

QUALSTAR CORP  
Form 10-K  
March 16, 2017  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-K**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2016

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
1934 FOR THE TRANSITION PERIOD FROM TO

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COMMISSION FILE NUMBER 000-30083

**QUALSTAR CORPORATION**

(Exact Name of registrant as specified in its charter)

CALIFORNIA

(State or other jurisdiction of incorporation or organization)

130 West Cochran Street, Unit C; Simi Valley, CA

(Address of principal executive offices)

95-3927330

(I.R.S. Employer Identification No.)

91365

(Zip Code)

Registrant's telephone number, including area code: (805) 583-7744

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class:</u>	<u>Name of each exchange on which registered:</u>
Common Stock	The NASDAQ Stock Market LLC

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Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark whether the registrant is well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933. Yes No

Indicate by check mark whether the registrant is not required to file reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

As of June 30, 2016, the aggregate market value of the common equity held by non-affiliates of the registrant was approximately \$2,715,049 based on the closing sales price as reported on the NASDAQ Stock Market. As of March

8, 2017 there were 2,042,019 shares of common stock without par value outstanding.

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**QUALSTAR CORPORATION**

**FORM 10-K**

**FOR THE FISCAL YEAR ENDED DECEMBER 31, 2016**

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## FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 ("Reform Act"). Forward-looking statements inherently are subject to risks and uncertainties, some of which we cannot predict or quantify. Therefore, our actual results may differ materially and adversely from the results projected in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in "ITEM 1A — Risk Factors," and in "ITEM 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations." Words such as "believes," "may," "will," "expects," "intends," "estimates," "anticipates," "plans," "seeks," or "continues," variations of such words, and similar expressions are intended to identify such forward-looking statements. Forward-looking statements also include the assumptions underlying or relating to any such statements. Forward-looking statements contained within this document represent a good-faith assessment of Qualstar Corporation's future performance for which management believes there is a reasonable basis. Qualstar Corporation disclaims any obligation to update the forward-looking statements contained herein, except as may be required by law.

## **PART I**

### **EXPLANATORY NOTE REGARDING THE UNAUDITED FINANCIAL RESULTS FOR THE TWELVE MONTHS ENDED DECEMBER 31, 2015**

On January 4, 2016, we changed our fiscal year from June 30 to December 31. As a result, this report on Form 10-K includes unaudited financial information for the twelve months ended December 31, 2015. A Transition Report was filed for the period from July 1, 2015 to December 31, 2015, which we refer to as a “transition period”. In this Report, we compare financial results for the twelve months beginning January 1, 2016 through December 31, 2016, which are audited, with the financial results for January 1, 2015 through December 31, 2015, which are unaudited. This report also compares the financial results for the six months ended December 31, 2015, which are audited with the financial results for the six months ended December 31, 2014, which are unaudited and the financial results for the fiscal years ended June 30, 2015 with the financial results for the fiscal years ended June 30, 2014, both of which are audited.

## **ITEM 1. BUSINESS**

### **INTRODUCTION**

Qualstar Corporation and its Subsidiary (“Qualstar”, the “Company”, “we”, “us” or “our”) is a leading provider of data storage systems marketed under the Qualstar brand and of high efficiency and high density power solutions marketed under the N2Power brand. Qualstar was incorporated in California in 1984. Qualstar is organized into two strategic business segments, power solutions and data storage systems. Power solutions products include ultra-small high efficiency switching power supplies that provide unique power solutions to original equipment manufacturers (“OEMs”) for a wide range of markets, including communications networking, industrial, gaming, test equipment, LED/lighting, medical as well as other market applications. Data storage system products include highly scalable automated magnetic tape storage solutions used to store, retrieve and manage electronic data primarily in the network computing environment and to provide solutions for organizations requiring backup, recovery and archival storage of critical electronic information.

Our storage products provide data protection and archive storage systems which are used to record, retrieve and manage electronic data, primarily in networked computing environments. Our storage products are compatible with a wide range of storage management software solutions such as those offered by QStar, Xendata, IBM, EMC, CommVault and Symantec. We offer products addressing the storage needs of the small and medium-size business market, as well as, to the enterprise market. In addition to storage products we offer service and support programs for our customers.

Our N2Power products provide high-efficiency and high density AC/DC and DC/DC power solutions for a variety of applications including data center technologies such as switches, routers, data storage, servers and networking communications equipment. With a wide variety of feature-rich standard products and the ability to create custom and semi-custom products, we offer a very comprehensive product line to OEMs that require high-value, high-efficiency power supplies to meet specific applications.

We design our products at our facilities in California and Singapore. We sell our products globally through authorized resellers and directly to original equipment manufacturers (“OEMs”). N2Power utilizes contract manufacturers in Asia to produce our power solutions products. Our storage products are manufactured by us at our factory in Simi Valley, California and by our OEM supplier in other parts of the world. Our engineering facility is located in Singapore.

On June 30, 2014, Qualstar established a Singapore subsidiary, Qualstar Corporation Singapore Private Limited (“QC Singapore”), in furtherance of our plan to establish an engineering footprint in Singapore. QC Singapore has allowed us to hire strategic engineering personnel for sustaining current products and new product development. Having a presence in Singapore allows the Company to be closer to our contract manufacturers and our Asian distribution partners and customers.



## DATA STORAGE INDUSTRY

### Background

The data protection and archival storage markets are comprised of a few large suppliers and a number of medium and smaller companies that offer specialized products and capacity ranges. Solutions include both disk based and tape based systems and related software.

The proliferation of digital data, e-commerce, big data, digital media streaming, and advanced software applications has created exponential growth in the production of digital information. As regulators and companies require the longer retention of and access to archived data, the market for products to store that data cost-effectively is needed. We believe this trend will drive continued demand for tape based data storage products.

### Strategy

Our primary objective in our storage business is to be a global leader in highly scalable, cost effective data protection and archival storage for the information technology markets. To achieve this objective we plan to:

**Continue to expand our sales channels and geographies.** We have begun to accelerate the promotion of Qualstar storage solutions on a global basis and will continue to add resellers outside the US in addition to adding new US resellers.

**Launch effective marketing campaigns which will increase market awareness of the Qualstar brand as well as reinforce tape's role within the storage arena.** We plan on advertising in select industry vertical markets highlighting the storage solutions Qualstar provides for those sectors. We also plan on attending trade shows with our partners in order to leverage both their coverage of their markets and their branding in the marketplace.

**Produce expandable storage solutions that deliver scalability within the data center and more effective capital spending for our customers.** Expandability is a key requirement for many customers who are dealing with rapidly growing capacity needs on a regular basis. Expandability enables customers to easily and quickly add more storage while providing a cost-effective solution that can be readily budgeted during their planning cycles.

**Expand our product line through private label offerings.** We will continue to partner with other designers and manufacturers to offer private label products. In this way, we can provide customers with a broad product offering that expands beyond the product choices they have today.

**Explore adjacent technologies to expand our functionality and footprint in the IT market.** Historically we have been focused on products using magnetic tape as the media in our systems and on automating the loading, unloading and storage of the media. We will explore partnerships with software and disk manufacturers where reasonable to offer a complete data storage solution.

**Expand our cost effective, service and support programs in international markets.** We will investigate enhancing our service and support programs in international markets as we expand product sales in those regions.

### **Our Storage Solutions**

We design, develop, manufacture and market storage products which deliver cost effective data protection and archival storage to small and medium sized businesses, and to more complex small and medium enterprise environments with stringent performance and data availability requirements. We provide a wide range of storage solutions that span data storage capacities from 75 Terabytes to over 33 Petabytes (1,000 Terabytes = 1 Petabyte).

The RLS-8350 and RLS-8500 Series Expandable Rack Mount Tape Libraries deliver both high density to maximize rack space utilization and easy customer expandability to keep pace with exploding archive storage and data protection requirements. RLS base models house 50, 60, 108 or 114 tape slots and up to seven LTO format tape drives. Up to three customer installable expansion modules can be installed on every base unit using Qualstar's unique FastPass™ elevator assembly to quickly move tapes between modules as needed. Each module adds 120 more tape storage slots and five additional tape drive slots. RLS configurations can scale capacity to 2.8 Petabytes in a single 19-inch rack. Advanced features include library-enabled data encryption to protect the data on tapes, dual AC input power to allow operation to continue if one power source drops off line and Q-Link, our easy to use remote library manager.

Qualstar's XLS Enterprise Library System ("XLS") provides the widest range of capacity and performance available to enterprise-class data protection and archive storage customers. Several Library Resource Modules (LRM) and two Memory Expansion Modules (MEM) can be combined in numerous configurations to cost-effectively deliver capacities from 300 Terabytes to over 33 Petabytes. Over 125 LTO tape drives can be configured in a single system to deliver throughput exceeding 63 Terabytes per hour to meet the performance needs of the most demanding environments. XLS' exclusive Compass Architecture™ design delivers storage density exceeding 180 Terabytes per square foot to minimize costly IT floor space requirements. Tape libraries are the most energy efficient data storage technology on the market, often using 1/20th the power of a similarly sized disk-based system. Advanced design has reduced the XLS power and cooling requirements.

The Qualstar Q24 Rack Mount Tape Library was introduced in April 2014. This 2U high by 24-slot tape library is an entry-level offering that enhances the library product family - extending from entry- to mid-range to enterprise-level tape libraries. The *Q24* is one of the highest density 2U libraries on the market supporting up to 24 tape cartridge slots and one or two half-height LTO tape drives. Using LTO 7 tape technology, as an example, this new offering can provide up to 144 terabytes of uncompressed data in a single unit.

Qualstar introduced the Q1 compact portable single-cartridge LTFS appliance in June 2015. Targeting primarily the Media & Entertainment industry for use in off-site, remote, or mobile filming environments, the integrated LTO 6 tape drive, internal hard disk, and computer coupled with the custom utility software create a flexible field deployable storage system. Data may be copied from memory cards inserted into the unit, external storage attached to the unit via USB 3.0 or eSATA, and over network attachment from PC's or Mac's to LTFS tape. The included utilities automate the process and provide options for verification of data and user scripting of additional operations. The system has built-in media players and optional asset management software to support media workflow requirements.

The Qualstar Q48 Rack Mount Tape Library was introduced in September 2015. This library is feature-rich and compact in a 4U high, 19-inch rackmount form-factor. The *Q48* offers outstanding storage capacity and data throughput while providing a cost-effective storage solution. The *Q48* supports flexible throughput and capacity scaling with its ability to be upgraded from one to four drives and from LTO5 to LTO6 technology, thus offering tangible investment protection. Qualstar provides leading-edge technology based on industry standards that effectively implement outstanding performance at the right value point.

The Qualstar Q80 Rack Mount Tape Library was introduced in January 2016. The Q80 is a scalable 6U high LTO tape library system designed for small and medium businesses. This scalable, cost effective unit allows easy field configuration of up to 7 individual modules containing up to 560 cartridges and 42 Half Height LTO drives. With

LTO 7 tape technology, the Q80 will offer a maximum of 3.36PB native storage capacity and maximum native throughput of 45.4 TB/hr.

## **POWER SUPPLY INDUSTRY**

### **Background**

The power supply industry is comprised of a few large suppliers and a vast number of smaller companies that focus on specialized products and markets. Currently, the power solutions markets for our N2Power brand products include the Servers, Storage and Network (“SSN”), Industrial and Transportation (“IND”), Network Power Systems (“NPS”), Medical, Gaming and LED/Lighting markets.

We believe the following key trends will continue to drive demand for our power solutions products:

**Increasing amounts of power required by the communications infrastructure industry.** The proliferation of data centers and their related infrastructures, the internet, wireless communications, broadband applications, server and storage farms and other new technologies, have increased exponentially the amount of information transmitted. As a result, the push for higher bandwidth and more efficient and effective power solutions has been driving a faster replacement cycle for telecommunications equipment as well as strong infrastructure expansion.

**Increasing demand for high conversion efficiencies, high power density and digital power management.** Efforts in the EU, the United States and Asia to reduce energy consumption are increasing the demand for high conversion efficiencies and digital power control. In addition, groups such as the Climate Savers Computing Initiative, consisting of a consortium of companies including Google and Intel and other eco-conscious businesses and conservation organizations are promoting the development, deployment and adoption of smart technologies that can both improve the efficiency of a computer's power utilization and reduce the energy consumed when the computer is in an inactive state. Because a large portion of electrical energy waste occurs during the power conversion process, power companies have an opportunity to improve the conversion efficiency to reduce the operating costs for the end user. Our AC/DC power supplies provide conversion efficiency ratings up to 93%. Our digital power control technologies allow us to achieve high levels of power conversion efficiency and control that are not possible with analog designs. Higher conversion efficiencies help reduce overall power usage and therefore cut greenhouse gas emissions and total cost of infrastructure ownership.

## **Strategy**

Our primary objective in our power supply business is to be a global leader in high-efficiency, high-density power solutions for the data center equipment, medical, gaming, test equipment, transportation, industrial and telecommunications network power markets. To achieve this objective we plan to:

**Continue to expand our sales channels and geographies.** We promote the N2Power brand on a global basis and are targeting larger OEMs, and distributors who have a presence in markets and geographies that we do not currently serve.

**Continue to increase volume in our current OEM customers.** Our OEM customers are constantly changing their products and introducing new products. We are driving to become the supplier of choice within our OEM customer base to leverage our existing relationships and drive volume growth within the same sales channel.

**Continue to expand our footprint in the current markets we serve.** We are currently supporting the data center equipment, medical, gaming, test equipment, transportation, industrial and telecommunications systems markets. We have secured several sizable OEM customers and are driving to add new OEM customers in these markets.

**Expand our product line while continuing to drive for higher power levels and greater conversion efficiencies in a smaller footprint.** Minimizing space requirements within our customers' products is critical, and as a result there is a continuing need for smaller packaging while delivering additional power. Our product roadmap addresses these needs and our objective is to lead the industry with the greatest efficiency in the smallest footprint with the highest power available. In this way, we can deliver advantages to our OEM customers as they leverage our technology in their product designs.

**Expand our product line through private label offerings.** We have identified a need for utilizing other manufacturers' core products to complement our own, where we lack products in specific markets or power levels. To achieve this we will utilize our relationships with other power solutions manufacturers.

**Organize our technology resources for fast time to market on derivative products.** Our customers continually request derivative configurations to our existing products. In order to serve this market effectively, we are organizing our engineering resources for fast turnaround on these designs to shorten our OEM customers' design cycle, leading to faster time to market.

## **Our Power Solution Products**

We design, develop, manufacture and market our power solution products, whose purpose is to convert, regulate, purify, manage or distribute electrical power for electronic equipment. Our products are used in a variety of products and generally convert AC current from the grid to DC current, or modify the voltage being delivered (DC to DC). We typically target markets where high efficiency and power density are important to our customers.

We sell standard, modified-standard and custom designed products. Standard products are sold unmodified to our customers. Modified-standard products are based on lightly modified versions of standard products. Custom products are designed specifically to the customer's specification and are not generally sold to other customers. Custom products may require non-recurring engineering and tooling costs to bring the product to production.

On November 5, 2015, N2Power, announced the new higher-powered XL500 power supply, which demonstrates our continuing commitment to give OEM engineers more power in less space compared to our competitors' product offerings. Our XL500 product, puts 500 watts in a 3"x 5" package. The XL500 is a key addition to our existing power supply products that deliver a variety of single output voltages ranging from 5V to 60V and supporting 20 to 3000 watts of power. These supplies are ideal for power-hungry broadcast, storage and networking products with applications in the industrial, gaming and instrumentation markets.

On November 1, 2016, N2Power introduced its new product to the AC-DC offerings by adding two (2) new series - XR125 & XR160. These products are an updated design of our original 3"x 5" XL Series (125 & 160 watts). N2Power's introduction of the XR125 & XR160 Original and RE (remote enable) Series demonstrates our continued commitment to give OEM engineers robust, high quality, state-of-the-art designs. The XR-Original series is designed to be a drop-in replacement of our current XL series products. The XR-RE series provides the ability to use the new add-on 5Vsb output for remote enable functionality. All models offer special features such as, current sharing, redundancy, and de-rating for convection cooling operations. The XR power supplies provide high-efficiency and increased power density, withstand up to 2G vibrations and have a 3 year standard warranty. The XR Series constitutes over 80 different combinations of connector and output voltages ranging from 12V to 56V in single output combinations. These supplies are ideal for power hungry broadcast, storage and networking products with additional application solutions for industrial, gaming and instrumentation markets.

## **CUSTOMERS**

Our solution-focused product offerings are designed specifically for OEMs, information technology departments, and small and medium businesses. We sell our storage products through our worldwide authorized distributor and reseller network. Power supplies are sold through distributors and direct through independent outside sales representatives. All

of our products and services are designed and manufactured to address our customers' stringent requirements and reliability standards. The following provides additional detail on our channels:

**Storage Reseller channel.** Our reseller channel includes systems integrators, value added resellers ("VARs") and value added distributors ("VADs"). Our resellers frequently package our products as part of a comprehensive data processing system or with other storage devices to deliver a complete storage subsystem. Our resellers frequently recommend our products as replacement solutions when backup and archive systems are upgraded or bundle our products with storage management software specific to the end user's system. We support the reseller channel through our dedicated field sales representatives and technical support technicians.

**Storage OEM channel.** OEM customers incorporate our storage products with their application software and other components to deliver a focused solution. Our products may or may not carry our label.

**N2Power OEM channel.** We have supply agreements with our major power supply customers who incorporate our products into their server, telephony, network and industrial product offerings.

We divide our worldwide sales into three geographical regions:

Americas, consisting of Mexico, United States, Canada and South America;

EMEA, consisting of Europe, the Middle East and Africa; and

APAC, consisting of Asia Pacific countries.



We support our customers in the Americas primarily through a network of trained distribution partners and representatives located throughout the Americas. We support our EMEA, APAC and other foreign customers through our distributors and resellers located throughout the regions.

Sales to customers outside the United States represent a significant portion of our sales. International sales are subject to various risks and uncertainties. See "Risk Factors" in Part I, Item 1A of this report. The following table sets forth foreign revenue by geographic area (\$ in thousands):

	<b>Twelve Months Ended December 31,</b>		<b>Six Months Ended December 31,</b>	<b>Twelve Months Ended June 30,</b>
	<b>2016</b>	<b>2015</b>	<b>2015</b>	<b>2015</b>
Foreign revenue:	Audited	(Unaudited)	Audited	Audited
EMEA	\$1,955	\$ 1,820	\$ 713	\$ 2,195
APAC	2,293	3,228	1,211	4,169
Other foreign revenue	92	476	140	609
	\$4,340	\$ 5,524	\$ 2,064	\$ 6,973
Foreign revenue as a percentage of total net revenue	46.1 %	50.3 %	41.9 %	54.0 %

We provide a full range of marketing materials for branded products, including product specifications, sales literature and application notes. We also offer lead generation opportunities to key channel partners. Our sales management and engineering personnel provide support to the channel partners and visit potential customer sites to demonstrate the technical advantages of our products. We maintain press relations in the United States, and we participate in trade shows worldwide.

## **CUSTOMER SERVICE AND SUPPORT**

Customer service and support are key elements of our company strategy and critical components of our commitment to making enterprise-class support and services available to companies of all sizes. Our technical support staff is trained to assist our customers with deployment and compatibility for any combination of hardware platforms, operating systems and backup, data protection and storage management software. Our application engineers assist with complex customer issues. We maintain global toll-free service and support phone lines and we also provide self-service and support through our website and email.

Standard warranties include:

Three-year standard limited warranty on our RLS and XLS tape library products;

Two-year standard limited warranty on our “Q-Series” products;

Optional 24x7 or next business day onsite service on our products in many countries throughout the world; and

Three-year return to factory warranty on our N2Power products.

## **ENGINEERING**

In the year ended December 31, 2016, our power supply team introduced the XR125 and XR160, which are key additions to our product portfolio. We continue to perform sustaining engineering work on our current products as well as investigate future design opportunities.

Our engineering efforts have expanded to encompass both the USA and Singapore. We have also formed strategic partnerships for supplementary engineering resources with third party companies in Europe and Asia to capture additional state-of-the-art technology driven power designs. Growing our engineering both internally and externally will allow us to increase our product breadth in releasing more standard and modified standard power solution products in the future.

We incurred engineering costs of \$1.0 million and \$1.4 million (unaudited) for the twelve months ended December 31, 2016 and 2015, representing 10.5%, and 12.4% of net revenues, respectively.

## **MANUFACTURING AND SUPPLIERS**

We perform product assembly, integration and testing for our storage products at our factory in Simi Valley, California. Our private label storage products are manufactured in various geographical locations by a select group of suppliers. Our N2Power branded products are manufactured in China at specifically qualified contract manufacturers. We purchase tape drives, chassis, printed circuit boards, integrated circuits, and all other major components from outside suppliers. We carefully select suppliers based on their ability to provide quality parts and components which meet technical specifications and volume requirements. We actively monitor these suppliers but we are subject to substantial risks associated with the performance of our suppliers. For certain components, we qualify a single source, which magnifies the risk of shortages and decreases our ability to negotiate with that supplier. See "If our suppliers fail to meet our component and manufacturing needs, it would delay our production and our product shipments to customers and negatively affect our operations" under the heading "Risk Factors" in Part I, Section 1A of this report.

## **COMPETITION**

The worldwide storage market is highly competitive. Competitors vary in size from small start-ups to large multi-national corporations which may have substantially greater financial, engineering and marketing resources than us. In the tape automation market, we believe our primary competitors are International Business Machines Corporation ("IBM"), Oracle/StorageTek, Dell Inc., Hewlett Packard, Sphere 3D (formally Overland Storage), Spectra Logic and Quantum Corporation. Key competitive factors include product features, reliability, durability, scalability and price. Barriers to entry in tape automation are relatively high.

Our primary power supply competitors are Artesyn, TDK Lambda, XP Power and Bel Power (Power One). Key competitive factors in these markets include price, performance, functionality, availability, interoperability, connectivity, time to market, enhancements and total value of ownership. Barriers to entry for power supply products are high.

The markets for all of our products are characterized by significant price competition and we anticipate that our products will continue to face substantial pricing pressure.

## **INTELLECTUAL PROPERTY**

We rely on copyright protection of our firmware, as well as patent protection for some of our designs and products. We also rely on a combination of trademark, trade secret and other intellectual property laws to protect our proprietary rights. Despite our efforts to protect our proprietary rights, competition in our businesses is significant. We believe that, because of the rapid pace of technological change in the tape storage and power supply industries, patent, copyright, trademark and trade secret protection are less significant than factors such as market responsiveness, knowledge, ability and the experience of our personnel as well as timely new product introductions.

We enter into Employee Proprietary Information and Inventions Agreements with all employees and consultants to protect our technology and designs. However, we do not believe that such protection can preclude competitors from developing substantially equivalent products.

## **EMPLOYEES**

As of December 31, 2016, we had 22 employees worldwide. We also employ a small number of consultants and temporary employees as needed. We are not a party to any collective bargaining agreement or other similar agreement. We believe that we have a good relationship with our employees. During the year ended December 31, 2016, we continued to adjust our staffing by eliminating certain positions and creating new positions that were more suited to the strategy of the Company.

## **AVAILABILITY OF SEC FILINGS**

We are subject to the informational requirements of the Securities Exchange Act of 1934. Therefore, we file periodic reports, proxy statements and other information with the SEC. Such reports, proxy statements and other information may be obtained by visiting the Public Reference Room of the SEC at 100 F Street N.E., Washington, D.C. 20549 or by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site (<http://www.sec.gov>) that contains reports, proxy and information statements and other information regarding issuers that file electronically. Our Annual Reports on Form 10-K, our Quarterly Reports on Form 10-Q, our Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are made available free of charge on our website as soon as reasonably practicable after we electronically file them with, or furnish them to, the SEC. Our website addresses are [www.qualstar.com](http://www.qualstar.com) and [www.n2power.com](http://www.n2power.com). Information contained on our web site is not part of this report on Form 10-K or our other filings with the SEC.

## **ITEM 1A. RISK FACTORS**

Our future results of operations are subject to risks and uncertainties over which we have limited control, and which could cause our actual results to differ materially from our expectations. We are subject to all of the business risks facing manufacturing companies, including business cycles and trends in the general economy, financial market conditions, unpredicted cost variances in raw materials and purchased components, demand variations and volatility, potential loss of key personnel, supply chain disruptions, government legislation and regulation, and natural causes. The following list of risk factors is not all-inclusive. Other factors and unanticipated events could adversely affect our financial position or results of operations. We believe that the most significant potential risk factors that could adversely impact us are the following:

**We have had a history of operating losses and we may not achieve profitability.**

The Company has had a history of operating losses since fiscal year ended June 30, 2004. There is no assurance that management can reverse this trend and if profitability is not achieved, the Company may require additional financing.

**We face intense industry competition, price erosion and product obsolescence, which, in turn, could reduce our operating results.**

We operate in an industry that is generally characterized by intense competition and rapid technological change. We believe that the principal bases of competition in our markets are breadth of product line, quality of products, stability, reliability and reputation of the provider, along with cost. Quantity discounts, price erosion, and rapid product obsolescence due to technological improvements are therefore common in our industry as competitors strive to retain or expand market share. Product obsolescence can lead to increases in unsellable inventory that may need to be written off and therefore could reduce our operating results. Similarly, price erosion can reduce our operating results by decreasing our revenues and our gross margins.

Our long-term operating results depend substantially upon our ability to continually develop, introduce, and market new and innovative products, to modify existing products, to respond to technological change, and to customize certain products to meet customer requirements. There are numerous risks inherent in this process, including the risks that we will be unable to anticipate the direction of technological change or that we will be unable to develop and market new products and applications in a timely fashion to satisfy customer demands, which could result in a decrease in our net sales and a loss of market share to our competitors. Historically, we have had write-offs of excess and obsolete inventory which negatively impacted our results of operations. In the future, excess or obsolete inventory may need to be written off, and this in turn could reduce our operating results.

**Changes in demand or downturns in the markets we serve could affect our business and operating results.**

The industries into which we market and sell our products are cyclical and may experience downturns. These industries also experience volatility, and future volatility as well as downturns, or any failure of these industries to recover from downturns, could materially harm our business and operating results. Likewise, if we have difficulty managing growth in this business, it could materially and adversely affect us. In addition, our business and financial position may be adversely affected by current and future economic conditions that cause a decline in business and consumer spending in the markets served by our or our customers' products.

**Our revenues are approximately an equal percentage for each of our power supplies and data storage business segments. Our operating results may be impaired if demand for either technology declines or fails to develop as we expect.**

We will continue to be subject to the risk of a decrease in revenues if demand for tape-based storage products declines or if rising prices make it more difficult to sell them. If products incorporating other technologies gain comparable or superior market acceptance and competitive price advantage, our business, financial condition and operating results could be adversely and materially affected unless we successfully develop and market products incorporating the new technology.

**Our principal competitors devote greater financial resources to developing, marketing and selling their products. Consequently, we may be unable to maintain or increase our market share.**

We face significant competition in developing and selling our products. Rapid and ongoing changes in technology and product standards could quickly render our products less competitive, or even obsolete. We have significantly fewer financial, technical, manufacturing, marketing and other resources than many of our competitors and these limited resources may impair the operating results of our business in many ways. For example, in the past our competitors have offered wider ranges of products, expanded the geographic scope of their markets, acquired other companies, and developed or acquired proprietary technologies that operate in conjunction with their products.

In the future, our competitors may leverage their greater resources to:

develop, manufacture and market products that are less expensive or technologically superior to ours;

reach a wider array of potential customers through a broader range of marketing and distribution channels;

respond more quickly to new or changing technologies, customer requirements and standards; or

reduce prices in order to preserve or gain market share.

We believe competitive pressures are likely to continue. We cannot guarantee that our resources will be sufficient to address this competition or that we will manage costs and adopt strategies capable of effectively utilizing our resources. If we are unable to respond to competitive pressures successfully, our prices and profit margins may fall and our market share may decrease.



**We rely on indirect sales channels to market and sell our branded storage products and both direct and indirect sales channels to market and sell our branded power solutions products. A loss of or deterioration in our relationship with one or more of our resellers or distributors, or our inability to establish new indirect sales channels to drive growth of our products could negatively affect our operating results.**

We sell the majority of our branded storage products to value-added resellers, who in turn sell our products to end users. In some cases, resellers integrate our tape libraries with products of other manufacturers and sell the combined products to their own customers. We sell our branded power solution products both direct to OEM customers (or their contract manufacturers) and to our distribution channel who in turn sell our products to OEM customers. The success of these sales channels is hard to predict, particularly over time, and we have no purchase commitments or long-term orders from them that assure us of any baseline sales through these channels. Several of our resellers and distributors carry competing product lines that they may promote over our products, which may negatively impact our sales. A reseller or distributor might not continue to purchase our products or market them effectively, and each reseller or distributor determines the type and amount of our products that it will purchase from us and the pricing of the products that it sells to their customers. Establishing new indirect sales channels globally is an important part of our strategy to drive growth of our revenue.

Our operating results could be adversely affected by any number of factors including:

A change in competitive strategy that adversely affects a reseller's or distributor's willingness or ability to distribute our products;

Reaching fewer customers or losing sales due to ineffective efforts of resellers and distributors;

Reduced margins and increased costs associated with channel sales;

An inability to gain traction in developing new indirect sales channels for our branded products;

Any financial difficulties of our resellers, authorized distributors or direct OEM customers that result in their inability to pay amounts owed to us;

Changes in requirements or programs that allow our products to be sold by third parties to government customers;  
or

Changes in product requirements or certification programs that limit our ability for our products to be sold in our established current markets.

We do not have any exclusive agreements with our VARs or distributors who purchase our products on an individual purchase order basis. If we lose important VARs or distributors, or if they reduce their focus on our products or if we are unable to obtain additional VARs, our business could be negatively affected.

**If our suppliers fail to meet our component and manufacturing needs, it could delay our production and our product shipments to customers and negatively affect our operations.**

Our products comprise many components and subassemblies produced by outside suppliers. We depend greatly on these suppliers for items that are essential to the manufacture of our products, including tape drives, printed circuit boards and integrated circuits. For certain items, we qualify only a single source, which magnifies the risk of shortages and decreases our ability to negotiate with that supplier on the basis of price. From time to time, we have been unable to obtain sufficient components that we have needed due to shortages or quality issues from some of our suppliers. If our suppliers fail to meet our manufacturing needs, it would delay our production and our product shipments to customers and negatively affect our operations.

We also rely on software vendors to develop and support software needed for operation of our automated tape library products and their integration into the user's computing environment. Accordingly, the continued development and future growth of the market for our tape library products will depend partly upon the ability of these vendors to meet the overall data storage and management needs of tape library purchasers and our ability to maintain relationships with these firms.

The primary suppliers of our N2Power power supplies are located in China. If a manufacturer should be unable to deliver products to us on a timely basis or at all, our power supply business could be adversely affected. Though we have had many years of favorable experience with these suppliers, there can be no assurance that circumstances might not change and compel one or more of these suppliers to curtail or terminate deliveries to us. Moreover, the use of contract manufacturers to provide our power supplies typically requires that we place production orders several months in advance of our expected need for the products. This in turn leads to risks that we may lack sufficient inventory to sell to our customers where our expectations were conservative, or that we may order excess product inventory where our expectations were optimistic. We have in the past, experienced shortages of some parts needed to manufacture our power supplies.

**If we fail to develop and introduce new products on a timely and cost-effective basis, or if our products do not contain the features required by the marketplace, we may eventually lose market share and sales to competitors.**

The market for our products is characterized by changing technology and evolving industry standards. Our future results will depend on our ability to anticipate changes in technology, to develop new and enhanced products on a timely and cost-effective basis, and to introduce, manufacture and achieve market acceptance of these new and enhanced products. With respect to our tape library products in particular, the introduction of new storage technologies or the adoption of an industry standard different from our current product standards could render our existing products obsolete.

Development schedules for high technology products are inherently subject to uncertainty and there can be no assurance that we will be able to meet our product development schedules or that our development costs will be within budgeted amounts. If the products or product enhancements developed are not deliverable due to technical problems, quality issues or component shortages, or if such products or product enhancements are not accepted by the marketplace or are unreliable, then our business, financial condition and results of operations may be adversely affected.

**If we fail to protect our intellectual property or if others use our proprietary technology without authorization, our competitive position may suffer.**

We rely on copyright protection of our software, firmware and electronic circuits, as well as patent protection for some of our products and product features. We also rely on a combination of trademark, trade secret, and other intellectual property laws and various contract rights to protect our proprietary rights. Despite our efforts to protect our proprietary rights, however, unauthorized parties may attempt to copy or otherwise obtain or use our products or technology. As a consequence, these rights may not preclude competitors from developing products that are substantially equivalent or superior to our products. In addition, many aspects of our products are not subject to intellectual property protection and therefore can be reproduced by others.

**Undetected manufacturing flaws could increase our costs, reduce our revenues and divert resources from our core business needs.**

Despite our efforts to revise and update our manufacturing and test processes to address engineering and component changes, we may not be able to control and eliminate manufacturing flaws adequately. These flaws may include undetected software or hardware defects associated with a newly introduced product, a new version of an existing product, or a product that has been integrated into a system or apparatus with the products of other vendors. If we fail to adequately monitor, develop and implement appropriate test and manufacturing processes we could experience a rate of product failure that results in substantial shipment delays, warranty costs or damage to our reputation. Product flaws may also consume our limited engineering resources and interrupt our development efforts. Significant product failures would increase our costs and result in the loss of future sales and be harmful to our business.

**Much of our business is subject to risks associated with operations in foreign countries.**

We generate a significant percentage of our revenue internationally, and we believe that international sales will continue to represent a substantial portion of our revenues. In addition, our manufacturing of power supply products is performed by contract manufacturers in Asia. We face risks that the countries in which we conduct business, or in which we have customers, suppliers, or contract manufacturers could:

Experience financial, economic or political instability;

Adopt laws that make the enforcement of our contractual or other legal rights and remedies difficult or uncertain;

Provide inadequate intellectual property protection for our technology;

Impose restrictions on the export or import of technology that would affect our ability to obtain supplies from, or sell products into, such countries;

Impose tariffs, quotas, taxes, other market barriers; or

Impose other laws, regulations or policies adversely affecting trade, investment or taxes, including those relating to the repatriation of funds and to withholding taxes.

Other risks and costs associated with international operations include:

Currency exchange risk, to the extent that exchange rate fluctuations could make our products unaffordable to foreign purchasers or more expensive compared to those of foreign manufacturers;

Compliance with laws and regulations in various regions in which we operate;

Greater difficulty and longer delays in collecting accounts receivable from international customers; or

Increased risk of shipping disruptions particularly in foreign countries experiencing political instability.

**Change of board and senior management, and retention of key personnel.**

Turnover in key management positions could temporarily harm our financial performance and results of operations. Loss of certain members of our senior management may disrupt operations and relations with key customers and distributors and our operating results could be adversely affected. Our capacity to develop and implement new technologies depends on our ability to employ personnel with highly technical skills. If we cannot attract and retain key technical personnel, our technical expertise may suffer, and our operating results could be adversely affected. In addition, it could be difficult, time consuming and expensive to replace any key management member or other critical personnel and no guarantee exists that we will be able to recruit suitable replacements or assimilate new key management personnel into our organization to achieve our operating objectives.

**Intellectual property infringement claims brought against us could result in a substantial liability and significant costs, and as a result, our business, financial condition and operating results may be materially and adversely affected.**

From time to time, we may become subject to claims or inquiries regarding an alleged unauthorized use by us of another party's intellectual property. While we currently believe the amount of ultimate liability, if any, with respect to any such actions will not materially affect our financial position, results of operations or liquidity, the ultimate outcome of any license discussion or litigation is uncertain. Adverse resolution of any infringement claim could subject us to substantial liabilities and require us to refrain from manufacturing and selling certain products. In addition, the costs incurred in intellectual property litigation can be substantial, regardless of the outcome. As a result, our business, financial condition and operating results could be materially and adversely affected.

**Our revenues and operating results may fluctuate unexpectedly from quarter to quarter, which may in turn affect our stock price.**

Our quarterly revenues and operating results have fluctuated in the past, and are likely to vary in the future due to the various factors discussed above and others, including:

General economic conditions affecting spending and the rates of growth or decline in the markets we serve;

Variations in product order backlogs, and reductions in the size, delays in the timing, or cancellation of significant customer orders;

The timing of introductions and marketplace acceptance of new or enhanced products by us or our competitors;

Expansions or reductions in our relationships with distributors, VARs or OEM customers;

Unprofitable investments in engineering activities, or sales evaluation, testing, and acceptance processes;

Unforeseen warranty costs that exceed established reserves;

Timing and levels of our operating expenses; or

Emerging new technologies that change the nature of or need for our products.

We believe that period-to-period comparisons of our operating results may not necessarily be reliable indicators of our future performance. It is likely that in some future period our operating results will not meet your expectations or those of public market analysts. Any unanticipated change in revenues or operating results is likely to cause our stock price to fluctuate since such changes reflect new information available to investors and analysts. New information may cause investors and analysts to revalue our stock and this, in the aggregate, may cause fluctuations in our stock price.

**Trading in our stock has historically been limited and our stock price has been volatile, which may affect your ability to sell your shares.**

The average trading volume in our stock has been historically low, with little or no trading at all on some days. This, as well as the factors listed below, has caused the price of our stock to be volatile. Consequently, it may be difficult to sell your shares of our stock at the price you paid for them or at a price equal to that quoted on the NASDAQ Stock Market. Factors that may cause our stock price to fluctuate in the future include:

Quarterly variations in operating results, especially if they differ from our previously announced forecasts or forecasts made by analysts;

Announcements by us of anticipated future revenues or operating results, or by others concerning us, our competitors, our customers, or our industry;

The introduction of new technology or products by us or our competitors;

Comments about us and the data storage or power supply markets made by industry analysts or on Internet comment sites; or

Changes in earnings estimates by analysts or changes in accounting policies; in product pricing policies by us or our competitors; or in general economic conditions.



In addition, stock markets have experienced extreme price and volume volatility in recent years. This volatility has had a substantial effect on the market prices of securities of many smaller public companies for reasons frequently unrelated or disproportionate to the operating performance of the specific companies. These market fluctuations may adversely affect the market price of our common stock.

**Certain provisions in our charter documents and California law may hinder or prevent a change in control of our company.**

Certain provisions of our charter documents could make it difficult for a third party to obtain control of the Company. For example, our articles of incorporation and bylaws require that stockholders must timely inform our corporate secretary before a stockholders' meeting if they wish to nominate directors or submit proposals for shareholder approval, and contain provisions that eliminate cumulative voting in the election of directors. In addition, subject to the rules of the NASDAQ Stock Market, our board of directors has the authority, without any action by the shareholders, to issue up to 5,000,000 shares of preferred stock and to fix the rights and preferences of such shares. These provisions may have the effect of delaying, deferring or preventing a change in control, may discourage bids for our common stock at a premium over its market price and may adversely affect the market price, and the voting and other rights of the holders of our common stock.

**Our success depends in part on our CEO, who simultaneously leads other public corporations.**

Steven N. Bronson, our Chief Executive Officer and President, simultaneously serves as the President and Chief Executive Officer of Interlink Electronics, Inc. (NASDAQ: LINK) and Chief Executive Officer and Chairman of BKF Capital Group, Inc. (OTCMKTS: BKFG). As a result, he divides his time among these companies and does not devote his full business time and attention to Qualstar's business. Mr. Bronson currently works on average approximately 20 to 30 hours per week for Qualstar. There can be no assurance, however, that the amount of time Mr. Bronson devotes to our Company will not diminish from time to time for limited or extended periods as his other business obligations require a greater portion of his attention. Mr. Bronson is not required to spend a minimum amount of time on Qualstar business. Our continued success depends in part upon the availability and performance of Mr. Bronson, who possesses unique and extensive industry knowledge and experience as well as a deep understanding of our business and strategy. A reduction in Mr. Bronson's services to Qualstar from their current levels due to his obligations to Interlink Electronics, BKF Capital or other organizations with which he is affiliated could have a disruptive effect, adversely impacting our ability to manage our business effectively and execute our business strategy.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

## ITEM 2. PROPERTIES

Since May 1, 2016, headquarters has been located in Simi Valley, California. We occupy a building with 15,160 rentable square feet of space. Our lease on this facility began December 15, 2014 and expires February 28, 2018. Rent for this facility is \$10,000 per month. Prior to May 1, 2016, our headquarters were located in Westlake Village, California.

We signed a two year lease for a facility with 1,359 square feet in Singapore for our power supply engineering staff, effective April 1, 2016. Rent for this facility is \$2,200 per month. This lease will expire on March 31, 2018. Prior to this lease, our staff was subleasing space on a month to month basis from BDT Automation Pte. Ltd., in the amount of \$1,000 per month.

Qualstar entered into a lease for 5,400 square feet of rentable space at the Westlake Village, California facility, effective May 1, 2016 for our sales, finance and administration staff. Rent for this facility is approximately, \$10,000 per month. On March 21, 2016, in order to reduce operating expenses, Qualstar subleased its Westlake Village facility for approximately \$11,000 per month and the term will remain the same as the master lease, ending January 31, 2020.

On July 1, 2015, Qualstar Corporation entered into a one year sublease agreement with Interlink Electronics, Inc. The sublease agreement is for 608 square feet of space in the Qualstar building located in Simi Valley, California. Qualstar receives rent each month which is equal to the base rent per square foot in the master lease, plus additional rent for common area services, utilities and other shared expenses. The space is used for engineering and light manufacturing.

### **ITEM 3. LEGAL PROCEEDINGS**

Qualstar is subject to a variety of other claims and legal proceedings that arise from time to time in the ordinary course of our business. Although management currently believes that resolving claims against us, individually or in the aggregate, will not have a material adverse impact on our financial statements, these matters are subject to inherent uncertainties and management's view of these matters may change in the future. We accrue loss contingencies in connection with our commitments and contingencies, including litigation, when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. As of December 31, 2016, we had accrued aggregate current liabilities of \$25,000 in probable fees and costs related to these legal matters.

### **ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES****Market Information**

Qualstar's common stock is traded on The NASDAQ Capital Market or NASDAQ (Symbol — QBAK). On June 14, 2016, upon receiving approval from the majority of the Company's shareholders at the 2016 Annual Meeting, the Company filed with the Secretary of State of the State of California a Certificate of Amendment of Restated Articles of Incorporation to implement a one-for-six reverse stock split (the "Reverse Split") of all outstanding shares of common stock, effective as of the close of business on June 14, 2016. Upon the effectiveness of the Reverse Split, each six shares of common stock issued and outstanding immediately prior to the effective time automatically were combined, reclassified and converted into one fully paid and nonassessable share of common stock, subject to the treatment of fractional share interests, as determined by each beneficial owner. Shareholders who otherwise would have been entitled to receive fractional shares as a result of the reverse split instead received a cash payment in lieu thereof equal to the fraction to which such shareholder otherwise would have been entitled multiplied by \$2.52, which represents the last sale price of the common stock as reported on the NASDAQ (as adjusted to reflect the reverse split) on June 13, 2016, the last trading day preceding the effective date of the reverse split. In addition, the aggregate number of equity-based awards that remain available to be granted under the Company's equity incentive plans and other benefit plans were reduced proportionately to reflect the reverse split, and all outstanding options, warrants, notes, debentures and other securities convertible into Common Stock will be adjusted as a result of the reverse split, as required by the terms of these securities.

The reverse split decreased the number of outstanding shares of common stock from 12,253,117 to approximately 2,042,020, as of June 14, 2016. The Company's authorized number of shares of common stock remains 50,000,000 and the authorized number of shares of preferred stock of the Company remains 5,000,000.

The following table sets forth the high and low closing sale prices of our common stock as reported by NASDAQ, during the periods indicated, adjusted for the one-for-six reverse split:

<b>Period Ending</b>	<b>Date Range</b>		<b>High</b>	<b>Low</b>
<b>December 31, 2016:</b>				
First Quarter	January 1 —	March 31, 2016	\$ 4.92	\$ 2.28
Second Quarter	April 1 —	June 30, 2016	\$ 4.44	\$ 2.16
Third Quarter	July 1 —	September 30, 2016	\$ 5.90	\$ 2.65

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Fourth Quarter	October 1	—	December 31, 2016	\$	4.14	\$	2.62
<b>December 31, 2015:</b>							
First Quarter	January 1	—	March 31, 2015	\$	9.60	\$	7.92
Second Quarter	April 1	—	June 30, 2015	\$	9.24	\$	6.78
Third Quarter	July 1	—	September 30, 2015	\$	10.74	\$	5.70
Fourth Quarter	October 1	—	December 31, 2015	\$	7.86	\$	3.42

## Holders

There were approximately 28 owners of record of Qualstar's common stock as of March 8, 2017, not including beneficial owners who own their stock in street name through Cede & Co. and others.

## Dividend Policy

No dividends were declared in the twelve months ended December 31, 2016 or 2015. Any future determination to pay dividends will be at the discretion of the Company's Board of Directors and will depend upon, among many other factors, the Company's results of operations, financial condition, capital requirements and any contractual restrictions.

## Recent Sales of Unregistered Securities

None

## Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None

**SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS**

The following table provides additional information regarding Qualstar's equity compensation plans as of December 31, 2016:

<b>Plan category</b>	<b>(a)</b>	<b>(b)</b>		<b>(c)</b>
	<b>Number of securities to be issued upon exercise of outstanding options, warrants and rights (1)</b>	<b>Weighted-average exercise price of outstanding options, warrants and rights (1)</b>	<b>\$</b>	<b>Number of securities remaining available for future issuance under equity compensation plans(excluding securities reflected in column (a) (2)</b>
Equity compensation plans approved by security holders	23,333	\$	9.49	60,000
Equity compensation plans not approved by security holders	—		—	—
<b>Totals</b>	<b>23,333</b>	<b>\$</b>	<b>9.49</b>	<b>60,000</b>

Includes shares subject to stock options granted under the 1998 Stock Incentive Plan and the 2008 Stock

(1) Incentive Plan as of December 31, 2016. The 1998 Stock Incentive Plan expired in 2008 and no further options may be granted under that plan.

(2) Includes shares available for issuance under the 2008 Stock Incentive Plan as of December 31, 2016.

**ITEM 6. SELECTED FINANCIAL DATA**

The following selected financial data is qualified in its entirety by and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and notes thereto included elsewhere in this 10-K. Our historical financial results are not necessarily indicative of results to be expected for any future period.

<b>Twelve Months Ended December 31,</b>		<b>Six Months Ended December 31,</b>		<b>Fiscal Years Ended June 30,</b>	
<b>2016</b>	<b>2015</b>	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>

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	Audited	Unaudited	Audited	Unaudited	Audited	Audited
	(In thousands, except per share amounts)					
Consolidated Statements of Operations Data:						
Net revenues	\$9,417	\$ 10,978	\$4,924	\$ 6,848	\$12,902	\$10,941
Cost of goods sold	6,824	7,889	3,881	4,522	8,530	8,350
Gross profit	2,593	3,089	1,043	2,326	4,372	2,591
Operating expenses:						
Engineering	990	1,360	694	685	1,351	2,461
Sales and marketing	1,229	1,938	957	1,096	2,077	2,200
General and administrative	1,587	2,399	1,259	1,368	2,478	3,780
Restructuring expense (income)	-	-	-	(245 )	(245 )	(202 )
Total operating expenses	3,806	5,697	2,910	2,904	5,661	8,239
Loss from operations	(1,213)	(2,608 )	(1,867)	(578 )	(1,289 )	(5,648 )
Other income (loss)	3	2	2	11	(19 )	24
Loss before income taxes	(1,210)	(2,606 )	(1,865)	(567 )	(1,308 )	(5,624 )
Provision (benefit) for income taxes	-	20	20	-	-	-
Net loss	\$(1,210)	\$(2,626 )	\$(1,885)	\$(567 )	\$(1,308 )	\$(5,624 )
Net loss per Share:						
Basic and Diluted <sup>(1)</sup>	\$(0.59 )	\$(1.29 )	\$(0.92 )	\$(0.28 )	\$(0.64 )	\$(2.75 )
Shares used to compute net loss per share:						
Basic and Diluted <sup>(1)</sup>	2,042	2,042	2,042	2,042	2,042	2,042

<sup>(1)</sup> The prior period shares and per share amounts have been adjusted retrospectively for the reverse stock split, as described in Item 5.

	<b>December 31,</b>		<b>June 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2015</b>	<b>2014</b>
	Audited	Audited	Audited	Audited
	<b>(In thousands)</b>			
Consolidated Balance Sheet Data:				
Cash and cash equivalents	\$3,691	\$3,863	\$4,596	\$5,362
Restricted cash	100	100	100	100
Marketable securities	-	-	-	1,763
Working capital	4,644	5,707	7,573	8,653
Total assets	7,263	8,727	10,684	12,785
Shareholders' equity	4,839	6,047	7,910	9,123

## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis should be read in conjunction with our consolidated financial statements and notes thereto.

### **OVERVIEW**

Qualstar Corporation was incorporated in California in 1984. Qualstar focuses its efforts on designing, developing, manufacturing and selling high efficiency AC-DC and DC-DC power supplies under its N2Power brand, and automated tape libraries used to store, retrieve and manage electronic data under its Qualstar brand. Tape libraries consist of cartridge tape drives, tape cartridges and robotics to move the tape cartridges from their storage locations to the tape drives under software control. Qualstar's tape libraries provide storage solutions for organizations requiring backup, recovery and archival storage of critical electronic information.

Qualstar has developed a business plan to establish worldwide partnerships with other power supply and data storage related companies that will increase our engineering capabilities to develop new products and where we can 'private label' and sell already established strategic products that fit within our portfolio of products.

On June 30, 2014, Qualstar established a Singapore subsidiary, Qualstar Corporation Singapore Private Limited ("QC Singapore"), in furtherance of its plan to establish an engineering footprint in Singapore. QC Singapore has allowed us to hire strategic engineering personnel to assist in sustaining our current products and for new product development. QC Singapore has helped us in servicing our Asian customers and we believe will benefit us entering into relationships with various Singapore technical schools that have a strong history of working with local businesses in development of new breakthrough technologies.



Beginning in the fiscal year ended June 30, 2015, the Company took substantial action to reduce overhead spending. The Company reduced its leased space by 63.8% to 20,560 square feet from 56,845 square feet. The Company's base rent payments reduced to \$20,000 compared to \$44,000 per month, a 54.5% reduction. In April 2016, the Company reduced the size of its facilities and consolidated its offices into the Simi Valley facility, which consists of 15,160 square feet of rentable space and which reduced rental costs from \$20,000 to \$10,000 per month.

On January 4, 2016, Qualstar changed its fiscal year from June 30 to December 31. As a result, the Company reported a transition period for the six months beginning July 1, 2015 and ending December 31, 2015. The audited financial statements presented in this report reflect the twelve month period beginning, January 1, 2016 to December 31, 2016.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Our discussion and analysis of our consolidated financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to loss contingencies, product life cycles and inventory obsolescence, bad debts, sales returns, warranty costs, share-based compensation forfeiture rates, and the potential outcome of future tax consequences. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

### **Revenue Recognition**

We recognize revenue in accordance with Accounting Standards Codification (“ASC”) 605, “Revenue Recognition,” when there is persuasive evidence that an arrangement exists, title and risk of loss have passed, delivery has occurred or the services have been rendered, the sales price is fixed or determinable and collection of the related receivable is reasonably assured. Title and risk of loss generally pass to our customers upon shipment. In limited circumstances where either title or risk of loss pass upon destination or acceptance or when collection is not reasonably assured, we defer revenue recognition until such events occur.

In general, customers are allowed to return the product, free of penalty, within thirty days of shipment, if the product does not conform to its specifications. We record an allowance for estimated sales returns based on past experience and current knowledge of our customer base. Our experience has been such that only a very small percentage of products are returned. Should our experience change, however, we may require additional allowances for sales returns.

Revenue for established products that have previously satisfied a customer’s acceptance requirements and provide for full payment tied to shipment is generally recognized upon shipment and passage of title. In limited cases where a prior history of customer acceptance cannot be demonstrated or sales where customer payment dates are not determinable or when collection is not reasonably assured, revenue is deferred until customer acceptance occurs or

payment has been received. On the limited shipments where sales are not recognized, gross profit is generally recorded as deferred profit in our balance sheet representing the difference between the receivable recorded and the inventory shipped.

Service contracts are sold by Qualstar to customers for a period of time to provide product support after the warranty expires. The service contracts allow customers to call Qualstar for technical support, replace defective parts and to have onsite service provided by Qualstar's third party contract service provider.

Deferred revenue, which relates primarily to our service contracts, was approximately \$892,000 and we had no deferred profit at December 31, 2016. Deferred revenue was approximately \$1,098,000 and we had no deferred profit, at December 31, 2015.

### **Fair Value of Financial Instruments**

We measure fair value on all financial assets and liabilities and nonfinancial assets and liabilities that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis (at least quarterly). See “Note 1 – Accounting Policies” in the accompanying notes to the consolidated financial statements.

### **Allowance for Doubtful Accounts**

We estimate our allowance for doubtful accounts based on an assessment of the collectability of specific accounts and the overall condition of accounts receivable. In evaluating the adequacy of the allowance for doubtful accounts, we analyze specific trade receivables, historical bad debts, customer credits, customer credit-worthiness and changes in customers’ payment terms and patterns. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make additional payments, then we may need to make additional allowances. Likewise, if we determine that we could realize more of our receivables in the future than previously estimated, we would adjust the allowance to increase income in the period we made this determination.

### **Inventory Valuation**

We record inventories at the lower of cost or market value on a first in first out basis. We assess the value of our inventories periodically based upon numerous factors including expected product or material demand, current market conditions, technological obsolescence, current cost and net realizable value. If necessary, we write down our inventory for estimated obsolescence, potential shrinkage, or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If technology changes more rapidly than expected, or market conditions become less favorable than those projected by management, additional inventory write-downs may be required.

### **Warranty Obligations**

We provide for the estimated cost of product warranties at the time revenue is recognized. We engage in extensive product quality programs and processes, including active monitoring and evaluation of product failure rates, material usage and estimation of service delivery costs incurred in correcting a product failure. However, should actual product failure rates, material usage, or service delivery costs differ from our estimate; revisions to the estimated warranty liability would be required. Historically our warranty costs have not been significant.

## **Legal and Other Contingencies**

The outcomes of legal proceedings and claims brought against us are subject to significant uncertainty. An estimated loss from a loss contingency such as a legal proceeding or claim is accrued by a charge to income if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. When legal costs that the entity expects to incur in defending itself in connection with a loss contingency accrual are expected to be material, the loss should factor in all costs and, if the legal costs are reasonably estimable, they should be accrued regardless of whether a liability can be estimated for the contingency itself. Disclosure of a contingency is required if there is at least a reasonable possibility that a loss has been incurred. Changes in these factors could materially impact our financial statements.

## **Share-Based Compensation**

Share-based compensation is accounted for at fair value over the vesting period. We use the Black-Scholes option-pricing model to determine fair value of the award at the date of grant and recognize compensation expense over the vesting period. The inputs we use for the model require the use of judgment, estimates and assumptions regarding the expected volatility of the stock, the expected term the average employee will hold the option prior to the date of exercise, expected future dividends, and the amount of share-based awards that are expected to be forfeited. Changes in these inputs and assumptions could occur and actual results could differ from these estimates, and our results of operations could be materially impacted.

## **Accounting for Income Taxes**

We estimate our tax liability based on current tax laws in the statutory jurisdictions in which we operate. These estimates include judgments about deferred tax assets and liabilities resulting from temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes, as well as about the realization of deferred tax assets. We may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained upon examination by the taxing authorities, based on the technical merits of the position. 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. ASC 740 also provides guidance on de-recognition 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.

We maintain a valuation allowance to reduce our deferred tax assets due to the uncertainty surrounding the timing of realizing the benefits of net deferred tax assets in future years. We have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for such a valuation allowance. In the event we were to determine that we would be able to realize all or part of our net deferred tax asset in the future, the valuation allowance would be decreased accordingly.

We may periodically undergo examinations by the federal and state regulatory authorities and the Internal Revenue Service. We may be assessed additional taxes and or penalties contingent on the outcome of these examinations. Our previous examinations have not resulted in any unfavorable or significant assessments.

The Company has net operating loss carry-forwards for federal income tax purposes of approximately \$33.0 million and net operating loss carry-forwards for state income tax purposes of approximately \$22.0 million. The Company has engineering and other credits for tax purposes of \$2.7 million. If not utilized, the federal net operating loss and other tax credit carry-forwards will start to expire beginning in 2025 and 2024, respectively. If not utilized, the state net operating loss carry-forward as of December 31, 2016 will begin to expire December 31, 2017. The state engineering credit has no limit on the carry-forward period.

## **Recent Accounting Pronouncements**

See Recent Accounting Guidance in "Note 1 Summary of Significant Accounting Policies" in the accompanying notes to the consolidated financial statements for a full description of recent accounting pronouncements including the respective expected dates of adoption and effects on our results of operations and financial condition.



**RESULTS OF OPERATIONS**

The following table reflects, as a percentage of net revenues, consolidated statements of operations data for the periods indicated. The table summarizes the revenue for the Company's two business segments, data storage and power supplies, as discussed in Note 11 of our consolidated financial statements.

	<b>Twelve Months Ended</b>				<b>Six Months Ended</b>		<b>Twelve Months Ended</b>	
	<b>December 31,</b>				<b>December 31,</b>		<b>June 30,</b>	
	<b>2016</b>	<b>2015</b>			<b>2015</b>		<b>2015</b>	
	<b>Audited</b>	<b>Unaudited</b>			<b>Audited</b>		<b>Audited</b>	
	(In thousands)							
	\$	%	\$	%	\$	%	\$	%
Power supply revenues	\$5,601	59.5 %	\$5,842	53.2 %	\$2,463	50.0 %	\$6,330	49.1 %
Storage revenues:								
Product	1,949	20.7 %	3,063	27.9 %	1,410	28.6 %	4,478	34.7 %
Service	1,867	19.8 %	2,073	18.9 %	1,051	21.4 %	2,094	16.2 %
Total storage revenues	3,816	40.5 %	5,136	46.8 %	2,461	50.0 %	6,572	50.9 %
Net revenues	9,417	100.0 %	10,978	100.0 %	4,924	100.0 %	12,902	100.0 %
Cost of goods sold	6,824	72.5 %	7,889	71.9 %	3,881	78.8 %	8,530	66.1 %
Gross profit	2,593	27.5 %	3,089	28.1 %	1,043	21.2 %	4,372	33.9 %
Operating expenses:								
Engineering	990	10.5 %	1,360	12.4 %	694	14.1 %	1,351	10.5 %
Sales and marketing	1,229	13.1 %	1,938	17.7 %	957	19.4 %	2,077	16.1 %
General and administrative	1,587	16.9 %	2,399	21.9 %	1,259	25.6 %	2,478	19.2 %
Restructuring recovery	-	- %	-	- %	-	- %	(245 )	(1.9 )%
Total operating expenses	3,806	40.5 %	5,697	51.9 %	2,910	59.1 %	5,661	43.9 %
Loss from operations	(1,213)	(13.0 )%	(2,608 )	(23.8 )%	(1,867)	(37.9 )%	(1,289 )	(10.0 )%
Other income (expense)	3	0.0 %	2	0.0 %	2	(0.0 )%	(19 )	(0.1 )%
Loss before income taxes	(1,210)	(13.0 )%	(2,606 )	(23.8 )%	(1,865)	(37.9 )%	(1,308 )	(10.1 )%
Provision for income taxes	-	0.0 %	20	(0.2 )%	20	0.4 %	-	0.0 %
Net loss	\$(1,210)	(13.0 )%	\$(2,626 )	(24.0 )%	\$(1,885)	(38.3 )%	\$(1,308 )	(10.1 )%

On January 4, 2016, the Company changed the fiscal year from June 30 to December 31. In this Report, we compare financial results for the twelve months beginning January 1, 2016 through December 31, 2016, which are audited, with the financial results for January 1, 2015 through December 31, 2015, which are unaudited. This report also compares the financial results for the six months ended December 31, 2015, which are audited with the financial results for the six months ended December 31, 2014, which are unaudited and the financial results for the fiscal years ended June 30, 2015 with the financial results for the fiscal years ended June 30, 2014, both of which are audited.



**Comparison of the Twelve Months Ended December 31, 2016 (audited) and 2015 (unaudited)**

**Change in Net Revenues:**

	<b>Twelve Months Ended December 31,</b>				
	<b>2016</b>	<b>2015</b>			<b>Change</b>
	<b>Audited</b>	<b>Unaudited</b>			
	<b>Amount</b>	<b>% of net</b>	<b>Amount</b>	<b>% of net</b>	<b>Amount</b>
		<b>revenue</b>		<b>revenue</b>	
Power supply revenues	\$5,601	59.5 %	\$5,842		