. All options under this grant have been at fair market value on the date of the grant. The options are exercisable in accordance with terms specified by the Stock Option Committee or, in certain cases, the Chief Executive Officer. Options outstanding under this plan are as follows:

| | Number of shares | Weighted average exercise price |
|------------------------------|------------------|------------------------------------|
| Balance at December 31, 1999 | 328,050 | \$ 4.25 |
| Granted | 514,650 | 6.36 |
| Exercised | (42,050) | 4.27 |
| Expired | (150,275) | 5.01 |
| | ----- | ---- |
| Balance at December 31, 2000 | 650,375 | \$ 5.74 |
| Granted | 248,825 | 2.45 |
| Exercised | - | - |
| Expired | (199,300) | 5.82 |
| | ----- | ---- |
| Balance at December 31, 2001 | 699,900 | \$ 4.55 |
| Granted | 363,600 | 1.00 |
| Exercised | - | - |
| Expired | (283,000) | 3.55 |
| | ----- | ---- |
| Balance at December 31, 2002 | 780,500 | \$ 3.16 |
| | ===== | ===== |

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The following table summarizes information about fixed stock options under the 1998 Plan outstanding on December 31, 2002:

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

| Range of Exercise Prices | Options Outstanding | | | Options Exer | |
|-----------------------------|-----------------------|---|------------------------------------|-----------------------|-----------|
| | Number Outstanding | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number Exercisable | Wei Ex |
| \$ 1.00 to \$ 1.75 | 336,900 | 2.40 | \$ 1.01 | 4,000 | |
| 1.75 to 3.50 | 196,350 | 1.30 | 2.68 | 122,512 | |
| 3.50 to 5.25 | 12,000 | 1.00 | 3.63 | 6,000 | |
| 5.25 to 7.00 | 168,250 | 0.50 | 5.86 | 168,250 | |
| 7.00 to 8.75 | 47,000 | 0.20 | 7.98 | 47,000 | |
| 8.75 to 10.50 | 20,000 | 0.30 | 10.00 | 20,000 | |
| \$ 1.00 to \$10.50 | 780,500 | 1.5 years | \$ 3.16 | 367,762 | |
| ===== | ===== | ===== | ===== | ===== | |

On December 31, 2002 there were 845,446 additional shares available for issuance under all three stock option plans. The per share weighted-average fair value of stock options granted during 2000, 2001, and 2002 was \$3.48, \$1.47 and \$0.54, respectively, on the date of grant using the Black Scholes option-pricing model.

(12) Income Taxes

Income tax expense (benefit) consists of the following:

| | Current | Deferred | Total |
|--------------------------------|-----------|----------------|----------------|
| Year ending December 31, 2000: | | | |
| US federal | \$ 48,160 | \$ (1,539,591) | \$ (1,491,431) |
| State and local | - | 192,515 | 192,515 |
| Foreign | - | - | - |
| | \$ 48,160 | \$ (1,347,076) | \$ (1,298,916) |
| | ===== | ===== | ===== |
| Year ending December 31, 2001: | | | |
| US federal | \$ - | \$ 3,337,900 | \$ 3,337,900 |
| State and local | - | 462,100 | 462,100 |
| Foreign | - | - | - |
| | \$ - | \$ 3,800,000 | \$ 3,800,000 |
| | ===== | ===== | ===== |
| Year ending December 31, 2002: | | | |
| US federal | \$ - | \$ 1,612,634 | \$ 1,612,634 |
| State and local | - | 400,210 | 400,210 |
| Foreign | 1,695 | - | 1,695 |
| | \$ 1,695 | \$ 2,012,844 | \$ 2,014,539 |
| | ===== | ===== | ===== |

Income tax expense (benefit) was (\$1,298,916), \$3,800,000 and \$2,014,539 for the years ending December 31, 2000, 2001 and 2002, respectively, and differed from the amounts as computed by applying the US statutory tax rate of 34% to pretax loss as a result of the following:

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| | 2000 ---- | 2001 ---- |
|---|----------------|----------------|
| Computed "expected" US tax benefit | \$ (1,487,896) | \$ (4,939,834) |
| Increase (reduction) in income taxes resulting from: | | |
| State and local income taxes, net of federal income tax benefit | 127,061 | 304,986 |
| Increase (reduction) in federal valuation allowance | - | 8,427,351 |
| Other, net | 61,919 | 7,497 |
| | ----- | ----- |
| Income tax expense (benefit) | \$ (1,298,916) | \$ 3,800,000 |
| | ===== | ===== |

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

Total income tax expense (benefit) was allocated as follows:

| | 2000 ---- | 2001 ---- |
|--|----------------|--------------|
| Loss from operations | \$ (1,298,916) | \$ 3,800,000 |
| Stockholders' equity, for compensation expense for tax purposes in excess of amounts recognized for financial statement purposes | (489,845) | - |
| | ----- | ----- |
| | \$ (1,788,761) | \$ 3,800,000 |
| | ===== | ===== |

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2000, 2001, and 2002 are presented below:

| | 2000 ---- | 2001 ---- |
|---|--------------|--------------|
| Deferred tax assets: | | |
| Inventories, primarily non-deductible reserves | \$ 1,830,940 | \$ 2,862,364 |
| Accounts receivable, primarily returns and allowances | 534,204 | 497,510 |
| Accrued expenses, principally provisions not currently deductible | 392,011 | 345,249 |
| Net operating loss carryforwards and credits | 3,697,196 | 8,307,793 |
| Other | 525,493 | 1,224,952 |
| | ----- | ----- |
| Total gross deferred tax assets | 6,979,844 | 13,237,868 |
| Less valuation allowance | (1,167,000) | (11,225,024) |
| | ----- | ----- |
| Net deferred tax assets | \$ 5,812,844 | \$ 2,012,844 |
| | ===== | ===== |

On December 31, 2002, the Company had federal and state net operating loss carryforwards of approximately \$20,841,000 and \$20,597,000, respectively. These federal and state net operating losses are available to offset future taxable income, and are due to expire beginning 2018 and 2003, respectively. The Company recorded a deferred tax asset valuation allowance against a portion of the deferred tax assets that management believes may expire unused. The valuation allowance reduces deferred tax assets to reflect the estimated amount of deferred tax assets, which will more likely not be realized.

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Realization of deferred tax assets is dependent upon the generation of future taxable income or gains from the sale or certain real estate. The Company has recorded a valuation allowance against its deferred tax assets because management believes that, after considering all the available objective evidence, historical and prospective, with greater weight given to historical evidence, it is more likely than not that these assets will not be realized.

(13) Significant Customers

Two customers accounted for approximately 15% and 11% of net sales for the year ending December 31, 2000. Four customers each comprised over 10% of net sales for the year ending December 31, 2001. Three customers each comprised over 10% of net sales for the year ending December 31, 2002. On December 31, 2001, two customers comprised approximately 40% of net accounts receivable. On December 31, 2002, three customers comprised approximately 79% of net accounts receivable.

(14) Investment in Affiliates

In September 1999, the Company made an investment in a limited liability company ("LLC"). The Company granted the LLC the rights to a software license in exchange for 300,000 Class A shares of the LLC, which were valued by the Company at \$300,000. The value at which the outside investors paid cash for shares received as part of the same equity infusion was used by the Company to value their shares received. In May 2000, the LLC converted to a "C" corporation. In March 2001, and December 2001, the Company made additional investments in the affiliate for a total of \$141,665, maintaining the same percent of ownership. As a result of the recognition of the Company's share of equity in losses of the affiliate, the investment balance as of December 31, 2002 has been reduced to zero.

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

(15) Supplemental Disclosure of Cash Flow Information

| | 2000 | 2001 | 2002 |
|--|-------|------------|------------|
| | ---- | ---- | ---- |
| Cash paid during year for interest | \$ - | \$ 426,803 | \$ 306,237 |
| | ===== | ===== | ===== |
| Cash paid during year for income taxes | \$ - | \$ - | \$ 66,624 |
| | ===== | ===== | ===== |

The tax benefit of the exercise of stock options resulted in increases to common stock of \$489,845 in 2000. No options were exercised in 2001 or 2002.

(16) Dependence on Key Suppliers and Contract Manufacturers

The Company produces its products using components or subassemblies purchased from third-party suppliers. An important factor in the Company's liquidity is the receipt and use of "no-charge components". The Company has entered into supply arrangements with suppliers of some components that include price and other concessions, including no-charge components, for meeting certain purchase requirements or commitments. Under these arrangements, the Company is committed to purchase approximately \$8.0 million of components over a period of approximately 30-months that commenced on January 1, 2002, provided that those components are were offered at competitive terms and prices. The Company believes that at December 31, 2002, that it's on track to meet the \$8.0 million commitment. The Company is also required to purchase either a minimum percentage, as measured by unit purchases or dollar amount of components, from a supplier over a two-year period commencing on January 1, 2002, and the Company is

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currently exceeding that percentage. In connection with these arrangements, the Company became entitled to receive at least \$3.0 million of no-charge components, based upon the supplier's market price for the components in late 2001 and early 2002, and other pricing concessions based on our purchase volumes. The Company received \$1.2 million of these no-charge components in the fourth quarter of 2001. The Company received the remainder of the no-charge components in the first quarter of 2002. Through December 31, 2002, the Company consumed \$1.8 million of these chips in our manufacturing process and they were shipped in finished products to customers in 2002. In 2002, the Company's purchases and payments were approximately \$2 million less than expected without the no-charge components. Of the original \$3.0 million chip valuation, \$.3 million has been written down as a result of a decline in the market value of the free chips. The favorable impact to the Company's statement of operations is being recognized on a delayed basis as a purchase discount over the total number of components acquired through the 30 month supply agreement. Since the start of these arrangements in January 2002, the favorable impact to the Company's statement operations was \$.8 million.

A substantial percentage of the Company's manufacturing in 2002 was performed by a contract manufacturer, SameTime Electronics, Inc. ("SameTime"); the loss of SameTime's services or a material adverse change in SameTime's business or in the Company's relationship with SameTime could materially and adversely harm the Company's business.

(17) Segment and Geographic Information

The Company's operations are classified into one reportable segment. Substantially all of the Company's operations and long-lived assets reside primarily in the United States. The Company's net sales to North America and net sales to international locations for 2000, 2001, and 2002 were comprised as follows:

| | 2000 | % of Total | 2001 | % of Total | 2002 | % of Total |
|---------------|---------------|------------|---------------|------------|---------------|------------|
| | ----- | ----- | ----- | ----- | ----- | ----- |
| North America | \$ 40,524,456 | 70% | \$ 25,828,176 | 62% | \$ 22,375,552 | 60% |
| International | 17,184,000 | 30% | 15,742,100 | 38% | 14,898,735 | 40% |
| | ----- | --- | ----- | --- | ----- | --- |
| Total | \$ 57,708,456 | 100% | \$ 41,570,276 | 100% | \$ 37,274,287 | 100% |
| | ===== | ==== | ===== | ==== | ===== | ===== |

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements (Continued)

(18) Retirement Plan

The Company established a 401(k) retirement savings plan for employees in January 1996. Under the provisions of the plan, the Company matches 25% of an employee's contribution, up to a maximum of \$350 per employee per year. Total Company contributions in 2000, 2001 and 2002 were \$55,314, \$46,749 and \$34,531, respectively.

(19) Selected Quarterly Financial Information (in thousands, except per share data, unaudited)

The following table sets forth selected quarterly financial for the years ended December 31, 2001 and 2002. The operating results for any given quarter are not necessarily indicative of results for any future period.

2001 Quarter Ending

2002 Quarter

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| | Mar. 31 | June 30 | Sept. 30 | Dec. 31 | Mar. 31 | June 30 | S |
|--|------------|------------|------------|------------|------------|------------|-------|
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| Net sales | 10,027 | \$10,246 | \$11,719 | \$ 9,578 | \$ 8,973 | \$ 9,207 | \$ |
| Costs of goods sold | 9,875 | 8,091 | 8,889 | 8,338 | 7,183 | 7,225 | |
| Gross profit (loss) | 152 | 2,155 | 2,830 | 1,240 | 1,790 | 1,982 | |
| Operating expenses: | | | | | | | |
| Selling | 2,224 | 1,813 | 1,802 | 1,642 | 1,572 | 1,492 | |
| General and administrative | 1,635 | 1,503 | 1,433 | 3,367 | 911 | 852 | |
| Research and development | 1,479 | 1,341 | 1,334 | 1,174 | 1,076 | 856 | |
| Total operating expenses | 5,338 | 4,657 | 4,569 | 6,183 | 3,559 | 3,200 | |
| Operating profit (loss) | (5,186) | (2,502) | (1,739) | (4,943) | (1,769) | (1,218) | |
| Other income (expense), net | (29) | (128) | 22 | (24) | 35 | 11 | |
| Income (loss) before income taxes and extraordinary item | (5,215) | (2,630) | (1,717) | (4,967) | (1,734) | (1,207) | |
| Income tax expense (benefit) | - | 3,800 | - | - | 2,013 | - | |
| Income (loss) before extraordinary item | - | - | - | - | (3,747) | (1,207) | |
| Extraordinary gain on elimination of goodwill | - | - | - | - | 255 | - | |
| Net income (loss) | \$ (5,215) | \$ (2,630) | \$ (5,517) | \$ (4,967) | \$ (3,492) | \$ (1,207) | \$ |
| Net loss per common share: | | | | | | | |
| Basic and diluted | \$ (0.66) | \$ (0.33) | \$ (0.70) | \$ (0.63) | \$ (0.44) | \$ (0.15) | \$ |
| Weighted average common and common equivalent Shares: | | | | | | | |
| Basic and diluted | 7,861 | 7,861 | 7,861 | 7,861 | 7,861 | 7,861 | |

ITEM 15 - EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) Financial Statements, Schedules and Exhibits:

- (1), (2) The consolidated financial statements and required schedules are indexed on page F-1.
- (3) Exhibits required by the Exhibit Table of Item 601 of SEC Regulation S-K. (Exhibit numbers refer to numbers in the Exhibit Table of Item 601.)
 - 3.1 Certificate of Incorporation, filed as Exhibit 3.1 to Zoom Technologies, Inc. Current Report on Form 8-K dated February 28, 2002, filed with the Commission on March 4, 2002 (the "March 2002 Form 8-K"). *
 - 3.2 By-Laws of Zoom Technologies, Inc., filed as Exhibit 3.2 to the March 2002 Form 8-K. *
- **10.1 1990 Stock Option Plan, as amended, of Zoom Telephonics, Inc., filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 1998. *
- **10.2 1991 Director Stock Option Plan, as amended, of Zoom Telephonics,

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Inc., filed as Exhibit 10.2 to the Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 1996 (the "June 1996 Form 10-Q") and as further amended on June 14, 2001, filed as Exhibit 10.2 to the Annual Report on Form 10-K for the fiscal year ending December 31, 2001. *

- 10.3 1998 Employee Equity Incentive Plan, as amended, filed as Exhibit 99.1 to Registration Statement on Form S-8 (Reg. No.333-47188).*
- 10.4 Lease between Zoom Telephonics, Inc. and "E" Street Associates, filed as Exhibit 10.5 to the June 1996 Form 10-Q. *
- 10.5 Form of Indemnification Agreement, filed as Exhibit 10.6 to the June 1996 Form 10-Q. *
- **10.6 Letter Agreement between Zoom and an executive officer, filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the fiscal quarter ending September 30, 2000. *
- **10.7 Employment Agreement, filed as Exhibit 10.9 to the Form 10-K for the fiscal year ended December 31, 2002. *
- 10.8 Mortgage, Security Agreement and Assignment between Zoom and Wainwright Bank & Trust Company, filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2001 (the "March 2001 Form 10-Q"). *
- 10.9 Commercial Real Estate Promissory Note, between Zoom and Wainwright Bank & Trust Company, filed as Exhibit 10.2 to the March 2001 Form 10-Q. *
- 10.10 Operating Agreement, Zoom Group LLC dated as of March 29, 2002, filed as Exhibit 10.1 to the Quarterly Report on Form 10-Q for the fiscal quarter ended March 2002. *
- 10.11 Agreement between Zoom Telephonics, Inc and Members of the Zoom Group dated as of March 22, 2002, filed as Exhibit 10.2 to the March 2002 Form 10-Q. *
- 10.12 Reinstatement Agreement, Assignment Agreement and Second amendment of Purchase and Sale dated as of March 29, 2002, filed as Exhibit 10.3 to the March 2002 Form 10-Q. *

ITEM 15 - EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(Continued)

- 21. Subsidiaries. *
 - 23. Consent of KPMG LLP.
 - 99.1 Certification, Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code).
 - 99.2 Certification, Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code).
- (b) Reports on Form 8-K.
No current reports on Form 8-K have been filed during the last quarter for the period covered by this report.

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- (c) Exhibits - See Item 15(a)(3) above for a list of Exhibits incorporated herein by reference or filed with this Report.
- (d) Schedules - Schedule II: Valuation and Qualifying Accounts. Schedules other than those listed above have been omitted since they are either inapplicable or not required.
- * In accordance with Rule 12b-32 under the Securities Exchange Act of 1934, as amended, reference is made to the documents previously filed with the Securities and Exchange Commission, which documents are hereby incorporated by reference.
- ** Compensation Plan or Arrangement.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

ZOOM TECHNOLOGIES, INC.
(Registrant)

By: /s/ Robert A. Crist

Principal Financial and
Accounting Officer

Date: June 12, 2003

CERTIFICATION

I, Frank B. Manning, President and Chief Executive Officer of Zoom Technologies, Inc., certify that:

1. I have reviewed this annual report on Form 10-K/A of Zoom Technologies, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities,

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particularly during the period in which this annual report is being prepared;

- b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
 - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: June 12, 2003

/s/ Frank B. Manning

Frank B. Manning
President and Chief Executive Officer

CERTIFICATION

I, Robert A. Crist, Chief Financial Officer of Zoom Technologies, Inc., certify that:

1. I have reviewed this annual report on Form 10-K/A of Zoom Technologies, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

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- a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
 - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: June 12, 2003

/s/ Robert A. Crist

Robert A. Crist
Chief Financial Officer

EXHIBIT INDEX

- 3.1 Certificate of Incorporation, filed as Exhibit 3.1 to Zoom Technologies, Inc. Current Report on Form 8-K dated February 28, 2002, filed with the Commission on March 4, 2002 (the "March 2002 Form 8-K). *
- 3.2 By-Laws of Zoom Technologies, Inc., filed as Exhibit 3.2 to the March 2002 Form 8-K. *
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10-Q") and as further amended on June 14, 2001, filed as Exhibit 10.2 to the Annual Report on Form 10-K for the fiscal year ending December 31, 2001. *

- 10.3 1998 Employee Equity Incentive Plan, as amended filed as Exhibit 99.1 to Registration Statement on Form S-8 (Reg. No. 333-47188).*
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- **10.7 Employment Agreement, filed as Exhibit 10.9 to the Form 10-K for the fiscal year ended December 31, 2002. *
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- 10.11 Agreement between Zoom Telephonics, Inc and Members of the Zoom Group dated as of March 22, 2002, filed as Exhibit 10.2 to the March 2002 Form 10-Q. *
- 10.12 Reinstatement Agreement, Assignment Agreement and Second amendment of Purchase and Sale dated as of March 29, 2002, filed as Exhibit 10.3 to the March 2002 Form 10-Q. *
- 21. Subsidiaries. *
- 23. Consent of KPMG LLP.
- 99.1 Certification, Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code).
- 99.2 Certification, Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code).
- * In accordance with Rule 12b-32 under the Securities Exchange Act of 1934, as amended, reference is made to the documents previously filed with the Securities and Exchange Commission, which documents are hereby incorporated by reference.
- ** Compensation Plan or Arrangement.

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ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
VALUATION AND QUALIFYING ACCOUNTS
Years ending December 31, 2000, 2001 and 2002

| Description | Balance at Beginning of year | Charged (Credited) to Expense | Amount written off | Balance at end of year |
|---------------------------------------|------------------------------------|-------------------------------------|-----------------------|------------------------------|
| Reserve for doubtful accounts | \$ 958,663 | \$ (43,608) | \$ 560,849 | \$ 354,206 |
| Reserve for price protection | 649,686 | 235,651 | 686,588 | 198,749 |
| Reserve for sales returns | 2,934,019 | 7,532,526 | 9,401,130 | 1,065,415 |
| COOP advertising and other allowances | 2,228,223 | 6,566,840 | 7,285,978 | 1,509,085 |
| Year ending December 31, 2000 | \$ 6,770,591 | \$14,291,409 | \$17,934,545 | \$ 3,127,455 |
| Reserve for doubtful accounts | \$ 354,206 | \$ 162,416 | \$ 284,351 | \$ 232,271 |
| Reserve for price protection | 198,749 | 943,820 | 403,456 | 739,113 |
| Reserve for sales returns | 1,065,415 | 5,628,163 | 6,013,536 | 680,042 |
| COOP advertising and other allowances | 1,509,085 | 4,332,751 | 4,676,813 | 1,165,023 |
| Year ending December 31, 2001 | \$ 3,127,455 | \$11,067,150 | \$11,378,156 | \$ 2,816,449 |
| Reserve for doubtful accounts | \$ 232,271 | \$ 36,944 | \$ 209,809 | \$ 59,406 |
| Reserve for price protection | 739,113 | 699,482 | 774,263 | 664,332 |
| Reserve for sales returns | 680,042 | 756,012 | 522,040 | 914,014 |
| COOP advertising and other allowances | 1,165,023 | 3,960,531 | 4,116,898 | 1,008,656 |
| Year ending December 31, 2002 | \$ 2,816,449 | \$ 5,452,969 | \$ 5,623,010 | \$ 2,646,408 |

EXHIBIT 23

REPORT ON FINANCIAL STATEMENT SCHEDULE AND
CONSENT OF INDEPENDENT AUDITORS

The Board of Directors;
Zoom Technologies, Inc.

The audits referred to in our report dated February 11, 2003, except as to notes 3 and 7(c), which are as of March 28, 2003, included the related financial statement schedule for each of the years in the three-year period ended December 31, 2002 included in the annual report on Form 10-K. The financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statement schedule based on our audits. In our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

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We consent to incorporation by reference in the registration statements (No. 33-42834, No.33-90930, No.333-60565, No.333-75575, No.33-90191, No.333-47188 and No.333-97573) on Form S-8 of Zoom Technologies, Inc., of our report dated February 11, 2003, except as to notes 3 and 7(c), which are as of March 28, 2003, relating to the consolidated balance sheets of Zoom Technologies, Inc. and subsidiary as of December 31, 2001 and 2002, and the related consolidated statements of operations, stockholders' equity and comprehensive loss and cash flows and related schedule for each of the years in the three-year period ended December 31, 2002, which report appears in the December 31, 2002 annual report on Form 10-K/A of Zoom Technologies, Inc.

/s/ KPMG LLP

Boston, Massachusetts
March 28, 2003

Exhibit 99.1

Certification

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United
States Code)

I, Frank B. Manning, President and Chief Executive Officer of Zoom Technologies, Inc., a Delaware corporation (the "Company"), do hereby certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) that, to the best of my knowledge and belief:

- (1) The Annual Report on Form 10-K/A for the year ended December 31, 2002 (the "Form 10-K") of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Form 10-K/A fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: June 12, 2003

/s/ Frank B. Manning

Frank B. Manning
President and Chief Executive Officer

Exhibit 99.2

Certification

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United
States Code)

I, Robert A. Crist, Chief Financial Officer of Zoom Technologies, Inc., a Delaware corporation (the "Company"), do hereby certify, pursuant to Section 906

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of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) that, to the best of my knowledge and belief:

- (1) The Annual Report on Form 10-K/A for the year ended December 31, 2002 (the "Form 10-K") of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Form 10-K/A fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: June 12, 2003

/s/ Robert A. Crist

Robert A. Crist
Chief Financial Officer