FRANKLIN ELECTRONIC PUBLISHERS INC
Form 10-Q
November 14, 2001

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

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

For Quarter ended September 30, 2001 Commission File No. 0-14841

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED
(Exact name of registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	22-2476703 (I.R.S. Employer Identification No.)
One Franklin Plaza, Burlington, New Jersey (Address of principal executive office)	08016-4907 (Zip Code)

Registrant's telephone number (609) 386-2500

Indicate by check mark whether 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 Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ___

COMMON STOCK OUTSTANDING AS OF
SEPTEMBER 30, 2001 - 7,947,882 SHARES

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	September 3 2001 (Unaudited
ASSETS	

CURRENT ASSETS:	
Cash and cash equivalents	$ 2,947
Accounts receivable, less allowance for doubtful accounts of $1,157 and $1,161	13,082
Preferred stock subscriptions receivable	--
Inventories	24,125
Income tax receivable	568
Prepaids and other assets	1,924
TOTAL CURRENT ASSETS	42,646
PROPERTY AND EQUIPMENT	7,410
OTHER ASSETS:	
Deferred income tax asset	5,700
Trademark, less accumulated amortization of $1,943 and $1,749	13,604
Advance royalties and licenses	1,061
Software development costs	7,223
Other assets	2,731
TOTAL OTHER ASSETS	30,319
TOTAL ASSETS	$ 80,375

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:	
Accounts payable and accrued expenses	$ 17,555
Notes payable	10,404
Revolving credit facility	7,107
Current portion of long-term liabilities - Other	334
TOTAL CURRENT LIABILITIES	35,400
LONG-TERM LIABILITIES	
Notes payable	--
Revolving credit facility	--
Other liabilities	1,929
TOTAL LONG-TERM LIABILITIES	1,929
SHAREHOLDERS' EQUITY:	
Preferred stock, $2.50 par value, authorized 10,000,000 shares 3,500 issued and outstanding	3,566
Preferred stock subscribed	--
Common stock, no par value, authorized 50,000,000 shares, issued and outstanding, 7,947,882 and 7,952,882 shares	49,879
Retained earnings (deficit)	(9,272
Foreign currency translation adjustment	(1,127
TOTAL SHAREHOLDERS' EQUITY	43,046
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 80,375

See notes to consolidated financial statements.

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED
AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS
(in thousands, except for per share data)
(unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2001	2000	2001	2000
SALES	$ 18,714	$ 20,510	$ 34,723	$ 37,561
COST OF SALES	11,977	11,699	21,339	21,291
WRITE-DOWN ON EBOOKMAN INVENTORY	2,898	--	2,898	--
TOTAL COST OF SALES	14,875	11,699	24,237	21,291
GROSS MARGIN	3,839	8,811	10,486	16,270
EXPENSES:				
Sales and marketing	5,675	4,215	10,528	7,545
Research and development	1,043	1,226	2,013	1,993
General and administrative	2,271	2,447	4,552	4,771
Total operating expenses	8,989	7,888	17,093	14,309
OPERATING INCOME (LOSS)	(5,150)	923	(6,607)	1,961
Interest expense	(441)	(410)	(815)	(814)
Interest and investment income	(197)	54	(160)	142
Other, net	(87)	(359)	(250)	(648)
INCOME (LOSS) BEFORE INCOME TAXES	(5,875)	208	(7,832)	641
INCOME TAX PROVISION (BENEFIT)	--	--	--	--
NET INCOME (LOSS)	(5,875)	208	(7,832)	641
PREFERRED STOCK DIVIDEND	88	--	88	--
NET INCOME (LOSS) APPLICABLE TO COMMON STOCK	$ (5,963)	$ 208	$ (7,920)	$ 641
NET INCOME (LOSS) PER COMMON SHARE:				
Basic	$ (0.75)	$ 0.03	$ (1.00)	$ 0.08
Diluted	$ (0.75)	$ 0.02	$ (1.00)	$ 0.08

WEIGHTED AVERAGE COMMON SHARES:				
Basic	7,948	7,916	7,951	7,915
Diluted	7,948	8,541	7,951	8,352

See notes to consolidated financial statements.

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED
AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(in thousands, except for share data)

	Common Stock		Preferred Stock	
	Shares	Amount	Shares	Amount
BALANCE - MARCH 31, 2001	7,952,882	$49,658	3,500	$3,500
Issuance of shares and amortization of deferred compensation expense are issued for services (unearned portion $11)	(5,000)	(2)	-	-
Value of stock options granted	-	223		
Preferred stock dividend			88	88
Costs incurred in issuance of preferred stock				(22)
Loss for the period	-	-	-	-
Foreign currency translation adjustment	-	-	-	-
BALANCE - SEPTEMBER 30, 2001 (unaudited)	7,947,882	$49,879	3,588	$3,566

* Comprehensive income, i.e., net income (loss), plus, or less, other comprehensive income, totaled ($7,431) for the six months ended September 30, 2001.

See notes to consolidated financial statements.

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED
AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
(in thousands)
(unaudited)

CASH FLOWS FROM OPERATING ACTIVITIES:	
NET INCOME (LOSS)	$
ADJUSTMENTS TO RECONCILE NET INCOME TO	
NET CASH PROVIDED BY OPERATING ACTIVITIES	
Depreciation and amortization	
Provision for losses on accounts receivable	
Loss (gain) on disposal of property and equipment	
Provisions for eBookMan inventory, assets and price protection	
Stock issued for services	
Source (use) of cash from change in operating assets and liabilities:	
Accounts receivable	
Inventories	
Prepaids and other assets	
Accounts payable and accrued expenses	
Other, net	

NET CASH USED IN OPERATING ACTIVITIES	
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchase of property and equipment	
Proceeds from sale of property and equipment	
Software development costs	
Change in other assets	

NET CASH USED IN INVESTING ACTIVITIES	
CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from revolving credit facility	
Proceeds from issuance of preferred shares	
Other liabilities	

NET CASH PROVIDED BY FINANCING ACTIVITIES	
EFFECT OF EXCHANGE RATE CHANGES ON CASH	

INCEASE (DECREASE) IN CASH AND CASH EQUIVALENTS	
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	

CASH AND CASH EQUIVALENTS AT END OF PERIOD	$
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See notes to consolidated financial statements.

FRANKLIN ELECTRONIC PUBLISHERS, INCORPORATED
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Reference is made to the financial statements included in the Company's annual Report (Form 10-K) filed with the Securities and Exchange Commission for the year ended March 31, 2001.

The financial statements for the periods ended September 30, 2001 and 2000 are unaudited and include all adjustments necessary to a fair presentation of the results of operations for the periods then ended. All such adjustments are of a normal recurring nature. The results of the Company's operations for any interim period are not necessarily indicative of the results of the Company's operations for a full year.

EBOOKMAN PROVISIONS

In February 2001 the Company began shipment of its new eBookMan product that had been in development for approximately one year. Through September 30, 2001 sales of this product have been below expectations, as the eBook market did not develop and grow as anticipated. Because of the lower than expected sales, the Company recorded provisions totaling $4,201 to reduce the carrying value of its eBookMan inventory and certain related assets and provide for price protection related to the eBookMan product.

NOTES PAYABLE

The Company is not in compliance with certain financial covenants of its Senior Note Agreement pertaining to EBITDA coverage of interest expense and fixed charges. Therefore, the $10,404 of Senior Notes and the $7,107 due under the Company's $25,000 Revolving Credit Facility are shown as current liabilities. The Company is currently in discussions with the Noteholders to restructure the Agreement to allow the Company to operate in compliance with all financial covenants. At March 31 $2,000 of Senior Notes were included in current liabilities and the remaining $8,329, along with the $4,064 due under the Revolving Credit Facility, were shown as long-term liabilities.

OPERATIONS

Under FAS No. 131 "Disclosure about Segments of an Enterprise and Related Information", the Company's operations are treated as one operating segment as it only reports profit and loss information on an aggregate basis to the chief operating decision maker of the Company. Information about the Company's product sales are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	September 30,		September 30,	
Product Sales	2001	2000	2001	2000
Reference	$15,679	$17,171	$27,547	$31,845
Rolodex	4,156	3,253	6,098	5,566
eBookMan	(1,121)		1,078	--
Other		86	--	150
Total Sales	$18,714	$20,510	$34,723	$37,561

Approximate foreign sources of revenues including export sales were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	September 30,		September 30,	
Product Sales	2001	2000	2001	2000
Europe	$ 3,922	$ 4,125	$ 7,858	$10,054
Other International	1,851	1,241	2,945	2,338

For the three-month periods ended September 30, 2001 and 2000, one customer in each period accounted for more than 10% of the Company's revenues. Total sales to these customers were $1,910 and $2,500 respectively. The sales of $1,910 in 2001 were comprised of reference product while the sales of $2,500 in 2000 and included reference product and Rolodex Electronic products. For the six months ended September 30, 2001 and 2000 no customer accounted for more than 10% of the Company's revenues.

ISSUANCE OF PREFERRED STOCK

In April 2001, Dr. James H. Simons, the Company's Chairman of the Board, paid $3,500,000 for 3,500 shares of the Company's Series A 10% Convertible Preferred Stock for which he had subscribed in March 2001. For additional information regarding the Preferred Stock issue, refer to the financial statements included in the Company's annual Report (Form 10-K) for the year ended March 31, 2001

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142). SFAS No. 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. The provisions of this statement are required to be applied starting with fiscal years beginning after December 15, 2001 and applied to all goodwill and other intangible assets recognized in its financial statements at that date. The Company expects to adopt this standard for its fiscal year commencing April 1, 2002 and is currently evaluating the impact of SFAS 142 on its financial results.

RECLASSIFICATIONS

Certain reclassifications have been made to the prior years' financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or retained earnings.

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

RESULTS OF OPERATIONS (in thousands)

Overview

The retail market for handheld eBook readers has not developed and grown as anticipated, resulting in substantially lower sales of eBookMan than were expected. Accordingly, the Company has incurred, and reported in the second quarter, losses from operations of eBookMan and a write-down of inventory and certain retail marketing and promotion costs pertaining to eBookMan. As a result, the Company incurred net losses of ($5,875) and ($7,832) respectively for the three- and six-month periods ended September 30, 2001.

Three months ended September 30, 2001 compared with three months ended September 30, 2000:

A comparative summary of the results of operations of the Company's core business (Reference and ROLODEX(R) Electronics products) and eBookMan product line is shown below.

	For the Quarter Ended September 30, 2001			For the Quarter Ende September 30, 2000	
	Core	eBookMan	Total	Core	eBookMan
SALES	$ 19,835	$ (1,121)*	$ 18,714	$ 20,510	$ --
COST OF SALES	11,734	243	11,977	11,699	--
PROVISION FOR LOSS ON EBOOKMAN INVENTORY	--	2,898	2,898	--	--
TOTAL COST OF SALES	11,734	3,141	14,875	11,699	--
GROSS MARGIN	8,101	(4,262)	3,839	8,811	--
OPERATING EXPENSES	6,655	2,334	8,989	6,830	1,058
OPERATING INCOME (LOSS)	1,446	(6,596)	(5,150)	1,981	(1,058)
INTEREST AND OTHER	(334)	(391)	(725)	(715)	--
NET INCOME (LOSS)	$ 1,112	$ (6,987)	$ (5,875)	$ 1,266	$ (1,058)

* After provisions for returns and price protection of $1,722.

Net Sales

Sales of $18,714 for the quarter ended September 30, 2001 were 9% lower than sales of $20,510 last year due to negative sales of eBookMan of ($1,121) resulting from return and price protection provisions of $1,722 and lower sales of reference products of $1,492, partially offset by increased ROLODEX(R) Electronics products sales of $903.

Gross Margin

Gross Margin was $3,839 or 21% of sales in the current period primarily because of a write-down of inventory and provisions for price protection and returns of eBookMan aggregating $4,016. Core business gross margin of $8,101 is 41% of sales compared with $8,811 or 43% of sales last year. The reduction in core business gross margin percentage resulted from lower margin ROLODEX(R) Electronics products comprising 21% of sales in the current period compared with 16% last year.

Operating Expenses

Total operating expenses increased to $8,989 compared with $7,888 in the prior period. Sales and marketing expenses increased by $1,460 to $5,675 from $4,215 primarily because of $1,088 of promotional expense relating to eBookMan and increased customer advertising allowances of $228. General and administrative expenses were reduced to $2,271 from $2,447 in the prior period. Research and development costs were reduced to $1,043 from $1,226 because the prior period included $227 of non-recurring vendor charges pertaining to the development of eBookMan.

Other Income/Expense

Interest expense of $441 for the current period approximates the $410 of the prior period. Currency transaction losses net of investment income were $284 this year compared with $305 last year.

Net Income (Loss)

There was a net loss of ($5,875) for the current period compared with net income of $208 last year. The current year's loss is wholly attributable to eBookMan operations and inventory write down aggregating $6,987. The Company's core Reference and ROLODEX(R) Electronics products business had net income of $1,112 for the current period compared with $1,266 last year.

Six months ended September 30, 2001, compared with six months ended September 30, 2000:

A comparative summary of operations for the Company's core business (Reference and ROLODEX(R) Electronics products) and eBookMan product lines is shown below.

	Six Months Ended September 30, 2001			Six Months Ended September 30, 2000	
	Core	eBookMan	Total	Core	eBookMan
SALES	$ 33,645	$ 1,078*	$ 34,723	$ 37,561	$ --
COST OF SALES	19,430	1,909	21,339	21,291	--
PROVISION FOR LOSS ON EBOOKMAN INVENTORY	--	2,898	2,898	--	
TOTAL COST OF SALES	19,430	4,807	24,237	21,291	--
GROSS MARGIN	14,215	(3,729)	10,486	16,270	--
OPERATING EXPENSES	13,246	3,847	17,093	13,022	1,287

OPERATING INCOME (LOSS)	969	(7,576)	(6,607)	3,248	(1,287)
INTEREST AND OTHER	(510)	(715)	(1,225)	(1,320)	--
NET INCOME (LOSS)	$ 459	$ (8,291)	$ (7,832)	$ 1,928	$ (1,287)

* After provisions for returns and price protection of $2,250.

Net Sales

Sales of $34,723 for the six-month period ended September 30, 2001 were $2,838 or 8% lower than sales of $37,561 in the prior period. The primary reasons for the decline were a reduction of $1,736 in sales of reference products in the United States consumer and OEM markets and a decline of $2,040 in European sales of reference products, caused in part by weaker currencies, offset by eBookMan sales of $1,078.

Gross Margin

Gross margin in the current period was $10,486 or 30% of sales including eBookMan operations and write-down of inventory aggregating ($3,729) or 11% of sales. Core business gross margin of $14,215 approximates 42% of sales compared with $16,270 or 43% of sales in the prior period.

Operating Expenses

Total operating expenses increased to $17,093 from $14,309 in the prior period. The increase is attributable to higher sales and marketing expenses of $2,983 caused by an increase of $2,423 in eBookMan operations and $560 in the core business. The eBookMan increase consists primarily of advertising and promotion expenses of $1,934 while the core business increase is attributable to increased personnel expenses of $220 and increased customer advertising allowances of $201. General and administrative expense was reduced to $4,552 in the current period from $4,771 in the prior period primarily because of a lower provision for bad debts of $205 and lower depreciation and amortization of $158. Research and development expense remained relatively constant at $ 2,013 compared with $1,993 in the prior period.

Other Income/Expense

Interest expense of $815 for the current period approximates the $814 of the prior period. Currency transaction losses net of investment income were $410 this year compared with $506 last year.

Net Income (Loss)

There was a net loss of ($7,832) in the current period compared with net income of $641 in the prior period. The current year's loss is wholly attributable to eBookMan operations and inventory write down aggregating $8,291. The Company's core Reference and ROLODEX(R) Electronics products business net income in the current period decreased by $1,469 to $459 from $1,928 in the prior period. The reduction in core business net income results from lower sales of $3,916 and lower gross margin of $2,055, partially offset by lower interest expense and currency transaction losses of $810.

Changes In Financial Condition - September 30, 2001 compared with March 31, 2001

Inventories increased to $24,125 from $20,879 at March 31 as the amount of core business inventory seasonally increased to $18,675 from $12,550 while the carrying value of eBookMan inventory decreased to $5,450 from $8,329 at March 31, 2001.

Other assets increased from $29,703 to $30,319 as capitalized software development costs of $1,976 relating to the Company's new enterprise resource system were partially offset by net amortization of prior development costs and licenses.

Accounts payable and accrued expenses increased to $17,555 from $13,647 primarily because of the seasonal increase in core business inventory and the accrual of price protection of $716 pertaining to eBookMan.

The $10,404 of Senior Notes and the $7,107 due under the Company's $25,000 Revolving Credit Facility are shown as current liabilities because the Company is not in compliance with certain financial covenants of its Senior Note Agreement pertaining to EBITDA coverage of interest expense and fixed charges. At March 31, $2,000 of Senior Notes was included in current liabilities and the remaining $8,329, along with the $4,064 due under the Revolving Credit Facility, were shown as long term liabilities.

In April 2001, the Company received $3,500 in payment for the Convertible Preferred Stock that had been subscribed for in March 2001.

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Liquidity and Capital Resources

The Company has a $25,000 secured Revolving Credit Facility with a commercial lender which expires on December 7, 2002. Borrowings under the facility bear interest at the bank's prime rate plus 3/8%. As of September 30, 2001, the Company had outstanding borrowings of $7,107 under this facility and had a balance of $10,404 outstanding under its Senior Notes. The Company is not in compliance with certain financial covenants of its Senior Note Agreement pertaining to EBITDA coverage of interest expense and fixed charges. The Company is currently in discussions with the Noteholders to restructure the Agreement to allow the Company to operate in compliance with all financial covenants and is in discussions with the lender to extend the term of the Revolving Credit Facility.

Management believes that cash flow from operations and the secured Revolving Credit Facility will be adequate to provide for the Company's liquidity and capital needs for the foreseeable future subject to satisfactory completion of discussions with the lender. The Company has no material commitments for capital expenditures in the next twenty-four months.

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PART II

ITEM 3. DEFAULT UPON SENIOR SECURITIES

The Company is not in compliance with certain financial covenants of its Senior Note Agreement pertaining to EBITDA coverage of interest expense and fixed charges. The Company is currently in discussions with the Noteholders to restructure the Agreement to allow the Company to operate in compliance with all financial covenants.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS

The Annual Meeting of Shareholders of the Company was held on July 20, 2001. Reference is made to the Company's Proxy Statement furnished to shareholders in connection with the solicitation of proxies in connection with that Annual Meeting. In connection with the annual election of directors, nine incumbent directors were re-elected with Edward H. Cohen and James H. Simons each receiving 7,096,003 votes with 578,477 votes withheld; Kenneth D. Cron and Howard L. Morgan receiving 7,096,253 votes with 578,227 votes withheld; James Meister and Jerry R. Schubel receiving 7,088,311 votes with 586,159 votes withheld; Barry Lipsky receiving 7,095,003 votes with 579,477 votes withheld; Leonard M. Lodish receiving 7,091,949 votes with 582,531 votes withheld; and William H. Turner receiving 7,095,803 votes with 578,677 votes withheld. Shareholders approved the increase in the number of shares with respect to which options may be granted under the Company's 1998 Stock Option Plan and certain other amendments thereto with 3,836,285 votes for and 901,517 votes against with 7,750 abstentions. Shareholders approved the issuance of 10,000,000 shares of Series A Preferred Stock with a value of $2.50 per share by vote of 4,056,939 votes in favor, 680,863 votes against, and 7,750 abstentions. Shareholders ratified the appointment of Radin, Glass & Co. as auditors for the Company's 2002 fiscal year by vote of 7,657,501 in favor, 12,479 votes against, and 4,500 abstentions.

ITEM 5. OTHER INFORMATION

ROLODEX(R) is a registered trademark of Berol Corporation, a subsidiary of Newell Rubbermaid, Inc. Rocket eBook is a trademark of NuvoMedia, Inc.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

No additional exhibits are required and no reports on Form 8-K were filed.

SIGNATURES

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

FRANKLIN ELECTRONIC PUBLISHERS,
INCORPORATED
Registrant

November 14, 2001	/s/ Barry J. Lipsky
Date	Barry J. Lipsky, President and Chief Executive Officer (Duly Authorized Officer)
November 14, 2001	/s/ Arnold D. Levitt
Date	Arnold D. Levitt, Senior Vice President, Chief Financial Officer, and Treasurer (Principal Financial and Accounting Officer)