Zoom Telephonics, Inc.
Form 10-Q
November 14, 2011

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 September 30, 2011

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

The number of shares outstanding of the registrant's Common Stock, $.01 par value, as of November 10, 2011, was 5,450,622 shares.

ZOOM TELEPHONICS, INC.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ZOOM TELEPHONICS, INC.
Condensed Balance Sheets
(Unaudited)

	September 30, 2011	December 31, 2010
ASSETS		
Current assets		
Cash and cash equivalents	$ 797,850	$ 1,009,996
Marketable securities	121,918	328,704
Accounts receivable, net of allowances of $721,542 at September 30, 2011 and $564,722 at December 31, 2010	1,008,941	1,079,413
Receivables, other	150,000	166,144
Inventories	2,465,534	2,713,616
Prepaid expenses and other current assets	201,913	172,971
Total current assets	4,746,156	5,470,844
Equipment, net	24,497	43,070
Total assets	$ 4,770,653	$ 5,513,914
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 1,139,476	$ 911,299
Accrued expenses	362,574	346,074
Total current liabilities	1,502,050	1,257,373
Total liabilities	1,502,050	1,257,373
Stockholders' equity		
Common stock, $0.01 par value:		
Authorized - 25,000,000 shares; issued – 5,450,622 shares at September 30, 2011 and December 31, 2010	54,506	54,506
Additional paid-in capital	33,486,083	33,388,753
Accumulated deficit	(30,443,821)	(29,568,392)
Accumulated other comprehensive income (loss)	171,835	381,674
Total stockholders' equity	3,268,603	4,256,541
Total liabilities and stockholders' equity	$ 4,770,653	$ 5,513,914

See accompanying notes.

ZOOM TELEPHONICS, INC.

Condensed Statements of Operations
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net sales	$ 3,046,790	$ 4,218,118	$ 9,020,942	$ 10,212,191
Cost of goods sold	2,287,504	2,825,219	6,705,032	7,155,597
Gross profit	759,286	1,392,899	2,315,910	3,056,594
Operating expenses:				
Selling	477,044	540,065	1,596,120	1,487,792
General and administrative	310,073	317,586	917,146	956,373
Research and development	235,733	253,652	747,096	852,963
	1,022,850	1,111,303	3,260,362	3,297,128
Operating profit (loss)	(263,564)	281,596	(944,452)	(240,535)
Other:				
Interest income	30	34	465	314
Other, net	(682)	(2,480)	70,006	59,614
Total other income (expense), net	(652)	(2,446)	70,471	59,928
Income (loss) before income taxes	(264,216)	279,150	(873,981)	(180,607)
Income tax expense (benefit)	542	—	1,448	389
Net income (loss)	$ (264,758)	$ 279,150	$ (875,429)	$ (180,996)
Earnings (loss) per share:				
Basic earnings (loss) per share	$ (0.05)	$ 0.14	$ (0.16)	$ (0.09)
Diluted income (loss) per share	$ (0.05)	$ 0.14	$ (0.16)	$ (0.09)
Weighted average common and common equivalent shares:				
Basic	5,450,622	1,980,978	5,450,622	1,980,978
Diluted	5,450,622	1,983,978	5,450,622	1,980,978

See accompanying notes.

ZOOM TELEPHONICS, INC.

Condensed Statements of Cash Flows
(Unaudited)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Operating activities:		
Net income (loss)	$ (875,429)	$ (180,996)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	20,116	21,471
Stock based compensation	97,330	80,298
Provision for (reversal of) accounts receivable allowances	157,000	87,199
Changes in operating assets and liabilities:		
Accounts receivable	(89,953)	(596,662)
Inventories	246,737	(723,523)
Prepaid expenses and other assets	(29,474)	(4,215)
Accounts payable and accrued expenses	243,348	528,524
Net cash provided by (used in) operating activities	(230,325)	(787,904)
Investing activities:		
Proceeds from sale of Unity investment	16,144	16,144
Additions to property, plant and equipment	(1,547)	(12,739)
Net cash provided by (used in) investing activities	14,597	3,405
Effect of exchange rate changes on cash	3,582	(730)
Net change in cash	(212,146)	(785,229)
Cash and cash equivalents at beginning of period	1,009,996	1,223,507
Cash and cash equivalents at end of period	$ 797,850	$ 438,278
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ —	$ —
Income taxes	$ 1,448	$ 389

See accompanying notes.

ZOOM TELEPHONICS, INC.
Notes to Condensed Financial Statements
(Unaudited)

(1) Summary of Significant Accounting Policies

On January 28, 2009, Zoom Technologies, Inc. entered into a Share Exchange Agreement (the “Agreement”) with Tianjin Tong Guang Group Digital Communication Co., Ltd (“TCB Digital”), TCB Digital’s majority shareholder, Gold Lion Holding Limited (“Gold Lion”) and Lei Gu (“Gu”), a shareholder of Gold Lion. On May 12, 2009, the parties amended the Agreement to, among other actions, add Songtao Du (“Du”), a shareholder of Gold Lion, as a party to the Agreement. On September 22, 2009, pursuant to the Agreement, Zoom Technologies acquired all the outstanding shares of Gold Lion. In addition, as part of the transaction, Zoom Technologies spun off its then-current business, which consisted of its ownership of Zoom Telephonics, to its stockholders, by distributing and transferring its assets and liabilities to Zoom Telephonics and issuing a dividend of the Zoom Telephonics’ shares to its stockholders.

For many years prior to the spin-off, Zoom Technologies was the public company parent of Zoom Telephonics, and the two companies’ financials were consolidated. Upon the completion of the spin-off, Zoom Telephonics became a separate, independent publicly traded company headquartered in Boston, Massachusetts. Zoom Telephonics continues to produce, market, sell, and support dial-up modems, fixed and mobile broadband products, WiFi® compatible and Bluetooth® wireless products, and other communication-related products (the “Communications Business”) .

As used in this Quarterly Report on Form 10-Q, the terms “we,” “us,” “our,” and the “Company” mean Zoom Telephonics Inc. (unless the context indicates a different meaning).

The Company has had recurring net losses and continues to experience negative cash flows from operations. To conserve cash and manage liquidity, the Company has implemented cost cutting initiatives including the reduction of employee headcount and overhead costs. Furthermore, 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.

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, 2010 included in the Company's 2010 Annual Report on Form 10-K.

The accompanying financial statements are unaudited. However, the condensed balance sheet as of December 31, 2010 was derived from audited financial statements. In the opinion of management, the accompanying financial statements include all adjustments, normal recurring adjustments, necessary for a fair presentation.

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 September 30, 2011 through the date of this filing and determined that there are no such events requiring recognition or disclosure in the financial statements.

(2) Liquidity

On September 30, 2011 we had working capital of $3.2 million including $0.8 million in cash and cash equivalents. On December 31, 2010 we had working capital of $4.2 million including $1.0 million in cash and cash equivalents. Our current ratio at September 30, 2011 was 3.2 compared to 4.4 at December 31, 2010.

The decrease in cash was primarily due to a $0.9 million loss, partially offset by a $0.1 million decrease in net accounts receivable, a $0.2 million decrease in inventory, a $0.2 million increase in accounts payable, and $0.1 million incurred in stock-based compensation expense. Zoom has no long-term debt.

The Company is continuing to develop new products and to work with its distribution partners with the goal of increasing sales. During the second quarter of 2011 Zoom began selling to some of its major US retailers a new wireless-N cable modem/router and two new mobile broadband routers, and Zoom expanded the shelf space for one of its dial-up modems in one US major retailer.

The Company has had recurring net losses and continues to experience negative cash flows from operations. Furthermore, 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. Refer to “Risk Factors” set forth in our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the Securities and Exchange Commission (“SEC”) on March 29, 2011 and in our other filings with the SEC for additional information with respect to events and uncertainties that could harm our business, operating results and financial condition.

On September 13, 2011 the Company announced a rights offering to its shareholders scheduled to end November 7, 2011 unless the Company extended it. The offering was extended to November 11, 2011. This rights offering granted Zoom shareholders the right to purchase an aggregate of up to $2.9 million in shares of common stock at a price of $0.27 per share. It is now clear that the rights offering will be completed, and that the Company will sell at least 1,523,082 shares for gross receipts of $411,232.14 before expenses. If there is any increase beyond this amount, it will only come from beneficial shareholders whose purchase agreement has been mailed on or before November 11, 2011 and not yet received.

(3) Inventories

Inventories consist of :	September 30, 2011	December 31, 2010
Raw materials	$ 938,421	$ 1,165,383
Work in process	129,392	5,314
Finished goods (including $537,000 and $633,000 held by a customer at September 30, 2011 and December 31, 2010, respectively)	1,397,721	1,542,919
Total inventories	$ 2,465,534	$ 2,713,616

(4) Comprehensive Income (Loss)

Comprehensive income (loss) follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net income (loss)	$ (264,758)	$ 279,150	$ (875,429)	$ (180,996)
Foreign currency translation adjustment	(8,866)	—	(3,053)	—
Unrealized gain (loss) on securities	(71,154)	23,487	(206,786)	8,746
Comprehensive income (loss)	$ (344,778)	$ 302,637	$ (1,085,268)	$ (172,250)

(5) Contingencies

The Company is not currently party to any lawsuit, but lawsuits may occur 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 claims that it believes are without merit.

(6) 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 September 30, 2011	% of Total	Three Months Ended September 30, 2010	% of Total	Nine Months Ended September 30, 2011	% of Total	Nine Months Ended September 30, 2010	% of Total
North America	$ 2,712,720	89%	$ 3,622,012	86%	$ 8,066,050	90%	$ 8,588,648	84%
UK	210,051	7%	305,177	7%	571,229	6%	846,958	8%
All Other	124,019	4%	290,929	7%	383,663	4%	776,585	8%
Total	$ 3,046,790	100%	$ 4,218,118	100%	$ 9,020,942	100%	$ 10,212,191	100%

(7) Customer Concentrations

Relatively few customers account for a substantial portion of the Company's net sales. In the third quarter of 2011 the Company's net sales to its top three customers accounted for 60% of its total net sales. In the third quarter of 2010 the Company's net sales to its top three customers accounted for 55% of its total net sales. The Company's customers generally do not enter into long-term agreements obligating them to purchase the Company's 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 could 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. In the first nine months of 2011, the Company's net sales to its top three customers accounted for 53% of its total net sales. In the first nine months of 2010, the Company's net sales to its top three customers accounted for 52% of its total net sales.

(8) Investments

During the quarter ended September 30, 2007, the Company purchased all the Series A Preferred Shares (the Series A Shares) of Unity Business Networks, LLC (Unity) for cash of $1.2 million, including transaction costs. The Series A Shares were convertible at any time at the Company's option into 15% of Unity's common stock on a fully-diluted basis. In addition, the Company had an option to purchase all the outstanding common stock of Unity based on a specified multiple of Unity's 2008 revenues, as defined.

On September 30, 2009 the Company received a cash payment of $766,950 in connection with Telesphere Networks' purchase of the VoIP services business of Unity, including Zoom's preferred stock investment described above. The transaction called for additional periodic payments totaling $43,050 over 24 months beginning in October 2009 and a final payment of $150,000 on September 30, 2011, or $960,000 in total. The periodic payments have been received, and the remaining balance is recorded on the September 30, 2011 balance sheet as a current other receivable of $150,000. The final payment of $150,000 was received and deposited to the Company's account on October 13, 2011.

(9) 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. None of these shares could be sold for the first 6 months after the effective date of October 18, 2010. After the first 6 months, Zoom Telephonics may sell up to 20,000 of these shares, and may sell an additional 20,000 shares every three months thereafter. Due to these restrictions on selling the stock, the Company has valued the marketable securities at market value less a liquidity discount. The Company did not sell any Zoom Technologies shares during the first nine months of 2011. The closing price of Zoom Technologies common stock declined from $4.47 on December 31, 2010 to $1.54 on September 30, 2011.

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, 2010, filed with the SEC on March 29, 2011 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 dial-up modems, fixed and mobile broadband products, WiFi® compatible and Bluetooth® wireless products, and other communication-related products. We sell these products primarily to retailers, distributors, Internet Service Providers and Original Equipment Manufacturers. We sell our products through a direct sales force and through independent sales agents. Our employees are primarily located at our headquarters in Boston, Massachusetts and our sales office in the United Kingdom. We are experienced in electronics hardware, firmware, and software design and test, regulatory approvals, 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 in China.

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. On June 30, 2006 we announced our plans to move most of our Summer Street operations to a dedicated facility in Tijuana, Mexico commencing approximately September 1, 2006, and we have since implemented that plan. In August 2006 we signed a lease for a 35,575 square foot manufacturing and warehousing facility in Tijuana, Mexico with an initial lease term from October 2006 to May 2007, with five two-year options thereafter. In February, 2007 we renegotiated the first renewal term and signed a one-year extension starting in May 2007, with five two-year options thereafter. We signed a one-year extension starting in May 2008. In March 2009 we signed a one-year lease with one one-year option for a smaller facility for lower cost. In March 2011 we signed a one-year lease extension starting May 1, 2011, with three one-year renewal options thereafter.

Since 1983 our headquarters has been near South Station in downtown Boston. Zoom historically owned two adjacent buildings which connect on most floors, and which house our entire Boston staff. In December 2006 we sold our headquarters buildings to a third party, with a two-year lease-back of approximately 25,000 square feet of the 62,000 square foot facility. Our net sale proceeds were approximately $7.7 million of which approximately $3.6 million was repaid to our mortgage holder, eliminating the mortgage debt from our balance sheet. In January 1, 2009 we reduced our leased Boston space from 25,000 square feet to 14,400 square feet with an increase in rent per square foot, resulting in a savings in 2009 of $54,000. 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.

For many years we derived a majority of our net sales from the retail after-market sale of dial-up modems to customers seeking to add or upgrade a modem for their personal computers. In recent years the size of this market and our sales to this market have declined, as personal computer manufacturers have incorporated a modem as a built-in component in most consumer personal computers and as increasing numbers of consumers world-wide have switched to broadband Internet access. The consensus of communications industry analysts is that after-market sales of dial-up modems will probably continue to decline. There is also consensus among industry analysts that the installed base for broadband Internet connection devices, such as cable modems and DSL modems, will grow rapidly during the decade. In response to increased and forecasted worldwide demand for faster connection speeds and increased modem functionality, we have invested and continue to invest resources to advance our product line of broadband modems, both DSL modems and cable modems.

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 each 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 response to lower sales volume, we have cut costs by reducing staffing and some overhead costs. Our total headcount was reduced from 38 on September 30, 2010 to 33 on September 30, 2011. As of September 30, 2011 Zoom had 32 full-time and part-time employees and 1 full-time contractor. Of the 33 included in our headcount on September 30, 2011, 7 were engaged in research and development, 8 were involved in manufacturing management, purchasing, assembly, packaging, shipping and quality control, 12 were engaged in sales, marketing and technical support, and the remaining 6 performed accounting, administrative, management information systems, 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 27 full-time employees, 1 full-time contractor and 5 employees working less than 5 days per week. On September 30, 2011, Zoom had 20 dedicated manufacturing personnel in Mexico who are employees of our Mexican manufacturing service provider and not included in our headcount.

On September 30, 2011 we had working capital of $3.2 million including $0.8 million in cash and cash equivalents. On December 31, 2010 we had working capital of $4.2 million including $1.0 million in cash and cash equivalents. Our current ratio at September 30, 2011 was 3.2 compared to 4.4 at December 31, 2010.

The decrease in cash was primarily due to a $0.9 million loss, partially offset by a $0.1 million decrease in net accounts receivable, a $0.2 million decrease in inventory, a $0.2 million increase in accounts payable, and $0.1 million incurred in stock-based compensation expense. Zoom has no long-term debt.

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 18.7% and 7.9%, for the third quarter of 2011 and 2010, respectively. One reason for the increase in return percentage is that a higher percentage of Zoom's sales came from high volume U.S. retailers in the third quarter of 2011, and high volume retailers typically have the highest return percentage among Zoom categories because customers are typically allowed to return non-defective products. Another reason for the increase in return percentage was that Zoom's sales included a higher percentage of cable modems in the third quarter of 2011, and cable modems suffer from higher returns than other top-selling Zoom products because some cable service providers do not provide a service discount to customers who supply their own cable modem, thereby reducing the value of a Zoom cable modem to a customer using that cable service. Some customers don't realize this fact until after they've purchased the Zoom cable modem, and those customers often return the product. Very recently Zoom cable modem packages state which large cable service providers offer a discount to customers who supply their own cable modems, and which ones do not, in an attempt to discourage purchases by customers who are likely to return their Zoom cable modem.

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 $2.6 thousand and $10.5 thousand in the third quarter of 2011 and 2010, respectively.

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 $100.6 thousand in the third quarter of 2011 and $125.9 thousand in the third quarter of 2010.

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 $12.2 thousand in the third quarter of 2011 and $17.3 thousand in the third quarter of 2010.

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 third quarter of 2011 and the third quarter of 2010.

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 write-downs related to obsolete and slow-moving products were negligible in the third quarter of 2011 and $26.2 thousand in the third quarter of 2010.

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 of the 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(s).

As of December 31, 2010 the Company had federal net operating loss carry forwards of approximately $45,219,000 which are available to offset future taxable income. They are due to expire in varying amounts from 2018 to 2029. As of December 31, 2010, the Company had Massachusetts state net operating loss carry forwards of approximately $16,640,000 which are available to offset future taxable income. They are due to expire in varying amounts from 2011 through 2014.

Results of Operations

Summary. Net sales were $3.0 million for our third quarter ended September 30, 2011, down from $4.2 million in the third quarter of 2010. We reported a net loss of $265 thousand for the third quarter of 2011, compared to net income of $279 thousand in the third quarter of 2010. Net loss per diluted share was $0.05 in the third quarter of 2011 compared to a net income per diluted share of $0.14 for the third quarter of 2010. Net sales were $9.0 million for the nine months ended September 30, 2011, down from $10.2 million for the nine months ended September 30, 2010. We had a net loss of $0.9 million for the first nine months ended September 30, 2011 compared to a net loss of $0.2 million for the nine months ended September 30, 2010. Net loss per diluted share was $0.16 in the nine months ended September 30, 2011 compared to $0.09 for the nine months ended September 30, 2010.

Net Sales. Our total net sales for the third quarter of 2011 decreased $1.2 million or 28% from the third quarter of 2010, primarily due to a decline in dial-up modem revenues of $950 thousand.

Our total net sales for the first nine months of 2011 decreased $1.2 million or 12% from the first nine months of 2010, due to a $1.5 million drop in dial-up modem sales and smaller declines in ADSL and non-broadband products which were partially offset by sales gains for cable modem and mobile broadband products.

Zoom tracks sales geographically in three main categories – North America, the UK, and All Other. North America is the largest, representing 89% of Zoom’s sales in the third quarter of 2011 and 90% of Zoom’s sales in the first nine months of 2011. Sales in all three geographic categories decreased from the third quarter of 2010 to the third quarter of 2011, and from the first nine months of 2010 to the first nine months of 2011.

In the quarter ended September 30, 2011 three customers accounted for 60% of total net sales. In the first nine months of 2011 the Company's top three customers accounted for 53% of total 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. Our total gross profit was $0.8 million in the third quarter of 2011, down from $1.4 million in the third quarter of 2010 primarily due to lower net sales. Our gross margin percent of net sales was 24.9% in the third quarter of 2011 compared to 33.0% in the third quarter of 2010. The decrease in gross profit was primarily due to lower sales in the third quarter of 2011, resulting in higher margin impact from fixed production costs.

Our total gross profit was $2.3 million for the first nine months of 2011, down $0.7 million or 24.2% from our gross profit of $3.1 million for the first nine months of 2010 primarily due to lower net sales. Our gross margin for the first nine months of 2011 was 25.7%, down from our gross margin of 29.9% for the first nine months of 2010.

Selling Expense. Selling expense was $477 thousand or 15.7% of net sales in the third quarter of 2011 compared to $540 thousand or 12.8% of net sales in the third quarter of 2010. The decrease in selling expense was primarily due to decreased sales, which resulted in lower variable selling expenses including freight for shipments to customers and sales commissions. Selling expense was $1.60 million or 17.7% of net sales for the first nine months of 2011, up from $1.49 million or 14.6% of sales in the first nine months of 2010. The dollar increase for the first nine months of 2011 was due primarily to higher freight and advertising costs.

General and Administrative Expense. General and administrative expense was $310 thousand or 10.2% of net sales in the third quarter of 2011, down from $318 thousand or 7.5% of net sales in the third quarter of 2010. General and administrative expense decreased in the third quarter of 2011 compared to the third quarter of 2010 primarily due to lower personnel costs. General and administrative expense was $917 thousand or 10.2% of net sales for the first nine months of 2011, down from $956 million or 9.4 % for the first nine months of 2010 primarily due to lower personnel costs.

Research and Development Expense. Research and development expense was $236 thousand or 7.7% of net sales in the third quarter of 2011, down from $254 thousand or 6.0% of net sales in the third quarter of 2010, with the reduction primarily due to lower personnel costs. Research and development expense was $747 thousand or 8.3% of net sales in the first nine months of 2011, down from $853 thousand or 8.4% of net sales in the first nine months of 2010, with the reduction primarily due to lower personnel costs.

Other Income. Other income (expenses) was negligible in the third quarter of both 2011 and 2010. Other income was $70 thousand in the first nine months of 2011 and $60 thousand in the first nine months of 2010.

Net Income (Loss). Net loss was $265 thousand for the third quarter of 2011, compared to a net income of $279 thousand for the third quarter of 2010 primarily due to lower net sales and gross profit in the third quarter of 2011. Net loss was $875 thousand for the first nine months of 2011, compared to net loss of $181 thousand for the first nine months of 2010. The increase in net loss was due to decreased net sales and lower gross profit in the first nine months of 2011.

Liquidity and Capital Resources

On September 30, 2011 we had working capital of $3.2 million including $0.8 million in cash and cash equivalents. On December 31, 2010 we had working capital of $4.2 million including $1.0 million in cash and cash equivalents. Our current ratio at September 30, 2011 was 3.2 compared to 4.4 at December 31, 2010.

The decrease in cash was primarily due to a $0.9 million loss, partially offset by a $0.1 million decrease in net accounts receivable, a $0.2 million decrease in inventory, a $0.2 million increase in accounts payable, and $0.1 million incurred in stock-based compensation expense. Zoom has no long-term debt.

To conserve cash and manage our liquidity, we have implemented cost-cutting initiatives including the reduction of employee headcount and overhead costs. On September 30, 2011 we had a headcount of 33, including 27 full-time employees and 5 part-time employees and 1 contractor compared to a headcount of 37 as of September 30, 2010. As of November 1, 2011 we had a headcount of 32 including full-time and part-time employees and 1 contractor. 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 the actions are deemed necessary.

The Company has had recurring net losses and continues to experience negative cash flows from operations. Furthermore, 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. Refer to “Risk Factors” set forth in our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the Securities and Exchange Commission (“SEC”) on March 29, 2011 and in our other filings with the SEC for additional information with respect to events and uncertainties that could harm our business, operating results and financial condition.

On September 13, 2011 the Company announced a rights offering to its shareholders scheduled to end November 7, 2011 unless the Company extended it. The offering was extended to November 11, 2011. This rights offering granted Zoom shareholders the right to purchase an aggregate of up to $2.9 million in shares of common stock at a price of $0.27 per share. It is now clear that the rights offering will be completed, and that the Company will sell at least

1,523,082 shares for gross receipts of $411,232.14 before expenses. If there is any increase beyond this amount, it will only come from beneficial shareholders whose purchase agreement has been mailed on or before November 11, 2011 and not yet received.

Commitments

During the nine months ended September 30, 2011, 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, 2010.

"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, 2010, filed with the SEC on March 29, 2011 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 September 30, 2011 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, 2010, filed with the SEC on March 29, 2011, as well as those discussed in this report and in our other filings with the SEC.

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

Over the next twelve months we may require additional funding if, for instance, we experience losses or significantly increase our investments in new product development and promotion. In Q3 and Q4 2010 we enjoyed profits, but in the first three quarters of 2011 we experienced losses. We currently have no line of credit from which we can borrow. Additional 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, 2010 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, 2010 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.

Our cable modem sales may be significantly reduced due to long lead-times.

Zoom currently sells two Docsis 3.0 cable modems, including a model that began shipping recently and that includes a built-in wireless-N router. Our Docsis 3.0 cable modems are primarily sold through high-volume retailers. We have enjoyed unexpectedly strong demand for the wireless-N cable modem, but long lead-times due to current component production lead-times of up to 20 weeks may significantly reduce our potential sales.

ITEM 6. EXHIBITS

Exhibit No.	Exhibit Description
31.1	CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	CEO 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: November 14, 2011	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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