

FRANKLIN WIRELESS CORP
Form 10-K
October 12, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

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

For fiscal year ended June 30, 2010

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)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value \$.001 per share

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 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 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.

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input checked="" type="checkbox"/>
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Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

The aggregate market value of the voting common stock held by non-affiliates of the Registrant, based on the closing price of the Registrant's common stock on December 31, 2009, as reported by The OTC Bulletin Board, was approximately \$9,228,169. For the purpose of this calculation only, shares owned by officers, directors (and their affiliates) and 5% or greater stockholders have been excluded. The Registrant does not have any non-voting stock issued or outstanding.

The Registrant has 11,977,807 shares of common stock outstanding as of October 12, 2010.

FRANKLIN WIRELESS CORP.
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NOTE ON FORWARD LOOKING STATEMENTS

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

- o the terms "we", "us", "our", "Franklin", "Franklin Wireless", or the "Company" refer to Franklin Wireless Corp.
- o our fiscal year ends on June 30; references to fiscal 2010 and fiscal 2009 and similar constructions refer to the fiscal year ended on June 30 of the applicable year.

This Annual Report on Form 10-K 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 captions "Business," "Management's Discussion and Analysis of Financial Condition and Results of Operation", and elsewhere in this Annual Report on Form 10-K. 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 words 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" These forward looking statements are made only as of the date of this Annual Report on Form 10-K. 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

ITEM 1. BUSINESS.

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 technology ("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 other Caribbean and South American countries.

On October 1, 2009, we completed the acquisition of approximately 50.6% of the outstanding capital stock of Diffon Corporation, a South Korean corporation ("Diffon"). The purpose of the acquisition was to acquire a significant interest in a facility in South Korea that provides design, development and manufacturing services to the Company for high speed wireless data communication products including 3G and 4G wireless modules and modems. Diffon performs research and development functions and outsources its manufacturing process to third parties. The acquisition involved two separate but related transactions.

In the first transaction, we entered into a Share Exchange Agreement, dated October 1, 2009, with two major shareholders of Diffon (the "Diffon Shareholders"). We issued the Diffon Shareholders an aggregate of 550,000 shares of the Company's Common Stock in exchange for 440,000 shares of capital stock of Diffon, representing approximately 20.1% of the outstanding capital stock of Diffon. Under the Agreement, the Diffon Shareholders, acting together, have an unconditional right of rescission for one year, so that they may elect to return the Company's Common Stock received by them and receive the Diffon shares in return. On February 27, 2010, we announced the revocation of the right of rescission, which terminated the Diffon Shareholders' right to return the Company's Common Stock received by them for the Diffon shares in return.

In the second transaction, pursuant to a Common Stock Purchase Agreement dated October 1, 2009, we purchased 666,667 newly-issued shares of Diffon, representing approximately 30.5% of the outstanding capital stock of Diffon after giving effect to the issuance, for cash in the amount of \$833,333. The Agreement provides that at the Closing the Board of Directors of Diffon will be fixed at five directors, including two directors to be designated by the Company. The Company, Diffon and the Diffon Shareholders entered into a Shareholders' Agreement concerning ownership of the Diffon shares and certain other matters.

We accounted for the acquisition under the purchase method of accounting in accordance with the provisions of ASC 805, "Business Combinations." Under this accounting method, the company recorded at fair value the acquired assets of Diffon less the liabilities assumed, with the excess of the purchase price over the estimated fair value of such net assets reflected as goodwill. Our consolidated statement of operations includes the operations of Diffon from the date of acquisition.

On October 15, 2009, we opened a branch office in Seoul, South Korea, through a wholly-owned subsidiary of Franklin Wireless. The office manages certain logistical and administrative efforts for the Company.

OUR STRUCTURE

We incorporated in 1982 in California and reincorporated in Nevada on January 2, 2008. The reincorporation had no effect on the nature of our business or our management. Our headquarters office is located in San Diego, California. The office is principally composed of marketing, sales, operations, finance and administrative support. It is responsible for all customer-related activities, such as marketing communications, product planning, product management and customer support, along with sales and business development activities on a worldwide basis.

On October 1, 2009, we completed the acquisition of approximately 50.6% of the outstanding capital stock of Diffon Corporation, a South Korean corporation ("Diffon"). Diffon provides design, development and manufacturing services to the Company for certain of its high speed wireless data communications products including 3G and 4G wireless modems, routers and modules.

ASC 280, "Segment Reporting," requires public companies to report financial and descriptive information about their reportable operating segments. We identify our operating segments based on how 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 which consist 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:

Net sales:	Fiscal Year Ended June 30,	
	2010	2009
United States	\$ 98,404,968	\$ 14,334,956
Caribbean and South America	2,858,225	9,665,548
Asia	634,926	–
Totals	\$ 101,898,119	\$ 24,000,504

Long-lived assets, net:	June 30,	
	June 30, 2010	2009
United States	\$ 110,913	\$ 89,807
Asia	3,733,292	–
Totals	\$ 3,844,205	\$ 89,807

OUR PRODUCTS

We were the world's first supplier of both CDMA EVDO Rev A and dual-mode (CDMA Rev A/WiMAX) Universal Serial Bus (USB) modems. Our mobile broadband and data products include a variety of wireless USB modems as well as Wi-Fi "hotspot" routers (which operate over WiMAX or CDMA networks) and embedded modules. Our products provide consumers with an easy and convenient way in which to wirelessly connect to the Internet from laptop or desktop computers. These high-speed devices support the viewing of web pages, sending and receiving email with large file attachments, as well as downloading pictures, videos and music content. Our products are based on widely deployed cellular technologies and operate across 3G and 4G networks including:

- o Code Division Multiple Access ("CDMA") technology 1xEVDO – Evolution-Data Optimized technology in both Rev 0 and Rev A releases. Rev 0 modems have a download speed of up to 2.4 megabits per second (Mbps) and the Rev A products achieve broadband like speeds of 3.1 Mbps.
- o High Speed Packet Access ("HSPA") based on the Universal Mobile Telecommunications System standard or sometimes referred to as Wideband Code Division Multiple Access ("WCDMA") technology. This technology allows download speeds of up to 14.4 Mbps.
 - o Worldwide Interoperability for Microwave Access ("WiMAX") based on the IEEE 802.16 standard.

- o Long Term Evolution (LTE) is a 4G mobile broadband standard.

The following are representative selections of our current CDMA, HSPA, WiMax and LTE wireless data products:

USB MODEMS:

- o Dual-mode (3G and 4G) USB modems: These devices, when plugged into the Universal Serial Bus (USB) port of laptop or desktop computers, provide an easy and convenient way for consumers to connect to 3G or 4G wireless broadband networks.

- o Single mode USB modems: Operate over a variety of networks including CDMA EVDO Rev A and HSPA.

STAND-ALONE MODEMS:

- o For Machine-to-Machine and other vertical markets with a need for an Internet connection, such as a kiosk or other remote location, where no cable or DSL service exists.

ROUTERS:

- o Hotspot Routers: Embedded Wi-Fi hotspot routers that operate over CDMA EVDO Rev A or WiMAX Wave II networks.

MODULES:

- o Embedded Modules: In general, these are single mode devices whose primary market is original equipment manufacturers (OEMs) who seek a reliable embedded module solution for their wireless data applications.

CUSTOMERS

Our global customer base is comprised of wireless operators, strategic partners and distributors who are located primarily in the United States, South America and the Caribbean regions. The Company's 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 other Caribbean and South American countries.

SALES AND MARKETING

We market and sell our products primarily to wireless operators located in the United States, South America and the Caribbean regions mainly through our internal, direct sales organization and to a lesser degree, indirectly through strategic partners and distributors. The sales process is supported with a range of marketing activities including trade shows, product marketing and public relations.

All of our wireless devices must pass Federal Communications Commission (FCC) testing in order to be sold in United States markets. CDMA Development Group ("CDG") test certifications are required in order to launch CDMA wireless data products with wireless operators in North America, the Caribbean and South America, and PCS Type Certification Review Board ("PTCRB") test certifications are required for HSPA wireless data products. Certifications are issued as being a qualifier of CDG1, CDG 2 and CDG 3 as well as PTCRB.

RESEARCH AND DEVELOPMENT

On October 1, 2009, we completed the acquisition of approximately 50.6% of the outstanding capital stock of Diffon Corporation, a South Korean corporation. The purpose of the acquisition was to acquire a significant interest in a facility in South Korea that provides design, development and manufacturing services to us for high speed wireless data communication products including 3G and 4G wireless modules and modems. Diffon performs research and development functions and outsources its manufacturing process to third parties.

PRODUCTION AND MANUFACTURING OPERATIONS

For the fiscal year ended June 30, 2010, the manufacturing of our products was contracted out to C-Motech Co. Ltd. (“C-Motech”), an electronics manufacturing company, located in South Korea and to other manufacturing companies located in various parts of Asia outsourced through Diffon.

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In January 2005, we entered into a manufacturing and supply agreement with C-Motech for the manufacture of our products. On November 2, 2009, C-Motech provided a written notice to terminate the agreement effective January 5, 2010. Following this date, C-Motech continues to supply the Company with certain products.

EMPLOYEES

As of June 30, 2010, we employed approximately 58 employees. We also use the services of consultants and contract workers from time to time. Our employees are not represented by any collective bargaining organization, and we have never experienced a work stoppage.

ITEM 1A: RISK FACTORS.

The following risk factors do not purport to be a complete explanation of the risks involved in our business.

WE MAY NEED ADDITIONAL FINANCING DUE TO LIMITED RESOURCES. Our financial resources are limited, and the amount of funding that is required to develop and commercialize our products and technologies is highly uncertain. Adequate funds may not be available when needed or on terms satisfactory to us. Lack of funds may cause us to delay, reduce and/or abandon certain or all aspects of our development and commercialization programs. We may seek additional financing through the issuance of equity or convertible debt securities. The percentage ownership of our stockholders will be reduced, stockholders may experience additional dilution, and such securities may have rights, preferences and privileges senior to those of our Common Stock. There can be no assurance that additional financing will be available on terms favorable to us or at all. If adequate funds are not available or are not available on acceptable terms, we may not be able to fund our expansion, take advantage of desirable acquisition opportunities, develop or enhance services or products or respond to competitive pressures. Such inability could have a materially adverse effect on our business, results of operations and financial conditions.

WE MAY INFRINGE THE INTELLECTUAL PROPERTY RIGHTS OF OTHERS. The industry in which we operate has many participants that own, or claim to own, proprietary intellectual property. In the past we have received, and in the future may receive, claims from third parties alleging that we, and possibly our customers, violate their intellectual property rights. Rights to intellectual property can be difficult to verify and litigation may be necessary to establish whether or not we have infringed the intellectual property rights of others. In many cases, these third parties are companies with substantially greater resources than us, and they may be able to, and may choose to, pursue complex litigation to a greater degree than we could. Regardless of whether these infringement claims have merit or not, we may be subject to the following:

- o We may be liable for potentially substantial damages, liabilities and litigation costs, including attorneys' fees;
- o We may be prohibited from further use of the intellectual property and may be required to cease selling our products that are subject to the claim;
- o We may have to license the third party intellectual property, incurring royalty fees that may or may not be on commercially reasonable terms. In addition, there is no assurance that we will be able to successfully negotiate and obtain such a license from the third party;
- o We may have to develop a non-infringing alternative, which could be costly and delay or result in the loss of sales. In addition, there is no assurance that we will be able to develop such a non-infringing alternative;
 - o The diversion of management's attention and resources;
 - o Our relationships with customers may be adversely affected; and,

- o We may be required to indemnify our customers for certain costs and damages they incur in such a claim.

In the event of an unfavorable outcome in such a claim and our inability to either obtain a license from the third party or develop a non-infringing alternative, then our business, operating results and financial condition may be materially adversely affected and we may have to restructure our business.

Absent a specific claim for infringement of intellectual property, from time to time we have and expect to continue to license technology, intellectual property and software from third parties. There is no assurance that we will be able to maintain our third party licenses or obtain new licenses when required and this inability could materially adversely affect our business and operating results and the quality and functionality of our products. In addition, there is no assurance that third party licenses we execute will be on commercially reasonable terms.

Under purchase orders and contracts for the sale of our products we may provide indemnification to our customers for potential intellectual property infringement claims for which we may have no corresponding recourse against our third party licensors. This potential liability, if realized, could materially adversely affect our business, operating results and financial condition.

WE OPERATE IN AN INTENSIVELY COMPETITIVE MARKET. The wireless broadband data access market is highly competitive, and we may be unable to compete effectively. Many of our competitors or potential competitors have significantly greater financial, technical and marketing resources than we do. To survive and be competitive, we will need to continuously invest in research and development, sales and marketing, and customer support. Increased competition could result in price reduction and smaller customer orders. Our failure to compete effectively could seriously impair our business.

WE OPERATE IN THE HIGH-RISK TELECOM SECTOR. We are in a volatile industry. In addition, our revenue model is evolving and relies substantially on the assumption that we will be able to successfully complete the development and sales of our products and services in the marketplace. Our prospects must be considered in the light of the risk, uncertainties, expenses and difficulties frequently encountered by companies in the early stages of development and marketing. In order to be successful in the market we must, among other things:

- o Complete development and introduction of functional and attractive products and services;
 - o Attract and maintain customer loyalty;
- o Establish and increase awareness of our brand and develop customer loyalty;
- o Provide desirable products and services to customers at attractive prices;
- o Establish and maintain strategic relationships with strategic partners and affiliates;
 - o Rapidly respond to competitive and technological developments;
- o Build operations and customer service infrastructure to support our business; and
 - o Attract, retain, and motivate qualified personnel.

We cannot guarantee that we will be able to achieve these goals, and our failure to achieve them could adversely affect our business, results of operations, and financial condition. We expect that revenues and operating results will fluctuate in the future. There is no assurance that any or all of our efforts will produce a successful outcome.

WE OPERATE IN A FIELD WITH RAPIDLY CHANGING TECHNOLOGY. Since our products and services are new, we cannot be certain that these products and services will function as anticipated or be desirable to our intended markets. Our current or future products and services may fail to function properly, and if our products and services do not achieve and sustain market acceptance, our business, results of operations and profitability may suffer. If we are unable to predict and comply with evolving wireless standards, our ability to introduce and sell new products will be adversely affected. If we fail to develop and introduce products on time, we may lose customers and potential product orders.

WE DEPEND ON THE DEMAND FOR WIRELESS NETWORK CAPACITY. The demand for our products is completely dependent on the demand for broadband