

QUALSTAR CORP
Form 10-Q
May 15, 2003

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2003

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 000-30083

QUALSTAR CORPORATION

Incorporated under the laws of the State of California

(I.R.S. Employer Identification No.) 95-3927330

3990-B Heritage Oak Court

Simi Valley, CA 93063

(805) 583-7744

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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The total shares of common stock without par value outstanding at May 12, 2003 is 12,638,409.

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QUALSTAR CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
JUNE 30, 2002 AND MARCH 31, 2003
(in thousands)

	<u>JUNE 30,</u> <u>2002</u>	<u>MARCH 31,</u> <u>2003</u>
		(Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 16,363	\$ 27,899
Marketable securities	14,482	8,007
Receivables, net of allowances of \$2,100 at June 30, 2002 and \$1,943 at March 31, 2003	6,695	3,571
Inventories	9,652	7,160
Prepaid expenses and other current assets	355	472
Prepaid income taxes	148	416
Deferred income taxes	1,501	1,501
	<hr/>	<hr/>
Total current assets	49,196	49,026
	<hr/>	<hr/>
Property and equipment, net	1,324	1,514
Other assets	238	362
	<hr/>	<hr/>
	\$ 50,758	\$ 50,902
	<hr/>	<hr/>
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 1,590	\$ 844
Accrued payroll and related liabilities	308	549
Other accrued liabilities	693	720
Income taxes payable	98	
	<hr/>	<hr/>
Total current liabilities	2,689	2,113
	<hr/>	<hr/>
Deferred income taxes	96	96
Shareholders' equity:		
Preferred stock, no par value; 5,000 shares authorized; no shares issued		
Common stock, no par value; 50,000 shares authorized, 12,656 and 12,638 shares issued and outstanding at June 30, 2002 and March 31, 2003, respectively	20,751	20,407
Deferred compensation	(631)	(217)
Notes from directors	(387)	(236)
Accumulated other comprehensive loss	(31)	(124)
Retained earnings	28,271	28,863
	<hr/>	<hr/>
Total shareholders' equity	47,973	48,693
	<hr/>	<hr/>
Total liabilities and shareholders' equity	\$ 50,758	\$ 50,902
	<hr/>	<hr/>

See the accompanying notes to these condensed consolidated financial statements.

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QUALSTAR CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
THREE MONTHS AND NINE MONTHS ENDED MARCH 31, 2002 AND 2003
(in thousands, except per share amounts)
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31,		NINE MONTHS ENDED MARCH 31,	
	2002	2003	2002	2003
Net revenues	\$ 8,603	\$ 8,189	\$27,431	\$25,389
Cost of goods sold	5,412	5,085	17,112	15,959
Gross profit	3,191	3,104	10,319	9,430
Operating expenses:				
Research and development	533	1,138	1,523	2,905
Sales and marketing	860	921	2,168	2,826
General and administrative	946	1,143	2,672	3,083
Total operating expenses	2,339	3,202	6,363	8,814
Income (loss) from operations	852	(98)	3,956	616
Interest income	256	116	882	502
Income before provision for income taxes	1,108	18	4,838	1,118
Provision for income taxes	413	7	1,768	526
Net income	\$ 695	\$ 11	\$ 3,070	\$ 592
Basic earnings per share	\$ 0.06	\$ 0.00	\$ 0.25	\$ 0.05
Diluted earnings per share	\$ 0.05	\$ 0.00	\$ 0.24	\$ 0.05
Shares used to compute earnings per share:				
Basic	12,513	12,614	12,470	12,579
Diluted	12,743	12,641	12,665	12,667

See the accompanying notes to these condensed consolidated financial statements.

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QUALSTAR CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED MARCH 31, 2002 AND 2003
(in thousands)
(UNAUDITED)

	2002	2003
OPERATING ACTIVITIES:		
Net income	\$ 3,070	\$ 592
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	205	278
Amortization of deferred compensation	322	237
Provision for bad debts and returns	70	(25)
Accrued interest on directors' notes	(23)	(15)
Changes in operating assets and liabilities:		
Accounts receivable	(753)	3,149
Inventories	498	2,540
Prepaid expenses and other assets	(18)	(41)
Prepaid income taxes and income taxes payable	895	(366)
Accounts payable	(1,298)	(746)
Accrued liabilities	(30)	268
	2,938	5,871
INVESTING ACTIVITIES:		
Purchases of equipment and leasehold improvements	(226)	(428)
Sales (purchases) of marketable securities, net	(5,394)	6,382
Purchase of assets of N2Power, Inc.		(288)
	(5,620)	5,666
FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	26	145
Repurchase of common stock		(312)
Principal and interest payments on directors' notes	152	166
	178	(1)
Net cash provided by (used in) financing activities	178	(1)
Net increase (decrease) in cash and cash equivalents	(2,504)	11,536
Cash and cash equivalents at beginning of period	20,809	16,363
	\$ 18,305	\$ 27,899
Supplemental cash flow disclosure:		
Income taxes paid	\$ 873	\$ 340
	\$ 873	\$ 340

See the accompanying notes to these condensed consolidated financial statements.

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QUALSTAR CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
NINE MONTHS ENDED MARCH 31, 2003
(in thousands)
(UNAUDITED)

	PREFERRED STOCK		COMMON STOCK		ACCUMULATED			TOTAL	
	SHARES	AMOUNT	SHARES	AMOUNT	DEFERRED	NOTES	OTHER		
					COMPENSATION	FROM DIRECTORS	COMPREHENSIVE LOSS		RETAINED EARNINGS
Balance at July 1, 2002		\$	12,656	\$20,751	\$ (631)	\$ (387)	\$ (31)	\$28,271	\$47,973
Amortization of deferred compensation					237				237
Forfeiture of stock options				(177)	177				
Exercise of stock options			52	145					145
Repurchase of common stock			(70)	(312)					(312)
Accrued interest on directors' notes						(15)			(15)
Receipt of principal and interest payments on directors' notes						166			166
Comprehensive income:									
Change in unrealized losses on investments							(93)		(93)
Net income								592	592
Comprehensive income									499
Balance at March 31, 2003		\$	12,638	\$20,407	\$ (217)	\$ (236)	\$ (124)	\$28,863	\$48,693

See the accompanying notes to these condensed consolidated financial statements.

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QUALSTAR CORPORATION
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2003
(in thousands, except per share amounts)
(UNAUDITED)

NOTE 1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements are unaudited, except for the balance sheet at June 30, 2002 which is derived from our audited financial statements, and should be read in conjunction with the consolidated financial statements and related notes included in Qualstar Corporation's (Qualstar, us, we, or our) Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on September 30, 2002. In the opinion of management, these unaudited condensed consolidated financial statements include all adjustments, consisting primarily of normal recurring items, which are necessary for the fair presentation of Qualstar's consolidated financial position as of March 31, 2003, consolidated results of operations for the three months and nine months ended March 31, 2002 and 2003, and consolidated cash flows for the nine months ended March 31, 2003. Operating results for the three month and nine month periods ended March 31, 2003 are not necessarily indicative of results to be expected for a full year.

NOTE 2. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted net income per share for the three months and nine months ended March 31, 2002 and 2003:

	THREE MONTHS MARCH 31,		NINE MONTHS ENDED MARCH 31,	
	2002	2003	2002	2003
Numerator:				
Net income	\$ 695	\$ 11	\$ 3,070	\$ 592
Denominator:				
Denominator for basic net income per share - weighted average shares	12,513	12,614	12,470	12,579
Dilutive potential common shares from employee stock options and restricted stock	230	27	195	88
Denominator for diluted net income per share - adjusted weighted average shares and assumed conversions	12,743	12,641	12,665	12,667
Basic net income per share	\$ 0.06	\$ 0.00	\$ 0.25	\$ 0.05
Diluted net income per share	\$ 0.05	\$ 0.00	\$ 0.24	\$ 0.05

Shares issuable under stock options of 68,000 and 467,000 at March 31, 2002 and 2003, respectively, have been excluded from the computation of diluted earnings per share because the effect would be antidilutive.

NOTE 3. MARKETABLE SECURITIES

Marketable securities consist primarily of high-quality corporate, federal and state government securities. These securities are classified in one of three categories: trading, available-for-sale, or held-to-maturity. Trading securities are bought and held principally for the purpose of selling them in the near term. Held-to-maturity securities are those securities which the Company has the ability and intent to hold until maturity. All other securities not included in trading or held-to-maturity are classified as available-for-sale. All of the Company's marketable securities were classified as available-for-sale at June 30, 2002 and March 31, 2003.

Available-for-sale securities are recorded at market value. Unrealized holding gains and losses, net of the related income tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of shareholders' equity until

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realized. Dividend and interest income are recognized when earned. Realized gains and losses for securities classified as available-for-sale are included in earnings when the underlying securities are sold and are derived using the specific identification method for determining the cost of securities sold.

Table of Contents**NOTE 4. INVENTORIES**

Inventories are stated at the lower of cost (first-in, first-out basis) or market. Inventory is comprised as follows:

	<u>JUNE 30, 2002</u>	<u>MARCH 31, 2003</u>
Raw materials	\$7,980	\$6,463
Finished goods	1,672	697
	<u> </u>	<u> </u>
	\$9,652	\$7,160
	<u> </u>	<u> </u>

NOTE 5. COMPREHENSIVE INCOME

For the nine months ended March 31, 2002 and 2003, comprehensive income amounted to approximately \$2.8 million and \$0.5 million, respectively. The difference between net income and comprehensive income relates to the changes in the unrealized losses or gains the Company recorded for its available-for-sale securities.

NOTE 6. STOCK BASED COMPENSATION

Employee stock options are accounted for under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, as amended and interpreted, which requires recognition of expense when the option price is less than the fair value of the stock at the date of grant. The Company generally awards options for a fixed number of shares at an option price equal to the fair value of the stock at the date of grant. The Company has adopted the disclosure only provisions of the Financial Accounting Standards Board's Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation (SFAS 123).

If the Company recognized employee stock option related compensation expense in accordance with SFAS 123 and used the minimum value method for grants prior to the Company's initial public offering and the Black-Scholes method model afterward for determining the weighted average fair value of options granted, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

	<u>THREE MONTHS</u>		<u>NINE MONTHS</u>	
	<u>MARCH 31,</u>		<u>ENDED</u>	
	<u>2002</u>	<u>2003</u>	<u>2002</u>	<u>2003</u>
Net income as reported	\$ 695	\$ 11	\$ 3,070	\$ 592
Stock-based employee compensation cost included in reported net income	150	65	322	237
Pro forma stock-based employee compensation cost under SFAS 123	(165)	(162)	(495)	(486)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Pro forma net income (loss)	\$ 680	\$ (86)	\$ 2,897	\$ 343
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Earnings (loss) per share:				
Basic as reported	\$ 0.06	\$ 0.00	\$ 0.25	\$ 0.05
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Basic pro forma	\$ 0.05	\$(0.01)	\$ 0.23	\$ 0.03
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Diluted as reported	\$ 0.05	\$ 0.00	\$ 0.24	\$ 0.05
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Diluted pro forma	\$ 0.05	\$(0.01)	\$ 0.23	\$ 0.03
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

All shares issuable under stock options at March 31, 2003 have been excluded from the proforma diluted earnings per share computation for the three month period ended March 31, 2003 because the effect would be antidilutive.

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NOTE 7. BUSINESS ACQUISITIONS

On July 11, 2002, the Company acquired the assets and intellectual properties of N2Power, Incorporated (N2Power), a privately held company which designs and produces small and efficient open-frame switching power supplies. The consideration for this acquisition was \$250,000 plus acquisition expenses of \$38,000. The purchase price was primarily allocated to a patent which will be amortized over 5 years. The accompanying consolidated financial statements include the operations of N2Power from the date of acquisition.

NOTE 8. STOCK REPURCHASE

On February 12, 2003, the Company announced that the Board of Directors authorized a stock repurchase program of up to 500,000 shares of the Company's common stock. The stock repurchase will be funded by available working capital. There is no time limit for the completion of the stock repurchase program and it may be discontinued at any time. As of March 31, 2003, the Company had repurchased 69,667 shares of its common stock at a total cost of approximately \$312,000, or an average price of approximately \$4.47 per share.

NOTE 9. LEGAL PROCEEDINGS

On January 10, 2003, Raytheon Company (Raytheon) filed a complaint in the United States District Court for the Eastern District of Texas alleging that Qualstar and seven other named defendants infringe a patent owned by Raytheon entitled Mass Data Storage Library. Raytheon filed an amended complaint on or about February 6, 2003, which includes an allegation that Qualstar's tape libraries infringe Raytheon's patent. The complaint seeks an injunction against all defendants and an unspecified amount of damages. Qualstar responded to the complaint on March 7, 2003 and denied Raytheon's allegations of infringement. A scheduling conference is set for May 20, 2003 to determine future scheduling matters and the trial date. Qualstar and its legal counsel continue to analyze Raytheon's patent and available defenses to the claims of infringement. Based on our analysis, we believe that Raytheon's claims against Qualstar are without merit and we intend to vigorously defend against this complaint.

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ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements inherently are subject to risks and uncertainties, some of which we cannot predict or quantify. Our actual results may differ materially 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 our Annual Report on Form 10-K for the fiscal year ended June 30, 2002 in ITEM 1 Business, including the section therein entitled Risk Factors, and in ITEM 7- Management's Discussion and Analysis of Financial Condition and Results of Operations. You generally can identify forward-looking statements by the use of forward-looking terminology such as believes, may, expects, intends, estimates, anticipates, plans, seeks, or continues, or the negative thereof or variations thereon or similar terminology. We disclaim any obligation to update or revise these forward-looking statements to reflect the occurrence of events or circumstances in the future.

RESULTS OF OPERATIONS

Three months ended March 31, 2003 Compared to three months ended March 31, 2002.

NET REVENUES. Revenues are recognized upon shipment of the product to the customer, less estimated returns, for which provision is made at the time of sale.

Net revenues for the three months ended March 31, 2003 were \$8.2 million, compared with net revenues of \$8.6 million for the three months ended March 31, 2002, a decrease of \$0.4 million. The decrease can be attributed to fewer libraries sold as well as reduced tape media revenue. Partially offsetting this decrease were increases in tape drive and service contract revenue. The selling prices of our tape libraries have remained relatively stable during the quarter ended March 31, 2003 compared to the prior year quarter. The selling prices of tape media have decreased somewhat since the third quarter of fiscal 2002, whereas the selling prices of tape drives have had an overall increase. The decrease in selling prices of tape media is primarily due to decreases in our cost to purchase media, which we pass through to our customers. The increase in selling prices of tape drives is primarily due to the introduction of new releases of existing tape drive technology, such as SDLT 320, which were not yet available during the third quarter of fiscal 2002. We do not anticipate significant changes in the selling prices of our tape libraries during the fourth quarter of fiscal 2003.

GROSS PROFIT. Gross profit was \$3.1 million or 37.9% of net revenues for the three months ended March 31, 2003 compared to \$3.2 million or 37.1% for the three months ended March 31, 2002, representing a decrease of 2.7%. Our gross margin is partially a function of the mix of products sold. Generally, larger tape libraries and newer tape drive technologies have higher gross margins than do smaller tape libraries and older tape drive technologies. Historically, tape libraries and drives have higher gross profit margins as a percentage of sales than do tape media. Furthermore, changes in service revenues, which are reported net of cost, can impact the Company's overall gross margin. The increase in our gross profit margin as a percentage of net revenues is primarily due to product mix.

RESEARCH AND DEVELOPMENT. Research and development expenses consist of engineering salaries, benefits, purchased parts and supplies used in development activities. Research and development expenses for the three months ended March 31, 2003 were \$1.1 million or 13.9% of revenues as compared to \$0.5 million or 6.2% of revenues for the three months ended March 31, 2002. Our higher research and development spending reflects our establishment of an Advanced Development Group in Boulder, Colorado. This Group has been established to broaden our overall product line with new and innovative tape libraries. We expect research and development expenses to remain steady or slightly increase during the next quarter.

SALES AND MARKETING. Sales and marketing expenses consist primarily of employee salaries and benefits, sales commissions, trade show costs, advertising, technical support and travel related expenses. Sales and marketing expenses remained consistent at \$0.9 million for the three months ended March 31, 2003 and 2002. Sales and marketing expenses as a percentage of net revenues were 11.2% for the three months ended March 31, 2003 as compared with 10.0% for the three months ended March 31, 2002. The increase in sales and marketing expenses as a percentage of revenues is primarily due to an overall decrease in revenue of 4.8%. We anticipate sales and marketing expenses will remain stable or increase slightly for the fourth quarter of fiscal year 2003.

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GENERAL AND ADMINISTRATIVE. General and administrative expenses consist of employee salaries and benefits, deferred compensation related to equity incentives, provisions for doubtful accounts and returns and professional service fees. General and administrative expenses for the three months ended March 31, 2003 were \$1.1 million, or 14.0% of net revenues, compared with \$0.9 million, or 11.0% of net revenues, for the three months ended March 31, 2002. The increase in general and administrative expenses is due to increased insurance costs, professional service fees, employee benefit costs, and legal fees. We anticipate that general and administrative expenses will remain stable or slightly increase in the fourth quarter of fiscal 2003.

PROVISION FOR INCOME TAXES. The provision for income taxes was \$7,000 or 38.9% of pre-tax income, for the three months ended March 31, 2003, compared to \$413,000 or 37.3% of pretax income, for the three months ended March 31, 2002.

Nine months ended March 31, 2003 Compared to nine months ended March 31, 2002.

NET REVENUES. Net revenues for the nine months ended March 31, 2003 were \$25.4 million, compared with net revenues of \$27.4 million for the nine months ended March 31, 2002. The primary reason for this decrease is that we sold fewer libraries during the current fiscal year compared with the same period for the prior fiscal year. Sales of tape media, which we purchase from the manufacturers and resell, also declined. The selling prices of our tape libraries have remained relatively stable during the nine month period ended March 31, 2003 compared to the same period a year ago. The selling prices of tape media have decreased slightly since the end of fiscal 2002 whereas the selling prices of tape drives have had an overall increase. The decrease in selling prices of tape media is primarily due to decreases in our cost to purchase media, which we pass through to our customers. The increase in selling prices of tape drives is primarily due to the introduction of new releases of existing tape drive technology, such as SDLT 320, which were not yet available during the first three quarter of fiscal 2002.

GROSS PROFIT. Gross profit was \$9.4 million or 37.1% of net revenues for the nine months ended March 31, 2003 compared to \$10.3 million or 37.6% for the nine months ended March 31, 2002, representing a decrease of 8.6%. Our gross margin is partially a function of the mix of products sold. Generally, larger tape libraries and newer tape drive technologies have higher gross margins than do smaller tape libraries and older tape drive technologies. Furthermore, tape libraries and drives have higher gross profit margins as a percentage of sales than do tape media. The minor decrease in our gross profit margin as a percentage of net revenues is primarily due to product mix.

RESEARCH AND DEVELOPMENT. Research and development expenses consist of engineering salaries, benefits, purchased parts and supplies used in development activities. Research and development expenses for the nine months ended March 31, 2003 were \$2.9 million or 11.4% of revenues as compared to \$1.5 million and 5.6% of revenues for the nine months ended March 31, 2002. Our higher research and development spending reflects our establishment of an Advanced Development Group in Boulder, Colorado. This Group has been established to broaden our overall product line with new and innovative tape libraries.

SALES AND MARKETING. Sales and marketing expenses consist primarily of employee salaries and benefits, sales commissions, trade show costs, advertising, technical support and travel related expenses. Sales and marketing expenses for the nine months ended March 31, 2003 were \$2.8 million, an increase of \$0.7 million compared to the nine months ended March 31, 2002. Sales and marketing expenses as a percentage of net revenues were 11.1% for the nine months ended March 31, 2003 as compared with 7.9% for the nine months ended March 31, 2002. The increase in sales and marketing expenses is attributable primarily to an overall reduction of marketing development funds and rebates from our key suppliers and an increased level of advertising to help launch our new RLS product line. Expenditures on salaries, commissions, and trade shows have remained stable.

GENERAL AND ADMINISTRATIVE. General and administrative expenses consist of employee salaries and benefits, deferred compensation related to equity incentives, provisions for doubtful accounts and returns and professional service fees. General and administrative expenses for the nine months ended March 31, 2003 were \$3.1 million, or 12.1% of net revenues, compared with \$2.7 million, or 9.7% of net revenues, for the nine months ended March 31, 2002. The increase in general and administrative expenses is due to increased insurance costs, professional service fees, employee benefit costs and legal expenses.

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PROVISION FOR INCOME TAXES. The provision for income taxes was \$0.5 million or 47.0% of pre-tax income, for the nine months ended March 31, 2003, compared to \$1.8 million, or 36.5% of pre-tax income, for the nine months ended March 31, 2002. The increase in the provision for income taxes as a percentage of pre-tax income is primarily due to an additional provision in the current year, net of certain items, related to prior fiscal years. This amount was not material to those years and had a greater impact on the current year's effective tax rate due to the low pre-tax book income amount.

LIQUIDITY AND CAPITAL RESOURCES

Historically, we have funded our capital requirements with cash flows from operations. Cash flows provided by operating activities were \$5.9 million and \$2.9 million for the first nine months of fiscal 2003 and 2002, respectively. For the nine months ended March 31, 2003, operating cash was primarily provided by collection of accounts receivables and reductions in inventory levels. For the nine months ended March 31, 2002, operating cash was primarily provided by net income.

Cash provided by investing activities was \$5.7 million during the first nine months of fiscal year 2003. The primary reason for the increase in cash from investing activities was the sale of marketable securities, offset partially by purchases of fixed assets and the assets of N2Power, Inc. During the first nine months of fiscal year 2002, the Company used \$5.6 million of cash in investing activities. This use was attributable to the purchase of marketable securities and fixed assets.

There was no significant cash used or provided by financing activities during the nine month periods ending March 31, 2003, and March 31, 2002, respectively.

On February 12, 2003, we announced that our Board of Directors authorized a program to repurchase up to 500,000 shares of our common stock in open market transactions, block purchases or private transactions. The stock repurchase will be funded by available working capital and is not expected to negatively impact our liquidity. There is no time limit for the completion of the stock repurchase program and it may be discontinued at any time. As of March 31, 2003, the Company had repurchased 69,667 of its common stock through this buyback program for a total expenditure of approximately \$312,000.

We believe our existing cash and cash equivalents, plus anticipated cash flows from operating activities, will be sufficient to fund our working capital and capital expenditure needs for at least the next 12 months. We may utilize cash to invest in businesses, products or technologies we believe are strategic. We regularly evaluate other companies and technologies for possible investment by us. In addition, we have made and expect to make investments in companies with whom we have identified potential synergies. However, we have no present commitments or agreements with respect to any material acquisition of other businesses or technologies.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

We develop products in the United States and sell them worldwide. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Since all sales are currently made in U.S. dollars, a strengthening of the US dollar could make our products less competitive in foreign markets. Our interest income is sensitive to changes in the general level of US interest rates, particularly since the majority of our investments are in short-term instruments. We have no outstanding debt nor do we utilize derivative financial instruments. Therefore, no quantitative tabular disclosures are required.

ITEM 4. Controls and Procedures

The Company's principal executive officer and its principal financial officer have concluded that the Company's disclosure controls and procedures are adequate and effective for the purposes set forth in Exchange Act Rule 13a-14(c). This conclusion was based on an evaluation of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-14(c)) as of a date within 90 days prior to the filing of this Quarterly Report on Form 10-Q.

There were no significant changes in the Company's internal controls or in other factors since the date of this evaluation that could significantly affect the Company's internal controls.

Table of Contents**PART II OTHER INFORMATION****ITEM 1. Legal Proceedings**

On January 10, 2003, Raytheon Company (Raytheon) filed a complaint in the United States District Court for the Eastern District of Texas alleging that Qualstar and seven other named defendants infringe a patent owned by Raytheon entitled Mass Data Storage Library. Raytheon filed an amended complaint on or about February 6, 2003, which includes an allegation that Qualstar's tape libraries infringe Raytheon's patent. The complaint seeks an injunction against all defendants and an unspecified amount of damages. Qualstar responded to the complaint on March 7, 2003 and denied Raytheon's allegations of infringement. A scheduling conference is set for May 20, 2003 to determine future scheduling matters and the trial date. Qualstar and its legal counsel continue to analyze Raytheon's patent and available defenses to the claims of infringement. Based on our analysis, we believe that Raytheon's claims against Qualstar are without merit and we intend to vigorously defend against this complaint.

ITEM 4. Submission of Matters to a Vote of Security Holders

The following matters were voted upon at the Annual Meeting of Stockholders of the Company held on February 6, 2003:

1. The following persons were elected as directors to serve a one year term expiring at the Annual Meeting of Stockholders to be held in 2004 or until their successors are elected and qualified:

Name	Number of Votes Cast	
	For	Authority Withheld
William J. Gervais	9,129,123	67,600
Richard A. Nelson	9,129,123	67,600
Bruce E. Gladstone	9,129,123	67,600
Robert E. Rich	9,129,123	67,600
Trude C. Taylor	9,129,123	67,600
Robert T. Webber	9,129,123	67,600

ITEM 6. Exhibits and Reports on Form 8-K.

- (a) Exhibits:

99.1 Certification by Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99.2 Certification by Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

- (b) No Reports on Form 8-K were filed during the fiscal quarter ended March 31, 2003.

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SIGNATURES

Pursuant to the requirements 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

Dated: May 14, 2003

/s/ WILLIAM J. GERVAIS

**William J. Gervais, President,
Chief Executive Officer**

Dated: May 14, 2003

/s/ FREDERIC T. BOYER

**Frederic T. Boyer
Principal Financial Officer**

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Certification of Principal Executive Officer

I, William J. Gervais, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Qualstar Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Rules 13a-14 and 15d-14 of the Exchange Act) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors:
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ WILLIAM J. GERVAIS

William J. Gervais
Principal Executive Officer

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Certification of Principal Financial Officer

I, Frederic T. Boyer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Qualstar Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Rules 13a-14 and 15d-14 of the Exchange Act) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors:
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ FREDERIC T. BOYER

Frederic T. Boyer
Principal Financial Officer

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EXHIBIT INDEX

Exhibit No.	Description
99.1	Certification by Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.2	Certification by Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.