



Qualstar Corporation and Subsidiaries

**Quarterly Report
For the Quarter Ended March 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)

	March 31, 2023	December 31, 2022
Assets		
Current assets:		
Cash and cash equivalents	\$ 2,535	\$ 2,767
Marketable securities	318	33
Accounts receivable, net	1,085	1,643
Inventories	2,995	3,036
Prepaid expenses and other current assets	98	138
Total current assets	7,031	7,617
Property and equipment, net	72	82
Right-of-use assets	205	243
Deferred tax assets	30	30
Other assets	72	71
Total assets	\$ 7,410	\$ 8,043
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 440	\$ 946
Accrued payroll and related liabilities	124	140
Deferred service revenue	749	687
Lease liabilities, current	169	165
Other accrued liabilities	122	133
Total current liabilities	1,604	2,071
Long-term liabilities:		
Lease liabilities, long-term	52	95
Deferred service revenue, long-term	504	510
Other long-term liabilities	27	27
Total long-term liabilities	583	632
Total liabilities	2,187	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; 1,587,845 shares issued and outstanding at March 31, 2023, and 1,627,419 shares issued and outstanding at December 31, 2022	18,114	18,218
Accumulated deficit	(12,891)	(12,878)
Total shareholders' equity	5,223	5,340
Total liabilities and shareholders' equity	\$ 7,410	\$ 8,043

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

	Three Months Ended	
	March 31,	
	2023	2022
Revenues	\$ 2,192	\$ 2,410
Cost of goods sold	1,538	1,687
Gross profit	654	723
Operating expenses:		
Engineering	71	50
Sales and marketing	304	323
General and administrative	336	312
Total operating expenses	711	685
Income (loss) from operations	(57)	38
Other income (expense), net	44	1
Income (loss) before income taxes	(13)	39
Provision for income taxes	-	-
Net income (loss)	\$ (13)	\$ 39
Earnings (loss) per share:		
Basic and diluted	\$ (0.01)	\$ 0.02
Weighted average common shares outstanding:		
Basic and diluted	1,621	1,884

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

Three Months Ended March 31, 2023	Common Stock		Accumulated		Total
	Shares	Amount	Deficit		
Balances at January 1, 2023	1,627	\$ 18,218	\$ (12,878)	\$	5,340
Share repurchases	(39)	(104)	-	-	(104)
Net (loss)	-	-	(13)	-	(13)
Balances at March 31, 2023	1,588	\$ 18,114	\$ (12,891)	\$	5,223

Three Months Ended March 31, 2022	Common Stock		Accumulated		Total
	Shares	Amount	Deficit		
Balances at January 1, 2022	1,884	\$ 18,779	\$ (12,933)	\$	5,846
Share repurchases	-	-	-	-	-
Net income	-	-	39	-	39
Balances at March 31, 2022	1,884	\$ 18,779	\$ (12,894)	\$	5,885

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

	Three Months Ended	
	March 31,	
	2023	2022
Cash flows from operating activities:		
Net income (loss)	\$ (13)	\$ 39
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	10	12
Realized and unrealized (gain) on marketable securities	(27)	-
Adjustment to reconcile operating lease expense to cash paid	(2)	-
Changes in operating assets and liabilities:		
Accounts receivable	558	(275)
Inventories	41	(99)
Prepaid expenses and other assets	40	(70)
Accounts payable	(506)	(115)
Accrued payroll and related liabilities	(16)	(50)
Deferred service revenue	56	157
Other liabilities	(11)	7
Net cash provided by (used in) operating activities	130	(394)
Cash flows from investing activities:		
Purchases of marketable securities, net	(258)	-
Net cash (used in) investing activities	(258)	-
Cash flows from financing activities:		
Share repurchases	(104)	-
Net cash (used in) financing activities	(104)	-
Net (decrease) in cash, cash equivalents, and restricted cash	(232)	(394)
Cash, cash equivalents, and restricted cash at beginning of period	2,767	4,195
Cash, cash equivalents, and restricted cash at end of period	<u>\$ 2,535</u>	<u>\$ 3,801</u>
Reconciliation of cash, cash equivalents and restricted cash, end of period:		
Cash and cash equivalents, end of period	\$ 2,535	\$ 3,701
Restricted cash, end of period	-	100
Cash, cash equivalents and restricted cash, end of period	<u>\$ 2,535</u>	<u>\$ 3,801</u>

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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 may be adversely affected by health concerns regarding the outbreak of viruses, widespread illness, infectious diseases, contagions and the occurrence of unforeseen epidemics (including the outbreak of the COVID-19 coronavirus and its potential impact on our financial results) 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

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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 March 31, 2023, we had deferred service revenue of approximately \$1,253,000. 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.

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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 to freight revenue. All inbound and outbound shipping and fulfillment costs are classified as costs of goods sold.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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

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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 May 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:

	March 31, 2023	December 31, 2022
Inventories	(In thousands)	
Raw materials	\$ 136	\$ 145
Finished goods	2,859	2,891
Net inventory balance	<u>\$ 2,995</u>	<u>\$ 3,036</u>

	March 31, 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	(687)	(677)
Property and equipment, net	<u>\$ 72</u>	<u>\$ 82</u>

Depreciation and amortization expense for the three months ended March 31, 2023 and 2022 was \$10,000 and \$12,000, respectively.

	March 31, 2023	December 31, 2022
Accrued payroll and related liabilities	(In thousands)	
Accrued salaries, wages, and payroll taxes	\$ 20	\$ 32
Accrued vacation	104	108
Total accrued payroll and related liabilities	<u>\$ 124</u>	<u>\$ 140</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

	March 31, 2023	December 31, 2022
Other accrued liabilities	(In thousands)	
Accrued warranty	\$ 78	\$ 81
Accrued outside commissions	42	49
Other accrued liabilities	2	3
Total other accrued liabilities	\$ 122	\$ 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 March 31, 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 March 31, 2023 and December 31, 2022, there were 1,587,845 and 1,627,419 shares of common stock outstanding, respectively.

During the three months ended March 31, 2023 and 2022, the Company repurchased 39,574 and 0 shares of common stock, respectively, for aggregate purchase prices of \$104,000 and \$0, respectively, in connection with the stock repurchase program described below.

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 at an aggregate purchase price of up to \$1,200,000, through August 31, 2023 (with those share-quantity and dollar-amount limits being applicable for the stock repurchase activity during the period from August 2022 through August 2023). During the overall period of the Stock Repurchase Program from September 1, 2021 through March 31, 2023, the Company has repurchased 291,509 shares for an aggregate purchase price of \$709,000.

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 that 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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	
	March 31,	
	2023	2022
Net income (loss)	\$ (13)	\$ 39
Weighted average outstanding shares of common stock - basic	1,621	1,884
Dilutive potential common shares from employee stock options	-	-
Weighted average outstanding shares of common stock - diluted	1,621	1,884
Earnings (loss) per share:		
Basic earnings (loss) per share	\$ (0.01)	\$ 0.02
Diluted earnings (loss) per share	\$ (0.01)	\$ 0.02

For the three months ended March 31, 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 March 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.

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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 March 31, 2023	116,300	7.08	4.35	-
Exercisable at March 31, 2023	116,300	\$ 7.08	4.35	\$ -

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.

Two customers each accounted for more than 10% of the Company’s net revenue for each of the three-month periods ended March 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.

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

	Three Months Ended March 31,			
	2023		2022	
North America	\$ 1,457	66.5 %	\$ 1,789	74.2 %
Europe	496	22.6	374	15.5
Asia Pacific	197	9.0	196	8.1
Other	42	1.9	51	2.1
	<u>\$ 2,192</u>	<u>100.0 %</u>	<u>\$ 2,410</u>	<u>100.0 %</u>

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 \$4,600 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.

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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 three months ended March 31, 2023 or 2022. 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 March 31, 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 March 31, 2023, the Company had current and long-term operating lease liabilities of \$169,000 and \$52,000, respectively, and right-of-use assets of \$205,000. Future imputed interest as of March 31, 2023 totaled approximately \$7,000. The weighted average remaining lease term of the Company's leases as of December 31, 2022 is 1.2 years.

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

	Minimum Lease Payment
2023 (remainder of year)	\$ 131
2024	96
2025	-
2026	-
2027	-
Total undiscounted future non-cancelable minimum lease payments	227
Less: Imputed interest	(7)
Present value of lease liabilities	<u>\$ 220</u>

During the three months ended March 31, 2023 and 2022, the Company incurred approximately \$45,000 and \$44,000, 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

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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 March 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. Qualstar made matching contributions of \$12,000 and \$0 during the three months ended March 31, 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.

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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

	Three Months Ended	
	March 31,	
	2023	2022
(In thousands)		
Revenues		
Data Storage:		
Product	\$ 1,301	\$ 1,319
Service	264	260
Total Data Storage	1,565	1,579
Power Supplies	627	831
Revenues	<u>\$ 2,192</u>	<u>\$ 2,410</u>

	Three Months Ended	
	March 31,	
	2023	2022
(In thousands)		
Income (Loss) Before Taxes		
Data Storage	\$ 165	\$ 107
Power Supplies	(178)	(68)
Income (loss) before taxes	<u>\$ (13)</u>	<u>\$ 39</u>

	March 31,	December 31,
	2023	2022
	(In thousands)	
Total Assets		
Data Storage:		
Cash and cash equivalents	\$ 2,393	\$ 2,331
Marketable securities	318	33
Accounts receivable, net	596	932
Inventories	1,811	2,099
Prepaid expenses and other current assets	87	131
Property and equipment, net	72	82
Right-of-use assets	205	243
Other assets	102	101
Total Data Storage assets	5,584	5,952
Power Supplies:		
Cash and cash equivalents	142	436
Accounts receivable, net	489	711
Inventories	1,184	937
Prepaid expenses and other current assets	11	7
Property and equipment, net	-	-
Total Power Supplies assets	1,826	2,091
Total Assets	<u>\$ 7,410</u>	<u>\$ 8,043</u>

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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 Irvine, California and Los Angeles California office facilities, 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 also agree 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 March 31,			
	2023		2023	
	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	-	22
Paid by Interlink to Qualstar	-	(25)	-	(22)
Billed (or accrued) to Qualstar by Interlink	225	-	185	-
Paid by Qualstar to Interlink	(210)	-	(251)	-
Balance at March 31,	\$ 21	\$ -	\$ 19	\$ 8

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

QUALSTAR CORPORATION AND SUBSIDIARIES

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BKF Capital agree 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 March 31,			
	2023		2023	
	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	-	-	-	-
Paid by BKF Capital to Qualstar	-	-	-	-
Billed (or accrued) to Qualstar by BKF Capital	(53)	-	30	-
Paid by Qualstar to BKF Capital	53	-	(30)	-
Balance at March 31,	\$ -	\$ -	\$ -	\$ -

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

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 March 31,			
	2023		2022	
	\$	%	\$	%
Data storage revenues	\$ 1,565	71.4 %	\$ 1,579	65.5 %
Power supplies revenues	627	28.6	831	34.5
Revenues	2,192	100.0	2,410	100.0
Cost of goods sold	1,538	70.2	1,687	70.0
Gross profit	654	29.8	723	30.0
Operating expenses:				
Engineering	71	3.2	50	2.1
Sales and marketing	304	13.9	323	13.4
General and administrative	336	15.3	312	12.9
Total operating expenses	711	32.4	685	28.4
Income (loss) from operations	(57)	(2.6)	38	1.6
Other income (expense), net	44	2.0	1	0.0
Income before taxes	(13)	(0.6)	39	1.6
Provision for income taxes	-	-	-	-
Net income (loss)	\$ (13)	(0.6) %	\$ 39	1.6 %

Net Revenues:

	Three months ended March 31,				Change	
	2023		2022			
	Amount	% of Revenues	Amount	% of Revenues	\$	%
Data storage revenues	\$ 1,565	71.4 %	\$ 1,579	65.5 %	\$ (14)	(0.9) %
Power supplies revenues	627	28.6	831	34.5	(204)	(24.5)
Revenues	\$ 2,192	100.0 %	\$ 2,410	100.0 %	\$ (218)	(9.0) %

The decreases in net revenues for the three months ended March 31, 2023 compared to the prior year period is attributable to the segment-specific factors described below.

Segment Revenue

Data Storage – For the three months ended March 31, 2023 compared to the corresponding period in the prior year, our data storage product revenues and our data storage service revenues were substantially unchanged.

Power Supplies – The decrease in power supplies revenues in the three-month period ended March 31, 2023 compared to the corresponding prior year period 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.

QUALSTAR CORPORATION AND SUBSIDIARIES

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

Gross Profit:

	Three months ended March 31,				Change	
	2023		2022			
	Amount	% of Revenues	Amount	% of Revenues	\$	%
Gross profit	\$ 654	29.8 %	\$ 723	30.0 %	\$ (69)	(9.5) %

The decrease in gross profit for the three months ended March 31, 2023 compared to the corresponding period in the prior year is primarily due to the decline in revenues described above. Gross margin percentage for the three months ended March 31, 2023 was substantially unchanged from the corresponding prior year period.

Operating Expenses:

	Three months ended March 31,				Change	
	2023		2022			
	Amount	% of Revenues	Amount	% of Revenues	\$	%
Engineering	\$ 71	3.2 %	\$ 50	2.1 %	\$ 21	42.0 %
Sales and marketing	304	13.9	323	13.4	(19)	(5.9)
General and administrative	336	15.3	312	12.9	24	7.7
Total operating expenses	\$ 711	32.4 %	\$ 685	28.4 %	\$ 26	3.8 %

Engineering

Engineering expenses increased for the three months ended March 31, 2023 compared to the same period in the prior year primarily due to an increase in prototyping and related product development costs in the power supplies segment in the current year period compared to the prior year period.

Sales and Marketing

Sales and marketing expenses decreased slightly for the three months ended March 31, 2023 compared to the three months ended March 31, 2022 primarily due to a decrease in sales and marketing employees and consultants in the current year period compared to the prior year periods.

General and Administrative

General and administrative costs increased for the three months ended March 31, 2023 compared to the same period in the prior year primarily due to an increase in the nature and costs of professional services provided to the Company in the current year period as compared to the prior year period.

Other Income (Expense), net

Other income (expense) for the three months ended March 31, 2023 includes \$30,000 of realized and unrealized gains on marketable securities, \$12,000 of gains on foreign currency exchange, and \$1,000 of interest income. Other income (expense) for the three months ended March 31, 2022 includes \$1,000 of gains on foreign currency exchange.

Liquidity and Capital Resources

Cash and cash equivalents decreased \$232,000 to \$2,535,000 at March 31, 2023 from \$2,767,000 at December 31, 2022.

Operating Activities

Cash provided by operating activities was \$130,000 for the three months ended March 31, 2023 compared with cash used in operations of \$394,000 for the three months ended March 31, 2022. Cash provided by operations for the

QUALSTAR CORPORATION AND SUBSIDIARIES

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

three months ended March 31, 2023 was the result of net loss of \$13,000, non-cash expenses of \$8,000, gains on marketable securities of \$27,000, and cash provided by changes in operating assets and liabilities of \$162,000. Cash used in operations for the three months ended March 31, 2022 was the result of net income of \$39,000, non-cash expenses of \$12,000, and cash used in changes in operating assets and liabilities and \$445,000.

Investing Activities

Cash used in investing activities for the three months ended March 31, 2023 consisted of \$258,000 of purchases (net) of marketable securities. No cash was provided by or used in investing activities for the three months ended March 31, 2022.

Financing Activities

Cash used in financing activities for the three months ended March 31, 2023 consisted of \$104,000 of cash used to repurchase shares of the Company's common stock under a stock repurchase program approved by the board of directors. No cash was provided by or used in financing activities for the three months ended March 31, 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.