



Qualstar Corporation and Subsidiaries

**Annual Report
For the Year Ended December 31, 2023**

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QUALSTAR CORPORATION AND SUBSIDIARIES

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QUALSTAR CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)
(Unaudited)

	December 31,	
	2023	2022
Assets		
Current assets:		
Cash and cash equivalents	\$ 2,275	\$ 2,767
Marketable securities	140	33
Accounts receivable, net	2,174	1,643
Inventories	2,870	3,036
Prepaid expenses and other current assets	343	138
Total current assets	<u>7,802</u>	<u>7,617</u>
Property and equipment, net	52	82
Right-of-use assets	88	243
Deferred tax assets	30	30
Other assets	59	71
Total assets	<u>\$ 8,031</u>	<u>\$ 8,043</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 1,482	\$ 946
Accrued payroll and related liabilities	139	140
Deferred service revenue	577	687
Lease liabilities, current	95	165
Other accrued liabilities	130	133
Total current liabilities	<u>2,423</u>	<u>2,071</u>
Long-term liabilities:		
Lease liabilities, long-term	-	95
Deferred service revenue, long-term	567	510
Other long-term liabilities	27	27
Total long-term liabilities	<u>594</u>	<u>632</u>
Total liabilities	<u>3,017</u>	<u>2,703</u>
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Preferred stock, no par value; 5,000,000 shares authorized; no shares issued	-	-
Common stock, no par value; 50,000,000 shares authorized; 1,447,122 shares issued and outstanding at December 31, 2023, and 1,627,419 shares issued and outstanding at December 31, 2022	17,701	18,218
Accumulated deficit	<u>(12,687)</u>	<u>(12,878)</u>
Total shareholders' equity	<u>5,014</u>	<u>5,340</u>
Total liabilities and shareholders' equity	<u>\$ 8,031</u>	<u>\$ 8,043</u>

QUALSTAR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended		Year Ended December 31,	
	December 31,			
	2023	2022	2023	2022
Revenues	\$ 3,404	\$ 2,826	\$ 10,616	\$ 9,845
Cost of goods sold	2,191	1,879	7,336	6,850
Gross profit	1,213	947	3,280	2,995
Operating expenses:				
Engineering	149	66	393	336
Sales and marketing	390	307	1,353	1,215
General and administrative	364	347	1,394	1,352
Total operating expenses	903	720	3,140	2,903
Income from operations	310	227	140	92
Other income (expense), net	13	52	54	(32)
Income before income taxes	323	279	194	60
Provision for income taxes	3	5	3	5
Net income	\$ 320	\$ 274	\$ 191	\$ 55
Earnings per share:				
Basic and diluted	\$ 0.21	\$ 0.16	\$ 0.12	\$ 0.03
Weighted average common shares outstanding:				
Basic and diluted	1,498	1,692	1,570	1,829

QUALSTAR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In thousands)

(Unaudited)

Three Months Ended December 31, 2023	Common Stock		Accumulated	
	Shares	Amount	Deficit	Total
Balances at October 1, 2023	1,573	\$ 18,075	\$ (13,007)	\$ 5,068
Share repurchases	(128)	(379)	-	(379)
Share based compensation	2	5	-	5
Net income	-	-	320	320
Balances at December 31, 2023	<u>1,447</u>	<u>\$ 17,701</u>	<u>\$ (12,687)</u>	<u>\$ 5,014</u>

Year Ended December 31, 2023	Common Stock		Accumulated	
	Shares	Amount	Deficit	Total
Balances at January 1, 2023	1,627	\$ 18,218	\$ (12,878)	\$ 5,340
Share repurchases	(182)	(522)	-	(522)
Share based compensation	2	5	-	5
Net income	-	-	191	191
Balances at December 31, 2023	<u>1,447</u>	<u>\$ 17,701</u>	<u>\$ (12,687)</u>	<u>\$ 5,014</u>

Three Months Ended December 31, 2022	Common Stock		Accumulated	
	Shares	Amount	Deficit	Total
Balances at October 1, 2022	1,749	\$ 18,490	\$ (13,152)	\$ 5,338
Share repurchases	(122)	(272)	-	(272)
Net income	-	-	274	274
Balances at December 31, 2022	<u>1,627</u>	<u>\$ 18,218</u>	<u>\$ (12,878)</u>	<u>\$ 5,340</u>

Year Ended December 31, 2022	Common Stock		Accumulated	
	Shares	Amount	Deficit	Total
Balances at January 1, 2022	1,884	\$ 18,789	\$ (12,933)	\$ 5,856
Share repurchases	(257)	(571)	-	(571)
Net income	-	-	55	55
Balances at December 31, 2022	<u>1,627</u>	<u>\$ 18,218</u>	<u>\$ (12,878)</u>	<u>\$ 5,340</u>

QUALSTAR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Year Ended December 31,	
	2023	2022
Cash flows from operating activities:		
Net income	\$ 191	\$ 55
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	37	43
Share-based compensation	5	-
Realized and unrealized (gain) on marketable securities	(6)	(8)
Adjustment to reconcile operating lease expense to cash paid	(10)	(4)
Changes in operating assets and liabilities:		
Accounts receivable	(531)	(289)
Inventories	166	(760)
Prepaid expenses and other assets	(193)	117
Accounts payable	536	(31)
Accrued payroll and related liabilities	(1)	(48)
Deferred service revenue	(53)	129
Other liabilities	(3)	(35)
Net cash provided by (used in) operating activities	<u>138</u>	<u>(831)</u>
Cash flows from investing activities:		
Purchases of property and equipment	(7)	(1)
Purchases of marketable securities	(295)	(25)
Proceeds from sales of marketable securities	194	-
Net cash used in investing activities	<u>(108)</u>	<u>(26)</u>
Cash flows from financing activities:		
Share repurchases	(522)	(571)
Net cash used in financing activities	<u>(522)</u>	<u>(571)</u>
Net decrease in cash and cash equivalents	(492)	(1,428)
Cash and cash equivalents at beginning of period	2,767	4,195
Cash and cash equivalents at end of period	<u>\$ 2,275</u>	<u>\$ 2,767</u>
Supplemental disclosure of cash flow information:		
Income taxes paid, net	<u>\$ 5</u>	<u>\$ 1</u>
Interest paid	<u>\$ -</u>	<u>\$ -</u>
Supplemental non-cash investing and financing activities:		
Lease liabilities arising from obtaining right-of-use assets	<u>\$ -</u>	<u>\$ 77</u>

QUALSTAR CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 – Significant Accounting Policies

Business

Qualstar Corporation and its Subsidiaries (“Qualstar”, the “Company”, “we”, “us” or “our”) manufactures and markets data storage system products and compact, high efficiency power solutions. Our data storage systems are marketed under the Qualstar brand and include highly scalable automated magnetic tape libraries used to store, retrieve and manage electronic data primarily in the network computing environment. Our data storage devices include models ranging from entry level to enterprise and are a cost-effective solution for organizations requiring backup, recovery and archival storage of critical electronic information. The distribution channels for our data storage devices include resellers, system integrators, and original equipment manufacturers (“OEMs”). In addition, the Company is a leading provider of standard, semi-custom and custom power solutions marketed under the N2Power brand. Our power solution products provide OEM designers increased functionality while reducing thermal loads and cooling requirements and lowering operating costs. Our power solution products are currently sold to OEMs in a wide range of markets, including telecom/networking equipment, audio/visual, industrial, gaming and medical.

Qualstar Corporation was incorporated in California in 1984 and currently has three wholly owned subsidiaries. The N2Power, Inc. subsidiary (“N2Power”) operates the Company’s power supplies business. The Q-Smart Data Limited (China) subsidiary pursues new data storage business opportunities in Asia. The Qualstar Limited (U.K.) subsidiary expands the Company’s data storage business in Europe and Africa. The Company’s former Qualstar Corporation Singapore Private Limited subsidiary previously gave the Company an engineering footprint in Singapore, and the Company’s former Q-Smart Data Private Limited (Singapore) subsidiary previously pursued new business opportunities in Asia, both of which were dissolved in March 2022.

We sell our products globally through authorized resellers, distributors, and directly to OEMs. Our data storage products are manufactured by our OEM suppliers in other parts of the world and configured to order by us at our facility in Camarillo, California, or at our facility in Shenzhen, China, or by our fulfilment and logistics partner in Warsaw, Poland. N2Power utilizes contract manufacturers in Asia to produce our power solutions products.

Principles of Consolidation

The consolidated financial statements include our accounts and the accounts of each of our wholly owned subsidiaries that were in existence during the periods presented: N2Power, Inc., Q-Smart Data Limited (China), Qualstar Limited (U.K.), Qualstar Corporation Singapore Private Limited, and Q-Smart Data Private Limited (Singapore). All significant intercompany accounts and transactions have been eliminated in consolidation.

Estimates and Assumptions

Preparing financial statements in accordance with accounting principles generally accepted in the United States of America (“GAAP”) 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, credit loss bad debts, sales returns, warranty costs, share-based compensation forfeiture rates, the tax consequences of events that have been recognized in our consolidated 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.

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Public Health Threats

Our operations and financial results may be adversely affected by outbreaks of viruses, widespread illness, infectious diseases, contagions and unforeseen epidemics (such as the COVID-19 coronavirus) in countries in which our products are manufactured and sold. We experienced delays in the receipt of certain goods and the supply of our products from international and domestic shipping origins as a result of the COVID-19 pandemic and more general global supply chain constraints in fiscal 2021, and to a lesser extent in fiscal 2022 and fiscal 2023. Depending on the continued extent and duration of these and similar constraints and disruptions, our supply chain, results of operations (including sales) or future business may be materially and adversely impacted. These and other issues affecting our international suppliers or internationally manufactured merchandise could have a material adverse effect on our business, results of operations and financial condition.

Revenue Recognition

The Company recognizes revenue when its customer obtains control of promised goods or services, in an amount that reflects the consideration which we expect to receive in exchange for those goods or services. To determine revenue recognition for arrangements that the Company determines are within the scope of ASC 606, we perform the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) we satisfy a performance obligation. The five-step model is applied to contracts when it is probable that we will collect the consideration we are entitled to in exchange for the goods or services transferred to the customer. At contract inception, once the contract is determined to be within the scope of ASC 606, we assess the goods or services promised within each contract and determine those that are performance obligations and assess whether each promised good or service is distinct. We then recognize revenue in the amount of the transaction price that is allocated to the respective performance obligation when (or as) the performance obligation is satisfied.

Title and risk of loss generally pass to our customers upon shipment and therefore revenue is recognized at the time goods are shipped to the customers. In limited circumstances where either title or risk of loss pass upon destination, we defer revenue recognition until such events occur. We derive revenues from two primary sources: products and services. Product revenue includes the shipment of product according to the agreement with our customers for data storage products and power supplies. Services include customer support (technical support), installations, consulting, and design services. A contract may include both product and services. Rarely, contracts with customers contain multiple performance obligations. For these contracts, the Company accounts for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations on a relative standalone selling price basis. Standalone selling prices are typically estimated based on observable transactions when these services are sold on a standalone basis.

A variety of technical services can be contracted by our customers for a designated period of time. 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. We record revenue for contract services at the amount of the service contract, but such amount is deferred at the beginning of the service term and amortized ratably over the life of the contract.

Deferred service revenue is shown separately in the consolidated balance sheets as current and long term. At December 31, 2023 we had deferred service revenue of approximately \$1,144,000. At December 31, 2022 we had deferred service revenue of approximately \$1,197,000.

Cash and Cash Equivalents

Qualstar classifies as cash equivalents only cash and those investments that are highly liquid, interest-earning investments with original maturities of three months or less from the date of purchase.

QUALSTAR CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Allowance for Credit Losses

The allowance for credit losses reflects our best estimate of probable losses inherent in the accounts receivable balance. We determine the allowance based on known troubled accounts, historical experience, and other currently available evidence.

Inventories

Inventories are stated at the lower of cost (first in, first out basis) or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis.

Property and Equipment, net

Property and equipment are recorded at cost less accumulated depreciation and amortization. Depreciation expense is computed using the straight-line method. Leasehold improvements are amortized over the shorter of the estimated useful life of the asset or the term of the lease. Estimated useful lives are as follows:

Machinery and equipment	5-7 years
Furniture and fixtures	5-7 years
Computer equipment	3-5 years
Leasehold improvements	Shorter of estimated useful life of the asset or the lease term

Expenditures for normal maintenance and repairs are charged to expense as incurred, and improvements are capitalized. Upon the sale or retirement of property or equipment, the asset cost and related accumulated depreciation are removed from the respective accounts and any gain or loss is included in the results of operations.

Long-Lived Assets

Qualstar evaluates long-lived assets for potential impairment whenever events or changes in circumstances indicate the carrying amount of any asset may not be recoverable. An impairment loss would be recognized when the estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition is less than the carrying amount. If impairment is indicated, the amount of the loss to be recorded is based upon an estimate of the difference between the carrying amount and the fair value of the asset. Fair value is based upon discounted cash flows expected to result from the use of the asset and its eventual disposition and other valuation methods. No impairment losses of long-lived assets were recognized during the periods presented.

Warranty Obligations

A provision for costs related to warranty expense is recorded when revenue is recognized, which is estimated based on historical warranty costs incurred.

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

We provide a three-year warranty on all Q-Series, XLS and RLS libraries. This includes replacement of components, or if necessary, complete libraries. XLS libraries sold in North America also include one year of on-site service. Customers may purchase on-site service if they are located in the United States and selected countries in Europe, Asia Pacific and Latin America. All customers may purchase extended warranty service coverage upon expiration of the standard warranty.

We provide a three-year warranty on all power supplies that includes repair or, if necessary, replacement of the power supply.

Shipping and Handling Costs

Qualstar records all customer charges for outbound shipping and handling to freight revenue. All inbound and outbound shipping and fulfillment costs are classified as costs of goods sold.

Engineering

All engineering costs are charged to expense as incurred. These costs consist primarily of engineering salaries, benefits, outside consultant fees, purchased parts and supplies directly involved in the design and development of new products, compliance testing, facilities costs and other internal costs.

Advertising

Advertising and promotion expenses include costs associated with direct and indirect marketing, trade shows and public relations. Qualstar expenses all costs of advertising and promotion as incurred.

Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, which include cash equivalents, marketable securities, accounts receivable, and accounts payable, approximate their fair values.

We determine fair value measurements based on assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, we follow the following fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) our own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs):

Level 1: Observable inputs such as quoted prices for identical assets or liabilities in active markets;

Level 2: Other inputs observable directly or indirectly, such as quoted prices for similar assets or liabilities or market-corroborate inputs; and

Level 3: Unobservable inputs for which there is little or no market data and which requires the owner of the assets or liabilities to develop its own assumptions about how market participants would price these assets or liabilities.

Our assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of assets and liabilities and their placement within the fair value hierarchy.

Our marketable securities consist of equity securities classified as available-for-sale ("AFS") and recorded at fair value, as determined using Level 1 inputs on the fair value hierarchy. Realized and unrealized gains and losses are reported in earnings within "other income (expense), net". The specific identification method is used to determine realized gains and losses on AFS securities.

QUALSTAR CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Foreign Currency Translation

The functional currency for our subsidiaries in China and the United Kingdom is the United States dollar. However, our Chinese and United Kingdom subsidiaries also transact business in their local currency. Foreign currency transaction and remeasurement gains and losses are included in results of operations within “other income (expense), net”, for which gains of \$2,000 and \$28,000 recorded for the three months ended December 31, 2023 and 2022, respectively, and loss of \$21,000 and \$1,000 were recorded in the years ended December 31, 2023 and 2022, respectively.

Share-Based Compensation

Share-based compensation cost is measured at the grant date based on fair value of the award and is recognized as expense over the applicable vesting period of the stock award using the straight-line method.

Income Taxes

Income taxes are accounted for using the liability method. Under this method, deferred tax liabilities and assets are recognized for the expected future tax consequences of temporary differences between the financial statement and tax bases of assets and liabilities, and for the expected future tax benefit to be derived from tax credits and loss carryforwards. Current income tax expense or benefit represents the amount of income taxes expected to be payable or refundable for the current year. A valuation allowance is established when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Leases

The Company accounts for its leases under ASC 842, *Leases*. Under this guidance, arrangements meeting the definition of a lease are classified as operating or financing leases, and are recorded on the consolidated balance sheet as both a right-of-use asset and lease liability, calculated by discounting fixed lease payments over the lease term at the rate implicit in the lease or the Company’s incremental borrowing rate. Lease liabilities are increased by interest and reduced by payments each period, and the right-of-use asset is amortized over the lease term. For operating leases, interest on the lease liability and the amortization of the right-of-use asset result in straight-line rent expense over the lease term. For finance leases, interest on the lease liability and the amortization of the right-of-use asset results in front-loaded expense over the lease term. Variable lease expenses are recorded when incurred.

In calculating the right-of-use asset and lease liability, the Company has elected to combine lease and non-lease components. The Company excludes short-term leases having initial terms of 12 months or less as an accounting policy election and recognizes rent expense on a straight-line basis over the lease term.

Operating Segments

The Company operates in two segments, Data Storage and Power Supplies. Operating segments are identified as functional groups within an enterprise for which discrete financial information is utilized by the chief operating decision maker in allocating resources and assessing performance. In the case of Qualstar, the chief operating decision maker is its President and Chief Executive Officer. This position maintains decision-making control over, and assesses the performance of, the two divisional levels of the Company.

Recent Accounting Guidance Not Yet Adopted

We reviewed all recently issued, but not yet effective, accounting pronouncements and concluded none are expected to be applicable or material to our consolidated financial statements.

QUALSTAR CORPORATION AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

Subsequent Events

The Company has evaluated subsequent events through March 26, 2024, being the date these consolidated financial statements were issued.

On February 5, 2024, the Company extended its lease agreement on its Camarillo, CA facility for three years through July 31, 2027, with base rents of \$12,883 per month for the first year, \$13,269 per month for the second year, and \$13,668 per month for the third year.

On February 13, 2024, the Board of Directors approved an executive employment agreement with Steven N. Bronson, the Company's CEO. The agreement provides for a base salary of \$250,000, discretionary bonus compensation of up to 50% of the base salary, and an option to acquire 100,000 shares of common stock at an exercise price of \$4.45 per share, vesting 50% on January 31, 2025 and 50% on January 31, 2026, and expiring February 13, 2034.

Note 2 – Balance Sheet Details

The following tables provide details of selected balance sheet accounts:

	December 31,	
	2023	2022
Inventories	(In thousands)	
Raw materials	\$ 161	\$ 145
Finished goods	2,709	2,891
Net inventory balance	\$ 2,870	\$ 3,036

	December 31,	
	2023	2022
Property and equipment, net	(In thousands)	
Machinery and equipment	\$ 389	\$ 382
Furniture and fixtures, and computer equipment	258	258
Leasehold improvements	119	119
	766	759
Less accumulated depreciation and amortization	(714)	(677)
Property and equipment, net	\$ 52	\$ 82

Depreciation and amortization expense for the three months ended December 31, 2023 and 2022 was \$9,000 and \$10,000, respectively. Depreciation and amortization expense for the years ended December 31, 2023 and 2022 was \$37,000 and \$43,000, respectively.

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(Unaudited)**

	December 31,	
	2023	2022
Accrued payroll and related liabilities	(In thousands)	
Accrued salaries, wages, and payroll taxes	\$ 26	\$ 32
Accrued vacation	113	108
Total accrued payroll and related liabilities	\$ 139	\$ 140

	December 31,	
	2023	2022
Other accrued liabilities	(In thousands)	
Accrued warranty	\$ 36	\$ 81
Accrued commissions	84	49
Other accrued liabilities	10	3
Total other accrued liabilities	\$ 130	\$ 133

Note 3 – Income Taxes

The provision for income taxes is comprised of the following:

	Year Ended December 31,	
	2023	2022
	(In thousands)	
Current:		
Federal	\$ -	\$ -
State	3	5
Foreign	-	-
Current income tax provision (benefit)	3	5
Deferred:		
Federal	-	-
State	-	-
Foreign	-	-
Deferred income tax provision (benefit)	-	-
Net income tax provision	\$ 3	\$ 5

The following is a reconciliation of the statutory federal income tax rate to Qualstar's effective income tax rate:

	Year Ended December 31,	
	2023	2022
Statutory federal income tax provision	21.0 %	21.0 %
State income taxes, net of federal income tax benefit	54.1	15.5
Rate adjustment related to foreign income	13.2	21.4
Non-deductible recapitalization expenses	-	12.4
Deferred tax adjustment – Research and development credit	(9.4)	-
Deferred tax adjustment – Capital loss carry forward / NOL / share-based compensation	(17.9)	4.3
Valuation allowance	(59.7)	(68.0)
Other	(0.1)	1.4
Effective income tax rate	1.2 %	8.0 %

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(Unaudited)

The tax effect of temporary differences resulted in deferred income tax assets (liabilities) as follows:

	December 31,	
	2023	2022
	(In thousands)	
Deferred tax assets:		
Net operating loss carry forwards	\$ 8,191	\$ 8,109
Capital loss carry forwards	42	-
Engineering credit carry forwards	1,847	1,921
Inventory reserves	327	470
Depreciation and other	3	4
Allowance for bad debts and returns	3	3
Share-based compensation	97	96
Capitalized inventory costs, and other accruals	204	252
Total gross deferred tax assets	10,714	10,855
Less valuation allowance on deferred tax assets	(10,662)	(10,773)
Net deferred tax assets	52	82
Deferred tax liabilities:		
Depreciation and other	(3)	(2)
Right-of-use assets	(19)	(50)
Total deferred tax liabilities	(22)	(52)
Net deferred taxes	\$ 30	\$ 30

With respect to global intangible low-taxed income (“GILTI”) rules which are applicable to a U.S. shareholder of any controlled foreign corporation, the Company accounts for taxes related to GILTI as such income is incurred.

The Company records a valuation allowance against its net deferred income tax assets when, in management’s judgment, it is more likely than not that the deferred income tax assets will not be realized in the foreseeable future. For the years ended December 31, 2023 and 2022, the Company placed a valuation allowance on net deferred tax assets. With the exception of a small amount of the California net operating loss (“NOL”) carryforward, the Company continues to fully offset its deferred tax assets with a valuation allowance. With regard to California deferred tax assets, because Qualstar files on a separate company basis, and because Qualstar expects to generate income in the foreseeable future applicable to California, the Company reduced a portion of the valuation allowance related to Qualstar’s separate company NOL carryforwards.

The Company had NOL carryforwards for federal income tax purposes of approximately \$32.2 million as of December 31, 2023 and \$31.9 million as of December 31, 2022. The Company had NOL carryforwards for state income tax purposes of approximately \$21.7 million as of December 31, 2023 and \$21.5 million as of December 31, 2022. The Company had engineering and other credit carryforwards for tax purposes of \$2.5 million and \$2.7 million, respectively as of December 31, 2023 and 2022. The Company also had capital loss carryforwards for federal income tax purposes and state income tax purposes of approximately \$0.2 million as of both December 31, 2023 and 2022.

If not utilized, the federal NOL will begin to expire in 2027, and other tax credits will expire beginning in 2024. If not utilized, the state NOL will begin to expire in 2024. The state engineering credit has no limit on the carryforward period.

For U.S. purposes, the Company completed an evaluation, as of December 31, 2020, of the NOL and credit carryforward utilization limitations under Internal Revenue Code, as amended (the “Code”) Section 382 and 383, change of ownership rules. Code Sections 382 and 383 impose certain limitations on the use of NOL or credit

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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carryforwards in certain situations, including when a company has a change in ownership as defined in such sections. As of December 31, 2020, the Company has determined that it has not had a change in ownership within the meaning of Code Sections 382 and 383. Management, at the date of this filing, is of the opinion that its NOL and credit carryforwards should not be limited, pursuant to Sections 382 and 383, as to the amount of such carryforwards that can be utilized each year.

The following table summarizes the activity related to the Company’s uncertain tax positions:

	Year Ended December 31,	
	2023	2022
	(In thousands)	
Balance at beginning of year	\$ 27	\$ 27
Increases related to tax positions taken in current year	2	2
Increases related to tax positions taken in prior year	-	-
Decreases due to lapse of statute of limitations and other adjustments	(2)	(2)
Related interest and penalties, net of federal tax benefit	-	-
Balance at end of year	\$ 27	\$ 27

The deferred tax asset amounts related to NOL and credit carryforwards have been reduced by approximately \$503,000 of uncertain tax positions. The Company expects that any future changes in the unrecognized tax benefit will have no impact on the Company’s effective tax rate due to the existence of the valuation allowance.

The Company’s policy is to include interest and penalties on uncertain tax positions in income tax expense, but they are not significant for the years ended December 31, 2023 and 2022. The Company files its tax returns by the laws of the jurisdictions in which it operates. The Company’s federal tax returns for the years 2020 and subsequent and California tax returns for the years 2019 and subsequent, are still subject to examination. Various state and foreign jurisdictions’ tax years remain open to examination as well, though the Company believes any additional assessment will be immaterial to its consolidated financial statements. The Company does not have any open examinations as of December 31, 2023. For the years ended December 31, 2023 and 2022, the operations of Qualstar Corporation Singapore Private Limited, Qualstar Limited, and Q-Smart Data Private Limited (Singapore) were not material for tax purposes and had no significant impact on the tax provision.

Note 4 – Shareholders’ Equity

Preferred Stock

The Company’s Articles of Incorporation allow for the issuance of up to 5,000,000 shares of preferred stock. The Board of Directors has authority to fix the rights, preferences, privileges and restrictions, including voting rights, of these shares of preferred stock without any vote or action by the shareholders. At December 31, 2023 and 2022, there were no outstanding shares of preferred stock.

Common Stock

The Company’s Articles of Incorporation allow for the issuance of up to 50,000,000 shares of common stock. At December 31, 2023 and 2022, there were 1,447,122 and 1,627,419 shares of common stock outstanding, respectively. During the years ended December 31, 2023 and 2022, the Company repurchased 182,570 and 256,614 shares, respectively, for aggregate purchase prices of \$522,000 and \$571,000, respectively, in connection with the Stock Repurchase Program and the August 2022 Reverse Stock Split described below.

QUALSTAR CORPORATION AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

Stock Repurchase Program

In September 2021, the Company’s board of directors approved a stock repurchase program (the “Stock Repurchase Program”) to repurchase shares of the Company’s common stock. In August 2022, the Company’s board of directors approved an update and extension to the Stock Repurchase Program. The Stock Repurchase Program (as updated and extended) permits the Company to repurchase up to a maximum of 500,000 shares of common stock. During the overall period of the Stock Repurchase Program from September 1, 2021 through December 31, 2023, the Company has repurchased 434,505 shares for an aggregate purchase price of \$1,127,000. During the years ended December 31, 2023, and 2022, respectively, the Company repurchased 182,570 and 182,609 shares for aggregate purchase prices of \$522,000 and \$404,000.

Reverse Stock Split and Forward Stock Split

On August 26, 2022, the Company announced that the Company’s stockholders approved an amendment to the Company’s Restated Articles of Incorporation to accomplish a 1-for-1,000 reverse stock split of its issued and outstanding common stock, followed immediately by a 1,000-for-1 forward stock split of its issued and outstanding common stock. The reverse stock split and forward stock split were completed on September 26, 2022. Shares of common stock that would have been converted into less than one share in the reverse stock split were cashed out at \$2.25 per share of common stock held before the reverse stock split. Stockholders who held at least 1,000 shares of common stock at the effective time of the reverse stock split experienced no changes in their holdings. As a result of the stock split transactions, the Company cashed-out 74,005 shares of common stock for \$167,000. Shares that were cashed-out were accounted for as repurchased shares.

Note 5 – Earnings Per Share

Basic earnings per share has been computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the weighted average number of diluted common shares, which is inclusive of common stock equivalents from unexercised stock options. Unexercised stock options are considered to be common stock equivalents if, using the treasury stock method, they are determined to be dilutive.

The following table sets forth the computation of basic and diluted earnings per share for the periods indicated (in thousands, except per share amounts).

	Three Months Ended December 31,		Year Ended December 31,	
	2023	2022	2023	2022
Net income	\$ 320	\$ 274	\$ 191	\$ 55
Weighted average outstanding shares of common stock - basic	1,498	1,692	1,570	1,829
Dilutive potential common shares from employee stock options	-	-	-	-
Weighted average outstanding shares of common stock - diluted	1,498	1,692	1,570	1,829
Earnings per share:				
Basic and diluted earnings per share	\$ 0.21	\$ 0.16	\$ 0.12	\$ 0.03

For the three months ended December 31, 2023 and 2022, 111,300 outstanding stock options were excluded from the calculation of diluted earnings per share as their inclusion would have been anti-dilutive. For the years ended

QUALSTAR CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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December 31, 2023 and 2022, respectively, 111,300 and 121,300 outstanding stock options were excluded from the calculation of diluted earnings per share as their inclusion would have been anti-dilutive.

Note 6 – Stock Based Compensation

Stock Incentive Plan

The Company’s 2017 Stock Incentive Plan (the “2017 Plan”) permits the award of stock options (both incentive and non-qualified options), stock appreciation rights, restricted stock, restricted stock units, unrestricted stock, performance shares, dividend equivalent rights and cash-based awards to employees (including executive officers), directors and consultants of the Company and its subsidiaries. The 2017 Plan authorizes the issuance of an aggregate of 300,000 shares of common stock, of which 188,700 shares remain available for issuance as of December 31, 2023. The 2017 Plan is administered by the Compensation Committee of the Company’s Board of Directors.

With respect to options, the fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model that uses various assumptions, such as volatility, expected term and risk-free interest rate. Expected volatilities are based on the historical volatility of the Company’s stock. The Company uses historical data to estimate option exercise and employee termination in determining forfeiture rates. The expected term of options granted is estimated based on the vesting term of the award, historical employee exercise behavior, expected volatility of the Company’s stock and an employee’s average length of service. The risk-free interest rate used in this model correlates to a U.S. constant rate Treasury security with a contractual life that approximates the expected term of the option award.

The following table summarizes stock option activity:

	Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at December 31, 2022	111,300	\$ 7.08	4.59	\$ -
Granted	-			
Exercised	-			
Forfeited, canceled or expired	-			
Outstanding at December 31, 2023	111,300	\$ 7.08	3.59	\$ -
Exercisable at December 31, 2023	111,300	\$ 7.08	3.59	\$ -

Note 7 – Concentration of Credit Risk, Significant Customers, and Geographic Information

Our cash balances in our bank accounts may be in excess of FDIC insurance limits.

One customer accounted for more than 10% of the Company’s revenue for the three-month periods and the years ended December 31, 2023 and 2022.

Our financial results could be affected by changes in foreign currency exchange rates or weak economic conditions in foreign markets. As all sales are currently made in U.S. dollars, a strengthening of the dollar could make our products less competitive in foreign markets.

QUALSTAR CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The following table summarizes revenue by geographic area (in thousands, except percentages):

	Three Months Ended December 31,				Year Ended December 31,			
	2023		2022		2023		2022	
North America	\$ 2,515	73.9 %	\$ 1,601	56.7 %	\$ 7,637	71.9 %	\$ 6,656	67.6 %
Europe	690	20.3	1,034	36.6	2,170	20.4	2,394	24.3
Asia Pacific	184	5.4	166	5.9	744	7.0	678	6.9
Other	15	0.4	25	0.8	65	0.7	117	1.2
	\$ 3,404	100.0 %	\$ 2,826	100.0 %	\$ 10,616	100.0 %	\$ 9,845	100.0 %

Note 8 – Commitments and Contingencies

Lease Agreements

The Company leases a 9,910 square-foot facility in Camarillo, California. The term of the lease is 5 years and two months, expiring July 31, 2024. The rent on this facility is currently \$11,254 per month with a 3% step-up annually. Qualstar permits Interlink Electronics, Inc. (“Interlink”) to use a portion of the facility and is reimbursed for the space and other related expenses on a monthly basis. As described in Note 10, Interlink is a related party.

Company leases a 1,400 square-foot storage facility in Camarillo, California. The term of the lease is for one year expiring in August 2024 with the option to renew 2 additional years at a \$50 per month step-up each year. The rent on this facility is currently \$1,800 per month.

The Company uses a portion of Interlink’s Irvine, California office as its corporate headquarters, pursuant to which the Company pays a facility usage fee of approximately \$1,600 per month. The Company also used a portion of Interlink’s Los Angeles, California office through August 2023, pursuant to which the Company paid a facility usage fee of approximately \$1,100 per month.

The Company leases a 7,287 square foot facility in Shenzhen, China. In May 2022, the Company renewed this lease for the period September 1, 2022 through May 31, 2024 for approximately \$3,500 per month.

The Company leases a 80 square-foot office in London, England for less than \$1,000 per month on a month-to-month term, which we recently provided notice to terminate on March 31, 2024.

The Company also leases a 560 square-foot office in Singapore for \$1,600 per month. The term of the lease is for one year expiring in July 2024.

The Company’s leases do not require any contingent rental payments, impose any financial restrictions, or contain any residual value guarantees. Variable expenses generally represent the Company’s share of the landlord’s operating expenses. The Company does not have any leases classified as financing leases.

The rate implicit in each lease is not readily determinable; we therefore use our incremental borrowing rate to determine the present value of the lease payments. No new ROU assets were capitalized during the year ended December 31, 2023. The weighted average incremental borrowing rate used to determine the initial value of ROU assets and lease liabilities during the year ended December 31, 2022 was 5.00%. Certain of our contracts for real estate may contain both lease and non-lease components which we have elected to treat as a single lease component.

Right-of-use assets for operating leases are periodically reduced by impairment losses. We use the long-lived assets impairment guidance in ASC Subtopic 360-10, *Property, Plant, and Equipment – Overall*, to determine whether a ROU asset is impaired, and if so, the amount of the impairment loss to recognize. As of December 31, 2023, we have not recognized any impairment losses for our ROU assets.

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

We monitor for events or changes in circumstances that require a reassessment of our leases. When a reassessment results in the remeasurement of a lease liability, a corresponding adjustment is made to the carrying amount of the corresponding ROU asset unless doing so would reduce the carrying amount of the ROU asset to an amount less than zero. In that case, the amount of the adjustment that would result in a negative ROU asset balance is recorded in profit or loss.

At December 31, 2023, the Company had current operating lease liabilities of \$95,000, and right-of-use assets of \$88,000. Future imputed interest as of December 31, 2023 totaled approximately \$1,000. The weighted average remaining lease term of the Company's leases as of December 31, 2023 is 0.6 years.

Future minimum lease payments under these leases are as follows, in thousands:

	Minimum Lease Payment
2024	\$ 96
2025	-
2026	-
2027	-
2028	-
Total undiscounted future non-cancelable minimum lease payments	96
Less: Imputed interest	(1)
Present value of lease liabilities	<u>\$ 95</u>

During the three months ended December 31, 2023 and 2022, the Company incurred approximately \$44,000 and \$45,000, respectively, of operating lease costs, which are included in operating expenses in our consolidated statement of operations. During the years ended December 31, 2023 and 2022, the Company incurred approximately \$173,000 and \$176,000, respectively, of operating lease costs, which are included in operating expenses in our consolidated statement of operations.

Legal and Other Contingencies

The Company is subject to a variety of 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 consolidated financial statements, these matters are subject to inherent uncertainties and management's view of these matters may change in the future. 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 in accordance with ASC 450, 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 consolidated financial statements. No loss contingency was recorded as of December 31, 2023.

Benefit Plan

The Company has a voluntary deferred compensation plan (the "Plan") qualifying for treatment under Internal Revenue Code Section 401(k). All employees are eligible to participate in the Plan following three months of service of employment and may contribute up to 100% of their compensation on a pre-tax basis, not to exceed the annual IRS maximum. Effective November 1, 2022, the Company makes matching contributions in an amount equal to 50% of compensation contributed by participants, up to \$5,000 per participant per year. Qualstar made matching contributions of \$28,000 and \$6,000 during the years ended December 31, 2023 or 2022.

QUALSTAR CORPORATION AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

Note 9 – Segment Information

In its operation of the business, management reviews certain financial information, including segmented internal profit and loss statements prepared on a basis consistent with GAAP. Our two segments are Data Storage and Power Supplies. The two segments discussed in this analysis are presented in the way we internally manage and monitor performance for 2023 and 2022. The types of products and services provided by each segment are summarized below:

Data Storage — We manufacture and market data storage systems, including highly scalable automated magnetic tape libraries used to store, retrieve and manage electronic data. Our tape-based storage solutions enable businesses to manage the massive growth of digital data assets in a cost-effective manner, and address long-term archive, backup and recovery of electronic data. These products consist of networked libraries that store and move high-density tape cartridges and high-speed tape drives that stream data to and from the tape cartridges. These optimized solutions allow data-rich and video-centric markets such as media and entertainment, oil and gas, surveillance, digital security and medical imaging to achieve targeted data workflows.

Power Supplies — We design and market high-efficiency switching power supplies. These power supplies are used to convert AC line voltage to DC voltages, or DC voltages to other DC voltages for use in a wide variety of electronic equipment such as communications equipment, industrial machine tools, wireless systems, as well as medical and gaming devices. We utilize contract manufacturers in Asia to produce our power supplies products. We sell our products globally through authorized resellers and directly to original equipment manufacturers.

Segment revenue, income (loss) before taxes, and total assets were as follows:

	Three Months Ended December 31,		Year Ended December 31,	
	2023	2022	2023	2022
	(In thousands)			
Revenues				
Data Storage:				
Product	\$ 1,327	\$ 1,677	\$ 4,500	\$ 5,207
Service	296	305	1,148	1,159
Total Data Storage	1,623	1,982	5,648	6,366
Power Supplies	1,781	844	4,968	3,479
Revenues	\$ 3,404	\$ 2,826	\$ 10,616	\$ 9,845
	Three Months Ended December 31,		Year Ended December 31,	
	2023	2022	2023	2022
	(In thousands)			
Income (Loss) Before Income Taxes				
Data Storage	\$ 263	\$ 402	\$ 399	\$ 616
Power Supplies	60	(123)	(205)	(556)
Income before taxes	\$ 323	\$ 279	\$ 194	\$ 60

QUALSTAR CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

	December 31,	
	2023	2022
	(In thousands)	
Total Assets		
Data Storage		
Cash and cash equivalents	\$ 2,211	\$ 2,331
Marketable securities	140	33
Accounts receivable, net	662	932
Inventories	1,569	2,099
Prepaid expenses and other current assets	316	131
Property and equipment, net	45	82
Right-of-use assets	88	243
Other assets	51	101
Total Data Storage assets	<u>5,082</u>	<u>5,952</u>
Power Supplies		
Cash and cash equivalents	64	436
Accounts receivable, net	1,512	711
Inventories	1,301	937
Prepaid expenses and other current assets	27	7
Property and equipment, net	7	-
Other assets	38	-
Total Power Supplies assets	<u>2,949</u>	<u>2,091</u>
Total Assets	<u>\$ 8,031</u>	<u>\$ 8,043</u>

Note 10 – Related Party Transactions

Interlink Electronics, Inc.

Interlink Electronics, Inc. (NASDAQ: LINK) (“Interlink”) is a related party. Steven N. Bronson, our President and Chief Executive Officer and Director, is also Chairman of the Board, President and Chief Executive Officer of Interlink. Ryan J. Hoffman, our Chief Financial Officer through August 2023, is also the Chief Financial Officer of Interlink. Mr. Bronson, together with BKF Capital Group, Inc. (OTCMKTS: BKFG) which he controls, has a controlling interest in both Qualstar and Interlink. We have a facilities agreement with Interlink to allow Interlink to use of a portion of our Camarillo, California office and warehouse facility, for which we have agreed to split substantially all rent and facilities-related costs on an apportioned basis according to the approximate relative usage levels by each entity. We also have a facilities agreement with Interlink to allow us to use of a portion of Interlink’s office facilities in Irvine and Los Angeles California, for which we have agreed to split substantially all rent and facilities-related costs on an apportioned basis according to the approximate relative usage levels by each entity. The facility in Los Angeles was available through August 2023. In addition, we have consulting agreements with Interlink for certain of our respective employees and/or independent contractors that provide certain operational, sales, marketing, general and administrative

QUALSTAR CORPORATION AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

services to the other entity. Qualstar and Interlink have also agreed to reimburse, or be reimbursed by, one another for expenses paid by one company on behalf of the other. Transactions with Interlink are as follows:

	Three Months Ended December 31,			
	2023		2022	
	Due to Interlink	Due from Interlink	Due to Interlink	Due from Interlink
	(in thousands)			
Balance at October 1,	\$ 27	\$ 12	\$ 26	\$ 8
Billed (or accrued) to Interlink by Qualstar	-	47	-	23
Paid by Interlink to Qualstar		(25)	-	(31)
Billed (or accrued) to Qualstar by Interlink	128	-	206	-
Paid by Qualstar to Interlink	(151)	-	(226)	-
Balance at December 31,	\$ 4	\$ 34	\$ 6	\$ -

	Year Ended December 31,			
	2023		2022	
	Due to Interlink	Due from Interlink	Due to Interlink	Due from Interlink
	(in thousands)			
Balance at January 1,	\$ 6	\$ -	\$ 85	\$ 8
Billed (or accrued) to Interlink by Qualstar	-	134	-	96
Paid by Interlink to Qualstar	-	(100)	-	(104)
Billed (or accrued) to Qualstar by Interlink	758	-	798	-
Paid by Qualstar to Interlink	(760)	-	(877)	-
Balance at December 31,	\$ 4	\$ 34	\$ 6	\$ -

BKF Capital Group, Inc.

BKF Capital Group, Inc. (OTCMKTS: BKFG) is a related party. Steven N. Bronson, our President and Chief Executive Officer and Director, is also the Chief Executive Officer and Chairman of the Board of BKF Capital. Ryan J. Hoffman, our Chief Financial Officer through August 2023, is also the Chief Financial Officer of BKF Capital. BKF Capital, together with Mr. Bronson, has a controlling interest in Qualstar. We have consulting agreements with BKF Capital for certain of our respective employees and/or independent contractors that provide operational and general and administrative services to the other entity. We entered into a M&A advisory consulting services agreement with Bronson Financial LLC (“BF”), a wholly owned subsidiary of BKF Capital, in which BF provides M&A advisory

QUALSTAR CORPORATION AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

consulting services to us. Qualstar and BKF Capital have also agreed to reimburse, or be reimbursed by, one another for expenses paid by one company on behalf of the other. Transactions with BKF Capital are as follows:

	Three Months Ended December 31,			
	2023		2022	
	Due to BKF Capital	Due from BKF Capital	Due to BKF Capital	Due from BKF Capital
	(in thousands)			
Balance at October 1,	\$ -	\$ -	\$ -	\$ -
Billed (or accrued) to BKF Capital by Qualstar	-	-	-	-
Paid by BKF Capital to Qualstar	-	-	-	-
Billed (or accrued) to Qualstar by BKF Capital	30	-	53	-
Paid by Qualstar to BKF Capital	(30)	-	(53)	-
Balance at December 31,	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
	Year Ended December 31,			
	2023		2022	
	Due to BKF Capital	Due from BKF Capital	Due to BKF Capital	Due from BKF Capital
	(in thousands)			
Balance at January 1,	\$ -	\$ -	\$ -	\$ -
Billed (or accrued) to BKF Capital by Qualstar	-	3	-	1
Paid by BKF Capital to Qualstar	-	(3)	-	(1)
Billed (or accrued) to Qualstar by BKF Capital	143	-	150	-
Paid by Qualstar to BKF Capital	(143)	-	(150)	-
Balance at December 31,	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Ridgefield Acquisition Corp.

Ridgefield Acquisition Corp. (NASDAQ: RDGA) (“Ridgefield”) is a related party. Steven N. Bronson, our President and Chief Executive Officer and Director, is also the Chief Executive Officer and Chairman of the Board of Ridgefield as well as Ridgefield’s largest shareholder. On September 27, 2022, the Company executed an unsecured Revolving Promissory Note with Ridgefield (the “Ridgefield Note”). Under the terms of the Ridgefield Note, the Company may (but is not required to) make loans to Ridgefield from time to time upon request by Ridgefield, up to a maximum principal amount of \$200,000 outstanding at any time. The Ridgefield Note may be prepaid by Ridgefield at any time without penalty and is repayable on demand by the Company on or after December 31, 2024. The Ridgefield Note provides for interest to accrue on the outstanding principal balance at a rate of ten percent per annum (calculated on the basis of a 360-day year), compounded and payable quarterly. Ridgefield borrowed an initial amount of \$20,000 under the Ridgefield Note in September 2022, and additional amounts of \$30,000 in December 2022, \$25,000 in June 2023, and \$25,000 in December 2023. The balance of principal and accrued interest on the Ridgefield Note was \$108,000 as of December 31, 2023 (classified in Prepaid Expenses and Other Current Assets on our consolidated balance sheet) and \$51,000 as of December 31, 2022 (classified in Other Assets on our consolidated balance sheet).

QUALSTAR CORPORATION AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Qualstar Corporation and its subsidiaries (collectively, "Qualstar", the "Company", "we", "us" or "our") manufacture and market data storage system products and compact, high efficiency power solutions. Our data storage systems are marketed under the Qualstar brand and include highly scalable automated magnetic tape libraries used to store, retrieve and manage electronic data primarily in the network computing environment. Our data storage devices include models ranging from entry level to enterprise and are a cost-effective solution for organizations requiring backup, recovery and archival storage of critical electronic information. The distribution channels for our data storage devices include resellers, system integrators, and original equipment manufacturers ("OEMs"). In addition, the Company is a leading provider of standard, semi-custom and custom power solutions marketed under the N2Power brand. Our power solution products provide OEM designers increased functionality while reducing thermal loads and cooling requirements and lowering operating costs. Our power solution products are currently sold to OEMs in a wide range of markets, including telecom/networking equipment, audio/visual, industrial, gaming and medical.

Qualstar Corporation was incorporated in California in 1984 and currently has three wholly owned subsidiaries. The N2Power, Inc. subsidiary ("N2Power") operates the Company's power supplies business. The Q-Smart Data Limited (China) subsidiary pursues new data storage business opportunities in Asia. The Qualstar Limited (U.K.) subsidiary expands the Company's data storage business in Europe and Africa. The Company's former Qualstar Corporation Singapore Private Limited subsidiary previously gave the Company an engineering footprint in Singapore, and the Company's former Q-Smart Data Private Limited (Singapore) subsidiary previously pursued new business opportunities in Asia; both of these subsidiaries were dissolved in March 2022.

The Company's objectives include growing sales in both business units in two key areas: adding key customers and expanding its product portfolios. The data storage business adds strategic partners that are expected to expand our geographic footprint, increase our reach to additional industries, and increase our product development capabilities. The power supplies business unit charges its sales resources to grow its customer base in specific growth market verticals, such as the gaming industry. In addition to adding new internally designed and private label products, the power supplies business provides value-add services such as optimized product development services for current and future customers, allowing N2Power to act as a one-stop shop providing solutions for more complex power assembly units and chassis builds for its OEM customers.

We sell our products globally through authorized resellers and distributors, and directly to OEMs. Our data storage products are manufactured by our OEM suppliers in other parts of the world and configured to order by us at our facility in Camarillo, California, or at our facility in Shenzhen, China, or by our fulfilment and logistics partner in Warsaw, Poland. N2Power utilizes contract manufacturers in Asia to produce our power solutions products.

QUALSTAR CORPORATION AND SUBSIDIARIES

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

The dollar amounts in the following tables are presented in thousands.

Results of Operations - (Unaudited)

The percentages in the table are based on net revenues.

	Three Months Ended December 31,				Year Ended December 31,			
	2023		2022		2023		2022	
	\$	%	\$	%	\$	%	\$	%
Data storage revenues	\$ 1,623	47.7 %	\$ 1,982	70.1 %	\$ 5,648	53.2 %	\$ 6,366	64.7 %
Power supplies revenues	1,781	52.3	844	29.9	4,968	46.8	3,479	35.3
Revenues	3,404	100.0	2,826	100.0	10,616	100.0	9,845	100.0
Cost of goods sold	2,191	64.4	1,879	66.5	7,336	69.1	6,850	69.6
Gross profit	1,213	35.6	947	33.5	3,280	30.9	2,995	30.4
Operating expenses:								
Engineering	149	4.4	66	2.3	393	3.7	336	3.4
Sales and marketing	390	11.5	307	10.9	1,353	12.7	1,215	12.3
General and administrative	364	10.7	347	12.3	1,394	13.1	1,352	13.7
Total operating expenses	903	26.5	720	25.5	3,140	29.6	2,903	29.5
Income from operations	310	9.1	227	8.0	140	1.3	92	0.9
Other income (expense), net	13	0.4	52	1.8	54	0.5	(32)	(0.3)
Income before taxes	323	9.5	279	9.9	194	1.8	60	0.6
Provision for income taxes	3	0.1	5	0.2	3	-	5	0.1
Net income	\$ 320	9.4 %	\$ 274	9.7 %	\$ 191	1.8 %	\$ 55	0.6 %

Net Revenues:

	Three Months Ended December 31,				Change	
	2023		2022		\$	%
	Amount	% of Revenues	Amount	% of Revenues		
Data storage revenues	\$ 1,623	47.7 %	\$ 1,982	70.1 %	\$ (359)	(18.1) %
Power supplies revenues	1,781	52.3	844	29.9	937	111.0
Revenues	\$ 3,404	100.0 %	\$ 2,826	100.0 %	\$ 578	20.5 %

	Year Ended December 31,				Change	
	2023		2022		\$	%
	Amount	% of Revenues	Amount	% of Revenues		
Data storage revenues	\$ 5,648	53.2 %	\$ 6,366	64.7 %	\$ (718)	(11.3) %
Power supplies revenues	4,968	46.8	3,479	35.3	1,489	42.8
Revenues	\$ 10,616	100.0 %	\$ 9,845	100.0 %	\$ 771	7.8 %

The increases in net revenues for the three months and year ended December 31, 2023 compared to the prior year periods is attributable to the segment-specific factors described below.

QUALSTAR CORPORATION AND SUBSIDIARIES

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

Segment Revenue

Data Storage – For the three months ended December 31, 2023 compared to the corresponding period in the prior year we experienced a 20.9% decrease in our data storage product revenues attributable to a reduction in shipments of our tape-based data storage products and solutions in the current quarter as compared to the same year-ago quarter, while our data storage service revenues reduced by 3.0% compared to the prior year period. For the year ended December 31, 2023 compared to the prior year we experienced a 13.6% decrease in our data storage product revenues attributable to a reduction in shipments in the current year as compared to the prior year and a 0.9% decrease in our data storage service revenues as a result of a corresponding decrease in technical support services rendered during the current year as compared to the prior year. Our data storage product revenues were lower mainly due to reduced demand from customers and fluctuations in timing of order fulfillment.

Power Supplies – The 111.0% and 42.8%, increases in power supplies revenues in the three-month and the twelve-month periods, respectively, ended December 31, 2023, compared to the corresponding prior year periods were due to new designs and opportunities that launched in early 2023 and increased volume with a major customer. We also experienced improved lead times for our components which allowed us to fulfill certain customer orders more quickly, resulting in increased shipments to our customers of our power supplies products and solutions in the current year.

Gross Profit:

	Three Months Ended December 31,				Change	
	2023		2022			
	Amount	% of Revenues	Amount	% of Revenues	\$	%
Gross profit	\$ 1,213	35.6 %	\$ 947	33.5 %	\$ 266	28.1 %

	Year Ended December 31,				Change	
	2023		2022			
	Amount	% of Revenues	Amount	% of Revenues	\$	%
Gross profit	\$ 3,280	30.9 %	\$ 2,995	30.4 %	\$ 285	9.5 %

The gross profit and gross margin percentage changes for the three months and year ended December 31, 2023 compared to the corresponding periods in the prior year are primarily attributed to changes in sales volumes and product mix between the prior year and the current year, offset by reduced average selling prices of our data storage and power supplies products and increases in components and materials costs.

QUALSTAR CORPORATION AND SUBSIDIARIES

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

Operating Expenses:

	Three Months Ended December 31,				Change	
	2023		2022			
	Amount	% of Revenues	Amount	% of Revenues	\$	%
Engineering	\$ 149	4.4 %	\$ 66	2.3 %	\$ 83	125.8 %
Sales and marketing	390	11.5	307	10.9	83	27.0
General and administrative	364	10.7	347	12.3	17	4.9
Total operating expenses	<u>\$ 903</u>	<u>26.5 %</u>	<u>\$ 720</u>	<u>25.5 %</u>	<u>\$ 183</u>	<u>25.4 %</u>

	Year Ended December 31,				Change	
	2023		2022			
	Amount	% of Revenues	Amount	% of Revenues	\$	%
Engineering	\$ 393	3.7 %	\$ 336	3.4 %	\$ 57	17.0 %
Sales and marketing	1,353	12.7	1,215	12.3	138	11.4
General and administrative	1,394	13.1	1,352	13.7	42	3.1
Total operating expenses	<u>\$ 3,140</u>	<u>29.6 %</u>	<u>\$ 2,903</u>	<u>29.5 %</u>	<u>\$ 237</u>	<u>8.2 %</u>

Engineering

Engineering expenses increased for both the three months and the year ended December 31, 2023 compared to the same periods in the prior year primarily due to an increase in the number of engineering consultants and increased compliance testing costs, in the power supplies segment due to increased sales volume offset by reduced prototyping costs in the current year periods compared to the prior year periods.

Sales and Marketing

Sales and marketing expenses increased for the three months and year ended December 31, 2023 compared to the same periods in the prior year primarily due to increased sales commissions and travel costs resulting from the increased sales volumes, offset slightly by reduced sales and marketing employees and consultants in the current year periods compared to the prior year periods.

General and Administrative

General and administrative costs increased for the three months and the year ended December 31, 2023 compared to the same periods in the prior year primarily due to increased payroll and related costs, consulting costs and facilities costs.

Other Income (Expense), net

Other income (expense), net for the three months ended December 31, 2023 includes \$22,000 of interest income, \$25,000 of gains on foreign currency exchange offset by \$34,000 of realized and unrealized loss on marketable securities. Other income (expense) for the three months ended December 31, 2022 includes \$1,000 of interest income, \$42,000 of gains on foreign currency exchange and \$9,000 of realized and unrealized loss on marketable securities. Other income (expense), net for the year ended December 31, 2023 includes \$5,000 of realized and unrealized gain on marketable securities, \$3,000 of gains on foreign currency exchange, and \$46,000 of interest income. Other income (expense) for the year ended December 31, 2022 includes \$3,000 of realized and unrealized losses on marketable securities, \$31,000 of losses on foreign currency exchange offset by \$2,000 of interest income.

Provision for Income Taxes

The provision for income taxes for the years ended December 31, 2023 and 2022 is comprised substantially of state minimum taxes.

QUALSTAR CORPORATION AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Liquidity and Capital Resources

Cash, cash equivalents, and restricted cash decreased \$492,000 to \$2,275,000 at December 31, 2023 from \$2,767,000 at December 31, 2022.

Operating Activities

Net cash provided by operating activities was \$138,000 for the year ended December 31, 2023 compared with \$831,000 net cash used in operating activities for the year ended December 31, 2022. Cash provided by operations in 2023 was primarily related to net income of \$191,000 offset by non-cash expenses of \$32,000, unrealized gain on marketable securities of \$6,000, and cash used from changes in operating assets and liabilities of \$79,000. Cash used in operations in 2022 was primarily related to net income of \$55,000, offset by non-cash expenses of \$39,000, unrealized gain on marketable securities of \$8,000, and cash used from changes in operating assets and liabilities of \$917,000.

Investing Activities

Cash used in investing activities was \$108,000 for the year ended December 31, 2023 compared to \$26,000 for the year ended December 31, 2022. Cash used in investing activities in 2023 consisted of \$295,000 of purchases of marketable securities net of \$194,000 proceeds from sale of marketable securities and \$7,000 of purchases of property and equipment. Cash used in investing activities in 2022 consisted of \$25,000 of purchases of marketable securities net of proceeds from sale of marketable securities and \$1,000 of purchases of equipment.

Financing Activities

Cash used in financing activities for the year ended December 31, 2023 consisted of \$522,000 of cash used to repurchase shares of the Company's common stock under a stock repurchase program approved by the board of directors. Cash used in financing activities for the year ended December 31, 2022 consisted of \$404,000 of cash used to repurchase shares of the Company's common stock under a stock repurchase program approved by the board of directors, and \$167,000 for shares cashed-out in connection with the Company's reverse/forward stock splits in September 2022.

We believe that our existing cash and cash equivalents and cash flows from our operating activities will be sufficient to fund our working capital and capital expenditure needs for at least twelve months from the date of this report. We may utilize cash to invest in or acquire businesses, products or technologies that we believe are additive to the strategic expansion of the Company. We periodically evaluate other companies and technologies for possible investment or acquisition. In addition, we have made, and may in the future make, investments in companies with whom we have identified potential synergies. However, we have no present commitments or agreements with respect to any material investment in or acquisition of other businesses or technologies. In the event that we require additional capital to meet our business needs, there can be no assurance that additional funding will be available to us when needed or, if available, that it can be obtained on commercially reasonable terms.