

FRANKLIN WIRELESS CORP
Form 10-Q
February 14, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2011

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: 0-11616

FRANKLIN WIRELESS CORP.

(Exact name of Registrant as specified in its charter)

Nevada
(State or other jurisdiction of incorporation or
organization)

95-3733534
(I.R.S. Employer Identification Number)

5440 Morehouse Drive, Suite 1000,
San Diego, California
(Address of principal executive offices)

92121
(Zip code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

Large accelerated
filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

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

The Registrant has 11,882,971 shares of common stock outstanding as of February 14, 2012.

FRANKLIN WIRELESS CORP.
INDEX TO QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2011

		Page
PART I – Financial Information		
Item 1:	Consolidated Financial Statements (unaudited)	
	Consolidated Balance Sheets as of December 31, 2011 and June 30, 2011	4
	Consolidated Statements of Operations for the three months and six months ended December 31, 2011 and 2010	5
	Consolidated Statements of Cash Flows for the six months ended December 31, 2011 and 2010	6
	Notes to Consolidated Financial Statements	7
Item 2:	Management’s Discussion and Analysis of Financial Condition and Results of Operations	19
Item 3:	Quantitative and Qualitative Disclosures About Market Risk	24
Item 4:	Controls and Procedures	24
PART II – Other Information		
Item 1:	Legal Proceedings	25
Item 1A:	Risk Factors	25
Item 2:	Unregistered Sales of Equity Securities and Use of Proceeds	25
Item 3:	Defaults Upon Senior Securities	26
Item 4:	Mine Safety Disclosures	26
Item 5:	Other Information	26
Item 6:	Exhibits	26
Signatures		

NOTE ON FORWARD LOOKING STATEMENTS

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

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

This Report on Form 10-Q contains statements which, to the extent they do not recite historical fact, constitute “forward looking” statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward looking statements are used under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operation,” and elsewhere in this Quarterly Report on Form 10-Q. You can identify these statements by the use of words like “may,” “will,” “could,” “should,” “project,” “believe,” “anticipate,” “expect,” “plan,” “estimate,” “forecast,” “potential,” “intend,” “continue,” and variations of these or comparable words. Forward looking statements do not guarantee future performance and involve risks and uncertainties. Actual results may differ substantially from the results that the forward looking statements suggest for various reasons, including those discussed under the caption “Risk Factors” in Item 1A of our Annual Report on Form 10-K for the year ended June 30, 2011. These forward looking statements are made only as of the date of this Report on Form 10-Q. We do not undertake to update or revise the forward looking statements, whether as a result of new information, future events or otherwise.

PART I – FINANCIAL INFORMATION

ITEM 1. Financial Statements

FRANKLIN WIRELESS CORP.
CONSOLIDATED BALANCE SHEETS
(unaudited)

	December 31, 2011	June 30, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 14,055,525	\$ 11,357,878
Accounts receivable	2,182,303	6,916,020
Inventories	251,359	934,636
Prepaid expenses and other current assets	40,162	24,918
Employee loan	34,683	–
Prepaid income taxes	88,261	88,261
Deferred tax assets, current	220,031	220,031
Advance payment to vendor	26,099	41,376
Total current assets	16,898,423	19,583,120
Property and equipment, net	369,507	440,120
Intangible assets, net	2,774,036	2,275,357
Deferred tax assets, non-current	1,968,577	1,459,119
Goodwill	273,285	273,285
Other assets	137,949	140,258
TOTAL ASSETS	\$ 22,421,777	\$ 24,171,259
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Trade accounts payable	\$ 1,819,984	\$ 2,781,651
Advance payments from customers	96,756	15,507
Income taxes payable	–	121,362
Accrued liabilities	242,232	319,415
Marketing funds payable	1,633,806	1,633,806
Short-term borrowings	139,134	139,134
Total current liabilities	3,931,912	5,010,875
Other long-term liabilities	212,132	188,104
Total liabilities	4,144,044	5,198,979
Stockholders' equity:		
Preferred stock, par value \$0.001 per share, authorized 10,000,000 shares; No preferred stock issued and outstanding as of December 31, 2011 and June 30, 2011	–	–
Common stock, par value \$0.001 per share, authorized 50,000,000 shares; 11,882,971 and 13,781,491 shares issued and outstanding as of December 31, 2011 and June 30, 2011, respectively	13,616	13,546
Additional paid-in capital	6,558,391	6,420,672
Retained earnings	12,586,661	13,527,435
Treasury stock, 1,803,684 shares	(1,873,065)	(1,873,065)

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

Non-controlling interests	975,632	900,874
Accumulated other comprehensive income (loss)	16,498	(17,182)
Total stockholders' equity	18,277,733	18,972,280
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 22,421,777	\$ 24,171,259

See accompanying notes to unaudited consolidated financial statements.

FRANKLIN WIRELESS CORP.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	2010	2011	2010
Net sales	\$3,012,481	\$15,582,793	\$6,135,935	\$32,145,635
Cost of goods sold	2,381,234	9,483,026	4,778,741	21,156,049
Gross profit	631,247	6,099,767	1,357,194	10,989,586
Operating expenses:				
Selling, general, and administrative	1,638,762	2,497,214	3,302,659	5,448,292
Total operating expenses	1,638,762	2,497,214	3,302,659	5,448,292
Income (loss) from operations	(1,007,515)	3,602,553	(1,945,465)	5,541,294
Other income (loss), net:				
Interest income	8,645	11,080	18,000	24,302
Gain from sale of property and equipment	–	120	–	212,303
Loss on disposal of property and equipment	(291)	(1,054)	(291)	(140,283)
Other income (loss), net	(8,534)	(104,284)	10,479	(16,548)
Total other income (loss), net	(180)	(94,138)	28,188	79,774
Net income (loss) before provision for income taxes	(1,007,695)	3,508,415	(1,917,277)	5,621,068
Income tax provision (benefit)	(332,658)	1,105,232	(508,658)	2,255,232
Net income (loss) before non-controlling interests	(675,037)	2,403,183	(1,408,619)	3,365,836
Non-controlling interests in net loss (income) of subsidiary at 48.2% and 49.4% for the three and six months ended December 31, 2011 and 2010, respectively	186,847	(371,906)	467,845	(207,740)
Net income (loss)	\$(488,190)	\$2,031,277	\$(940,774)	\$3,158,096
Basic earnings (loss) per share	\$(0.04)	\$0.17	\$(0.08)	\$0.25
Diluted earnings (loss) per share	\$(0.04)	\$0.17	\$(0.08)	\$0.25
Weighted average common shares outstanding – basic	11,837,559	11,977,808	11,834,788	12,717,023
Weighted average common shares outstanding – diluted	12,050,924	12,150,765	12,048,153	12,889,980

See accompanying notes to unaudited consolidated financial statements.

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

	Six Months Ended December 31,	
	2011	2010
CASH FLOWS FROM OPERATIONS ACTIVITIES:		
Net income (loss)	\$ (940,774)	\$ 3,158,096
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Non-controlling interests	(467,845)	207,740
Gain on sale of property and equipment	–	(212,303)
Loss on disposal of property and equipment	291	140,283
Depreciation	81,522	69,757
Amortization of intangible assets	421,640	454,704
Write off of uncollectible accounts receivable	151,681	–
Deferred tax assets	(509,458)	3,671
Share-based compensation	101,539	434,177
Increase (decrease) in cash due to change in:		
Accounts receivable	4,582,036	(1,486,477)
Inventories	683,277	(122,835)
Prepaid expenses and other current assets	(15,244)	(14,371)
Prepaid income taxes	–	(109,649)
Employee Loan	(34,683)	–
Advance payment to vendor	15,277	(172,346)
Other assets	2,309	(31,787)
Trade accounts payable, including related party	(961,667)	(1,306,550)
Advance payments from customers	81,249	(303,385)
Income taxes payable	(121,362)	(929,538)
Accrued liabilities	(77,183)	(369,980)
Marketing funds payable	–	346,104
Other liabilities	24,028	(17,126)
Net cash provided by (used in) operating activities	3,016,633	(261,815)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(11,200)	(67,676)
Payments for capitalized development costs	(881,906)	–
Purchases of intangible assets	(38,413)	(75,454)
Proceeds from sales of property and equipment	–	594,643
Net cash provided by (used in) investing activities	(931,519)	451,513
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of short-term borrowings	–	(173,511)
Payment of long-term borrowings	–	(231,761)
Proceeds from exercise of stock options	36,250	–
Proceeds from subsidiary's sale of stock to non-controlling shareholders	542,603	–
Net cash provided by (used in) financing activities	578,853	(405,272)

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

Effect of foreign currency translation on cash	33,680	(82,292)
Net increase (decrease) in cash and cash equivalents	2,697,647	(297,866)
Cash and cash equivalents, beginning of period	11,357,878	16,107,501
Cash and cash equivalents, end of period	\$ 14,055,525	\$ 15,809,635
Supplemental disclosure of cash flow information:		
Cash paid during the years for:		
Interest	\$ 3,918	\$ -
Income taxes	\$ 122,162	\$ 3,282,767
Supplemental disclosure of non-cash financing activity:		
Repurchase of treasury stock (see "Note 10")	\$ -	\$ 1,873,065

See accompanying notes to unaudited consolidated financial statements.

FRANKLIN WIRELESS CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Franklin Wireless Corp. (“the Company”) have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and are presented in accordance with the requirements of Form 10-Q. In the opinion of management, the financial statements included herein contain all adjustments, including normal recurring adjustments, considered necessary to present fairly the financial position, the results of operations and cash flows of the Company for the periods presented. These financial statements and notes hereto should be read in conjunction with the financial statements and notes thereto for the fiscal year ended June 30, 2011 included in the Company’s Form 10-K, filed on September 28, 2011. The operating results or cash flows for the interim periods presented herein are not necessarily indicative of the results to be expected for any other interim period or the full year.

NOTE 2 - BUSINESS OVERVIEW

We are engaged in the design, manufacture and sale of broadband high speed wireless data communication products such as third generation (“3G”) and fourth generation (“4G”) wireless modules and modems. We focus primarily on wireless broadband Universal Serial Bus (“USB”) modems, which provide a flexible way for consumers to connect to wireless broadband networks from laptop or desktop computers. Our broadband wireless data communication products are positioned at the convergence of wireless communications, mobile computing and the Internet, each of which we believe represents a growing market.

Our wireless products are based on Evolution Data Optimized technology (“EV-DO technology”) of Code Division Multiple Access (“CDMA”), High-Speed Packet Access (“HSPA”) technology of Wideband Code Division Multiple Access (“WCDMA”), Worldwide Interoperability for Microwave Access (“WiMAX”) based on the IEEE 802.16 standard and Long Term Evolution (LTE) which enable end users to send and receive email with large file attachments, play interactive games, receive, send and download high resolution pictures, videos and music content.

We market our products directly to wireless operators, and indirectly through strategic partners and distributors. Our global customer base extends primarily from the United States to South American and Caribbean countries. Our USB modems are certified by Sprint, Comcast Cable, Cox, Clearwire, Time Warner Cable and other wireless operators located in the United States and also by wireless operators located in Caribbean and South American countries.

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, a wholly-owned subsidiary, and a subsidiary with a majority voting interest of 51.8% (48.2% is owned by non-controlling interests) and 51.5% (48.5% is owned by non-controlling interests) as of December 31, 2011 and June 30, 2011, and 50.6% (49.4% was owned by non-controlling interests) prior to January, 2011. In the preparation of consolidated financial statements of the Company, intercompany transactions and balances are eliminated and net earnings are reduced by the portion of the net earnings of subsidiaries applicable to non-controlling interests.

As consolidated financial statements are based on the assumption that they represent the financial position and operating results of a single economic entity, the retained earnings or deficit of a subsidiary at the date of acquisition, October 1, 2009, by the parent are excluded from consolidated retained earnings. When a subsidiary is consolidated during the six months ended December 31, 2011 and 2010, the consolidated financial statements include the subsidiary's revenues, expenses, gains, and losses only from the date the subsidiary is initially consolidated, and the noncontrolling interest is reported in the consolidated statement of financial position within equity, separately from the parent's equity. That amount is clearly identified and labeled. There are no shares of the Company held by the subsidiaries as of December 31, 2011 or June 30, 2011.

Non-controlling Interest in a Consolidated Subsidiary

On July 1, 2011, we entered into a Convertible Bond Purchase Agreement with our Korea-based subsidiary, Franklin Technology Inc. ("FTI"). Under this agreement, we purchased a convertible bond from FTI with an original principal amount of \$500,000 that bears interest at a rate of 5% per annum (with interest payable semi-annually) and matures on July 1, 2016. Pursuant to the terms of this agreement, upon conversion, the bond will convert into FTI Common Stock at a price of approximately \$0.55 per share. On August 11, 2011, we converted the full amount of the bond of \$500,000 into 916,666 shares of FTI Common Stock at a price of approximately \$0.55. Concurrent with the bond conversion, FTI raised \$542,603 by issuing 853,328 shares of its common stock to new investors at a price of approximately \$0.64 per share. As a result of these transactions, FTI's total outstanding shares increased by 1,769,994 shares to 1,988,660 shares. In addition, we own 1,029,332 shares, or 51.8% of the outstanding capital stock of FTI, with 48.2% owned by non-controlling interests.

As of December 31, 2011, the non-controlling interest was \$975,632, which represents a \$74,758 increase from \$900,874 as of June 30, 2011. The increase of \$74,758 in the non-controlling interest was due to the \$542,603 that FTI raised by issuing 853,328 shares of its common stock to new investors, which was partially offset by the non-controlling interests in net loss of subsidiary of \$467,845 for the six months ended December 31, 2011.

Segment Reporting

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

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	2010	2011	2010
Net sales:				
United States	\$2,057,228	\$ 10,213,979	\$4,435,735	\$ 22,975,775
Caribbean and South America	13,200	5,074,575	51,900	8,875,621
Asia	942,053	294,239	1,648,300	294,239
Totals	\$3,012,481	\$ 15,582,793	\$6,135,935	\$ 32,145,635

		December 31,	
Long-lived assets, net:		2011	June 30, 2011

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

United States	\$252,430	\$93,434
Asia	2,891,113	2,622,043
Totals	\$3,143,543	\$2,715,477

8

Estimates

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

Allowance for Doubtful Accounts

Based upon our review of our collection history associated with all significant outstanding invoices, we do not believe an allowance for doubtful accounts is necessary.

Revenue Recognition

We recognize revenue in accordance with ASC 605, "Revenue Recognition," when persuasive evidence of an arrangement exists, the price is fixed or determinable, collection is reasonably assured and delivery of products has occurred or services have been rendered. Accordingly, we recognize revenues from product sales upon shipment of the products to customers or when the products are received by the customers in accordance with the shipping or delivery terms. We provide a factory warranty for one year from the shipment date, which is covered by our vendors pursuant to purchase agreements.

Goodwill

Intangible assets, consisting of goodwill, are accounted for in accordance with ASC Topic 350, Intangibles – Goodwill and Other (formerly SFAS No. 142, Goodwill and Other Intangibles) which does not permit the amortization of goodwill. Rather, these items must be tested for impairment annually and when events occur or circumstances change that would indicate the carrying amount may be impaired. Goodwill is recorded as the excess of purchase price over the fair value of the identifiable net assets acquired.

Our valuation methodology for assessing impairment, using both the discounted cash flows approach and the market approach, requires management to make judgments and assumptions based on historical experience and projections of future operating performance. Our annual impairment review performed on June 30, 2011 did not indicate that goodwill was impaired.

Capitalized Product Development

Capitalized product development, noted as Technology in progress in the Intangible Assets table, includes payroll, employee benefits, and other headcount-related expenses associated with product development. Once technological feasibility is reached, such costs are capitalized and amortized over a three year useful life of the products commencing on the date that products are available for general release, using the straight-line method which approximates the benefits to be obtained from the sale of these products. We determine that technological feasibility for our products is reached after all high-risk development issues have been resolved, which generally occurs shortly before the products are released to manufacturing. As of December 31, 2011 and 2010, capitalized product development costs were \$1,009,210 and \$0, respectively, and are included in intangible assets in our consolidated balance sheet. During the three and six months ended December 31, 2011, we incurred \$497,765 and \$881,906 in capitalized product development costs, respectively. All expenses incurred before technological feasibility is reached

are expensed and included in our consolidated statements of operations.

Shipping and Handling Costs

Costs associated with product shipping and handling are expensed as incurred. Shipping and handling costs, which are included in selling, general and administrative expenses in the Statement of Operations, amounted to \$10,320 and \$292,868 for the three months ended December 31, 2011 and 2010, respectively, and \$40,188 and \$428,150 for the six months ended December 31, 2011 and 2010, respectively.

Warranties

We provide a factory warranty for one year which is covered by our vendors and manufacturers under purchase agreements between the Company and the vendors. In general, these products are shipped directly from our vendors to our customers. As a result, we do not have warranty exposure and do not accrue any warranty expenses.

Cash and Cash Equivalents

For purposes of the Consolidated Statements of Cash Flow, we consider all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

Inventories

Our inventories consist of finished goods and are stated at the lower of cost or market, cost being determined on a first-in, first-out basis. We assess the inventory carrying value and reduce it, if necessary, to its net realizable value based on customer orders on hand, and internal demand forecasts using management's best estimates given information currently available. Our customer demand is highly unpredictable, and can fluctuate significantly caused by factors beyond the control of the Company. We may write down our inventory value for potential obsolescence and excess inventory. However, at December 31, 2011, we believe our inventory needs no such reserves and have recorded no inventory reserves.

Property and Equipment

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

Machinery	6 years
Office equipment	5 years
Molds	3 years
Vehicles	5 years
Computers and software	5 years
Furniture and fixtures	7 years
Facilities	5 years

Intangible Assets

The definite lived intangible assets consisted of the following at June 30, 2011:

Definite lived intangible assets:	Expected Life	Average Remaining Life	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
Complete technology	3 years	1.3 years	\$ 490,000	\$ 285,833	\$ 204,167
Complete technology	3 years	1.8 years	1,517,683	592,936	924,747
Customer contracts / relationships	8 years	6.3 years	1,121,000	245,219	875,781
	Not				
Technology in progress	Applicable	–	127,304	–	127,304
Software	5 years	4.3 years	155,004	14,027	140,977
Patent	10 years	9.8 years	2,441	60	2,381
Total at June 30, 2011			\$ 3,413,432	\$ 1,138,075	\$ 2,275,357

The definite lived intangible assets consisted of the following at December 31, 2011:

Definite lived intangible assets:	Expected Life	Average Remaining Life	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
Complete technology	3 years	0.8 years	\$ 490,000	\$ 367,500	\$ 122,500
Complete technology	3 years	1.3 years	1,517,683	845,883	671,800
Customer contracts / relationships	8 years	5.8 years	1,121,000	315,280	805,720
	Not				
Technology in progress	Applicable	–	1,009,210	–	1,009,210
Software	5 years	3.8 years	160,575	28,896	131,679
Patent	10 years	9.3 years	11,513	175	11,338
Certification	3 years	2.8 years	23,770	1,981	21,789
Total at December 31, 2011			\$ 4,333,751	\$ 1,559,715	\$ 2,774,036

Long-lived Assets

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

We tested the long-lived assets for impairment as of June 30, 2011 by comparing the discounted cash flows of the assets to their carrying values and concluded that, as of June 30, 2011, no impairment existed. As of December 31, 2011, we are not aware of any events or changes in circumstances following June 30, 2011 that would indicate that the long-lived assets are impaired.

Income Taxes

We follow ASC 740, Income Taxes, which require the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates, applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

Based on management's assessment, management believes that the Company is more likely than not to fully realize our deferred tax assets. As such, no valuation allowance has been established for the Company's deferred tax assets. However, the Company may need to establish a valuation allowance should it continue to incur taxable losses.

We adopted ASC 740-10-25 on January 1, 2007, which provides criteria for the recognition, measurement, presentation and disclosure of uncertain tax position. We must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. We did not recognize any additional liabilities for uncertain tax positions as a result of the implementation of ASC 740-10-25.

As of December 31, 2011, we have no material unrecognized tax benefits. We recorded an income tax benefit of \$332,658 and \$508,658 for the three and six months ended December 31, 2011.

Concentrations of Credit Risk

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

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

A significant portion of our revenue is derived from a small number of customers. For the six months ended December 31, 2011, net sales to our four largest customers accounted for 24%, 22%, 18% and 15% of our consolidated net sales and 68%, 0%, 0% and 14% of our accounts receivable balance as of December 31, 2011. In the same period in 2010, net sales from our two largest customers accounted for 55% and 15% of our consolidated net sales and 2% and 14% of our accounts receivable as of December 31, 2010. No other individual customer accounted for more than ten percent of total net sales for the six months ended December 31, 2011 and 2010.

For the six months ended December 31, 2011, we purchased our wireless data products from two major manufacturing companies located in various parts of Asia. If any of these manufacturing companies were to experience delays, capacity constraints or quality control problems, product shipments to our customers could be delayed, or our customers could consequently elect to cancel the underlying product purchase order, which would negatively impact the Company's revenue. For the six months ended December 31, 2011, we purchased wireless data products from these suppliers in the amount of \$3,598,862, or 89% of total purchases, and had related accounts payable of \$1,446,015 as of December 31, 2011.

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

Recently Issued Accounting Pronouncements

ASU 2011-05, Presentation of Comprehensive Income, eliminates the option of presenting the components of other comprehensive income (OCI) as part of the statement of changes in stockholders' equity. The ASU instead permits an entity to present the total of comprehensive income, the components of net income, and the components of OCI either in a single continuous statement of comprehensive income or in two separate but consecutive statements. With either format, the entity is required to present each component of net income along with total net income, each component of OCI along with the total for OCI, and a total amount for comprehensive income. Also, the ASU requires entities to present, for either format, reclassification adjustments for items that are reclassified from OCI to net income in the statement(s) where the components of net income and the components of OCI are presented. This ASU is to be applied retrospectively. For public entities, the ASU is effective for interim and annual periods beginning after December 15, 2011. For non-public entities, the amendments are effective for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. Early adoption is permitted, since compliance with the amendments is already permitted. We do not believe the adoption of this guidance will have a material impact on our consolidated financial statements.

NOTE 4 – PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at:

	December 31, 2011	June 30, 2011
Machinery and facility	\$ 143,967	\$ 143,967
Office equipment	281,084	271,508
Molds	284,645	284,645
Vehicle	9,843	9,843
	719,539	709,963
Less accumulated depreciation	(350,032)	(269,843)
Total	\$ 369,507	\$ 440,120

Depreciation expense associated with property and equipment was \$81,522 and \$69,757 for the six months ended December 31, 2011 and 2010, respectively.

NOTE 5 - ACCRUED LIABILITIES

Accrued liabilities consisted of the following at:

	December 31,	
	2011	June 30, 2011
Accrued salaries, severance	\$ 94,120	\$ 231,917
Accrued vacations	97,905	66,143
Payroll deductions to pay	6,485	-
Other accrued liabilities	43,722	21,355
Total	\$ 242,232	\$ 319,415

NOTE 6 – SHORT-TERM BORROWINGS FROM BANKS

Short-term borrowings from banks consisted of the following at:

	December 31,	
	2011	June 30, 2011
Loan dated June 2011, due to a financial institution, with principal and monthly interest payments (interest rate of 8.90% per annum), and the remaining balance due September, 2011, which was extended to March 9, 2012.	\$ 139,134	\$ 139,134
Total	\$ 139,134	\$ 139,134

NOTE 7 – EARNINGS PER SHARE

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

	Three Months ended		Six Months Ended	
	December 31,		December 31,	
	2011	2010	2011	2010
Net income (loss) before non-controlling interests	\$(675,037)	\$2,403,183	\$(1,408,619)	\$3,365,836
Non-controlling interests in net loss (income) of subsidiary	186,847	(371,906)	467,845	(207,740)
Net income (loss)	\$(488,190)	\$2,031,277	\$(940,774)	\$3,158,096
Weighted-average shares of common stock outstanding:				
Basic	11,837,559	11,977,808	11,834,788	12,717,023
Dilutive effect of common stock equivalents arising from stock options	213,365	172,957	213,365	172,957
Outstanding shares (diluted)	12,050,924	12,150,765	12,048,153	12,889,980
Basic earnings (loss) per share	\$(0.04)	\$0.17	\$(0.08)	\$0.25

Diluted earnings (loss) per share	\$ (0.04) \$ 0.17	\$ (0.08) \$ 0.25
-----------------------------------	----------	-----------	----------	-----------

NOTE 8 - COMMITMENTS AND CONTINGENCIES

Leases

We leased approximately 6,070 square feet of office space in San Diego, California, at a monthly rent of \$8,975, and the lease expired on August 31, 2011. In addition to monthly rent, the lease provided for periodic cost of living increases in the base rent and payment of common area costs. On September 1, 2011, we moved into new office space, consisting of approximately 11,318 square feet located in San Diego, California, at a monthly rent of \$16,576. Rent expense related to these operating leases was approximately \$49,728 and \$26,926 for the three months ended December 31, 2011 and 2010, respectively, and \$87,073 and \$53,852 for the six months ended December 31, 2011 and 2010, respectively.

Our subsidiary, FTI, leases approximately 10,000 square feet of office space in Seoul, Korea, at a monthly rent of approximately \$7,750, and the lease expires on September 1, 2013. In addition to monthly rent, the lease provides for periodic cost of living increases in the base rent and payment of common area costs. The facility is covered by an appropriate level of insurance and we believe it to be suitable for our use and adequate for our present needs. Rent expense related to the operating lease was approximately \$23,250 for each of the three months ended December 31, 2011 and 2010, respectively, and \$46,500 and \$31,000 for the six months ended December 31, 2011 and 2010, respectively.

We lease two corporate housing facilities for our vendors and employees who travel, under non-cancelable operating leases that expire on July 31, 2012 and September 30, 2012. Rent expense related to these operating leases was \$6,142 and \$8,865 for the three and six months ended December 31, 2011, respectively. For the six months ended December 31, 2010, we leased two corporate housing facilities under non-cancelable operating leases that expired on May 31, 2011 and August 1, 2011. Rent expense related to these operating leases was \$6,876 and \$13,062 for the three and six months ended December 31, 2010, respectively.

Contingency

On July 27, 2010, we entered into a Common Stock Repurchase Agreement with C-Motech (the "Agreement"), under which we agreed to repurchase 3,370,356 shares of our Common Stock from C-Motech for \$3,500,000. A total of 1,803,684 shares were repurchased on the date of the Agreement in exchange for non-cash consideration in the amount of \$1,873,065, which represented amounts owed to the Company by C-Motech for certain marketing funds as well as the settlement of a price dispute for products previously purchased by the Company from C-Motech. Under the Agreement, the remaining 1,566,672 shares were to be repurchased by us upon payment of the balance, \$1,626,935, on or before December 31, 2010. On January 28, 2011 (the "Amendment Date") the Agreement was amended to reflect (1) a change in the date the 1,566,672 shares are to be repurchased from C-Motech from December 31, 2010 to March 31, 2011, and (2) a change to the non-cash consideration of \$1,873,065. In exchange for the 1,803,684 shares, we were to pay cash to C-Motech (in the same amount) for the shares, by March 31, 2011. In addition, in a separate agreement dated January 28, 2011, C-Motech agreed to pay us \$1,873,065, for amounts owed, by March 31, 2011. The purpose of these revisions was to more clearly differentiate each party's payment obligations to the other with respect to this transaction. Following the Amendment Date, we paid C-Motech \$1,873,065 in exchange for the 1,803,684 shares previously transferred to us by C-Motech, and C-Motech paid us \$1,873,065 for amounts owed. The repurchase of the remaining 1,566,672 shares has not been completed. We have provided formal notification to C-Motech that it is in breach of its obligations and we have also provided a demand to sell the shares back to us. We have attempted to tender payment for the shares without results, and as of the date of this filing, we are unable to determine whether or not this repurchase will take place.

As of December 31, 2011, C-Motech owns 1,566,672 shares, or approximately 13%, of our Common Stock.

Litigation

We are from time to time involved in certain legal proceedings and claims arising in the ordinary course of business. On August 16, 2011, Brandywine Communications Technologies, LLC filed a complaint in the United States District Court for the Middle District of Florida, Orlando Division against one of our customers as one of several defendants. The complaint alleges that certain wireless devices, including one device provided by the Company, infringe on U.S. Patent No. 5,373,149. The Company provided device was purchased by the Company from one of our suppliers. The supplier has been notified of the complaint and is evaluating this matter. As of December 31, 2011, this legal proceeding is pending, but we do not believe this action will have a material effect on the Company.

On December 10, 2010, Novatel Wireless, Inc. filed a complaint in the United States District Court for the Southern District of California, against us and one other defendant. The complaint alleges that certain products, including, but not limited to, mobile data hot spots and data modems, infringe on U.S. Patent Nos. 5,129,098; 7,318,225; 7,574,737 and 7,319,715. Due to the preliminary nature of these proceedings, we do not believe an amount of loss, if any, can be reasonably estimated for this matter. We have filed a Motion to Dismiss and are waiting for the judge to rule on our motion. We intend to vigorously defend ourselves against these allegations.

On December 14, 2011 our officers and directors were named as defendants in an action filed by Sherman Capital Group LLC, Singer Children's Management Trust, David S. Oros, Milfam NG LLC and Lloyd I. Miller-Trust C in the Superior Court of the State of California for the County of San Diego. The complaint seeks damages and declaratory relief for alleged breaches of fiduciary duty by our officers and directors in the management of the Company, as well as attorneys' fees. The complaint does not specify an amount of damages. We believe this action is without merit, and we intend to vigorously defend our officers and directors against these allegations. Our officers and directors are entitled to indemnity from the Company under the Company's bylaws. We do not believe this action will have a material effect on the Company. On January 20, 2012 we filed a Notice of Removal from the Superior Court of the State of California for the County of San Diego to the United States District Court for the Southern District of California. On January 27, 2012, we filed a Motion to Dismiss and a hearing has been scheduled for March 5, 2012.

Change of Control Agreements

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

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

On September 16, 2011, the Board of Directors approved extending the Change of Control Agreements with OC Kim, our President and Acting Chief Financial Officer, Yun J. (David) Lee, our Chief Operating Officer, and Yong Bae Won, our Vice President, Engineering for an additional three years. Following this approval, the Change of Control

Agreement with Mr. Kim will expire on September 21, 2015 and the Change of Control Agreements with Messrs. Lee and Won will expire on September 21, 2014.

NOTE 9 – LONG-TERM INCENTIVE PLAN AWARDS

As we adopted the 2009 Stock Incentive Plan (“2009 Plan”), we provided for the grant of incentive stock options and non-qualified stock options to our employees and directors on June 11, 2009.

We issued additional options in 2010 under the 2009 Plan. The options granted in 2010 generally vest and become exercisable at the rate of between 33% and 100% per year with a life of ten years. For the six months ended December 31, 2011, we did not issue any options under the plan.

We adopted ASC 718, “Compensation – Stock Compensation,” using a modified prospective application, and the Black-Scholes model. Under this application, we are required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption. Compensation costs will be recognized over the period that an employee provides service in exchange for the award.

The estimated forfeiture rate considers historical turnover rates stratified into employee pools in comparison with an overall employee turnover rate, as well as expectations about the future. We periodically revise the estimated forfeiture rate in subsequent periods if actual forfeitures differ from those estimates. Compensation expense recorded under this method for the three and six months ended December 31, 2011 was \$59,989 and \$101,539, respectively, and reduced operating income and income before income taxes by the same amount by increasing compensation expense recognized in selling and administrative expense. The recognized tax benefit related to the compensation expense for the three months ended December 31, 2011 was \$0.

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

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value
Outstanding at June 30, 2011	930,836	\$ 1.40	7.2	\$ 978,470
Granted	30,000	0.57	2.8	27,900
Exercised	(70,000)	(0.52)	-	-
Forfeited or Expired	(14,334)	(1.35)	-	-
Outstanding at December 31, 2011	876,502	\$ 1.45	6.8	\$ 46,425
Exercisable at December 31, 2011	651,832	\$ 1.15	5.7	\$ 230,675
Vested and Expected to Vest at December 31, 2011	651,832	\$ 1.15	5.7	\$ 230,675

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based upon the Company's closing stock price of \$1.50 as of December 31, 2011, which would have been received by the option holders had all option holders exercised their options as of that date. The weighted-average grant-date fair value of stock options of 846,502, which is outstanding at December 31, 2011, was \$1.36 per share.

As of December 31, 2011, there was \$252,141 of total unrecognized compensation cost related to non-vested stock options granted. That cost is expected to be recognized over a weighted-average period of 0.8 years.

NOTE 10 – RELATED PARTY TRANSACTIONS

We purchased wireless data products in the amounts of \$360 and \$6,661,415 from C-Motech, for the six months ended December 31, 2011 and 2010, respectively, and had related accounts payable of \$0 and \$466,290 as of December 31, 2011 and 2010, respectively. As of December 31, 2011, C-Motech owns 1,566,672 shares, or 13.3%, of our Common Stock.

On September 14, 2010, we completed the repurchase and transfer of 1,803,684 shares out of the total number of shares of 3,379,356, which were owned by C-Motech, on the date of the Agreement in exchange for non-cash consideration in the amount of \$1,873,065, which represented amounts owed to the Company by C-Motech for certain marketing funds as well as the settlement of a price dispute for products previously purchased by the Company from C-Motech. Under the Agreement, the remaining 1,566,672 shares were to be repurchased by us upon payment of the balance, \$1,626,935, on or before December 31, 2010.

On January 28, 2011 (the "Amendment Date") the Agreement was amended to reflect (1) a change in the date the 1,566,672 shares are to be repurchased from C-Motech from December 31, 2010 to March 31, 2011, and (2) a change to the non-cash consideration of \$1,873,065. In exchange for the 1,803,684 shares, we were to pay cash to C-Motech (in the same amount) for the shares, by March 31, 2011. In addition, in a separate agreement dated January 28, 2011, C-Motech agreed to pay us \$1,873,065, for amounts owed, by March 31, 2011. The purpose of these revisions was to more clearly differentiate each party's payment obligations to the other with respect to this transaction. Following the Amendment Date, we paid C-Motech \$1,873,065 in exchange for the 1,803,684 shares previously transferred to us by C-Motech included in treasury stock at March 31, 2011, and C-Motech paid us \$1,873,065 for amounts owed. The repurchase of the remaining 1,566,672 shares has not been completed. We have provided formal notification to C-Motech that it is in breach of its obligations and we have also provided a demand to sell the shares back to us. We have attempted to tender payment for the shares without results, and as of the date of this filing, we are unable to determine whether or not this repurchase will take place.

As of December 31, 2011, C-Motech owes us approximately \$52,000, relating to the defense of an infringement claim.

NOTE 11 - SUBSEQUENT EVENTS

ASC 855, "Subsequent Events." ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. During this period, we did not have any material recognizable subsequent events required to be disclosed.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our financial statements and related notes included elsewhere in this report. This report contains certain forward-looking statements relating to future events or our future financial performance. These statements are subject to risks and uncertainties which could cause actual results to differ materially from those discussed in this report. You are cautioned not to place undue reliance on this information, which speaks only as of the date of this report. We are not obligated to publicly update this information, whether as a result of new information, future events or otherwise, except to the extent we are required to do so in connection with our obligation to file reports with the SEC. For a discussion of the important risks to our business and future operating performance, see the discussion under the caption "Item 1A. Risk Factors" and under the caption "Factors That May Influence Future Results of Operations" in the Company's Form 10-K for the year ended June 30, 2011, filed on September 28, 2011. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this report might not occur.

BUSINESS OVERVIEW

We are engaged in the design, manufacture and sale of broadband high speed wireless data communication products such as third generation ("3G") and fourth generation ("4G") wireless modules and modems. We focus primarily on wireless broadband Universal Serial Bus ("USB") modems, which provide a flexible way for consumers to connect to wireless broadband networks from laptop or desktop computers. Our broadband wireless data communication products are positioned at the convergence of wireless communications, mobile computing and the Internet, each of which we believe represents a growing market.

We market and sell our products through two channels: Directly to wireless operators, and indirectly through strategic partners and distributors. Our global customer base extends primarily from the United States to South American and Caribbean countries. Our USB modems are certified by Sprint, Comcast Cable, Cox, Clearwire, Time Warner Cable and other wireless operators located in the United States and also by wireless operators located in Caribbean and South American countries.

FACTORS THAT MAY INFLUENCE FUTURE RESULTS OF OPERATIONS

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

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

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, a wholly-owned subsidiary, and a subsidiary with a majority voting interest of 51.8% (48.2% is owned by non-controlling interests) and 51.5% (48.5% is owned by non-controlling interests) as of December 31, 2011 and June 30, 2011, and 50.6% (49.4% was owned by non-controlling interests) prior to January, 2011. In the preparation of consolidated financial statements of the

Company, intercompany transactions and balances are eliminated and net earnings are reduced by the portion of the net earnings of subsidiaries applicable to non-controlling interests.

As consolidated financial statements are based on the assumption that they represent the financial position and operating results of a single economic entity, the retained earnings or deficit of a subsidiary at the date of acquisition, October 1, 2009, by the parent are excluded from consolidated retained earnings. When a subsidiary is consolidated during the six months ended December 31, 2011 and 2010, the consolidated financial statements include the subsidiary's revenues, expenses, gains, and losses only from the date the subsidiary is initially consolidated, and the noncontrolling interest is reported in the consolidated statement of financial position within equity, separately from the parent's equity. That amount is clearly identified and labeled. There are no shares of the Company held by the subsidiaries as of December 31, 2011 or June 30, 2011.

Revenue Recognition

We recognize revenue in accordance with ASC 605, "Revenue Recognition," when persuasive evidence of an arrangement exists, the price is fixed or determinable, collection is reasonably assured and delivery of products has occurred or services have been rendered. Accordingly, we recognize revenues from product sales upon shipment of the products to customers or when the products are received by the customers in accordance with the shipping or delivery terms. We provide a factory warranty for one year from the shipment date, which is covered by our vendors pursuant to purchase agreements.

Capitalized Product Development

Capitalized product development, noted as Technology In progress in the Intangible Assets table, includes payroll, employee benefits, and other headcount-related expenses associated with product development. Once technological feasibility is reached, such costs are capitalized and amortized over a three year useful life of the products, using the straight-line method. We determine that technological feasibility for our products is reached after all high-risk development issues have been resolved, which generally occurs shortly before the products are released to manufacturing. As of December 31, 2011 and 2010, capitalized product development costs were \$1,009,210 and \$0, respectively, and are included in intangible assets in our consolidated balance sheet. During the three and six months ended December 31, 2011, we incurred \$497,765 and \$881,906 in capitalized product development costs, respectively. All expenses incurred before technological feasibility is reached are expensed and included in our consolidated statements of operations.

RESULT OF OPERATIONS

The following table sets forth, for the three and six months ended December 31, 2011 and 2010, our statements of operations expressed as a percentage of sales:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	2010	2011	2010
Net Sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	79.0%	60.9%	77.9%	65.8%
Gross profit	21.0%	39.1%	22.1%	34.2%
Selling, general and administrative expenses	54.4%	16.0%	53.8%	16.9%
Income (loss) from operations	(33.4%)	23.1%	(31.7%)	17.3%
Other income (loss), net	(0.0%)	(0.6%)	0.5%	0.2%
Net income (loss) before income taxes	(33.4%)	22.5%	(31.2%)	17.5%

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10-Q

Income tax provision (benefit)	(11.0%)	7.1%	(8.3%)	7.0%
Net income (loss) before non-controlling interest	(22.4%)	15.4%	(22.9%)	10.5%
Non-controlling interest in net loss (income) of subsidiary	6.2%	(2.4%)	7.6%	(0.6%)
Net income (loss)	(16.2%)	13.0%	(15.3%)	9.9%

20

THREE MONTHS ENDED DECEMBER 31, 2011 COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2010

NET SALES - Net sales decreased by \$12,570,312, or 80.7%, to \$3,012,481 for the three months ended December 31, 2011 from \$15,582,793 for the corresponding period of 2010. For the three months ended December 31, 2011, net sales by geographic region, consisting of South America and the Caribbean, the United States and Asia were \$13,200 (0.4% of net sales), \$2,057,228 (68.3% of net sales), and \$942,053 (31.3% of net sales), respectively.

Net sales in the South American and Caribbean regions decreased by \$5,061,375, or 99.7%, to \$13,200 for the three months ended December 31, 2011 from \$5,074,575 for the corresponding period of 2010. The decrease was primarily due to the general nature of sales in these regions, which often fluctuate significantly from period to period due to by timing of orders placed by a relatively small number of customers. In addition, some carrier customers in these regions are transitioning from CDMA to LTE or HSPA+ networks, which affected the quantity of CDMA related products that were sold during the three months ended December 31, 2011. Net sales in the United States decreased by \$8,156,751, or 79.9%, to \$2,057,228 for the three months ended December 31, 2011, from \$10,213,979 for the corresponding period of 2010. The decrease in net sales was due to several factors, including increased competition in the dual-mode (3G and 4G) USB modem market, as well as competition from other similar products, which negatively affected volume and price. Sales during the three months ended December, 2011 were also affected by delays in launching new products due to longer than expected schedules associated with design, testing and certification efforts. Net sales in Asia increased by \$647,814, or 220.2%, to \$942,053 for the three months ended December 31, 2011 from \$294,239 for the corresponding period of 2010. The increase in net sales was primarily due to the addition of a new customer in this region who purchased production quantities of the Company's M600 dual-mode (3G and 4G) embedded module.

GROSS PROFIT – Gross profit decreased by \$5,468,520, or 89.7%, to \$631,247 for the three months ended December 31, 2011 from \$6,099,767 for the corresponding period of 2010. The decrease was primarily due to the change in net sales as discussed above. The gross profit in terms of net sales percentage was 21.0% for the three months ended December 31, 2011 compared to 39.1% for the corresponding period of 2010. The decrease in gross profit in terms of net sales percentage was due to variations in customer and product mix, which generally vary from quarter to quarter.

SELLING, GENERAL, AND ADMINISTRATIVE - Selling, general, and administrative expenses decreased by \$858,452, or 34.4%, to \$1,638,762 for the three months ended December 31, 2011 from \$2,497,214 for the corresponding period of 2010. The decrease was primarily due to lower share-based compensation expense (a significant portion of the value of the options previously granted was expensed in prior periods), R&D expense (due to the amount of costs being expensed vs. capitalized) and other items including marketing and shipping expense (due to lower sales volumes).

OTHER INCOME (LOSS), NET - Other income (loss), net decreased by \$93,958 to net other loss of (\$180) for the three months ended December 31, 2011 from net other loss of (\$94,138) for the corresponding period of 2010. The decrease in net other loss was primarily due to a favorable foreign currency translation adjustment relating to our Korea-based subsidiary FTI.

SIX MONTHS ENDED DECEMBER 31, 2011 COMPARED TO SIX MONTHS ENDED DECEMBER 31, 2010

NET SALES - Net sales decreased by \$26,009,700, or 80.9%, to \$6,135,935 for the six months ended December 31, 2011 from \$32,145,635 for the corresponding period of 2010. For the six months ended December 31, 2011, net sales by geographic region, consisting of South America and the Caribbean, the United States and Asia were \$51,900 (0.8% of net sales), \$4,435,735 (72.3% of net sales), and \$1,648,300 (26.9% of net sales), respectively.

Net sales in the South American and Caribbean regions decreased by \$8,823,721, or 99.4%, to \$51,900 for the six months ended December 31, 2011 from \$8,875,621 for the corresponding period of 2010. The decrease was primarily due to the general nature of sales in these regions, which often fluctuate significantly from period to period due to by timing of orders placed by a relatively small number of customers. In addition, some carrier customers in these regions are transitioning from CDMA to LTE or HSPA+ networks, which affected the quantity of CDMA related products that were sold during the six months ended December 31, 2011. Net sales in the United States decreased by \$18,540,040, or 80.7%, to \$4,435,735 for the six months ended December 31, 2011, from \$22,975,775 for the corresponding period of 2010. The decrease in net sales was due to several factors, including increased competition in the dual-mode (3G and 4G) USB modem market, as well as competition from other similar products, which negatively affected volume and price. Sales during the three months ended December, 2011 were also affected by delays in launching new products due to longer than expected schedules associated with design, testing and certification efforts. Net sales in Asia increased by \$1,354,061, or 460.2%, to \$1,648,300 for the six months ended December 31, 2011 from \$294,239 for the corresponding period of 2010. The increase in net sales was primarily due to the addition of a new customer in this region who purchased production quantities of the Company's M600 dual-mode (3G and 4G) embedded module.

GROSS PROFIT – Gross profit decreased by \$9,632,392, or 87.7%, to \$1,357,194 for the six months ended December 31, 2011 from \$10,989,586 for the corresponding period of 2010. The decrease was primarily due to the change in net sales as discussed above. The gross profit in terms of net sales percentage was 22.1% for the six months ended December 31, 2011 compared to 34.2% for the corresponding period of 2010. The decrease in gross profit in terms of net sales percentage was due to variations in customer and product mix, which generally vary from quarter to quarter.

SELLING, GENERAL, AND ADMINISTRATIVE – Selling, general, and administrative expenses decreased by \$2,145,633, or 39.4%, to \$3,302,659 for the six months ended December 31, 2011 from \$5,448,292 for the corresponding period of 2010. The decrease was primarily due to lower sales commission expense, share-based compensation expense (a significant portion of the value of the options previously granted was expensed in prior periods), R&D expense (due to the amount of costs being expensed vs. capitalized) and other items including marketing and shipping expense (due to lower sales volumes).

OTHER INCOME (LOSS), NET - The net of other income (loss) decreased by \$51,586 to \$28,188 for the six months ended December 31, 2011 from \$79,774 for the corresponding period of 2010. For the six months ended December 31, 2010, the net of other income (loss) included the gain on the sale of property and equipment of \$212,184 by our Korea-based subsidiary, FTI, which was partially offset by other expenses. For the six months ended December 31, 2011, the net of other income (loss) included a favorable foreign currency translation adjustment relating to our Korea-based subsidiary FTI, but the resulting income was lower than the sale of property and equipment that took place during the corresponding period of 2010.

LIQUIDITY AND CAPITAL RESOURCES

Our principal liquidity requirements are for working capital and capital expenditures. We fund our liquidity requirements with cash on hand and cash flow from operations. We continue to invest in product development and have incurred losses, but we believe we will be able to fund our future cash requirements for operations from our cash available, operating cash flows, bank lines of credit and issuance of equity securities for the next twelve months.

OPERATING ACTIVITIES – Net cash provided by operating activities for the six months ended December 31, 2011 was \$3,016,633, and net cash used in operating activities for the six months ended December 31, 2010 was \$261,815.

The \$3,016,633 in net cash provided by operating activities for the six months ended December 31, 2011 was primarily due to the decreases in accounts receivable and inventory of \$4,582,036 and \$683,277, respectively, which were partially offset by the decrease in accounts payable of \$961,667 as well as the net loss and non-controlling interests of \$940,774 and \$467,845, respectively. The \$261,815 in net cash used in operating activities for the six months ended December 31, 2010 was primarily due to the increase in accounts receivable of \$1,486,477 as well as decreases in accounts payable, income taxes payable, accrued liabilities and advance payments from customers of \$1,306,550, \$929,538, \$369,980 and \$303,385 respectively, which were partially offset by the favorable effect of net income and non-cash items including depreciation, amortization, share-based compensation expense and non-controlling interests.

INVESTING ACTIVITIES – Net cash used in investing activities for the six months ended December 31, 2011 was \$931,519, and net cash provided by investing activities for the six months ended December 31, 2010 was \$451,513. The \$931,519 in net cash used in investing activities for the six months ended December 31, 2011 was primarily due to the capitalization of product development costs of \$881,906. We capitalize product development costs because such products are expected to be sold in future periods and provide economic benefit to the Company. The \$451,513 in net cash provided by investing activities for the six months ended December 31, 2010 was primarily due to proceeds from the sale of property and equipment of \$594,643.

FINANCING ACTIVITIES – Net cash provided by financing activities for the six months ended December 31, 2011 was \$578,853, and net cash used in financing activities for the six months ended December 31, 2010 was \$405,272. The \$578,853 in net cash provided by financing activities for the six months ended December 31, 2011 was primarily due to the proceeds from the issuance of FTI common stock to new investors of \$542,603. The \$405,272 in net cash used in financing activities for six months ended December 31, 2010 was primarily due to paying off the short and long-term borrowings associated with the building and land sold by FTI.

CONTRACTUAL OBLIGATIONS AND OTHER COMMITMENTS

Leases

We leased approximately 6,070 square feet of office space in San Diego, California, at a monthly rent of \$8,975, and the lease expired on August 31, 2011. In addition to monthly rent, the lease provided for periodic cost of living increases in the base rent and payment of common area costs. On September 1, 2011, we moved into new office space, consisting of approximately 11,318 square feet located in San Diego, California, at a monthly rent of \$16,576. Rent expense related to these operating leases was approximately \$49,728 and \$26,926 for the three months ended December 31, 2011 and 2010, respectively, and \$87,073 and \$53,852 for the six months ended December 31, 2011 and 2010, respectively.

Our subsidiary, FTI, leases approximately 10,000 square feet of office space in Seoul, Korea, at a monthly rent of approximately \$7,750, and the lease expires on September 1, 2013. In addition to monthly rent, the lease provides for periodic cost of living increases in the base rent and payment of common area costs. The facility is covered by an appropriate level of insurance and we believe it to be suitable for our use and adequate for our present needs. Rent expense related to the operating lease was approximately \$23,250 for each of the three months ended December 31, 2011 and 2010, respectively, and \$46,500 and \$31,000 for the six months ended December 31, 2011 and 2010, respectively.

We lease two corporate housing facilities for our vendors and employees who travel under non-cancelable operating leases that expire on July 31, 2012 and September 30, 2012. Rent expense related to these operating leases was \$6,142 and \$8,865 for the three and six months ended December 31, 2011, respectively. For the six months ended December 31, 2010, we leased two corporate housing facilities under non-cancelable operating leases that expired on May 31, 2011 and August 1, 2011. Rent expense related to these operating leases was \$6,876 and \$13,062 for the three and six months ended December 31, 2010, respectively.

Change of Control Agreements

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

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

On September 15, 2011, the Board of Directors approved extending the Change of Control Agreements with OC Kim, our President and Acting Chief Financial Officer, Yun J. (David) Lee, our Chief Operating Officer, and Yong Bae Won, our Vice President, Engineering for an additional three years. Following this approval, the Change of Control Agreement with Mr. Kim will expire on September 21, 2015 and the Change of Control Agreements with Messrs. Lee and Won will expire on September 21, 2014.

OFF-BALANCE SHEET ARRANGEMENTS

None.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

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

ITEM 4. CONTROLS AND PROCEDURES.

Disclosure Controls and Procedures

The Company's President and Acting Chief Financial Officer have concluded, based on an evaluation of the Company's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15(d)-15(e)), that such disclosure controls and procedures were effective as of the end of the period covered by this report.

Changes in Internal Control Over Financial Reporting

There has been no change in the Company's internal control over financial reporting during the six months ended December 31, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

We are from time to time involved in certain legal proceedings and claims arising in the ordinary course of business. On August 16, 2011, Brandywine Communications Technologies, LLC filed a complaint in the United States District Court for the Middle District of Florida, Orlando Division against one of our customers as one of several defendants. The complaint alleges that certain wireless devices, including one device provided by the Company, infringe on U.S. Patent No. 5,373,149. The Company provided device was purchased by the Company from one of our suppliers. The supplier has been notified of the complaint and is evaluating this matter. As of December 31, 2011, this legal proceeding is pending, but we do not believe this action will have a material effect on the Company.

On December 10, 2010, Novatel Wireless, Inc. filed a complaint in the United States District Court for the Southern District of California, against us and one other defendant. The complaint alleges that certain products, including, but not limited to, mobile data hot spots and data modems, infringe on U.S. Patent Nos. 5,129,098; 7,318,225; 7,574,737 and 7,319,715. Due to the preliminary nature of these proceedings, we do not believe an amount of loss, if any, can be reasonably estimated for this matter. We have filed a Motion to Dismiss and are waiting for the judge to rule on our motion. We intend to vigorously defend ourselves against these allegations.

On December 14, 2011 our officers and directors were named as defendants in an action filed by Sherman Capital Group LLC, Singer Children's Management Trust, David S. Oros, Milfam NG LLC and Lloyd I. Miller-Trust C in the Superior Court of the State of California for the County of San Diego. The complaint seeks damages and declaratory relief for alleged breaches of fiduciary duty by our officers and directors in the management of the Company, as well as attorneys' fees. The complaint does not specify an amount of damages. We believe this action is without merit, and we intend to vigorously defend our officers and directors against these allegations. Our officers and directors are entitled to indemnity from the Company under the Company's bylaws. We do not believe this action will have a material effect on the Company. On January 20, 2012 we filed a Notice of Removal from the Superior Court of the State of California for the County of San Diego to the United States District Court for the Southern District of California. On January 27, 2012, we filed a Motion to Dismiss and a hearing has been scheduled for March 5, 2012.

ITEM 1A. RISK FACTORS.

Our Annual Report on Form 10-K for the fiscal year ended June 30, 2011, filed with the SEC on September 28, 2011 (the "Annual Report"), includes a detailed discussion of our risk factors under the heading "PART I, ITEM 1A – RISK FACTORS." You should carefully consider the risk factors discussed in our Annual Report, as well as other information in this quarterly report. Any of these risks could cause our business, financial condition, results of operations and future growth prospects to suffer.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURES.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS*.

31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Acting Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Acting Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.DEF	XBRL Definition Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

SIGNATURES

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

Franklin Wireless Corp.

By: /s/ OC Kim
OC Kim, President and Acting Chief Financial Officer

Dated: February 14, 2012

