Zoom Telephonics, Inc.
Form 10-Q
May 15, 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 March 31, 2014

or

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

For the transition period from________ to ________

Commission File Number 0-53722

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

Delaware (State or Other Jurisdiction of Incorporation or Organization)	04-2621506 (I.R.S. Employer Identification No.)
207 South Street, Boston, Massachusetts (Address of Principal Executive Offices)	02111 (Zip Code)

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES þ NO ¨

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 ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (do not check if a smaller reporting company)	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 ¨ NO þ

The number of shares outstanding of the registrant’s Common Stock, $.01 par value, as of March 31, 2014, was 7,982,704 shares.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ZOOM TELEPHONICS, INC.
Condensed Balance Sheets (Unaudited)

ASSETS	March 31, 2014	December 31, 2013
Current assets		
Cash and cash equivalents	$ 39,314	$ 55,393
Accounts receivable, net of allowances of $571,177 at March 31, 2014 and $640,456 at December 31, 2013	1,861,014	1,674,812
Inventories	1,867,938	1,714,081
Prepaid expenses and other current assets	242,876	225,152
Total current assets	4,011,142	3,669,438
Equipment, net	48,736	51,025
Total assets	$ 4,059,878	$ 3,720,463
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Bank debt	$ 455,409	$ 318,318
Accounts payable	949,437	693,546
Accrued expenses	299,767	322,410
Total current liabilities	1,704,613	1,334,274
Total liabilities	1,704,613	1,334,274
Stockholders' equity		
Common stock, $0.01 par value:		
Authorized - 25,000,000 shares; issued and outstanding – 7,982,704 shares at March 31, 2014 and December 31, 2013, respectively	79,827	79,827
Additional paid-in capital	34,183,549	34,177,779
Accumulated deficit	(32,272,828)	(32,235,772)
Accumulated other comprehensive income(loss)	364,717	364,355
Total stockholders' equity	2,355,265	2,386,189
Total liabilities and stockholders' equity	$ 4,059,878	$ 3,720,463

See accompanying notes.

ZOOM TELEPHONICS, INC.
Condensed Statements of Operations and
Comprehensive Income (Loss)

(Unaudited)

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Net sales	$ 3,146,345	$ 2,817,599
Cost of goods sold	2,213,878	2,113,631
Gross profit	932,467	703,968
Operating expenses:		
Selling	352,780	422,665
General and administrative	292,552	339,534
Research and development	308,667	258,512
	953,999	1,020,711
Operating profit (loss)	(21,532)	(316,743)
Other income (expense) :		
Interest income	7	9
Other, net	(14,200)	(16,328)
Total other income (expense), net	(14,193)	(16,319)
Income (loss) before income taxes	(35,725)	(333,062)
Income taxes (benefit)	1,331	512
Net income (loss)	$ (37,056)	$ (333,574)
Other comprehensive income (loss):		
Foreign currency translation adjustments	362	(9,955)
Unrealized gain (loss) for the period	—	12,800
Net comprehensive income (loss)	$ (36,694)	$ (330,729)
Net income (loss) per share:		
Basic and Diluted	$ (0.00)	$ (0.05)
Weighted average common and common equivalent shares:		
Basic and Diluted	7,982,704	6,973,704

See accompanying notes.

ZOOM TELEPHONICS, INC.
Condensed Statements of Cash Flows

(Unaudited)

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Operating activities:		
Net income (loss)	$ (37,056)	$ (333,574)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,289	3,023
Stock based compensation	5,770	10,892
Provision for accounts receivable allowances	10,011	(44,465)
Provision for inventory reserves	(34,266)	(372,445)
Changes in operating assets and liabilities:		
Accounts receivable	(196,149)	491,198
Inventories	(119,591)	330,835
Prepaid expenses and other assets	(17,685)	12,752
Accounts payable and accrued expenses	233,277	30,082
Net cash provided by (used in) operating activities	(153,400)	128,298
Investing activities:		
Additions to property, plant and equipment	—	(19,414)
Net cash provided by (used in) investing activities	—	(19,414)
Financing activities:		
Net funds received from (paid to) bank credit lines	137,091	(111,097)
Net cash provided by (used in) financing activities	137,091	(111,097)
Effect of exchange rate changes on cash	230	1,217
Net change in cash	(16,079)	(996)
Cash and cash equivalents at beginning of period	55,393	195,704
Cash and cash equivalents at end of period	$ 39,314	$ 194,708
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 14,374	$ 17,236
Income taxes	$ 1,331	$ 512

See accompanying notes.

ZOOM TELEPHONICS, INC.
Notes to Condensed Financial Statements

(Unaudited)

(1) Summary of Significant Accounting Policies

The accompanying financial statements are unaudited. However, the condensed balance sheet as of December 31, 2013 was derived from audited financial statements. In the opinion of management, the accompanying financial statements include all adjustments to present fairly the financial position, results of operations and cash flows of the Company. The adjustments are of a normal, recurring nature.

The results of operations for the periods presented are not necessarily indicative of the results to be expected for the entire year. The Company has evaluated subsequent events from March 31, 2014 through the date of this filing and determined that there are no such events requiring recognition or disclosure in the financial statements.

The condensed financial statements of the Company presented herein have been prepared pursuant to the rules of the Securities and Exchange Commission for quarterly reports on Form 10-Q and do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America. These financial statements should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2013 included in the Company's 2013 Annual Report on Form 10-K.

(a) Reclassifications

Certain reclassifications have been made to the prior year’s financial statements to conform to the 2014 presentation. The reclassifications relate to the presentation of changes in accounts receivable and inventory on the statements of cash flows. The reclassifications do not change the balance sheet or statement of operations.

(2) Liquidity

Zoom’s cash and cash equivalents balance on March 31, 2014 was $39 thousand, down $16 thousand from December 31, 2013. Zoom’s maximum available line of credit was $1.25 million on March 31, 2014, and bank debt outstanding under this line of credit was $455 thousand. Zoom’s $0.1 million increase in bank debt and $0.2 million increase in other current liabilities in Q1 2014 increased cash, while a $0.2 million increase in net accounts receivable and $0.2 million increase in net inventory decreased cash.

On March 31, 2014 the Company had working capital of $2.3 million including $39 thousand in cash and cash equivalents. On December 31, 2013 we had working capital of $2.3 million including $55 thousand in cash and cash equivalents. Our current ratio at March 31, 2014 was 2.4 compared to 2.8 at December 31, 2013.

On December 18, 2012, we entered into a Financing Agreement with Rosenthal & Rosenthal, Inc. (the “Financing Agreement”). The Financing Agreement provided for up to $1.75 million of revolving credit, subject to a borrowing base formula and other terms and conditions as specified in the Financing Agreement. The Financing Agreement has a two year term. Borrowings are secured by all of our assets including our intellectual property. The Loan Agreement contained several covenants, including a requirement that we maintain a tangible net worth not less than $2.5 million and working capital not less than $2.5 million. On March 25, 2014, we entered into an amendment to the Financing Agreement (the “Amendment”) with an effective date of January 1, 2013. The Amendment clarified the definition of current assets in the Financing Agreement, reduced the size of the revolving credit line to $1.25 million, and revised the financial covenants so that Zoom is required to maintain tangible net worth of not less than $2.0 million and working capital of not less than $1.75 million.

The Company is continuing to develop new products and to take other measures to increase sales. Increasing sales typically results in increased inventory and higher accounts receivable, both of which reduce cash. Zoom has one significant account who buys from Zoom on a consignment basis. Consigned inventory tends to result in the slowest payment to Zoom, since Zoom is only paid after the consigned inventory is sold by Zoom's customer.

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

(3) Inventories

Inventories consist of :	March 31, 2014	December 31, 2013
Materials	$ 347,876	$ 440,723
Work in process	16,372	—
Finished goods (including $231,700 and $304,500 held by customers at March 31, 2014 and December 31, 2013, respectively)	1,503,690	1,273,358
Total	$ 1,867,938	$ 1,714,081

(4) Contingencies

The Company is party to various lawsuits and administrative proceedings arising in the ordinary course of business. The Company evaluates such lawsuits and proceedings on a case-by-case basis, and its policy is to vigorously contest any such claims which it believes are without merit. The Company's management believes that the ultimate resolution of such matters will not materially and adversely affect the Company's business, financial position, results of operations or cash flows.

On October 15, 2012 Telecomm Innovations LLC filed a complaint against Zoom Telephonics and at least 23 other companies including Dell Inc., various dial-up modem producers, and many fax machine producers. The complaint was related to dial-up modems and alleged that Zoom infringed upon Telecomm Innovation patents. Zoom believed that it was licensed for these patents already through its modem chipset suppliers. On January 22, 2014, a Stipulation of Dismissal was filed for the case and the case has been closed pursuant to a resolution of the dispute between Zoom and Telecomm Innovations. The closing of the case did not materially affect the Company's business, financial position, results of operations or cash flows.

On November 6, 2013 Innovative Wireless Solutions, LLC (“IWS”) filed a complaint against Zoom Telephonics alleging infringement of U.S. Patents Nos. 5,912,895, 6,327,264, and 6,587,473 all entitled “Information Network Access Apparatus and Methods of Communicating Information packets via Telephone Links.” The Complaint asserts that Zoom sells products with “wireless access points and/or routers capable of connecting to an Ethernet network and an IEEE 802.11 wireless network to provide wireless Internet access.” The case is in its early stages and a Scheduling conference is currently set for May 22, 2014. Management is unable to reasonably estimate any potential outcome at this time.

(5) Segment and Geographic Information

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

	Three Months Ended March 31, 2014	% of Total		Three Months Ended March 31, 2013	% of Total	
North America	$3,075,782	98	%	$2,572,673	91	%
UK	35,411	1	%	144,220	5	%
All Other	35,152	1	%	100,706	4	%
Total	$3,146,345	100	%	$2,817,599	100	%

(6) Customer Concentrations

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

Relatively few customers have accounted for a substantial portion of the Company’s revenues. In the first quarter of 2014, three customers accounted for 73% of our total net sales with our largest customer accounting for 56% of our net sales. In the first quarter of 2013, three customers accounted for 63% of the Company’s total net sales with our largest customer accounting for 45% of our net sales. One customer accounted for 73% of net accounts receivable on March 31, 2014.

The Company’s customers generally do not enter into long-term agreements obligating them to purchase products. The Company may not continue to receive significant revenues from any of these or from other large customers. A reduction or delay in orders from any of the Company’s significant customers, or a delay or default in payment by any significant customer could materially harm the Company’s business and prospects. Because of the Company’s significant customer concentration, its net sales and operating income (loss) could fluctuate significantly due to changes in political or economic conditions, or the loss, reduction of business, or less favorable terms for any of the Company's significant customers.

(7) Valuation of Marketable Securities

In October 2010 Zoom Telephonics, Inc. entered into an agreement with Zoom Technologies, Inc. (Nasdaq: ZOOM) in which Zoom Telephonics transferred its rights to the zoom.com domain name and certain trademark rights in exchange for 80,000 shares of Zoom Technologies common stock. These shares had trading restrictions that ended January 18, 2012. The Company valued the marketable securities at market value in the financial statements. In the fourth quarter of 2013, Zoom Technologies, Inc. announced a reverse merger resulting in a 10:1 split so that the 80,000 shares became 8,000 shares. In December 2013 the Company sold all 8,000 shares of Zoom Technologies, Inc. stock. The Company received proceeds of $40 thousand and reported a realized loss of $273 thousand in 2013.

(8) Bank Credit Lines

On December 18, 2012, we entered into a Financing Agreement with Rosenthal & Rosenthal, Inc. (the “Financing Agreement”). The Financing Agreement provided for up to $1.75 million of revolving credit, subject to a borrowing base formula and other terms and conditions as specified in the Financing Agreement. The Financing Agreement has a two year term. Borrowings are secured by all of our assets including our intellectual property. The Loan Agreement contained several covenants, including a requirement that we maintain a tangible net worth not less than $2.5 million and working capital not less than $2.5 million. On March 25, 2014, we entered into an amendment to the Financing Agreement (the “Amendment”) with an effective date of January 1, 2013. The Amendment clarified the definition of current assets in the Financing Agreement, reduced the size of the revolving credit line to $1.25 million, and revised the financial covenants such that we are required to maintain tangible net worth of not less than $2.0 million and working capital of not less than $1.75 million.

On March 31, 2014 Zoom was in compliance with the covenants of the Financing Agreement with Rosenthal & Rosenthal, Inc.

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

The following discussion and analysis should be read in conjunction with the safe harbor statement and the risk factors contained in Item IA of Part II of this Quarterly Report on Form 10-Q, in our Annual Report on Form 10-K for the year ended December 31, 2013, filed with the SEC on March 31, 2014 and in our other filings with the SEC. Readers should also be cautioned that results of any reported period are often not indicative of results for any future period.

Overview

We derive our net sales primarily from sales of Internet-related communication products, principally broadband and dial-up modems and other communication products, to retailers, distributors, Internet Service Providers and Original Equipment Manufacturers. We sell our products through a direct sales force and through independent sales agents. All but two of our employees are located at our headquarters in Boston, Massachusetts. We are experienced in electronics hardware, firmware, and software design and test, regulatory certifications, product documentation, and packaging; and we use that experience in developing each product in-house or in partnership with suppliers who are typically based in Asia. Electronic assembly and testing of the Company’s products in accordance with our specifications is typically done at the product’s manufacturing facility in China.

Since 1983 our headquarters has been near South Station in downtown Boston at 201 and 207 South Street. In December 2006, the Company sold its owned headquarters buildings in Boston, Massachusetts and leased back 25,200 square feet for two years expiring December 2008. In November 2008 the Company signed a lease amendment for its headquarters’ offices in Boston in the existing building to approximately 14,400 square feet for three years with a six month termination option starting July 1, 2010. In May 2010 we signed a second lease amendment extending the term of the lease to April 30, 2016 with a six month termination option starting December 1, 2011. In December 2011 we signed a third lease amendment reducing our leased space to 10,600 square feet effective June 1, 2012, with a corresponding decrease in lease expense.

For many years we performed most of the final assembly, test, packaging, warehousing and distribution at a production and warehouse facility on Summer Street in Boston, Massachusetts, which had also engaged in firmware programming for some products. We moved most of our Summer Street operations to a dedicated 35,575 square foot facility in Tijuana, Mexico in October 2006. We moved these operations to a 10,800 square foot facility in Tijuana, Mexico in March 2009.

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

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

In most but not all years our sales have declined. In response, we have cut costs by reducing staffing and some overhead costs. Our total headcount was reduced from 30 on March 31, 2013 to 27 on March 31, 2014. As of May 6, 2014, Zoom had 26 employees and one temporary employee. Of the 27 included in our headcount on May 6, 2014, 9 were engaged in research and development and quality control, 5 were involved in manufacturing oversight, purchasing, assembly, packaging and shipping, 8 were engaged in sales, marketing, technical support, and the remaining 5 performed accounting, administrative and executive functions. Zoom has implemented cost cutting measures including reducing our headcount and reducing the number of days that certain employees work. As a result, Zoom currently has 16 full-time employees and 11 employees working less than 5 days per week. Our dedicated manufacturing personnel in Mexico are employees of our Mexican manufacturing service provider and not included in our headcount. On March 31, 2014, Zoom had one consultant in sales and one consultant in information systems that was not included in our headcount.

Zoom's cash balance on March 31, 2014 was $39 thousand, down $16 thousand from December 31, 2013. Zoom's maximum available line of credit was $1.25 million on March 31, 2014, and bank debt outstanding under this line of credit was $455 thousand. Zoom's $0.1 million increase in bank debt and $0.2 million increase in other current liabilities in Q1 2014 increased cash, while a $0.2 million increase in net accounts receivable and $0.2 million increase in net inventory decreased cash.

On March 31, 2014 the Company had working capital of $2.3 million including $39 thousand in cash and cash equivalents. On December 31, 2013 we had working capital of $2.3 million including $55 thousand in cash and cash equivalents. Our current ratio at March 31, 2014 was 2.4 compared to 2.8 at December 31, 2013.

On December 18, 2012, we entered into a Financing Agreement with Rosenthal & Rosenthal, Inc. (the "Financing Agreement"). The Financing Agreement provided for up to $1.75 million of revolving credit, subject to a borrowing base formula and other terms and conditions as specified in the Financing Agreement. The Financing Agreement has a two year term. Borrowings are secured by all of our assets including our intellectual property. On March 25, 2014, we entered into an amendment to the Financing Agreement (the "Amendment") with an effective date of January 1, 2013. The Amendment clarified the definition of current assets in the Financing Agreement, reduced the size of the revolving credit line to $1.25 million, and revised the financial covenants such that we are required to maintain tangible net worth of not less than $2.0 million and working capital of not less than $1.75 million.

On March 31, 2014 Zoom was in compliance with the covenants of the Financing Agreement with Rosenthal & Rosenthal, Inc.

Critical Accounting Policies and Estimates

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

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

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

- computer peripherals retailers,
- computer product distributors,
- Internet service providers, and
- original equipment manufacturers (OEMs)

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

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

Product Returns. Products are returned by retail stores and distributors for inventory balancing, contractual stock rotation privileges, and warranty repair or replacements. We estimate the sales and cost value of expected future product returns of previously sold products. Our estimates for product returns are based on recent historical trends plus estimates for returns prompted by, among other things, announced stock rotations and announced customer store closings. Management reviews historical returns, current economic trends, and changes in customer demand and acceptance of our products when estimating sales return allowances. The estimate for future returns is recorded as a reserve against accounts receivable, a reduction in our net sales, and the corresponding change to inventory reserves and cost of sales. Product returns as a percentage of total shipments were 11.9% and 16.3% for the first quarter of 2014 and 2013, respectively.

Price Protection Refunds. We have a policy of offering price protection to certain of our retailer and distributor customers for some or all their inventory. Under the price protection policies, when we reduce our prices for a product, the customer receives a credit for the difference between the original purchase price and our reduced price for their unsold inventory of that product. Our estimates for price protection refunds are based on a detailed understanding and tracking by customer and by sales program. Estimated price protection refunds are recorded in the same period as the announcement of a pricing change. Information from customer inventory-on-hand reports or from direct communications with the customers is used to estimate the refund, which is recorded as a reduction of net sales and a reserve against accounts receivable. Reductions in our net sales due to price protection were negligible in both the first quarter of 2014 and the first quarter of 2013.

Sales and Marketing Incentives. Many of our retailer customers require sales and marketing support funding, usually set as a percentage of our sales in their stores. The incentives were reported as reductions in our net sales and were $37 thousand in the first quarter of 2014 and $51 thousand in the first quarter of 2013.

Consumer Mail-In and In-Store Rebates. Our estimates for consumer mail-in and in-store rebates are based on a detailed understanding and tracking by customer and sales program, supported by actual rebate claims processed by the rebate redemption centers plus an accrual for an estimated lag in processing at the redemption centers. The estimate for mail-in and in-store rebates is recorded as a reserve against accounts receivable and a reduction of net sales in the same period that the rebate obligation was triggered. Reductions in our net sales due to the consumer rebates were $74 thousand in the first quarter of 2014 and negligible in the first quarter of 2013.

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

Accounts Receivable Valuation. We establish accounts receivable valuation allowances equal to the above-discussed net sales adjustments for estimates of product returns, price protection refunds, consumer rebates, and general bad debt reserves. These allowances are reduced as actual credits are issued to the customer's accounts. Our bad-debt write-offs were negligible in both the first quarter of 2014 and the first quarter of 2013.

Inventory Valuation and Cost of Goods Sold. Inventory is valued at the lower of cost, determined by the first-in, first-out method, or market. We review inventories for obsolete slow moving products each quarter and make provisions based on our estimate of the probability that the material will not be consumed or that it will be sold below cost. Additional charges to inventory reserves related to obsolete and slow-moving products were negligible in both the first quarter of 2014 and the first quarter of 2013.

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

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

As of December 31, 2013 the Company had federal net operating loss carry forwards of approximately $49,363,000 which are available to offset future taxable income. They are due to expire in varying amounts from 2018 to 2033. As of December 31, 2013, the Company had Massachusetts state net operating loss carry forwards of approximately $8,069,000 which are available to offset future taxable income. They are due to expire in varying amounts from 2014 through 2018.

Valuation of Investments. In October 2010 Zoom Telephonics, Inc. entered into an agreement with Zoom Technologies, Inc. (Nasdaq: ZOOM) in which Zoom Telephonics transferred its rights to the zoom.com domain name and certain trademark rights in exchange for 80,000 shares of Zoom Technologies common stock. These shares had trading restrictions that ended January 18, 2012. The Company valued the marketable securities at market value in the financial statements. In the fourth quarter of 2013, Zoom Technologies, Inc. announced a reverse merger resulting in a 10:1 split so that the 80,000 shares became 8,000 shares. In December 2013 the Company sold all 8,000 shares of Zoom Technologies, Inc. stock. The Company received proceeds of $40 thousand and reported a realized loss of $273 thousand in 2013.

Results of Operations

Summary. Net sales were $3.1 million for our first quarter ended March 31, 2014, up 11.6% from $2.8 million in the first quarter of 2013. Zoom reported a net loss of $37 thousand or $0.00 per share for the first quarter of 2014 (“Q1 2014”), compared to Zoom’s net loss of $334 thousand or $0.05 per share for the first quarter of 2013 (“Q1 2013”).

Net Sales. Our total net sales for the first quarter of 2014 increased $329 thousand or 11.6% from the first quarter of 2013, primarily due to sales increases in North America, offset by declines in the international and UK markets. Geographically, our North American sales continue to maintain their dominant share of our overall sales, going from 91% of our net sales in Q1 2013 to 98% in Q1 2014. Our second largest market, the UK, experienced a significant decline from 5% of our net sales in Q1 2013 to 1% in Q1 2014.

In the first quarter of 2014, three customers accounted for 73% of our total net sales with our largest customer accounting for 56% of our net sales. In the first quarter of 2013, three customers accounted for 63% of the Company’s total net sales with our largest customer accounting for 45% of our net sales. Because of our significant customer concentration, our net sales and operating income has fluctuated and could in the future fluctuate significantly due to changes in political or economic conditions or the loss, reduction of business, or less favorable terms for any of our significant customers.

Gross Profit. Gross profit was $932 thousand or 29.6% of net sales in Q1 2014, versus $704 thousand or 25.0% of net sales in Q1 2013. The increases in gross profit was due to increased sales, which lowered the overhead per unit, and to reductions in the unit cost of some products.

Selling Expense. Selling expense was $353 thousand or 11.2% of net sales in the first quarter of 2014 compared to $423 thousand or 15.0% of net sales in the first quarter of 2013. The decrease in selling expense is due primarily to decreases in salary and salary-related benefit costs.

General and Administrative Expense. General and administrative expense was $292 thousand or 9.3% of net sales in the first quarter of 2014, down from $340 thousand or 12.1% of net sales in the first quarter of 2013. Most of the decrease was in personnel reductions as a result of reduced work weeks for many employees.

Research and Development Expense. Research and development expense was $309 thousand or 9.8% of net sales in the first quarter of 2014 and $259 thousand or 9.2% of net sales in the first quarter of 2013. An increase in product certification costs was a significant contributor to the $50 thousand increase from Q1 2013 to Q1 2014.

Other Income (Expense). Other income (expense), net was $(14) thousand in the first quarter of 2014, and $(16) thousand in the first quarter of 2013, consisting primarily of interest expense related to the line of credit agreement.

Liquidity and Capital Resources

Zoom's cash balance on March 31, 2014 was $39 thousand, down $16 thousand from December 31, 2013. Zoom's maximum available line of credit was $1.25 million on March 31, 2014, of which bank debt outstanding under this line of credit was $455 thousand. Zoom's $0.1 million increase in bank debt and $0.2 million increase in other current liabilities in Q1 2014 increased cash, while a $0.2 million increase in net accounts receivable and $0.2 million increase in net inventory decreased cash.

On March 31, 2014 the Company had working capital of $2.3 million including $39 thousand in cash and cash equivalents. On December 31, 2013 we had working capital of $2.3 million including $55 thousand in cash and cash equivalents. Our current ratio at March 31, 2014 was 2.4 compared to 2.8 at December 31, 2013.

To conserve cash and manage our liquidity, we have for years implemented cost-cutting initiatives including the reduction of employee headcount and overhead costs. On March 31, 2014 we had 27 employees, down from 30 employees on March 31, 2013. We plan to continue to assess our cost structure as it relates to our revenues and cash position, and we may make further reductions if appropriate.

On December 18, 2012, we entered into a Financing Agreement with Rosenthal & Rosenthal, Inc. (the "Financing Agreement"). The Financing Agreement provided for up to $1.75 million of revolving credit, subject to a borrowing base formula and other terms and conditions as specified in the Financing Agreement. The Financing Agreement has a two year term. Borrowings are secured by all of our assets including our intellectual property. On March 25, 2014, we entered into an amendment to the Financing Agreement (the "Amendment") with an effective date of January 1, 2013. The Amendment clarified the definition of current assets in the Financing Agreement, reduced the size of the revolving credit line to $1.25 million and revised the financial covenants such that we are required to maintain tangible net worth of not less than $2.0 million and working capital of not less than $1.75 million.

On March 31, 2014 Zoom was in compliance with the covenants of the Financing Agreement with Rosenthal & Rosenthal, Inc.

The Company is continuing to develop new products and to take other measures to increase sales. Increasing sales typically result in increased inventory and higher accounts receivable, both of which reduce cash. Zoom has one significant customer who buy from Zoom on a consignment basis. Consigned inventory tends to result in the slowest payment to Zoom, since Zoom is only paid after the consigned inventory is sold by Zoom's customer.

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

Commitments

During the three months ended March 31, 2014, there were no material changes to our capital commitments and contractual obligations from those disclosed in our Form 10-K for the year ended December 31, 2013.

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

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

In some cases, you can identify forward-looking statements by terms such as "may," "will, " "should," "could," "would," "expects," "plans," "anticipates," "believes," "estimates," "projects," "predicts," "potential" and similar expressions intended to identify forward-looking statements. These statements are only predictions and involve known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by such forward-looking statements. Given these uncertainties you should not place undue reliance on these forward-looking statements. Also, these forward-looking statements represent our estimates and assumptions only as of the date of this report. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained in this report to reflect any change in our expectations or any change in events, conditions or circumstances on which any of our forward-looking statements are based. Factors that could cause or contribute to differences in our future financial results include those discussed in the risk factors set forth in Item 1A of Part II below as well as those discussed elsewhere in this report, in our Annual Report on Form 10-K for the year ended December 31, 2013, filed with the SEC on March 31, 2014 and in our other filings with the SEC.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Required.

ITEM 4. CONTROLS AND PROCEDURES

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

As of March 31, 2014 we carried out an evaluation, under the supervision and with the participation of our management including our Chief Executive Officer and Acting Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and Acting Chief Financial Officer concluded that our disclosure controls and procedures are effective in enabling us to record, process, summarize and report information required to be included in our periodic SEC filings within the required time period.

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

PART II OTHER INFORMATION

ITEM 1A. RISK FACTORS

This report contains forward-looking statements that involve risks and uncertainties, such as statements of our objectives, expectations and intentions. The cautionary statements made in this report are applicable to all forward-looking statements wherever they appear in this report. Our actual results could differ materially from those discussed herein. Factors that could cause or contribute to such differences include the risk factors contained in our Annual Report on Form 10-K for the year ended December 31, 2013, filed with the SEC on March 31, 2014, as well as those discussed in this report and in our other filings with the SEC.

Other than as set forth below, there have not been any material changes from the risk factors previously disclosed under Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2013.

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

Over the next twelve months we will probably require additional funding. We currently have a line of credit of up to $1.25 million from which we can borrow, and this line is subject to covenants that must be met. It is not certain whether all or part of this line of credit will be available to us in the future; and other sources of financing may not be available to us on a timely basis if at all, or on terms acceptable to us. If we fail to obtain acceptable additional financing when needed, we may not have sufficient resources to fund our normal operations; and this would have a material adverse effect on our business.

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

The audit report issued by our independent registered public accounting firm for our financial statements for the fiscal year ended December 31, 2013 states that the auditing firm has substantial doubt in our ability to continue as a going concern due to the risk that we may not have sufficient cash and liquid assets at December 31, 2013 to cover our operating and capital requirements for the next twelve-month period; and if in that case sufficient cash cannot be obtained, we would have to substantially alter, or possibly even discontinue, operations. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty.

We may experience costs and senior management distractions due to patent-related matters.

Many of our products incorporate patented technology. We attempt to license appropriate patents either directly or through our integrated circuit suppliers. However, we are subject to costs and senior management distractions due to patent-related litigation On November 6, 2013 Innovative Wireless Solutions, LLC (“IWS”) filed a complaint against Zoom Telephonics alleging infringement of U.S. Patents Nos. 5,912,895, 6,327,264, and 6,587,473 all entitled “Information Network Access Apparatus and Methods of Communicating Information packets via Telephone Links.” The Complaint asserts that Zoom sells products with “wireless access points and/or routers capable of connecting to an Ethernet network and an IEEE 802.11 wireless network to provide wireless Internet access.” The case is in its early stages and a Scheduling conference is currently set for May 22, 2014. Patent litigation matters are complex and time consuming and expose Zoom to potentially material obligations. It is impossible to assess the potential cost and senior management distraction associated with patent litigation matters that are currently outstanding or may occur in the future.

Our reliance on a small number of customers for a large portion of our revenues could materially harm our business and prospects.

Relatively few customers have accounted for a substantial portion of the Company's revenues. In Q1 2014 three customers accounted for 73% of our total net sales, with our largest customer accounting for 56% of our net sales. One customer accounted for 73% of our net accounts receivable on March 31, 2014. In 2013 three customers accounted for 69% of our total net sales with our largest customer accounting for 51% of our net sales. At December 31, 2013, three customers accounted for 84% of our gross accounts receivable, with our largest customer representing 71% of our gross accounts receivable. Our customers generally do not enter into long-term agreements obligating them to purchase our products. We may not continue to receive significant revenues from any of these or from other large customers. Because of our significant customer concentration, our net sales and operating income could fluctuate significantly due to changes in political or economic conditions or the loss of, reduction of business with, or less favorable terms for any of our significant customers. A reduction or delay in orders from any of our significant customers, or a delay or default in payment by any significant customer could materially harm our business, results of operation and liquidity.

ITEM 6. EXHIBITS

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

ZOOM TELEPHONICS, INC.

SIGNATURES

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

ZOOM TELEPHONICS, INC.
(Registrant)

Date: May 15, 2014	By:	/s/ Frank B. Manning Frank B. Manning, President, Chief Executive Officer and Acting Chief Financial Officer (Principal Executive Officer and Principal Financial Officer)

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