

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10QSB

FRANKLIN WIRELESS CORP  
Form 10QSB  
May 24, 2006

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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended: March 31, 2006

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-11616

FRANKLIN WIRELESS CORP.  
-----

(Exact name of small business issuer in its charter)

California

95-3733534

-----  
(State or other jurisdiction of  
incorporation or organization)

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

9853 Pacific Heights Suite N, San Diego, California 92121  
-----

(Address of Principal Executive Offices) (Zip Code)

Issuer's Telephone Number, Including Area Code: (858) 623-0000

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

Securities registered pursuant to Section 12(g) of the Act: Common Stock,  
without par value  
-----

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES  NO

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:

TITLE OF EACH CLASS OF COMMON STOCK	OUTSTANDING AT April 15, 2006
-----	-----
Common Stock, no par value	835,040,550

# Edgar Filing: FRANKLIN WIRELESS CORP - Form 10QSB

Transitional Small Business Disclosure format (Check one): YES [ ] NO [X]

## FRANKLIN WIRELESS CORP. INDEX

Page No.  
-----

### PART I - FINANCIAL INFORMATION

Item 1:	Financial Statements (Unaudited)	
	Consolidated Statements of Operations (Unaudited).....	3
	Consolidated Balance Sheets (Unaudited).....	4
	Consolidated Statements of Cash Flows (Unaudited).....	5
	Notes to Consolidated Financial Statements.....	6
Item 2:	Management's Discussion and Analysis or Plan of Operation.....	11
Item 3:	Controls and Procedures.....	14

### PART II - OTHER INFORMATION

Item 1:	Legal Proceedings.....	15
Item 2:	Unregistered Sales of Equity Securities and Use of Proceeds.....	15
Item 3:	Defaults Upon Senior Securities.....	15
Item 4:	Submission of Matters to a Vote of Security Holders.....	15
Item 5:	Other Information .....	15
Item 6:	Exhibits.....	15
Signatures .....		16

### PART I - FINANCIAL INFORMATION

#### ITEM 1: FINANCIAL STATEMENTS

#### FRANKLIN WIRELESS CORP. CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	THREE MONTHS ENDED MARCH 31,		NINE MONTH MARCH
	2006	2005	2006
Net sales	\$ 162,698	\$ 27,429	\$ 323,088
Cost of goods sold	142,448	--	202,648
Gross profit	20,250	27,429	120,440

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10QSB

Operating expenses:			
Selling, general and administrative	131,503	77,334	416,875
Research and development	--	--	36,300
Total operating expenses	131,503	77,334	453,175
Loss from operations	(111,253)	(49,905)	(332,735)
Other income (expense), net	(712)	(217)	13,800
Net loss before income taxes	(111,965)	(50,122)	(318,935)
Provision for income taxes	--	--	800
Net loss	\$ (111,965)	\$ (50,122)	\$ (319,735)
Basic loss per share	\$ (0.0001)	\$ (0.0001)	\$ (0.0004)
Diluted loss per share	\$ (0.0001)	\$ (0.0001)	\$ (0.0004)
Weighted average common shares outstanding:			
Basic	835,040,050	773,040,050	814,506,717
Diluted	835,040,050	773,040,050	814,506,717

SEE ACCOMPANYING NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS.

3

FRANKLIN WIRELESS CORP.  
CONSOLIDATED BALANCE SHEETS

	(UNAUDITED) MARCH 31, 2006	JUNE 30, 2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 76,850	\$ 39,542
Accounts receivable	950	--
Total current assets	77,800	39,542
Property and equipment, net	13,108	14,921
Intangible asset	67,167	97,917
Other assets	2,107	2,107
TOTAL ASSETS	\$ 160,182	\$ 154,487
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Accounts payable	\$ 561	\$ 17,926

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10QSB

Accrued liabilities	201,797	150,147
Notes payable to stockholders, current portion	550,025	590,000
-----		
Total current liabilities	752,383	758,073
Notes payable to stockholders, long-term portion	--	--
Other long-term liabilities	--	3,878
-----		
Total liabilities	752,383	761,951
-----		
Stockholders' deficit:		
Common stock, no par value, authorized 900,000,000 shares and Preferred stock, no par value, authorized 10,000,000 shares; Common stock issued and outstanding - 835,040,050 as of March 31, 2006 and 793,040,050 as of June 30, 2005 and no Preferred stocks issued and outstanding	--	--
Additional paid-in capital	4,119,393	3,784,393
Stock subscription receivable	(17,395)	(17,395)
Accumulated deficit	(4,694,199)	(4,374,462)
-----		
Total stockholders' deficit	(592,201)	(607,464)
-----		
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$ 160,182	\$ 154,487
=====		

SEE ACCOMPANYING NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS.

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

	NINE MONTHS ENDED MARCH 31,	
	2006	2005
-----		
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (319,735)	\$ (519,914)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	38,400	38,400
Increase (decrease) in cash due to change in:		
Accounts receivable	(950)	99,390
Other assets	--	3,493
Accounts payable	(17,367)	--
Accrued liabilities	47,772	(56,409)
-----		
Net cash used in operating activities	(251,880)	(322,222)
-----		
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of intangible asset	(3,000)	--
Purchases of property and equipment	(2,837)	(3,000)
-----		

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10QSB

Net cash used in investing activities	(5,837)	(3,000)
-----		
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings (payments) from (to) stockholders	(39,975)	30,000
Proceeds from issuance of common stock	335,000	120,450
-----		
Net cash provided by financing activities	295,025	150,450
-----		
Net increase (decrease) in cash	37,308	(174,772)
Cash and cash equivalents, beginning of year	39,542	209,048
-----		
Cash and cash equivalents, end of period	\$ 76,850	\$ 34,276
=====		
Supplemental disclosure of cash flow information: Cash paid		
during the period for:		
Interest	\$ --	\$ --
Incomes taxes	\$ 800	\$ 800

SEE ACCOMPANYING NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS.

5

FRANKLIN WIRELESS CORP.  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - NATURE OF OPERATIONS

Franklin Wireless Corp. ("Franklin" or the "Company") designs, builds, and markets broadband high speed data communication products such as 3G wireless modules and modems. Franklin is dedicated to serving the global wireless community by becoming a leading developer/marketer of wireless communications devices and enabling technologies, as well as an applications provider catering to the dynamic needs of its customers, global wireless carriers. In addition, service for its technology is provided to vertical application companies.

The Company's products are marketed through Original Equipment Manufacturers ("OEMs") and distributors, as well as directly to operators and end users. The Company's customers are located primarily in the United States, Canada, South America, Asia, and parts of Europe in a wide range of industries including cellular operators, government, PC maker, and application integrator. In summary, the Company's products are marketed to cellular operators for end-users as well as computer/handheld computing industry, automotive industry, telemetry, other vertical markets.

NOTE 2 - GOING CONCERN MATTERS

The accompanying consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP"), which contemplate continuation of the Company as a going concern. The Company incurred

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10QSB

a net loss of \$319,735 and had negative cash flows from operations of \$251,880 during the nine months ended March 31, 2006. These factors raise substantial doubt about the Company's ability to continue as a going concern.

Recovery of the Company's assets is dependent upon future events, the outcome of which is indeterminable. The Company's attainment of profitable operations is dependent upon its obtaining adequate debt and equity financing and achieving a level of sales adequate to support the Company's cost structure. In addition, realization of a major portion of the assets in the accompanying balance sheet is dependent upon the Company's ability to meet its financing requirements and the success of its plans to sell its products. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence. Management plans to raise additional equity capital, continue to develop its products, and market the products.

### NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### PRINCIPLES OF CONSOLIDATION AND SEGMENT REPORTING

The accompanying consolidated financial statements include the accounts of Franklin and ARG. ARG is a wholly owned subsidiary in South Korea that designs the cellular phone. All inter-company balances and transactions have been eliminated in consolidation.

The Company has two reportable segments as defined by SFAS No. 131, Disclosure About Segments of an Enterprise and Related Information. The Company's subsidiary located in South Korea, ARG, was not active and in operation during the nine months ended March 31, 2006 and 2005. Furthermore, all of its subsidiary's assets were written off during the fiscal year 2004 as the operation was shut-down during the period. As a result, the Company's consolidated financial statements include \$550,000 of debt from ARG financial statements. During the latter part of 2003, the Company discontinued its financial support and operations of ARG but kept the business as an inactive subsidiary for future use. The subsidiary will be used for supporting manufacturing and sourcing new product and business in the future.

6

#### USE OF ESTIMATES

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates.

#### REVENUE RECOGNITION

The Company recognizes revenue when persuasive evidence of an arrangement exists, the price is fixed or determinable, collection is reasonably assured and delivery of products has occurred or services have been rendered. Accordingly, the Company recognizes revenues from product sales upon shipment of the product to the customers. The Company does not allow the right of return on product sales but warrant the products over one year from the shipment. Allowance for doubtful accounts is estimated based on estimates of losses related to customer receivable balances. Estimates are developed by using standard quantitative measures based on historical losses, adjusting for current economic conditions

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10QSB

and, in some cases, evaluating specific customer accounts for risk of loss. The establishment of reserves requires the use of judgment and assumptions regarding the potential for losses on receivable balances. Though the Company considers these balances adequate and proper, changes in economic conditions in specific markets in which the Company operates could have a material effect on reserve balances required.

### CASH AND CASH EQUIVALENTS

For purposes of the statements of cash flows, the Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

### PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. The Company provides for depreciation using the straight-line method over the estimated useful lives as follows:

Computers and software	5 years
Machinery and equipment	5 years
Furniture and fixtures	5 years

Expenditures for maintenance and repairs are charged to operations as incurred while renewals and betterments are capitalized. Gains or losses on the sale of property and equipment are reflected in the statements of operations.

### INTANGIBLE ASSETS - LICENSES

Licenses are stated at cost and are amortized using the straight-line method over the license periods of five years or life of the license.

### IMPAIRMENT OF LONG-LIVED ASSETS

The Company, in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for Impairment on Disposal of Long-lived Assets", reviews for impairment of long-lived assets and certain identifiable intangibles whenever events or circumstances indicate that the carrying amount of the asset may not be recoverable. An impairment loss would be recognized when estimated future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. As of March 31, 2006, the Company is not aware of any events or changes in circumstances that would indicate that the long-lived assets are impaired.

7

### WARRANTIES

The Company does not provide any warranties on its products. However, the manufacturer provides limited warranties up to one year from the date of the sale to the Company's customers. These products are shipped directly from the manufacturer to the customers. As a result, the Company is not required to and does not accrue any warranty expenses.

### ADVERTISING AND MARKETING COSTS

The company expenses the costs of advertising and marketing as incurred. The Company incurred no advertising and marketing expenses during the three and nine months ended March 31, 2006 and 2005.

### INCOME TAXES

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10QSB

The Company accounts for income taxes under the asset and liability method of accounting. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is required when it is less likely than not that the Company will be able to realize all or a portion of its deferred tax assets.

### LOSS PER SHARE

The Company reports loss per share in accordance with Statement of Financial Accounting Standards No. 128, "Earnings Per Share". Basic loss per share is computed using the weighted average number of shares outstanding during the year. Diluted earnings per share include the potentially dilutive effect of outstanding common stock options and warrants which are convertible to common shares.

### CONCENTRATIONS OF CREDIT RISK

The Company sells its products throughout the United States and South America and extends credit to its customers and performs ongoing credit evaluations of such customers. The Company evaluates its accounts receivable on a regular basis for collectibility and provides for an allowance for potential credit losses as deemed necessary.

### NOTE 4 - PROPERTY AND EQUIPMENT

Property and equipment at March 31, 2006 and June 30, 2005 consisted of the following:

	(Unaudited)	
	March 31, 2006	June 30, 2005
	-----	-----
Computers and software	\$ 25,062	\$ 22,224
Machinery and equipment	3,000	3,000
Furniture and fixtures	8,713	8,713
	-----	-----
	36,775	33,937
Less accumulated depreciation	(23,667)	(19,016)
	-----	-----
TOTAL	\$ 13,108	\$ 14,921
	=====	=====

### NOTE 5 - INVESTMENT IN SUBSIDIARY

In April 2002, the Company invested \$384,615 in its wholly owned subsidiary in South Korea for R&D and manufacturing support. Since August 2003 and as of March 31, 2006 and June 30, 2005, ARG has been inactive.

### NOTE 6 - INTANGIBLE ASSETS



## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10QSB

The Company purchased licenses to design phone and data communication products. Below are the details for the licenses.

	(Unaudited) March 31, 2006	June 30, 2005
	-----	-----
GSM software license	\$ 200,000	\$ 200,000
Text input methods licenses & other	28,000	25,000
	-----	-----
	228,000	225,000
Less accumulated amortization	(160,833)	(127,083)
	-----	-----
Net Balance	\$ 67,167	\$ 97,917
	=====	=====

Amortization expense associated with intangible assets was \$11,250 for the three months ended March 31, 2006 and 2005 and \$33,750 for the nine months ended March 31, 2006 and 2005.

GSM software license was contracted with a supplier for the Company to design GSM phone and module and was paid in September of 2002. This software license has an approximate life of 5 years based on the life of the GSM software.

Text input method license was paid in October of 2002 and has an approximate life of 5 years or the life of the text input license.

### NOTE 7 - OTHER ASSETS

Other assets as of March 31, 2006 and June 30, 2005 consisted of facility lease and utility deposits.

### NOTE 8 - NOTES PAYABLE TO STOCKHOLDERS

	(Unaudited) March 31, 2006	June 30, 2005
	-----	-----
Promissory Note	\$ 10,000	\$ 10,000
Promissory Note	--	30,000
Non-interest Bearing Note	540,025	550,000
	-----	-----
Total	550,025	560,000
Less current portion	(550,025)	(590,000)
	-----	-----
Long-term portion	\$ --	\$ --
	=====	=====

The Company issued a non-interest bearing promissory note in the amount of \$10,000 to the Company's former chief technology officer on June 30, 2004. This note is due upon demand.

During June 2005, the Company issued a promissory note to its stockholder in the amount of \$30,000 with no interest. The note is convertible to the Company's common stocks upon issuance at the option of the holder at exercise price on the date of issuance, or \$0.005. The note was converted to the Company's common stock at \$0.005 on November 11, 2005.

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10QSB

On August 20, 2002, the Company's wholly owned subsidiary, ARG, issued a promissory note to a stockholder in the amount of \$550,000, bearing interest at 10%, due on March 20, 2004. The Company and the stockholder agreed to change the promissory note to a convertible promissory note during the year ended June 30, 2004. The note is convertible into shares of Common Stock at the option of the holder at a conversion price equal to the fair value of the Company's Common Stock on the date of issuance, or \$0.005 per share. As of March 31, 2006, this note was outstanding and had not been converted.

### NOTE 9 - ACCRUED LIABILITIES

Accrued liabilities at March 31, 2006 and June 30, 2005 consisted of the following:

	(Unaudited) March 31, 2006	June 30, 2005
Salaries	\$138,250	\$111,000
Other accrued liabilities	63,547	39,147
TOTAL	\$201,797	\$150,147

### NOTE 10 - COMMITMENTS AND CONTINGENCIES

#### OPERATING LEASES

The Company leases its administrative facilities under a non-cancelable operating lease that expire on April 30, 2007. In addition to the minimum annual rental commitments, the leases provide for periodic cost of living increases in the base rent and payment by the Company of common area costs.

#### LITIGATION

During June 2005, the Company's landlord filed a suit against the Company alleging that the Company defaulted under the terms and conditions of the Company's lease agreement when the Company failed to pay for its facility lease valued at \$18,221. The parties have settled at \$9,308, to be paid in twelve equal monthly installments on December 6, 2005.

In addition, the Company is involved in certain legal proceedings and claims which arise in the normal course of business. Management does not believe that the outcome of these matters will have any material adverse effect on the Company's consolidated financial condition.

#### SUPPLY AND PURCHASE AGREEMENTS

In May 2005, the Company entered into a contract for low cost GSM phone and a worldwide distribution agreement with a design and manufacturing company. The agreement provides for a one-year term and may be extended on a year-to-year basis thereafter.

### NOTE 11 - EARNINGS PER SHARE

Basic earnings per share ("EPS") excludes dilution and is computed by dividing net income or loss attributable to common shareholders by the weighted-average number of common shares outstanding for the period. As of March 31, 2006 and June 30, 2005, the Company did not have any dilutive common stock shares.

NOTE 12 - STOCK REPURCHASE

REPURCHASE OF SHARES

The Company has agreed to repurchase the shares held by Hanjin Jhun, its former Chief Executive Officer, for the price paid by Mr. Jhun, \$.005 per share. Mr. Jhun, who resigned during the third quarter of fiscal 2006, holds approximately 20,000,000 shares. The Company plans to repurchase the shares for cash during the fourth quarter of its 2006 fiscal year.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included in Item 1 of this filing and the financial statements and notes thereto and Management's Discussion and Analysis or Plan of Operation contained in the Company's Form 10-KSB for the year ended June 30, 2005.

BUSINESS OVERVIEW

Franklin Wireless Corp. ("Franklin" or the "Company") designs, builds, and markets broadband high speed data communication products such as 3G wireless modules and modems. Franklin is dedicated to serving the global wireless community by becoming a leading developer/marketer of wireless communications devices and enabling technologies, as well as an applications provider catering to the dynamic needs of its customers, global wireless carriers. In addition, service for its technology is provided to vertical application companies. .

The Company's products are marketed through Original Equipment Manufacturers ("OEMs") and distributors, as well as directly to operators and end users. The Company's customers are located primarily in the United States, Canada, South America, Asia, and parts of Europe in a wide range of industries including cellular operators, government, PC maker, and application integrator. In summary, the Company's products are marketed to cellular operators for end-users as well as computer/handheld computing industry, automotive industry, telemetry, other vertical markets.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company believes the following critical accounting policies affect the Company's more significant judgments and estimates used in the preparation of the financial statements.

USE OF ESTIMATES

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates.

REVENUE RECOGNITION

The Company recognizes revenue when persuasive evidence of an arrangement exists, the price is fixed or determinable, collection is reasonably assured and delivery of products has occurred or services have been rendered. Accordingly,

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10QSB

the Company recognizes revenues from product sales upon shipment of the product to the customers. The Company does not allow the right of return on product sales but warrant the products over one year from the shipment. Allowance for doubtful accounts is estimated based on estimates of losses related to customer receivable balances. Estimates are developed by using standard quantitative measures based on historical losses, adjusting for current economic conditions and, in some cases, evaluating specific customer accounts for risk of loss. The establishment of reserves requires the use of judgment and assumptions regarding the potential for losses on receivable balances. Though the Company considers these balances adequate and proper, changes in economic conditions in specific markets in which the Company operates could have a material effect on reserve balances required.

11

### IMPAIRMENT OF LONG-LIVED ASSETS

The Company, in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for Impairment on Disposal of Long-lived Assets", reviews for impairment of long-lived assets and certain identifiable intangibles whenever events or circumstances indicate that the carrying amount of the asset may not be recoverable. An impairment loss would be recognized when estimated future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. As of March 31, 2006, the Company is not aware of any events or changes in circumstances that would indicate that the long-lived assets are impaired.

### INCOME TAXES

The Company accounts for income taxes under the asset and liability method of accounting. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is required when it is less likely than not that the Company will be able to realize all or a portion of its deferred tax assets.

### RESULTS OF OPERATIONS

The results of the interim periods are not necessarily indicative of results for the entire fiscal year

#### THREE MONTHS ENDED MARCH 31, 2006 COMPARED TO THREE MONTHS ENDED MARCH 31, 2005

**NET SALES** - Net sales increased by \$135,269, or 493.2%, to \$162,698 for the three months ended March 31, 2006 from \$27,429 for the corresponding period of 2005. The change is principally due to the shift in the Company's business strategy, from being a product engineering company to a product development/marketing company.

**GROSS PROFIT** - Gross profit decreased in terms of net sales percentage as the percentage of gross profit, which was 12.4% for the three months ended March 31, 2006, compared to 100% for the corresponding period of 2005. The gross profit for the three months ended March 31, 2005 was attributed to having no cost of sales, which was due to the sale of refurbished units.

..  
**SELLING, GENERAL, AND ADMINISTRATIVE** - Selling, general, and administrative

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10QSB

expenses increased by \$54,169, or 70.0%, to \$131,503 for the three months ended March 31, 2006 from \$77,334 for the corresponding period of 2005. The increase can be attributed to increased cost of travel expense, payroll, and other general and administrative infrastructure.

OTHER EXPENSE - Other expense increased by \$495, or 228.1%, to \$712 for the three months ended March 31, 2006 from \$217 for the corresponding period of 2005.

### NINE MONTHS ENDED MARCH 31, 2006 COMPARED TO NINE MONTHS ENDED MARCH 31, 2005

NET SALES - Net sales increased by \$178,719, or 123.8%, to \$323,088 for the nine months ended March 31, 2006 from \$144,369 for the corresponding period of 2005. The major portion of sales during this period were still from phone sales, but the change is principally due to the shift in the Company's business strategy, from being a product engineering company to a product development/marketing company.

GROSS PROFIT - Gross profit increased in terms of net sales percentage as the percentage of gross profit, which was 37.3% for the nine months ended March 31, 2006, compared to 24.4% for the corresponding period of 2005. The gross profit percentage increase can be attributed to its shift from being a product engineering company to a product development/marketing company and the fact that module products having carry a higher gross profit margin compared to other products.

SELLING, GENERAL, AND ADMINISTRATIVE - Selling, general, and administrative expenses decreased by \$137,579, or 24.8%, to \$416,875 for the nine months ended March 31, 2006 from \$554,454 for the corresponding period of 2005. The decrease can be attributed to decreased cost of consulting expense for engineering and development, payroll, and other general and administrative infrastructure.

12

RESEARCH AND DEVELOPMENT - Research and development expenses of \$36,300, mainly attributable to the design of a phone product, was incurred during the nine months ended March 31, 2006. No research and development costs were incurred during the nine months ended March 31, 2005.

OTHER INCOME - Other income increased by \$13,629, or 7970.2%, to \$13,800 for the nine months ended March 31, 2006 from \$171 for the corresponding period of 2005. This is primarily due to a settlement of an account payable with a customer in an amount less than what had been accrued.

### LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents increased by \$37,308, to \$76,850 as of March 31, 2006 compared to \$39,542 as of June 30, 2005. The increase was primarily from the issuance of equity securities, offset by operating losses.

The Company believes that its current negative working capital of \$674,582 and anticipated working capital to be generated by future operations will not be sufficient to support the Company's working capital requirements through March 31, 2007. Accordingly, the Company will have to rely on outside financing.

OPERATING ACTIVITIES - Net cash used in operating activities amounted to \$251,880 and \$322,222 for the nine months ended March 31, 2006 and 2005, respectively. The decrease from the prior period relates mainly to reduced engineering expense by terminating the outside service and focusing on research

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10QSB

and development for the Company's own module.

INVESTING ACTIVITIES - Net cash used in investing activities totaled \$5,837 and \$3,000 for the nine months ended March 31, 2006 and 2005, respectively, consisting of capital expenditures.

FINANCING ACTIVITIES - Net cash provided by financing activities for the nine months ended March 31, 2006 and 2005 totaled \$295,025 and \$150,450, respectively, which consisted of proceeds from issuances of common stock.

### CONTRACTUAL OBLIGATIONS AND OTHER COMMITMENTS

The Company's principal future obligations and commitments as of March 31, 2006, include the following:

#### LEASES

The Company leases its administrative facilities under a non-cancelable operating lease that expires on April 30, 2007. In addition to the minimum annual rental commitments, the lease provides for periodic cost of living increases in the base rent and payment by the Company of common area costs.

#### LITIGATION

During June 2005, the Company's landlord filed a suit against the Company alleging that the Company defaulted under the terms and conditions of the Company's lease agreement when the Company failed to pay for its facility lease valued at \$18,221. The parties have settled at \$9,308, to be paid in twelve equal monthly installments commencing on December 6, 2005.

In addition, the Company is involved in certain legal proceedings and claims which arise in the normal course of business. Management does not believe that the outcome of these matters will have a material adverse effect on the Company's consolidated financial condition.

#### SUPPLY AND PURCHASE AGREEMENTS

In May 2005, the Company entered into a contract for low cost GSM phone and a worldwide distribution agreement with a design and manufacturing company. The agreement provides for a one-year term and may be extended on a year-to-year basis thereafter.

13

### ITEM 3. CONTROLS AND PROCEDURES

At the end of the period covered by this Form 10-QSB, the Company carried out an evaluation, under the supervision and with the participation of members of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our company's disclosure controls and procedures pursuant to Rule 13a-15(b) of the U.S. Securities Exchange Act of 1934 (the "Exchange Act"). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2006, our disclosure controls and procedures, related to internal control over financial reporting and the recording of certain equity transactions, were not effective in light of the material weaknesses described below.

1. INADEQUATE FINANCIAL STATEMENT PREPARATION AND REVIEW PROCEDURES - We

## Edgar Filing: FRANKLIN WIRELESS CORP - Form 10QSB

do not have adequate procedures and controls to ensure that accurate financial statements can be prepared and reviewed on a timely basis, including insufficient

- a. review and supervision within the accounting and finance departments;
  - b. underlying accurate data to ensure that balances are properly summarized and posted to the general ledger; and
  - c. technical accounting resources.
2. INADEQUATE SEGREGATION OF DUTIES - We do not have adequate procedures and controls in place to ensure proper segregation of duties within the accounting department. As a result, adjustments in the financial statements could occur and not be prevented or detected by our controls in a timely manner.
3. INADEQUATE TECHNICAL ACCOUNTING EXPERTISE - We lacked the necessary depth of personnel with adequate technical accounting expertise to ensure the preparation of interim and annual financial statements in accordance with GAAP. This material weakness represented more than a remote likelihood that a material misstatement of our interim financial statements for the nine months ended March 31, 2006 would not have been prevented or detected.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projection of any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

### PART II - OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

None.

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

None

#### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

#### ITEM 5. OTHER INFORMATION

None.

14

#### ITEM 6. EXHIBITS

31.1 Certificate of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certificate of Acting Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Edgar Filing: FRANKLIN WIRELESS CORP - Form 10QSB

32.1 Certificate of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certificate of Acting Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of Section 13 of 15(d) 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 Wireless Corp.

By: /s/ OC Kim

-----  
OC Kim

President and Acting Chief Financial Officer

Dated: May 24, 2006