

Zoom Telephonics, Inc.
Form 10-Q
May 16, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 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 0-53722

ZOOM TELEPHONICS, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

04-2621506
(I.R.S. Employer
Identification No.)

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

02111
(Zip Code)

Registrant's Telephone Number, Including Area Code: (617) 423-1072

(Former Name, Former Address, Former Fiscal Year, if Changed Since Last Report)

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

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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.

Large accelerated filer	<input type="radio"/>	Accelerated filer	<input type="radio"/>
Non-accelerated filer	<input type="radio"/>	Smaller Reporting Company	<input type="checkbox"/>

(do not check if a 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 number of shares outstanding of the registrant's Common Stock, \$.01 par value, as of March 31, 2011, was 5,450,622 shares.

ZOOM TELEPHONICS, INC.
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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ZOOM TELEPHONICS, INC.
Condensed Balance Sheets
(Unaudited)

	March 31, 2011	December 31, 2010
ASSETS		
Current assets		
Cash and cash equivalents	\$ 857,493	\$ 1,009,996
Marketable securities	251,346	328,704
Accounts receivable, net of allowances of \$599,339 at March 31, 2011 and \$564,722 at December 31, 2010	1,271,335	1,079,413
Receivables, other	160,763	166,144
Inventories	2,319,619	2,713,616
Prepaid expenses and other current assets	246,948	172,971
Total current assets	5,107,504	5,470,844
Equipment, net	36,565	43,070
Total assets	\$ 5,144,069	\$ 5,513,914
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 884,347	\$ 911,299
Accrued expenses	334,905	346,074
Total current liabilities	1,219,252	1,257,373
Total liabilities	1,219,252	1,257,373
Stockholders' equity		
Common stock, \$0.01 par value:		
Authorized - 25,000,000 shares; issued - 5,450,622 shares at March 31, 2011 and December 31, 2010	54,506	54,506
Additional paid-in capital	33,410,283	33,388,753
Accumulated deficit	(29,852,994)	(29,568,392)
Accumulated other comprehensive income (loss)	313,022	381,674
Total stockholders' equity	3,924,817	4,256,541
Total liabilities and stockholders' equity	\$ 5,144,069	\$ 5,513,914

See accompanying notes.

ZOOM TELEPHONICS, INC.
Condensed Statement of Operation
(Unaudited)

	Three Months Ended	
	March 31,	
	2011	2010
Net sales	\$ 2,808,262	\$ 2,493,592
Cost of goods sold	2,000,083	1,730,332
Gross profit	808,179	763,260
Operating expenses:		
Selling	536,918	447,784
General and administrative	316,898	372,666
Research and development	237,559	305,347
	1,091,375	1,125,797
Operating profit (loss)	(283,196)	(362,537)
Other :		
Interest income	328	183
Other, net	(1,570)	64,537
Total other income (expense), net	(1,242)	64,720
Income (loss) before income taxes	(284,438)	(297,817)
Income taxes (benefit)	164	261
Net income (loss)	\$ (284,602)	\$ (298,078)
Net income (loss) per share:		
Basic	\$ (0.05)	\$ (0.15)
Diluted	\$ (0.05)	\$ (0.15)
Weighted average common and common equivalent shares:		
Basic	5,450,622	1,980,978
Diluted	5,450,622	1,980,978

See accompanying notes.

ZOOM TELEPHONICS, INC.
Condensed Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31,	
	2011	2010
Operating activities:		
Net income (loss)	\$ (284,602)	\$ (298,078)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	9,339	7,902
Stock based compensation	21,530	33,163
(Reversal of) provision for accounts receivable allowances	34,618	(31,710)
Changes in operating assets and liabilities:		
Accounts receivable	(220,272)	266,110
Inventories	394,376	(129,629)
Prepaid expenses and other assets	(73,133)	26,321
Accounts payable and accrued expenses	(36,368)	100,396
Net cash provided by (used in) operating activities	(154,512)	(25,525)
Investing activities:		
Proceeds from sale of Unity investment	5,381	5,381
Additions to property, plant and equipment	(2,812)	—
Net cash provided by (used in) investing activities	2,569	5,381
Effect of exchange rate changes on cash	(560)	(1,281)
Net change in cash	(152,503)	(21,425)
Cash and cash equivalents at beginning of period	1,009,996	1,223,507
Cash and cash equivalents at end of period	\$ 857,493	\$ 1,202,082
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$ —	\$ —
Income taxes	\$ 164	\$ 261

See accompanying notes.

ZOOM TELEPHONICS, INC.
Notes to Condensed Financial Statements
(Unaudited)

(1) Summary of Significant Accounting Policies

On January 28, 2009, Zoom Technologies, Inc. entered into a Share Exchange Agreement (the "Agreement") with Tianjin Tong Guang Group Digital Communication Co., Ltd ("TCB Digital"), TCB Digital's majority shareholder, Gold Lion Holding Limited ("Gold Lion") and Lei Gu ("Gu"), a shareholder of Gold Lion. On May 12, 2009, the parties amended the Agreement to, among other actions, add Songtao Du ("Du"), a shareholder of Gold Lion, as a party to the Agreement. On September 22, 2009, pursuant to the Agreement, Zoom Technologies acquired all the outstanding shares of Gold Lion. In addition, as part of the transaction, Zoom Technologies spun off its then-current business, which consisted of its ownership of Zoom Telephonics, to its stockholders, by distributing and transferring its assets and liabilities to Zoom Telephonics and issuing a dividend of the Zoom Telephonics' shares to its stockholders.

For many years prior to the spin-off, Zoom Technologies was the public company parent of Zoom Telephonics, and the two companies' financials were consolidated. Upon the completion of the spin-off, Zoom Telephonics became a separate, independent publicly traded company headquartered in Boston, Massachusetts. Zoom Telephonics continues to produce, market, sell, and support dial-up modems, fixed and mobile broadband products, WiFi® compatible and Bluetooth® wireless products, and other communication-related products (the "Communications Business").

As used in Quarterly Report on Form 10-Q, the terms "we," "us," "our," and the "Company" mean Zoom Telephonics, Inc. (unless the context indicates a different meaning).

The Company has had recurring net losses and continues to experience negative cash flows from operations. To conserve cash and manage liquidity, the Company has implemented cost cutting initiatives including the reduction of employee headcount and overhead costs. Furthermore, management does not believe the Company has sufficient resources to fund its normal operations over the next 12 months unless sales improve significantly or it raises capital. Additional financing may not be available on terms favorable to the Company, or at all. If these funds are not available, the Company may not be able to execute its business plan or take advantage of business opportunities. The ability of the Company to obtain such additional financing and to achieve its operating goals is uncertain. In the event that the Company does not obtain additional capital or is not able to increase cash flow through the increase of sales, there is substantial doubt as to its ability to continue as a going concern. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The condensed financial statements of Zoom Telephonics, Inc. (the "Company") presented herein have been prepared pursuant to the rules of the Securities and Exchange Commission for quarterly reports on Form 10-Q and do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America. These financial statements should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2010 included in the Company's 2010 Annual Report on Form 10-K.

The accompanying financial statements are unaudited. However, the condensed balance sheet as of December 31, 2010 was derived from audited financial statements. In the opinion of management, the accompanying financial statements include all adjustments, normal recurring adjustments, necessary for a fair presentation.

The results of operations for the periods presented are not necessarily indicative of the results to be expected for the entire year. The Company has evaluated subsequent events from March 31, 2011 through the date of this filing and

determined that there are no such events requiring recognition or disclosure in the financial statements.

(2) Liquidity

Zoom's cash balance on March 31, 2011 was \$0.9 million, down \$153 thousand from December 31, 2010. Zoom's \$0.3 million loss and \$0.2 million increase in accounts receivable decreased cash, and Zoom's \$0.4 million decrease in inventory increased cash.

On March 31, 2011 the Company had working capital of \$3.9 million including \$0.9 million in cash and cash equivalents. On December 31, 2010 we had working capital of \$4.2 million including \$1.0 million in cash and cash equivalents. Our current ratio at March 31, 2011 was 4.2 compared to 4.4 at December 31, 2010. The most significant contributor to the decrease in working capital and reduction of the current ratio was a decrease in net inventory in Q1 2011 of \$394 thousand. Zoom has no long-term debt.

In 2010 the Company's net cash provided by financing activities was \$0.8 million from the net proceeds of a stock rights offering completed in December 2010. Under the rights offering, existing shareholders of the Company's common stock were granted rights to purchase, at an offering price of \$0.25 per share, 4 shares of stock for each share held. The rights offering resulted in the issuance of 3,469,644 shares of common stock. These shares are included in the 5,450,622 total Zoom Telephonics shares issued and outstanding on March 31, 2011.

To conserve cash and manage our liquidity, we have implemented cost-cutting initiatives including the reduction of employee headcount and overhead costs. On March 31, 2011 we had a headcount of 37, including 31 full-time employees and 6 part-time employees, compared to 40 as of March 31, 2010. We plan to continue to assess our cost structure as it relates to our revenues and cash position, and we may make further reductions if the actions are deemed necessary.

The Company is continuing to develop new products and work with its distribution partners with the goal of increasing sales. During Q1 2011 one of Zoom's major retailers elected to discontinue some of Zoom's slower selling products, and consequently that retailer began returning some of Zoom's consigned inventory. Reduction of these products' shelf space will impact Zoom's revenues. However, the Company expects that the same retailer will begin carrying two new Zoom products in Q2 2011, and believes the retailer's sales of these new products is likely to more than offset the lost sales from discontinued products. In addition, in Q2 2011 Zoom expects to increase the shelf space and number of products carried in another one of Zoom's major retailers. New product placement by Zoom requires Zoom to pay for inventory, and Zoom receives payment for that inventory based on the payment terms. Consigned inventory tends to result in the slowest payment to Zoom, since Zoom is only paid after the consigned inventory is sold by Zoom's customer.

The Company has had recurring net losses and continues to experience negative cash flows from operations. Furthermore, management does not believe the Company has sufficient resources to fund its normal operations over the next 12 months unless sales improve significantly or it raises capital. Additional financing may not be available on terms favorable to the Company, or at all. If these funds are not available, the Company may not be able to execute its business plan or take advantage of business opportunities. The ability of the Company to obtain such additional financing and to achieve its operating goals is uncertain. In the event that the Company does not obtain additional capital or is not able to increase cash flow through the increase of sales, there is substantial doubt as to its ability to continue as a going concern. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty. Refer to "Risk Factors" set forth in our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the Securities and Exchange Commission ("SEC") on March 29, 2011 and in our other filings with the SEC for additional information with respect to events and uncertainties that could harm our business, operating results and financial condition.

(3) Inventories

Inventories consist of :	March 31, 2011	December 31, 2010
Raw materials	\$ 958,696	\$ 1,165,383
Work in process	50,038	5,314
Finished goods (including \$528,000 and \$633,000 held by a customer at March 31, 2011 and December 31, 2010, respectively)	1,310,885	1,542,919
Total Inventories	\$ 2,319,619	\$ 2,713,616

(4) Comprehensive Income (Loss)

Comprehensive income (loss) follows:

	Three Months Ended March 31,	
	2011	2010
Net income (loss)	\$ (284,602)	\$ (298,078)
Foreign currency translation adjustment	8,706	(10,954)
Unrealized gain (loss) on securities	(77,358)	
Comprehensive income (loss)	\$ (353,254)	\$ (309,032)

(5) Contingencies

The Company is not currently party to any lawsuit, but lawsuits may occur in the ordinary course of business. The Company evaluates such lawsuits and proceedings on a case-by-case basis, and its policy is to vigorously contest any such claims that it believes are without merit.

(6) Segment and Geographic Information

The Company's operations are classified as one reportable segment. The Company's net sales by geographic region follow:

	Three Months Ended March 31, 2011	% of Total		Three Months Ended March 31, 2010	% of Total	
North America	\$2,503,364	89	%	\$2,181,055	87	%
UK	172,427	6	%	194,828	8	%
All Other	132,471	5	%	117,709	5	%
Total	\$2,808,262	100	%	\$2,493,592	100	%

(7) Customer Concentrations

The Company sells its products primarily through high-volume distributors and retailers, Internet service providers, telephone service providers, value-added resellers, PC system integrators, and original equipment manufacturers ("OEMs"). The Company supports its major accounts in their efforts to discern strategic directions in the market, to maintain appropriate inventory levels, and to offer a balanced selection of attractive products.

Relatively few customers have accounted for a substantial portion of the Company's revenues. In the first quarter of 2011, three customers accounted for 58% of the Company's total net sales. In the first quarter of 2010, three customers accounted for 52% of the Company's total net sales.

The Company's customers generally do not enter into long-term agreements obligating them to purchase products. The Company may not continue to receive significant revenues from any of these or from other large customers. A reduction or delay in orders from any of the Company's significant customers, or a delay or default in payment by any significant customer could materially harm the Company's business and prospects. Because of the Company's

significant customer concentration, its net sales and operating income (loss) could fluctuate significantly due to changes in political or economic conditions, or the loss, reduction of business, or less favorable terms for any of the Company's significant customers.

(8) Investments

During the quarter ended September 30, 2007 the Company purchased all the Series A Preferred Shares (the Series A Shares) of Unity Business Networks, LLC (Unity) for cash of \$1.2 million, including transaction costs. The Series A Shares were convertible at any time at the Company's option into 15% of Unity's common stock on a fully-diluted basis. In addition, the Company had an option to purchase all the outstanding common stock of Unity based on a specified multiple of Unity's 2008 revenues, as defined.

On September 30, 2009 the Company received a cash payment of \$766,950 in connection with Telesphere Networks' purchase of the VoIP services business of Unity, including Zoom's preferred stock investment described above. The transaction calls for additional periodic payments totaling \$43,050 over 24 months beginning in October 2009 and a final payment of \$150,000 on September 30, 2011, or \$960,000 in total. Additional payments have been received and the remaining balance of expected payments recorded on the March 31, 2011 balance sheet are reported as a current other receivable of \$160,763.

(9) Valuation of Marketable Securities

In October 2010, Zoom Telephonics, Inc. entered into an agreement with Zoom Technologies, Inc. (Nasdaq: ZOOM) in which Zoom Telephonics transferred its rights to the zoom.com domain name and certain trademark rights in exchange for 80,000 shares of Zoom Technologies common stock. None of these shares could be sold for the first 6 months after the effective date of October 18, 2010. After the first 6 months, Zoom Telephonics may sell up to 20,000 of these shares, and may sell an additional 20,000 shares every three months thereafter. Due to these restrictions on selling the stock, the Company has valued the marketable securities at market value less a liquidity discount. The Company did not sell any Zoom Technologies shares during Q1 2011. The closing price of Zoom Technologies common stock declined from \$4.47 on December 31, 2010 to \$3.31 on March 31, 2011.

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

The following discussion and analysis should be read in conjunction with the safe harbor statement and the risk factors contained in Item IA of Part II of this Quarterly Report on Form 10-Q, in our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 29, 2011 and in our other filings with the SEC. Readers should also be cautioned that results of any reported period are often not indicative of results for any future period.

Overview

We derive our net sales primarily from sales of Internet-related communication products, principally dial-up modems, fixed and mobile broadband products, WiFi® compatible and Bluetooth® wireless products, and other communication-related products. We sell these products primarily to retailers, distributors, Internet Service Providers and Original Equipment Manufacturers. We sell our products through a direct sales force and through independent sales agents. Our employees are primarily located at our headquarters in Boston, Massachusetts and our sales office in the United Kingdom. We are experienced in electronics hardware, firmware, and software design and test, regulatory approvals, product documentation, and packaging; and we use that experience in developing each product in-house or in partnership with suppliers who are typically based in Asia. Electronic assembly and testing of the Company's products in accordance with our specifications is typically done in China.

For many years we performed most of the final assembly, test, packaging, warehousing and distribution at a production and warehouse facility on Summer Street in Boston, Massachusetts, which had also engaged in firmware programming for some products. On June 30, 2006 we announced our plans to move most of our Summer Street operations to a dedicated facility in Tijuana, Mexico commencing approximately September 1, 2006, and we have since implemented that plan. In August 2006 we signed a lease for a 35,575 square foot manufacturing and warehousing facility in Tijuana, Mexico with an initial lease term from October 2006 to May 2007, with five two-year options thereafter. In February, 2007 we renegotiated the first renewal term and signed a one-year extension starting in May 2007, with five two-year options thereafter. We signed a one-year extension starting in May 2008. In March 2009 we signed a one-year lease with one one-year option for a smaller facility for lower cost. In March 2011 we signed a one-year lease extension starting May 1, 2011, with three one-year renewal options thereafter.

Since 1983 our headquarters has been near South Station in downtown Boston. Zoom historically owned two adjacent buildings which connect on most floors, and which house our entire Boston staff. In December 2006 we sold our headquarters buildings to a third party, with a two-year lease-back of approximately 25,000 square feet of the 62,000 square foot facility. Our net sale proceeds were approximately \$7.7 million of which approximately \$3.6 million was repaid to our mortgage holder, eliminating the mortgage debt from our balance sheet. In January 1, 2009 we reduced our leased Boston space from 25,000 square feet to 14,400 square feet with an increase in rent per square foot, resulting in a savings in 2009 of \$54,000. In May 2010 we signed a second lease amendment extending the term of the lease to April 30, 2016 with a six month termination option starting December 1, 2011.

For many years we derived a majority of our net sales from the retail after-market sale of dial-up modems to customers seeking to add or upgrade a modem for their personal computers. In recent years the size of this market and our sales to this market have declined, as personal computer manufacturers have incorporated a modem as a built-in component in most consumer personal computers and as increasing numbers of consumers world-wide have switched to broadband Internet access. The consensus of communications industry analysts is that after-market sales of dial-up modems will probably continue to decline. There is also consensus among industry analysts that the installed base for broadband Internet connection devices, such as cable modems and DSL modems, will grow rapidly during the decade. In response to increased and forecasted worldwide demand for faster connection speeds and increased modem functionality, we have invested and continue to invest resources to advance our product line of broadband modems, both DSL modems and cable modems.

We continually seek to improve our product designs and manufacturing approach in order to improve product performance and reduce our costs. We pursue a strategy of outsourcing rather than internally developing our modem chipsets, which are application-specific integrated circuits that form the technology base for our modems. By outsourcing the chipset technology, we are able to concentrate our research and development resources on modem system design, leverage the extensive research and development capabilities of our chipset suppliers, and reduce our development time and associated costs and risks. As a result of this approach, we are able to quickly develop new products while maintaining a relatively low level of research and development expense as a percentage of net sales. We also outsource aspects of our manufacturing to contract manufacturers as a means of reducing our costs of production, and to provide us with greater flexibility in our production capacity.

Generally our gross margin for a given product depends on a number of factors including the type of customer to whom we are selling. The gross margin for retailers tends to be higher than for some of our other customers; but the sales, support, returns, and overhead costs associated with retailers also tend to be higher. Zoom's sales to certain countries are currently handled by a single master distributor for each country who handles the support and marketing costs within the country. Gross margin for sales to these master distributors tends to be low, since lower pricing to these distributors helps them to cover the support and marketing costs for their country.

Over the past several years our net sales have declined. In response to declining sales volume, we have cut costs by reducing staffing and some overhead costs. Our total headcount was reduced from 40 on March 31, 2010 to 37 on March 31, 2011. As of April 29, 2011, Zoom had 37 full-time and part-time employees. Of the 37 included in our headcount, 7 were engaged in research and development, 9 were involved in manufacturing oversight, purchasing, assembly, packaging, shipping and quality control, 14 were engaged in sales, marketing and technical support, and the remaining 7 performed accounting, administrative, management information systems, and executive functions. Zoom has implemented cost cutting measures including reducing our headcount and reducing the number of days that certain employees work. As a result, Zoom currently has 31 full-time employees and 6 employees working less than 5 days per week. Our dedicated manufacturing personnel in Mexico are employees of our Mexican manufacturing service provider and not included in our headcount.

Zoom's cash balance on March 31, 2011 was \$0.9 million, down \$153 thousand from December 31, 2010. Zoom's \$0.3 million loss and \$0.2 million increase in accounts receivable decreased cash, and Zoom's \$0.4 million decrease in inventory increased cash.

On March 31, 2011, the Company had working capital of \$3.9 million including \$0.9 million in cash and cash equivalents. On December 31, 2010 we had working capital of \$4.2 million including \$1.0 million in cash and cash equivalents. Our current ratio at March 31, 2011 was 4.2 compared to 4.4 at December 31, 2010. The most significant contributor to the decrease in working capital and reduction of the current ratio was a decrease in net inventory in Q1 2011 of approximately \$394 thousand. Zoom has no long-term debt.

Critical Accounting Policies and Estimates

Following is a discussion of what we view as our more significant accounting policies and estimates. As described below, management judgments and estimates must be made and used in connection with the preparation of our financial statements. We have identified areas where material differences could result in the amount and timing of our net sales, costs, and expenses for any period if we had made different judgments or used different estimates.

Revenue (Net Sales) Recognition. We primarily sell hardware products to our customers. The hardware products include dial-up modems, DSL modems, cable modems, voice over IP products, and wireless and wired networking equipment. We earn a small amount of royalty revenue that is included in our net sales, primarily from internet service providers. We generally do not sell software. We began selling services in 2004. We introduced our Global Village VoIP service in late 2004, but sales of those services to date have not been material.

We derive our net sales primarily from the sales of hardware products to four types of customers:

computer peripherals retailers,

computer product distributors,

Internet service providers, and

original equipment manufacturers (OEMs)

We recognize hardware net sales for our customers at the point when the customers take legal ownership of the delivered products. Legal ownership passes from Zoom to the customer based on the contractual FOB point specified in signed contracts and purchase orders, which are both used extensively. Many of our customer contracts or purchase orders specify FOB destination. We verify the delivery date on all significant FOB destination shipments made during the last 10 business days of each quarter.

Our net sales of hardware include reductions resulting from certain events which are characteristic of the sales of hardware to retailers of computer peripherals. These events are product returns, certain sales and marketing incentives, price protection refunds, and consumer mail-in and in-store rebates. Each of these is accounted for as a reduction of net sales based on detailed management estimates, which are reconciled to actual customer or end-consumer credits on a monthly or quarterly basis.

Product Returns. Products are returned by retail stores and distributors for inventory balancing, contractual stock rotation privileges, and warranty repair or replacements. We estimate the sales and cost value of expected future product returns of previously sold products. Our estimates for product returns are based on recent historical trends plus estimates for returns prompted by, among other things, announced stock rotations and announced customer store closings. Management reviews historical returns, current economic trends, and changes in customer demand and acceptance of our products when estimating sales return allowances. The estimate for future returns is recorded as a reserve against accounts receivable, a reduction in our net sales, and the corresponding change to inventory reserves and cost of sales. Product returns as a percentage of total shipments were 7.9% and 5.7% for the first quarter of 2011 and 2010, respectively.

Price Protection Refunds. We have a policy of offering price protection to certain of our retailer and distributor customers for some or all their inventory. Under the price protection policies, when we reduce our prices for a product, the customer receives a credit for the difference between the original purchase price and our reduced price for their unsold inventory of that product. Our estimates for price protection refunds are based on a detailed understanding

and tracking by customer and by sales program. Estimated price protection refunds are recorded in the same period as the announcement of a pricing change. Information from customer inventory-on-hand reports or from direct communications with the customers is used to estimate the refund, which is recorded as a reduction of net sales and a reserve against accounts receivable. Reductions in our net sales due to price protection were negligible in both the first quarter of 2011 and the first quarter of 2010.

Sales and Marketing Incentives. Many of our retailer customers require sales and marketing support funding, usually set as a percentage of our sales in their stores. The incentives were reported as reductions in our net sales and were \$160 thousand in the first quarter of 2011 and \$190 thousand in the first quarter of 2010.

Consumer Mail-In and In-Store Rebates. Our estimates for consumer mail-in and in-store rebates are based on a detailed understanding and tracking by customer and sales program, supported by actual rebate claims processed by the rebate redemption centers plus an accrual for an estimated lag in processing at the redemption centers. The estimate for mail-in and in-store rebates is recorded as a reserve against accounts receivable and a reduction of net sales in the same period that the rebate obligation was triggered. Reductions in our net sales due to the consumer rebates were negligible in both the first quarter of 2011 and the first quarter of 2010.

To ensure that the sales, discounts, and marketing incentives are recorded in the proper period, we perform extensive tracking and documenting by customer, by period, and by type of marketing event. This tracking includes reconciliation to the accounts receivable records for deductions taken by our customers for these discounts and incentives.

Accounts Receivable Valuation. We establish accounts receivable valuation allowances equal to the above-discussed net sales adjustments for estimates of product returns, price protection refunds, consumer rebates, and general bad debt reserves. These allowances are reduced as actual credits are issued to the customer's accounts. Our bad-debt write-offs were negligible in both the first quarter of 2011 and the first quarter of 2010.

Inventory Valuation and Cost of Goods Sold. Inventory is valued at the lower of cost, determined by the first-in, first-out method, or market. We review inventories for obsolete slow moving products each quarter and make provisions based on our estimate of the probability that the material will not be consumed or that it will be sold below cost. Additional charges to inventory reserves related to obsolete and slow-moving products were negligible in both the first quarter of 2011 and the first quarter of 2010.

Valuation and Impairment of Deferred Tax Assets. As part of the process of preparing our financial statements we estimate our income tax expense and deferred income tax position. This process involves the estimation of our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our balance sheet. We then assess the likelihood that our deferred tax assets will be recovered from future taxable income. To the extent we believe that recovery is not likely, we establish a valuation allowance. Changes in the valuation allowance are reflected in the statement of operations.

Significant management judgment is required in determining our provision for income taxes and any valuation allowances. We have recorded a 100% valuation allowance against our deferred income tax assets. It is management's estimate that, after considering all of the available objective evidence, historical and prospective, with greater weight given to historical evidence, it is more likely than not that these assets will not be realized. If we establish a record of continuing profitability, at some point we will be required to reduce the valuation allowance and recognize an equal income tax benefit which will increase net income in that period(s).

As of December 31, 2010 the Company had federal net operating loss carry forwards of approximately \$45,219,000 which are available to offset future taxable income. They are due to expire in varying amounts from 2018 to 2029. As of December 31, 2010, the Company had Massachusetts state net operating loss carry forwards of approximately \$16,640,000 which are available to offset future taxable income. They are due to expire in varying amounts from 2011 through 2014.

Valuation of Investments. During the quarter ended September 30, 2007 the Company purchased all the Series A Preferred Shares (the Series A Shares) of Unity Business Networks, LLC (Unity) for cash of \$1.2 million, including transaction costs. The Series A Shares were convertible at any time at the Company's option into 15% of Unity's common stock on a fully-diluted basis. In addition, the Company had an option to purchase all the outstanding common stock of Unity based on a specified multiple of Unity's 2008 revenues, as defined.

On September 30, 2009 the Company received a cash payment of \$766,950 in connection with Telesphere Networks' purchase of the VoIP services business of Unity, including Zoom's preferred stock investment described above. The transaction calls for additional periodic payments totaling \$43,050 over 24 months beginning in October 2009 and a final payment of \$150,000 on September 30, 2011, or \$960,000 in total. Additional payments have been received and the remaining balance of expected payments recorded on the March 31, 2011 balance sheet are reported as a current other receivable of \$160,763.

Results of Operations

Summary. Net sales were \$2.8 million for our first quarter ended March 31, 2011, up 12.6% from \$2.5 million in the first quarter of 2010. Zoom reported a net loss of \$285 thousand or \$0.05 per share for Q1 2011, a slight improvement over Zoom's net loss of \$298 thousand or \$0.15 per share for Q1 2010.

Net Sales. Our total net sales for the first quarter of 2011 increased \$0.3 million or 12.6% from the first quarter of 2010, primarily due to increased sales of cable modems and mobile broadband products. The increase in cable modem sales was primarily due to strong sales of Zoom's DOCSIS 3.0 cable modems in the US, and the increase in mobile broadband products' sales was primarily due to a growth trend that Zoom and the overall mobile broadband market are experiencing in many markets. These sales increases were primarily offset by reduced sales of Zoom's dial-up modems, which suffered from the trend toward broadband modems.

Geographically, our North American sales increased their already dominant share of our overall sales, going from 87.5% of our net sales in Q1 2010 to 89.1% in Q1 2011. Our second largest market, the UK, experienced a decline from 7.8% of our net sales in Q1 2010 to 6.1% in Q1 2011.

In the quarter ended March 31, 2011 three customers accounted for 58% of total net sales. Because of our significant customer concentration, our net sales and operating income has fluctuated and could in the future fluctuate significantly due to changes in political or economic conditions or the loss, reduction of business, or less favorable terms for any of our significant customers.

Gross Profit. Gross profit was \$808 thousand or 28.8% of net sales in Q1 2011, as gross profit increased from \$763 thousand in Q1 2010 despite a decrease in gross margin from 30.6% of net sales in Q1 2010. Gross profit increased due to higher sales, and gross margin decreased primarily because a lower percentage of our sales came from dial-up modems, which typically have higher margins.

Selling Expense. Selling expense was \$537 thousand or 19.1% of net sales in the first quarter of 2011 compared to \$448 thousand or 18.0% of net sales in the first quarter of 2010. Selling expenses increased primarily due to higher variable expenses associated with increased revenues in Q1 2011 compared to Q1 2010 and increased costs from internet related advertising.

General and Administrative Expense. General and administrative expense was \$317 thousand or 11.3% of net sales in the first quarter of 2011, down from \$373 thousand or 14.9% of net sales in the first quarter of 2010. This decrease was primarily due to lower personnel costs.

Research and Development Expense. Research and development expense was \$238 thousand or 8.5% of net sales in the first quarter of 2011 and \$305 thousand or 12.2% of net sales in the first quarter of 2010. This decrease was primarily due to lower personnel costs.

Other Income (Expense). Other expense was negligible in the first quarter of 2011 and other income was \$65 thousand in the first quarter of 2010. The other income in the first quarter of 2010 was primarily due to our share of a DRAM semi-conductor class action refund settlement.

Liquidity and Capital Resources

Zoom's cash balance on March 31, 2011 was \$0.9 million, down \$153 thousand from December 31, 2010. Zoom's \$0.3 million loss and \$0.2 million increase in accounts receivable decreased cash, and Zoom's \$0.4 million decrease in inventory increased cash.

On March 31, 2011, the Company had working capital of \$3.9 million including \$0.9 million in cash and cash equivalents. On December 31, 2010, we had working capital of \$4.2 million including \$1.0 million in cash and cash equivalents. Our current ratio at March 31, 2011 was 4.2 compared to 4.4 at December 31, 2010. The most significant contributor to the decrease in working capital and reduction of the current ratio was a decrease in net inventory in Q1 2011 of \$394 thousand. Zoom has no long-term debt.

To conserve cash and manage our liquidity, we have implemented cost-cutting initiatives including the reduction of employee headcount and overhead costs. On March 31, 2011, we had a headcount of 37, including 31 full-time employees and 6 part-time employees, compared to 40 as of March 31, 2010. As of April 29, 2011, we had 37 full-time and part-time employees. We plan to continue to assess our cost structure as it relates to our revenues and cash position, and we may make further reductions if the actions are deemed necessary.

The Company is continuing to develop new products and work with our distribution partners with the primary goal of increasing sales.

The Company has had recurring net losses and continues to experience negative cash flows from operations. To conserve cash and manage liquidity, the Company has implemented cost cutting initiatives including the reduction of employee headcount and overhead costs. Furthermore, management does not believe the Company has sufficient resources to fund its normal operations over the next 12 months unless sales improve significantly or it raises capital. Additional financing may not be available on terms favorable to the Company, or at all. If these funds are not available, the Company may not be able to execute its business plan or take advantage of business opportunities. The ability of the Company to obtain such additional financing and to achieve its operating goals is uncertain. In the event that the Company does not obtain additional capital or is not able to increase cash flow through an increase of sales, there is substantial doubt as to its ability to continue as a going concern. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty. Refer to "Risk Factors" set forth in our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 29, 2011 and in our other filings with the SEC for additional information with respect to events and uncertainties that could harm our business, operating results and financial condition.

Commitments

During the three months ended March 31, 2011, there were no material changes to our capital commitments and contractual obligations from those disclosed in our Form 10-K for the year ended December 31, 2010.

"Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995.

Some of the statements contained in this report are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements involve known and unknown risks, uncertainties and other factors which may cause our or our industry's actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Forward-looking statements include, but are not limited to statements regarding: Zoom's plans, expectations and intentions, including statements relating to Zoom's prospects and plans relating to sales of and markets for its products and Zoom's financial condition or results of operations.

In some cases, you can identify forward-looking statements by terms such as "may," "will," "should," "could," "would," "expects," "plans," "anticipates," "believes," "estimates," "projects," "predicts," "potential" and similar expressions intended to identify forward-looking statements. These statements are only predictions and involve known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by such forward-looking statements. Given these uncertainties you should not place undue reliance on these forward-looking statements. Also, these forward-looking statements represent our estimates and assumptions only as of the date of this report. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained in this report to reflect any change in our expectations or any change in events, conditions or circumstances on which any of our forward-looking statements are based. Factors that could cause or contribute to differences in our future financial results include those discussed in the risk factors set forth in Item 1A of Part II below as well as those discussed elsewhere in this report, in our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 29, 2011 and in our other filings with the SEC.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Required.

ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act of 1934 reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer who is also our Acting Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as ours are designed to do, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As of March 31, 2011 we carried out an evaluation, under the supervision and with the participation of our management including our Chief Executive Officer and Acting Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and Acting Chief Financial Officer concluded that our disclosure controls and procedures are effective in enabling us to record, process, summarize and report information required to be included in our periodic SEC filings within the required time period.

There have been no changes in our internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1A. RISK FACTORS

This report contains forward-looking statements that involve risks and uncertainties, such as statements of our objectives, expectations and intentions. The cautionary statements made in this report are applicable to all forward-looking statements wherever they appear in this report. Our actual results could differ materially from those discussed herein. Factors that could cause or contribute to such differences include the risk factors contained in our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 29, 2011, as well as those discussed in this report and in our other filings with the SEC.

We may require additional funding, which may be difficult to obtain on favorable terms, if at all.

Over the next twelve months we may require additional funding if, for instance, we experience losses. In Q3 and Q4 2010 we enjoyed profits, but in Q1 2011 we experienced losses. We currently have no line of credit from which we can borrow. Additional financing may not be available to us on a timely basis if at all, or on terms acceptable to us. If we fail to obtain acceptable additional financing when needed, we may not have sufficient resources to fund our normal operations; and this would have a material adverse effect on our business.

Our auditors have expressed substantial doubt about our ability to continue as a going concern.

The audit report issued by our independent registered public accounting firm for our financial statements for the fiscal year ended December 31, 2010 states that the auditing firm has substantial doubt in our ability to continue as a going concern due to the risk that we may not have sufficient cash and liquid assets at December 31, 2010 to cover our operating and capital requirements for the next twelve-month period; and if in that case sufficient cash cannot be obtained, we would have to substantially alter, or possibly even discontinue, operations. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty.

ITEM 6. EXHIBITS

Exhibit No.	Exhibit Description
31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

ZOOM TELEPHONICS, INC.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ZOOM TELEPHONICS, INC.
(Registrant)

Date: May 16, 2011

By: /s/ Frank B. Manning
Frank B. Manning, President,
Chief Executive
Officer and Acting Chief
Financial Officer
(Principal Executive Officer
and Principal Financial Officer)

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