ZOOM TECHNOLOGIES INC
Form 10-Q
May 17, 2004

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 ending March 31, 2004

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 0-18672

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

Delaware	51-0448969
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
207 South Street, Boston, Massachusetts	02111
(Address of Principal Executive Offices)	(Zip Code)

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

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 an accelerated filer (as defined in Exchange Act Rule 12b-2). YES [ ] NO [X]

The number of shares outstanding of the registrant's Common Stock, $.01 Par Value, as of May 7, 2004, was 8,513,041 shares.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
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PART I - FINANCIAL INFORMATION

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
Consolidated Balance Sheets
(unaudited)

	March 31, 2004	December 31, 200
Assets		
Current assets:		
Cash and cash equivalents	$ 9,048,942	$ 9,904,384
Accounts receivable, net of reserves for doubtful accounts, returns, and allowances of $1,811,169 at March 31, 2004 and $1,790,205 at December 31, 2003	4,081,654	3,944,699
Inventories, net	5,568,002	4,771,216
Prepaid expenses and other current assets	459,105	434,694
Total current assets	19,157,703	19,054,993
Property, plant and equipment, net	2,828,440	2,918,985
Total assets	$ 21,986,143	$ 21,973,978
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of long-term debt	$ 226,358	$ 223,833
Accounts payable	1,931,661	2,172,028
Accrued expenses	1,194,148	1,011,910
Total current liabilities	3,352,167	3,407,771

Long-term debt	5,038,917	5,095,986
Total liabilities	8,391,084	8,503,757
Stockholders' equity:		
Common stock, $0.01 par value. Authorized 25,000,000 shares; issued 8,353,566 shares, outstanding 8,345,166 at March 31,2003 and issued 8,084,616 shares, outstanding 8,076,216 at December 31, 2003	83,536	80,846
Additional paid-in capital	28,780,744	28,500,421
Subscriptions receivable due to exercise of stock options	287,191	-
Retained earnings (accumulated deficit)	(15,995,895)	(15,438,333)
Accumulated other comprehensive income (loss)	446,805	334,609
Treasury stock	(7,322)	(7,322)
Total stockholders' equity	13,595,059	13,470,221
Total liabilities and stockholders' equity	$ 21,986,143	$ 21,973,978

See accompanying notes to consolidated financial statements.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
Consolidated Statements of Operations
(Unaudited)

	Three Months Ending March 31,	
	2004	2003
Net sales	$ 7,791,605	$ 7,538,513
Costs of goods sold	5,479,549	5,393,719
Gross profit	2,312,056	2,144,794
Operating expenses:		
Selling	1,225,977	1,361,768
General and administrative	953,332	957,796
Research and development	678,219	752,204
Total operating expenses	2,857,528	3,071,768
Operating income (loss)	(545,472)	(926,974)
Other income (expense):		
Interest income	24,182	21,311
Interest (expense)	(52,648)	(54,812)
Other, net	16,376	120,907
Total other income (expense), net	(12,090)	87,406
Income (loss) before income tax expense	(557,562)	(839,568)
Income tax expense (benefit)	-	-
Net income (loss)	$ (557,562)	$ (839,568)

Earnings (loss) per common share:		
Basic	$ (0.07)	$ (0.11)
Diluted	$ (0.07)	$ (0.11)
Weighted average common and common equivalent shares		
Basic	8,136,012	7,853,382
Diluted	8,136,012	7,853,382

See accompanying notes to consolidated financial statements.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ending March 31,	
	2004	2003
Cash flows from operating activities:		
Net income (loss)	$ (557,562)	$ (839,568
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Non-operating gain on refund of deposit	-	(40,237
Depreciation	116,721	145,334
Changes in operating assets and liabilities:		
Accounts receivable, net	(24,938)	486,589
Inventories, net	(796,786)	584,951
Prepaid expenses and other assets	(24,411)	585,794
Accounts payable and accrued expenses	(58,129)	(786,283
Net cash provided by (used in) operating activities	(1,345,105)	136,580
Cash flows from investing activities:		
Additions to property, plant and equipment	(26,176)	(594
Net cash provided by (used in) investing activities	(26,176)	(594
Cash flows from financing activities:		
Principal payments on long-term debt	(54,544)	(51,803
Proceeds from exercise of stock options	570,204	-
Purchase of Treasury stock	-	(5,126
Net cash provided by (used in) financing activities	515,660	(56,929
Effect of exchange rate changes on cash	179	(1,304
Net increase (decrease) in cash	(855,442)	77,753
Cash beginning of period	9,904,384	7,612,274

Cash end of period	$ 9,048,942	$ 7,690,027
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 52,648	$ 58,090
Income taxes	$ -	$ -

See accompanying notes to consolidated financial statements.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements
(Unaudited)

(1) Summary of Significant Accounting Policies

(a) Basis of Presentation and Principles of Consolidation

The consolidated financial statements of Zoom Technologies, Inc. (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 footnote disclosures required by accounting principles generally accepted in the United States of America. These statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ending December 31, 2003 included in the Company's 2003 Annual Report on Form 10-K.

The consolidated balance sheet as of March 31, 2004, the consolidated statements of operations for the three months ending March 31, 2004 and 2003, and the consolidated statements of cash flows for the three months ending March 31, 2004 and 2003 are unaudited, but, in the opinion of management, include all adjustments (consisting of normal, recurring adjustments) necessary for a fair presentation of results for these interim periods.

The consolidated financial statements include the accounts and operations of the Company's wholly-owned subsidiary, Zoom Telephonics, Inc., a Delaware corporation. All significant intercompany accounts and transactions have been eliminated in consolidation.

The results of operations for the periods presented are not necessarily indicative of the results to be expected for the entire year ending December 31, 2004.

(b) Stock-Based Compensation

The Company accounts for its stock option plans under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees, and Related Interpretations." No stock-based compensation expense is reflected in net income (loss) for these plans, as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net loss and loss per share if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board (FASB) Statement No. 123, "Accounting for Stock Based Compensation", to stock based compensation:

	FOR THE THREE MONTHS ENDED MARCH 31, (UNAUDITED)	
	2004	2003

Net income (loss), as reported.........	$ (557,562)	$ (839,568)
Deduct: Total stock-based employee Compensation expense determined under fair value based method for all awards, net of related tax effects...........	(173,868)	(117,259)
Pro forma net income (loss)...........	$ (731,430)	$ (956,827)
Income (loss) per share:		
Basic and diluted - as reported........	$ (0.07)	$ (0.11)
Basic and diluted - pro forma..........	$ (0.09)	$ (0.12)

(c) RECENTLY ISSUED ACCOUNTING STANDARDS

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities - an Interpretation of ARB No. 51", and, in October 2003, the FASB issued FASB Staff Position (FSP) No. FIN 46-6, "Effective Date of FASB Interpretation 46." This staff position deferred the effective date for applying FIN 46 to an interest held in a Variable Interest Entity ("VIE") or potential VIE that was created before February 1, 2003 until the end of the first interim or annual period ending after December 15, 2003, except if the company had already issued statements reflecting a VIE in accordance with FIN 46. In December 2003, the FASB issued Interpretation No. 46R (FIN 46R), "Consolidation of Variable Interest Entities -- An Interpretation of ARB No. 51." FIN 46R replaces FIN 46 and addresses consolidation by business enterprises of variable interest entities that possess certain characteristics. A variable interest entity is defined as (a) an ownership, contractual or monetary interest in an entity where the ability to influence financial decisions is not proportional to the investment interest, or (b) an entity lacking the invested capital sufficient to fund future activities without the support of a third party. FIN 46R establishes standards for determining under what circumstances VIEs should be consolidated with their primary beneficiary, including those to which the usual condition for consolidation does not apply. Adoption of the required sections of FIN 46, as modified and interpreted, including the provisions of FIN 46R, did not have any effect on the Company's consolidated financial statements or disclosures. The Company adopted the remaining sections of this guidance in 2004. The provisions of FIN 46R, did not have any significant impact on the Company's consolidated financial statements or disclosures.

In December 2003, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 104, "Revenue Recognition" (SAB 104), which supersedes SAB 101, "Revenue Recognition in Financial Statements". The primary purpose of SAB 104 is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements, which was superseded as a result of the issuance of EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables". While the wording of SAB 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104. The adoption of SAB 104 did not have a material impact on the Company's consolidated financial statements.

(2) Liquidity

On December 31, 2003 Zoom had cash of approximately $9.9 million. On March 31, 2004 Zoom had cash of approximately $9.0 million. Currently, the Company does not have a debt facility, and the Company cannot assure that it could obtain one on acceptable terms unless there is a change in the Company's circumstances.

To conserve cash and manage its liquidity, the Company implemented expense reductions throughout 2002, 2003 and the first three months of 2004. The

employee headcount was 185 at December 31, 2002 and 159 at March 31, 2004. The Company will continue to assess its cost structure as it relates to its revenues and cash position in 2004, and may make further reductions if these actions are deemed necessary.

Management believes it has sufficient resources to fund its planned operations over the next 12 months. However if the Company is unable to increase its revenues, reduce or otherwise adequately control its expenses, or raise capital, the Company's longer-term ability to continue as a going concern and achieve its intended business objectives could be adversely affected. See "Risk Factors" below, for further information with respect to events and uncertainties that could harm our business, operating results, and financial condition.

(3) Earnings Per Share

The reconciliation of the numerators and denominators of the basic and diluted net earnings (loss) per share computations for the Company's reported net income (loss) is as follows:

	Three Months Ending March 31, 2004	Three Months Ending March 31, 2003
Basic:		
Net income (loss)	$ (557,562)	$ (839,568)
Weighted average shares outstanding	8,136,012	7,853,382
Net income (loss) per share	$ (.07)	$ (.11)
Diluted:		
Net income (loss)	$ (557,562)	$ (839,568)
Weighted average shares outstanding	8,136,012	7,853,382
Net effect of dilutive stock options based on the Treasury stock method using average market price	-	-
Weighted average shares outstanding	8,136,012	7,853,382
Net income (loss) per share	$ (.07)	$ (.11)

Potential common shares for which inclusion would have the effect of increasing diluted earnings per share (i.e., antidilutive) are excluded from the three months ending March 31, 2004 and 2003 computations. Options to purchase 1,518,000 and 1,822,875 shares of common stock at March 31, 2004 and 2003, respectively, were outstanding but not included in the computation of diluted earnings per share as their effect would be antidilutive.

(4) Inventories

Inventories consist of the following:	March 31, 2004	December 31, 2003
Raw materials	$ 2,161,274	$ 1,754,850
Work in process	1,088,788	639,425

Finished goods	2,317,940	2,376,941
Total Inventories, net	$ 5,568,002	$ 4,771,216

During the three months ending March 31, 2004 and March 31, 2003 the Company recorded lower of cost or market write-downs of zero and $237,715, respectively, related to broadband and wireless inventory.

(5) Comprehensive Income (Loss)

Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income" establishes rules for the reporting and display of comprehensive income (loss) and its components; however, it has no impact on the Company's net income (loss). SFAS No. 130 requires all changes in equity from non-owner sources to be included in the determination of comprehensive income (loss).

The components of comprehensive income (loss), net of tax, are as follows:

	Three Months Ending March 31,	
	2004	2003
Net income (loss)	$ (557,562)	$ (839,568)
Foreign currency translation adjustment	112,196	(13,523)
Comprehensive income (loss)	$ (445,366)	$ (853,091)

At March 31, 2004 and December 31, 2003, Accumulated other comprehensive income (loss) as reported on the Company's balance sheet is comprised solely of foreign currency translation adjustments.

(6) Long-Term Debt

On January 10, 2001 the Company obtained a mortgage loan for $6 million secured by the real estate property located at 201 and 207 South Street, Boston, Massachusetts. This is a 20-year direct reduction mortgage with a five-year balloon due January 10, 2006. The interest rate is fixed for one year, based on the one year Federal Home Loan Bank rate plus 2.5 % per annum. The rate is adjusted on January 10th of each calendar year commencing on January 10, 2002. Zoom's rate was adjusted to 3.99% on January 10, 2004.

(7) Commitments

During the three month period ending March 31, 2004 there were no material changes to the capital commitments and contractual obligations of the Company from those disclosed in the Form 10-K for the year ending December 31, 2003.

(8) Segment and Geographic Information

The Company's operations are classified into one reportable segment. The Company's United States and international net sales for the three months ending March 31, 2004 and 2003, respectively, were comprised as follows:

	Three Months Ending March 31, 2004	% of Total	Three Months Ending March 31, 2003	% of Total

United States	$ 3,779,156	48%	$ 4,579,258	61%
International-UK	2,477,000	32%	2,215,645	29%
International-All Other	1,535,449	20%	743,610	10%
Total	$ 7,791,605	100%	$7,538,513	100%

(9) Customer Concentrations

The Company's fourth largest customer in the first quarter of 2004, Best Buy, recently advised the Company that they plan to discontinue the sale of the Company's dial-up modems starting around June 2004. This action is being taken to reduce the amount of shelf space allocated to dial-up modems and increase Best Buy's house-brand share of their modem category.

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 herein and set forth in our Annual Report on Form 10-K for the year ending December 31, 2003. Readers should also be cautioned that results of any reported period are often not indicative of results for any future period.

OVERVIEW

Zoom sells computer peripheral products, principally dial-up and ADSL modems, to retailers, distributors, Internet Service Providers (ISPs), and Original Equipment Manufacturers (OEMs). We sell our products to these customers through our direct sales force and through commissioned sales representatives. The majority of our employees work in either our corporate-owned headquarters or our leased production facility in Boston, Massachusetts. We also have a sales and support office in the United Kingdom and a support center in Boca Raton, Florida.

Historically, most of Zoom's sales have resulted from the after-market sale of dial-up modems to retail customers. These customers typically either wanted to add a modem to a computer that did not have a modem, needed to replace a defective modem or wanted to upgrade to a higher speed modem. Since the vast majority of retail personal computers now come with 56K modems installed, and since 56K is the highest speed dial-up modem available, the upgrade market has steadily declined over the past few years. This decline, coupled with competition from broadband access devices like ADSL and cable modems and lower selling prices for dial-up modems, has resulted in a corresponding decline in Zoom's dial-up modem sales.

Our fourth largest customer in Q1 2004, Best Buy, has advised us that they plan to discontinue the sale of our dial-up modems starting around June 2004, coincident with their reduction of shelf space for the category and their introduction of a house brand modem.

To mitigate this decline, Zoom has made significant investments in broadband and other technologies. The broadband market has grown rapidly over the past few years and is expected to continue to grow quickly. So far Zoom has been more successful in the ADSL market than in the cable modem market.

Zoom's product philosophy emphasizes quality, reliability, and low cost. We therefore continually seek to optimize our product designs and lower our cost of goods through intelligent design, aggressive sourcing, and the use of new technology. Most of our products use modem or other chipsets purchased from outside vendors. This lets us take advantage of the extensive research and

development capabilities and competitiveness of our chipset suppliers and reduces our development time and the associated costs and risks of bringing new products to market. As a result of this approach, Zoom is able to quickly develop new and innovative products while keeping its research and development expense relatively small as a percentage of sales.

Zoom also out-sources most of its board-level manufacturing, allowing us to take advantage of the competitive worldwide market for contract manufacturing services. Subcontract manufacturing frees us from the capital equipment cost and the inflexibility, expense, and management burden associated with maintaining a dedicated workforce for electronics assembly operations. Packaging, testing and shipping are typically done at our Boston, Massachusetts manufacturing facility. This helps to reduce shipping costs from our contract assemblers and gives us the opportunity to monitor manufacturing quality and to efficiently customize product for our customers.

In recent years Zoom has benefited from purchase discount programs with our major chipset suppliers. These agreements have resulted in reduced unit costs for our dial-up modems. From the first quarter of 2002 through the first quarter of 2004, we realized significant benefits as a result of these agreements, the most significant of which expires during 2004. Zoom hopes to replace these agreements, but our ability to negotiate favorable terms will depend on a number of factors including our projected volumes, our ability to reach those volumes, and the competitive landscape in the chipset market. The outcome of these negotiations could have a significant effect on the gross margins of products that use chipsets covered by the existing agreements.

Over the past three years, our net sales have declined an average of 16% per year. In response to the declining sales volume, we reduced staffing and overhead costs. In December 31, 2000, our total headcount of full-time employees, including temporary workers, was 329, which was reduced to 215, 185, and 159 at year-end 2001, 2002, and 2003, respectively. Our headcount on March 31, 2004 was 159.

In the first quarter of 2004 and the fourth quarter of 2003, respectively, our net sales for the quarter were up 3.4% and 11.5% over the same quarter in the prior year. The main reason for this increase was the growth in ADSL modem sales, which more than offset our declining dial-up modem sales. While we remain optimistic about continued growth in the ADSL modem area, our ADSL sales are currently concentrated with a small number of customers, so there is no predictable uniformity for our quarterly ADSL sales and our sales may fluctuate. We are continuing our efforts to expand our ADSL customer base and to use our strength in ADSL to expand our ADSL product line and enter new markets later this year. One new product will incorporate VoIP capability into an ADSL modem. We also plan to introduce our own VoIP service called "Global Village(TM)" to offer free IP-to-IP service, low-cost calling to virtually anyone worldwide, and unlimited fixed price domestic calling.

Our cash and cash equivalents balance at March 31, 2004 was $9.0 million, down from $9.9 million at December 31, 2003. Most of this change resulted from the increase of inventories and accounts receivable, offset partially by $0.6 million cash received from the exercise of employee stock options.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The following is a discussion of what we view as our more significant accounting policies and estimates. These policies and estimates are also described in the notes to our audited consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ending December 31, 2003. As described below, management judgments and estimates must be made and used in connection with the preparation of our consolidated financial statements. Where noted, material differences could result in the amount and timing of our net

sales, costs, and expenses for any period if we made different judgments or used different estimates.

REVENUE (NET SALES) RECOGNITION. We sell hardware products to our customers. The products include dial-up modems, embedded modems, cable modems, PC cameras, ISDN and ADSL modems, telephone dialers, and wireless and wired networking equipment. We generally do not sell software or services We derive our net sales primarily from the sale of hardware products to four types of customers:

- computer peripherals retailers,
- computer product distributors,
- Internet Service Providers (ISPs), and
- original equipment manufacturers (OEMs).

We recognize net sales for all four types of customers at the point when the customer takes 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 to computer products retailers are reduced by certain events that are characteristic of the sales of hardware to computer peripherals retailers. These events are product returns, certain sales and marketing incentives, price protection refunds, and consumer and in-store mail-in 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, new product introductions, announced stock rotations and announced customer store closings, etc. 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 of net sales, and the corresponding change to inventory and cost of sales. The relationship of quarterly physical product returns to quarterly product sales has remained relatively stable for many years.

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.

Sales and Marketing Incentives. Many of our retail customers require sales and marketing support funding, usually set as a percentage of our sales in their stores.

Consumer Mail-In and In-Store Rebates and Store Rebates. Our estimates for

consumer mail-in rebates are based on a detailed understanding and tracking by customer and by 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. Our estimates for store rebates are comprised of actual credit requests from the eligible customers. The estimate for mail-in and 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.

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 reserves equal to the above-discussed net sales adjustments for estimates of product returns, price protection refunds, and consumer and store rebates. These reserves are drawn down as actual credits are issued to the customer's accounts.

Our bad-debt write-offs have not been significant during 2001, 2002 and 2003 or 2004 to date.

INVENTORY VALUATION AND COST OF GOODS SOLD. Inventory is valued on a standard cost basis where the material standards are periodically updated for current material pricing. Reserves for obsolete inventory are established by management based on usability reviews performed each quarter. Our reserves against the inventory of a particular product range from 0% to 100%, based on management's estimate of the probability that the material will not be consumed. In the second half of 2000, when industry expectations were very high for expansion of the broadband and wireless markets, we purchased parts to support our aggressive forecast for a ramp-up of sales of cable modems, ADSL modems, and wireless networking products. The subsequent slow down in the industry resulted in a significant excess inventory position of materials. During 2001, the market selling prices for the broadband and wireless products declined significantly because of an industry-wide oversupply. Starting in 2001 and to a lesser extent in 2002 and 2003, the sales prices for some of the products dropped below our cost and, accordingly, we then valued our inventory on a "lower of cost or market" basis. Our valuation process is to compare our cost to the selling prices each quarter, and if the selling price of a product is less than the "if completed" cost of our inventory, we write-down the inventory on a "lower of cost or market" basis.

We have entered into supply arrangements with suppliers of some components that include price and other concessions, including no-charge components, for meeting certain purchase requirements or commitments. Under one of these arrangements, we are committed to purchase approximately $8.0 million of components over a period of approximately 30-months that commenced on January 1, 2002, provided that those components were offered at competitive terms and prices. We believe that at March 31, 2004, we are on track to meet the $8.0 million commitment in 2004. In connection with this arrangement, we became entitled to receive at least $3.0 million of no-charge components, based upon the supplier's market price for the components in late 2001 and early 2002, and other pricing concessions based on our purchase volumes. We received $1.2 million of these no-charge components in the fourth quarter of 2001. We received the remainder of the no-charge components in the first quarter of 2002. The favorable impact to our statement of operations is being calculated as a purchase discount over the estimated total number of components acquired through the 30 month supply agreement and recognized on a delayed basis as the products employing the acquired components involved in the supply arrangement are sold. This method of accounting has been consistent each year.

VALUATION AND IMPAIRMENT OF DEFERRED TAX ASSETS. As part of the process of preparing our consolidated financial statements we are required to 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 consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the statement of operations.

Significant management judgment is required in determining our provision for income taxes and any valuation allowance recorded against our net deferred tax assets. In 2001, we recorded a $3.8 million income tax charge to reflect an additional increase in our deferred tax asset valuation allowance. Management's decision to record the valuation allowance was based on the uncertain recoverability of our deferred tax asset balance. In our first quarter ending March 31, 2002, we recorded an additional $2.0 million income tax charge and valuation reserve, which reduced our net deferred tax asset balance to zero. This additional reserve reflected our decision to discontinue our specific tax planning strategy to sell our headquarters building in Boston in light of the less favorable market conditions for the sale of such building. At March 31, 2004, we currently have a 100% valuation allowance against our deferred tax assets. It is management's estimate that, after considering all 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 reverse the valuation allowance and restore the deferred asset value to the balance sheet, recording an equal income tax benefit which will increase net income in that period(s).

Results of Operations

SUMMARY. Net sales were $7.8 million for our first quarter ending March 31, 2004, up 3.4% from $7.5 million in the first quarter of 2003. We had a net loss of $0.6 million for the first quarter of 2004, compared to a net loss of $0.8 million in the first quarter of 2003. Loss per diluted share was $0.07 for the first quarter of 2004 compared to a loss per diluted share of $.11 for the first quarter of 2003.

NET SALES. Our net sales for the first quarter of 2004 increased 3.4% from the first quarter of 2003 primarily due to the increase in ADSL modem sales and the positive currency translation impact from converting sales transactions in Euros and British Pounds to US dollars. These increases were partially offset by the decline in dial-up modem sales. Dial-up modem sales declined due to a decrease of both dial-up modem unit sales and dial-up modem average selling prices, primarily resulting from the continued decline of the dial-up modem after-market. The increase in ADSL modem sales represented our tenth straight quarterly sales increase in this product category.

Our net sales in the United States declined from $4.6 million in the first quarter of 2003 to $3.8 million in the first quarter of 2004. Our international net sales increased from $3.0 million in the first quarter of 2003 to $4.0 million in the first quarter of 2004. These changes reflect our declining sales of dial-up modems worldwide, our stronger ADSL sales in the international markets, and the positive currency impact on a significant portion of our international sales.

GROSS PROFIT. Our gross profit increased to $2.3 million in the first quarter of 2004 from $2.1 million in the first quarter of 2003. Our gross profit

as a percentage of net sales improved to 29.7% in the first quarter of 2004 from 28.5% in the first quarter of 2003. The improvement in gross profit percentage resulted primarily from product cost reductions and the favorable exchange rate impact on our international sales.

OPERATING EXPENSE. Our operating expense decreased by $0.2 million to $2.9 million or 36.7% of net sales in the first quarter of 2004 from $3.1 million or 40.7% of net sales in the first quarter of 2003. The decrease of $0.2 million was comprised of lower selling expense of $0.1 million and lower research and development expense of $0.1 million.

Selling Expense. Selling expense decreased $.1 million to $1.2 million or 15.7% of net sales in the first quarter of 2004 from $1.4 million or 18.1% of net sales in the first quarter of 2003. Selling expense was lower primarily because of lower personnel costs resulting from employee headcount reductions, reduced marketing costs and reduced product delivery expense.

General and Administrative Expense. General and administrative expense was $1.0 million, or 12.2% of net sales in the first quarter of 2004 and $1.0 million, or 12.7% of net sales, in the first quarter of 2003. Although total General and Administrative expense did not change from the first quarter of 2003 to the first quarter of 2004, there were increases and decreases in categories included in total General and Administrative expense. General and administrative expense increases included higher unemployment insurance costs and legal fees. General and administrative expense decreases included lower medical insurance claims and depreciation expense.

Research and development expense decreased $.1 million to $0.7 million or 8.7% of net sales in the first quarter of 2004 from $0.8 million or 10.0% of net sales in the first quarter of 2003. Research and development costs decreased primarily as a result of reduced personnel costs and product approval fees. Development and support continues on all of our major product lines.

OTHER INCOME (EXPENSE). Other income (expense), net decreased to a loss of $.01 million in the first quarter of 2004 from income of $.09 million in the first quarter of 2003, primarily due to realized foreign exchange losses.

INCOME TAX EXPENSE (BENEFIT). We did not record any tax expense in the first quarter of 2004 or the first quarter of 2003. The net deferred tax asset balance at March 31, 2004 is zero. This accounting treatment is described in further detail under the caption CRITICAL ACCOUNTING POLICIES AND ESTIMATES above.

Liquidity and Capital Resources

On March 31, 2004 we had working capital of $15.8 million, including $9.0 million in cash and cash equivalents.

In the first three months of 2004, operating activities used $1.3 million in cash. Our net loss in the first three months of 2004 was $.6 million. Uses of cash from operations included an increase of inventory of $.8 million. The primary reason for the inventory increase was an increase in ADSL modem inventory in anticipation of shipments in the second quarter of 2004.

In the first three months of 2004 financing activities provided $.5 million of cash, due primarily to receipt of $.6 million cash from the exercise of employee stock options, partially offset by $.05 million in cash for monthly principal payments of our $6.0 million mortgage.

Currently we do not have a debt facility, and we cannot assure that we could obtain one on acceptable terms unless there is a change in our circumstances.

To conserve cash and manage our liquidity, we implemented expense reductions throughout 2002, 2003 and in the first three months of 2004. Our employee headcount was 185 at December 31, 2002 which has been reduced to 159 at March 31, 2004. We will continue to assess our cost structure as it relates to our revenues and cash position in 2004, and we may make further reductions if the actions are deemed necessary.

Management believes we have sufficient resources to fund our normal operations over the next 12 months. However, if we are unable to increase our revenues, reduce or otherwise adequately control our expenses, or raise capital, our longer-term ability to continue as a going concern and achieve our intended business objectives could be adversely affected. See "Risk Factors" below, for further information with respect to events and uncertainties that could harm our business, operating results, and financial condition.

Commitments

During the three months ending March 31, 2004, there were no material changes to our capital commitments and contractual obligations from those disclosed in the Form 10-K for the year ending December 31, 2003.

RECENTLY ISSUED ACCOUNTING STANDARDS

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities - an Interpretation of ARB No. 51", and, in October 2003, the FASB issued FASB Staff Position (FSP) No. FIN 46-6, "Effective Date of FASB Interpretation 46." This staff position deferred the effective date for applying FIN 46 to an interest held in a Variable Interest Entity ("VIE") or potential VIE that was created before February 1, 2003 until the end of the first interim or annual period ending after December 15, 2003, except if the company had already issued statements reflecting a VIE in accordance with FIN 46. In December 2003, the FASB issued Interpretation No. 46R (FIN 46R), "Consolidation of Variable Interest Entities -- An Interpretation of ARB No. 51." FIN 46R replaces FIN 46 and addresses consolidation by business enterprises of variable interest entities that possess certain characteristics. A variable interest entity is defined as (a) an ownership, contractual or monetary interest in an entity where the ability to influence financial decisions is not proportional to the investment interest, or (b) an entity lacking the invested capital sufficient to fund future activities without the support of a third party. FIN 46R establishes standards for determining under what circumstances VIEs should be consolidated with their primary beneficiary, including those to which the usual condition for consolidation does not apply. Adoption of the required sections of FIN 46, as modified and interpreted, including the provisions of FIN 46R, did not have any effect on our consolidated financial statements or disclosures. We adopted the remaining sections of this guidance in 2004. The provisions of FIN 46R, did not have any significant impact on our consolidated financial statements or disclosures.

In December 2003, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 104, "Revenue Recognition" (SAB 104), which supersedes SAB 101, "Revenue Recognition in Financial Statements". The primary purpose of SAB 104 is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements, which was superseded as a result of the issuance of EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables". While the wording of SAB 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104. The adoption of SAB 104 did not have a material impact on the Company's financial statements.

"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 our dial-up, cable and ADSL modems and VoIP products; the anticipated development and timing of new product introductions; the consolidation in and the decline of the dial-up modem market; the anticipated development of Zoom's markets and sales channels; the level of demand for Zoom's products; Zoom's ability to obtain debt or equity financing; the anticipated impact of Zoom's cost-cutting initiatives, 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 below as well as those discussed elsewhere in this report and in our filings with the Securities and Exchange Commission. We qualify all of our forward-looking statements by these cautionary statements.

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 should be read as 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 those discussed below, as well as those discussed elsewhere in this report.

WE MAY CONTINUE TO INCUR NET LOSSES IF WE ARE UNABLE TO INCREASE SALES OF OUR BROADBAND MODEMS.

Our net sales continue to decline primarily due to the decline in the dial-up modem market, decreases in average selling prices of dial-up modems, and the trend toward faster connection speeds and broadband access products. Despite numerous cost reductions over the last few years, we have continued to incur significant net losses primarily due to our continuous decline in net sales from dial-up modems. We believe that the future of our business is largely dependent on the success of our broadband modems and other products. Although we believe that we have sufficient resources to fund our planned operations over the next year, if we fail to increase our net sales of our broadband modems and other products, our longer-term ability to stay in business and to achieve our

intended business objectives could be adversely effected. Our continuing losses could also adversely affect our ability to fund the growth of our business should our strategies prove successful.

TO STAY IN BUSINESS WE MAY REQUIRE FUTURE ADDITIONAL FUNDING WHICH WE MAY BE UNABLE TO OBTAIN ON FAVORABLE TERMS, IF AT ALL.

Over the next twelve months, we may require additional financing for our operations either to fund losses beyond those we anticipate or to fund an increase of our inventory should growth occur. We currently do not have a debt facility from which we can borrow and may not be able to obtain one on acceptable terms unless we have a change in circumstances. 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 be required to further reduce planned expenditures or forego business opportunities, which could reduce our net sales, increase our losses, and harm our business. Moreover, additional equity financing could dilute the per share value of our common stock held by current shareholders, while additional debt financing could restrict our ability to make capital expenditures or incur additional indebtedness, all of which would impede our ability to succeed.

OUR CUSTOMER BASE IS CONCENTRATED, AND THE RECENT LOSS OF A SIGNIFICANT CUSTOMER WILL REDUCE REVENUES AND THE PROFIT CONTRIBUTION OF OUR DIAL-UP MODEM BUSINESS.

In the first quarter of 2004, 36% of our net sales were attributable to four customers, each of whom accounted for more than 6% of our net sales. Our fourth largest customer in the first quarter of 2004, Best Buy, advised us in April, 2004 that they plan to discontinue the sales of our dial-up modems starting around June 2004. This action is being taken to reduce the amount of Best Buy shelf space allocated to dial-up modems and to increase Best Buy's house-brand share of their modem category. In the first quarter of 2004 and 2003, respectively, Best Buy accounted for 6.6% and 6.9% of our total net sales. The loss of Best Buy as a customer, as well as a loss, reduction of business or less favorable terms of sale for any other of our significant customers, may reduce revenues and negatively impact our dial-up modem business.

OUR NET SALES AND OPERATING RESULTS HAVE BEEN ADVERSELY AFFECTED BECAUSE OF A DECLINE IN AVERAGE SELLING PRICES FOR OUR DIAL-UP MODEMS AND BECAUSE OF THE DECLINE IN THE RETAIL MARKET FOR DIAL-UP MODEMS.

The dial-up modem industry has been characterized by declining average selling prices and a declining retail market. The decline in average selling prices is due to a number of factors, including technological change, lower component costs, and competition. The decline in the size of the retail market for dial-up modems is primarily due to the inclusion of dial-up modems in most new PCs, and alternatives to dial-up modems including broadband modems. Less advantageous terms of sales, decreasing average selling prices and reduced demand for our dial-up modems have resulted and may in the future result in decreased net sales for dial-up modems, which has been our primary source of net sales. If we fail to replace declining revenue from the sales of dial-up modems with the sales of our other products, including our broadband modems, our business and results of operation will be harmed.

WE BELIEVE THAT OUR FUTURE SUCCESS WILL DEPEND IN LARGE PART ON OUR ABILITY TO MORE SUCCESSFULLY PENETRATE THE BROADBAND MODEM MARKETS, WHICH HAVE BEEN CHALLENGING MARKETS WITH SIGNIFICANT BARRIERS TO ENTRY.

With the shrinking of the dial-up modem market, we believe that our future success will depend in large part on our ability to more successfully penetrate the cable and ADSL modem markets. These markets have been challenging, with significant barriers to entry that have adversely affected our sales to these markets. Although some cable and ADSL modems are sold at retail, in most

countries the high volume purchases of these modems are concentrated in a relatively few large cable, telecommunications, and Internet service providers which offer broadband modem services to their customers. These customers typically also have extensive and varied approval processes for modems to be approved for use on their network. These approvals can be expensive and time consuming. Successfully penetrating the broadband modem market therefore presents a number of challenges including:

- the current limited retail market for broadband modems;
- the relatively small number of cable, telecommunications and Internet service provider customers that make up a substantial part of the market for broadband modems in most countries;
- the significant bargaining power of these large volume purchasers;
- the time consuming, expensive, uncertain and varied approval process of the various cable service providers; and
- the strong relationships with service providers enjoyed by incumbent some equipment providers.

Our sales of broadband products have been adversely affected by all of these factors. Sales of our broadband products in European countries have fluctuated and may continue to fluctuate due to approvals and delays in the deployment by service providers of cable and ADSL service in these countries. We cannot assure that we will be able to successfully penetrate these markets.

OUR EXISTING INDEBTEDNESS COULD PREVENT US FROM OBTAINING ADDITIONAL FINANCING AND HARM OUR LIQUIDITY.

In January 2001 we obtained a $6 million, 20 year direct reduction mortgage from a bank, secured by our owned real estate in Boston, Massachusetts. As of March 31, 2004, our outstanding indebtedness was $5.3 million. This mortgage has a balloon payment due in January 2006. Our outstanding indebtedness could adversely affect our ability to obtain additional financing for working capital, acquisitions, or other purposes. Our existing indebtedness could also make us more vulnerable to economic downturns and competitive pressures, make it more difficult to obtain additional debt financing, and adversely affect our liquidity. In the event of a cash shortfall, we could be forced to reduce other expenditures to meet our requirements with respect to our outstanding debt. Our ability to meet our obligations will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations. Many of these factors are beyond our control. If we are unable to generate sufficient cash flow from operations in the future to service our debt, we may be required to refinance all or a portion of these obligations or obtain additional financing in order to stay in business.

OUR FAILURE TO MEET CHANGING CUSTOMER REQUIREMENTS AND EMERGING INDUSTRY STANDARDS WOULD ADVERSELY IMPACT OUR ABILITY TO SELL OUR PRODUCTS.

The market for PC communications products and high-speed broadband access products is characterized by aggressive pricing practices, continually changing customer demand patterns, rapid technological advances, emerging industry standards and short product life cycles. In the past some of our product developments and enhancements have taken longer than planned and have delayed the availability of our products, which adversely affected our sales and profitability in the past. Any significant delays in the future may adversely impact our ability to sell our products, and our results of operations and financial condition may be adversely affected. Our future success will depend in large part upon our ability to:

- identify and respond to emerging technological trends in the market;
- develop and maintain competitive products that meet changing customer demands;
- enhance our products by adding innovative features that differentiate our

products from those of our competitors;

- bring products to market on a timely basis;
- introduce products that have competitive prices;
- manage our product transitions, inventory levels and manufacturing processes efficiently; and
- respond effectively to new technological changes or new product announcements by others.

Our product cycles tend to be short, and we may incur significant non-recoverable expenses or devote significant resources to sales that do not occur when anticipated. Therefore the resources we devote to product development, sales, and marketing may not generate material net sales for us. In addition, short product cycles have resulted in and may in the future result in excess and obsolete inventory, which has had and may in the future have an adverse affect on our results of operations. In an effort to develop innovative products and technology, we have incurred and may in the future incur substantial development, sales, marketing, and inventory costs. If we are unable to recover these costs, our financial condition and operating results could be adversely affected. In addition, if we sell our products at reduced prices in anticipation of cost reductions and we still have higher cost products in inventory, our business would be harmed and our results of operations and financial condition would be adversely affected.

OUR OPERATING RESULTS HAVE BEEN ADVERSELY AFFECTED BECAUSE OF PRICE PROTECTION PROGRAMS.

Our operating results have been adversely affected by reductions in average selling prices because of credits given to some of our customers as a result of contractual price protection guarantees. Specifically, when we reduce the price for a product, the customer receives a credit for the difference between the customer's most recent purchase price and our reduced price for the product, for all unsold product at the time of the price reduction. If the amount of credits we give to our customers increases by a material amount, our operating results could be adversely affected.

WE MAY BE SUBJECT TO PRODUCT RETURNS RESULTING FROM DEFECTS, OR FROM OVERSTOCKING OF OUR PRODUCTS. PRODUCT RETURNS COULD RESULT IN THE FAILURE TO ATTAIN MARKET ACCEPTANCE OF OUR PRODUCTS, WHICH WOULD HARM OUR BUSINESS.

If our products contain undetected defects, errors, or failures, we could face:

- delays in the development of our products;
- numerous product returns; and
- other losses to us or to our customers or end users.

Any of these occurrences could also result in the loss of or delay in market acceptance of our products, either of which would reduce our sales and harm our business. We are also exposed to the risk of product returns from our customers as a result of contractual stock rotation privileges and our practice of assisting some of our customers in balancing their inventories. Overstocking has in the past led and may in the future lead too higher than normal returns.

OUR FAILURE TO EFFECTIVELY MANAGE OUR INVENTORY LEVELS COULD MATERIALLY AND ADVERSELY AFFECT OUR LIQUIDITY AND HARM OUR BUSINESS.

During fiscal 2000, in anticipation of future sales of our broadband access products, particularly cable modems, we significantly increased our inventory for these products. We also built up this inventory in response to shortages of components for these products earlier in that year. We have also had difficulty in generating significant orders for some of our products, particularly broadband products, and as a result, we experienced a significant increase in

our inventory, to $21.7 million on December 31, 2000 from $14.3 million on December 31, 1999. At March 31, 2004 we were able to reduce our inventory levels to $5.6 million as a result of sales, raw material returns to suppliers, and the write-down of value of some of our inventory. Our failure to effectively manage our inventory may adversely affect our liquidity and increases the risk of inventory obsolescence, a decline in market value of the inventory, or losses from theft, fire, or other casualty.

WE MAY BE UNABLE TO PRODUCE SUFFICIENT QUANTITIES OF OUR PRODUCTS BECAUSE WE DEPEND ON THIRD PARTY MANUFACTURERS. IF THESE THIRD PARTY MANUFACTURERS FAIL TO PRODUCE QUALITY PRODUCTS IN A TIMELY MANNER, OUR ABILITY TO FULFILL OUR CUSTOMER ORDERS WOULD BE ADVERSELY IMPACTED.

We use contract manufacturers to manufacture our products. We use these third party manufacturers to help ensure low costs, rapid market entry, and reliability. Any manufacturing disruption could impair our ability to fulfill orders, and failure to fulfill orders would adversely affect our sales. Although we currently use four contract manufacturers for the bulk of our purchases, in some cases a given product is only provided by one of these companies. The loss of the services of any of our significant third party manufacturers or a material adverse change in the business of or our relationships with any of these manufacturers could harm our business. Since third parties manufacture our products and we expect this to continue in the future, our success will depend, in part, on the ability of third parties to manufacture our products cost effectively and in sufficient quantities to meet our customer demand.

We are subject to the following risks because of our reliance on third party manufacturers:

- reduced management and control of component purchases;
- reduced control over delivery schedules;
- reduced control over quality assurance;
- reduced control over manufacturing yields;
- limited warranties on products supplied to us;
- potential increases in prices;
- interruption of supplies from assemblers as a result of a fire, natural calamity, strike or other significant event; and
- misappropriation of our intellectual property.

WE MAY BE UNABLE TO PRODUCE SUFFICIENT QUANTITIES OF OUR PRODUCTS BECAUSE WE OBTAIN KEY COMPONENTS FROM, AND DEPEND ON, SOLE OR LIMITED-SOURCE SUPPLIERS.

We obtain certain key parts, components, and equipment from sole or limited sources of supply. For example, we purchase dial-up and broadband modem chipsets from Conexant Systems and Agere Systems. Integrated circuit product areas covered by one or both companies include dial-up modems, ADSL modems, cable modems, networking, routers, and gateways. In the past, we have experienced delays in receiving shipments of modem chipsets from our sole source suppliers. We may experience similar delays in the future. In addition, some products may have other components that are available from only one source. We believe the market for some components, including memory components, is currently experiencing shortages and there are increased lead times and higher prices for these components. If we are unable to obtain a sufficient supply of components from our current sources, we could experience difficulties in obtaining alternative sources or in altering product designs to use alternative components. Resulting delays or reductions in product shipments could damage relationships with our customers and our customers could decide to purchase products from our competitors. Inability to meet our customers' demand or a decision by one or more of our customers to purchase products from our competitors could harm our operating results.

OUR FAILURE TO OBTAIN NEW CHIPSET PURCHASE PROGRAMS WITH CHIPSET SUPPLIERS COULD

REDUCE OUR GROSS PROFIT.

Our primary dial-up modem chipset purchase agreement, which includes price and other concessions for meeting minimum purchase requirements or commitments, is due to expire in 2004. If we are unable to replace this agreement with an equally favorable chipset purchase agreement, our chipset costs could increase significantly and our gross profit could be adversely affected.

THE MARKET FOR HIGH-SPEED COMMUNICATIONS PRODUCTS AND SERVICES HAS MANY COMPETING TECHNOLOGIES AND, AS A RESULT, THE DEMAND FOR OUR PRODUCTS AND SERVICES IS UNCERTAIN.

The market for high-speed communications products and services has a number of competing technologies. For instance, Internet access can be achieved by:

- using a standard telephone line and appropriate service for dial-up modems, ISDN modems, or ADSL modems, possibly in combination;
- using a cable modem with a cable TV line and cable modem service;
- using a router and some type of modem to service the computers connected to a local area network; or
- other approaches, including wireless links to the Internet.

Although we currently sell products that include many of these technologies, the market for high-speed communication products and services is fragmented and evolving. The introduction of new products by competitors, market acceptance of products based on new or alternative technologies, or the emergence of new industry standards could render and have in the past rendered our products less competitive or obsolete. If any of these events occur, we may be unable to sustain or grow our business. Industry analysts believe that the market for our dial-up modems will continue to decline. If we are unable to increase demand for and sales of our broadband modems, we may be unable to sustain or grow our business.

WE FACE SIGNIFICANT COMPETITION, WHICH COULD RESULT IN DECREASED DEMAND FOR OUR PRODUCTS OR SERVICES.

We may be unable to compete successfully. A number of companies have developed, or are expected to develop, products that compete or will compete with our products. Furthermore, many of our current and potential competitors have significantly greater resources than we do. Intense competition, rapid technological change and evolving industry standards could result in less favorable selling terms to our customers, decrease demand for our products or make our products obsolete.

CHANGES IN CURRENT OR FUTURE LAWS OR GOVERNMENTAL REGULATIONS THAT NEGATIVELY IMPACT OUR PRODUCTS AND TECHNOLOGIES COULD HARM OUR BUSINESS.

The jurisdiction of the Federal Communications Commission, or the FCC, extends to the entire United States communications industry including our customers and their products and services that incorporate our products. Our products are also required to meet the regulatory requirements of other countries throughout the world where our products are sold. Obtaining government regulatory approvals is time-consuming and very costly. In the past, we have encountered delays in the introduction of our products, such as our cable modems, as a result of government certifications. We may face further delays if we are unable to comply with governmental regulations. Delays caused by the time it takes to comply with regulatory requirements may result in cancellations or postponements of product orders or purchases by our customers, which would harm our business.

OUR INTERNATIONAL OPERATIONS ARE SUBJECT TO A NUMBER OF RISKS INHERENT IN INTERNATIONAL ACTIVITIES.

Our international sales continue to represent an increasingly significant portion of our sales. International sales have increased from 38% of net sales in 2001 to approximately 52% of our net sales in the first quarter of 2004. Currently our operations are significantly dependent on our international operations, particularly sales of our ADSL modems, and may be materially and adversely affected by many factors including:

- international regulatory and communications requirements and policy changes;
- pricing of Internet and voice services;
- bundling of discounted or free equipment with services;
- favoritism toward local suppliers;
- delays in the rollout of broadband services by cable and ADSL service providers;
- local language and technical support requirements;
- difficulties in inventory management, accounts receivable collection and the management of distributors or representatives;
- difficulties in staffing and managing foreign operations;
- political and economic changes and disruptions;
- governmental currency controls;
- shipping costs;
- currency exchange rate fluctuations; and
- tariff regulations.

We anticipate that our international sales will continue to account for a significant percentage of our net sales. If foreign markets for our current and future products develop more slowly than currently expected, our sales and our future results of operations may be harmed.

FLUCTUATIONS IN THE FOREIGN CURRENCY EXCHANGE RATES IN RELATION TO THE U.S. DOLLAR COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR OPERATING RESULTS.

Changes in currency exchange rates that increase the relative value of the U.S. dollar may make it more difficult for us to compete with foreign manufacturers on price, or may otherwise have a material adverse effect on our sales and operating results. A significant increase in our foreign currency denominated sales would increase our risk associated with foreign currency fluctuations.

OUR FUTURE SUCCESS WILL DEPEND ON THE CONTINUED SERVICES OF OUR EXECUTIVE OFFICERS AND KEY RESEARCH AND DEVELOPMENT PERSONNEL WITH EXPERTISE IN HARDWARE AND SOFTWARE DEVELOPMENT.

The loss of any of our executive officers or key research and development personnel, the inability to attract or retain qualified personnel in the future or delays in hiring skilled personnel could harm our business. Competition for skilled personnel is significant. We may be unable to attract and retain all the personnel necessary for the development of our business. In addition, the loss of Frank B. Manning, our president and chief executive officer, or Peter Kramer, our executive vice president, some other member of the management team, a key engineer, or other key contributors, could harm our relations with our customers, our ability to respond to technological change, and our business.

OUR BUSINESS MAY BE HARMED BY ACQUISITIONS WE MAY COMPLETE IN THE FUTURE.

We may pursue acquisitions of related businesses, technologies, product lines, or products. Our identification of suitable acquisition candidates involves risk inherent in assessing the values, strengths, weaknesses, risks and profitability of acquisition candidates, including the effects of the possible acquisition on our business, diversion of our management's attention, risk of increased leverage, shareholder dilution, risk associated with unanticipated

problems, and risks associated with liabilities we assume. If we pursue any such transaction, we cannot assure that we would be able to successfully negotiate the terms of such transaction, finance such transaction, or integrate such business, products or technologies into our existing business and products.

WE MAY HAVE DIFFICULTY PROTECTING OUR INTELLECTUAL PROPERTY.

Our ability to compete is heavily affected by our ability to protect our intellectual property. We rely primarily on trade secret laws, confidentiality procedures, patents, copyrights, trademarks, and licensing arrangements to protect our intellectual property. The steps we take to protect our technology may be inadequate. Existing trade secret, trademark and copyright laws offer only limited protection. Our patents could be invalidated or circumvented. We have more intellectual property assets in some countries than we do in others. In addition, the laws of some foreign countries in which our products are or may be developed, manufactured or sold may not protect our products or intellectual property rights to the same extent as do the laws of the United States. This may make the possibility of piracy of our technology and products more likely We cannot assure that the steps that we have taken to protect our intellectual property will be adequate to prevent misappropriation of our technology.

WE COULD INFRINGE THE INTELLECTUAL PROPERTY RIGHTS OF OTHERS.

Particular aspects of our technology could be found to infringe on the intellectual property rights or patents of others. Other companies may hold or obtain patents on inventions or may otherwise claim proprietary rights to technology necessary to our business. We cannot predict the extent to which we may be required to seek licenses. We cannot assure that the terms of any licenses we may be required to seek will be reasonable. We are often indemnified by our suppliers relative to certain intellectual property rights; but these indemnifications do not cover all possible suits, and there is no guarantee that a relevant indemnification will be honored by the indemnifying company.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We own financial instruments that are sensitive to market risks as part of our investment portfolio. The investment portfolio is used to preserve our capital until it is required to fund operations, including our research and development activities. None of these market-risk sensitive instruments are held for trading purposes. We do not own derivative financial instruments in our investment portfolio. The investment portfolio contains instruments that are subject to the risk of a decline in interest rates.

Investment Rate Risk - Our investment portfolio consists entirely of money market funds, which are subject to interest rate risk. Due to the short duration and conservative nature of these instruments, we do not believe that it has a material exposure to interest rate risk. The 20 year mortgage of our headquarters building is a variable rate loan with the interest rate adjusted annually. A 1% change in the interest rate would result in a decrease or increase of approximately $53,000 of interest expense per year.

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 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 and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized 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, 2004 we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and 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 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 6. Exhibits and reports on Form 8-K

(a) Exhibits

31.1 CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 CFO 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.

32.2 CFO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Form 8-K

On February 11, 2004, the Company furnished a Current Report on Form 8-K relating to its financial information for the quarter ended December 31, 2003, as presented in a press release dated February 11, 2004.

On February 18, 2004, the Company furnished a Current Report on Form 8-K announcing potential stock option exercises by members of senior management, as presented in a press release dated February 17, 2004.

ZOOM TECHNOLOGIES, INC. AND SUBSIDIARY

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 TECHNOLOGIES, INC.

Date: May 14, 2004   By: /s/ Frank B. Manning

Frank B. Manning, President

Date: May 14, 2004   By: /s/ Robert Crist

Robert Crist, Vice President of Finance and Chief Financial Officer (Principal Financial and Accounting Officer)

EXHIBIT INDEX

Exhibit No.	Description
31.1	CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	CFO 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
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