FARMSTEAD TELEPHONE GROUP INC
Form 10-K
March 30, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

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

For the fiscal year ended December 31, 2000

Commission file number 0-15938

FARMSTEAD TELEPHONE GROUP, 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	06108-3728
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (860) 610-6000

Securities registered under Section 12(b) of the Act:

Title of each class	Name of each Exchange on which registered
Common Stock, $.001 par value	American Stock Exchange

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

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 report), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

As of February 28, 2001, the aggregate market value of the Common Stock of the registrant held by non-affiliates, based upon the last sale price of the registrant's Common Stock on such date, was $6,046,800.

As of February 28, 2001, the registrant had 3,272,579 shares of its $0.001 par value Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the registrant's definitive proxy statement for the Annual Meeting of Stockholders to be held on June 14, 2001 are incorporated by reference in Items 10 through 13 of Part III of this Annual Report on

Form 10-K.

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PART I

Item 1. Business

General

Farmstead Telephone Group, Inc. ("Farmstead" or the "Company") was incorporated in Delaware in 1986 and became publicly held in May 1987 following the completion of an initial public offering. The Company's main offices are located at 22 Prestige Park Circle, East Hartford, CT 06108, and its telephone number is (860) 610-6000. The Company is principally engaged as a secondary market reseller, and Authorized Remarketing Supplier of Classic Avaya(TM) and new Avaya Inc. ("Avaya") business communication products. These products are primarily customer premises-based private switching systems and peripheral telecommunications products, including voice processing systems. The Company also provides telecommunications equipment repair and refurbishing, rental, inventory management, and related value-added services. The Company sells its products and services primarily to both large and small end-user businesses, government agencies, and other secondary market dealers.

In March, 2001, the Company entered into a joint venture relationship with TriNet Systems, Inc. , and a company to be operated under the name of InfiNet Systems, LLC ("InfiNet") was formed. InfiNet, which has been appointed as an Avaya Dealer, will be involved in the sale and installation of Avaya telecommunications systems and solutions primarily in the State of Connecticut and certain metropolitan counties in New York.

Products

The Company sells both refurbished (by the Company or other equipment refurbishers) and new telecommunications products manufactured by Avaya (See "Relationship with Avaya Inc./Lucent Technologies" for further information on the Company's relationship with these companies). Refurbished products are primarily sold under the Classic Avaya(TM) label, pursuant to a licensing agreement with Avaya. The Company's products are primarily components of private switching systems, generally PBXs and key systems, located at the customers premises, that permit a number of local telephones or terminals to communicate with one another, with or without use of the public telephone network. Key systems are generally used by small businesses, and are characterized by telephones which have multiple buttons permitting the user to select outgoing or incoming telephone lines directly. PBXs are private telephone switching systems usually located on a customer's premises, with an attendant console, and are designed for use by larger businesses. A PBX normally has more memory capacity and therefore can provide more features and flexibility than a key system. Parts sold include both digital and analog telephone sets and circuit packs, and other system accessories and related products such as headsets, consoles, speakerphones, paging systems and voice processing products offered by Avaya.

Avaya key systems include: Merlin(R), Spirit(R) and Partner(R). Avaya PBX equipment sold by the Company includes Definity(R) and System 75.

Equipment sales revenues accounted for approximately 93% of consolidated revenues from continuing operations in 2000, 92% in 1999 and 94% in 1998, while service revenues accounted for 7% of consolidated revenues from continuing operations in 2000, 8% in 1999 and 6% in 1998. Sales of PBX equipment and associated telephones and peripherals accounted for approximately 86% of total equipment sales in 2000, 76% in 1999 and 81% in 1998, while key equipment and other equipment sales, including data equipment, accounted for 14% of total equipment sales in 2000, 24% in1999 and 19% in 1998.

Relationship with Avaya Inc./Lucent Technologies

Lucent Technologies ("Lucent") was formed in 1995 from the systems and technology units that were formerly a part of AT&T Corp., including the research and development capabilities of Bell Laboratories. In April 1996, Lucent completed the initial public offering of its common stock and on September 30, 1996, became independent of AT&T when AT&T distributed to its shareholders all of its Lucent shares.

On September 30, 2000, Lucent completed the spin-off of its Enterprise Networks Group business segment (essentially its PBX business, and within which market segment the Company participates), as well as its SYSTIMAX(R) cabling and LAN-based data businesses to Lucent shareholders, forming a separate company named Avaya Inc. ("Avaya") that will focus directly and independently on the enterprise networking market. According to

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Lucent, Avaya has started out as an $8 billion Fortune 200 company with a #1 position in the U.S. call center and voice communications systems markets. The Company's contractual relationships with Lucent are being continued with Avaya.

Since 1985, AT&T, Lucent, and now Avaya, have provided support to the secondary market by offering installation and maintenance services for its products purchased by end-users through equipment resellers. Equipment resellers such as the Company may also, with various restrictions, utilize Avaya documentation, technical information and software. Avaya also generally provides up to a one-year warranty on products purchased from them for resale. The installation and maintenance of Avaya equipment is generally provided directly by Avaya. The Company does, however, coordinate the installation scheduling directly with Avaya if requested to do so by its customers. The Company also has relationships with a number of companies throughout the United States who can also provide such installation and maintenance services.

The Company operates in an Avaya-sponsored Authorized Remarketing Supplier ("ARS") program as an ARS Dealer (the "ARS Agreement"), selling Classic Avaya(TM) products to end-users nationwide. On February 2, 2001, the ARS Agreement was amended to extend its expiration date to December 31, 2003. Classic Avaya(TM) products are defined as used Avaya PBX system and key system parts, currently supported by Avaya, that have been refurbished by the Company under Avaya quality standards. This designation applies to substantially all of the used Avaya products which the Company now sells. The Company is currently one of four appointed ARS Dealers, none of whom has been granted an exclusive territory. The ARS Agreement also allows the Company to sell certain new Avaya PBX products and voice processing products to end-users, including government agencies. In February 1999, as a condition of its initial agreement with Lucent to become an ARS Dealer, the Company's new key system distributor agreement was terminated, and its associated dealer base was transferred to another Lucent distributor. Prior to the ARS Agreement, the Company was an "Authorized Distributor of Selected Lucent - Remanufactured Products" since 1991. In January 2000, the Company's direct supplier relationship with Lucent was assigned to Catalyst Telecom, a Lucent (and now Avaya) distributor, from whom the Company now purchases its new telecommunications products.

The Company believes that its relationship with Avaya is satisfactory and has no indication that Avaya has any intention of terminating its ARS Agreement with the Company. The Company could be materially adversely affected should Avaya decide to terminate this agreement.

Marketing and Customers

Telecommunications parts and value added services are marketed nationally through the Company's direct sales staff, which includes salespersons located throughout the Eastern Seaboard, Illinois, Ohio, Texas and California. The Company also sells its products through a call center operation started up in 1999. During 2000, the Company shipped products to approximately 10,000 businesses, with customers ranging from large, multilocation corporations, to small companies, and to equipment wholesalers, dealers, and government agencies and municipalities. End-users accounted for approximately 91% of the Company's revenues in 2000, 96% in 1999 and 87% in 1998, while sales to dealers and other resellers accounted for approximately 9%, 4% and 13% of revenues during the same three year period. During the year ended December 31, 2000, no single customer accounted for more than 10% of revenues. One customer, Lucent Technologies Inc., accounted for approximately 15% of the Company's revenues during the years ended December 31, 1999 and 1998. The Company's business is not considered seasonal.

Customer Services

The Company is committed to respond to its customers' service or project-oriented telecommunications needs. While each type of service is not material to the Company's operations as a whole, the Company believes these services help differentiate it from its competitors, as well as contribute to longer-lasting customer relationships and incremental equipment sales. Services include:

Repair and Refurbishing: The Company performs fee-based repair and refurbishing services for its customers through its in-house facilities and use of subcontract repair shops. The in-house work includes cleaning, buffing and minor repairs. The Company outsources major repairs of circuit boards and digital telephone sets.

Installation services: The Company utilizes Avaya and other equipment installation companies on a subcontract basis to install telecommunication parts and systems, as well as equipment moves, adds and changes.

Equipment Rentals: The Company rents out equipment on a month-to-month basis, servicing those customers that have temporary, short-term equipment needs.

Other Services: The Company's technical staff currently provide engineering, configuration, and technical "hot line" telephone support services. For customers in the television broadcast industry, the Company provides telecommunications coordination services for broadcast sports and other events throughout the country.

The Company's combined service revenues accounted for 7% of revenues from continuing operations in 2000, 8% in 1999 and 6% in 1998. No individual service category accounted for more than 5% of revenues from continuing operations.

Competition

The Company operates in a highly competitive marketplace. Telephone equipment product competitors currently include Avaya and other new equipment manufacturers such as Nortel Networks Corporation, other new equipment distributors, as well as other secondary market equipment resellers, of which the Company estimates there are over 100 nationwide. In the sale of Classic Avaya(TM) products, the Company competes with the other Avaya-designated ARS Dealers. The Company believes that key competitive factors in its market are timeliness of delivery, service support, price and product reliability. The Company also considers its working relationships with its customers to be an important and integral competitive factor. The Company anticipates intensified competition from larger companies having substantially greater technical, financial and marketing resources, as well as larger customer bases and name recognition. As the industry further develops voice and data convergence products, the Company anticipates that it will encounter a broader variety of competitors, including new entrants from related computer and communication industries.

Suppliers

Lucent, and since October 1, 2000 Avaya, have historically been the Company's largest suppliers of new telecommunication products and, until 1999, was one of its largest suppliers of refurbished products. In January 2000, the Company's direct supplier relationship with Lucent was assigned to Catalyst Telecom, a former Lucent, and now an Avaya distributor, from whom the Company has since purchased its new telecommunications products. The Company acquires used equipment from a variety of sources, depending upon price and availability at the time of purchase. These sources include other secondary market equipment dealers, leasing companies and end-users. The equipment so acquired may be in a refurbished state and ready for resale, or it may be purchased "as-is", requiring repair and/or refurbishing prior to its resale. The Company is dependent upon its relationships and agreements with Catalyst and Avaya for the provision of new equipment for resale. The Company is not otherwise dependent upon any other single supplier for used equipment. The Company believes that the availability of used equipment in the marketplace is presently sufficient to allow the Company to meet its customers' used equipment delivery requirements. See also "Relationship with Avaya Inc./Lucent Technologies."

Patents, Licenses and Trademarks

No patent or trademark is considered material to the Company's continuing operations. Pursuant to agreements in effect with Avaya, the Company may utilize, during the term of these agreements, certain Avaya designated trademarks, insignia and symbols in the Company's advertising and promotion of Avaya products. The Company operates under a license agreement with Avaya, in which the Company was granted a non-exclusive license to use the Classic Avaya(TM) trademark in connection with the refurbishing, marketing and sale of Avaya products sold under the ARS Agreement. Under this agreement, the Company is obligated to pay Avaya a fee, amounting to 10% of the sales price, on Classic Avaya products sold by the Company. The license agreement and ARS Agreement were recently amended on February 2, 2001 extending the expiration date to December 31, 2003.

Research and Development

The Company did not incur any research and development expenses during the three years ended December 31, 2000, and research and development activities are not material to the Company's business.

Backlog

The backlog of unshipped orders was approximately $1,556,000 at December 31, 2000 and $889,000 at December 31, 1999.

Employees

At December 31, 2000, the Company had 116 full-time employees. The Company's employees are not represented by any organized labor union and are not covered by any collective bargaining agreements.

Item 2. Properties

At December 31, 2000, the Company operated two facilities under long-term lease agreements, occupying in excess of 49,000 square feet of warehouse and office space in East Hartford, CT. The lease agreements expire December 31, 2004. The Company believes that its facilities are adequate for its present needs and suitable for their intended uses. If new or additional space is required, the Company believes that adequate facilities are available at competitive prices in the immediate areas of its current operations.

Item 3. Legal Proceedings

From time to time the Company is involved in legal proceedings arising in the ordinary course of business. The Company believes there is no litigation pending that could have, individually or in the aggregate, a material adverse effect on its financial position, results of operations or cash flows.

Item 4. Submission of Matters to a Vote of Security Holders

No matter was submitted to a vote of security holders in the fourth quarter of the fiscal year covered by this report.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

The Company's securities are traded on the American Stock Exchange, under the following symbols: Common Stock - "FTG"; Warrants issued in the Company's 1987 initial public offering ("IPO Warrants") - "FTG.WS"; Redeemable Class A Common Stock Purchase Warrants - "FTG.WS.A"; Redeemable Class B Common Stock Purchase Warrants - "FTG.WS.B". The following sets forth the range of quarterly high and low sales prices for these securities, for the two years ended December 31, 2000:

	Common Stock:				IPO Warrants:			
	2000		1999		2000		1999	
Quarter Ended	High	Low	High	Low	High	Low	High	Low
March 31	$2.13	$1.13	$2.75	$1.44	$.50	$.25	$.81	$.41
June 30	1.69	1.00	1.88	1.31	.38	.25	.50	.25
September 30	1.50	1.00	1.75	1.13	.38	.25	.25	.25
December 31	1.81	1.06	1.50	.88	.13	.13	.25	.25

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	Class A Warrants:				Class B Warrants:			
	2000		1999		2000		1999	
Quarter Ended	High	Low	High	Low	High	Low	High	Low

March 31	$.56	$.13	$.88	$.38	$.56	$.13	$.75	$.31
June 30	.31	.13	.56	.19	.31	.13	.56	.25
September 30	.13	.06	.44	.19	.31	.06	.25	.13
December 31	.38	.13	.38	.13	.50	.06	.19	.13

There were 3,272,579 common shares outstanding at December 31, 2000 and 1999. There were 183,579 IPO Warrants, 1,137,923 Class A Warrants and 1,137,923 Class B Warrants outstanding at December 31, 2000 and 1999. As of December 31, 2000 there were 540 holders of record of the common stock representing approximately 3,200 beneficial stockholders, based upon the number of proxy materials distributed in connection with the 2000 Annual Meeting of Stockholders. The Company has paid no dividends and does not expect to pay dividends in the foreseeable future as it intends to retain earnings to finance the growth of its operations. Pursuant to a revolving credit agreement with First Union National Bank, the Company is prohibited from declaring or paying any dividends or making any other distribution on any of the shares of its capital stock, without the prior consent of the lender.

Item 6. Selected Financial Data

(In thousands, except per share amounts)	Years ended December 31				
	2000	1999	1998	1997 (1)(3)	1996 (2)(3)
Revenues	$42,786	$32,871	$27,738	$20,559	$16,306
Income (loss) from continuing operations	1,753	57	780	(600)	1,206
Income (loss) from continuing operations per common share:					
Basic	.54	.02	.23	(.18)	.49
Diluted	.54	.02	.23	(.18)	.48
Total Assets	15,494	15,657	13,498	10,829	12,074
Long term debt	1,726	4,578	1,916	1,997	-
Stockholders' equity	8,202	6,417	6,344	5,769	7,635
Dividends paid	-	-	-	-	-