FULLNET COMMUNICATIONS INC
Form 10-Q
August 14, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014

o **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: 000-27031

FULLNET COMMUNICATIONS, INC.

(Exact name of registrant as specified in its charter)

OKLAHOMA	**73-1473361**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

201 Robert S. Kerr Avenue, Suite 210

Oklahoma City, Oklahoma 73102

(Address of principal executive offices)

(405) 236-8200

(Registrant's telephone number)

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer o Accelerated filer o Non-accelerated filer o Smaller reporting company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

As of August 14, 2014, 9,118,161 shares of the registrant’s common stock, $0.00001 par value, were outstanding.

FORM 10-Q

TABLE OF CONTENTS

Table of Contents

FullNet Communications, Inc. and Subsidiaries

CONDENSED CONSOLIDATED BALANCE SHEETS

	JUNE 30, 2014 (Unaudited)	DECEMBER 31, 2013
ASSETS		
CURRENT ASSETS		
Cash	$ 4,396	$ 30,072
Accounts receivable, net	14,178	17,540
Prepaid expenses and other current assets	14,204	8,728
Total current assets	32,778	56,340
PROPERTY AND EQUIPMENT, net	123,557	44,635
OTHER ASSETS AND INTANGIBLE ASSETS	7,994	10,948
TOTAL ASSETS	$ 164,329	$ 111,923
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Accounts payable	$ 177,142	$ 127,077
Accrued and other liabilities	449,528	410,763
Convertible notes payable, related party - current portion	46,811	45,060
Deferred revenue	339,461	302,129
Total current liabilities	1,012,942	885,029
CONVERTIBLE NOTES PAYABLE, related party - less current portion	214,815	230,129
Total liabilities	1,227,757	1,115,158
STOCKHOLDERS' DEFICIT		
Preferred stock — $.001 par value; authorized, 10,000,000 shares; Series A convertible; issued and outstanding, 987,102 shares in 2014 and 2013	460,644	430,382
Common stock — $.00001 par value; authorized, 40,000,000 shares; issued and outstanding, 9,118,161 shares in 2014 and 2013	91	91
Additional paid-in capital	8,697,865	8,716,803

Accumulated deficit	(10,222,028)	(10,150,511)
Total stockholders' deficit	(1,063,428)	(1,003,235)
	$	$
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	164,329	111,923

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

FullNet Communications, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
REVENUES	$	$	$	$
Access service revenues	19,279	31,889	43,068	66,295
Co-location and other revenues	438,454	378,472	838,442	737,011
Total revenues	457,733	410,361	881,510	803,306
OPERATING COSTS AND EXPENSES				
Cost of access service revenues	22,503	27,329	49,717	56,008
Cost of co-location and other revenues	88,978	85,978	174,395	176,878
Selling, general and administrative expenses	356,300	344,499	701,994	670,093
Depreciation and amortization	10,915	7,319	18,830	15,402
Total operating costs and expenses	478,696	465,125	944,936	918,381
LOSS FROM OPERATIONS	(20,963)	(54,764)	(63,426)	(115,075)
GAIN ON SERIES A CONVERTIBLE PREFERRED STOCK ISSUED IN EXCHANGE FOR INDEBTEDNESS	-	401,004	-	401,004
INTEREST EXPENSE	(3,996)	(5,720)	(8,091)	(11,107)
NET INCOME (LOSS)	$ (24,959)	$ 340,520	$ (71,517)	$ 274,822
Preferred stock dividends	(15,131)	(8,605)	(30,262)	(8,605)
Net income (loss) available to common stockholders	$ (40,090)	$ 331,915	$ (101,779)	$ 266,217
Net income (loss) per share —basic	$ (.00)	$ .04	$ (.01)	$ .03
Net income (loss) per share — assuming dilution	$ (.00)	$ .03	$ (.01)	$ .03

Weighted average shares outstanding — basic	9,118,161	9,118,161	9,118,161	9,118,161
Weighted average shares outstanding — assuming dilution	9,118,161	10,288,031	9,118,161	10,011,511

See accompanying notes to unaudited condensed consolidated financial statements.

-

Table of Contents

FullNet Communications, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT (UNAUDITED)

Six Months Ended June 30, 2014

	Common stock		Preferred stock		Additional paid-in	Accumulated	
	Shares	Amount	Shares	Amount	capital	deficit	Total
Balance at January 1, 2014	9,118,161	$91	987,102	$430,382	$8,716,803	$(10,150,511)	$(1,003,235)
Stock options compensation	-	-	-	-	11,324	-	11,324
Amortization of increasing dividend rate preferred stock discount	-	-	-	30,262	(30,262)	-	-
Net loss	-	-	-	-	-	(71,517)	(71,517)
Balance at June 30, 2014 -(unaudited)	9,118,161	$91	987,102	$460,644	$8,697,865	$(10,222,028)	$(1,063,428)

See accompanying notes to unaudited condensed consolidated financial statements.

-

Table of Contents

FullNet Communications, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended	
	June 30, 2014	June 30, 2013
CASH FLOWS FROM OPERATING ACTIVITIES	$	$
Net income (loss)	(71,517)	274,822
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation and amortization	18,830	15,402
Stock options compensation	11,324	22,121
Stock warrants issued for services	-	6,182
Provision for uncollectible accounts receivable	(9,938)	10,281
(Gain) on Series A convertible preferred stock issued in exchange for indebtedness	-	(401,004)
Net (increase) decrease in		
Accounts receivable	13,300	(28,257)
Prepaid expenses and other current assets	(5,476)	(7,666)
Net increase (decrease) in		
Accounts payable	11,533	45,496
Accrued and other liabilities	38,765	63,533
Deferred revenue	37,332	19,196
Net cash provided by operating activities	44,153	20,106
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(56,266)	(5,634)
Net cash used in investing activities	(56,266)	(5,634)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on borrowings under notes payable – related party	(13,563)	(11,194)
Net cash used in financing activities	(13,563)	(11,194)
NET INCREASE (DECREASE) IN CASH	(25,676)	3,278
Cash at beginning of period	30,072	10,847
	$	$
Cash at end of period	4,396	14,125
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid for interest	$	$

	8,091	9,848
NON-CASH INVESTING AND FINANCING ACTIVITIES		
Fixed assets purchased on accounts	$ 38,532	$ -
Amortization of increasing dividend rate preferred stock discount	$ 30,262	$ 8,605

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents

FullNet Communications, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. UNAUDITED INTERIM FINANCIAL STATEMENTS

The unaudited condensed consolidated financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. The accompanying unaudited condensed consolidated financial statements and related notes should be read in conjunction with the audited consolidated financial statements of the Company and notes thereto for the year ended December 31, 2013.

The information furnished reflects, in the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results of the interim periods presented. Operating results of the interim period are not necessarily indicative of the amounts that will be reported for the year ending December 31, 2014. Certain reclassifications have been made to prior period balances to conform with the presentation for the current period.

2. GOING CONCERN AND MANAGEMENT'S PLANS

At June 30, 2014, current liabilities exceed current assets by $980,164. The Company does not have a line of credit or credit facility to serve as an additional source of liquidity. Historically the Company has relied on shareholder loans as an additional source of funds. These factors raise substantial doubts about the Company's ability to continue as a going concern.

The ability of the Company to continue as a going concern is dependent upon continued operations of the Company that in turn is dependent upon the Company's ability to meet its financing requirements on a continuing basis, to maintain present financing, to achieve the objectives of its business plan and to succeed in its future operations. 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.

The Company's business plan includes, among other things, expansion through mergers and acquisitions and the development of its co-location and advanced voice and data solutions. Execution of the Company's business plan will require significant capital to fund capital expenditures, working capital needs and debt service. Current cash balances will not be sufficient to fund the Company's current business plan beyond the next few months. As a consequence, the Company is currently focusing on revenue enhancement and cost cutting opportunities as well as working to sell non-core assets and to extend vendor payment terms. The Company continues to seek additional convertible debt or equity financing as well as the placement of a credit facility to fund the Company's liquidity. There can be no assurance that the Company will be able to obtain additional capital on satisfactory terms, or at all, or on terms that will not dilute the shareholders' interests.

3. CONVERTIBLE NOTES PAYABLE RELATED PARTY

At December 31, 2013 the Company had a secured convertible promissory note from a shareholder with a balance of $225,189. During the six months ended June 30, 2014, the Company made principal and interest payments totaling $19,804. The secured convertible promissory note had a balance of $211,976 at June 30, 2014.

At December 31, 2013 the Company had a secured convertible promissory from a shareholder with a balance of $50,000. During the six months ended June 30, 2014, the Company made principal and interest payments totaling $1,850. The secured convertible promissory note had a balance of $49,650 at June 30, 2014.

Table of Contents

4. STOCK BASED COMPENSATION

The following table summarizes the Company's employee stock option activity for the six months ended June 30, 2014:

	Options	Weighted average exercise price	Weighted average remaining contractual life (yrs)	Aggregate intrinsic value
Options outstanding, December 31, 2013	3,202,882	$ .030	9.10	
Options exercisable, December 31, 2013	1,755,882	$ .027	8.75	$ 42,261
Options granted during the period	4,500	$ .043		
Options expired during the period	(15,000)	$ .050		
Options forfeited during the period	(1,000)	$ .02		
Options outstanding June 30, 2014	3,191,382	$ .029	8.65	
Options exercisable, June 30, 2014	1,867,549	$ .026	8.36	$ 17,222

During the six months ended June 30, 2014, 4,500 nonqualified employee stock options were granted with exercise prices ranging from $03 to $.05. The options were valued using Black-Scholes option pricing model on the respective date of issuance and the fair value of the shares was determined to be $193 of which $25 was recognized as stock-based compensation expense for the six months ended June 30, 2014. The stock options will vest one-third on each annual anniversary date of the grant and will expire ten years from the date of the grant. During the six months ended June 30, 2014, 1,000 employee stock options were forfeited that were related to options granted in prior years.

Stock-based compensation expense for the three and six months ended June 30, 2014 was $5,632 and $11,324, respectively. Stock-based compensation is measured at the grant date, based on the calculated fair value of the option, and is recognized as an expense on a straight-line basis over the requisite employee service period (generally the vesting period of the grant).

The Black-Scholes option pricing model was used with the following weighted-average assumptions for options granted during the six months ended June 30, 2014:

Risk-free interest rate 1.64% - 1.70%

Expected option life 5 years

Expected volatility 229% - 234%

Expected dividend yield 0%

5. SERIES A CONVERTIBLE PREFERRED STOCK

On March 31, 2014 the Company's board of directors made the determination that it was in the best interest of the Company and its stockholders to conserve the Company's working capital at this time and not make the annual dividend payment for the year ending December 31, 2013. As a result, pursuant to the Certificate of Designations, Preferences, and Rights of the Series A Convertible Preferred Stock, each share of the Series A Convertible Preferred Stock shall hereafter be entitled to two votes upon any matter that the holders of the Company's common stock are entitled to vote.

The amortization of the increasing dividend rate preferred stock discount for the three and six months ended June 30, 2014 was $15,131 and $30,262, respectively. The amortization of the increasing dividend rate preferred stock discount for the three and six months ended June 30, 2013 was $8,605.

-

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion is qualified in its entirety by the more detailed information in our 2013 Annual Report on Form 10-K and the financial statements contained therein, including the notes thereto, and our other periodic reports filed with the Securities and Exchange Commission since December 31, 2013 (collectively referred to as the "Disclosure Documents"). Certain forward-looking statements contained in this Report and in the Disclosure Documents regarding our business and prospects are based upon numerous assumptions about future conditions which may ultimately prove to be inaccurate and actual events and results may materially differ from anticipated results described in such statements. Our ability to achieve these results is subject to certain risks and uncertainties, including those inherent risks and uncertainties generally in the Internet service provider and competitive local exchange carrier industries, the impact of competition and pricing, changing market conditions, and other risks. Any forward-looking statements contained in this Report represent our judgment as of the date of this Report. We disclaim, however, any intent or obligation to update these forward-looking statements. As a result, the reader is cautioned not to place undue reliance on these forward-looking statements. References to us in this report include our subsidiaries: FullNet, Inc. ("FullNet"), FullTel, Inc. ("FullTel"), FullWeb, Inc. ("FullWeb") and CallMultiplier, Inc. ("CallMultiplier").

Overview

We are an integrated communications provider offering integrated communications and Internet connectivity to individuals, businesses, organizations, educational institutions and government agencies. Through our subsidiaries, we provide high quality, reliable and scalable Internet access, web hosting, equipment co-location, traditional telephone services as well as advanced voice and data solutions.

Our principal executive offices are located at 201 Robert S. Kerr Avenue, Suite 210, Oklahoma City, Oklahoma 73102, and our telephone number is (405) 236-8200. We also maintain Internet sites on the World Wide Web ("WWW") at www.fullnet.net, www.fulltel.com and www.callmultiplier.com. Information contained on our Web sites is not and should not be deemed to be a part of this Report.

Company History

We were founded in 1995 as CEN-COM of Oklahoma, Inc., an Oklahoma corporation, to bring dial-up Internet access and education to rural locations in Oklahoma that did not have dial-up Internet access. We changed our name to FullNet Communications, Inc. in December 1995. Today we are a total solutions provider to individuals and companies seeking a "one-stop shop" in Oklahoma.

Our current business strategy is to become a successful integrated communications provider in Oklahoma. We expect to grow through the acquisition of additional customers for our carrier-neutral co-location space and advanced voice and data solutions.

We market our carrier neutral co-location solutions in our network operations center to other competitive local exchange carriers, Internet service providers and web-hosting companies. Our co-location facility is carrier neutral, allowing customers to choose among competitive offerings rather than being restricted to one carrier. Our facility is Telco-grade and provides customers a high level of operative reliability and security. We offer flexible space arrangements for customers and 24-hour onsite support with both battery and generator backup.

Through FullTel, our wholly owned subsidiary, we are a fully licensed competitive local exchange carrier or CLEC in Oklahoma. FullTel activates local access telephone numbers for the cities in which we market, sell and operate our retail FullNet Internet service provider brand, wholesale dial-up Internet service; our business-to-business network design, connectivity, domain and Web hosting businesses; and traditional telephone services as well as advanced voice and data solutions. At June 30, 2014 FullTel provided us with local telephone access in approximately 232 cities.

Our common stock trades on the OTC QB marketplace under the symbol FULO. While our common stock trades on the OTC QB marketplace, it is very thinly traded, and there can be no assurance that our stockholders will be able to sell their shares should they so desire. Any market for the common stock that may develop, in all likelihood, will be a limited one, and if such a market does develop, the market price may be volatile.

-

Table of Contents

Results of Operations

The following table sets forth certain statement of operations data as a percentage of revenues for the three and six months ended June 30, 2014 and 2013:

	Three Months Ended				Six Months Ended			
	June 30, 2014		June 30, 2013		June 30, 2014		June 30, 2013	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Revenues:								
Access service revenues	$ 19,279	4.2%	$ 31,889	7.8%	$ 43,068	4.9%	$ 66,295	8.3%
Co-location and other revenues	438,454	95.8	378,472	92.2	838,442	95.1	737,011	91.7
Total revenues	457,733	100.0	410,361	100.0	881,510	100.0	803,306	100.0
Cost of access service revenues	22,503	4.9	27,329	6.7	49,717	5.7	56,008	7.0
Cost of co-location and other revenues	88,978	19.4	85,978	20.9	174,395	19.8	176,878	22.0
Selling, general and administrative expenses	356,300	77.9	344,499	83.9	701,994	79.6	670,093	83.4
Depreciation and amortization	10,915	2.4	7,319	1.8	18,830	2.1	15,402	1.9
Total operating costs and expenses	478,696	104.6	465,125	113.3	944,936	107.2	918,381	114.3
Loss from operations	(20,963)	(4.6)	(54,764)	(13.3)	(63,426)	(7.2)	(115,075)	(14.3)
Gain on Series A convertible preferred stock issued in exchange for indebtedness	-	-	401,004	97.7	-	-	401,004	49.9
Interest expense	(3,996)	(0.9)	(5,720)	(1.4)	(8,091)	(0.9)	(11,107)	(1.4)

Net income (loss)	$ (24,959)	(5.5)%	$ 340,520	83.0%	$ (71,517)	(8.1)%	$ 274,822	34.2%
Preferred stock dividends	(15,131)	(3.3)	(8,605)	2.1	(30,262)	(3.4)	(8,605)	1.1
Net income (loss) available to common stockholders	$ (40,090)	(8.8)%	$ 331,915	80.9%	$ (101,779)	(11.5)%	$ 266,217	33.1%

Three Months Ended June 30, 2014 (the "2014 2nd Quarter") Compared to Three Months Ended June 30, 2013 (the "2013 2nd Quarter")

Revenues

Access service revenues decreased $12,610 or 39.5% to $19,279 for the 2014 2nd Quarter from $31,889 for the same period in 2013 primarily due to a decline in the number of customers.

Co-location and other revenues increased $59,982 or 15.8% to $438,454 for the 2014 2nd Quarter from $378,472 for the same period in 2013. This increase was primarily attributable to the net addition of new customers and the sale of additional services to existing customers.

Table of Contents

Operating Costs and Expenses

Cost of access service decreased $4,826 or 17.7% to $22,503 for the 2014 2nd Quarter from $27,329 for the same period in 2013. This decrease was primarily due to reductions in recurring costs associated with our network. Cost of access service revenues as a percentage of access service revenues increased to 116.7% during the 2014 2nd Quarter, compared to 85.7% during the same period in 2013.

Cost of co-location and other revenues increased $3,000 or 3.5% to $88,978 for the 2014 2nd Quarter from $85,978 for the same period in 2013. This increase was primarily attributable to increases in costs of servicing our advanced voice and data solutions customers due to an increase in the number of customers utilizing those services. The increase was offset by reductions in costs of servicing our traditional phone service customers due to a reduction in the number of customers utilizing that service. Cost of co-location and other revenues as a percentage of co-location and other revenues decreased to 20.3% during the 2014 2nd Quarter, compared to 22.7% during the same period in 2013.

Selling, general and administrative expenses increased $11,801 or 3.4% to $356,300 for the 2014 2nd Quarter compared to $344,499 for the same period in 2013. This increase was primarily related to increases in rent, advertising, employee costs and professional services expenses of $7,388, $7,248, $5,066 and $4,146, respectively. These increases were offset by decreases in bad debt, agent commissions and property tax expenses of $8,179, $2,174 and $2,074, respectively. Selling, general and administrative expenses as a percentage of total revenues decreased to 77.9% during the 2014 2nd Quarter from 83.9% during the same period in 2013.

Depreciation and amortization expense increased $3,596 or 49.1% to $10,915 for the 2014 2nd Quarter compared to $7,319 for the same period in 2013 primarily related to the addition of assets.

Gain on Series A convertible preferred stock issued in exchange for indebtedness

On June 3, 2013, pursuant to shareholder authorization, we issued 987,102 shares of our Series A convertible preferred stock and $401,004 was recognized as gain on Series A convertible preferred stock issued in exchange for indebtedness. See breakdown below:

We issued 59,634 and 203,169 shares of our series A convertible preferred stock to settle $55,000 of debt, $4,634 of accrued interest and $203,169 of accounts payable. As a result, we recognized a gain on settlement of debt and accrued interest of $57,248 and a gain on settlement of accounts payable of $195,042.

Members of our management and board of directors accounted for 609,507 shares of the shares issued in exchange for $609,507 and $46,626 of our deferred compensation and accrued payroll taxes. Participation of our management and board of directors in this exchange was approved by a majority of our shareholders.

Also, accounts payable of $114,792 was exchanged for 114,792 shares of our series A convertible preferred stock. We recognized $110,200 as gain on settlement of accounts payable. An additional $38,514 of gain netted against $9,694 of professional fees was recognized as we wrote off additional accounts payables and deferred compensation due to the applicable Statute of Limitations.

Interest Expense

Interest expense decreased $1,724 or 30.1% to $3,996 for the 2014 2nd Quarter compared to $5,720 for the same period in 2013 primarily related to the decrease in notes payable.

Six Months Ended June 30, 2014 (the "2014 Period") Compared to Six Months Ended June 30, 2013 (the "2013 Period")

Revenues

Access service revenues decreased $23,227 or 35.0% to $43,068 for the 2014 Period from $66,295 for the 2013 Period primarily due to a decline in the number of customers.

Co-location and other revenues increased $101,431 or 13.7% to $838,442 for the 2014 Period from $737,011 for the 2013 Period. This increase was primarily attributable to the net addition of new customers and the sale of additional services to existing customers.

-

Table of Contents

Operating Costs and Expenses

Cost of access service revenues decreased $6,291 or 11.2% to $49,717 for the 2014 Period from $56,008 for the 2013 Period. This decrease was primarily due to reductions in recurring costs associated with our network. Cost of access service revenues as a percentage of access service revenues increased to 115.4% during the 2014 Period, compared to 84.5% during the 2013 Period.

Cost of co-location and other revenues decreased $2,483 or 1.4% to $174,395 for the 2014 Period from $176,878 for the 2013 Period This decrease was primarily related to reductions in costs of servicing our traditional phone service customers due to a reduction in the number of customers utilizing that service. The decrease was offset by increases in costs of servicing our advanced voice and data solutions customers due to an increase in the number of customers utilizing those services. Cost of co-location and other revenues as a percentage of co-location and other revenues decreased to 20.8% during the 2014 Period compared to 24.0% during the 2013 Period.

Selling, general and administrative expenses increased $31,901 or 4.8% to $701,994 for the 2014 Period compared to $670,093 for the 2013 Period. This increase was primarily related to increases in employee costs, advertising and rent expenses of $39,152, $16,506 and $15,321, respectively. These increases were offset by decreases in professional services, bad debt, agent commissions and property taxes expenses of $14,678, $13,229, $8,501 and $6,515, respectively. Selling, general and administrative expenses as a percentage of total revenues decreased to 79.6% during the 2014 Period from 83.4% during the 2013 Period.

Depreciation and amortization expense increased $3,428 or 22.3% to $18,830 for the 2014 Period compared to $15,402 for the 2013 Period primarily related to the addition of assets.

Gain on Series A convertible preferred stock issued in exchange for indebtedness

On June 3, 2013, pursuant to shareholder authorization, we issued 987,102 shares of our Series A convertible preferred stock and $401,004 was recognized as gain on Series A convertible preferred stock issued in exchange for indebtedness. See breakdown below:

We issued 59,634 and 203,169 shares of our series A convertible preferred stock to settle $55,000 of debt, $4,634 of accrued interest and $203,169 of accounts payable. As a result, we recognized a gain on settlement of debt and accrued interest of $57,248 and a gain on settlement of accounts payable of $195,042.

Members of our management and board of directors accounted for 609,507 shares of the shares issued in exchange for $609,507 and $46,626 of our deferred compensation and accrued payroll taxes. Participation of our management and board of directors in this exchange was approved by a majority of our shareholders.

Also, accounts payable of $114,792 was exchanged for 114,792 shares of our series A convertible preferred stock. We recognized $110,200 as gain on settlement of accounts payable. An additional $38,514 of gain netted against $9,694 of professional fees was recognized as we wrote off additional accounts payables and deferred compensation due to the applicable Statute of Limitations.

Interest Expense

Interest expense decreased $3,016or 27.2% to $8,091 for the 2014 Period compared to $11,107 for the 2013 Period primarily related to the decrease in notes payable.

Liquidity and Capital Resources

As of June 30, 2014, we had $4,396 in cash and $1,012,942 in current liabilities, including $339,461 of deferred revenues that will not require settlement in cash.

At June 30, 2014 and December 31, 2013, we had working capital deficits of $980,164 and $828,689, respectively. We do not have a line of credit or credit facility to serve as an additional source of liquidity. Historically we have relied on shareholder loans as an additional source of funds.

As of June 30, 2014, of the $177,142 we owed to our trade creditors $163,756 was past due. We have no formal agreements regarding payment of these amounts.

- 12 -

Table of Contents

Cash flow for the six-month periods ended June 30, 2014 and 2013 consist of the following.

	For the Six-Months Periods Ended June 30,	
	2014	**2013**
	$	$
Net cash flows provided by operations	44,153	20,106
Net cash flows used in investing activities	(56,266)	(5,634)
Net cash flows used in financing activities	(13,563)	(11,194)

Cash used for the purchase of equipment was $56,266 and $5,634, respectively, for the six months ended June 30, 2014 and 2013.

Cash used for principal payments on notes payable was $13,563 and $11,194, respectively, for the six months ended June 30, 2014 and 2013.

The planned expansion of our business will require significant capital to fund capital expenditures, working capital needs, and debt service. Our principal capital expenditure requirements will include:

- mergers and acquisitions and
- further development of operations support systems and other automated back office systems

Because our cost of developing new networks and services, funding other strategic initiatives, and operating our business depend on a variety of factors (including, among other things, the number of customers and the service for which they subscribe, the nature and penetration of services that may be offered by us, regulatory changes, and actions taken by competitors in response to our strategic initiatives), it is almost certain that actual costs and revenues will materially vary from expected amounts and these variations are likely to increase our future capital requirements. Our current cash balances will not be sufficient to fund our current business plan beyond a few months. As a consequence, we are currently focusing on revenue enhancement and cost cutting opportunities as well as working to sell non-core assets and to extend vendor payment terms. We continue to seek additional convertible debt or equity financing as well as the placement of a credit facility to fund our liquidity needs. There is no assurance that we will be able to obtain additional capital on satisfactory terms or at all or on terms that will not dilute our shareholders' interests.

Until we obtain sufficient additional capital, the further development of our network will be delayed or we will be required to take other actions. Our inability to obtain additional capital resources has had and will continue to have a material adverse effect on our business, operating results and financial condition.

Our ability to fund the capital expenditures and other costs contemplated by our business plan and to make scheduled payments with respect to borrowings will depend upon, among other things, our ability to seek and obtain additional financing in the near term. Capital will be needed in order to implement our business plan, deploy our network, expand our operations and obtain and retain a significant number of customers in our target markets. Each of these factors is, to a large extent, subject to economic, financial, competitive, political, regulatory, and other factors, many of which are beyond our control.

There is no assurance that we will be successful in developing and maintaining a level of cash flows from operations sufficient to permit payment of our outstanding indebtedness. If we are unable to generate sufficient cash flows from operations to service our indebtedness, we will be required to modify or abandon our growth plans, limit our capital expenditures, restructure or refinance our indebtedness or seek additional capital or liquidate our assets. There is no assurance that (i) any of these strategies could be effectuated on satisfactory terms, if at all, or on a timely basis or (ii) any of these strategies will yield sufficient proceeds to service our debt or otherwise adequately fund operations.

On March 31, 2014 our board of directors made the determination that it was in the best interest of the Company and its stockholders to conserve our working capital at this time and not make the annual dividend payment for the year ending December 31, 2013. As a result, pursuant to the Certificate of Designations, Preferences, and Rights of the Series A Convertible Preferred Stock, each share of the Series A Convertible Preferred Stock shall hereafter be entitled to two votes upon any matter that the holders of our common stock are entitled to vote.

-

Table of Contents

Financing Activities

We have a secured convertible promissory note from a shareholder which requires monthly installments of $3,301 including principal and interest and is secured by all of our tangible and intangible assets. At June 30, 2014, the outstanding principal and accrued interest of the secured convertible promissory note was $211,976.

We have a secured convertible promissory note from a shareholder which requires monthly installments of interest only through May 31, 2014 then monthly installments of $600 including principal and interest. This note is secured by certain equipment. At June 30, 2014, the outstanding principal and accrued interest of the secured convertible promissory note was $49,650.

Critical Accounting Policies and Estimates

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect certain reported amounts and disclosures. In applying our accounting principles, we must often make individual estimates and assumptions regarding expected outcomes or uncertainties. As might be expected, the actual results or outcomes are generally different than the estimated or assumed amounts. These differences are usually minor and are included in our consolidated financial statements as soon as they are known. Our estimates, judgments and assumptions are continually evaluated based on available information and experience. Because of the use of estimates inherent in the financial reporting process, actual results could differ from those estimates.

We periodically review the carrying value of our property and equipment whenever business conditions or events indicate that those assets may be impaired. If the estimated future undiscounted cash flows to be generated by the property and equipment are less than the carrying value of the assets, the assets are written down to fair market value and a charge is recorded to current operations. Significant and unanticipated changes in circumstances, including significant adverse changes in business climate, adverse actions by regulators, unanticipated competition, loss of key customers and/or changes in technology or markets, could require a provision for impairment in a future period.

We review loss contingencies and evaluate the events and circumstances related to these contingencies. We disclose material loss contingencies that are possible or probable, but cannot be estimated. For loss contingencies that are both estimable and probable the loss contingency is accrued and expense is recognized in the financial statements.

Access service revenues are recognized on a monthly basis over the life of each contract as services are provided. Contract periods range from monthly to yearly. Carrier-neutral telecommunications co-location revenues, traditional telephone services and advanced voice and data services are recognized on a monthly basis over the life of the contract as services are provided. Revenue that is received in advance of the services provided is deferred until the services are provided by us. Revenue related to set up charges is also deferred and amortized over the life of the contract. We classify certain taxes and fees billed to customers and remitted to governmental authorities on a net basis in revenue.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As a smaller reporting company, we are not required and have not elected to report any information under this item.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act that are designed to ensure that information required to be disclosed in our reports filed or submitted to the SEC under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms, and that information is accumulated and communicated to our management, including our principal executive and financial officer as appropriate, to allow timely decisions regarding required disclosures.

Our principal executive officer and principal financial officer evaluated the effectiveness of disclosure controls and procedures as of June 30, 2014 pursuant to Rule 13a-15(b) under the Exchange Act. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act, 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 CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Table of Contents

A system of controls, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the system of controls are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

Changes in Internal Control over Financial Reporting

No change in our system of internal control over financial reporting occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

As a provider of telecommunications, we are affected by regulatory proceedings in the ordinary course of our business at the state and federal levels. These include proceedings before both the Federal Communications Commission and the Oklahoma Corporation Commission ("OCC"). In addition, in our operations we rely on obtaining many of our underlying telecommunications services and/or facilities from incumbent local exchange carriers or other carriers pursuant to interconnection or other agreements or arrangements. In January 2007, we concluded a regulatory proceeding pursuant to the Federal Telecommunications Act of 1996 before the OCC relating to the terms of our interconnection agreement with Southwestern Bell Telephone, L.P. d/b/a AT&T, which succeeds a prior interconnection agreement. The OCC approved this agreement in May 2007. This agreement may be affected by regulatory proceedings at the federal and state levels, with possible adverse impacts on us. We are unable to accurately predict the outcomes of such regulatory proceedings at this time, but an unfavorable outcome could have a material adverse effect on our business, financial condition or results of operations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the six months ended June 30, 2014, we issued 4,500 nonqualified employee stock options with exercise prices ranging from $.03 to $.05. The stock options will vest one-third on each annual anniversary date of the grant and will expire ten years from the date of the grant. We do not have a written employee stock option plan. In connection with the issuance of these common stock options, no underwriting discounts or commissions were paid or will be paid. The common stock options were issued without registration under the Securities Act of 1933, as amended, in reliance on the registration exemption afforded by Regulation D and more specifically Rule 506 of Regulation D.

Item 5. Other Information

During the three months ended June 30, 2014 all events reportable on Form 8-K were reported.

Item 6. Exhibits

(a) The following exhibits are either filed as part of or are incorporated by reference in this Report:

Exhibit Number	*Exhibit*	
3.1	Certificate of Incorporation, as amended (filed as Exhibit 2.1 to Registrant's Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).	#
3.2	Bylaws (filed as Exhibit 2.2 to Registrant's Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference)	#

3.3	Amended and Restated Certificate of Incorporation of FullNet Communications, Inc.	#
4.1	Specimen Certificate of Registrant’s Common Stock (filed as Exhibit 4.1 to the Company’s Form 10-KSB for the fiscal year ended December 31, 1999, and incorporated herein by reference).	#
4.2	Certificate of Correction to the Amended Certificate of Incorporation and the Ninth Section of the Certificate of Incorporation (filed as Exhibit 2.1 to Registrant’s Registration Statement on form 10-SB, file number 000-27031 and incorporated by reference).	#
4.3	Certificate of Correction to Articles II and V of Registrant’s Bylaws (filed as Exhibit 2.1 to Registrant’s Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).	#

Table of Contents

Exhibit Number	*Exhibit*	
4.4	Certificate of Designations, Preferences, and Rights of Series A Convertible Preferred Stock of FullNet Communications, Inc.	#
10.1	Financial Advisory Services Agreement between the Company and National Securities Corporation, dated September 17, 1999 (filed as Exhibit 10.1 to Registrant's Form 10-KSB for the fiscal year ended December 31, 1999, and incorporated herein by reference).	#
10.2	Lease Agreement between the Company and BOK Plaza Associates, LLC, dated December 2, 1999 (filed as Exhibit 10.2 to Registrant's Form 10-KSB for the fiscal year ended December 31, 1999, and incorporated herein by reference).	#
10.3	Interconnection agreement between Registrant and Southwestern Bell dated March 19, 1999 (filed as Exhibit 6.1 to Registrant's Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).	#
10.4	Registrar Accreditation Agreement effective February 8, 2000, by and between Internet Corporation for Assigned Names and Numbers and FullWeb, Inc. d/b/a FullNic f/k/a Animus Communications, Inc. (filed as Exhibit 10.1 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).	#
10.5	Amendment to Financial Advisory Services Agreement between Registrant and National Securities Corporation, dated April 21, 2000 (filed as Exhibit 10.3 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended June 30, 2000 and incorporated herein by reference).	#
10.6	Placement Agency Agreement dated November 8, 2000 between FullNet Communications, Inc. and National Securities Corporation (filed as Exhibit 10.31 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).	#
10.7	Employment Agreement with Timothy J. Kilkenny dated July 31, 2002	#
10.8	Employment Agreement with Roger P. Baresel dated July 31, 2002	#
10.9	Secured Promissory Note and Security Agreement dated December 30, 2009, issued to High Capital Funding, LLC	#
10.10	Employment Agreement with Jason Ayers dated January 1, 2011	#

10.11	Form 8-K dated May 9, 2013 reporting expansion of the Board of Directors and the election of Jason C. Ayers to the Board of Directors	#
10.12	Schedule 14C Definitive Information Statement dated May 15, 2013 reporting Notice of Action by Written Consent of Shareholders	#
10.13	Form 8-K dated June 3, 2013 reporting the Shareholder Consent to Action in Lieu of a Meeting approving the Amendment and Restatement of the Company's Certificate of Incorporation, the re-election of the Board of Directors, the authorization of Series A Convertible Preferred Stock, the authorization of the Exchange Offer and the issuance of Series A Convertible Preferred Stock	#

Table of Contents

Exhibit Number	*Exhibit*	
10.14	Form of Exchange Offer Acceptance Agreement	#
10.15	Secured Exchange Promissory Note and Security Agreement dated May 31, 2013, issued to High Capital Funding, LLC	#
10.16	Secured Exchange Promissory Note and Security Agreement dated May 31, 2013, issued to High Capital Funding, LLC	#
22.1	Subsidiaries of the Registrant	#
31.1	Certification pursuant to Rules 13a-14(a) and 15d-14(a) of Timothy J. Kilkenny	*
31.2	Certification pursuant to Rules 13a-14(a) and 15d-14(a) of Roger P. Baresel	*
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Timothy J. Kilkenny	*
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Roger P. Baresel	*
101.INS	XBRL Instance Document	**
101.SCH	XBRL Taxonomy Extension Schema Document	**
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	**
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	**
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	**
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	**

Incorporated by reference.

* Filed herewith.

**

In accordance with Rule 406T of Regulation S-T, the XBRL (Extensible Business Reporting Language)related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except to the extent expressly set forth by specific reference in such filing.

Table of Contents

SIGNATURES

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

REGISTRANT:

FULLNET COMMUNICATIONS, INC.

Date: August 14, 2014	By:	/s/ TIMOTHY J. KILKENNY Timothy J. Kilkenny Chief Executive Officer
Date: August 14, 2014	By:	/s/ ROGER P. BARESEL Roger P. Baresel President and Chief Financial and Accounting Officer

EXHIBIT 31.1

CERTIFICATIONS

I, Timothy J. Kilkenny, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended June 30, 2014 of FullNet Communications, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: August 14, 2014

/s/ Timothy J. Kilkenny

Chief Executive Officer

EXHIBIT 31.2

CERTIFICATIONS

I, Roger P. Baresel, certify that:.

1. I have reviewed this quarterly report on Form 10-Q for the period ended June 30, 2014 of FullNet Communications, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2014

/s/ Roger P. Baresel,

President and Chief Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to 18 U.S.C. §1350 (as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002), I, the undersigned Chief Executive Officer of FullNet Communications, Inc. (the "Company"), hereby certify that, to the best of my knowledge, the Quarterly Report on Form 10-Q of the Company for the period ended June 30, 2014 (the "Report") fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 14, 2014	/s/ Timothy J. Kilkenny, Chief Executive Officer

Exhibit 32.2

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to 18 U.S.C. §1350 (as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002), I, the undersigned President and Chief Financial and Accounting Officer of FullNet Communications, Inc. (the "Company"), hereby certify that, to the best of my knowledge, the Quarterly Report on Form 10-Q of the Company for the period ended June 30, 2014 (the "Report") fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 14, 2014	/s/ Roger P. Baresel, President and Chief Financial and Accounting Officer