Qualstar Corporation and Subsidiaries

Annual Report
For the Year Ended December 31, 2022

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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)

	December 31, 2022	December 31, 2021
Assets		
Current assets:		
Cash and cash equivalents	$ 2,767	$ 4,095
Restricted cash	-	100
Marketable securities	33	-
Accounts receivable, net	1,643	1,354
Inventories	3,036	2,276
Prepaid expenses and other current assets	138	304
Total current assets	7,617	8,129
Property and equipment, net	82	124
Right-of-use assets	243	300
Deferred tax assets	30	30
Other assets	71	24
Total assets	$ 8,043	$ 8,607
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 946	$ 977
Accrued payroll and related liabilities	140	188
Deferred service revenue	687	622
Lease liabilities, current	165	117
Other accrued liabilities	133	168
Total current liabilities	2,071	2,072
Long-term liabilities:		
Lease liabilities, long-term	95	204
Deferred service revenue, long-term	510	447
Other long-term liabilities	27	28
Total long-term liabilities	632	679
Total liabilities	2,703	2,751
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Preferred stock, no par value; 5,000,000 shares authorized; no shares issued		-
Common stock, no par value; 50,000,000 shares authorized; 1,627,419 shares issued and outstanding at December 31, 2022, 1,884,033 shares issued and outstanding at December 31, 2021	18,218	18,789
Accumulated deficit	(12,878)	(12,933)
Total shareholders' equity	5,340	5,856
Total liabilities and shareholders' equity	$ 8,043	$ 8,607

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

	Three Months Ended December 31,		Year Ended December 31,	
	2022	**2021**	**2022**	**2021**
Revenues	$ 2,826	$ 2,443	$ 9,845	$ 9,164
Cost of goods sold	1,879	1,460	6,850	5,997
Gross profit	947	983	2,995	3,167
Operating expenses:				
Engineering	66	76	336	451
Sales and marketing	307	370	1,215	1,476
General and administrative	347	101	1,352	809
Total operating expenses	720	547	2,903	2,736
Income (loss) from operations	227	436	92	431
Other income (expense), net	52	3	(32)	2
Income (loss) before income taxes	279	439	60	433
Provision for income taxes	5	3	5	3
Net income (loss)	$ 274	$ 436	$ 55	$ 430
Earnings (loss) per share:				
Basic and diluted	$ 0.16	$ 0.23	$ 0.03	$ 0.22
Weighted average common shares outstanding:				
Basic and diluted	1,692	1,888	1,829	1,934

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

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

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

Three Months Ended December 31, 2021	Common Stock Shares	Common Stock Amount	Accumulated Deficit	Total
Balances at October 1, 2021	1,892	$ 18,807	$ (13,369)	$ 5,438
Share repurchases	(8)	(18)	-	(18)
Net income	-	-	436	436
Balances at December 31, 2021	1,884	$ 18,789	$ (12,933)	$ 5,856

Year Ended December 31, 2021	Common Stock Shares	Common Stock Amount	Accumulated Deficit	Total
Balances at January 1, 2021	1,950	$ 18,980	$ (13,363)	$ 5,617
Share repurchases	(69)	(201)	-	(201)
Share-based compensation	3	10	-	10
Net income	-	-	430	430
Balances at December 31, 2021	1,884	$ 18,789	$ (12,933)	$ 5,856

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

	Year Ended December 31, 2022	2021
Cash flows from operating activities:		
Net income	$ 55	$ 430
Adjustments to reconcile net income to net cash (used in) operating activities:		
Depreciation and amortization	43	35
Share-based compensation	-	10
Unrealized (gain) on marketable securities	(8)	-
Adjustment to reconcile operating lease expense to cash paid	(4)	(4)
Gain on forgiveness of PPP loan	-	(521)
Changes in operating assets and liabilities:		
Accounts receivable	(289)	25
Inventories	(760)	(366)
Prepaid expenses and other assets	117	(129)
Accounts payable	(31)	311
Accrued payroll and related liabilities	(48)	(26)
Deferred service revenue	129	194
Other liabilities	(35)	(27)
Net cash (used in) operating activities	(831)	(68)
Cash flows from investing activities:		
Purchases of property and equipment	(1)	(56)
Purchases of marketable securities	(25)	-
Net cash (used in) investing activities	(26)	(56)
Cash flows from financing activities:		
Share repurchases	(571)	(201)
Proceeds received from PPP loan	-	263
Net cash provided by (used in) financing activities	(571)	62
Net (decrease) in cash, cash equivalents, and restricted cash	(1,428)	(62)
Cash, cash equivalents, and restricted cash at beginning of period	4,195	4,257
Cash, cash equivalents, and restricted cash at end of period	$ 2,767	$ 4,195
Reconciliation of cash, cash equivalents and restricted cash, end of period:		
Cash and cash equivalents, end of period	$ 2,767	$ 4,095
Restricted cash, end of period	-	100
Cash, cash equivalents and restricted cash, end of period	$ 2,767	$ 4,195
Supplemental disclosure of cash flow information:		
Income taxes paid	$ 1	$ 2
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 ("Qualstar", the "Company", "we", "us" or "our") manufactures and markets data storage system products and compact, high efficiency power solutions. Our data storage systems are marketed under the Qualstar brand and include highly scalable automated magnetic tape libraries used to store, retrieve and manage electronic data primarily in the network computing environment. Our data storage devices include models ranging from entry level to enterprise and are a cost-effective solution for organizations requiring backup, recovery and archival storage of critical electronic information. The distribution channels for our data storage devices include resellers, system integrators, and original equipment manufacturers ("OEMs"). In addition, the Company is a leading provider of standard, semi-custom and custom power solutions marketed under the N2Power brand. Our power solution products provide OEM designers increased functionality while reducing thermal loads and cooling requirements and lowering operating costs. Our power solution products are currently sold to OEMs in a wide range of markets, including telecom/networking equipment, audio/visual, industrial, gaming and medical.

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

We sell our products globally through authorized resellers, distributers, 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

Public health threats could adversely affect our ongoing or planned business operations. For example, the COVID-19 pandemic resulted in quarantines, restrictions on travel and other business and economic disruptions. We cannot predict the scope and severity of any potential business shutdowns or disruptions from such public health threats, but if we or any of the third parties with whom we engage, including the suppliers, distributers, resellers and other third parties with whom we conduct business, were to experience shutdowns or other business disruptions, our ability to conduct our business in the manner and on the timelines we plan could be materially and adversely impacted.

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, replace defective parts and to have onsite service provided by Qualstar's third party contract service provider. We record revenue for contract services at the amount of the service contract, but such amount is deferred at the beginning of the service term and amortized ratably over the life of the contract.

Deferred service revenue is shown separately in the consolidated balance sheets as current and long term. At December 31, 2022 we had deferred service revenue of approximately $1,197,000. At December 31, 2021 we had deferred service revenue of approximately $1,069,000.

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.

Restricted Cash

At December 31, 2022 and 2021, $0 and $100,000, respectively, in cash was restricted for use as collateral for the Company's credit cards.

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

Engineering

All engineering costs are charged to expense as incurred. These costs consist primarily of engineering salaries, benefits, outside consultant fees, purchased parts and supplies directly involved in the design and development of new products, 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 March 6, 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:

Inventories	December 31, 2022	December 31, 2021
	(In thousands)	
Raw materials	$ 145	$ 164
Finished goods	2,891	2,112
Net inventory balance	$ 3,036	$ 2,276

Property and equipment, net	December 31, 2022	December 31, 2021
	(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	(677)	(635)
Property and equipment, net	$ 82	$ 124

Depreciation and amortization expense for the years ended December 31, 2022 and 2021 was $43,000 and $35,000, respectively.

Accrued payroll and related liabilities	December 31, 2022	December 31, 2021
	(In thousands)	
Accrued salaries, wages, and payroll taxes	$ 32	$ 82
Accrued vacation	108	106
Total accrued payroll and related liabilities	$ 140	$ 188

Other accrued liabilities	December 31, 2022	December 31, 2021
	(In thousands)	
Accrued warranty	$ 81	$ 142
Accrued outside commissions	49	26
Other accrued liabilities	3	-
Total other accrued liabilities	$ 133	$ 168

Note 3 – Paycheck Protection Program Loans

During the second quarter of 2020, the Company received a loan from in the aggregate principal amount of $258,000 pursuant to the Paycheck Protection Program (the "PPP") under the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"). The loan was evidenced by a promissory note, dated May 4, 2020, issued by us to the lender, which was to mature on May 3, 2022, and bore interest at a rate of 1.00% per annum. Proceeds from the loan were used to fund designated expenses, including certain payroll costs, group health care benefits and other permitted expenses, in accordance with the PPP. Under the terms of the PPP, up to the entire amount of principal and accrued interest was eligible to be forgiven to the extent the loan proceeds are used for qualifying expenses as described in the CARES Act and applicable implementing guidance issued by the U.S. Small Business Administration under the PPP. The full amount of the principal and interest of the loan was forgiven in May 2021. The Company recorded the loan forgiveness as contra-expense within general and administrative expense, where the substantial majority of the Company's corresponding payroll and operating expenses are incurred. Forgiveness of the PPP loan resulted in contra-expense of $258,000 being recorded in general and administrative expense during the second quarter of 2021.

During the second quarter of 2021, the Company received second draw PPP loans from two lenders, one loan for Qualstar Corporation, and another loan for N2Power, Inc., in the aggregate principal amount of $263,000. The loans were evidenced by promissory notes, dated May 17, 2021 and June 14, 2021, respectively, issued by us to the lenders, which were to mature on May 17, 2026 and June 14, 2026, respectively, and bore interest at a rate of 1.00% per annum. Proceeds from the loans were used to fund designated expenses, including certain payroll costs, group health care benefits and other permitted expenses, in accordance with the PPP. Under the terms of the PPP, up to the entire amount of principal and accrued interest was eligible to be forgiven to the extent the loan proceeds are used for qualifying expenses as described in the CARES Act and applicable implementing guidance issued by the U.S. Small Business Administration under the PPP. The full amount of the principal and interest of the loans were forgiven in November 2021. The Company recorded the loan forgiveness as contra-expense within general and administrative expense, where the substantial majority of the Company's corresponding payroll and operating expenses are incurred. Forgiveness of the PPP loan resulted in contra-expense of $263,000 being recorded in general and administrative expense during the fourth quarter of 2021.

Note 4 – Income Taxes

The provision for income taxes is comprised of the following:

	Year Ended December 31, 2022	Year Ended December 31, 2021
	(In thousands)	
Current:		
Federal	$ -	$ -
State	5	3
Foreign	-	-
Current income tax provision (benefit)	5	3
Deferred:		
Federal	-	-
State	-	-
Foreign	-	-
Deferred income tax provision (benefit)	-	-
Net income tax provision (benefit)	$ 5	$ 3

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

	Year Ended December 31, 2022	Year Ended December 31, 2021
Statutory federal income tax provision (benefit)	21.0 %	21.0 %
State income taxes, net of federal income tax benefit	15.5	(1.3)
Foreign income taxes, net of federal income tax benefit	21.4	4.9
PPP loan forgiveness – exempt income	-	(25.1)
Non-deductible recapitalization expenses	12.4	-
Deferred tax adjustment – NOL / share-based compensation	4.3	(0.1)
Valuation allowance	(68.0)	0.1
Other	1.4	1.2
Effective income tax rate	8.0 %	0.7 %

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

	December 31, 2022	December 31, 2021
	(In thousands)	
Deferred tax assets:		
Net operating loss carryforwards	$ 8,109	$ 8,166
Engineering credit carryforwards	1,921	1,920
Inventory reserves	470	508
Depreciation and other	4	-
Allowance for bad debts and returns	3	2
Share-based compensation	96	96
Capitalized inventory costs, and other accruals	252	229
Total gross deferred tax assets	10,855	10,921
Less valuation allowance on deferred tax assets	(10,773)	(10,810)
Net deferred tax assets	82	111
Deferred tax liabilities:		
Depreciation and other	(2)	(2)
Right-of-use assets	(50)	(79)
Total deferred tax liabilities	(52)	(81)
Net deferred taxes	$ 30	$ 30

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

The Company records a valuation allowance against its net deferred income tax assets when, in management's judgment, it is more likely than not that the deferred income tax assets will not be realized in the foreseeable future. For the years ended December 31, 2022 and 2021, the Company placed a valuation allowance on net deferred tax assets. With the exception of a small amount of the California net operating loss ("NOL") carryforward, the Company continues to fully offset its deferred tax assets with a valuation allowance. With regard to California deferred tax assets, because Qualstar files on a separate company basis, and because Qualstar expects to generate income in the foreseeable future applicable to California, the Company reduced a portion of the valuation allowance related to Qualstar's separate company NOL carryforwards.

The Company had NOL carryforwards for federal income tax purposes of approximately $31.9 million as of December 31, 2022 and $32.1 million as of December 31, 2021. The Company had NOL carryforwards for state income tax purposes of approximately $21.5 million as of December 31, 2022 and $21.6 million as of December 31, 2021. The Company had engineering and other credit carryforwards for tax purposes of $2.7 million as of both December 31, 2022 and 2021.

If not utilized, the federal NOL will begin to expire in 2027, and other tax credits will expire beginning in 2024. If not utilized, the state NOL will begin to expire in 2023. The state engineering credit has no limit on the carryforward period.

For U.S. purposes, the Company completed an evaluation, as of December 31, 2020, of the NOL and credit carryforward utilization limitations under Internal Revenue Code, as amended (the "Code") Section 382 and 383, change of ownership rules. Code Sections 382 and 383 impose certain limitations on the use of NOL or credit carryforwards in certain situations, including when a company has a change in ownership as defined in such sections. As of December 31, 2020, the Company has determined that it has not had a change in ownership within the meaning of Code Sections 382 and 383. Management, at the date of this filing, is of the opinion that its NOL and credit carryforwards should not be limited, pursuant to Sections 382 and 383, as to the amount of such carryforwards that can be utilized each year.

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

	Year Ended December 31, 2022	Year Ended December 31, 2021
	(In thousands)	
Balance at beginning of year	$ 27	$ 27
Increases related to tax positions taken in current year	2	-
Increases related to tax positions taken in prior year	-	-
Decreases due to lapse of statute of limitations and other adjustments	(2)	-
Related interest and penalties, net of federal tax benefit	-	-
Balance at end of year	$ 27	$ 27

The deferred tax asset amounts related to NOL and credit carryforwards have been reduced by approximately $527,000 of uncertain tax positions. The Company expects that any future changes in the unrecognized tax benefit will have no impact on the Company's effective tax rate due to the existence of the valuation allowance.

The Company's policy is to include interest and penalties on uncertain tax positions in income tax expense, but they are not significant for the years ended December 31, 2022 and 2021. The Company files its tax returns by the laws of the jurisdictions in which it operates. The Company's federal tax returns for the years 2019 and subsequent and California tax returns for the years 2018 and subsequent, are still subject to examination. Various state and foreign jurisdictions' tax years remain open to examination as well, though the Company believes any additional assessment will be immaterial to its consolidated financial statements. The Company does not have any open examinations as of December 31, 2022. For the years ended December 31, 2022 and 2021, the operations of Qualstar Corporation Singapore Private Limited, Qualstar Limited, and Q-Smart Data Private Limited (Singapore) were not material for tax purposes and had no significant impact on the tax provision.

Note 5 – 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 December 31, 2022 and 2021, there were no outstanding shares of preferred stock.

Common Stock

The Company's Articles of Incorporation allow for the issuance of up to 50,000,000 shares of common stock. At December 31, 2022 and 2021, there were 1,627,419 and 1,884,033 shares of common stock outstanding, respectively.

During the years ended December 31, 2022 and 2021, the Company repurchased 256,614 and 69,326 shares, respectively, for aggregate purchase prices of $571,000 and $201,000, respectively, in connection with the stock repurchase program and the August 2022 reverse/forward stock split 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 December 31, 2022, the Company has repurchased 251,935 shares for an aggregate purchase price of $605,000. During the years ended December 31, 2022, and 2021, respectively, the Company repurchased 182,609 and 69,326 shares for aggregate purchase prices of $404,000 and $201,000.

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.

Note 6 – 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 December 31,		Year Ended December 31,	
	2022	2021	2022	2021
Net income (loss)	$ 274	$ 436	$ 55	$ 430
Weighted average outstanding shares of common stock - basic	1,692	1,888	1,829	1,934
Dilutive potential common shares from employee stock options	-	-	-	-
Weighted average outstanding shares of common stock - diluted	1,692	1,888	1,829	1,934
Earnings (loss) per share:				
Basic earnings (loss) per share	$ 0.16	$ 0.23	$ 0.03	$ 0.22
Diluted earnings (loss) per share	$ 0.16	$ 0.23	$ 0.03	$ 0.22

For the three months ended December 31, 2022 and 2021, 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 years ended December 31, 2022 and 2021, respectively, 126,300 and 140,633 outstanding stock options were excluded from the calculation of diluted earnings per share as their inclusion would have been anti-dilutive.

Note 7 – 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 December 31, 2022. 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, 2021	126,300	$ 7.08	5.59	$ -
Granted	-			
Exercised	-			
Forfeited, canceled or expired	(10,000)	7.08		
Outstanding at December 31, 2022	116,300	7.08	4.59	-
Exercisable at December 31, 2022	116,300	$ 7.08	4.59	$ -

Note 8 – Concentration of Credit Risk, Significant Customers, and Geographic Information

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

One customer accounted for more than 10% of the Company's revenue for the three-month period ended December 31, 2022. No customer accounted for more than 10% of the Company's revenue for the three-month period ended December 31, 2021. One customer accounted for more than 10% of the Company's revenue for the year ended December 31, 2022. One customer accounted for more than 10% of the Company's revenue for the year ended December 31, 2021.

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 December 31,				Year Ended December 31,			
	2022		2021		2022		2021	
North America	$ 1,601	56.7 %	$ 1,782	72.9 %	$ 6,656	67.6 %	$ 6,898	75.3 %
Europe	1,034	36.6	402	16.5	2,394	24.3	1,533	16.7
Asia Pacific	166	5.9	259	10.6	678	6.9	703	7.7
Other	25	0.9	-	0.0	117	1.2	30	0.3
	$ 2,826	100.0 %	$ 2,443	100.0 %	$ 9,845	100.0 %	$ 9,164	100.0 %

Note 9 – 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 11, 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.

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. The weighted average incremental borrowing rate used to determine the initial value of right-of-use (ROU) assets and lease liabilities as of January 1, 2019 was 4.33%. No new ROU assets were capitalized during the year ended December 31, 2021. The weighted average incremental borrowing rate used to determine the initial value of ROU assets and lease liabilities during the year ended December 31, 2022 was 5.00%. Certain of our contracts for real estate may contain both lease and non-lease components which we have elected to treat as a single lease component.

Right-of-use assets for operating leases are periodically reduced by impairment losses. We use the long-lived assets impairment guidance in ASC Subtopic 360-10, *Property, Plant, and Equipment – Overall*, to determine whether a ROU asset is impaired, and if so, the amount of the impairment loss to recognize. As of December 31, 2022, 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 December 31, 2022, the Company had current and long-term operating lease liabilities of $165,000 and $95,000, respectively, and right-of-use assets of $243,000. Future imputed interest as of December 31, 2022 totaled approximately $10,000. The weighted average remaining lease term of the Company's leases as of December 31, 2022 is 1.4 years.

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

	Minimum Lease Payment
2023	$ 173
2024	96
2025	-
2026	-
2027	-
Total undiscounted future non-cancelable minimum lease payments	269
Less: Imputed interest	(10)
Present value of lease liabilities	$ 259

During the three months ended December 31, 2022 and 2021, the Company incurred approximately $45,000 and $44,000, respectively, of operating lease costs, which are included in operating expenses in our consolidated statement of operations. During the years ended December 31, 2022 and 2021, the Company incurred approximately $176,000 and $168,000, respectively, of operating lease costs, which are included in operating expenses in our consolidated statement of operations.

Legal and Other Contingencies

The Company is subject to a variety of claims and legal proceedings that arise from time to time in the ordinary course of our business. Although management currently believes that resolving claims against us, individually or in the aggregate, will not have a material adverse impact on our consolidated financial statements, these matters are subject to inherent uncertainties and management's view of these matters may change in the future. An estimated loss from a loss contingency such as a legal proceeding or claim is accrued by a charge to income if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. When legal costs that the entity expects to incur in defending itself in connection with a loss contingency accrual are expected to be material, the loss should factor in all costs and, if the legal costs are reasonably estimable, they should be accrued in accordance with ASC 450, regardless of whether a liability can be estimated for the contingency itself. Disclosure of a contingency is required if there is at least a reasonable possibility that a loss has been incurred. Changes in these factors could materially impact our consolidated financial statements. No loss contingency was recorded as of December 31, 2022.

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 years ended December 31, 2022 or 2021.

Note 10 – Segment Information

In its operation of the business, management reviews certain financial information, including segmented internal profit and loss statements prepared on a basis consistent with GAAP. Our two segments are Data Storage and Power Supplies. The two segments discussed in this analysis are presented in the way we internally manage and monitor performance for 2022 and 2021. The types of products and services provided by each segment are summarized below:

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

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

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

	Three Months Ended December 31, 2022	Three Months Ended December 31, 2021	Year Ended December 31, 2022	Year Ended December 31, 2021
	(In thousands)			
Revenues				
Data Storage:				
Product	$ 1,677	$ 1,362	$ 5,207	$ 4,619
Service	305	305	1,159	1,171
Total Data Storage	1,982	1,667	6,366	5,790
Power Supplies	844	776	3,479	3,374
Revenues	$ 2,826	$ 2,443	$ 9,845	$ 9,164

	Three Months Ended December 31, 2022	Three Months Ended December 31, 2021	Year Ended December 31, 2022	Year Ended December 31, 2021
	(In thousands)			
Income (Loss) Before Taxes				
Data Storage	$ 402	$ 540	$ 616	$ 728
Power Supplies	(123)	(101)	(556)	(295)
Income (loss) before taxes	$ 279	$ 439	$ 60	$ 433

	December 31, 2022	December 31, 2021
	(In thousands)	
Total Assets		
Data Storage		
Cash and cash equivalents	$ 2,331	$ 3,474
Restricted cash	-	100
Marketable securities	33	-
Accounts receivable, net	932	804
Inventories	2,099	1,936
Prepaid expenses and other current assets	131	185
Property and equipment, net	82	123
Right-of-use assets	243	300
Other assets	101	54
Total Data Storage assets	5,952	6,976
Power Supplies		
Cash and cash equivalents	436	621
Accounts receivable, net	711	550
Inventories	937	340
Prepaid expenses and other current assets	7	119
Property and equipment, net	-	1
Total Power Supplies assets	2,091	1,631
Total Assets	$ 8,043	$ 8,607

Note 11 – 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 December 31,			
	2022		2021	
	Due to Interlink	Due from Interlink	Due to Interlink	Due from Interlink
	(in thousands)			
Balance at October 1,	$ 26	$ 8	$ 16	$ -
Billed (or accrued) to Interlink by Qualstar	-	23	-	26
Paid by Interlink to Qualstar	-	(31)	-	(18)
Billed (or accrued) to Qualstar by Interlink	206	-	200	-
Paid by Qualstar to Interlink	(226)	-	(131)	-
Balance at December 31,	$ 6	$ -	$ 85	$ 8

	Year Ended December 31,			
	2022		2021	
	Due to Interlink	Due from Interlink	Due to Interlink	Due from Interlink
	(in thousands)			
Balance at January 1,	$ 85	$ 8	$ 52	$ 34
Billed (or accrued) to Interlink by Qualstar	-	96	-	102
Paid by Interlink to Qualstar	-	(104)	-	(128)
Billed (or accrued) to Qualstar by Interlink	798	-	892	-
Paid by Qualstar to Interlink	(877)	-	(859)	-
Balance at December 31,	$ 6	$ -	$ 85	$ 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 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 December 31,			
	2022		2021	
	Due to BKF Capital	Due from BKF Capital	Due to BKF Capital	Due from BKF Capital
	(in thousands)			
Balance at October 1,	$ -	$ -	$ -	$ -
Billed (or accrued) to BKF Capital by Qualstar	-	-	-	-
Paid by BKF Capital to Qualstar	-	-	-	-
Billed (or accrued) to Qualstar by BKF Capital	53	-	30	-
Paid by Qualstar to BKF Capital	(53)	-	(30)	-
Balance at December 31,	$ -	$ -	$ -	$ -

	Year Ended December 31,			
	2022		2021	
	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	-	-	-	6
Paid by BKF Capital to Qualstar	-	-	-	(6)
Billed (or accrued) to Qualstar by BKF Capital	150	-	60	-
Paid by Qualstar to BKF Capital	(150)	-	(60)	-
Balance at December 31,	$ -	$ -	$ -	$ -

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

Overview

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

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

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, distributers, 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 December 31,				Year Ended December 31,			
	2022		2021		2022		2021	
	$	%	$	%	$	%	$	%
Data storage revenues	$ 1,982	70.1 %	$ 1,667	68.2 %	$ 6,366	64.7 %	$ 5,790	63.2 %
Power supplies revenues	844	29.9	776	31.8	3,479	35.3	3,374	36.8
Revenues	2,826	100.0	2,443	100.0	9,845	100.0	9,164	100.0
Cost of goods sold	1,879	66.5	1,460	59.8	6,850	69.6	5,997	65.4
Gross profit	947	33.5	983	40.2	2,995	30.4	3,167	34.6
Operating expenses:								
Engineering	66	2.3	76	3.1	336	3.4	451	4.9
Sales and marketing	307	10.9	370	15.1	1,215	12.3	1,476	16.1
General and administrative	347	12.3	101	4.1	1,352	13.7	809	8.8
Total operating expenses	720	25.5	547	22.4	2,903	29.5	2,736	29.9
Income from operations	227	8.0	436	17.8	92	0.9	431	4.7
Other income (expense), net	52	1.8	3	0.1	(32)	(0.3)	2	0.0
Income before taxes	279	9.9	439	18.0	60	0.6	433	4.7
Provision for income taxes	5	0.2	3	0.1	5	0.1	3	0.0
Net income	$ 274	9.7 %	$ 436	17.8 %	$ 55	0.6 %	$ 430	4.7 %

Net Revenues:

	Three months ended December 31,				Change	
	2022		2021			
	Amount	% of Revenues	Amount	% of Revenues	$	%
Data storage revenues	$ 1,982	70.1 %	$ 1,667	68.2 %	$ 315	18.9 %
Power supplies revenues	844	29.9	776	31.8	68	8.8
Revenues	$ 2,826	100.0 %	$ 2,443	100.0 %	$ 383	15.7 %

	Year ended December 31,				Change	
	2022		2021			
	Amount	% of Revenues	Amount	% of Revenues	$	%
Data storage revenues	$ 6,366	64.7 %	$ 5,790	63.2 %	$ 576	9.9 %
Power supplies revenues	3,479	35.3	3,374	36.8	105	3.1
Revenues	$ 9,845	100.0 %	$ 9,164	100.0 %	$ 681	7.4 %

The increases in net revenues for the three months and year ended December 31, 2022 compared to the prior year periods is attributable to the segment-specific factors described below.

Segment Revenue

Data Storage – For the three months ended December 31, 2022 compared to the corresponding period in the prior year we experienced a 23% increase in our data storage product revenues attributable to an increase in shipments of our tape-based data storage products and solutions in the current quarter as compared to the same year-ago quarter, while our data storage service revenues were flat with the prior year period. For the year ended December 31, 2022 compared to the prior year we experienced an 13% increase in our data storage product revenues attributable to an increase in shipments in the current year-to-date period as compared to the prior year, and a 1% decrease in our data storage service revenues as a result of a corresponding decrease in technical support services rendered during the current year as compared to the prior year.

Power Supplies – The increases in power supplies revenues in the three-month and twelve-month periods ended December 31, 2022 compared to the corresponding prior year periods were due to increased shipments to our customers of our power supplies products and solutions in the current year, due in part to the timing of demand and shipments and the availability of components.

Gross Profit:

	Three months ended December 31,				Change	
	2022		2021			
	Amount	% of Revenues	Amount	% of Revenues	$	%
Gross profit	$ 947	33.5 %	$ 983	40.2 %	$ (36)	(3.7) %

	Year ended December 31,				Change	
	2022		2021			
	Amount	% of Revenues	Amount	% of Revenues	$	%
Gross profit	$ 2,995	30.4 %	$ 3,167	34.6 %	$ (172)	(5.4) %

The gross profit and gross margin percentage changes for the three months and year ended December 31, 2022 compared to the corresponding periods in the prior year is primarily attributed to changes in average selling prices of our data storage and power supplies products, increases in components and materials costs, and changes in product mix between the prior year and the current year.

Operating Expenses:

	Three months ended December 31,				Change	
	2022		2021			
	Amount	% of Revenues	Amount	% of Revenues	$	%
Engineering	$ 66	2.3 %	$ 76	3.1 %	$ (10)	(13.2) %
Sales and marketing	307	10.9	370	15.1	(63)	(17.0)
General and administrative	347	12.3	101	4.1	246	243.6
Total operating expenses	$ 720	25.5 %	$ 547	22.4 %	$ 173	31.6 %

	Year ended December 31,				Change	
	2022		2021			
	Amount	% of Revenues	Amount	% of Revenues	$	%
Engineering	$ 336	3.4 %	$ 451	4.9 %	$ (115)	(25.5) %
Sales and marketing	1,215	12.3	1,476	16.1	(261)	(17.7)
General and administrative	1,352	13.7	809	8.8	543	67.1
Total operating expenses	$ 2,903	29.5 %	$ 2,736	29.9 %	$ 167	6.1 %

Engineering
Engineering expenses decreased for both the three months and year ended December 31, 2022 compared to the same periods in the prior year primarily due to a decrease in the number of engineering employees in both the data storage segment and the power supplies segment in the current year periods compared to the prior year periods.

Sales and Marketing
Sales and marketing expenses decreased for the three months and year ended December 31, 2022 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 increased for the three months and year ended December 31, 2022 compared to the same periods in the prior year primarily due to the prior year periods having included gains/benefits in connection with forgiveness of the PPP loans, for which a gain of approximately $258,000 was recorded in the second quarter of 2021, and a gain of approximate $263,000 was recorded in the fourth quarter of 2021.

Provision for Income Taxes
The provision for income taxes for the years ended December 31, 2022 and 2021 is comprised substantially of state minimum taxes.

Liquidity and Capital Resources
Cash, cash equivalents, and restricted cash decreased $1,394,000 to $2,801,000 at December 31, 2022 from $4,195,000 at December 31, 2021.

Operating Activities
Cash used in operating activities was $831,000 for the year ended December 31, 2022 compared with $68,000 for the year ended December 31, 2021. Cash used in operations in 2022 was primarily related to net income of $55,000 offset by non-cash expenses of $31,000, unrealized gain on marketable securities of $8,000, and cash used from changes in operating assets and liabilities of $917,000. Cash used in operations in 2021 was primarily related to net income of $430,000 offset by non-cash expenses of $41,000, non-cash gain on forgiveness of PPP loan of $521,000, and cash used from changes in operating assets and liabilities of $18,000.

Investing Activities
Cash used in investing activities was $26,000 for the year ended December 31, 2022 compared to $56,000 for the year ended December 31, 2021. Cash used in investing activities in 2022 consisted of $25,000 of purchases of marketable securities and $1,000 of purchases of property and equipment. Cash used in investing activities in 2021 consisted of $56,000 of purchases of warehouse equipment, and furniture, fixtures, and computer equipment.

Financing Activities
Cash used in financing activities for the year ended December 31, 2022 consisted of $404,000 of cash used to repurchase shares of the Company's common stock under a stock repurchase program approved by the board of directors, and $167,000 for shares cashed-out in connection with the Company's reverse/forward stock splits in September 2022. Cash provided by financing activities for the year ended December 31, 2021 consisted of $263,000 of proceeds from second draw PPP loans received during the second quarter of 2021, offset by $201,000 of cash used to repurchase shares of the Company's common stock under a stock repurchase program approved by the board of directors.

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.