Qualstar Corporation and Subsidiaries

Quarterly Report
For the Quarter Ended June 30, 2023

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QUALSTAR CORPORATION AND SUBSIDIARIES

INDEX TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

QUALSTAR CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)
(unaudited)

	June 30, 2023	December 31, 2022
Assets		
Current assets:		
Cash and cash equivalents	$ 2,401	$ 2,767
Marketable securities	162	33
Accounts receivable, net	931	1,643
Inventories	3,103	3,036
Prepaid expenses and other current assets	60	138
Total current assets	6,657	7,617
Property and equipment, net	63	82
Right-of-use assets	166	243
Deferred tax assets	30	30
Other assets	99	71
Total assets	$ 7,015	$ 8,043
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 550	$ 946
Accrued payroll and related liabilities	132	140
Deferred service revenue	467	687
Lease liabilities, current	168	165
Other accrued liabilities	109	133
Total current liabilities	1,426	2,071
Long-term liabilities:		
Lease liabilities, long-term	11	95
Deferred service revenue, long-term	627	510
Other long-term liabilities	27	27
Total long-term liabilities	665	632
Total liabilities	2,091	2,703
Commitments and contingencies (Note 7)		
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; 1,578,035 shares issued and outstanding at June 30, 2023, and 1,627,419 shares issued and outstanding at December 31, 2022	18,092	18,218
Accumulated deficit	(13,168)	(12,878)
Total shareholders' equity	4,924	5,340
Total liabilities and shareholders' equity	$ 7,015	$ 8,043

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	**2022**	**2023**	**2022**
Revenues	$ 1,878	$ 1,863	$ 4,070	$ 4,273
Cost of goods sold	1,446	1,382	2,984	3,069
Gross profit	432	481	1,086	1,204
Operating expenses:				
Engineering	55	118	126	168
Sales and marketing	293	336	597	659
General and administrative	355	348	691	660
Total operating expenses	703	802	1,414	1,487
Loss from operations	(271)	(321)	(328)	(283)
Other income (expense), net	(6)	(68)	38	(67)
Loss before income taxes	(277)	(389)	(290)	(350)
Provision for income taxes	-	-	-	-
Net loss	$ (277)	$ (389)	$ (290)	$ (350)
Earnings (loss) per share:				
Basic and diluted	$ (0.17)	$ (0.21)	$ (0.18)	$ (0.19)
Weighted average common shares outstanding:				
Basic and diluted	1,585	1,884	1,603	1,884

QUALSTAR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(in thousands)
(unaudited)

	Common Stock			Accumulated		
Three Months Ended June 30, 2023	**Shares**	**Amount**		**Deficit**		**Total**
Balances at April 1, 2023	1,588	$ 18,114	$	(12,891)	$	5,223
Share repurchases	(10)	(22)		-		(22)
Net loss	-	-		(277)		(277)
Balances at June 30, 2023	1,578	$ 18,092	$	(13,168)	$	4,924

	Common Stock			Accumulated		
Six Months Ended June 30, 2023	**Shares**	**Amount**		**Deficit**		**Total**
Balances at January 1, 2023	1,627	$ 18,218	$	(12,878)	$	5,340
Share repurchases	(49)	(126)		-		(126)
Net loss	-	-		(290)		(290)
Balances at June 30, 2023	1,578	$ 18,092	$	(13,168)	$	4,924

	Common Stock			Accumulated		
Three Months Ended June 30, 2022	**Shares**	**Amount**		**Deficit**		**Total**
Balances at April 1, 2022	1,884	$ 18,789	$	(12,894)	$	5,895
Net loss	-	-		(389)		(389)
Balances at June 30, 2022	1,884	$ 18,789	$	(13,283)	$	5,506

	Common Stock			Accumulated		
Six Months Ended June 30, 2022	**Shares**	**Amount**		**Deficit**		**Total**
Balances at January 1, 2022	1,884	$ 18,789	$	(12,933)	$	5,856
Net loss	-	-		(350)		(350)
Balances at June 30, 2022	1,884	$ 18,789	$	(13,283)	$	5,506

QUALSTAR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six Months Ended June 30, 2023	Six Months Ended June 30, 2022
Cash flows from operating activities:		
Net loss	$ (290)	$ (350)
Adjustments to reconcile net loss to net cash used in operating		
Depreciation and amortization	19	23
Realized and unrealized (gain) on marketable securities	(26)	-
Adjustment to reconcile operating lease expense to cash paid	(3)	(1)
Changes in operating assets and liabilities:		
Accounts receivable	712	261
Inventories	(67)	(791)
Prepaid expenses and other assets	49	122
Accounts payable	(396)	(355)
Accrued payroll and related liabilities	(8)	(48)
Deferred service revenue	(103)	7
Other liabilities	(24)	9
Net cash used in operating activities	(137)	(1,123)
Cash flows from investing activities:		
Purchases of marketable securities, net	(103)	-
Net cash used in investing activities	(103)	-
Cash flows from financing activities:		
Share repurchases	(126)	-
Net cash used in financing activities	(126)	-
Net decrease in cash, cash equivalents, and restricted cash	(366)	(1,123)
Cash, cash equivalents, and restricted cash at beginning of period	2,767	4,195
Cash, cash equivalents, and restricted cash at end of period	$ 2,401	$ 3,072
Reconciliation of cash, cash equivalents and restricted cash, end of period:		
Cash and cash equivalents, end of period	$ 2,401	$ 2,972
Restricted cash, end of period	-	100
Cash, cash equivalents and restricted cash, end of period	$ 2,401	$ 3,072
Supplemental disclosure of cash flow information:		
Income taxes paid	$ 6	$ 3
Interest paid	$ -	$ -
Supplemental non-cash investing and financing activities:		
Lease liabilities arising from obtaining right-of-use assets	$ -	$ 77

Note 1 – Significant Accounting Policies

Business

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.

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.

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, 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.

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 so far in 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. 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, to 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 June 30, 2023, we had deferred service revenue of approximately $1,094,000. 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.

Allowance for Doubtful Accounts

The allowance for doubtful accounts 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.

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 as 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, facilities 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, accounts receivable, and accounts payable, approximate their fair values.

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.

Subsequent Events

The Company has evaluated subsequent events through August 10, 2023, being the date these consolidated financial statements were issued.

Note 2 – Balance Sheet Details

The following tables provide details of selected balance sheet accounts:

	June 30, 2023	December 31, 2022
Inventories	(In thousands)	
Raw materials	$ 128	$ 145
Finished goods	2,975	2,891
Net inventory balance	$ 3,103	$ 3,036

	June 30, 2023	December 31, 2022
Property and equipment, net	(In thousands)	
Machinery and equipment	$ 382	$ 382
Furniture and fixtures, and computer equipment	258	258
Leasehold improvements	119	119
	759	759
Less accumulated depreciation and amortization	(696)	(677)
Property and equipment, net	$ 63	$ 82

Depreciation and amortization expense for the three months ended June 30, 2023 and 2022 was $9,000 and $11,000, respectively. Depreciation and amortization expense for the six months ended June 30, 2023 and 2022 was $19,000 and $23,000, respectively.

	June 30, 2023	December 31, 2022
Accrued payroll and related liabilities	(In thousands)	
Accrued salaries, wages, and payroll taxes	$ 27	$ 32
Accrued vacation	105	108
Total accrued payroll and related liabilities	$ 132	$ 140

Other accrued liabilities	June 30, 2023		December 31, 2022	
	(In thousands)			
Accrued warranty	$	89	$	81
Accrued outside commissions		17		49
Other accrued liabilities		3		3
Total other accrued liabilities	$	109	$	133

Note 3 – Stockholders' 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 June 30, 2023 and December 31, 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 June 30, 2023 and December 31, 2022, there were 1,578,035 and 1,627,419 shares of common stock outstanding, respectively.

During the three and six months ended June 30, 2023, the Company repurchased 9,810 and 49,384 shares of common stock, respectively, for aggregate purchase prices of $22,000 and $126,000, respectively, in connection with the Stock Repurchase Program described below. During the three and six months ended June 30, 2022, the Company did not repurchase any shares.

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 May 2023, 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 June 30, 2023, the Company has repurchased 301,319 shares for an aggregate purchase price of $731,000.

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 4 – Earnings Per Share

Basic earnings per share has been computed by dividing net income or loss by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income or loss 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 net income per share for the periods indicated (in thousands, except per share amounts).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Net loss	$ (277)	$ (389)	$ (290)	$ (350)
Weighted average outstanding shares of common stock - basic	1,585	1,884	1,603	1,884
Dilutive potential common shares from employee stock options	-	-	-	-
Weighted average outstanding shares of common stock - diluted	1,585	1,884	1,603	1,884
Earnings (loss) per share:				
Basic earnings (loss) per share	$ (0.17)	$ (0.21)	$ (0.18)	$ (0.19)
Diluted earnings (loss) per share	$ (0.17)	$ (0.21)	$ (0.18)	$ (0.19)

For the three months ended June 30, 2023 and 2022, respectively, 116,300, and 126,300 outstanding stock options were excluded from the calculation of diluted earnings per share as their inclusion would have been anti-dilutive. For the six months ended June 30, 2023 and 2022, respectively, 116,300, and 126,300 outstanding stock options were excluded from the calculation of diluted earnings per share as their inclusion would have been anti-dilutive.

Note 5 – 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 183,700 shares remain available for issuance as of June 30, 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	116,300	$ 7.08	4.59	$ -
Granted	-			
Exercised	-			
Forfeited, canceled or expired	-			
Outstanding at June 30, 2023	116,300	7.08	4.10	-
Exercisable at June 30, 2023	116,300	$ 7.08	4.10	$ -

Note 6 – Concentration of Credit Risk, Significant Customers, and Geographic Information

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

For each of the three-month periods ended June 30, 2023 and 2022, one customer accounted for more than 10% of the Company's net revenue. For the six-month periods ended June 30, 2023 and 2022, respectively, one and two customers accounted for more than 10% of the Company's net revenue.

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.

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2023		2022		2023		2022	
North America	$ 1,085	57.8 %	$ 1,393	74.8 %	$ 2,542	62.5 %	$ 3,182	74.5 %
Europe	605	32.2	349	18.7	1,101	27.1	723	16.9
Asia Pacific	182	9.7	103	5.5	379	9.3	299	7.0
Other	6	0.3	18	1.0	48	1.2	69	1.6
	$ 1,878	100.0 %	$ 1,863	100.0 %	$ 4,070	100.0 %	$ 4,273	100.0 %

Note 7 – 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 $10,929 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 9, Interlink is a related party.

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 uses a portion of Interlink's

Los Angeles, California office, pursuant to which the Company pays 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 June 1, 2022 through May 31, 2024 for approximately $3,500 per month.

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 six months ended June 30, 2023. The weighted average incremental borrowing rate used to determine the initial value of ROU assets and lease liabilities during the six-months ended June 30, 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 June 30, 2023, we have not recognized any impairment losses for our ROU assets.

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 June 30, 2023, the Company had current and long-term operating lease liabilities of $168,000 and $11,000, respectively, and right-of-use assets of $166,000. Future imputed interest as of June 30, 2023 totaled approximately $5,000. The weighted average remaining lease term of the Company's leases as of June 30, 2023 is 1.0 year.

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

	Minimum Lease Payment
2023 (remainder of year)	$ 88
2024	96
2025	-
2026	-
2027	-
Total undiscounted future non-cancelable minimum lease payments	184
Less: Imputed interest	(5)
Present value of lease liabilities	$ 179

During the three months ended June 30, 2023 and 2022, the Company incurred approximately $42,000 and $44,000, respectively, of operating lease costs, which are included in operating expenses in our consolidated statements of operations. During the six months ended June 30, 2023 and 2022, the Company incurred approximately $86,000 and $88,000, respectively, of operating lease costs, which are included in operating expenses in our consolidated statements 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 June 30, 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. Qualstar made matching contributions of $6,000 and $0 during the three months ended June 30, 2023 and 2022, and made matching contributions of $18,000 and $0 during the six months ended June 30, 2023 and 2022

Note 8 – 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. 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 revenues, income (loss) before taxes, and total assets were as follows:

	Three Months Ended June 30, 2023	Three Months Ended June 30, 2022	Six Months Ended June 30, 2023	Six Months Ended June 30, 2022
	(In thousands)			
Revenues				
Data Storage:				
Product	$ 968	$ 912	$ 2,269	$ 2,231
Service	301	297	565	557
Total Data Storage	1,269	1,209	2,834	2,788
Power Supplies	609	654	1,236	1,485
Revenues	$ 1,878	$ 1,863	$ 4,070	$ 4,273

	Three Months Ended June 30, 2023	Three Months Ended June 30, 2022	Six Months Ended June 30, 2023	Six Months Ended June 30, 2022
	(In thousands)			
Income (Loss) Before Taxes				
Data Storage	$ (53)	$ (132)	$ 112	$ (25)
Power Supplies	(224)	(257)	(402)	(325)
Income (loss) before taxes	$ (277)	$ (389)	$ (290)	$ (350)

	June 30, 2023	December 31, 2022
	(In thousands)	
Total Assets		
Data Storage		
Cash and cash equivalents	$ 2,380	$ 2,331
Marketable securities	162	33
Accounts receivable, net	459	932
Inventories	1,519	2,099
Prepaid expenses and other current assets	41	131
Property and equipment, net	63	82
Right-of-use assets	166	243
Other assets	129	101
Total Data Storage assets	4,919	5,952
Power Supplies		
Cash and cash equivalents	21	436
Accounts receivable, net	472	711
Inventories	1,584	937
Prepaid expenses and other current assets	19	7
Property and equipment, net	-	-
Total Power Supplies assets	2,096	2,091
Total Assets	$ 7,015	$ 8,043

Note 9 – 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, 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. 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 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 June 30,			
	2023		2022	
	Due to Interlink	Due from Interlink	Due to Interlink	Due from Interlink
	(in thousands)			
Balance at April 1,	$	$	$ 19	$ 8
Billed (or accrued) to Interlink by Qualstar	-		-	22
Paid by Interlink to Qualstar	-		-	(23)
Billed (or accrued) to Qualstar by Interlink		-	200	-
Paid by Qualstar to Interlink		-	(196)	-
Balance at June 30,	$ -	$ -	$ 23	$ 7

	Six Months Ended June 30,			
	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	-	25	-	44
Paid by Interlink to Qualstar	-	(25)	-	(45)
Billed (or accrued) to Qualstar by Interlink	225	-	385	-
Paid by Qualstar to Interlink	(210)	-	(447)	-
Balance at June 30,	$ 21	$ -	$ 23	$ 7

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, 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 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 June 30,			
	2023		2022	
	Due to BKF Capital	Due from BKF Capital	Due to BKF Capital	Due from BKF Capital
	(in thousands)			
Balance at April 1,	$	$	$ -	$ -
Billed (or accrued) to BKF Capital by Qualstar	-		-	1
Paid by BKF Capital to Qualstar	-		-	(1)
Billed (or accrued) to Qualstar by BKF Capital		-	30	-
Paid by Qualstar to BKF Capital		-	(30)	-
Balance at June 30,	$ -	$ -	$ -	$ -

	Six Months Ended June 30,			
	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	-	-	-	1
Paid by BKF Capital to Qualstar	-	-	-	(1)
Billed (or accrued) to Qualstar by BKF Capital	(53)	-	60	-
Paid by Qualstar to BKF Capital	53	-	(60)	-
Balance at June 30,	$ -	$ -	$ -	$ -

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.

Results of Operations - (Unaudited)

The following table is presented in thousands, except for percentages. The percentages in the table are based on net revenues.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2023		2022		2023		2022	
	$	%	$	%	$	%	$	%
Data storage revenues	$ 1,269	67.6 %	$ 1,209	64.9 %	$ 2,834	69.6 %	$ 2,788	65.2 %
Power supplies revenues	609	32.4	654	35.1	1,236	30.4	1,485	34.8
Revenues	1,878	100.0	1,863	100.0	4,070	100.0	4,273	100.0
Cost of goods sold	1,446	77.0	1,382	74.2	2,984	73.3	3,069	71.8
Gross profit	432	23.0	481	25.8	1,086	26.7	1,204	28.2
Operating expenses:								
Engineering	55	2.9	118	6.3	126	3.1	168	3.9
Sales and marketing	293	15.6	336	18.0	597	14.7	659	15.4
General and administrative	355	18.9	348	18.7	691	17.0	660	15.4
Total operating expenses	703	37.4	802	43.0	1,414	34.7	1,487	34.8
Income (loss) from operations	(271)	(14.4)	(321)	(17.2)	(328)	(8.1)	(283)	(6.6)
Other income (expense), net	(6)	(0.3)	(68)	(3.7)	38	0.9	(67)	(1.6)
Income before taxes	(277)	(14.7)	(389)	(20.9)	(290)	(7.1)	(350)	(8.2)
Provision for income taxes	-	-	-	-	-	-	-	-
Net income (loss)	$ (277)	(14.7) %	$ (389)	(20.9) %	$ (290)	(7.1) %	$ (350)	(8.2) %

Net Revenues:

	Three months ended June 30,					
	2023		2022		Change	
	Amount	% of Revenues	Amount	% of Revenues	$	%
Data storage revenues	$ 1,269	67.6 %	$ 1,209	64.9 %	$ 60	5.0 %
Power supplies revenues	609	32.4	654	35.1	(45)	(6.9)
Revenues	$ 1,878	100.0 %	$ 1,863	100.0 %	$ 15	0.8 %

	Six months ended June 30,					
	2023		2022		Change	
	Amount	% of Revenues	Amount	% of Revenues	$	%
Data storage revenues	$ 2,834	69.6 %	$ 2,788	65.2 %	$ 46	1.6 %
Power supplies revenues	1,236	30.4	1,485	34.8	(249)	(16.8)
Revenues	$ 4,070	100.0 %	$ 4,273	100.0 %	$ (203)	(4.8) %

The fluctuations in net revenues for the three and six months ended June 30, 2023 compared to the prior year periods is attributable to the segment-specific factors described below.

Segment Revenue

Data Storage – For the three and six months ended June 30, 2023 compared to the corresponding periods in the prior year, our data storage product revenues were slightly higher due to increased demand from customers and timing of order fulfillment, while our data storage service revenues were substantially unchanged.

Power Supplies – The decrease in power supplies revenues in the three-month and six-month periods ended June 30, 2023 compared to the corresponding prior year periods was due to decreased shipments to our customers of our power supplies products and solutions, due in part to the timing of customer demand and the availability of components.

Gross Profit:

	Three months ended June 30,					
	2023		2022		Change	
	Amount	% of Revenues	Amount	% of Revenues	$	%
Gross profit	$ 432	23.0 %	$ 481	25.8 %	$ (49)	(10.2) %

	Six months ended June 30,					
	2023		2022		Change	
	Amount	% of Revenues	Amount	% of Revenues	$	%
Gross profit	$ 1,086	26.7 %	$ 1,204	28.2 %	$ (118)	(9.8) %

The decrease in gross profit and gross margin for the three and six months ended June 30, 2023 compared to the corresponding periods in the prior year is primarily due to the decline in revenues described above, and an unfavorable change in our product mix and customer mix.

Operating Expenses:

	Three months ended June 30,					
	2023		2022		Change	
	Amount	% of Revenues	Amount	% of Revenues	$	%
Engineering	$ 55	2.9 %	$ 118	6.3 %	$ (63)	(53.4) %
Sales and marketing	293	15.6	336	18.0	(43)	(12.8)
General and administrative	355	18.9	348	18.7	7	2.0
Total operating expenses	$ 703	37.4 %	$ 802	43.0 %	$ (99)	(12.3) %

	Six months ended June 30,					
	2023		2022		Change	
	Amount	% of Revenues	Amount	% of Revenues	$	%
Engineering	$ 126	3.1 %	$ 168	3.9 %	$ (42)	(25.0) %
Sales and marketing	597	14.7	659	15.4	(62)	(9.4)
General and administrative	691	17.0	660	15.4	31	4.7
Total operating expenses	$ 1,414	34.7 %	$ 1,487	34.8 %	$ (73)	(4.9) %

Engineering
Engineering expenses decreased for the three and six months ended June 30, 2023 compared to the same periods in the prior year primarily due to a decrease in prototyping and related product development costs in the power supplies segment.

Sales and Marketing
Sales and marketing expenses decreased for the three and six months ended June 30, 2023 compared to the same periods in the prior year primarily due to a decrease in sales and marketing employees and consultants in the current year periods compared to the prior year periods.

General and Administrative
General and administrative costs for the three and six months ended June 30, 2023 were substantially unchanged from the same periods in the prior year.

Other Income (Expense), net
Other income (expense) for the three months ended June 30, 2023 includes $4,000 of realized and unrealized losses on marketable securities, $4,000 of losses on foreign currency exchange, and $2,000 of interest income. Other income (expense) for the three months ended June 30, 2022 includes $68,000 of losses on foreign currency exchange. Other income (expense) for the six months ended June 30, 2023 includes $26,000 of realized and unrealized gains on marketable securities, $8,000 of gains on foreign currency exchange, and $4,000 of interest income. Other income (expense) for the six months ended June 30, 2022 includes $68,000 of losses on foreign currency exchange, and $1,000 of interest income.

Liquidity and Capital Resources
Cash and cash equivalents decreased $366,000 to $2,401,000 at June 30, 2023 from $2,767,000 at December 31, 2022.

Operating Activities
Cash used in operating activities was $137,000 for the six months ended June 30, 2023 compared with $1,123,000 for the six months ended June 30, 2022. Cash used in operating activities for the six months ended June 30, 2023 was the result of net loss of $290,000, non-cash expenses of $16,000, gains on marketable securities of $26,000, and cash provided by changes in operating assets and liabilities of $163,000. Cash used in operations for the six months ended June 30, 2022 was the result of net loss of $350,000, non-cash expenses of $22,000, and cash used in changes in operating assets and liabilities of $795,000.

Investing Activities
Cash used in investing activities for the six months ended June 30, 2023 consisted of $103,000 of purchases (net) of marketable securities. No cash was provided by or used in investing activities for the six months ended June 30, 2022.

Financing Activities
Cash used in financing activities for the six months ended June 30, 2023 consisted of $126,000 of cash used to repurchase shares of the Company's common stock under our Stock Repurchase Program approved by the board of directors. No cash was provided by or used in financing activities for the six months ended June 30, 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.