FRANKLIN ELECTRONIC PUBLISHERS INC
Form 10-Q
February 14, 2002

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 December 31, 2001 Commission File No.-14841

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

Pennsylvania	22-2476703
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One Franklin Plaza, Burlington, New Jersey 08016-4907
(Address of principal executive office)

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
DECEMBER 31, 2001 - 7,947,882 SHARES

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

	Dece
	(una
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	$
Accounts receivable, less allowance for doubtful accounts of $1,055 and $1,161	1
Preferred stock subscriptions receivable	
Inventories	1
Income tax receivable	
Prepaids and other assets	
TOTAL CURRENT ASSETS	3
PROPERTY AND EQUIPMENT	
OTHER ASSETS:	
Deferred income tax asset	
Trademark, less accumulated amortization of $2,041 and $1,749	1
Advance royalties and licenses	
Software development costs	
Other assets	
TOTAL OTHER ASSETS	3
TOTAL ASSETS	$ 7
LIABILITIES AND SHAREHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts payable and accrued expenses	$ 1
Notes payable	
Current portion of long-term liabilities - Other	
TOTAL CURRENT LIABILITIES	1
LONG-TERM LIABILITIES	
Notes payable	
Revolving credit facility	1
Other liabilities	
TOTAL LONG-TERM LIABILITIES	1
SHAREHOLDERS' EQUITY:	
Preferred stock, $2.50 par value, $1,000 liquidation value, authorized 10,000,000 shares, 3,767 issued and outstanding	
Preferred stock subscribed	

Common stock, no par value, authorized 50,000,000 shares, issued and outstanding, 7,947,882 and 7,952,882 shares	4
Retained earnings (deficit)	(
Foreign currency translation adjustment	(
TOTAL SHAREHOLDERS' EQUITY	4
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 7

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 December 31,		Nine Months Ended December 31,	
	2001	2000	2001	2000
SALES	$ 23,284	$ 22,435	$ 58,007	$ 59,9
COST OF SALES	12,250	12,795	33,589	34,0
WRITE-DOWN ON EBOOKMAN INVENTORY	-	-	2,898	
TOTAL COST OF SALES	12,250	12,795	36,487	34,0
GROSS MARGIN	11,034	9,640	21,520	25,9
EXPENSES:				
Sales and marketing	5,676	5,605	16,204	13,1
Research and development	1,181	798	3,194	2,7
General and administrative	2,107	2,271	6,659	7,0
Total operating expenses	8,964	8,674	26,057	22,9
OPERATING INCOME (LOSS)	2,070	966	(4,537)	2,9
Interest expense	(493)	(440)	(1,308)	(1,2
Interest and investment income	52	16	(108)	1
Other, net	(247)	(18)	(497)	(6
INCOME (LOSS) BEFORE INCOME TAXES	1,382	524	(6,450)	1,1
INCOME TAX PROVISION (BENEFIT)	-	-	-	
NET INCOME (LOSS)	1,382	524	(6,450)	1,1
PREFERRED STOCK DIVIDEND	179	-	267	

NET INCOME (LOSS) APPLICABLE TO COMMON STOCK	$ 1,203	$ 524	$ (6,717)	$ 1,1
NET INCOME (LOSS) PER COMMON SHARE:				
Basic	$ 0.15	$ 0.07	$ (0.85)	$ 0.
Diluted	$ 0.15	$ 0.06	$ (0.85)	$ 0.
WEIGHTED AVERAGE COMMON SHARES:				
Basic	7,948	7,941	7,949	7,9
Diluted	7,948	8,282	7,949	8,2

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		A Ret Ear
	Shares	Amount	Shares	Amount	(De
BALANCE - MARCH 31, 2001 (audited)	7,952,882	$49,658	3,500	$3,500	$(
Issuance of shares and amortization of deferred compensation expense for shares issued for services (unearned portion $7)	(5,000)	2	-	-	
Value of stock options granted	-	307			
Preferred stock dividend			267	267	
Costs incurred in issuance of preferred stock				(22)	
Loss for the period	-	-	-	-	(
Foreign currency translation adjustment	-	-	-	-	
BALANCE - DECEMBER 31, 2001 (unaudited)	7,947,882	$49,967	3,767	$3,745	$(

* Comprehensive income, i.e., net income (loss), plus, or less, the change in foreign currency balance sheet translation adjustments, totaled ($5,989) for the nine months ended December 31, 2001.

See notes to consolidated financial statements

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

	Nine Months En December 31, 2001
CASH FLOWS FROM OPERATING ACTIVITIES:	
NET INCOME (LOSS)	$ (6,450)
ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES	
Depreciation and amortization	4,226
Provision for losses on accounts receivable	87
Loss (gain) on disposal of property and equipment	(75)
Provisions for eBookMan inventory, assets and obligations	4,201
Stock issued for services	307
Source (use) of cash from change in operating assets and liabilities:	
Accounts receivable	(2,863)
Inventories	600
Prepaids and other assets	58
Accounts payable and accrued expenses	(1,497)
Other, net	(10)
NET CASH USED IN OPERATING ACTIVITIES	(1,416)
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchase of property and equipment	(685)
Proceeds from sale of property and equipment	255
Software development costs	(3,666)
Change in other assets	(319)
NET CASH USED IN INVESTING ACTIVITIES	(4,415)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Principal payments of Senior Notes	(8,404)
Proceeds from revolving credit facility	9,731
Proceeds from issuance of preferred shares	3,478
Proceeds from issuance of common shares	-
Other liabilities	244
NET CASH PROVIDED BY FINANCING ACTIVITIES	5,049
EFFECT OF EXCHANGE RATE CHANGES ON CASH	461
DECREASE IN CASH AND CASH EQUIVALENTS	(321)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	2,835
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 2,514

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 December 31, 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. The consumer response to the retail versions of eBookMan was well below our expectations, resulting in substantially lower sales of eBookMan than were expected. As a result of the lower than expected sales, during the quarter ended September 30, 2001 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.

As of December 31, 2001 the Company has eBookMan inventory and related assets with a total carrying value of approximately $6,964. The Company believes it will be able to recover this amount primarily through direct sales to businesses, sales in vertical markets, and sales to certain overseas customers. If this inventory is not sold, the Company may be required to take an additional write-down of eBookMan assets, which would not have any impact on the Company's cash position.

NOTES PAYABLE

In December 2001, the Company prepaid $8,404 of the outstanding principal amount of its Senior Notes and received a waiver of non-compliance with certain financial covenants. Funds for the prepayment came from the Company's Revolving Credit Facility. The remaining $2,000 principal balance of the Senior Notes is due on or before March 31, 2002.

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

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	Nine

	December 31,		Dec
Product Sales	2001	2000	2001
Reference	$18,339	$17,098	$45,886
Rolodex	4,423	5,272	10,521
eBookMan	522	-	1,600
Other	-	65	-
Total Sales	$23,284	$22,435	$58,007

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

	Three Months Ended		Nine
	December 31,		Dec
Product Sales	2001	2000	2001
Europe	$6,565	$6,138	$14,424
Other International	2,336	3,196	5,281

For the three and nine month periods ended December 31, 2001 and 2000, no customer accounted for more than 10% of the Company's revenues.

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ISSUANCE OF PREFERRED STOCK

In April 2001, Dr. James H. Simons, the Company's Chairman of the Board, paid $3.5 million for 3,500 shares of the Company's Series A 10% Convertible Preferred Stock for which he had subscribed in March 2001. These shares are entitled to a liquidation preference of one-thousand dollars per share. An additional 267 shares have been issued through December 31, 2001 as dividends. 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 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 a net loss of $6,450 for the nine-month period ended December 31, 2001. That loss is wholly attributable to eBookMan operations and the inventory write down, aggregating $9,098.

As of December 31, 2001 the Company has eBookMan inventory and related assets with a total carrying value of approximately $6,964. The Company believes it will be able to recover this amount primarily through direct sales to businesses, sales in vertical markets, and sales to certain overseas customers. If this inventory is not sold, the Company may be required to take an additional write-down of eBookMan assets, which would not have any impact on the Company's cash position.

Three months ended December 31, 2001 compared with three months ended December 31, 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 December 31, 2001			For the Quar December 3	
	Core	eBookMan	Total	Core	eBookM
SALES	$ 22,762	$ 522	$ 23,284	$ 22,435	$
COST OF SALES	11,833	417	12,250	12,795	
GROSS MARGIN	10,929	105	11,034	9,640	
OPERATING EXPENSES	8,052	912	8,964	7,286	1,3
OPERATING INCOME (LOSS)	2,877	(807)	2,070	2,354	(1,3
INTEREST AND OTHER	(688)		(688)	(442)	

NET INCOME (LOSS)	$ 2,189	$ (807)	$ 1,382	$ 1,912	$ (1,3

Net Sales

Sales of $23,284 for the quarter ended December 31, 2001 were 4% higher than sales of $22,435 last year as higher reference product sales of $1,241 and eBookMan sales of $522 were partially offset by a decrease of $849 in sales of ROLODEX(R) Electronics products.

Gross Margin

Gross Margin was $11,034 or 47% of sales in the current period compared with $9,640 or 43% of sales last year. The increase in gross margin percentage resulted primarily from a more favorable sales mix, with higher margin reference products comprising 81% of core business sales in the current quarter compared with 76% last year.

Operating Expenses

Total operating expenses increased to $8,964 compared with $8,674 in the prior period. Sales and marketing expenses increased by $71 to $5,676 from $5,605 primarily because of increased customer advertising allowances of $566 relating to the Company's core products, largely offset by a decrease of $431 in marketing expenses relating to eBookMan. Research and development expense increased by $383 to $1,181 from $798 in the prior period primarily because all costs relating to eBookMan have been expensed in the current quarter while $652 of costs for eBookMan software development were capitalized last year. General and administrative expenses were reduced to $2,107 from $2,271 in the prior period mainly due to a lower provision for bad debts of $103.

Other Income/Expense

Interest and other increased to $688 in the current year form $442 in the prior year as interest expense increased by $53 due to higher average debt levels, currency transaction losses net of investment income were up by $101 and other, net in the current year includes a write-off of $92 of deferred financing expense relating to the prepayment of $8,404 of the Company's Senior Notes.

Net Income (Loss)

Net income for the current quarter was $1,382 compared with net income of $524 last year. The Company's core Reference and ROLODEX(R) Electronics products business had net income of $2,189 for the current period compared with $1,912 last year while eBookMan losses were $807 in the current year compared with a loss of $1,388 last year.

Nine months ended December 31, 2001, compared with nine months ended December 31, 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.

	Nine Months Ended December 31, 2001			
	Core	eBookMan	Total	Core
SALES	$ 56,407	$ 1,600*	$ 58,007	$ 59,997
COST OF SALES	31,263	2,326	33,589	34,086
PROVISION FOR LOSS ON EBOOKMAN INVENTORY	-	2,898	2,898	
TOTAL COST OF SALES	31,263	5,224	36,487	34,086
GROSS MARGIN	25,144	(3,624)	21,520	25,911
OPERATING EXPENSES	21,298	4,759	26,057	20,309
OPERATING INCOME (LOSS)	3,846	(8,383)	(4,537)	5,602
INTEREST AND OTHER	(1,198)	(715)	(1,913)	(1,762)
NET INCOME (LOSS)	$ 2,648	$ (9,098)	$ (6,450)	$ 3,840

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

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Net Sales

Sales of $58,007 for the nine-month period ended December 31, 2001 were $1,990 or 3% lower than sales of $59,997 in the prior period. The primary reasons for the decline were a reduction $2,242 in European sales of reference products, caused by the weakening European economy and currencies, a decline of $650 in sales of reference products in the United States Medical and OEM divisions and a decline in licensing revenue of $396. These declines were partially offset by eBookMan sales of $1,600.

Gross Margin

Gross margin in the current period was $21,520 or 37% of sales compared with $25,911 or 43% of sales in the prior period. The current period includes the negative effects of accrued price protection and inventory write-downs related to the eBookMan product line totaling $3,614 or 6%. Gross margin on the Company's core Reference and ROLODEX(R) Electronics product lines was $25,144 or 45% for the nine months ended December 31, 2001 compared with $25,911 or 43% in the same period last year.

Operating Expenses

Total operating expenses increased to $26,057 from $22,984 in the prior period. The increase is attributable to higher sales and marketing expenses of $3,053 caused by an increase of $1,993 in eBookMan operations and $1,060 in the core business. The eBookMan increase consists primarily of advertising and promotion expenses of $1,505 while the core business increase is attributable to increased personnel expenses of $205 and increased customer advertising allowances of $768. Research and development expense increased to $3,194 compared with $2,791 in the prior period as lower expenses in the current year of $791 were offset primarily by a reduction of $1,095 in the amount of expense for eBookMan development which was capitalized. General and administrative expense was reduced to $6,659 in the current period from $7,042 in the prior period primarily because of a lower provision for bad debts of $308 and lower depreciation and amortization of $165.

Other Income/Expense

Interest and other increased to $1,913 in the current year form $1,762 in the prior year as interest expense increased by $54 due to higher average debt levels, and a write-off in the current period of $92 of deferred financing expense relating to the prepayment of $8,404 of the Company's Senior Notes.

Net Income (Loss)

There was a net loss of $6,450 in the current period compared with net income of $1,165 in the prior period. The current year's loss is wholly attributable to eBookMan operations and inventory write down aggregating $9,098. The Company's core Reference and ROLODEX(R) Electronics products business net income in the current period decreased by $1,192 to $2,648 from $3,840. The reduction in core business net income results from lower sales of $3,590 and higher operating expenses of $989 partially offset by lower interest expense and a higher gross margin percentage.

Changes In Financial Condition - December 31, 2001 compared with March 31, 2001

Inventories decreased to $17,381 from $20,879 at March 31 as the amount of core business inventory decreased to $12,481 from $12,550 while the carrying value of eBookMan inventory decreased to $4,900 from $8,329 at March 31, 2001. Accounts receivable increased to a seasonally higher level of $14,945 from $12,094 at March 31, 2001. Prepaid expenses decreased to $2,079 at December 31, 2001 from $2,798 at March 31, 2001 primarily due to the write-off of $587 of prepaid trade show and other expenses related to eBookMan.

Other assets increased from $29,703 to $30,394 as capitalized software development costs of $2,557 relating to the Company's new enterprise resource system were partially offset by net amortization of prior product development costs and licenses. Accounts payable and accrued expenses decreased to $12,560 from $13,647.

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In December 2001, the Company prepaid $8,404, of the outstanding principal amount of its Senior Notes and received a waiver of non-compliance with certain financial covenants. Funds for the prepayment came from the Company's Revolving Credit Facility. The remaining $2,000 principal balance of the Senior Notes is due on or before March 31, 2002.

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

Liquidity and Capital Resources

The Company has a $25,000 secured Revolving Credit Facility with a commercial lender. In January 2002 the Company amended its agreement with the lender to extend this Credit Facility until December 7, 2004. As of December 31, 2001, the Company had outstanding borrowings of $13,795 under this facility and had a balance of $2,000 outstanding under its Senior Notes. The $2,000 balance of the Senior Notes is due on or before March 31, 2002.

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. The Company has no material commitments for capital expenditures in the next twenty-four months.

PART II.

ITEM 3. DEFAULT UPON SENIOR SECURITIES - The Company prepaid $8,404 of the outstanding principal amount of its Senior Notes in December 2001 and received a waiver of non-compliance with certain financial covenants in connection with the Senior Notes. The Company has agreed to pay the remaining $2,000 principal balance of the Senior Notes on or before March 31, 2002.

ITEM 5. OTHER INFORMATION - ROLODEX(R) is a registered trademark of Berol Corporation, a subsidiary of Newel Rubbermaid Inc. Rocket eBook is a trademark of NuvoMedia Inc.

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

February 14, 2002	/s/ Barry J. Lipsky
Date	Barry J. Lipsky President and Chief Executive Officer (Duly Authorized Officer)
February 14, 2002	/s/ Arnold D. Levitt
Date	Arnold D. Levitt Senior Vice President Principal Financial and Accounting Officer (Duly Authorized Officer)