FARMSTEAD TELEPHONE GROUP INC
Form 10-Q
August 14, 2006

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

Form 10-Q

(Mark One)
[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended June 30, 2006
or
[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Commission File Number: 001-12155

One IP Voice, Inc.
(Exact name of registrant as specified in its charter)

Delaware	06-1205743
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
22 Prestige Park Circle East Hartford, CT	06108
(Address of principal executive offices)	(Zip Code)

(860) 610-6000
(Registrant's telephone number)

Farmstead Telephone Group, Inc.
(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 [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ]   Accelerated filer [ ]   Non-accelerated filer [x]

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

As of July 31, 2006, the registrant had 4,057,532 shares of its $0.001 par value Common Stock outstanding.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (Unaudited)
Consolidated Balance Sheets - June 30, 2006 and December 31, 2005......................
Consolidated Statements of Operations - Three and Six Months Ended June 30, 2006 and 200
Consolidated Statement of Changes in Stockholders' Equity (Deficiency) - Six Months Ende
June 30, 2006..
Consolidated Statements of Cash Flows - Six Months Ended June 30, 2006 and 2005........
Notes to Consolidated Financial Statements...

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK ....

ITEM 4. CONTROLS AND PROCEDURES ....

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS..

ITEM 1A. RISK FACTORS...

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

ITEM 3. DEFAULTS UPON SENIOR SECURITIES...

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

ITEM 5. OTHER INFORMATION..

ITEM 6. EXHIBITS ....

SIGNATURES...

PART I - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS.

ONE IP VOICE, INC.
(f/k/a Farmstead Telephone Group, Inc.)

CONSOLIDATED BALANCE SHEETS

(In thousands)	June 30, 2006
	(Unaudited)
ASSETS	

Current assets:	
Cash and cash equivalents	$ 732
Accounts receivable, net	3,147
Inventories, net	861
Other current assets	228
Total Current Assets	4,968
Property and equipment, net	733
Deferred financing costs	487
Other assets	116
Total Assets	$ 6,304
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIENCY)	
Current liabilities:	
Accounts payable	$ 3,044
Accrued expenses and other current liabilities	524
Current portion of convertible debt, net of unamortized discount (Note 4)	661
Derivative financial instruments (Note 5)	618
Current portion of long-term debt (Note 3)	41
Total Current Liabilities	4,888
Postretirement benefit obligation	790
Convertible debt, net of unamortized discount (Note 4)	8
Derivative financial instruments (Note 5)	2,931
Long-term debt (Note 3)	55
Total Liabilities	8,672
Commitments and contingencies	
Stockholders' Equity (Deficiency):	
Preferred stock, $0.001 par value; 2,000,000 shares authorized; 259,426 and 0 Series A shares issued and outstanding at June 30, 2006 and December 30, 2005	177
Common stock, $0.001 par value; 30,000,000 shares authorized; 4,047,532 and 3,817,132 shares issued and outstanding at June 30, 2006 and December 31, 2005, respectively	4
Additional paid-in capital	13,093
Accumulated deficit	(15,630)
Accumulated other comprehensive loss	(12)
Total Stockholders' Equity (Deficiency)	(2,368)
Total Liabilities and Stockholders' Equity (Deficiency)	$ 6,304

See accompanying notes to consolidated financial statements.

3

ONE IP VOICE, INC.
(f/k/a Farmstead Telephone Group, Inc.)

CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
(In thousands, except loss per share amounts)	2006	2005	2006	20
Revenues:				
Equipment	$ 2,482	$3,723	$ 5,946	$ 5,6
Services and other revenue	773	760	1,723	1,2
Total revenues	3,255	4,483	7,669	6,8
Cost of Revenues:				
Equipment	1,918	2,695	4,335	4,0
Services and other revenue	546	321	1,191	5
Other cost of revenues	80	131	187	2
Total cost of revenues	2,544	3,147	5,713	4,8
Gross profit	711	1,336	1,956	2,0
Selling, general and administrative expenses	2,761	1,765	5,375	3,1
Operating loss	(2,050)	(429)	(3,419)	(1,0
Other income (expense):				
Interest expense	(61)	(48)	(145)	(
Derivative instrument income (Note 1)	4,297	681	1,663	2
Other income	13	1	15	
Total other income (expense)	4,249	634	1,533	2
Income (loss) before income taxes	2,199	205	(1,886)	(8
Provision for income taxes	3	3	10	
Net income (loss)	2,196	202	(1,896)	(8
Accretion of discount on preferred stock	25	-	26	-
Net income (loss) attributable to common stockholders	$ 2,171	$ 202	$(1,922)	$ (8
Net income (loss) per common share:				
Basic	$ .54	$ .06	$ (.49)	$ (.
Diluted	$ (.14)	$ .05	$ (.49)	$ (.
Weighted average common shares outstanding:				
Basic	4,002	3,353	3,930	3,3
Diluted	9,152	4,391	3,930	3,3

See accompanying notes to consolidated financial statements.

4

ONE IP VOICE, INC.
(f/k/a Farmstead Telephone Group, Inc.)

CONSOLIDATED STATEMENT OF CHANGES IN
STOCKHOLDERS' EQUITY (DEFICIENCY)

(UNAUDITED)
For the Six Months Ended June 30, 2006

(In thousands)	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accu ulat Defic
Balance at December 31, 2005	-	$ -	3,817	$4	$13,249	$(13,7
Net loss	-	-	-	-	-	(1,8
Amortization of pension liability adjustment	-	-	-	-	-	
Comprehensive loss						
Stock-based compensation	-	-	-	-	179	
Common stock issued under stock option and stock purchase plans	-	-	30	-	42	
Shares issued upon conversion of Laurus debt	-	-	190	-	202	
Warrants issued for notes payable	-	-	-	-	852	
Issuance of preferred stock	259	151	-	-	-	
Issue costs and expenses in connection with issuance of convertible note and Series A preferred stock	-	-	-	-	(507)	
Warrants for preferred and common stock issued in connection with issuance of convertible note and Series A preferred stock	-	-	-	-	(913)	
Common stock issued to consultant for services	-	-	10	-	15	
Accretion of discount on Series A preferred stock	-	26	-	-	(26)	
Balance at June 30, 2006	259	$177	4,047	$4	$13,093	$(15,6

See accompanying notes to consolidated financial statements.

5

ONE IP VOICE, INC.
(f/k/a Farmstead Telephone Group, Inc.)

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
For the Six Months Ended June 30, 2006 and 2005

(In thousands)	2006	2005

Cash Flows From Operating Activities:		
Net loss	$(1,896)	$ (830)
Adjustments to reconcile net loss to net cash used in operating activities:		
Provision for doubtful accounts receivable	18	18
Provision for losses on inventories	24	18
Depreciation and amortization of property and equipment	105	53
Amortization of deferred financing costs	48	23
Amortization of discounts on convertible notes	48	19
Unrealized (gain) loss on derivative instruments	(1,663)	(287)
Stock-based compensation expense	179	-
Value of common stock issued for services	15	-
Decrease in accumulated other comprehensive loss	4	5
Changes in operating assets and liabilities:		
Increase in accounts receivable	(40)	(2,032)
(Increase) decrease in inventories	(162)	180
Decrease in other assets	40	277
(Decrease) increase in accounts payable	(61)	1,564
(Decrease) increase in accrued expenses and other current liabilities	(15)	99
Increase in postretirement benefit obligation	71	63
Net cash used in operating activities	(3,285)	(830)
Cash flows from investing activities:		
Purchases of property and equipment	(188)	(18)
Net cash used in investing activities	(188)	(18)
Cash flows from financing activities:		
Repayment of BACC revolving loan advances	-	(179)
Borrowings under Laurus revolving loan facility	55	1,450
Proceeds from issuance of convertible note, net	913	-
Proceeds from issuance of Series A preferred stock, net	2,991	-
Deferred financing costs	-	(257)
Repayment of long-term debt and capital lease obligations	(18)	(10)
Proceeds from exercise of stock options and employee stock purchases	42	17
Net cash provided by financing activities	3,983	1,021
Net increase in cash and cash equivalents	510	173
Cash and cash equivalents at beginning of period	222	217
Cash and cash equivalents at end of period	$ 732	$ 390

6

Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ 68	$ 20
Income taxes	2	2
Supplemental disclosure of non-cash financing and investing activities:		
Purchase of equipment under capital lease	35	56
Common stock issued upon Laurus minimum borrowing note conversions	202	-
Discount on warrants issued to Laurus	-	335
Warrants issued in connection with convertible notes	852	-

Preferred shares issued on conversion of convertible note	628	-
Warrants issued to placement agent in connection with preferred shares and warrants issued to investors	3,460	-
Discounts on issuance of convertible debt	-	557

See accompanying notes to consolidated financial statements.

ONE IP VOICE, INC.
(f/k/a Farmstead Telephone Group, Inc.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. BASIS OF PRESENTATION, BUSINESS OPERATIONS, AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements presented herein consist of the accounts of One IP Voice, Inc., formerly known as Farmstead Telephone Group, Inc., and its wholly-owned subsidiaries. The accompanying consolidated financial statements as of June 30, 2006 and for the three and six months ended June 30, 2006 and 2005 have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules and regulations of the Securities and Exchange Commission for interim financial statements. In the Company's opinion, the unaudited interim consolidated financial statements and accompanying notes reflect all adjustments, consisting of normal and recurring adjustments, that are necessary for a fair statement of results for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results to be experienced for the entire fiscal year. This Form 10-Q should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

Corporate Name Change: Effective July 19, 2006 Farmstead Telephone Group, Inc. changed its corporate name to "One IP Voice, Inc.". Concurrently, the Company's wholly-owned subsidiary, One IP Voice, Inc., changed its corporate name to "OIPV Corp.".

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses and related disclosures in the consolidated financial statements. Actual results could differ from those estimates. Estimates are used in accounting for the allowances for uncollectible receivables, inventory obsolescence, depreciation, taxes and contingencies, among others. Estimates include the identification and valuation of derivative instruments, the amortization periods for debt issuance costs, and the amortization of discounts on convertible securities arising from bifurcated derivative instruments. Estimates are also used in determining product sales returns, which

7

are reflected as reductions to revenues. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the consolidated financial statements in the period they are determined to be necessary.

Derivative financial instruments

The identification of, and accounting for, derivative instruments is complex. Derivative financial instruments are initially measured at their fair value. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then revalued at each reporting date, with changes in the fair value reported as charges or credits to income. We determine the fair value of these instruments using the Black-Scholes option pricing model. That model requires assumptions related to the remaining term of the instruments and risk-free rates of return, our current common stock price and expected dividend yield, and the expected volatility of our common stock price over the life of the conversion option. We estimate the future volatility of our common stock price based on several factors, including the history of our stock price and the experience of other entities considered comparable to us. The identification of, and accounting for, derivative instruments and the assumptions used to value them can significantly affect our financial position and results of operations. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the derivative instrument could be required within 12 months of the balance sheet date.

During the three and six months ended June 30, 2006, we recorded derivative instrument income of $4,297,000 and $1,633,000 respectively, as compared to derivative instrument income of $681,000 and $287,000 for the respective three and six months ended June 30, 2005. The recording of derivative instrument income during these periods resulted from the decline in the calculated fair market value of such derivative instrument liabilities, primarily attributable to a decline in the market value of the Company's common stock. Income or losses generated from these derivative liabilities principally arise from changes in the fair market value of the Company's common stock price during each reporting period, as the Company is required to record "mark-to-market" adjustments to the value of its derivative liabilities. These "mark-to-market" adjustments are non-cash, with no impact on liquidity.

Business Operations

As presented in the consolidated financial statements contained in this report, the Company has incurred operating losses of $2,050,000 and $3,419,000 for the three and six months ended June 30, 2006, as compared to operating losses of $429,000 and $1,058,000 for the three and six months ended June 30, 2005. Approximately $1,241,000 and $2,217,000 of the operating losses reported for the three and six months ended June 30, 2006 were attributable to the start-up operations of the Company's wholly-owned subsidiary, OIPV Corp. The remaining operating losses are attributable to the Company's legacy telecommunications equipment business which has been negatively impacted by declining profit margins.

In May, 2005, OIPV Corp. was formed to provide carrier-based VoIP telephony solutions along with network services. Its primary target market is the small-to-medium sized business ("SMB") market, which the Company believes is the fastest growing segment of the telecommunications systems business. OIPV's product offerings include Hosted IP Centrex and IP Trunking services, bundled with private OIPV "last mile" connectivity on a national basis, long distance calling, On Net calling, local area calling, 911 capabilities and Wide Area Network ("WAN") voice and data connectivity. In January 2006, the Company launched the national marketing of OIPV's products and services; however revenues generated to date have been insufficient to cover its operating costs, and operating losses are expected to continue into 2007.

The Company continues to experience negative cash flows from operations and continues to be dependent upon its revolving credit facility and raising cash from private and public placements of debt and equity in order to fund its business operations. During the six months ended June 30, 2006, the Company raised approximately $3.9 million from private placements of convertible notes and preferred stock, which was used for working capital. Significant amounts of additional external financing, however, will be required in order to sustain current operations and for the further development of the OIPV Corp. IP telephony business to the operating levels anticipated by management. No assurance can be given, however, that such additional funding will be available.

For additional discussion on the Company's operating results and financial condition, refer to Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations, contained herein.

8

2. SUPPLEMENTARY FINANCIAL INFORMATION

Balance Sheet Information

(In thousands)	June 30, 2006	December 31, 2005
ACCOUNTS RECEIVABLE, NET: (1)		
Trade accounts receivable	$ 2,866	$ 2,815
Less: allowance for doubtful accounts	(86)	(75)
Trade accounts receivable, net	2,780	2,740
Other receivables	367	385
Accounts receivable, net	$ 3,147	$ 3,125
INVENTORIES, NET: (2)		
Finished goods and spare parts	$ 793	$ 1,136
Work in process	209	202
Rental equipment	64	12
	1,066	1,350
Less: reserves for excess and obsolete inventories	(205)	(627)
Inventories, net	$ 861	$ 723
PROPERTY AND EQUIPMENT, NET:		
Computer and office equipment	$ 1,162	$ 1,065
IP network equipment and licenses	442	391
Furniture and fixtures	304	288
Leasehold improvements	171	171
Capitalized software development costs	98	98
Automobiles	73	50
Leased computer equipment under capital lease	91	56
	2,341	2,119
Less: accumulated depreciation and amortization	(1,608)	(1,504)
Property and equipment, net	$ 733	$ 615
ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES:		
Salaries, commissions and benefits	$ 293	$ 296

Legal fees and expenses	32	104
State and local taxes	48	36
Customer deposits and unearned revenue	58	30
Employee Stock Purchase Plan deposits	15	28
Other	78	45
Accrued expenses and other current liabilities	$ 524	$ 539