

QUALSTAR CORP  
Form 10-K  
March 07, 2019

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K**

(Mark one)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2018

OR

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

COMMISSION FILE NUMBER 001-35810

**QUALSTAR CORPORATION**

(Exact Name of registrant as specified in its charter)

CALIFORNIA 95-3927330  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

130 West Cochran Street, Unit C; Simi Valley, CA 93065  
(Address of principal executive offices) (Zip Code)

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

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

Title of each class:

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

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

None

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports); and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

|                         |                   |                       |                           |                         |
|-------------------------|-------------------|-----------------------|---------------------------|-------------------------|
| Large accelerated filer | Accelerated filer | Non-accelerated filer | Smaller reporting company | Emerging Growth Company |
|-------------------------|-------------------|-----------------------|---------------------------|-------------------------|

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financing accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of June 29, 2018, the aggregate market value of the common equity held by non-affiliates of the registrant was approximately \$11,204,626 based on the closing sales price as reported on the NASDAQ Stock Market. As of March 1, 2019, there were 1,995,912 shares of common stock without par value outstanding.

**Documents Incorporated by Reference:**

None

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**QUALSTAR CORPORATION**

**FORM 10-K**

**FOR THE FISCAL YEAR ENDED DECEMBER 31, 2018**

**INDEX**

**PART I**

|                                    |    |
|------------------------------------|----|
| Item 1. Business                   | 3  |
| Item 1A. Risk Factors              | 10 |
| Item 1B. Unresolved Staff Comments | 16 |
| Item 2. Properties                 | 16 |
| Item 3. Legal Proceedings          | 17 |
| Item 4. Mine Safety Disclosures    | 17 |

**PART II**

|   |    |
|---|----|
| Item 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities | 17 |
| Item 6. Selected Financial Data   | 18 |
| Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations                         | 19 |
| Item 7A. Quantitative and Qualitative Disclosures about Market Risk   | 25 |
| Item 8. Financial Statements and Supplementary Data   | 26 |
| Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure                          | 47 |
| Item 9A. Controls and Procedures  | 47 |
| Item 9B. Other Information  | 48 |

**PART III**

|   |    |
|---|----|
| Item 10. Directors, Executive Officers and Corporate Governance   | 48 |
| Item 11. Executive Compensation   | 53 |
| Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters | 57 |
| Item 13. Certain Relationships and Related Transactions, and Director Independence                      | 59 |
| Item 14. Principal Accountant Fees and Services   | 60 |

**PART IV**

|  |    |
|--|----|
| Item 15. Exhibits, Financial Statement Schedules | 61 |
| Item 16. Form 10-K Summary                       | 62 |
| Signatures                                       | 63 |



## FORWARD-LOOKING STATEMENTS

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

## **PART I**

### **ITEM 1. BUSINESS**

#### **INTRODUCTION**

Qualstar Corporation and its Subsidiaries (“Qualstar”, the “Company”, “we”, “us” or “our”) is organized into two strategic business segments, power solutions and data storage systems. Qualstar is a leading provider of data storage systems marketed under the Qualstar brand and of high efficiency and high-density power solutions marketed under the N2Power brand. Qualstar Corporation was incorporated in California in 1984 and operates four wholly-owned subsidiaries. N2Power, Inc. was formed in 2017 to operate the Company’s power supply business. Qualstar Corporation Singapore Private Limited (“QC Singapore”) was created in 2014 to give the Company an engineering footprint in Singapore and better service our contract manufacturers and our Asian distribution partners and customers. On July 4, 2018, a wholly-owned subsidiary of Qualstar Corporation, Qualstar Limited, was created to operate the Company’s data storage business in Europe and Africa and on September 5, 2018, a wholly-owned subsidiary of Qualstar Corporation, Q-Smart Data Private Limited, was created to operate the Company’s data storage business in Asia.

Qualstar’s N2Power branded power solutions products provide unique power solutions to original equipment manufacturers (“OEMs”) for a wide range of markets, including communications networking, industrial, gaming, test equipment, LED/lighting, medical as well as other market applications. Data storage system products include highly scalable automated magnetic tape-based storage solutions used to store, retrieve and manage electronic data primarily in the network computing environment and to provide solutions for organizations requiring backup, recovery and archival storage of critical electronic information.

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

Our N2Power products provide high-efficiency and high-density AC/DC and DC/DC power solutions for a variety of applications including gaming products and data center technologies such as switches, routers, data storage, servers

and networking communications equipment. With a wide variety of feature-rich standard products and the ability to create custom and semi-custom products, we offer a comprehensive product line to OEMs that require high-value, high-efficiency power supplies to meet specific applications.

We sell our products globally through authorized resellers and directly to OEMs. N2Power utilizes contract manufacturers in Asia to produce our power solutions products. Our storage products are manufactured by us at our factory in Simi Valley, California and by our OEM suppliers in other parts of the world.



## DATA STORAGE INDUSTRY

### Background

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

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

### Strategy

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

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

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

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

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

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

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

### **Our Storage Solutions**

Today's Linear Tape-Open ("LTO") based data storage solutions yield a compelling outcome for organizations struggling to cope with fast growing data, reliable data retention and budgetary pressure. Qualstar offers LTO based data storage devices for various vertically focused business units, including but not limited to, media and entertainment, oil and gas, high performance computing, education, telecom and life sciences.

We design, develop, manufacture and market storage products which deliver cost effective data protection and archival storage to small and medium sized businesses, and to more complex small and medium enterprise environments with stringent performance and data availability requirements. We provide a wide range of storage solutions that span data storage capacities.

### ***Q Series - Tape based data storage devices***

Qualstar offers a full range of entry level and mid-range data storage solutions for customers ranging from 10 Terabytes to 6.72 Petabytes. Our Q1 appliance offers an all-in-one solution for on-location data storage needs where as our Q24, Q48 and scalable Q80 tape libraries satisfy the required data storage capacities as well as data transfer rates of entry level and mid-range customers.

### ***RLS Series - Tape based data storage devices***

These are our “Simply Reliable” robust tape libraries that are designed and manufactured in the United States to satisfy the data storage needs of mid-range customers. With built-in library enabled encryption, individual robots in each cabinet and elevator mechanism to transfer cartridges from one cabinet to other, these tape libraries offer robust data protection at a low cost of ownership. Ranging from 50 to 474 slots, using LTO 8 tape technology these libraries offer between 600 Terabytes and 5.69 Petabytes of data storage capacity and up to a 23.8 Terabytes per hour data transfer rate.

### ***XLS Series - Enterprise Class Tape based storage devices***

XLS is Qualstar’s highly modular enterprise library system delivering intelligence, density, flexibility, scalability, and ease of use, coupled with our reliability and value. XLS features Compass Architecture™, an advanced robotics design that yields superior reliability and density. XLS can be expanded from 435 tapes in easy increments to over 11,700 tapes to offer more than 140 Petabytes of data storage capacity. Our unique LRM (Library Resource Module) and MEM (Media Expansion Module) combination allows maximum density of 1368 Terabytes per sq. foot.

## **POWER SUPPLY INDUSTRY**

### **Background**

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

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

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

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

## **Strategy**

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

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

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

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

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

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

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

## **Our Power Solution Products**

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

customers.

6

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We sell standard, modified-standard and custom designed products. Standard products are sold unmodified to our customers. Modified-standard products are based on lightly modified versions of standard products. Custom products are designed specifically to the customer's specification and are not generally sold to other customers. Custom products may require non-recurring engineering and tooling costs to bring the product to production. With our core competencies in both power and mechanical design, we are an Optimized Power Systems Manufacturer (OPSM), offering complete custom power assemblies that eliminate the need for our customers to purchase additional components to integrate our power supplies into their products.

N2Power continues to develop products, such as:

The XL270 has a footprint of only 4" x 2" one of the most compact 270-Watt supplies on the market. This model offers outputs of 12, 24, 30, 48 and 56 Volts along with a 5Watt/5Volt standby output and a 6 Watt/12 Volt auxiliary output, with current sharing capabilities.

The XLM240 is a multi-purpose product that is certified for use in both IT and medical equipment. It offers 240 Watts of output cooled by a 10-cu. ft. minute fan, or 160 Watts with unobstructed convection cooling. The product is ultra-compact and is offered with 12, 15, 24 and 48-volt outputs.

The XLM500 is certified for use in both IT and medical equipment. This unit has a footprint of 5" x 3" delivering up to 500 Watts. The model is offered in 12, 15, 24, and 48 Volt outputs and can be in an open-frame or U-frame.

## CUSTOMERS

Our solution-focused product offerings are designed specifically for OEMs, information technology departments, and lower and middle market companies. We sell our storage products through our worldwide authorized distributor and reseller network. Power supplies are sold through distributors and direct through independent outside sales representatives. All of our products and services are designed and manufactured to address our customers' stringent requirements and reliability standards. The following provides additional detail on our channels:

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

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

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

We divide our worldwide sales into three geographical regions:

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

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

APAC, consisting of Asia Pacific countries.



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

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

|  | <b>Twelve Months<br/>Ended</b> |                |
|--|--------------------------------|----------------|
|  | <b>December 31,<br/>2018</b>   | <b>2017</b>    |
| Foreign revenue:                                     |                                |                |
| EMEA   | \$1,849                        | \$1,910        |
| APAC   | 3,276                          | 1,878          |
| Other foreign revenue                                | 147                            | 224            |
|  | <b>\$5,272</b>                 | <b>\$4,012</b> |
| Foreign revenue as a percentage of total net revenue | 43.1 %                         | 37.7 %         |

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

## **CUSTOMER SERVICE AND SUPPORT**

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

Standard warranties include:

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

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

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

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

## **ENGINEERING**

Our power supply engineering team work to improve our current products and create new products. Our engineers work closely with our customers to incorporate modifications for their specific project requirements.

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

We incurred engineering costs of \$0.5 million for both of the twelve months ended December 31, 2018 and 2017, representing 4.1%, and 5.0% of net revenues, respectively.

## **MANUFACTURING AND SUPPLIERS**

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

## **COMPETITION**

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

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

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

## **INTELLECTUAL PROPERTY**

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

We enter into Employee Proprietary Information and Inventions Agreements with all employees and consultants to protect our technology and designs.

## **EMPLOYEES**

As of December 31, 2018, we had 20 employees worldwide, 18 full-time and 2 part-time. We also employ a small number of consultants and temporary employees as needed. We are not a party to any collective bargaining agreement or other similar agreement. We believe that we have a good relationship with our employees.

## **AVAILABILITY OF SEC FILINGS**

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

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

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

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

The Company achieved profitability in the years ended December 31, 2018 and 2017. Prior to this year, the Company had a history of operating losses since fiscal year ended June 30, 2004. There is no assurance that management can sustain profitability.

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

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

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

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

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

***Our operating results may be impaired if demand for our technology declines or fails to develop as we expect.***

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

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

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

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

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

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

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

reduce prices in order to preserve or gain market share.

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

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

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



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

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

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

Reduced margins and increased costs associated with channel sales;

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

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

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

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

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

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

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

We also rely on software vendors to develop and support software needed for operation of our automated tape library products and their integration into the user's computing environment. Accordingly, the continued development and

future growth of the market for our tape library products will depend partly upon the ability of these vendors to meet the overall data storage and management needs of tape library purchasers and our ability to maintain relationships with these firms.

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

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

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

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

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

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

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

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

flaws may also consume our limited engineering resources and interrupt our development efforts. Significant product failures would increase our costs and result in the loss of future sales and be harmful to our business.

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

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

Experience financial, economic or political instability;

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

Provide inadequate intellectual property protection for our technology;

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

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

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

Other risks and costs associated with international operations include:

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

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

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

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

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

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

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

From time to time, we may become subject to claims or inquiries regarding an alleged unauthorized use by us of another party's intellectual property. While we currently believe the amount of ultimate liability, if any, with respect to any such actions will not materially affect our financial position, results of operations or liquidity, the ultimate

outcome of any license discussion or litigation is uncertain. Adverse resolution of any infringement claim could subject us to substantial liabilities and require us to refrain from manufacturing and selling certain products. In addition, the costs incurred in intellectual property litigation can be substantial, regardless of the outcome. As a result, our business, financial condition and operating results could be materially and adversely affected.

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

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

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

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

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

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

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

Unforeseen warranty costs that exceed established reserves;

Timing and levels of our operating expenses; or

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

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

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

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

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

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

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

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

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

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

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

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



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

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

***Changes in trade policy in the United States and other countries, including changes in trade agreements and the imposition of tariffs and the resulting consequences, may have adverse impacts on our business, results of operations and financial condition.***

The United States government has indicated and demonstrated its intent to alter its approach to international trade policy through the renegotiation, and termination, of certain existing bilateral and multi-lateral trade agreements and treaties with, and the imposition of tariffs on a wide range of products and other goods from, China and other countries. Given our primary contract manufacturer and a significant product supplier is located China, and we have limited manufacturing elsewhere, policy changes in the United States or other countries, such as the tariffs already proposed, implemented and threatened, present particular risks for us. Tariffs already announced and implemented and future tariffs may have an adverse effect on certain of our products. We cannot predict future trade policy, the terms of any renegotiated trade agreements or treaties, or tariffs and their impact on our business. A trade war could have a significant adverse effect on world trade and the world economy. To the extent that trade tariffs and other restrictions imposed by the United States or other countries increase the price of, or limit the amount of, our products or components or materials used in our products imported into the United States or other countries, or create adverse tax consequences, the cost or gross margin of our products may be adversely affected and the demand from our customers for products and services may be diminished. If we deem it necessary to alter all or a portion of our activities or operations in response to such policies, agreements or tariffs, our capital and operating costs may increase. Our ongoing efforts to address these risks may not be effective and may have long-term adverse effects on our operations and operating results that we may not be able to reverse. Such efforts may also take time to implement or to have effect, and may result in adverse quarterly financial results or fluctuations in our quarterly financial results. As a result, changes in international trade policy, changes in trade agreements and tariffs could adversely affect our business, results of operations and financial condition.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

Qualstar headquarters is located in Simi Valley, California. We occupy a building with 15,160 rentable square feet of space. Our three-year lease on this facility began December 15, 2014 and was renewed for an additional three years, expiring February 28, 2021. Rent for this facility is \$11,000 per month. Prior to May 1, 2016, our headquarters were located in Westlake Village, California.

We lease a facility in Singapore with 1,359 square feet for our power supply engineering staff. The two-year lease was effective April 1, 2016 and renewed for two years, expiring March 31, 2020. Rent for this facility is \$2,600 per month.

Qualstar entered into a lease for 5,400 square feet of rentable space at the Westlake Village, California facility, effective May 1, 2016 for our sales, finance and administration staff. Rent for this facility is approximately, \$11,000 per month. On March 21, 2016, in order to reduce operating expenses, Qualstar subleased its Westlake Village facility for approximately \$12,000 per month. The term of the sublease will expire on January 31, 2020, the same date the term of the master lease expires.

On July 1, 2015, Qualstar Corporation entered into a one-year sublease agreement with Interlink Electronics, Inc. The sublease agreement is for 1,000 square feet of space in the Qualstar building located in Simi Valley, California. Qualstar receives rent each month, equal to the base rent per square foot in the master lease, plus additional rent for common area services, utilities and other shared expenses. The space is used by Interlink Electronics for engineering and light manufacturing.

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

Qualstar 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 materially adverse impact on our financial statements, these matters are subject to inherent uncertainties and management's view of these matters may change in the future. We accrue loss contingencies in connection with our commitments and contingencies, including litigation, when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. As of December 31, 2018, an amount of \$100,000 was accrued for fees and costs related to a threatened dispute.

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

Not applicable.

## **PART II**

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

#### **Market Information**

Qualstar's common stock is traded on The NASDAQ Capital Market or NASDAQ (Symbol — QBAK). The following table sets forth the high and low closing sale prices of our common stock as reported by NASDAQ, during the periods indicated:

| <b>Period Ending</b>      | <b>Date Range</b>                        | <b>High</b> | <b>Low</b> |
|---------------------------|--|-------------|------------|
| <b>December 31, 2018:</b> |  |             |            |
| First Quarter             | January 1 <del>–</del> March 31, 2018    | \$13.50     | \$7.50     |
| Second Quarter            | April 1 <del>–</del> June 30, 2018       | \$11.50     | \$7.38     |
| Third Quarter             | July 1 <del>–</del> September 30, 2018   | \$9.18      | \$7.20     |
| Fourth Quarter            | October 1 <del>–</del> December 31, 2018 | \$8.03      | \$4.51     |
| <b>December 31, 2017:</b> |  |             |            |
| First Quarter             | January 1 <del>–</del> March 31, 2017    | \$10.00     | \$2.70     |
| Second Quarter            | April 1 <del>–</del> June 30, 2017       | \$9.47      | \$3.89     |
| Third Quarter             | July 1 <del>–</del> September 30, 2017   | \$13.20     | \$5.16     |
| Fourth Quarter            | October 1 <del>–</del> December 31, 2017 | \$10.36     | \$6.23     |

#### **Holder**s

There were approximately 21 owners of record of Qualstar's common stock as of March 1, 2019, not including beneficial owners who own their stock in street name through Cede & Co. and others.

## Dividend Policy

No dividends were declared in the twelve months ended December 31, 2018 or 2017. Any future determination to pay dividends will be at the discretion of the Company's Board of Directors and will depend upon, among many other factors, the Company's results of operations, financial condition, capital requirements and any contractual restrictions.

## Recent Sales of Unregistered Securities

None

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

The Company initiated a Stock Repurchase Program on December 5, 2018. The following table presents the information about purchases by Qualstar of its common stock during the year ended December 31, 2018:

|               |                     |                   | Maximum<br>Number of      | Maximum<br>Value of       |
|---------------|---------------------|-------------------|---------------------------|---------------------------|
|               | Total<br>Number of  | Average<br>Price  | Shares<br>Available<br>to | Shares<br>Available<br>to |
|               | Shares<br>Purchased | Paid Per<br>Share | Repurchase<br>Under the   | Repurchase<br>Under the   |
|               |                     |                   | Program                   | Program                   |
| Inception     |                     |                   | 409,000                   | \$2,400,000               |
| December 2018 | 18,102              | \$ 5.259          | 390,898                   | \$2,306,564               |

## SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

The following table provides additional information regarding Qualstar's equity compensation plans as of December 31, 2018:

| <b>Plan category</b>                                       | <b>(a)</b>   | <b>(b)</b>   | <b>(c)</b>   |
|--|--|--|--|
|  | <b>Number of securities to be issued upon exercise of outstanding options, warrants and rights (1)</b> | <b>Weighted-average exercise price of outstanding options, warrants and rights (1)</b> | <b>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</b> |
| Equity compensation plans approved by security holders     | 178,000  | \$ 7.19  | 22,000   |
| Equity compensation plans not approved by security holders | —  | —  | —  |
| Totals   | 178,000  | \$ 7.19  | 22,000   |

Includes shares subject to stock options granted under the 2017 Stock Incentive Plan and the 2008 Stock Incentive (1)Plan as of December 31, 2018. The 2008 Stock Incentive Plan has expired and no further options may be granted under the plan.

## ITEM 6. SELECTED FINANCIAL DATA

Not required for smaller reporting companies.

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

*You should read the following discussion and analysis of our financial condition and results of operations in conjunction with the consolidated financial statements and the related notes to the consolidated financial statements included later in this Annual Report on Form 10-K. In addition to historical financial information, the following discussion contains forward-looking statements that reflect our plans, estimates, beliefs and expectations that involve risks and uncertainties. Our actual results and the timing of events could differ materially from those discussed in these forward-looking statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this Annual Report on Form 10-K, particularly in "Risk Factors" and "Forward-Looking Statements."*

### OVERVIEW

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

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

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

Qualstar has established two additional subsidiaries to aid the Company's global expansion goals. On July 4, 2018, a wholly-owned subsidiary of Qualstar Corporation, Qualstar Limited, was created to support Qualstar's data storage business in Europe, Middle East and Africa. On September 5, 2018, a wholly-owned subsidiary of Qualstar Corporation, Q-Smart Data Private Limited, was created to assist the Company's data storage business growth in the

Asia Pacific region.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

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

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



## Revenue Recognition

Effective January 1, 2018, we adopted Accounting Standards Codification Topic 606, *Revenue from Contracts with Customers* (ASC 606), and we determined that the new guidance had no material impact to the revenue recognized prior to January 1, 2018 and, had no impact on retained earnings as of January 1, 2018. Accordingly, the adoption of ASC 606 had no impact on the Company's financial position, results of operations or liquidity. This standard applies to all contracts with customers, except for contracts that are within the scope of other standards, such as leases and financial instruments. Under ASC 606, 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.

We provide product warranties with varying lengths of time and terms. The product warranties are considered to be assurance-type in nature and do not cover anything beyond ensuring that the product is functioning as intended. Based on the guidance in ASC 606, assurance-type warranties do not represent separate performance obligations. We also sell separately-priced maintenance service contracts which qualify as service-type warranties and represent separate performance obligations. We have historically experienced a low rate of product returns under the warranty program.

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.

Our professional services include consulting, engineer and design services. Because control transfers over time, revenue is recognized based on progress toward completion of the performance obligation. The method to measure progress toward completion requires judgment and is based on the nature of the products or services to be provided. The Company generally uses the input method to measure progress for its contracts because it best depicts the transfer of assets to the customer, which occurs as the Company incurs costs for the contracts. Under the cost-to-cost measure of progress, the progress toward completion is measured based on the ratio of costs incurred to date to the total estimated costs at completion of the performance obligation. Revenue is recorded proportionally as costs are incurred. Costs to fulfill these obligations include labor and subcontractor costs.

One of the Company's contracts includes variable consideration that is constrained because the contract has a large number and broad range of possible consideration amounts. The Company uses an expected value method to estimate the amount of variable consideration in this contract.

The Company has elected the practical expedient to not disclose information about the transaction price that is unsatisfied as of December 31, 2018, because the transaction price only includes variable consideration that is constrained.

The Company has elected the practical expedient to not adjust the promised amount of consideration for the effects of a significant financing component for contracts where the period between when the Company transfers service and when the customer pays is one year or less.

Deferred service revenue is shown separately in the condensed consolidated balance sheets as current and long term. At December 31, 2018 we had deferred service revenue of approximately \$818,000. At December 31, 2017, we had deferred service revenue of approximately \$927,000.

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

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

### **Allowance for Doubtful Accounts**

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

### **Inventory Valuation**

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

## **Warranty Obligations**

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

## **Legal and Other Contingencies**

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

## Share-Based Compensation

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

## Accounting for Income Taxes

We estimate our tax liability based on current tax laws in the statutory jurisdictions in which we operate. These estimates include judgments about deferred tax assets and liabilities resulting from temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes, as well as about the realization of deferred tax assets. We may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained upon examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. ASC 740 also provides guidance on de-recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures.

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

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

The Company has net operating loss carry-forwards for federal income tax purposes of approximately \$30.4 million and net operating loss carry-forwards for state income tax purposes of approximately \$19.7 million. The Company has engineering and other credits for tax purposes of \$2.7 million. If not utilized, the federal net operating loss will start to

expire beginning in 2026 and other tax credit carry-forwards will start to expire beginning in 2024. If not utilized, the state net operating loss carry-forward as of December 31, 2018 will expire beginning in 2019. The state engineering credit has no limit on the carry-forward period.

### **Recent Accounting Pronouncements**

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

**RESULTS OF OPERATIONS**

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

|                            | <b>Twelve Months Ended</b> |        |             |        |  |
|----------------------------|----------------------------|--------|-------------|--------|--|
|                            | <b>December 31,</b>        |        | <b>2017</b> |        |  |
|                            | <b>2018</b>                |        | <b>2017</b> |        |  |
| Power supply revenues      | \$5,927                    | 48.5 % | \$6,297     | 59.2 % |  |
| Storage revenues:          |                            |        |             |        |  |
| Product                    | 3,111                      | 25.4 % | 2,427       | 22.8 % |  |
| Service                    | 3,191                      | 26.1 % | 1,917       | 18.0 % |  |
| Total storage revenues     | 6,302                      | 51.5 % | 4,344       | 40.8 % |  |
| Net revenues               | 12,229                     | 100.0% | 10,641      | 100.0% |  |
| Cost of goods sold         | 7,184                      | 58.7 % | 6,392       | 60.1 % |  |
| Gross profit               | 5,045                      | 41.3 % | 4,249       | 39.9 % |  |
| Operating expenses:        |                            |        |             |        |  |
| Engineering                | 502                        | 4.1 %  | 535         | 5.0 %  |  |
| Sales and marketing        | 1,337                      | 10.9 % | 1,239       | 11.6 % |  |
| General and administrative | 1,716                      | 14.0 % | 1,818       | 17.1 % |  |
| Total operating expenses   | 3,555                      | 29.1 % | 3,592       | 33.8 % |  |
| Income from operations     | 1,490                      | 12.2 % | 657         | 6.2 %  |  |
| Other income               | -                          | -      | -           | 0.0 %  |  |
| Income before income taxes | 1,490                      | 12.2 % | 657         | 6.2 %  |  |
| Provision for income taxes | 4                          | 0.0 %  | 17          | 0.2 %  |  |
| Net income                 | \$1,486                    | 12.2 % | \$640       | 6.0 %  |  |

**Comparison of the Twelve Months Ended December 31, 2018 and 2017****Change in Net Revenues:**

|  | <b>Twelve Months Ended December 31,</b> |             |               |             |                 |
|--|---|-------------|---------------|-------------|-----------------|
|  | <b>2018</b>                             |             | <b>2017</b>   |             | <b>Change</b>   |
|  | <b>Amount</b>                           | <b>% of</b> | <b>Amount</b> | <b>% of</b> | <b>Amount %</b> |
|  |   | <b>net</b>  |               | <b>net</b>  |                 |

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|                       |          | <b>revenue</b> |   |          | <b>revenue</b> |   |          |         |
|-----------------------|----------|----------------|---|----------|----------------|---|----------|---------|
| Power supply revenues | \$5,927  | 48.5           | % | \$6,297  | 59.2           | % | \$(370 ) | (5.9 )% |
| Storage revenues      | 6,302    | 51.5           | % | 4,344    | 40.8           | % | 1,958    | 45.1%   |
| Net revenues          | \$12,229 | 100.0          | % | \$10,641 | 100.0          | % | \$1,588  | 14.9%   |

The increase in net revenues is attributed to the segment-specific factors as set forth below.



**Segment Revenue**

**Power Supplies** – The decrease in sales is attributed to decreased demand from our existing customers. Key customers that incorporate our power supplies have variable life cycles and production demands. As some projects are accelerating and others approach end of life, the timing of new production creates a fluctuation in sales.

**Storage** – For the fiscal year ending December 31, 2018 compared to the prior year period, we experienced revenue growth from the sale of both products and services in our data storage segment. The increase in product revenues is attributed to new reseller relationships focused on media and entertainment, which resellers have a high demand for tape technology. With the release of LTO8 (Linear Tape-Open) tape technology and the capacity of tape libraries increasing by approximately 50%, the Company has seen a shift in sales to entry level and mid-size libraries. Our product portfolio is targeted to this market. Our service revenue increased compared to the previous year, primarily due to the product development service revenue received from our partnership with Sony Imaging Products & Solutions Inc. for the development of an enterprise class optical disk archive (“ODA”) library and an increase in our technical support revenue.

**Gross Profit:**

|              | Twelve Months Ended December 31, 2018 |                  | 2017    |                  | Change |        |
|--------------|---------------------------------------|------------------|---------|------------------|--------|--------|
|              | Amount                                | % of net revenue | Amount  | % of net revenue | Amount | %      |
| Gross profit | \$5,045                               | 41.3 %           | \$4,249 | 39.9 %           | \$796  | 18.7 % |

The gross profit increase is primarily attributed to the increase in product sales and improved profit margins on service contracts.

**Operating Expenses:**

|  | Twelve Months Ended December 31, |        | Change  |
|--|----------------------------------|--------|---------|
|  | 2018                             | 2017   |         |
|  | Amount                           | Amount | Amount% |

|                            |         | <b>% of net<br/>revenue</b> |   | <b>% of net<br/>revenue</b> |      |   |                |
|----------------------------|---------|-----------------------------|---|-----------------------------|------|---|----------------|
| Engineering                | \$502   | 4.1                         | % | \$535                       | 5.0  | % | \$(33 ) (6.2)% |
| Sales and marketing        | \$1,337 | 10.9                        | % | \$1,239                     | 11.6 | % | \$98 7.9 %     |
| General and administrative | \$1,716 | 14.0                        | % | \$1,818                     | 17.1 | % | \$(102) (5.6)% |

### ***Engineering***

Engineering expenses decreased in the twelve months ended December 31, 2018 compared to 2017, as a result of the reduction in payroll and related expenses and compliance testing costs.

### ***Sales and Marketing***

Sales and marketing expenses increased for the twelve months ended December 31, 2018 compared to 2017, as a result of an increase in payroll and related costs, additional tradeshow expenses and an increase in consulting expenses.

### ***General and Administrative***

General and administrative costs decreased for the twelve months ended December 31, 2018 compared to 2017, primarily due to the decrease in share-based compensation expense for stock options awarded to employees and board members, offset by an increase in legal fees, professional services and travel expenses.

### **Provision for Income Taxes:**

For the twelve months ended December 31, 2018 and 2017, the Company recorded a \$4,000 and \$17,000 tax provision, respectively, relating to state income taxes. The Company had a current year taxable income prior to taking into account net operating loss carryforwards for both federal and state purposes. For federal purposes, after taking into account the benefit of net operating loss carryforwards, no provision for federal taxes was necessary for the twelve months ended December 31, 2018 and 2017. For state tax purposes, after taking into account the benefit of state net operating loss carryforwards, only a small provision for state income tax was necessary, primarily due to minimum taxes in various states in which the Company has a taxable presence.

### **LIQUIDITY AND CAPITAL RESOURCES**

Cash provided from operating activities was \$0.2 million in the twelve months ended December 31, 2018 compared to \$1.0 million of cash provided in the twelve months ended December 31, 2017. The decline in cash provided by operations in 2018 was primarily related to the changes in assets and liabilities. In 2018, the Company invested in building inventory to meet increased sales demands. Inventory at December 31, 2018 was approximately \$2.9 million compared to approximately \$1.5 million at December 31, 2017.

Cash used in investing activities was \$26,000 in the twelve months ended December 31, 2018 compared to \$44,000 in the twelve months ended December 31, 2017. Our investing activities primarily include tooling for product manufacturing, and software upgrades.

Cash used in financing activities was \$54,000 in the twelve months ended December 31, 2018, \$93,000 for the repurchase of common stock offset with proceeds from the exercise of stock options. For the year ended December 31, 2017, cash provided by financing activities was \$4,000 from the exercise of stock options.

The Company continues to focus on maintaining profitability and improving cash flow. By introducing private label products, we have been able to get similar or greater margins without developing new products ourselves, allowing for less headcount and product risk. Since 2013, the Company has been adjusting headcount, facilities costs and other operating expenses to attain profitability and the Company has been profitable in the fiscal years ending December 31, 2018 and 2017. All of these efforts and our increase in revenue have contributed to our positive cash flow.

As of December 31, 2018, we had \$4.8 million in cash and cash equivalents and \$100,000 in restricted cash used as collateral for our corporate credit cards. We believe that our existing cash and cash equivalents 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 businesses, products or technologies that we believe are strategic. We periodically evaluate other companies and technologies for possible investment. 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.

## SUMMARY OF CONTRACTUAL OBLIGATIONS AND COMMITMENTS

The following is a summary of our future payments due, offset by sublease income, under contractual obligations as of December 31, 2018 (in thousands):

| <b>Contractual Obligations:</b> | <b>Total</b> | <b>Less<br/>than<br/>1<br/>Year</b> | <b>1 to 3<br/>Years</b> |
|---------------------------------|--------------|-------------------------------------|-------------------------|
| Operating Leases                | \$ 316       | \$ 150                              | \$ 166                  |

## OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not required for smaller reporting companies.



**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

|   | <b>Page</b> |
|---|-------------|
| Financial Statements                                      |             |
| Reports of Independent Registered Public Accounting Firms | 27          |
| Consolidated Balance Sheets                               | 28          |
| Consolidated Statements of Comprehensive Income (Loss)    | 29          |
| Consolidated Statements of Shareholders' Equity           | 30          |
| Consolidated Statements of Cash Flows                     | 31          |
| Notes to Consolidated Financial Statements                | 32          |

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Qualstar Corporation & Subsidiaries

**Opinion on the Financial Statements**

We have audited the accompanying consolidated balance sheet of Qualstar Corporation & Subsidiaries (the Company) as of December 31, 2018 and 2017, and the related consolidated statements of comprehensive income, stockholders' equity, and cash flows for the years ended December 31, 2018 and 2017, and the related notes (collectively referred to as the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the consolidated results of its operations and its cash flows for the years ended December 31, 2018 and 2017, in conformity with accounting principles generally accepted in the United States of America.

**Basis for Opinion**

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audit, we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/RBSM LLP

We have served  
as the  
Company's  
auditor since  
2017.

Larkspur, CA

March 7, 2019

27

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**QUALSTAR CORPORATION****CONSOLIDATED BALANCE SHEETS****(In thousands, except share amounts)**

|  | <b>December 31,</b> |             |
|--|---------------------|-------------|
|  | <b>2018</b>         | <b>2017</b> |
| <b>ASSETS</b>  |                     |             |
| Current assets:  |                     |             |
| Cash and cash equivalents  | \$4,781             | \$4,698     |
| Restricted cash  | 100                 | 100         |
| Accounts receivable, net   | 1,809               | 1,802       |
| Inventories, net   | 2,897               | 1,564       |
| Prepaid expenses and other current assets  | 180                 | 163         |
| Total current assets   | 9,767               | 8,327       |
| Property and equipment, net  | 112                 | 172         |
| Other assets   | 119                 | 68          |
| Total assets   | \$9,998             | \$8,567     |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                     |             |
| Current liabilities:   |                     |             |
| Accounts payable   | \$1,023             | \$1,065     |
| Accrued payroll and related liabilities  | 185                 | 173         |
| Deferred service revenue   | 736                 | 834         |
| Other accrued liabilities  | 559                 | 454         |
| Total current liabilities  | 2,503               | 2,526       |
| Other long-term liabilities  | 40                  | 52          |
| Deferred service revenue, long term  | 127                 | 93          |
| Total long-term liabilities  | 167                 | 145         |
| Total liabilities  | 2,670               | 2,671       |
| Commitments and contingencies (Note 10)  |                     |             |
| 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; 2,030,017 and 2,042,019 shares issued and outstanding as of December 31, 2018 and 2017, respectively | 19,426              | 19,480      |
| Accumulated deficit  | (12,098)            | (13,584)    |
| Total shareholders' equity   | 7,328               | 5,896       |
| Total liabilities and shareholders' equity   | \$9,998             | \$8,567     |

The accompanying notes are integral to the consolidated financial statements.



**QUALSTAR CORPORATION****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(In thousands, except per share amounts)**

|  | <b>Twelve Months<br/>Ended</b> |             |
|--|--------------------------------|-------------|
|  | <b>December 31,</b>            |             |
|  | <b>2018</b>                    | <b>2017</b> |
| Net revenues                                 | \$12,229                       | \$10,641    |
| Cost of goods sold                           | 7,184                          | 6,392       |
| Gross profit                                 | 5,045                          | 4,249       |
| Operating expenses:                          |                                |             |
| Engineering                                  | 502                            | 535         |
| Sales and marketing                          | 1,337                          | 1,239       |
| General and administrative                   | 1,716                          | 1,818       |
| Total operating expenses                     | 3,555                          | 3,592       |
| Income from operations                       | 1,490                          | 657         |
| Other income                                 | -                              | -           |
| Income before income taxes                   | 1,490                          | 657         |
| Provision for income taxes                   | 4                              | 17          |
| Net income                                   | \$1,486                        | \$640       |
| Comprehensive income                         | \$1,486                        | \$640       |
| Net income per share:                        |                                |             |
| Basic  | \$0.73                         | \$0.31      |
| Diluted                                      | \$0.72                         | \$0.31      |
| Shares used to compute net income per share: |                                |             |
| Basic  | 2,030                          | 2,042       |
| Diluted                                      | 2,057                          | 2,042       |

The accompanying notes are integral to the consolidated financial statements.

## QUALSTAR CORPORATION

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In thousands)

|                                      | Common Stock |                 | Accumulated<br>Other<br>Comprehensive<br>Income | Accumulated<br>Deficit | Total            |
|--------------------------------------|--------------|-----------------|---|------------------------|------------------|
|                                      | Shares       | Amount          | (Loss)  |                        |                  |
| <b>Balances at December 31, 2016</b> | <b>2,042</b> | <b>\$19,063</b> | <b>\$</b>                                       | <b>— \$ (14,224)</b>   | <b>) \$4,839</b> |
| Exercise of stock options            | 1            | 4               |   | —                      | 4                |
| Share-based compensation             | —            | 413             |   | —                      | 413              |
| Net income                           | —            | —               |   | 640                    | 640              |
| <b>Balances at December 31, 2017</b> | <b>2,043</b> | <b>\$19,480</b> | <b>\$</b>                                       | <b>— \$ (13,584)</b>   | <b>) \$5,896</b> |
| Exercise of stock options            | 5            | 39              |   | —                      | 39               |
| Stock repurchase                     | (18 )        | (93 )           |   | —                      | (93 )            |
| Share-based compensation             | —            | —               |   | —                      | —                |
| Net income                           | —            | —               |   | 1,486                  | 1,486            |
| <b>Balances at December 31, 2018</b> | <b>2,030</b> | <b>\$19,426</b> | <b>\$</b>                                       | <b>— \$ (12,098)</b>   | <b>) \$7,328</b> |

The accompanying notes are integral to the consolidated financial statements.

## QUALSTAR CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

|   | <b>Twelve Months<br/>Ended</b> |                |
|---|--------------------------------|----------------|
|   | <b>December 31,</b>            |                |
|   | <b>2018</b>                    | <b>2017</b>    |
| <b>CASH FLOW FROM OPERATING ACTIVITIES:</b>   |                                |                |
| Net income  | \$1,486                        | \$640          |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                                |                |
| Depreciation and amortization   | 86                             | 154            |
| Loss on disposal of assets  | -                              | 5              |
| (Recovery) of doubtful accounts, net  | 3                              | (7 )           |
| Provision for inventory reserve   | 362                            | 364            |
| Share-based compensation  | -                              | 413            |
| Changes in operating assets and liabilities:  |                                |                |
| Accounts receivable   | (10 )                          | (212 )         |
| Inventories   | (1,695)                        | (568 )         |
| Prepaid expenses and other assets   | (68 )                          | 11             |
| Accounts payable  | (42 )                          | 177            |
| Accrued payroll and related liabilities   | 12                             | (49 )          |
| Deferred service revenue  | (64 )                          | 35             |
| Other accrued liabilities   | 93                             | 84             |
| Net cash provided by (used in) operating activities   | 163                            | 1,047          |
| <b>CASH FLOW FROM INVESTING ACTIVITIES:</b>   |                                |                |
| Purchases of equipment  | (26 )                          | (44 )          |
| Net cash provided by (used in) investing activities   | (26 )                          | (44 )          |
| <b>CASH FLOW FROM FINANCING ACTIVITIES:</b>   |                                |                |
| Purchase of common stock  | (93 )                          | -              |
| Proceeds from the exercise of stock options   | 39                             | 4              |
| Net cash provided by (used in) financing activities   | (54 )                          | 4              |
| <b>NET INCREASE IN CASH, RESTRICTED CASH AND CASH EQUIVALENTS</b>                           | <b>83</b>                      | <b>1,007</b>   |
| <b>CASH, RESTRICTED CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>                      | <b>4,798</b>                   | <b>3,791</b>   |
| <b>CASH, RESTRICTED CASH AND CASH EQUIVALENTS, END OF PERIOD</b>                            | <b>\$4,881</b>                 | <b>\$4,798</b> |
| <b>SUPPLEMENTAL CASH FLOW DISCLOSURES:</b>  |                                |                |
| Income taxes paid   | \$32                           | \$3            |

The accompanying notes are integral to the consolidated financial statements.



## QUALSTAR CORPORATION

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### Note 1 – Significant Accounting Policies

##### Business

Qualstar Corporation and its Subsidiaries (“Qualstar”, the “Company”, “we”, “us” or “our”) is organized into two strategic business segments, power solutions and data storage systems. Qualstar is a leading provider of data storage systems marketed under the Qualstar brand and of high efficiency and high-density power solutions marketed under the N2Power brand. Qualstar Corporation was incorporated in California in 1984 and operates four subsidiaries. N2Power, Inc. was formed in 2017 to operate the Company’s power supply business and Qualstar Corporation Singapore Private Limited (“QC Singapore”) was created in 2014 to give the Company an engineering footprint in Singapore and better service our contract manufacturers and our Asian distribution partners and customers. Qualstar’s N2Power branded power solutions products provide unique power solutions to original equipment manufacturers (“OEMs”) for a wide range of markets, including communications networking, industrial, gaming, test equipment, LED/lighting, medical as well as other market applications. Data storage system products include highly scalable automated magnetic tape-based storage solutions used to store, retrieve and manage electronic data primarily in the network computing environment and to provide solutions for organizations requiring backup, recovery and archival storage of critical electronic information.

Qualstar has established two additional subsidiaries to aid in the Company’s global expansion. On July 4, 2018, a wholly-owned subsidiary of Qualstar Corporation, Qualstar Limited, was created to operate the Company’s data storage business in Europe and Africa. On September 5, 2018, a wholly-owned subsidiary of Qualstar Corporation, Q-Smart Data Private Limited, was created to operate the Company’s data storage business in Asia.

We design our products at our facilities in California and Singapore. We sell our products globally through authorized resellers and directly to OEMs. N2Power utilizes contract manufacturers in Asia to produce our power solutions products. Our storage products are manufactured by us at our factory in Simi Valley, California and by our OEM suppliers in other parts of the world.

The consolidated financial statements include our accounts and the accounts of our wholly-owned subsidiaries, N2Power, Inc., Qualstar Corporation Singapore Private Limited, Qualstar Limited and Q-Smart Data Private Limited. All significant intercompany accounts and transactions have been eliminated in consolidation.

## **Accounting Principles**

The consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”).

## **Estimates and Assumptions**

Preparing financial statements in accordance with 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.



## 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.

At December 31, 2018, we had deferred revenue of approximately \$863,000 and no deferred profit. At December 31, 2017, we had deferred revenue of approximately \$927,000 and no deferred profit.

## 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, 2017 and 2016, \$100,000 is restricted for use as collateral for the Company's credit cards.

### **Concentration of Credit Risk, Other Concentration Risks and Significant Customers**

Qualstar sells its products primarily through value added resellers located worldwide. Ongoing credit evaluations of customers' financial condition are performed by Qualstar, and generally, collateral is not required. Potential uncollectible accounts have been provided for in the financial statements.

We have no outstanding debt nor do we utilize auction rate securities or derivative financial instruments in our investment portfolio. Cash and other investments may be in excess of FDIC insurance limits.

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. Sales outside North America represented approximately 43.1% of net revenues for the twelve months ended December 31, 2018 and 37.7% of net revenues for the twelve months ended December 31, 2017.

Revenues from Qualstar's largest customer totaled approximately 12.6% and 13.2% of revenues for the twelve months ended December 31, 2018 and 2017, respectively. At December 31, 2018, the largest customer's accounts receivable balance, net of specific allowances, totaled approximately 2.0% of net accounts receivable. At December 31, 2017, the largest customer's accounts receivable balance, net of specific allowances, totaled approximately 9.3% of net accounts receivable.

## Suppliers

The primary suppliers of our power supplies segment, N2Power, are located in China. The primary suppliers of our tape storage products are located in California and Germany. If a manufacturer should be unable to deliver products to us in a timely basis or at all, our power supply or data storage business could be adversely affected. Though we have many years of favorable experience with these suppliers, there can be no assurance that circumstances might not change and compel a supplier to curtail or terminate deliveries to us.

## 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. Activity in the allowance for doubtful accounts was as follows (in thousands):

| Description                           | Balance<br>at<br>Beginning<br>of<br>Period | Charged<br>to Costs<br>and<br>Expenses | Charged<br>to Other<br>Accounts | Deductions<br>(1) | Balance<br>at<br>End of<br>Period |
|---------------------------------------|--|--|---------------------------------|-------------------|-----------------------------------|
| Twelve months ended December 31, 2018 | \$ 54                                      | \$ 8                                   | \$ —                            | \$ (5             | ) \$ 57                           |
| Twelve months ended December 31, 2017 | \$ 61                                      | \$ 3                                   | \$ —                            | \$ (10            | ) \$ 54                           |

(1)Uncollectible accounts written off, net of recoveries.

## Inventories, net

Inventories are stated at the lower of cost 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 (in years) | 5-7 |
| Furniture and fixtures (in years)  | 5-7 |
| Leasehold Improvements (in years)  | 3-5 |
| Computer equipment (in years)      | 3-5 |

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 reviews the impairment of long-lived assets 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.

### 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.

### Warranty Obligations

We provide a three-year advance replacement warranty on all XLS and RLS libraries and a two year warranty on our Q-Series libraries. This includes replacement of components, or if necessary, complete libraries. XLS libraries sold in North America also include one year of onsite service. Customers may purchase on-site service if they are located in the United States, Canada, 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.

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

Activity in the liability for product warranty (included in other accrued liabilities) for the periods presented is as follows (in thousands):

|                                 | <b>December</b> |             |
|---------------------------------|-----------------|-------------|
|                                 | <b>31,</b>      |             |
|                                 | <b>2018</b>     | <b>2017</b> |
| Beginning balance               | \$322           | \$236       |
| Cost of warranty claims         | (15 )           | (37 )       |
| Accruals for product warranties | 58              | 123         |
| Ending balance                  | \$365           | \$322       |

### 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. Advertising and promotion expenses for the years ended December 31, 2018 and 2017 were approximately \$92,000 and \$49,000, respectively.

### **Fair Value Measurements**

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

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

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

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

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

The following table presents our cash and cash equivalents and restricted cash measured at fair value on a recurring basis at December 31, 2018 and 2017 (in thousands):

|                 | <b>December 31, 2018</b> |                   |                   |              |                    |
|-----------------|--------------------------|-------------------|-------------------|--------------|--------------------|
|                 | <b>Adjusted</b>          | <b>Unrealized</b> | <b>Unrealized</b> | <b>Fair</b>  | <b>Cash &amp;</b>  |
|                 | <b>Cost</b>              | <b>Gains</b>      | <b>Losses</b>     | <b>Value</b> | <b>Cash</b>        |
|                 |                          |                   |                   |              | <b>Equivalents</b> |
| Level 1:        |                          |                   |                   |              |                    |
| Cash            | \$4,781                  | \$ -              | \$ -              | \$4,781      | \$ 4,781           |
| Restricted Cash | 100                      | -                 | -                 | 100          | 100                |
| Total           | \$4,881                  | \$ -              | \$ -              | \$4,881      | \$ 4,881           |

|                 | <b>December 31, 2017</b> |                   |                   |              |                    |
|-----------------|--------------------------|-------------------|-------------------|--------------|--------------------|
|                 | <b>Adjusted</b>          | <b>Unrealized</b> | <b>Unrealized</b> | <b>Fair</b>  | <b>Cash &amp;</b>  |
|                 | <b>Cost</b>              | <b>Gains</b>      | <b>Losses</b>     | <b>Value</b> | <b>Cash</b>        |
|                 |                          |                   |                   |              | <b>Equivalents</b> |
| Level 1:        |                          |                   |                   |              |                    |
| Cash            | \$4,698                  | \$ -              | \$ -              | \$4,698      | \$ 4,698           |
| Restricted Cash | 100                      | -                 | -                 | 100          | 100                |
| Total           | \$4,798                  | \$ -              | \$ -              | \$4,798      | \$ 4,798           |

### 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 (vesting can be immediate or over a period of four years) 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 carry forwards. 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.

### **Earnings per Share**

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



## Recent Accounting Guidance

### *Recent accounting guidance not yet adopted*

In July 2018, the FASB issued ASU 2018-10 and 2018-11 to provide additional guidance related to accounting for leases, such as the application of an implicit rate, lessee reassessment of lease classification and certain transition adjustments. These standards are effective for fiscal years beginning after December 15, 2018. ASU 2018-10 is not expected to have a material impact on the Company's condensed consolidated financial statements. The Company will elect ASU-11's alternative transition approach of recording lease liabilities and right-of-use assets via a cumulative effect adjustment to retained earnings at the date of adoption. On July 2018, the FASB issued ASU 2018-09, "Codification Improvements". This ASU makes changes to a variety of topics to provide clarification and correction of errors to the Accounting Standards Codification. The majority of the amendments in ASU 2018-09 are effective for the Company after December 15, 2018. We are evaluating the impact ASU 2018-09 may have on our condensed consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07 as a simplification for the accounting for nonemployee share-based payment transactions resulting from expanding the scope of Topic 718, Compensation-Stock Compensation. This standard is effective for fiscal years beginning after December 15, 2018. We are evaluating the impact ASU 2018-07 may have on our condensed consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02 to provide guidance related to adjustments for deferred tax assets and liabilities based on the changes created by the U.S. federal government tax bill enacted December 22, 2017. This standard is effective for fiscal years beginning after December 15, 2018. We are evaluating the impact ASU 2018-02 may have on our condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02 to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. For related party leases, the basis will be the legally enforceable terms and conditions of the arrangement. The FASB has also issued ASU 2018-10 to narrow aspects of the guidance in 2016-02, with the same effective date. This standard is effective for fiscal years beginning after December 15, 2018. The Company will adopt the new guidance using the alternative transition approach, by recording lease liability and right-to-use asset via a cumulative catch adjustment as of January 1, 2019, and will adopt the basket of practical expedients and the practical expedient to combine lease and non-lease components. Adoption of ASU 2016-02 is expected to result in the recording of a lease liability and corresponding right-to-use asset (before offset of existing deferred rent) of approximately \$500 thousand at January 1, 2019 and will have no effect on the Company's consolidated results of operations or consolidated cash flows.

***Recent accounting guidance adopted***

In August 2016, the FASB issued ASU 2016-15 to reduce the existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. Effective January 1, 2018, the Company adopted ASU 2016-15 and it did not have a material effect on our consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16 to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. Effective January 1, 2018, the Company adopted ASU 2016-15 and it did not have a material effect on our consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01 clarifying the definition of a business and adding guidance to evaluate whether transactions should be accounted for as acquisitions or disposals of assets or businesses. Effective January 1, 2018, the Company adopted ASU 2016-15 and it did not have a material effect on our consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09 to provide clarity and reduce both diversity in practice and cost and complexity, when applying the guidance for stock compensation, to a change to the terms or conditions of a share-based payment award. Effective January 1, 2018, the Company adopted ASU 2017-09 and it did not have a material effect on our consolidated financial statements.

**Note 2 – Balance Sheet Details***Inventories, net*

Inventories consist of the following, in thousands:

|                  | <b>December<br/>31,<br/>2018</b> | <b>December<br/>31,<br/>2017</b> |
|------------------|----------------------------------|----------------------------------|
| Raw materials    | \$ 136                           | \$ 55                            |
| Finished goods   | 2,761                            | 1,509                            |
| Inventories, net | \$ 2,897                         | \$ 1,564                         |

*Property and Equipment, net*

The components of property and equipment are as follows, in thousands:

|  | <b>December<br/>31,<br/>2018</b> | <b>December<br/>31,<br/>2017</b> |
|--|----------------------------------|----------------------------------|
| Leasehold improvements                         | \$ 114                           | \$ 114                           |
| Furniture and fixtures                         | 286                              | 268                              |
| Machinery and equipment                        | 844                              | 842                              |
| Total property and equipment                   | 1,244                            | 1,224                            |
| Less accumulated depreciation and amortization | (1,132 )                         | (1,052 )                         |
| Property and equipment, net                    | \$ 112                           | \$ 172                           |

Depreciation and amortization expense for the year ended December 31, 2018 and 2017 was \$85,000, \$154,000, respectively.

*Accrued Payroll and Related Liabilities*

The components of accrued payroll and related liabilities are as follows, in thousands:

|   | <b>December<br/>31,<br/>2018</b> | <b>December<br/>31,<br/>2017</b> |
|---|----------------------------------|----------------------------------|
| Accrued salaries and payroll taxes            | \$ 66                            | \$ 59                            |
| Accrued vacation                              | 119                              | 114                              |
| Accrued bonuses                               | -                                | -                                |
| Total accrued payroll and related liabilities | \$ 185                           | \$ 173                           |

**Other Accrued Liabilities**

The components of other accrued liabilities are as follows, in thousands:

|                                 | <b>December<br/>31,<br/>2018</b> | <b>December<br/>31,<br/>2017</b> |
|---------------------------------|----------------------------------|----------------------------------|
| Accrued warranty                | \$ 365                           | \$ 322                           |
| Accrued outside commissions     | 41                               | 69                               |
| Accrued contingent legal fees   | 100                              | -                                |
| Accrued deferred rent           | 22                               | 29                               |
| Other accrued liabilities       | 31                               | 34                               |
| Total other accrued liabilities | \$ 559                           | \$ 454                           |

**Note 3 – Income Taxes**

The provision for (benefit from) income taxes is comprised of the following, in thousands:

|  | <b>December<br/>31,<br/>2018</b> | <b>December<br/>31,<br/>2017</b> |
|--|----------------------------------|----------------------------------|
| Current:   |                                  |                                  |
| Federal (Net of a net operating loss benefit of \$288) | \$ —                             | \$ —                             |
| State (Net of a net operating loss benefit of \$97)    | 3                                | 13                               |
| Foreign  | 1                                | 4                                |
| Provision for income taxes                             | 4                                | 17                               |
| Deferred:  |                                  |                                  |
| Federal  | —                                | —                                |
| State  | —                                | —                                |
| Deferred income tax                                    | \$ —                             | \$ —                             |
| Net income tax expense                                 | \$ 4                             | \$ 17                            |

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

**Twelve Months  
Ended**

**December 31,  
2018 2017**

|  |        |         |
|--|--------|---------|
| Statutory federal income tax benefit                       | 21.0 % | 34.0 %  |
| State income taxes, net of federal income tax benefit      | 6.6    | 13.6    |
| Foreign income taxes, net of federal income tax benefit    | —      | 6.4     |
| Engineering credits  | —      | 3.4     |
| Tax effect of change in federal tax rate (from 34% to 21%) | —      | 649.5   |
| Valuation allowance  | (26.6) | (712.0) |
| Other  | (0.6 ) | 7.8     |
| Effective federal income tax rate                          | 0.4 %  | 2.7 %   |

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

|  | <b>December<br/>31,<br/>2018</b> | <b>December<br/>31,<br/>2017</b> |
|--|----------------------------------|----------------------------------|
| Deferred tax assets:   |                                  |                                  |
| Net operating loss carry forwards                                  | \$ 7,675                         | \$ 8,002                         |
| Engineering credit carry forwards                                  | 1,919                            | 1,919                            |
| Inventory reserves   | 558                              | 646                              |
| Capital loss and other credit carry forwards                       | —                                | —                                |
| Allowance for bad debts and returns                                | 16                               | 17                               |
| Capitalized inventory costs, stock compensation and other accruals | 520                              | 500                              |
| Total gross deferred tax assets                                    | 10,688                           | 11,084                           |
| Less valuation allowance on deferred tax assets                    | (10,688 )                        | (11,084 )                        |
| Net deferred tax assets  | —                                | —                                |
| Deferred tax liabilities:  |                                  |                                  |
| Depreciation and other   | —                                | —                                |
| Total deferred tax liabilities                                     | —                                | —                                |
| Net deferred taxes   | \$ —                             | \$ —                             |

On December 22, 2017, H.R. 1 (the “Tax Act”), originally known as the Tax Cuts and Jobs Act, was enacted in the United States. In addition to reducing the corporate tax rate to 21% effective January 1, 2018, the Tax Act contains many other tax provisions that affect recorded deferred tax assets and liabilities. The majority of these new provisions are also effective as of January 1, 2018, though there are a few that are effective during the 2017 calendar year. Although for 2017 the Company had federal alternative minimum tax (“AMT”) of approximately \$12,000, the Tax Act eliminated the AMT effective January 1, 2018, and provides that any AMT credit carryforwards will be refunded. Accordingly, the 2017 AMT tax liability is being treated as a receivable, and was not treated as a current tax expense in 2017. In addition, the Tax Act provided new rules related to global intangible low-taxed income (“GILTI”). The Tax Act provides that a U.S. shareholder of any controlled foreign corporation (“CFC”) must include in taxable income its pro rata shares of GILTI income. The Company accounts for taxes related to GILTI as such income is incurred, however, currently, the Company’s share of GILTI income is immaterial.

As previously indicated, the Company records a valuation allowance against its net deferred income tax assets in accordance with ASC 740 “Income Taxes” 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 year ended December 31, 2018, and the year ended December 31, 2017, the Company has recognized a full valuation allowance on net deferred tax assets.

The Company has net operating loss carry-forwards for federal income tax purposes of approximately \$30.4 million as of December 31, 2018 and \$31.7 million as of December 31, 2017. The Company has net operating loss carry-forwards for state income tax purposes of approximately \$19.7 million as of December 31, 2018 and \$20.6

million as of December 31, 2017. The Company had engineering and other credit carryforwards for tax purposes of \$2.7 million as of December 31, 2018 and \$2.7 million as of December 31, 2017.

If not utilized, the federal net operating loss will expire beginning in 2026, and other tax credit carry-forwards will expire beginning in 2024. If not utilized, the state net operating loss carry-forward as of December 31, 2018 will begin to expire beginning in 2019. The state engineering credit has no limit on the carry-forward period.

For U.S. purposes, the Company has completed its evaluation of the net operating loss (“NOL”) and credit carryforward utilization limitations under Internal Revenue Code, as amended (the “Code”) Section 382/383, change of ownership rules as of December 31, 2017. The Company has determined that it has not had a change in ownership within the meaning of IRC 382/383. Management is of the opinion that its NOL and credit carryforwards should not be limited, as to the amount that could be utilized each year, based on the Code, at the date of this filing.



The following table summarizes the activity related to the Company's uncertain tax positions (in thousands):

|  | <b>December<br/>31,<br/>2018</b> | <b>December<br/>31,<br/>2017</b> |
|--|----------------------------------|----------------------------------|
| Beginning Balance  | \$ 29                            | \$ 29                            |
| Increases related to tax positions taken in current year   | —                                | —                                |
| Increases related to tax positions taken in prior year     | —                                | —                                |
| Decreases due to lapse of statute of limitations           | —                                | —                                |
| Related interest and penalties, net of federal tax benefit | —                                | —                                |
| Balance at December 31                                     | \$ 29                            | \$ 29                            |

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 at December 31, 2018. The Company files its tax returns by the laws of the jurisdictions in which it operates. The Company's federal tax returns for fiscal years June 30, 2015 and subsequent and California tax returns for fiscal years June 30, 2014 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, 2018. As of December 31, 2018, the operations of Qualstar Corporation Singapore Private Limited ("QC Singapore") and Qualstar Limited were not material for tax purposes and had no significant impact on the year-end tax provision.

#### **Note 4 – Preferred Stock**

Qualstar's Articles of Incorporation allow for the Board of Directors to issue 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 future vote or action by the shareholders. At December 31, 2018 and 2017, there were no outstanding shares of preferred stock.

## **Note 5 –Stock Based Compensation**

No share-based compensation associated with outstanding stock options and restricted stock grants was recorded during the twelve months ended December 31, 2018. Approximately \$413,000 was recorded for the twelve months ended December 31, 2017. No income tax benefit was recognized in the statements of comprehensive income (loss) for share-based arrangements in any period presented.

### **Stock Option Plan**

The Company has two share-based compensation plans as described below.

Qualstar adopted the 2008 Stock Incentive Plan (the “2008 Plan”) under which incentive and nonqualified stock options and restricted stock may be granted for shares of common stock. The 2008 Plan expired in 2018 and no additional options may be granted under that plan. However, 20,000 options that were previously granted under the 2008 Plan will continue under their terms.

The 2017 Stock Incentive Plan (the “2017 Plan”) was approved by Qualstar shareholders on June 13, 2017. 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 200,000 shares of common stock and the 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 inputs, including 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. No options were granted in the fiscal year ended December 31, 2018. The following table summarizes the assumptions used in the Black-Scholes model to determine the fair value of stock options granted in the fiscal year ended December 31, 2017.

|   |                         |   |
|---|-------------------------|---|
|   | Fiscal<br>Year<br>Ended |   |
|   | December<br>31, 2017    |   |
| Expected lives, in years                  | 5.0                     |   |
| Estimated volatility                      | 36.89                   | % |
| Dividend yield                            | —                       |   |
| Risk-free interest rate                   | 1.92                    | % |
| Weighted average fair value on grant date | \$ 2.50                 |   |

The following table summarizes all stock option activity:

| <b>Options</b>                   | <b>Shares</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price per<br/>Share</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Term<br/>(years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|----------------------------------|---------------|--|--|--|
| Outstanding at December 31, 2016 | 23,333        | 9.49   | 6.43   | —  |
| Granted                          | 165,300       | 7.08   | —  | —  |
| Exercised                        | (600 )        | 7.08   | —  | —  |

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|                                  |          |         |      |      |
|----------------------------------|----------|---------|------|------|
| Forfeited, canceled or expired   | —        | —       | —    | —    |
| Outstanding at December 31, 2017 | 188,033  | 7.38    | 8.63 | —    |
| Granted                          | —        | —       | —    | —    |
| Exercised                        | (5,500 ) | 7.08    | —    | —    |
| Forfeited, canceled or expired   | (4,533 ) | 15.23   | —    | —    |
| Outstanding at December 31, 2018 | 178,000  | 7.19    | 8.63 | —    |
| Exercisable at December 31, 2018 | 178,000  | \$ 7.19 | 8.63 | \$ — |

At December 31, 2018 and 2017, there is no unrecognized compensation cost related to non-vested share-based compensation awards granted. No shares vested during the year ended December 31, 2018. The total fair value of shares vested for the year ended December 31, 2017 was \$413,000.

**Note 6 – Stockholders’ Equity**

On December 5, 2018, the board of directors approved a stock repurchase program (the “Stock Repurchase Program”) to repurchase shares of the Company’s common stock. The program permitted repurchases of up to a maximum aggregate purchase price of \$2,400,000 and the number of shares of Common Stock repurchased shall not exceed 409,000. As of December 31, 2018, under the Stock Repurchase Program 18,102 shares have been repurchased and the program expires December 5, 2019.

**Note 7 – Net Earnings Per Share**

Basic net earnings per share has been computed by dividing net income or loss by the weighted average number of common shares outstanding. Diluted net earnings per share has been computed by dividing net earnings by the weighted average common shares outstanding plus dilutive securities or other contracts to issue common stock as if these securities were exercised or converted to common stock.

The following table sets forth the computation of basic and diluted net income or loss per share for the periods indicated, in thousands, except per share amounts.

|  | <b>December<br/>31,<br/><br/>2018</b> | <b>December<br/>31,<br/><br/>2017</b> |
|--|---------------------------------------|---------------------------------------|
| In thousands (except per share amounts):                     |                                       |                                       |
| Net income (a)   | \$ 1,486                              | \$ 640                                |
| Weighted average outstanding shares of common stock (b)      | 2,030                                 | 2,042                                 |
| Dilutive potential common shares from employee stock options | 27                                    | -                                     |
| Common stock and common stock equivalents (c)                | 2,057                                 | 2,042                                 |
| Income per share:  |                                       |                                       |
| Basic net income per share (a)/(b)                           | \$ 0.73                               | \$ 0.31                               |
| Diluted net income per share (a)/(c)                         | \$ 0.72                               | \$ 0.31                               |

For the twelve months ended December 31, 2018, 4,666 outstanding stock options were excluded from the calculation of diluted net income per share as their inclusion would have been anti-dilutive.

**Note 8 – Commitments**

Qualstar leases a 15,160 square foot facility located in Simi Valley, California. The three-year lease began December 15, 2014 and has been renewed for an additional three years, expiring February 28, 2021. Rent on this facility is \$11,000 per month with a step-up of 3% annually. Qualstar subleases a portion of the warehouse space to Interlink Electronics, Inc. (“Interlink”) and is reimbursed for the space and other related expenses on a monthly basis. As described in Note 14, Interlink is a related party.

Qualstar also leases approximately 5,400 square feet of office space in Westlake Village, California, that expires January 31, 2020. Rent on this facility is \$11,000 per month, with a step-up of 3% annually. Effective March 21, 2016, Qualstar entered into a sublease agreement for the Westlake Village facility. The term of the sublease expires at the same time as the term of the master lease and the tenant pays Qualstar \$12,000 per month with a step-up of 3% annually.

Effective April 1, 2016, a two-year lease was signed for 1,359 square feet for \$2,500 per month in Singapore, which has been renewed until March 31, 2020.

The Company provides for rent expense on a straight-line basis over the lease terms.

Future minimum lease payments under these leases are as follows:

| Years Ending December 31, | Minimum<br>Lease<br>Payment | Net                 |                             |
|---------------------------|-----------------------------|---------------------|-----------------------------|
|                           |                             | Sublease<br>Revenue | Minimum<br>Lease<br>Payment |
| 2019                      | 297                         | (147 )              | 150                         |
| 2020                      | 155                         | (12 )               | 143                         |
| 2021                      | 23                          | -                   | 23                          |
| Total Commitment          | \$ 475                      | \$ (159 )           | \$ 316                      |

Rent expense for the twelve months ended December 31, 2018 and 2017 was \$151,000 and \$145,000, respectively.

#### Note 9 – Segment Information

Based on the provisions of ASC 280, “Segment Reporting,” and the manner in which the Chief Operating Decision Maker analyzes the business, Qualstar has determined that it has two separate operating segments: power supply and data storage. Segment revenue, loss before income taxes and total assets were as follows, in thousands:

|                    | Twelve Months<br>Ended |          |
|--------------------|------------------------|----------|
|                    | December 31,<br>2018   | 2017     |
| <b>Revenue</b>     |                        |          |
| Power Supplies     | \$5,927                | \$6,297  |
| Data Storage:      |                        |          |
| Product            | 3,111                  | 2,427    |
| Service            | 3,191                  | 1,917    |
| Total Data Storage | \$6,302                | \$4,344  |
| Total Revenue      | \$12,229               | \$10,641 |

**Twelve  
Months  
Ended**

**December 31,  
2018 2017**

**Income (loss) before Taxes**

|                |          |      |
|----------------|----------|------|
| Power Supplies | \$(153 ) | \$27 |
| Data Storage   | 1,643    | 630  |

|   |         |       |
|---|---------|-------|
| Total Income (Loss) before Income Taxes | \$1,490 | \$657 |
|---|---------|-------|



|                           | <b>December<br/>31,<br/>2018</b> | <b>December<br/>31,<br/>2017</b> |
|---------------------------|----------------------------------|----------------------------------|
| <b>Total Assets</b>       |                                  |                                  |
| Power Supplies            |                                  |                                  |
| Cash and cash equivalents | 381                              | 721                              |
| Accounts receivable, net  | 1,048                            | 831                              |
| Inventories, net          | 1,576                            | 725                              |
| Property and equipment    | 47                               | 64                               |
| Other assets              | 102                              | 8                                |
|                           | 3,154                            | 2,349                            |
| Data Storage              |                                  |                                  |
| Cash and cash equivalents | 4,400                            | 3,977                            |
| Restricted cash           | 100                              | 100                              |
| Accounts receivable, net  | 761                              | 971                              |
| Inventories, net          | 1,321                            | 839                              |
| Property and equipment    | 65                               | 108                              |
| Other assets              | 197                              | 223                              |
|                           | 6,844                            | 6,218                            |
| Total Assets              | \$ 9,998                         | \$ 8,567                         |

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 power supplies and data storage. The two segments discussed in this analysis are presented in the way we internally managed and monitored performance for the twelve months ended December 31, 2018. Internal resources were billed for the twelve months ended December 31, 2018 and 2017. Until the creation of our subsidiary to operate our power supply business, the power supplies segment tracked certain assets separately, and all others were recorded in the data storage segment for internal reporting presentations. Upon the creation of N2Power, Inc., the assets were separated and the internal resources were billed appropriately.

The types of products and services provided by each segment are summarized below:

**Power Supplies** — The Company designs, manufactures, and sells small, open frame, 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 telecommunications equipment, machine tools, routers, switches, wireless systems and gaming devices.

**Data Storage** — The Company designs, manufactures, supports and sells data storage devices used to store, retrieve and manage electronic data primarily in network computing environments. Tape libraries consist of cartridge tape drives, tape cartridges and robotics to move the cartridges from their storage locations to the tape drives under software

control. Our tape libraries provide data storage solutions for organizations requiring backup, recovery and archival storage of critical data.

Geographic Information

Information regarding revenues attributable to Qualstar's primary geographic operating regions is as follows, in thousands:

|                              | <b>Twelve Months<br/>Ended</b> |             |
|------------------------------|--------------------------------|-------------|
|                              | <b>December 31,</b>            |             |
|                              | <b>2018</b>                    | <b>2017</b> |
| <b>Total Revenue:</b>        |                                |             |
| North America                | \$6,957                        | \$6,629     |
| Europe                       | 1,849                          | 1,910       |
| Asia Pacific                 | 3,276                          | 1,878       |
| Other                        | 147                            | 224         |
|                              | \$12,229                       | \$10,641    |
| <b>Power Supply Revenue:</b> |                                |             |
| North America                | 3,356                          | 3,787       |
| Europe                       | 1,220                          | 1,262       |
| Asia Pacific                 | 1,351                          | 1,248       |
| Other                        | —                              | —           |
|                              | \$5,927                        | \$6,297     |
| <b>Data Storage Revenue:</b> |                                |             |
| North America                | 3,601                          | 2,842       |
| Europe                       | 629                            | 648         |
| Asia Pacific                 | 1,925                          | 630         |
| Other                        | 147                            | 224         |
|                              | \$6,302                        | \$4,344     |

The geographic classification of revenues is based upon the location to which the product is shipped. Qualstar does not have any significant long-lived assets outside of the United States.

**Note 10 – Legal Proceedings**

Qualstar 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 financial statements, these matters are subject to inherent uncertainties and management's view of these matters may change in the future. We accrue loss contingencies in

connection with our commitments and contingencies, including litigation, when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. As of December 31, 2018, an amount of \$100,000 was accrued for fees and costs related to a threatened dispute. No accrual was necessary as of December 31, 2017.

#### **Note 11 – Benefit Plans**

Qualstar 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. Qualstar, at the discretion of management, may make matching contributions in an amount equal to 25% of the first 6% of compensation contributed by eligible participants. Qualstar suspended the discretionary matching contribution effective August 2009.

#### **Note 12 – Related Party Transactions**

Steven N. Bronson is the Company’s CEO and is also the President and CEO and a majority shareholder of Interlink Electronics, Inc. (“Interlink”) and BKF Capital Group, Inc. (“BKF”). Interlink reimburses Qualstar for leased space at the Simi Valley facility and for other administrative expenses paid by or on behalf of the Company. The total amount charged to Interlink for the twelve months ended December 31, 2018 and 2017, was \$17,000 and \$13,000, respectively. Interlink owed Qualstar \$2,000 and \$2,000 at December 31, 2018 and December 31, 2017, respectively.

The Company reimburses Interlink for expenses paid on the Company's behalf. On December 1, 2017, the Company entered into a Consulting Agreement with Interlink. Pursuant to the Consulting Agreement, Interlink performs project management services to the Company. Interlink receives \$15,000 per month, or less depending on the project, plus expenses for these services. Also, Interlink occasionally pays travel and other expenses incurred by Qualstar employees. The Company reimbursed Interlink \$213,000 and \$28,000 for the twelve months ended December 31, 2018 and 2017, respectively. Qualstar owed Interlink \$3,000 and \$17,000, at December 31, 2018 and December 31, 2017, respectively.

The Company reimburses BKF for expenses paid on the Company's behalf. BKF occasionally pays consulting expenses incurred by Qualstar. The Company reimbursed BKF \$1,000 for the twelve months ended December 31, 2018 and no expenses were reimbursed for the twelve months ended December 31, 2017. Qualstar owed BKF \$1,000 at December 31, 2018 and no amount as of December 31, 2017.

#### **Note 13 – Subsequent Events**

None.

#### **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

#### **ITEM 9A. CONTROLS AND PROCEDURES**

##### **Evaluation of Disclosure Controls and Procedures**

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of Qualstar's disclosure controls and procedures as of December 31, 2018, pursuant to Rule 13a-15 under the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our

disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms, and to ensure that the information required to be disclosed by us in reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

#### Changes in Internal Control over financial reporting

We did not make any changes in our internal control over financial reporting during the twelve months ended December 31, 2018 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2018. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in "Internal Control – Integrated Framework" in 2013. Based on our assessment, we have concluded that, as of December 31, 2018, our internal control over financial reporting was effective based on those criteria.

This Annual Report on Form 10-K does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting due to the exemption of smaller reporting companies from the attestation requirements of Section 404 of the Sarbanes-Oxley Act.

## **ITEM 9B. OTHER INFORMATION**

None.

## **PART III**

## **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

### **DIRECTORS**

The following table sets forth certain information about the current directors of our Company. Directors are elected annually and hold office until the next annual meeting of shareholders or until their successors are elected and qualified. There are no family relationships among any of our directors and executive officers. For biographical information regarding our directors, see the discussion under "Biographical Information — Directors," below.

| <b>Name</b>            | <b>Age</b> | <b>Position</b>                                 |
|------------------------|------------|---|
| Steven N. Bronson      | 53         | President, Chief Executive Officer and Director |
| David J. Wolenski      | 57         | Director and Chairman of the Board of Directors |
| Leonard A. Hagan       | 66         | Director  |
| Nicholas A. Yarymovych | 54         | Director  |

### **EXECUTIVE OFFICERS AND OTHER KEY OFFICERS**

The following table sets forth certain information about the current executive officers and other key officers of our Company. There are no family relationships among any of our directors and executive officers. For biographical information regarding our executive officers, see the discussion under “Biographical Information — Executive Officers and other Key Officers,” below.

| <b>Name</b>       | <b>Age</b> | <b>Position</b>                       |
|-------------------|------------|---------------------------------------|
| Steven N. Bronson | 53         | President and Chief Executive Officer |
| Louann L. Negrete | 59         | Chief Financial Officer               |

## **BIOGRAPHICAL INFORMATION**

### **Background on Director Qualifications**

All Board members are expected to possess certain personal characteristics necessary to creating a functional Board: high personal and professional ethics, integrity and values; practical wisdom and mature judgment; an inquisitive and objective perspective; professional experience at a policy-making level in business; time availability for in-person participation at Board and committee meetings; and a commitment to representing the long-term interests of our shareholders. Directors are elected annually and hold office until the next annual meeting of shareholders or until their successors have been elected and qualified.

### **Directors**

Steven N. Bronson has served as our Chief Executive Officer and a member of our board since July 3, 2013. Mr. Bronson has over 35 years of business and entrepreneurial experience with a strong background in investment banking, operations and management. Mr. Bronson has been Chairman and Chief Executive Officer of BKF Capital Group Inc., since September 2008. In July 2010 he became Chairman and Chief Executive of Interlink Electronics, Inc., a global leader in the design of patented Force-Sensing Resistor™ (FSR™) technology and a pioneer in printed electronics. In addition, Mr. Bronson served as Chairman and Chief Executive Officer of Ridgefield Acquisition Corp. and 4net Software, Inc., both publicly traded companies. The Board has concluded that Mr. Bronson should serve on our Board based on his positions as President and Chief Executive Officer of our company, as well as his substantial experience in the electronics industry.



David J. Wolenski currently serves as President of Electro-Mechanical Products, Inc. (“EMP”), a privately held company engaged in the manufacture of precision-machined components and thermal management systems for the Semiconductor, Laser, and Medical Device industries. He has been a director on EMP’s board since August 2000.

From 1996 to 2000, Mr. Wolenski was Chief Executive Officer of OZO Automation, Inc. (OTCBB:OZO), a publicly-traded company that produced robotic workstations for the electronics industry.

As Chief Executive Officer, he also managed the sale of OZO’s assets to JOT Automation of Olunsalo, Finland, and served as President of their Depaneling subsidiary from 2000 to 2001. From 1983 to 1996, Mr. Wolenski held various positions with Johns Manville Corporation, a worldwide leader in fiberglass insulations and engineered products, which included managerial assignments in manufacturing, business development, and quality assurance. His past board affiliations have included OZO Automation, Inc. where he was a director from 1996-1999, and Bio-Medical Automation, Inc., where he was a director from 1999-2000. Mr. Wolenski holds a BS degree in Mechanical Engineering from the University of Colorado at Boulder (1983), and an MBA from the University of Colorado at Denver (1990). The Board has concluded that Mr. Wolenski should serve on our Board based on his senior executive management experience at privately held and publicly held manufacturing companies and his prior experience as a director of other companies.

Leonard A. Hagan is a founding partner at Hagan & Burns CPA’s P.C. (“Hagan & Burns”) where he provides financial and regulatory services to the broker dealer community as well as tax planning services to the firm’s clients. Prior to founding Hagan & Burns in 1995, Mr. Hagan worked for several years at the accounting firm of S.D. Leidesdorf & Co. where he was a manager, which was then merged into Ernst & Whitney. Following his time at S.D. Leidesdorf & Co. and Ernst & Whitney, Mr. Hagan spent three years at Credit Suisse until he founded his own accounting firm. Mr. Hagan has over forty years’ experience as a Certified Public Accountant and over twenty years as a licensed Financial and Operation Principal. Mr. Hagan is registered today as the Financial and Operating Principal for the following broker dealers registered with the Securities and Exchange Commission: Livingston Securities, LLC, Spoke Financial LLC and Core Financial LLC. Mr. Hagan is also a director of Ridgefield Acquisitions Corp. and BKF Capital Group Inc., each of which are publicly traded companies. Mr. Hagan earned a Bachelor of Arts degree in Economics from Ithaca College and continued his education at Cornell University where he received his MBA in accounting and finance. The Board has concluded that Mr. Hagan should serve on our Board based on his financial expertise and his experience of being a public company director.

Nicholas A. Yarymovych is currently the CEO and President (founder) of Cloudpointe, Inc. Previously, he was the Senior Vice President of Global Consulting & Operations at NTT Data, Cloud Services Inc. and also served as NTT Centerstance’s Managing Partner. Mr. Yarymovych founded Ventus Technology Solutions, Inc. (Ventus) in 2001, one of the first Salesforce.com consulting partners and served as President and Chief Executive Officer. In early 2011, he merged Ventus with Centerstance, Inc. which was then acquired by NTT in late 2012. Throughout his 28-year professional consulting career, he has launched new business units, established professional services practices, developed core business strategies and led numerous operational turnarounds. Prior, Mr. Yarymovych served as Vice President of e-Business Solutions with QuickStart Technologies where he led the companies' e-business consulting services division. Prior to QuickStart, Mr. Yarymovych served as a Client Partner with Cambridge Technology Partners in their Strategy and Management Consulting Group. Currently, he serves as an advisor for several private equity firms. Mr. Yarymovych earned an M.B.A. in Management and Operations from Pepperdine University, a B.S. in Aerospace Engineering from the University of Southern California and has a Bachelor of Science degree in Astronautical Engineering from the U.S. Air Force Academy. The Board has concluded that Mr. Yarymovych should serve on our Board based on his senior executive management experience and his experience with turnaround

companies, mergers and acquisitions.

### **Executive Officers and Other Key Officers**

Steven N. Bronson. See the discussion under “Biographical Information – Directors,” above.

Louann L. Negrete was appointed Chief Financial Officer on December 2, 2013. Ms. Negrete has more than 15 years of experience in public company accounting. Prior to joining Qualstar, Ms. Negrete was the Director of Corporate Accounting for LINE 6, Inc. Prior to Line 6 she was the Corporate Controller and CFO for 6 years at Interlink Electronics, Inc., a publicly traded company. She also served for 6 years as the Corporate Controller for publicly traded Biosource International, Inc. BioSource acquired two companies while she was controller and eventually the entire company was sold. She also held positions of controller at US Stamp and assistant controller at Patagonia, two other manufacturing companies. Ms. Negrete holds a CPA license from the State of California. She graduated from California State University, Northridge with a BS degree in Business Administration, Accounting.

There have been no events under any bankruptcy act, no criminal proceedings and no judgments or injunctions material to the evaluation of the ability and integrity of any officer or director during the past ten years. There are no family relationships between any of our directors, executive officers or other key personnel and any other of our directors, executive officers or other key personnel.

## **CORPORATE GOVERNANCE**

### **Director Independence**

Qualstar's current Board members consist of Mr. Bronson, Mr. Wolenski, Mr. Hagan, and Mr. Yarymovych. The Board of Directors has determined that Messrs. Wolenski, Hagan, and Yarymovych are independent applying the definition of independence under the listing standards of the NASDAQ and SEC regulations.

### **Board Leadership Structure and Role in Risk Oversight**

On June 27, 2014, the Board elected David J. Wolenski, an independent director, to serve as Chairman of the Board.

### **Committees**

Our Board of Directors oversees our risk management. This oversight is administered primarily through the following committees: (i) an Audit Committee, (ii) a Compensation Committee and (iii) a Nominating and Corporate Governance Committee. Each Committee has only independent directors as members.

### **Audit Committee**

The Audit Committee consists of three directors: Messrs. Hagan (chairman), Yarymovych and Wolenski. Each member of the committee is independent applying the definition of independence under the listing standards of NASDAQ and SEC regulations. The Audit Committee meets at least four times during the year. The Board has determined that Mr. Hagan qualifies as an "audit committee financial expert" as defined by Item 407(d)(5)(ii) of Regulation S-K.

Pursuant to the terms of the Audit Committee charter, our Audit Committee is required to consist of "independent" directors and shall serve at the pleasure of the Board of Directors. An "independent" director is defined as an individual who (a) is not an officer or salaried employee or an affiliate, (b) does not have any relationship that, in the opinion of the Board of Directors, would interfere with his or her exercise of independent judgment as an Audit Committee

member, (c) meets the independence requirements of the SEC and NASDAQ or such other securities exchange or market on which our securities are traded and (d) except as permitted by the SEC and NASDAQ or such other securities exchange or market on which our securities are traded, does not accept any consulting, advisory or other compensatory fee from us.

The Audit Committee has a charter that requires the committee to oversee our accounting and financial reporting process, our system of internal controls regarding finance, accounting, legal compliance and ethics, and the audits of our financial statements, a current copy of which is available to stockholders on our website, [www.qualstar.com](http://www.qualstar.com). The primary duties of the Audit Committee consist of, among other things:

- serving as an independent and objective party to monitor our financial reporting process, internal control system and disclosure control system;
- reviewing and appraising the audit efforts of our independent accountants;
- assuming direct responsibility for the appointment, compensation, retention and oversight of the work of the outside auditors and for the resolution of disputes between the outside auditors and our management regarding financial reporting issues;
- providing an open avenue of communication among the independent accountants, financial and senior management and the Board; and
- reviewing and approving all related party transactions.

## Compensation Committee

Our Compensation Committee consists of three directors: Messrs. Yarymovych (chairman), Hagan and Wolenski. Each such member of the Compensation Committee is independent applying the definition of independence under the listing standards of NASDAQ and SEC regulations. The Compensation Committee meets at least two times during each year.

Each member of our Compensation Committee must (i) be one of our independent directors satisfying the independence requirements of NASDAQ and other applicable regulatory requirements; (ii) qualify as an “outside director” under Section 162(m) of the Internal Revenue Code, as amended; and (iii) meet the requirements of a “non-employee director” for purposes of Section 16 of the Securities Exchange Act of 1934, as amended. Except as permitted by NASDAQ, members of the Compensation Committee must not accept any consulting, advisory or the other compensatory fee from us or any of our subsidiaries.

The Compensation Committee oversees the determination of all matters relating to employee compensation and benefits and specifically determines and approves salaries, bonuses and equity-based compensation for our executive officers.

We have adopted a Compensation Committee charter which outlines the Compensation Committee's primary duties which are to:

- evaluate the performance of the Chief Executive Officer in light of our goals and objectives and determine the Chief Executive Officer's compensation based on this evaluation and such other factors as the Committee shall deem appropriate;

- determine and approve all executive officer compensation;

- approve the aggregate amounts and methodology for determination of all salary, bonus, and long-term incentive awards for all employees other than executive officers;

- review and recommend equity-based compensation plans to the full Board of Directors and approve all grants and awards thereunder;

- review and approve changes to our equity-based compensation plans other than those changes that require stockholder approval under the plans, the requirements of NASDAQ or any exchange on which our securities may

be listed and/or any applicable law;

review and recommend to the full Board changes to our equity-based compensation plans that require stockholder approval under the plans, the requirements of NASDAQ or any exchange on which our securities may be listed and/or any applicable law;

review and approve changes in our retirement, health, welfare and other benefit programs that result in a material change in costs or the benefit levels provided;

- administer our equity-based compensation plans; and

approve, as required by applicable law, the annual Committee report on executive compensation for inclusion in our proxy statement.

A current copy of the Compensation Committee charter is available to shareholders on our website, [www.qualstar.com](http://www.qualstar.com).

The Compensation Committee has responsibility for establishing, implementing and monitoring the Company's compensation philosophy. Accordingly, the Compensation Committee strives to develop and maintain competitive, progressive programs that attract, retain and motivate high-caliber employees, foster teamwork, and maximize the long-term success of the Company by appropriately rewarding our employees for their achievements. The Compensation Committee evaluates risk and rewards associated with the Company's overall compensation philosophy and structure.

The Compensation Committee has the authority, in its sole discretion, to retain or obtain advice from compensation consultants, independent legal counsel and other advisers, and is directly responsible for the retention, termination, compensation and oversight of the work of any such consultant, counsel or other adviser. In selecting a consultant, counsel or other adviser, the Compensation Committee must, as required by NASDAQ rules, take into consideration all factors relevant to such person's independence from management, including all factors that NASDAQ identifies in its listing standards. In April 2017, the Compensation Committee retained a compensation consultant to prepare an assessment of compensation for the Chief Executive Officer. The results of the assessment were taken into consideration when the Compensation Committee increased the salary of Mr. Bronson and awarded him 100,000 options on August 3, 2017, as further discussed in Item 11 below. The Compensation Committee is regularly advised by the Company's outside legal counsel and has found no conflict of interest in such counsel's continuing to provide advice to the Compensation Committee.

The Compensation Committee may form and delegate its authority to subcommittees as appropriate. To date, the Compensation Committee has not delegated such authority.

Additionally, the Chief Executive Officer may make recommendations to the Compensation Committee relating to executive and director compensation, but consistent with NASDAQ rules, he may not be present during deliberations or voting regarding his own compensation. The Compensation Committee meets with the Company's Chief Executive Officer and other senior executives in order to obtain recommendations with respect to the Company's compensation programs and practices for executives and other employees. Management discusses with the Compensation Committee the practices that have been put in place to identify and mitigate, as necessary, potential risks. With support from market compensation data, performance reviews and other information, management makes recommendations to the Compensation Committee on the base salaries, bonus targets and equity compensation for the executive officers and other employees. The Compensation Committee takes management's recommendations into consideration but is not bound by management's recommendations with respect to executive compensation. The Chief Executive Officer annually reviews the performance of each executive officer, other than himself. The Chief Executive Officer's performance is reviewed by the Compensation Committee which makes recommendations to the full Board.

### **Nominating and Governance Committee**

Our Nominating and Governance Committee consists of three directors: Messrs. Wolenski (chairman), Yarymovych and Hagan. The Nominating and Governance Committee is empowered by the Board of Directors to recommend qualified individuals to serve on our Board and to identify the manner in which the Nominating and Governance Committee evaluates nominees recommended for membership on the Board. All members of the Nominating and Governance Committee of the Board of Directors have been determined to be "independent directors" pursuant to the definition contained in the rules of NASDAQ and SEC regulations.

## **Shareholder Communications**

Our Board of Directors has established a procedure that enables shareholders to communicate in writing with members of the Board of Directors. Any such communication should be addressed to our Secretary and should be sent to such individual *c/o* Qualstar Corporation. Any such communication must state, in a conspicuous manner, that it is intended for distribution to the entire Board of Directors. Under the procedures established by the Board of Directors, upon our Secretary's receipt of such a communication, a copy of such communication will be sent to each member of the Board of Directors, identifying it as a communication received from a shareholder. Absent unusual circumstances, at the next regularly scheduled meeting of the Board of Directors held more than two days after such communication has been distributed, the Board of Directors will consider the substance of any such communication.

## **Board and Committee Meeting Attendance**

During the twelve months ended December 31, 2018, our Board of Directors held seven meetings, our Audit Committee held four meetings, our Compensation Committee held three meetings and our Nominating and Governance Committee held one meeting. Each director attended (or participated by telephone in) 100% of the total number of meetings of the Board and committees on which he served.



## **Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934 requires Qualstar's directors and executive officers, and persons who own more than ten percent of Qualstar's common stock, to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of our common stock. Officers, directors and greater than ten percent shareholders are required by SEC regulations to furnish Qualstar with copies of all Section 16(a) forms they file.

To our knowledge, based solely on a review of the copies of Section 16(a) reports furnished to us and a review of the shareholders register, during the twelve months ended December 31, 2018, our officers, directors and greater than ten percent beneficial owners complied with all Section 16(a) filing requirements.

## **Code of Ethics**

Qualstar has adopted a written Code of Business Conduct and Ethics, which complies with the requirements for a code of ethics pursuant to Item 406(b) of Regulation S-K under the Securities Exchange Act of 1934, which applies to our chief executive officer, chief financial officer and persons performing similar functions. A copy of the Code of Business Conduct and Ethics has been filed as an exhibit to this report. A copy of the Code of Business Conduct and Ethics is also posted on our website at [www.qualstar.com](http://www.qualstar.com). A copy of the Code of Business Conduct and Ethics will be provided, without charge, to any shareholder who sends a written request to the Chief Financial Officer of Qualstar at 130 W. Cochran St. Unit C; Simi Valley, California 93065.

## **ITEM 11. EXECUTIVE COMPENSATION**

### **Overview**

Qualstar's executive compensation program is based on the same objectives that guide Qualstar in establishing all of its compensation programs:

Compensation fosters the long-term focus required for Qualstar's success. In general, the compensation of Company executives includes longer-term incentives because they are in a greater position to influence longer-term results.

Compensation reflects the level of job responsibility, individual performance, and Company performance. As employee's progress to higher levels in the organization, an increasing proportion of their pay should be linked to Company performance and shareholder returns because those employees are more able to affect Qualstar's operating results.

Compensation reflects the value of the job in the marketplace. To attract and retain a highly skilled work force, we must remain competitive with the pay of other employers who compete with us for talent.

While compensation programs and individual pay levels will always reflect differences in job responsibilities, geographies and marketplace considerations, the overall structure of the compensation and benefit programs should be broadly similar and equitable across the organization.

### **Components of Executive Compensation**

For the twelve months ended December 31, 2018, the principal components of compensation for named executive officers were: (1) base salary, (2) performance-based incentive compensation, (3) long-term equity incentive compensation, (4) personal benefits, and (5) other compensation. In determining the amount and relative allocation among each component of compensation for each named executive officer, the Compensation Committee considered, among other factors, the Company's and each executive officer's experience level and historical performance, compensation paid by companies comparable in size to Qualstar, data obtained from management's recruitment activities, historical rates of executive compensation, Company revenues and profitability, and alignment with the Company's overall compensation philosophy.

**Summary Compensation Table**

The following table shows information about the compensation awarded to, earned by and paid to Mr. Steven N. Bronson and Ms. Louann Negrete (collectively referred to as our “named executive officers”) during the years ended December 31, 2018 and 2017. Mr. Bronson and Ms. Negrete were the Company’s only two “named executive officers,” as defined under Item 402 of Regulation S-K promulgated by the SEC, for such fiscal years.

**Summary Compensation Table**

| Name and Principal Position | Year | Salary    | Bonus<br>(1) | Option  | All Other    | Total     |
|-----------------------------|------|-----------|--------------|---------|--------------|-----------|
|                             |      |           |              | Awards  | Compensation |           |
|                             |      |           |              | (2)     | (3)          |           |
| Steven N. Bronson           | 2018 | \$200,000 | \$140,000    | \$-     | \$1,516      | \$341,516 |
| Chief Executive Officer     | 2017 | 176,383   | 140,000      | 250,000 | 1,426        | 567,809   |
| Louann Negrete              | 2018 | 149,615   | 7,500        | -       | 1,516        | 158,631   |
| Chief Financial Officer     | 2017 | 139,808   | 10,100       | 25,000  | 1,222        | 176,130   |

(1) The amounts shown in this column reflect discretionary bonuses paid to the named executive officers.

The amounts shown in this column represent the aggregate grant date fair value of the equity-based compensation granted to the named executive officers as computed in accordance with FASB ASC Topic 718. Pursuant to SEC rules, these amounts exclude the impact of estimated forfeitures related to service-based vesting conditions. The (2) assumptions used in calculating the aggregate grant date fair value of the awards reported in the column are set forth in our financial statements included herein in Note 5. The amounts reported in this column reflect the accounting cost for these awards and do not correspond to the actual economic value that may be received by the named executive officers for the awards.

(3) The amounts shown in this column represent premiums paid by the Company for life and disability insurance.

**Components of Executive Compensation**

*Base Salary*

Base salaries were set at levels that the Compensation Committee deemed to be sufficient to attract and retain highly talented executive officers capable of fulfilling the Company's key objectives. Base salaries were also set with the goal of rewarding executive officers on a day-to-day basis for their time and services while encouraging them to strive for performance-based and long-term incentives.

*Performance-Based Incentive Compensation*

The Company utilizes an annual discretionary cash bonus program, which is intended to reward executive officers based on the Company's overall performance and the individual named executive officer's contributions to that performance. In determining an annual discretionary bonus for each named executive officer, we evaluate performance as measured against certain objective financial metrics as well as individual performance goals. We believe that the performance-based incentive compensation provides incentives that are necessary to retain executives and reward them for our short-term performance in the pursuit of our larger business objectives and is designed to provide for a portion of our cash compensation for named executive officers to be variable based upon Company and individual performance.

### *Long-Term Equity Incentive Compensation*

The Company has a long-term equity incentive plan, which is intended to retain executive officers and reward executive officers based on the Company's performance. Equity incentives, such as stock options and restricted stock awards, have been granted to executive officers as long-term incentives in order to align executives' performance with the interests of the Company's shareholders and also to encourage retention. No equity incentives were granted to executive officers in the twelve months ended December 31, 2018.

### *Personal Benefits*

As employees, the Company's executives are eligible to participate in health and welfare benefits, as offered to our general workforce, designed to attract and retain a skilled workforce in a competitive marketplace. These benefits help ensure that the Company has a healthy and focused workforce through reliable and competitive health and other personal benefits. These benefits were considered in relation to the total compensation package but did not materially impact decisions regarding other elements of executive officer compensation.

The Company also maintains a tax-qualified retirement plan ("401(k) Plan") that provides eligible employees with an opportunity to save for retirement on a tax-advantaged basis. All employees are eligible to participate in the 401(k) 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. The Company, at the discretion of management, may make matching contributions in an amount equal to 25% of the first 6% of compensation contributed by eligible participants. However, the Company has suspended discretionary matching contributions effective as of August 2009.

### *Employment of Steven N. Bronson*

The Company was party to an employment agreement with Mr. Bronson that commenced on June 1, 2016 and expired on December 31, 2016. The employment agreement provided Mr. Bronson with a base salary of \$160,000 and eligibility to earn a discretionary cash bonus up to 100% of his base salary, based on his achievement of various performance goals, as well as other general employment terms.

Subsequent to the expiration of his employment agreement, on August 3, 2017 the Compensation Committee (i) approved an increase in Mr. Bronson's base salary from \$160,000 to \$200,000, (ii) approved a \$100,000 cash bonus to Mr. Bronson based on the Company achieving profitability and positive cash flow for the six months ended June 30, 2017 and (iii) awarded Mr. Bronson an option to purchase 100,000 shares of the Company's common stock as further described above under the heading "Long Term Equity Compensation". On December 14, 2018, the Compensation Committee approved a cash bonus to Mr. Bronson in the amount of \$140,000 based on the Company's performance in

2018. The Company is currently in the process of negotiating a new employment agreement with Mr. Bronson.

*Tax and Accounting Implications*

Under Section 162(m) of the Internal Revenue Code of 1986, as amended (the “Code”), we generally receive a federal income tax deduction for compensation paid to any of our named executive officers only to the extent total compensation does not exceed \$1.0 million during any fiscal year or if it is “performance-based” under Section 162(m) of the Code. During the years ending December 31, 2018 and 2017, none of the executive officers of the Company had non-performance-based compensation in excess of \$1,000,000.

**Outstanding Equity Awards at Year Ending December 31, 2018**

The following table provides information regarding outstanding equity awards held by each named executive officer as of December 31, 2018.

**Outstanding Equity Awards at December 31, 2018**

| Name              | Option Awards (1)          |               | Option<br>Exercise<br>Price (\$) | Option<br>Expiration Date |
|-------------------|----------------------------|---------------|----------------------------------|---------------------------|
|                   | Number of Securities       |               |                                  |                           |
|                   | Underlying Unexercised     |               |                                  |                           |
|                   | Options (#)<br>Exercisable | Unexercisable |                                  |                           |
| Steven N. Bronson | 16,667                     | (1) —         | 7.38                             | 8/20/2024                 |
|                   | 100,000                    | (2)           | 7.08                             | 8/3/2027                  |
| Louann Negrete    | 10,000                     | (2)           | 7.08                             | 8/3/2027                  |

(1) Each stock option was granted pursuant to our 2008 Plan. The stock option vested immediately on the grant date, August 20, 2014.

(2) Each stock option was granted pursuant to our 2017 Plan. The stock option vested immediately on the grant date, August 3, 2017.

**Director Compensation**

Each of our non-employee directors receives cash fees as compensation for his service on our Board of Directors and the committees of the Board of Directors on which he is a member. During the fiscal year ending December 31, 2018, each of our non-employee directors received a stipend of \$15,000 per year, paid quarterly, for service on the Board of Directors. The Chairman of the Audit Committee received an additional stipend of \$5,000 per year, paid quarterly, the Chairman of the Compensation Committee received an additional stipend of \$3,000 per year, paid quarterly, the Chairman of the Nominating and Governance Committee received an additional stipend of \$3,000 per year, paid quarterly, and the Chairman of the Board of Directors received an additional stipend of \$7,500 per year, paid quarterly. No additional stipends were paid for service on a committee of the Board of Directors other than as Chairman of such committee. No fees were paid for service on the Board of Directors to directors who were also employees of the Company.

The table below sets forth cash compensation earned by each person who served as a non-employee director of our Board of Directors during the fiscal year ending December 31, 2018. Steven N. Bronson, who is our Chief Executive Officer, was an employee during the fiscal year ending December 31, 2018 and received no additional compensation for his service as a member of our Board of Directors. The compensation received by Mr. Bronson, as a named executive officer of the Company, is presented in “Executive Compensation—Summary Compensation Table” above.



**Director Compensation Table for the Twelve Months Ended December 31, 2018**

| Name                   | Fees         | Stock  | Total    |
|------------------------|--------------|--------|----------|
|                        | Earned or    | Awards |          |
|                        | Paid in Cash |        |          |
| David J. Wolenski      | \$25,500     | \$ -   | \$25,500 |
| Leonard A. Hagan       | 20,000       | -      | 20,000   |
| Nicholas A. Yarymovych | 18,000       | -      | 18,000   |

The non-employee directors were awarded 5,000 stock options on August 3, 2017 pursuant to the Company's 2017 Plan. The options have an exercise price of \$7.08 per share, a term of ten years and were fully vested upon grant.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The following table sets forth information with respect to the beneficial ownership of our common stock as of March 1, 2019 for:

each person (or group of affiliated persons) who we know beneficially owns more than 5% of our common stock;

each of our directors;

each of the named executive officers; and

all of our directors and executive officers as a group.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and includes voting and investment power with respect to shares. Except as indicated by footnote, the persons named in the table have sole voting and sole investment control with respect to all shares beneficially owned, subject to community property laws where applicable. The percentage of shares beneficially owned is based on 1,995,912 shares of common stock outstanding as of March 1, 2019. Shares of common stock subject to options currently exercisable or exercisable within 60 days of March 1, 2019, are deemed outstanding for computing the percentage of the person holding such options but are not deemed outstanding for computing the percentage of any other person. The address

for those individuals for which an address is not otherwise indicated is: c/o Qualstar Corporation, 130 W. Cochran St. Unit C, Simi Valley, California 93065.

| Name   | Common<br>Shares<br>Owned | Options                              |  | Beneficial<br>Ownership |         |
|--|---------------------------|--------------------------------------|--|-------------------------|---------|
|  |                           | Exercisable<br>Within 60<br>Days (1) |  | Number                  | Percent |
| BKF Asset Holdings, Inc. (2)   | 548,085                   | —                                    |  | 548,085                 | 27.5 %  |
| Steven N. Bronson, Chief Executive Officer (3)                                 | 24,617                    | 116,667                              |  | 679,369                 | 34.5 %  |
| Renaissance Technologies LLC (4)<br>800 Third Avenue; New York, New York 10022 | 159,700                   | —                                    |  | 159,700                 | 8.0 %   |
| Louann Negrete, Chief Financial Officer  | —                         | 10,000                               |  | 10,000                  | *       |
| Leonard A. Hagan, Director (5)   | 13,444                    | 5,000                                |  | 18,444                  | *       |
| Nicholas A. Yarymovych, Director (6)   | 6,667                     | 5,000                                |  | 11,667                  | *       |
| David J. Wolenski, Director (7)  | 833                       | 5,000                                |  | 5,833                   | *       |
| All directors and officers as a group (5 persons)                              | 593,646                   | 141,667                              |  | 735,313                 | 36.8 %  |

\*Less than 1.0%

(1) Represents shares that may be acquired upon exercise of stock options which are either currently vested or will vest within 60 days of March 8, 2019.

(2) Based on information contained in reports filed with the Securities and Exchange Commission, BKF Asset Holdings, Inc. is the owner of 548,085 shares of Qualstar common stock.

Based on information contained in reports filed with the Securities and Exchange Commission, Mr. Bronson, is the owner of 14,617 shares of Qualstar. Additionally, Mr. Bronson, as the Chairman and President and majority (3) shareholder of BKF Asset Holdings, Inc., may be deemed to beneficially own the 548,085 shares of Qualstar held by BKF Asset Holdings, Inc. Also, Mr. Bronson's spouse holds 10,000 shares of Qualstar. Mr. Bronson was awarded a total of 16,667 stock options on August 20, 2014 and 100,000 options on August 3, 2017.

(4) Based on information contained in reports filed with the Securities and Exchange Commission, Renaissance Technologies LLC, an investment adviser, beneficially owns 159,700 shares as of December 31, 2018.

Based on information contained in reports filed with the Securities and Exchange Commission, Leonard A. Hagan (5) beneficially owns 13,444 shares as of December 21, 2017. Mr. Hagan was awarded 5,000 stock options on August 3, 2017.

(6)

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Based on information contained in reports filed with the Securities and Exchange Commission, Nicholas A. Yarymovych beneficially owns 6,667 shares as of November 19, 2014. Mr. Yarymovych was awarded 5,000 stock options on August 3, 2017.

Based on information contained in reports filed with the Securities and Exchange Commission, David J. Wolenski (7) beneficially owns 833 shares as of December 31, 2015. Mr. Wolenski was awarded 5,000 stock options on August 3, 2017.

### **Additional Equity Compensation Plan Information**

Information regarding Qualstar's equity compensation plans as of December 31, 2018 is included in Item 5 of this report and is incorporated herein by reference.

## **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

### **Transactions with Related Persons**

In accordance with the charter of the Audit Committee of our Board of Directors, the Audit Committee is responsible for reviewing any proposed transaction with any related person which involves a potential conflict of interest or for which approval is required under applicable Securities and Exchange Commission and NASDAQ rules. Currently, this review and approval requirement applies to any transaction to which Qualstar will be a party, in which the amount involved exceeds the lesser of \$120,000 or one percent of the average of Qualstar's total assets at year-end for the last two completed fiscal years, and in which any of the following persons will have a direct or indirect material interest: (a) any of our directors or executive officers, (b) any nominee for election as a director, (c) any security holder who is known to us to own of record or beneficially more than five percent of our common stock, or (d) any member of the immediate family of any of the persons described in the foregoing clauses (a) through (c).

In the event that management becomes aware of any related person transaction, management will present information regarding the proposed transaction to the Audit Committee for review. Approval of a transaction with a related person requires the affirmative vote of a majority of the members of the Audit Committee or of a majority of the members of the full Board of Directors. If the related person transaction involves a member or members of the Board, approval requires a majority vote of the directors who do not have a financial interest in the transaction.

Steven N. Bronson is the Company's CEO and is also the President and CEO and a majority shareholder of Interlink Electronics, Inc. ("Interlink") and BKF Capital Group, Inc. ("BKF"). Interlink reimburses Qualstar for leased space at the Simi Valley facility and for other administrative expenses paid by or on behalf of the Company. The total amount charged to Interlink for the twelve months ended December 31, 2018 and 2017, was \$17,000 and \$13,000, respectively. Interlink owed Qualstar \$2,000 and \$2,000 at December 31, 2018 and December 31, 2017, respectively.

The Company reimburses Interlink for expenses paid on the Company's behalf. On December 1, 2017, the Company entered into a Consulting Agreement with Interlink. Pursuant to the Consulting Agreement, Interlink performs project

management services to the Company. Interlink receives \$15,000 per month, or less depending on the project, plus expenses for these services. Also, Interlink occasionally pays travel and other expenses incurred by Qualstar employees. The Company reimbursed Interlink \$213,000 and \$28,000 for the twelve months ended December 31, 2018 and 2017, respectively. Qualstar owed Interlink \$3,000 and \$17,000, at December 31, 2018 and December 31, 2017, respectively.

The Company reimburses BKF for expenses paid on the Company's behalf. BKF occasionally pays consulting expenses incurred by Qualstar. The Company reimbursed BKF \$1,000 for the twelve months ended December 31, 2018 and no expenses were reimbursed for the twelve months ended December 31, 2017. Qualstar owed BKF \$1,000 at December 31, 2018 and no amount as of December 31, 2017.

### **Director Independence**

Our Board has determined that all of our current directors, who served on our Board during the 2018 fiscal year at the time of their service, satisfied the "independent director" standards established by rules of The NASDAQ Stock Market, Inc. ("NASDAQ"), except for Steven N. Bronson. Each director serving on the Audit Committee of our Board, at the time of their service also met the more stringent independence requirements established by Securities and Exchange Commission rules applicable to audit committees. Our Board has determined that no director has a relationship that would interfere with the exercise of independent judgment in carrying out his responsibilities as a director. There are no family relationships among any of the directors or executive officers of the Company.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES****Fees Paid to Independent Registered Public Accountants**

The table below includes the aggregate fees billed by RBSM, LLP, our independent registered public accounting firm for each of the years ended December 31, 2018 and 2017.

|                    | <b>Twelve Months<br/>Ended</b> |             |
|--------------------|--------------------------------|-------------|
|                    | <b>December 31,<br/>2018</b>   | <b>2017</b> |
| Audit Fees         | \$78,250                       | \$84,362    |
| Audit related fees | -                              | -           |
| Tax fees           | 64,588                         | 37,500      |
| All other fees     | 18,175                         | 9,050       |
| Total fees         | \$161,013                      | \$130,912   |

Audit Fees. Audit fees include fees for professional services rendered in connection with the audit of our consolidated financial statements for each year and reviews of our unaudited condensed consolidated quarterly financial statements, as well as fees related to consents and reports in connection with regulatory filings for those fiscal years.

Audit Related Fees. We did not incur any fees during the last two completed fiscal years for assurance and related services.

Tax Fees. Tax fees include fees for professional services rendered for tax compliance, tax advice and tax planning.

All Other Fees. All other fees include fees for professional services rendered for financial reporting compliance with accounting standards.

**Audit Committee Pre-Approval Policies and Procedures**

Our Audit Committee's policy is to pre-approve all audit and permissible non-audit services provided by our independent registered public accountants in accordance with applicable Securities and Exchange Commission rules. The Audit Committee adopted a written pre-approval policy on June 25, 2003, and all services performed by RBSM and Everest Ito Group, a tax consultant to the Company, have been pre-approved in accordance with the Audit Committee's pre-approval policy. The Audit Committee generally pre-approves particular services or categories of services on a case-by-case basis. The independent registered public accountants and management periodically report to the Audit Committee regarding the extent of services provided by the independent registered public accountants in accordance with these pre-approvals, and the fees for the services performed to date.



**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a) The financial statements are set forth under Item 8 of this Report on Form 10-K.

All other schedules have been omitted since the required information is not present in amounts sufficient to require submission of the schedule, or because the required information is included in the financial statements or notes thereto.

(b) Exhibits:

**Exhibit**

| <b>No.</b> | <b>Description</b>   |
|------------|--|
| 3.1.1      | <u>Restated Articles of Incorporation, incorporated by reference to the designated exhibit to Qualstar's registration statement on Form S-1 (Commission File No. 333-96009), declared effective by the Commission on June 22, 2000.</u>  |
| 3.1.2      | <u>Certificate of Amendment of Restated Articles of Incorporation, incorporated by reference to Exhibit 3.1 to Qualstar's Report on Form 8-K dated June 14, 2016.</u>  |
| 3.2        | <u>Bylaws, as amended and restated as of March 24, 2011, incorporated by reference to Exhibit 3.1 to Qualstar's Report on Form 8-K dated March 30, 2011.</u>   |
| 4.1        | <u>Rights Agreement, dated February 5, 2013, between Qualstar Corporation and Corporate Stock Transfer, Inc., as rights agent, incorporated by reference to Exhibit 4.1 to Qualstar's Report on Form 8-K dated February 6, 2013.</u>   |
| 4.2        | <u>Amendment No. 1 to the Rights Agreement, dated February 5, 2013, between Qualstar Corporation and Corporate Stock Transfer, Inc., as rights agent, incorporated by reference to Exhibit 4.2 to Qualstar's Report on Form 8-K dated July 12, 2013.</u>   |
| 10.1       | <u>Form of Indemnification Agreement, incorporated by reference to the designated exhibit to Qualstar's registration statement on Form S-1 (Commission File No. 333-96009), declared effective by the Commission on June 22, 2000.</u>   |
| 10.2***    | <u>2008 Stock Incentive Plan, incorporated by reference to Exhibit 10.1 to Qualstar's Report on Form 10-Q/A for the fiscal quarter ended March 31, 2009.</u>   |
| 10.3       | <u>Standard Multi-Tenant Offices Lease between K-Swiss, Inc. and Qualstar Corporation, dated December 8, 2014, concerning the property located at 31248 Oak Crest Dr, Westlake Village, CA 91361, incorporated by reference to Exhibit 10.12 to Qualstar's report on Form 10-Q for the fiscal quarter ended December 31, 2014.</u> |
| 10.4       | <u>Industrial Real Estate Lease between Cypress Pointe Simi Valley, LLC and Qualstar Corporation, dated December 15, 2014 concerning the property located at 130 West Cochran St., Simi Valley, CA 93065.</u>  |

- incorporated by reference to Exhibit 10.13 to Qualstar's report on Form 10-Q for the fiscal quarter ended December 31, 2014.
- 10.5 Sublease Agreement between Interlink Electronics, Inc and Qualstar Corporation, dated July 1, 2015, concerning space at 130 West Cochran Street, Unit C; Simi Valley, CA 93065, incorporated by reference to Exhibit 10.14 to Qualstar's report on Form 10-K for the year ended June 30, 2015.
- 10.6 Tenancy Agreement between Hudson Development PTE LTD and Qualstar Corporation Singapore PTE LTD, dated January 22, 2016 concerning space at 16 New Industrial Road, Singapore 536204, incorporated by reference to Exhibit 10.15 to Qualstar's report on Form 10-KT for the transition year ended December 31, 2015.
- 10.7 Sublease agreement between Feld Care Therapy, Inc. d.b.a. Well Care Connects and Qualstar Corporation, dated March 22, 2016 concerning space at 31248 Oak Crest Drive Suite 120, Westlake Village, CA 91361, incorporated by reference to Exhibit 10.16 to Qualstar's report on Form 10-KT for the transition year ended December 31, 2015.
- 10.8\*\*\* Employment Agreement with Steven N. Bronson, dated June 1, 2016 incorporated by reference to Exhibit 10.10 to Qualstar's report on Form 8-K dated June 7, 2016.
- 10.9\*\*\* Qualstar Corporation 2017 Stock Option and Incentive Plan, incorporated by reference to Exhibit 10.1 to Qualstar's report on Form 8-K/A dated June 13, 2017.
- 14.1 Code of Business Conduct and Ethics, incorporated by reference to the designated exhibit to Qualstar's Report on Form 10-K for the fiscal year ended June 30, 2004.
- 21.1\* Subsidiaries of the Registrant
- 23.1\* Consent of Independent Registered Public Accounting Firm (RBSM LLP).
- 24.1\* Power of Attorney (included on signature page).

- 31.1\* Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2\* Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1\*\* Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2\*\* Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS\* XBRL Instance Document.
- 101.SCH\* XBRL Taxonomy Extension Schema Document.
- 101.CAL\* XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF\* XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB\* XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE\* XBRL Taxonomy Extension Presentation Linkbase Document.

\* Filed herewith

\*\* Furnished herewith

\*\*\*Each a management contract or compensatory plan or arrangement.

**ITEM 16. FORM 10-K Summary**

None.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

QUALSTAR  
CORPORATION

Date: March 7, 2019 By: /s/ STEVEN N.  
BRONSON  
Steven N.  
Bronson,  
*Chief Executive  
Officer*

## POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Steven N. Bronson and Louann Negrete, and each of them, as his or her true and lawful attorneys-in-fact and agents, with full power of substitution for him or her, and in his or her name in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done therewith, as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, and any of them or his or her substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <b><u>Signature</u></b> | <b><u>Title</u></b>                                | <b><u>Date</u></b> |
|-------------------------|--|--------------------|
| /s/ STEVEN N. BRONSON   | Chief Executive Officer, President and<br>Director | March 7,<br>2019   |
| Steven N. Bronson       |  |                    |

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(Principal executive officer)

|  |   |                  |
|--|---|------------------|
| /s/ LOUANN NEGRETE<br>Louann Negrete                 | Chief Financial Officer<br>(Principal financial and accounting officer) | March 7,<br>2019 |
| /s/ DAVID J. WOLENSKI<br>David J. Wolenski           | Chairman of the Board of Directors                                      | March 7,<br>2019 |
| /s/ LEONARD A. HAGAN<br>Leonard A. Hagan             | Director  | March 7,<br>2019 |
| /s/ NICHOLAS A. YARYMOVYCH<br>Nicholas A. Yarymovych | Director  | March 7,<br>2019 |