

FULLNET COMMUNICATIONS INC

Form 10-Q

May 15, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2018

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: 000-27031

FULLNET COMMUNICATIONS INC.

(Exact name of registrant as specified in its charter)

OKLAHOMA

731473361

(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation or organization)

201 Robert S. Kerr Avenue, Suite 210

Oklahoma City, Oklahoma 73102

(Address of principal executive offices)

(405) 236-8200

(Registrant's telephone number)

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting Company
Emerging-growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of May 15, 2018, 11,871,009 shares of the registrant's common stock, \$0.00001 par value, were outstanding.

FORM 10-Q

TABLE OF CONTENTS

| | Page |
|---|------|
| <u>PART I. FINANCIAL INFORMATION</u> | |
| <u>Condensed Consolidated Balance Sheets — March 31, 2018 (Unaudited) and December 31, 2017</u> | 3 |
| <u>Condensed Consolidated Statements of Operations — Three months ended March 31, 2018 and 2017 (Unaudited)</u> | 4 |
| <u>Condensed Consolidated Statements of Stockholders' Deficit — Three months ended March 31, 2018 (Unaudited)</u> | 5 |
| <u>Condensed Consolidated Statements of Cash Flows — Three months ended March 31, 2018 and 2017 (Unaudited)</u> | 6 |
| <u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u> | 7 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 13 |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | 17 |
| <u>Item 4. Controls and Procedures</u> | 17 |
| <u>PART II. OTHER INFORMATION</u> | |
| <u>Item 1. Legal Proceedings</u> | 18 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 18 |
| <u>Item 5. Other Information</u> | 18 |
| <u>Item 6. Exhibits</u> | 18 |
| <u>Signatures</u> | 21 |

Exhibit 31.1

Exhibit 32.1

- 2 -

Table of Contents**FullNet Communications, Inc. and Subsidiaries****CONDENSED CONSOLIDATED BALANCE SHEETS**

| | MARCH 31, 2018 (Unaudited) | DECEMBER 31, 2017 |
|---|---|------------------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash | \$143,423 | \$29,399 |
| Accounts receivable, net | 673 | 8,854 |
| Prepaid expenses and other current assets | 28,867 | 6,110 |
| Total current assets | 172,963 | 44,363 |
| PROPERTY AND EQUIPMENT, net | 43,184 | 39,448 |
| OTHER ASSETS AND INTANGIBLE ASSETS | 19,604 | 21,813 |
| ASSETS OF DISCONTINUED OPERATIONS, net (NOTE 8) | 23,779 | 29,343 |
| TOTAL ASSETS | \$259,530 | \$134,967 |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | | |
| CURRENT LIABILITIES | | |
| Accounts payable | \$41,110 | \$37,371 |
| Accounts payable, related party | 516 | 7,982 |
| Accrued and other liabilities | 638,540 | 610,107 |
| Convertible notes payable, related party - current portion | 7,203 | 5,354 |
| Deferred revenue | 435,279 | 397,931 |
| Total current liabilities | 1,122,648 | 1,058,745 |
| CONVERTIBLE NOTES PAYABLE, related party - less current portion | 24,730 | 27,888 |

| | | |
|---|---------------------|---------------------|
| LIABILITIES OF DISCONTINUED OPERATIONS (NOTE 8) | 82,255 | 193,812 |
| Total liabilities | 1,229,633 | 1,280,445 |
| STOCKHOLDERS' DEFICIT | | |
| Preferred stock — \$0.001 par value; authorized, 10,000,000 shares; Series A convertible; issued and outstanding, 987,102 shares in 2018 and 2017 | 625,399 | 618,675 |
| Common stock — \$0.00001 par value; authorized, 40,000,000 shares; issued and outstanding, 11,871,009 shares in 2018 and 2017 | 119 | 119 |
| Additional paid-in capital | 8,702,982 | 8,640,769 |
| Accumulated deficit | (10,298,603) | (10,405,041) |
| Total stockholders' deficit | (970,103) | (1,145,478) |
| TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT | \$259,530 | \$134,967 |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**FullNet Communications, Inc. and Subsidiaries****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**

| | Three Months Ended | |
|---|---------------------------|-----------------------|
| | March 31, 2018 | March 31, 2017 |
| REVENUES | | |
| Access service revenues | \$10,206 | \$11,859 |
| Co-location and other revenues | 496,854 | 453,724 |
| Total revenues | 507,060 | 465,583 |
| OPERATING COSTS AND EXPENSES | | |
| Cost of access service revenues | 2,527 | 2,429 |
| Cost of co-location and other revenues | 46,309 | 33,988 |
| Selling, general and administrative expenses | 550,357 | 393,125 |
| Depreciation and amortization | 4,389 | 4,773 |
| Total operating costs and expenses | 603,582 | 434,315 |
| INCOME (LOSS) FROM OPERATIONS | (96,522) | 31,268 |
| OTHER INCOME | 6,000 | - |
| INTEREST EXPENSE | (330) | (754) |
| INCOME TAX EXPENSE | (4,666) | - |
| Net income (loss) from continuing operations | (95,518) | 30,514 |
| Gain from sale of discontinued asset | 233,277 | - |
| Net income (loss) from discontinued operations (NOTE 8) | (31,321) | (25,325) |
| NET INCOME | \$106,438 | \$5,189 |
| Preferred stock dividends | (6,724) | (6,724) |
| Net income (loss) available to common stockholders | \$99,714 | \$(1,535) |

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Net income (loss) per share:

| | | |
|-----------------------------------|--------|----------|
| Continuing operations – basic | (0.01) | 0.00 |
| Continuing operations – diluted | (0.01) | 0.00 |
| Discontinued operations – basic | 0.02 | (0.00) |
| Discontinued operations – diluted | 0.02 | (0.00) |
| Net Income - basic and diluted | \$0.01 | \$(0.00) |

Weighted average common shares outstanding:

| | | |
|---------|------------|------------|
| Basic | 11,871,009 | 11,871,009 |
| Diluted | 11,871,009 | 14,289,011 |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**FullNet Communications, Inc. and Subsidiaries****CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT (UNAUDITED)**

Three Months Ended March 31, 2018

| | Common stock | | Preferred stock | | Additional | Accumulated | |
|---|--------------|--------|-----------------|-----------|-----------------|-----------------|------------|
| | Shares | Amount | Shares | Amount | paid-in capital | deficit | Total |
| Balance at January 1, 2018 | 11,871,009 | \$119 | 987,102 | \$618,675 | \$8,640,769 | \$ (10,405,041) | \$ (1,145, |
| Stock options compensation | - | - | - | - | 68,937 | - | 68,937 |
| Amortization of increasing dividend rate preferred stock discount | - | - | - | 6,724 | (6,724) | - | - |
| Net income | - | - | - | - | - | 106,438 | 106,438 |
| Balance at March 31, 2018 – (unaudited) | 11,871,009 | \$119 | 987,102 | \$625,399 | \$8,702,982 | \$ (10,298,603) | \$ (970,10 |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**FullNet Communications, Inc. and Subsidiaries****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

| | Three Months Ended | |
|---|---------------------------|-----------------------|
| | March 31, 2018 | March 31, 2017 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income (loss) | \$106,438 | \$5,189 |
| (Income) loss from discontinued operations | (201,956) | 25,325 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities | | |
| Depreciation and amortization | 4,389 | 4,773 |
| Stock options compensation | 68,937 | 1,651 |
| Provision for uncollectible accounts receivable | 110 | 238 |
| Net (increase) decrease in | | |
| Accounts receivable | 8,071 | 378 |
| Prepaid expenses and other current assets | (22,757) | (19,019) |
| Net increase (decrease) in | | |
| Accounts payable | 3,739 | (17,171) |
| Accounts payable – related party | (7,466) | (13,935) |
| Accrued and other liabilities | 28,433 | 22,160 |
| Deferred revenue | 37,348 | 39,598 |
| Net cash provided by operating activities | 25,286 | 49,187 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Cash paid for property and equipment | (5,916) | (766) |
| Cash paid for intangible asset | – | (7,700) |
| Net cash used in investing activities | (5,916) | (8,466) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Principal payments on borrowings under notes payable – related party | (1,309) | (1,648) |
| Net cash used in financing activities | (1,309) | (1,648) |
| DISCONTINUED OPERATIONS | | |
| Net cash used in operating activities | (5,598) | (19,814) |
| Net cash provided by investing activities | 218,153 | – |

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| | | |
|--|------------------|-----------------|
| Net cash used in financing activities | (116,592) | (9,192) |
| Net cash provided by (used in) discontinued operations | 95,963 | (29,006) |
| NET INCREASE (DECREASE) IN CASH – CONTINUING OPERATIONS | 114,024 | 10,067 |
| Cash at beginning of period | 29,399 | 19,383 |
| Cash at end of period | \$143,423 | \$29,450 |

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

| | | |
|--|----------------|--------------|
| Cash paid for income tax | \$4,666 | \$– |
| Cash paid for interest – continuing operations | 492 | 754 |
| Cash paid for interest – discontinued operations | 51 | 4,010 |

NON-CASH INVESTING AND FINANCING ACTIVITIES

| | | |
|---|----------------|----------------|
| Intangible asset purchased on account | \$– | \$8,300 |
| Amortization of increasing dividend rate preferred stock discount | \$6,724 | \$6,724 |

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents

FullNet Communications, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. UNAUDITED INTERIM FINANCIAL STATEMENTS

The unaudited condensed consolidated financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. The accompanying unaudited condensed consolidated financial statements and related notes should be read in conjunction with the audited consolidated financial statements of the Company and notes thereto for the year ended December 31, 2017.

Certain reclassifications have been made to prior period balances to conform with the presentation for the current period. These reclassifications did not impact the net income (loss).

The information furnished reflects, in the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results of the interim periods presented. Operating results of the interim period are not necessarily indicative of the amounts that will be reported for the year ending December 31, 2018.

Recent Accounting Pronouncement

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09 (Topic 606) "Revenue from Contracts with Customers." Topic 606 supersedes the revenue recognition requirements in Accounting Standards Codification Topic 605, "revenue Recognition", and requires entities to recognize revenue when they transfer control of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. We adopted Topic 606 as of January 1, 2018. The adoption of Topic 606 did not have any impact to our consolidated financial statements, including the presentation of revenues in our Consolidated Statements of Income.

Income (Loss) Per Share

Income (loss) per share – basic is calculated by dividing net income (loss) by the weighted average number of shares of stock outstanding during the year, including shares issuable without additional consideration. Income per share – assuming dilution is calculated by dividing net income by the weighted average number of shares outstanding during the year adjusted for the effect of dilutive potential shares calculated using the treasury stock method.

- 7 -

Table of Contents

Schedule of Income (Loss) Per Share

| | Three Months Ended | |
|--|--------------------|----------------|
| | March 31, 2018 | March 31, 2017 |
| Net income (loss): | | |
| Income (loss) from continuing operations | \$ (95,518) | \$30,514 |
| Income (loss) from discontinued operations - See Note 8 | 201,956 | (25,325) |
| Net income | 106,438 | 5,189 |
| Preferred stock dividends | (6,724) | (6,724) |
| Net income (loss) available to common shareholders | 99,714 | (1,535) |
| Basic income (loss) per share: | | |
| Weighted average common shares outstanding used in income (loss) per share computation | 11,871,009 | 11,871,009 |
| Basic income (loss) per share: | | |
| Continuing operations | (0.01) | 0.00 |
| Discontinued operations – See Note 8 | 0.02 | (0.00) |
| Basic income (loss) per share | 0.01 | (0.00) |
| Diluted income (loss) per share: | | |
| Shares used in diluted income (loss) per share | 11,871,009 | 14,289,011 |
| Diluted income (loss) per share | | |
| Continuing operations | (0.01) | 0.00 |
| Discontinued operations – See Note 8 | 0.02 | (0.00) |
| Diluted income (loss) per share | 0.01 | (0.00) |
| Computation of shares used in income (loss) per share: | | |
| Weighted average shares and share equivalents outstanding - basic | 11,871,009 | 11,871,009 |
| Effect of preferred stock | – | 987,102 |
| Effect of dilutive stock options | – | 1,228,407 |
| Effect of dilutive warrants | – | 202,493 |
| Weighted average shares and share equivalents outstanding – diluted | 11,871,009 | 14,289,011 |

Schedule of Anti-dilutive Securities Excluded

Three Months Ended

| | March 31, 2018 | March 31, 2017 |
|---|------------------|----------------|
| Preferred stock | 987,102 | - |
| Stock options | 4,120,834 | 36,000 |
| Warrants | 250,000 | - |
| Convertible promissory notes | 31,933 | 172,411 |
| Total anti-dilutive securities excluded | 5,389,869 | 208,411 |

Anti-dilutive securities consist of stock options and convertible promissory notes whose exercise price or conversion price, respectively, was greater than the average market price of the common stock.

2. GOING CONCERN AND MANAGEMENT'S PLANS

At March 31, 2018 current liabilities exceeded current assets by \$949,685. The Company does not have a line of credit or credit facility to serve as an additional source of liquidity. Historically the Company has relied on shareholder loans as an additional source of funds. These factors raise substantial doubts about the Company's ability to continue as a going concern.

The ability of the Company to continue as a going concern is dependent upon continued operations of the Company that in turn is dependent upon the Company's ability to meet its financing requirements on a continuing basis, to maintain present financing, to achieve the objectives of its business plan and to succeed in its future operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

Table of Contents

The Company's business plan includes, among other things, expansion through mergers and acquisitions and the development of its co-location and advanced voice and data solutions. Execution of the Company's business plan will require significant capital to fund capital expenditures, working capital needs and debt service. Current cash balances will not be sufficient to fund the Company's current business plan beyond the next few months. As a consequence, the Company is currently focusing on revenue enhancement and cost cutting opportunities as well as working to sell non-core assets and to extend vendor payment terms. The Company continues to seek additional convertible debt or equity financing as well as the placement of a credit facility to fund the Company's liquidity. There can be no assurance that the Company will be able to obtain additional capital on satisfactory terms, or at all, or on terms that will not dilute the shareholders' interests.

3. CONVERTIBLE NOTES PAYABLE RELATED PARTY

At December 31, 2017 the Company had a secured convertible promissory note from a shareholder with a balance of \$33,242. The interest rate of this note is 6%, required monthly installments of interest only through May 31, 2014, then requires monthly installments of \$600 including principal and interest and matures May 31, 2023. This convertible promissory note is secured by certain equipment of the Company. The note holder has the right to convert the note, in its entirety or in part, into common stock of the Company at the rate of \$1.00 per share. During the three months ended March 31, 2018, the Company made principal and interest payments totaling \$1,801, of which \$1,309 applied to the principal. The secured convertible promissory note had a balance of \$31,933 at March 31, 2018 of which \$7,203 is short-term and \$24,730 is long-term.

4. STOCK BASED COMPENSATION

The following table summarizes the Company's employee stock option activity for the three months ended March 31, 2018:

Schedule of Employee Stock Option Activity

| Options | Weighted average exercise price | Weighted average remaining | Aggregate Intrinsic value |
|---------|------------------------------------|-------------------------------|------------------------------|
|---------|------------------------------------|-------------------------------|------------------------------|

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| | | | contractual life (yrs) | |
|--|-----------|---------|------------------------|-----------|
| Options outstanding, December 31, 2017 | 2,110,834 | \$.006 | 8.18 | |
| Options exercisable, December 31, 2017 | 626,834 | \$0.003 | 6.03 | \$ 22,902 |
| Options issued during the period | 2,010,000 | 0.040 | | |
| Options outstanding, March 31, 2018 | 4,120,834 | \$0.023 | 8.88 | |
| Options exercisable, March 31, 2018 | 2,822,167 | \$0.027 | 8.81 | \$ 26,678 |

During the three months ended March 31, 2018, 2,010,000 nonqualified employee stock options were granted with an exercise price of \$.04. The options were valued using Black-Scholes option pricing model on the respective date of issuance and the fair value of the shares was determined to be \$76,895 of which \$67,280 was recognized as stock-based compensation expense for the three months ended March 31, 2018. 1,750,000 of the stock options vested immediately and 260,000 will vest one-fifth on each annual anniversary date of the grant. The total 2,010,000 will expire ten years from the date of the grant.

Total stock-based compensation expense for the three months ended March 31, 2018 was \$68,937 of which \$67,280 was related to options issued during the three months ended March 31, 2018 and \$1,657 was related to options issued in prior years.

Stock-based compensation is measured at the grant date, based on the calculated fair value of the option, and is recognized as an expense on a straight-line basis over the requisite employee service period (generally the vesting period of the grant).

The Black-Scholes option pricing model was used with the following weighted-average assumptions for options granted during the three months ended March 31, 2018:

Table of Contents

| | 2018 |
|---------------------------|-------------|
| Risk free interest rate | 2.65% |
| Expected lives (in years) | 5 |
| Expected volatility | 178% |
| Dividend yield | 0% |

5. SERIES A CONVERTIBLE PREFERRED STOCK

On March 9, 2018 the Company's board of directors made the determination that it was in the best interest of the Company and its stockholders to conserve the Company's working capital at this time and not make the annual dividend payment for the year ending December 31, 2017, on its Series A Convertible Preferred Stock. The Company has never made an annual dividend payment on its Series A convertible preferred stock.

The amortization of the increasing dividend rate preferred stock discount for the three months ended March 31, 2018 was \$6,724.

6. PROPERTY AND EQUIPMENT

During the three months ended March 31, 2018, 5,916 was paid for property and equipment and \$2,180 was recorded as depreciation expense.

During the three months ended March 31, 2017, \$766 was paid for property and equipment and \$2,432 was recorded as depreciation expense.

7. INTANGIBLE ASSET

During the three months ended March 31, 2018, \$2,209 was recorded as amortization expense.

During the three months ended March 31, 2017, \$7,700 was paid for an intangible asset and \$2,341 was recorded as amortization expense.

8. DISCONTINUED OPERATIONS

In response to the changes in the telecommunications market and deterioration in the Company's ability to effectively compete, the Company made the decision to exit the CLEC business. On October 27, 2017, the Company's board of directors adopted a plan to exit the CLEC business as soon as possible through the sale of its wholly owned CLEC subsidiary and/or substantially all of its CLEC subsidiary's operating assets. The Company was in negotiations with a potential buyer at December 31, 2017, which buyer subsequently purchased substantially all of its CLEC subsidiary's operating assets pursuant to an asset purchase agreement which was executed and closed on February 1, 2018, (the "Sale").

The Company determined that the Sale represented a strategic shift that will have a major effect on the Company's operations and financial results since it represented a complete exit from the CLEC business and, therefore, classified its CLEC subsidiary as held for sale at December 31, 2017.

The Company recognized a gain of \$233,277 on the Sale based on total considerations of \$264,872 less total basis in the assets sold and transactions costs of \$31,595. The assets sold consisted primarily of customers and associated customer premise equipment.

Table of Contents

Consideration:

| | |
|---|-------------------|
| Cash | \$ 246,500 |
| Assumption of deferred revenue | 8,366 |
| Waived service obligation for February 2018 | 10,006 |
| Total consideration | \$ 264,872 |

Total assets sold:

| | |
|---------------------|-------------------|
| Customer contracts | \$ - |
| Fiber innerduct | 3,248 |
| Fiber strands | - |
| Customer CPE | - |
| Total assets | 3,248 |
| Transactional costs | 28,347 |
| Total basis | \$ 31,595 |
| Net gain | \$ 233,277 |

At December 31, 2017, the Company had a secured convertible promissory note from a shareholder with a balance of \$116,592. The interest rate of this note was 6% through December 31, 2014, 7% through December 31, 2015 and was 8% through December 31, 2016, 8.5% through December 31, 2017, and 9% through May 31, 2018, with fixed monthly payments of \$3,301 and matures May 31, 2018, at which time the remaining balance of principal and all accrued interest shall be due and payable. This convertible promissory note is secured by all tangible and intangible assets of the Company. The note holder has the right to convert the note, in its entirety or in part, into common stock of the Company at the rate of \$1.00 per share. During the three months ended March 31, 2018, the Company paid the remaining balance of \$116,592 in full.

Assets and Liabilities of Discontinued Operations

| | March 31, 2018 | December 31, 2017 |
|---|-----------------------|--------------------------|
| Carrying amounts of assets included in discontinued operations | | |
| Cash | \$2,007 | \$1,801 |
| Prepaid expenses and other current assets | 2,467 | 2,671 |
| Property and equipment, net | 19,305 | 24,871 |
| Total Assets of Discontinued Operations | \$23,779 | \$29,343 |

Carrying amounts of liabilities included in discontinued operations

| | | |
|---|-----------------|------------------|
| Accounts payable | \$59,312 | \$57,342 |
| Accrued and other liabilities | 22,943 | 19,878 |
| Convertible notes payable, related party – current portion | – | 116,592 |
| Convertible notes payable, related party – less current portion | – | – |
| Total Liabilities of Discontinued Operations | \$82,255 | \$193,812 |

Operating Results of Discontinued Operations

| | March 31, 2018 | March 31, 2017 |
|---|------------------|--------------------|
| Revenues included in discontinued operations | | |
| Total colocation and other revenues | \$28,091 | \$ 42,280 |
| Operating costs and expenses included in discontinued operations | | |
| Cost of services | \$53,886 | \$ 56,396 |
| Selling, general and administrative expenses | 3,157 | 4,662 |
| Depreciation and amortization | 2,318 | 2,537 |
| Interest expense | 51 | 4,010 |
| Total operating costs and expenses included in discontinued operations | 59,412 | 67,605 |
| Other Income included in discontinued operations | | |
| Gain on sale of assets | 233,277 | - |
| Net Income (Loss) from Discontinued Operations | \$201,956 | \$ (25,325) |
| Net Income (Loss) per share from discontinued operations basic and diluted | \$0.02 | \$ (0.00) |

Table of Contents

Cash Flows from Discontinued Operations

| | March 31,2018 | March 31, 2017 |
|---|----------------------|---------------------------|
| Net cash used in operating activities | (5,598) | (19,814) |
| Net cash provided by investing activities | 218,153 | - |
| Net cash used in financing activities | (116,592) | (9,192) |
| Net cash provided by (used in) discontinued operations | 95,963 | (29,006) |

- 12 -

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion is qualified in its entirety by the more detailed information in our 2017 Annual Report on Form 10-K and the financial statements contained therein, including the notes thereto, and our other periodic reports filed with the Securities and Exchange Commission since December 31, 2017 (collectively referred to as the "Disclosure Documents"). Certain forward-looking statements contained in this Report and in the Disclosure Documents regarding our business and prospects are based upon numerous assumptions about future conditions which may ultimately prove to be inaccurate and actual events and results may materially differ from anticipated results described in such statements. Our ability to achieve these results is subject to certain risks and uncertainties, including those inherent risks and uncertainties generally in the Internet service provider and competitive local exchange carrier industries, the impact of competition and pricing, changing market conditions, and other risks. Any forward-looking statements contained in this Report represent our judgment as of the date of this Report. We disclaim, however, any intent or obligation to update these forward-looking statements. As a result, the reader is cautioned not to place undue reliance on these forward-looking statements.

Overview

We are an integrated communications provider. Through our subsidiaries, we provide high quality, reliable and scalable Internet access, web hosting, equipment co-location, customized live help desk outsourcing services, group text and voice message delivery services, traditional telephone services as well as advanced voice and data solutions.

References to us in this Report include our subsidiaries: FullNet, Inc. ("FullNet"), FullTel, Inc. ("FullTel"), and FullWeb, Inc. ("FullWeb"). Our principal executive offices are located at 201 Robert S. Kerr Avenue, Suite 210, Oklahoma City, Oklahoma 73102, and our telephone number is (405) 236-8200. We also maintain Internet sites on the World Wide Web ("WWW") at www.fullnet.net, www.fulltel.com and www.callmultiplier.com. Information contained on our Web sites is not, and should not be deemed to be, a part of this Report.

Company History

We were founded in 1995 as CEN-COM of Oklahoma, Inc., an Oklahoma corporation, to bring dial-up Internet access and education to rural locations in Oklahoma that did not have dial-up Internet access. We changed our name to FullNet Communications, Inc. in December 1995. Today we are an integrated communications provider.

We market our carrier neutral co-location solutions in our network operations center to other competitive local exchange carriers, Internet service providers and web-hosting companies. Our co-location facility is carrier neutral, allowing customers to choose among competitive offerings rather than being restricted to one carrier. Our data center is Telco-grade and provides customers a high level of operative reliability and security. We offer flexible space arrangements for customers and 24-hour onsite support with both battery and generator backup.

Through FullTel, our wholly owned subsidiary, we are a fully licensed competitive local exchange carrier or CLEC in Oklahoma. FullTel activates local access telephone numbers for the cities in which we market, sell and operate our retail FullNet Internet service provider brand, wholesale dial-up Internet service; our business-to-business network design, connectivity, domain and Web hosting businesses; and traditional telephone services as well as advanced voice and data solutions. At December 31, 2017 FullTel provided us with local telephone access in approximately 232 cities.

In response to changes in the telecommunications market and deterioration in our ability to effectively compete, we made the decision in the fourth quarter of 2017, to affect an orderly exit from the CLEC business. We were in negotiations with a potential buyer at December 31, 2017, which buyer subsequently purchased substantially all of FullTel's operating assets pursuant to an asset purchase agreement which was executed and closed on February 1, 2018.

Through CallMultiplier, our wholly owned subsidiary, we offer a comprehensive cloud-based solution to consumers and businesses for automated group voice and text message delivery.

Our common stock trades on the OTC "Pink Sheets" under the symbol FULO. While our common stock trades on the OTC "Pink Sheets", it is very thinly traded, and there can be no assurance that our stockholders will be able to sell their shares should they so desire. Any market for the common stock that may develop, in all likelihood, will be a limited one, and if such a market does develop, the market price may be volatile.

Table of Contents**Results of Operations**

The following table, which includes both continuing and discontinued operations (see Note 8 – Discontinued Operations of the financial statement appearing elsewhere in this Report), sets forth certain statement of operations data as a percentage of revenues for the three months ended March 31, 2018 and 2017:

| | Three Months Ended | | | March 31, 2017 | | |
|--|---------------------------|----------------|---|-----------------------|----------------|---|
| | March 31, 2018 | | | Amount | Percent | |
| | Amount | Percent | | Amount | Percent | |
| Revenues: | | | | | | |
| Access service revenues | \$ 10,206 | 2.0 | % | \$ 11,859 | 2.5 | % |
| Co-location and other revenues | 496,854 | 98.0 | | 453,724 | 97.5 | |
| Total revenues | 507,060 | 100.0 | | 465,583 | 100.0 | |
| Cost of access service revenues | 2,527 | 0.5 | | 2,429 | 0.5 | |
| Cost of co-location and other revenues | 46,309 | 9.1 | | 33,988 | 7.3 | |
| Selling, general and administrative expenses | 550,357 | 108.5 | | 393,125 | 84.4 | |
| Depreciation and amortization | 4,389 | 0.9 | | 4,773 | 1.0 | |
| Total operating costs and expenses | 603,582 | 119.0 | | 434,315 | 93.2 | |
| Income (loss) from operations | (96,522) | (19.0) | | 31,268 | 6.7 | |
| Other income | 6,000 | 1.2 | | – | – | |
| Interest expense | (330) | (0.1) | | (754) | (0.2) | |
| Income tax expense | (4,666) | (0.9) | | – | – | |
| Net income (loss) from continuing operations | \$ (95,518) | (18.8) | % | \$ 30,514 | 6.6 | % |
| Net income (loss) from discontinued operations | 201,956 | 39.8 | | (25,325) | (5.4) | |
| Net income | 106,438 | 21.0 | | 5,189 | 1.1 | |
| Preferred stock dividends | (6,724) | (1.3) | | (6,724) | (1.4) | |
| Net income available to common stockholders | \$ 99,714 | 19.7 | % | \$ (1,535) | (0.3) | % |

Three Months Ended March 31, 2018 (the “2018 1st Quarter”) Compared to Three Months Ended March 31, 2017 (the “2017 1st Quarter”)

Revenues

Access service revenues decreased \$1,653 or 13.9% to \$10,206 for the 2018 1st Quarter from \$11,859 for the same period in 2017 primarily due to a decline in the number of customers.

Co-location and other revenues increased \$43,130 or 9.5% to \$496,854 for the 2018 1st Quarter from \$453,724 for the same period in 2017. This increase was primarily attributable to the net addition of new customers and the sale of additional services to existing customers.

Operating Costs and Expenses

Cost of access service increased \$98 or 4.0% to \$2,527 for the 2018 1st Quarter from \$2,429 for the same period in 2017. This increase was primarily due to increases in costs of servicing access customers. Cost of access service revenues as a percentage of access service revenues remained unchanged at .5% during the 2018 1st Quarter from the same period in 2017.

Cost of co-location and other revenues increased \$12,321 or 36.3% to \$46,309 for the 2018 1st Quarter from \$33,988 for the same period in 2017. This increase was primarily related to an increase in advertising costs. Cost of co-location and other revenues as a percentage of co-location and other revenues increased to 9.1% during the 2018 1st Quarter, compared to 7.3% during the same period in 2017.

Selling, general and administrative expenses increased \$157,232 or 40.0% to \$550,357 for the 2018 1st Quarter compared to \$393,125 for the same period in 2017. This increase was primarily related to increases in employee costs, advertising,

Table of Contents

professional services, rent expense, and credit card fees of \$128,463, \$21,634, \$2,929, \$2,452, and \$2,005, respectively. Selling, general and administrative expenses as a percentage of total revenues increased to 108.5 during the 2018 1st Quarter from 84.4% during the same period in 2017.

Depreciation and amortization expense decreased \$384 or 8.0% to \$4,389 for the 2018 1st Quarter compared to \$4,773 for the same period in 2017. This decrease was primarily related to several assets reaching full depreciation.

Interest Expense

Interest expense decreased \$424 or 56.2% to \$330 for the 2018 1st Quarter compared to \$754 for the same period in 2017. This decrease was primarily related to the payoff of the related-party note payable made during the 2018 1st Quarter.

Liquidity and Capital Resources

As of March 31, 2018, we had \$143,423 in cash and \$1,122,648 in current liabilities, including \$435,279 of deferred revenues that will not require settlement in cash.

At March 31, 2018 and December 31, 2017, we had working capital deficits of \$949,685 and \$1,014,382, respectively. We do not have a line of credit or credit facility to serve as an additional source of liquidity. Historically we have relied on shareholder loans as an additional source of funds.

As of March 31, 2018, of the \$41,110 we owed to our trade creditors \$29,072 was past due. We have no formal agreements regarding payment of these amounts.

Cash flow for the three-month periods ended March 31, 2018 and 2017 consist of the following.

| | For the Three-Months Periods Ended | |
|---|---------------------------------------|-----------------|
| | March 31, | |
| | 2018 | 2017 |
| Net cash flows provided by operating activities | \$25,286 | \$49,187 |
| Net cash flows used in investing activities | (5,916) | (8,466) |
| Net cash flows used in financing activities | (1,309) | (1,648) |

Cash used for the purchase of property and equipment was \$5,916 and \$766, respectively, for the three months ended March 31, 2018 and 2017.

No intangible assets were purchased in the three months ended March 31, 2018, and cash used for the purchase of

intangible assets was \$7,700 in the three months ended March 31, 2017.

Cash used for principal payments on notes payable was \$1,309 and \$1,648, respectively, for the three months ended March 31, 2018 and 2017.

The planned expansion of our business will require significant capital to fund capital expenditures, working capital needs, and debt service. Our principal capital expenditure requirements will include:

- mergers and acquisitions and
- further development of operations support systems and other automated back office systems

Because our cost of developing new networks and services, funding other strategic initiatives, and operating our business depend on a variety of factors (including, among other things, the number of customers and the service for which they subscribe, the nature and penetration of services that may be offered by us, regulatory changes, and actions taken by competitors in response to our strategic initiatives), it is almost certain that actual costs and revenues will materially vary from expected amounts and these variations are likely to increase our future capital requirements. Our current cash balances will not be sufficient to fund our current business plan beyond a few months. As a consequence, we are currently focusing on revenue enhancement and cost cutting opportunities as well as working to sell non-core assets and to extend vendor payment terms. We continue to seek additional convertible debt or equity financing as well as the placement of a credit facility to fund our liquidity. There is no assurance that we will be able to obtain additional capital on satisfactory terms or at all or on terms that will not dilute our shareholders' interests.

Table of Contents

Until we obtain sufficient additional capital, the further development of our network will be delayed or we will be required to take other actions. Our inability to obtain additional capital resources has had and will continue to have a material adverse effect on our business, operating results and financial condition.

Our ability to fund the capital expenditures and other costs contemplated by our business plan and to make scheduled payments with respect to borrowings will depend upon, among other things, our ability to seek and obtain additional financing in the near term. Capital will be needed in order to implement our business plan, deploy our network, expand our operations and obtain and retain a significant number of customers in our target markets. Each of these factors is, to a large extent, subject to economic, financial, competitive, political, regulatory, and other factors, many of which are beyond our control.

There is no assurance that we will be successful in developing and maintaining a level of cash flows from operations sufficient to permit payment of our outstanding indebtedness. If we are unable to generate sufficient cash flows from operations to service our indebtedness, we will be required to modify or abandon our growth plans, limit our capital expenditures, restructure or refinance our indebtedness or seek additional capital or liquidate our assets. There is no assurance that (i) any of these strategies could be effectuated on satisfactory terms, if at all, or on a timely basis or (ii) any of these strategies will yield sufficient proceeds to service our debt or otherwise adequately fund operations.

On March 9, 2018, the Company's board of directors made the determination that it was in the best interest of the Company and its stockholders to conserve our working capital at this time and not make the annual dividend payment for the year ending December 31, 2017. We have never made an annual dividend payment on our Series A convertible preferred stock.

Financing Activities

We had a secured convertible promissory note from a shareholder which requires monthly installments of \$3,301 including principal and interest and is secured by all of our tangible and intangible assets. The note was paid in full on February 1, 2018 in the amount of \$116,592.

We have a secured convertible promissory note from a shareholder which requires monthly installments of interest only through May 31, 2014 then monthly installments of \$600 including principal and interest. This note is secured by certain equipment. At March 31, 2018, the outstanding principal and accrued interest of the secured convertible promissory note was \$31,933.

Critical Accounting Policies and Estimates

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect certain reported amounts and disclosures. In applying these accounting principles, we must often make individual estimates and assumptions regarding expected outcomes or uncertainties. As might be expected, the actual results or outcomes are generally different than the estimated or assumed amounts. These differences are usually minor and are included in our consolidated financial statements as soon as they are known. Our estimates, judgments and assumptions are continually evaluated based on available information and experience. Because of the use of estimates inherent in the financial reporting process, actual results could differ from those estimates.

We periodically review the carrying value of our intangible assets when events and circumstances warrant such a review. One of the methods used for this review is performed using estimates of future cash flows. If the carrying value of our intangible assets is considered impaired, an impairment charge is recorded for the amount by which the carrying value of the intangible assets exceeds its fair value. We believe that the estimates of future cash flows and fair value are reasonable. Changes in estimates of these cash flows and fair value, however, could affect the calculation and result in additional impairment charges in future periods.

We periodically review the carrying value of our property and equipment whenever business conditions or events indicate that those assets may be impaired. If the estimated future undiscounted cash flows to be generated by the property and equipment are less than the carrying value of the assets, the assets are written down to fair market value and a charge is recorded to current operations. Significant and unanticipated changes in circumstances, including significant adverse changes in business climate, adverse actions by regulators, unanticipated competition, loss of key customers and/or changes in technology or markets, could require a provision for impairment in a future period.

We review loss contingencies and evaluate the events and circumstances related to these contingencies. We disclose material loss contingencies that are possible or probable, but cannot be estimated. For loss contingencies that are both estimable and probable the loss contingency is accrued and expense is recognized in the financial statements.

Table of Contents

Access service revenues are recognized on a monthly basis over the life of each contract as services are provided. Contract periods range from monthly to yearly. Carrier-neutral telecommunications co-location revenues, traditional telephone services and advanced voice and data services are recognized on a monthly basis over the life of the contract as services are provided. Revenue that is received in advance of the services provided is deferred until the services are provided by us. Revenue related to set up charges is also deferred and amortized over the life of the contract. We classify certain taxes and fees billed to customers and remitted to governmental authorities on a net basis in revenue.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As a smaller reporting company, we are not required and have not elected to report any information under this item.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act that are designed to ensure that information required to be disclosed in our reports filed or submitted to the SEC under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms, and that information is accumulated and communicated to our management, including our principal executive and financial officer as appropriate, to allow timely decisions regarding required disclosures.

Our principal executive officer, who is also our principal financial officer, evaluated the effectiveness of disclosure controls and procedures as of March 31, 2018 pursuant to Rule 13a-15(b) under the Exchange Act. Based upon that evaluation, our CEO/CFO concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act, 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 CEO/CFO, as appropriate, to allow timely decisions regarding required disclosure.

A system of controls, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the system of controls are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

Changes in Internal Control over Financial Reporting

No change in our system of internal control over financial reporting occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

- 17 -

Table of Contents

PART II—OTHER INFORMATION**Item 1. Legal Proceedings**

As a provider of telecommunications, we are affected by regulatory proceedings in the ordinary course of our business at the state and federal levels. These include proceedings before both the Federal Communications Commission and the Oklahoma Corporation Commission (“OCC”). In addition, in our operations we rely on obtaining many of our underlying telecommunications services and/or facilities from incumbent local exchange carriers or other carriers pursuant to interconnection or other agreements or arrangements. In January 2007, we concluded a regulatory proceeding pursuant to the Federal Telecommunications Act of 1996 before the OCC relating to the terms of our interconnection agreement with Southwestern Bell Telephone, L.P. d/b/a AT&T, which succeeds a prior interconnection agreement. The OCC approved this agreement in May 2007. This agreement may be affected by regulatory proceedings at the federal and state levels, with possible adverse impacts on us. We are unable to accurately predict the outcomes of such regulatory proceedings at this time, but an unfavorable outcome could have a material adverse effect on our business, financial condition or results of operations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 5. Other Information

During the three months ended March 31, 2018 all events reportable on Form 8-K were reported.

Item 6. Exhibits

(a) The following exhibits are either filed as part of or are incorporated by reference in this Report:

Exhibit

Number Exhibit

| | | |
|------------|--|---|
| <u>3.1</u> | <u>Certificate of Incorporation, as amended (filed as Exhibit 2.1 to Registrant’s Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).</u> | # |
| <u>3.2</u> | <u>Bylaws (filed as Exhibit 2.2 to Registrant’s Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference)</u> | # |
| <u>3.3</u> | <u>Amended and Restated Certificate of Incorporation of FullNet Communications, Inc.</u> | # |

- 4.1 Specimen Certificate of Registrant's Common Stock (filed as Exhibit 4.1 to the Company's Form 10-KSB for the fiscal year ended December 31, 1999, and incorporated herein by reference). #
- 4.2 Certificate of Correction to the Amended Certificate of Incorporation and the Ninth Section of the Certificate of Incorporation (filed as Exhibit 2.1 to Registrant's Registration Statement on form 10-SB, file number 000-27031 and incorporated by reference). #
- 4.3 Certificate of Correction to Articles II and V of Registrant's Bylaws (filed as Exhibit 2.1 to Registrant's Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference). #
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Table of Contents

| <i>Exhibit Number</i> | <i>Exhibit</i> | |
|---------------------------|--|---|
| <u>4.4</u> | <u>Certificate of Designations, Preferences, and Rights of Series A Convertible Preferred Stock of FullNet Communications, Inc.</u> | # |
| <u>10.1</u> | <u>Financial Advisory Services Agreement between the Company and National Securities Corporation, dated September 17, 1999 (filed as Exhibit 10.1 to Registrant's Form 10-KSB for the fiscal year ended December 31, 1999, and incorporated herein by reference).</u> | # |
| <u>10.2</u> | <u>Lease Agreement between the Company and BOK Plaza Associates, LLC, dated December 2, 1999 (filed as Exhibit 10.2 to Registrant's Form 10-KSB for the fiscal year ended December 31, 1999, and incorporated herein by reference).</u> | # |
| <u>10.3</u> | <u>Interconnection agreement between Registrant and Southwestern Bell dated March 19, 1999 (filed as Exhibit 6.1 to Registrant's Registration Statement on Form 10-SB, file number 000-27031 and incorporated herein by reference).</u> | # |
| <u>10.4</u> | <u>Registrar Accreditation Agreement effective February 8, 2000, by and between Internet Corporation for Assigned Names and Numbers and FullWeb, Inc. d/b/a FullNic f/k/a Animus Communications, Inc. (filed as Exhibit 10.1 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended March 31, 2000 and incorporated herein by reference).</u> | # |
| <u>10.5</u> | <u>Amendment to Financial Advisory Services Agreement between Registrant and National Securities Corporation, dated April 21, 2000 (filed as Exhibit 10.3 to Registrant's Quarterly Report on Form 10-QSB for the Quarter ended September 30, 2000 and incorporated herein by reference).</u> | # |
| <u>10.6</u> | <u>Placement Agency Agreement dated November 8, 2000 between FullNet Communications, Inc. and National Securities Corporation (filed as Exhibit 10.31 to Registrant's Form 10-KSB for the fiscal year ended December 31, 2000).</u> | # |
| 10.7 | Employment Agreement with Timothy J. Kilkenny dated July 31, 2002 | # |
| 10.8 | Employment Agreement with Roger P. Baresel dated July 31, 2002 | # |
| 10.9 | Secured Promissory Note and Security Agreement dated December 30, 2009, issued to High Capital Funding, LLC | # |
| 10.10 | Employment Agreement with Jason Ayers dated January 1, 2011 | # |
| 10.11 | Employment Agreement with Timothy J. Kilkenny dated July 6, 2011 | # |

| | | |
|--------------|--|---|
| 10.12 | Employment Agreement with Roger P. Baresel dated July 6, 2011 | # |
| 10.13 | Employment Agreement with Jason Ayers dated July 6, 2011 | # |
| <u>10.14</u> | <u>Form 8-K dated May 9, 2013 reporting expansion of the Board of Directors and the election of Jason C. Ayers to the Board of Directors</u> | # |
| <u>10.15</u> | <u>Schedule 14C Definitive Information Statement dated May 15, 2013 reporting Notice of Action by Written Consent of Shareholders</u> | # |

Table of Contents

| <i>Exhibit Number</i> | <i>Exhibit</i> | |
|---------------------------|--|----|
| 10.16 | Form of Exchange Offer Acceptance Agreement | |
| 10.17 | Secured Exchange Promissory Note and Security Agreement dated May 31, 2013, issued to High Capital Funding, LLC | # |
| 10.18 | Secured Exchange Promissory Note and Security Agreement dated May 31, 2013, issued to High Capital Funding, LLC | # |
| 10.19 | Form 8-K dated June 3, 2013 reporting the Shareholder Consent to Action in Lieu of a Meeting approving the Amendment and Restatement of the Company's Certificate of Incorporation, the re-election of the Board of Directors, the authorization of Series A Convertible Preferred Stock, the authorization of the Exchange Offer and the issuance of Series A Convertible Preferred Stock | |
| 10.20 | Form 8-K dated June 6, 2016 reporting the appointment of Roger P. Baresel as Chief Executive Officer, the appointment of Jason C. Ayers as President and a modification in the exercise price for all of the outstanding unexercised common stock purchase options previously issued to employees. | # |
| <u>10.21</u> | <u>Form 8K dated December 7, 2016 reporting the sale of 2,752,848 restricted shares of common stock pursuant to the exercise of previously issued and outstanding common stock purchase options held by various officers and directors of the Company and their family members.</u> | # |
| 22.1 | Subsidiaries of the Registrant | # |
| <u>31.1</u> | <u>Certification pursuant to Rules 13a-14(a) and 15d-14(a) of Roger P. Baresel</u> | * |
| <u>32.1</u> | <u>Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Roger P. Baresel</u> | * |
| 101.INS | XBRL Instance Document | ** |
| 101.SCH | XBRL Taxonomy Extension Schema Document | ** |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document | ** |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document | ** |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document | ** |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document | ** |

Incorporated by reference.

* Filed herewith.

** In accordance with Rule 406T of Regulation S-T, the XBRL (Extensible Business Reporting Language) related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be “filed” for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except to the extent expressly set forth by specific reference in such filing.

- 20 -

Table of Contents

SIGNATURES

Pursuant to the requirements of the Exchange Act, the Registrant caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

REGISTRANT:

**FULLNET
COMMUNICATIONS, INC.**

Date: May 15,2018 By: /s/ ROGER
P.
BARESEL
Roger P.
Baresel
Chief
Executive
Officer and
Chief
Financial
Officer