

QUALSTAR CORP
Form 10-Q
November 14, 2007

**SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-Q

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

For the Quarterly Period Ended September 30, 2007

OR

**o 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 000-30083

QUALSTAR CORPORATION

CALIFORNIA
(State of incorporation)

95-3927330
(I.R.S. Employer Identification No.)

**3990-B Heritage Oak Court, Simi Valley, CA 93063
(805) 583-7744**

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer Accelerated filer Non-accelerated filer

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

Total shares of common stock without par value outstanding at October 31, 2007 is 12,253,117.



QUALSTAR CORPORATION
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007
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QUALSTAR CORPORATION
CONSOLIDATED CONDENSED BALANCE SHEETS
(In thousands)

	September 30, 2007 (Unaudited)	June 30, 2007 (Audited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 8,602	\$ 7,697
Marketable securities, short-term	8,377	9,574
Receivables, net of allowances of \$129 as of September 30, 2007, and \$170 at June 30, 2007	3,231	3,462
Inventories, net	5,707	5,928
Prepaid expenses and other current assets	767	576
Prepaid income taxes	134	137
Total current assets	26,818	27,374
Property and equipment, net	590	601
Marketable securities, long-term	16,703	15,994
Other assets	94	94
Total assets	\$ 44,205	\$ 44,063
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,127	\$ 654
Accrued payroll and related liabilities	299	455
Other accrued liabilities	1,008	1,113
Total current liabilities	2,434	2,222
Other long term liabilities	45	—
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, no par value; 5,000 shares authorized; no shares issued	—	—
Common stock, no par value; 50,000 shares authorized, 12,253 shares issued and outstanding as of September 30, 2007 and June 30, 2007	18,626	18,593
Accumulated other comprehensive income (loss)	39	(55)
Retained earnings	23,061	23,303
Total shareholders' equity	41,726	41,841
Total liabilities and shareholders' equity	\$ 44,205	\$ 44,063

See the accompanying notes to these interim consolidated condensed financial statements.

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QUALSTAR CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(Unaudited) (In thousands, except per share data)

	Three Months Ended	
	September 30,	
	2007	2006
Net Revenues	\$ 5,332	\$ 4,659
Cost of goods sold	3,708	3,357
Gross profit	1,624	1,302
Operating expenses:		
Research and development	728	750
Sales and marketing	759	768
General and administrative	739	744
Total operating expenses	2,226	2,262
Loss from operations	(602)	(960)
Investment Income	413	381
Loss before income taxes	(189)	(579)
Provision for income taxes	17	—
Net loss	\$ (206)	\$ (579)
Loss per share:		
Basic	\$ (0.02)	\$ (0.05)
Diluted	\$ (0.02)	\$ (0.05)
Shares used to compute loss per share:		
Basic	12,253	12,253
Diluted	12,253	12,253

See the accompanying notes to these interim consolidated condensed financial statements.

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QUALSTAR CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)(In thousands)

	Three Months Ended	
	September 30,	
	2007	2006
OPERATING ACTIVITIES:		
Net loss	\$ (206)	\$ (579)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Share based compensation	33	2
Gain on sale of marketable securities	(3)	—
Depreciation and amortization	78	110
(Recovery of) provision for bad debts and returns	(21)	5
Changes in operating assets and liabilities:		
Accounts receivable	252	574
Inventories	221	53
Prepaid expenses and other assets	(213)	(86)
Prepaid income taxes	3	(7)
Accounts payable	473	(85)
Accrued payroll and related liabilities	(156)	(143)
Other accrued liabilities	(74)	(80)
Net cash provided by (used in) operating activities	387	(236)
INVESTING ACTIVITIES:		
Purchases of property, equipment and leasehold improvements	(67)	(14)
Proceeds from sale of marketable securities	6,299	2,163
Purchases of marketable securities	(5,714)	(2,610)
Net cash provided by (used in) investing activities	518	(461)
Net change in cash and cash equivalents	905	(697)
Cash and cash equivalents, beginning of period	7,697	6,845
Cash and cash equivalents, end of period	\$ 8,602	\$ 6,148
Supplemental cash flow disclosure:		
Income taxes paid	\$ 7	\$ 7

See the accompanying notes to these interim consolidated condensed financial statements.

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QUALSTAR CORPORATION
CONSOLIDATED CONDENSED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
THREE MONTHS ENDED SEPTEMBER 30, 2007
(Unaudited)(In thousands)

	Common Stock		Accumulated Other Comprehensive		Retained	Total
	Shares	Amount	(Loss)/Income	Earnings		
Balance at July 1, 2007	12,253	\$ 18,593	\$ (55)	\$ 23,303		\$ 41,841
Share based compensation	—	33	—	—		33
Comprehensive loss:						
Net loss	—	—	—	(206)		(206)
Cumulative effect of a change in accounting principle (FIN 48)	—	—	—	(36)		(36)
Change in unrealized losses on investments	—	—	94	—		94
Comprehensive loss						(148)
Balance at September 30, 2007	12,253	\$ 18,626	\$ 39	\$ 23,061		\$ 41,726

See the accompanying notes to these consolidated condensed financial statements

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QUALSTAR CORPORATION
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)(In thousands, except per share data)

Note 1 – Basis of Presentation and Consolidation

Basis of Presentation

In the opinion of management, the accompanying consolidated condensed financial statements, including balance sheets and related interim statements of operations, cash flows, and stockholders' equity, include all adjustments, consisting primarily of normal recurring items, which are necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP").

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Examples include estimates of loss contingencies, product life cycles and inventory obsolescence, bad debts, sales returns, share based compensation forfeiture rates, the potential outcome of future tax consequences of events that have been recognized in our financial statements or tax returns, and determining when investment impairments are other-than-temporary. Actual results and outcomes may differ from management's estimates and assumptions.

Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with Management's Discussion and Analysis and the financial statements and notes thereto included in the Qualstar Corporation Annual Report on Form 10-K for the fiscal year ended June 30, 2007, filed with the Securities and Exchange Commission ("SEC") on September 26, 2007.

Basis of Consolidation

The consolidated financial statements include the accounts and operations of Qualstar and its wholly owned subsidiary. All significant intercompany accounts have been eliminated.

Recent Accounting Pronouncements

On July 1, 2007, the Company adopted the provisions of the Financial Accounting Standards Board ("FASB") Interpretation No. 48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*. FIN 48 prescribes a recognition and measurement threshold for tax positions taken or expected to be taken on a tax return and relates to the uncertainty in income taxes recognized in the financial statements in accordance with FAS109, *Accounting for Income Taxes*. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Upon adoption, we recognized a \$36,000 charge to our beginning retained earnings as a cumulative effect of a change in accounting principle. See Note 8 – Income Taxes.

Note 2 – Loss Per Share

Qualstar calculates loss per share in accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, *Earnings per Share*. Basic earnings per share has been computed by dividing net loss by the weighted average number of common shares outstanding. Diluted loss per share has been computed by dividing net loss by the weighted average common shares outstanding plus dilutive securities or other contracts to issue common stock as if

these securities were exercised or converted to common stock.

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The following table sets forth the computation of basic and diluted net loss per share for the periods indicated:

	Three Months Ended September 30,	
	2007	2006
Net loss (a)	\$ (206)	\$ (579)
Weighted average outstanding shares of common stock (b)	12,253	12,253
Dilutive potential common shares from employee stock options	—	—
Common stock and common stock equivalents (c)	12,253	12,253
Loss per share:		
Basic net loss per share (a)/(b)	\$ (0.02)	\$ (0.05)
Diluted net loss per share (a)/(c)	\$ (0.02)	\$ (0.05)

Stock options are excluded for the three months ended September 30, 2007 and 2006, respectively, from the computation of diluted loss per share as the effect would have been antidilutive.

Note 3 – Marketable Securities

Marketable securities consist primarily of high-quality U.S. corporate securities and U.S. federal government and state government debt securities. These securities are classified in one of three categories: trading, available-for-sale, or held-to-maturity. Trading securities are bought and held principally for the purpose of selling them in the near term. Held-to-maturity securities are those securities, which Qualstar has the ability and intent to hold until maturity. All other securities not included in trading or held-to-maturity are classified as available-for-sale. All of Qualstar's marketable securities were classified as available-for-sale at September 30, 2007 and June 30, 2007.

Available-for-sale securities are recorded at market value. Unrealized holding gains and losses, net of the related income tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of shareholders' equity until realized. Dividend and interest income are recognized when earned. Realized gains and losses for securities classified as available-for-sale are included in earnings when the underlying securities are sold and are derived using the specific identification method for determining the cost of securities sold.

Note 4 - Inventories

Inventories are stated at the lower of cost (first-in, first-out basis) or market. Inventory is comprised as follows:

	September 30, 2007	June 30, 2007
Raw materials, net		