QUALSTAR CORP
Form 10-Q
November 08, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 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)

(805) 583-7744

(Registrant's telephone number, including area code)

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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or 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 financial 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 Exchange Act). Yes No

At November 1, 2018 the issuer had 2,048,118 shares of common stock, no par value, issued and outstanding.

QUALSTAR CORPORATION

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2018

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PART I — FINANCIAL INFORMATION

ITEM 1. Financial Statements

QUALSTAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	September 30, 2018 (Unaudited)	**December 31, 2017**
Assets		
Current assets:		
Cash and cash equivalents	$ 4,831	$ 4,698
Restricted cash	100	100
Accounts receivables, net	2,046	1,802
Inventories, net	2,718	1,564
Prepaid expenses and other current assets	188	163
Total current assets	9,883	8,327
Non-current assets:		
Property and equipment, net	120	172
Other assets	119	68
Total assets	$ 10,122	$ 8,567
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 1,082	$ 1,065
Accrued payroll and related liabilities	326	173
Deferred service revenue, short-term	710	834
Other accrued liabilities	453	454
Total current liabilities	2,571	2,526
Long-term liabilities:		
Other long-term liabilities	39	52

Deferred service revenue	108	93
Total long-term liabilities	147	145
Total liabilities	2,718	2,671
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, shares issued and outstanding 2,048,118 at September 30, 2018 and 2,042,019 shares at December 31, 2017	19,519	19,480
Accumulated deficit	(12,115)	(13,584)
Total shareholders’ equity	7,404	5,896
Total liabilities and shareholders’ equity	$ 10,122	$ 8,567

See notes to condensed consolidated financial statements.

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QUALSTAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Net revenues	$3,154	$2,755	$9,320	$7,461
Cost of goods sold	1,901	1,697	5,217	4,616
Gross profit	1,253	1,058	4,103	2,845
Operating expenses:				
Engineering	123	131	372	427
Sales and marketing	351	360	1,000	886
General and administrative	374	715	1,262	1,563
Total operating expenses	848	1,206	2,634	2,876
Income (loss) from operations	405	(148)	1,469	(31)
Other expenses	-	-	-	-
Income (loss) before income taxes	405	(148)	1,469	(31)
Provision for income taxes	-	-	-	-
Net income (loss)	$405	$(148)	$1,469	$(31)
Earnings (loss) per share:				
Basic	$0.20	$(0.07)	$0.72	$(0.02)
Diluted	$0.20	$(0.07)	$0.70	$(0.02)
Shares used in per share calculation:				
Basic	2,048	2,042	2,048	2,042
Diluted	2,065	2,042	2,088	2,042

See notes to condensed consolidated financial statements.

QUALSTAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine months Ended September 30, 2018	2017
Cash flows from operating activities:		
Net income (loss)	$1,469	$(31)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	69	119
Loss on disposal of assets	-	5
Provision for recovery of bad debts and returns, net	1	(7)
Provision for inventory obsolescence	227	233
Share based compensation	-	413
Changes in operating assets and liabilities:		
Accounts receivable	(245)	137
Inventories	(1,381)	45
Prepaid expenses and other current assets	(75)	2
Accounts payable	17	14
Accrued payroll and related liabilities	153	(16)
Deferred service revenue	(109)	60
Other accrued liabilities	(14)	8
Total adjustments	(1,357)	1,013
Net cash provided by operating activities	112	982
Cash flows from investing activities:		
Purchases of equipment	(18)	(10)
Net cash used in investing activities	(18)	(10)
Cash flows from financing activities:		
Proceeds from the exercise of stock options	39	-
Net cash provided by financing activities	39	-
Net increase in cash, restricted cash and cash equivalents	133	972
Cash, restricted cash and cash equivalents at beginning of period	4,798	3,791
Cash, restricted cash and cash equivalents at end of period	$4,931	$4,763
Supplemental cash flow disclosures:		

Income taxes paid	$32	$3

See notes to condensed consolidated financial statements.

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying condensed consolidated balance sheet as of December 31, 2017, has been derived from audited consolidated financial statements. The accompanying unaudited interim condensed consolidated financial statements have been prepared on the same basis as our annual audited consolidated financial statements and in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and the rules and regulations of the Securities and Exchange Commission (“SEC”) for interim financial statements.

Preparing condensed consolidated financial statements 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, share-based compensation, forfeiture rates, the potential outcome of future tax consequences of events that have been recognized in our 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.

On June 5, 2017, a wholly-owned subsidiary of Qualstar Corporation, N2Power, Inc., was created to operate the Company’s internal business unit known as N2Power. The N2Power business unit is reflected in the Company’s SEC filings under the power supplies business segment. Following the establishment of N2Power, Inc., all assets (and liabilities) associated with the N2Power business were assigned to the newly created entity.

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.

The Company's significant accounting policies are disclosed in Note 2 to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on March 16, 2018 (the "Annual Report"). There were no material changes to the significant accounting policies during the nine months ended September 30, 2018, apart from the Company's accounting policy related to revenue recognition, as discussed below.

Effective January 1, 2018, the Company adopted Accounting Standards Codification ("ASC") 606, *Revenue from Contracts with Customers* ("ASC 606" or the "New Revenue Standard"), the new standard on revenue from contracts with customers, which codified Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers* ("ASU 2014-09"). As a result, the Company changed its accounting policy for revenue recognition to ensure compliance with ASC 606 as described below.

Principles of Consolidation

The condensed consolidated financial statements include our accounts and the accounts of each of our wholly owned subsidiaries that were in existence during the periods presented: Qualstar Corporation Singapore Private Limited, N2Power, Inc., Qualstar Limited and Q-Smart Data Private Limited. All significant intercompany accounts and transactions have been eliminated in consolidation.

Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with information included in the Company's Annual Report.

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

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.

Furthermore, we recognize revenue when there is persuasive evidence that an arrangement exists, title and risk of loss have passed, delivery has occurred or the services have been rendered, the sales price is fixed or determinable and collection of the related receivable is reasonably assured. 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 or acceptance or when collection is not reasonably assured, 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.

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

Deferred service revenue is shown separately in the condensed consolidated balance sheets as current and long term. At September 30, 2018 we had deferred service revenue of approximately $818,000. At December 31, 2017, we had deferred service revenue of approximately $927,000.

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 in accordance with ASC 450, regardless of whether a liability can be estimated for the contingency itself. Disclosure of a contingency is required if there is at least a reasonable possibility that a loss has been incurred. Changes in these factors could materially impact our condensed consolidated financial statements.

Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, which include cash equivalents, accounts receivable, accounts payable, related party, and other long-term liabilities, approximate their fair values.

Accounting for Income Taxes

We estimate our tax liabilities based on current tax laws in the statutory jurisdictions in which we operate in accordance with ASC 740, “Income Taxes.” 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 derecognition 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.

Operating Segments

The Company operates in two segments, as the chief operating decision maker makes decisions and assesses performance at the divisional level. Operating segments are identified as components of an enterprise about which separate discrete financial information is utilized for evaluation by the chief operating decision maker in making decisions regarding resource allocation and assessing performance. To date, the chief operating decision maker has made such decisions and assessed performance at the two divisional levels. The Company's chief operating decision maker is its President and Chief Executive Officer.

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

NOTE 2 – RECENT ACCOUNTING PRONOUNCEMENTS

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. This standard is effective for fiscal years beginning after December 15, 2018. We are evaluating the impact of ASU 2018-10 and 2018-11 may have on our condensed consolidated financial statements.

In 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. We are evaluating the impact ASU 2016-02 may have on our condensed consolidated financial statements.

NOTE 3 – SIGNIFICANT CUSTOMERS, CONCENTRATION OF CREDIT RISK, AND GEOGRAPHIC INFORMATION

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.

	Three Months Ended				**Nine months Ended**			
	September 30, 2018		**2017**		**September 30, 2018**		**2017**	
Revenue – geographic activity (in thousands):	**(unaudited)**		**(unaudited)**		**(unaudited)**		**(unaudited)**	
	$	**%**	**$**	**%**	**$**	**%**	**$**	**%**
North America	$1,723	54.6 %	$1,962	71.2 %	$5,082	54.5 %	$4,785	64.1 %
Europe	545	17.3 %	356	12.9 %	1,427	15.3 %	1,447	19.4 %
Asia Pacific	883	28.0 %	396	14.4 %	2,769	29.7 %	1,113	14.9 %
Other	3	0.1 %	41	1.5 %	42	0.5 %	116	1.6 %
	$3,154	100.0%	$2,755	100.0%	$9,320	100.0%	$7,461	100.0%

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

Three customers accounted for 12.1%, 11.1% and 10.7% of the Company's net revenue for the three-month period ended September 30, 2018. At September 30, 2018, the same three customers were 60.0% of the accounts receivable balance. One customer accounted for 14.6% of the Company's net revenue for the three-month period ended September 30, 2017. At December 31, 2017, two of the customers from September 30, 2018 represented 31.1% of the total accounts receivable balance.

One customer accounted for 12.3% of the Company's net revenue for the nine-month period ended September 30, 2018. A different customer accounted for 15.0% of the Company's net revenue for the nine-month period ended September 30, 2017.

NOTE 4 – 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.

	Three Months Ended		Nine months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
In thousands (except per share amounts):				
Net income (loss) (a)	$405	$(148)	$1,469	$(31)

Weighted average outstanding shares of common stock (b)	2,048	2,042	2,048	2,042
Dilutive potential common shares from employee stock options	17	—	40	—
Common stock and common stock equivalents (c)	2,065	2,042	2,088	2,042
Income per share:				
Basic net income (loss) per share (a)/(b)	$0.20	$(0.07)	$0.72	$(0.02)
Diluted net income (loss) per share (a)/(c)	$0.20	$(0.07)	$0.70	$(0.02)

For the three and nine months ended September 30, 2018, 1,333 and 188,633 outstanding stock options were excluded from the calculation of diluted net income per share as their inclusion would have been anti-dilutive.

NOTE 5 - BALANCE SHEET DETAILS

The following tables provide details of selected balance sheet accounts (in thousands):

Inventories

Inventories are stated at the lower of cost (first-in, first-out basis) or net realizable value. Inventories are comprised as follows (in thousands):

	September 30, 2018 (unaudited)	**December 31, 2017**
Raw materials	$ 174	$ 55
Finished goods	2,544	1,509
Net inventory balance	$ 2,718	$ 1,564

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QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

Property and equipment, net

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

	September 30, 2018 (unaudited)	**December 31, 2017**
Leasehold improvements	$ 114	$ 114
Furniture and fixtures	286	268
Machinery and equipment	836	842
	1,236	1,224
Less accumulated depreciation and amortization	(1,116)	(1,052)
Property and equipment, net	$ 120	$ 172

Depreciation and amortization expense for the three months ended September 30, 2018 and 2017 was $17,000 and $36,000 (unaudited), respectively, and for the nine months ended September 30, 2018 and 2017 was $69,000 and $119,000 (unaudited), respectively.

Other Accrued Liabilities

The components of other liabilities are as follows (in thousands):

	September 30, 2018 (unaudited)	**December 31, 2017**
Accrued warranty	$ 372	$ 322
Accrued outside commissions	48	69

Deferred rent		24		29
Other accrued liabilities		9		34
Total other accrued liabilities	$	453	$	454

NOTE 6 –CONTINGENCIES

Accrued Warranty

We provide for the estimated costs of hardware warranties at the time the related revenue is recognized. We estimate the costs based on historical and projected product failure rates, historical and projected repair costs, and knowledge of specific product failures (if any). The specific hardware warranty terms and conditions for tape libraries generally include parts and labor over a three-year period. The warranty for power supplies is generally three years. We regularly re-evaluate our estimates to assess the adequacy of the recorded warranty liabilities and adjust the amounts as necessary.

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

Activity in the liability for product warranty, which is included in other accrued liabilities in the condensed consolidated balance sheets for the periods presented, is as follows (in thousands):

	Nine months Ended September 30, 2018 (unaudited)	Year Ended December 31, 2017
Beginning balance	$ 322	$ 236
Cost of warranty claims	(13)	(37)
Accruals for product warranties	63	123
Ending balance	$ 372	$ 322

NOTE 7 –COMMITMENTS

Lease Agreements

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 11, 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 June 30, 2019.

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, in thousands, (unaudited):

Years Ending December 31,	**Minimum Lease Payment**	**Sublease Revenue**	**Net Minimum Lease Payment**
Remainder of 2018	$ 73	(36)	$ 37
2019	274	(147)	127
2020	147	(12)	135
2021	23	-	23
Total Commitment	$ 517	$ (195)	$ 322

Net rent expense for the three months ended September 30, 2018 and 2017 was $37,000 and $36,000, respectively and for the nine months ended September 30, 2018 and 2017 was $113,000 and $107,000, respectively.

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

NOTE 8 –STOCK INCENTIVE PLANS AND SHARE-BASED COMPENSATION

Share-Based Compensation

The Company did not incur an expense for share-based compensation associated with outstanding stock options for the nine months ended September 30, 2018 and 2017. No income tax benefit was recognized in the condensed consolidated statements of operations for share-based arrangements in any period presented. At September 30, 2018, the Company did not have any unrecognized compensation costs related to share-based compensation.

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 could be granted for shares of common stock. The 2008 Plan has expired 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 assumptions, such as volatility, expected term and risk-free interest rate. Expected volatilities are based on the historical volatility of the Company's stock. The Company uses historical data to estimate option exercise and employee termination in determining forfeiture rates. The expected term of options granted is estimated based on the vesting term of the award, historical employee exercise behavior, expected volatility of the Company's stock and an employee's average length of service. The risk-free interest rate used in this model correlates to a U.S. constant rate Treasury security with a contractual life that approximates the expected term of the option award.

The following table summarizes stock option activity:

Options	**Shares**	**Weighted Average Exercise Price per Share**	**Weighted Average Remaining Contractual Term (years)**	**Aggregate Intrinsic Value**
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 September 30, 2018	178,000	7.19	8.01	—
Exercisable at September 30, 2018	178,000	$ 7.19	8.01	$ —

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

NOTE 9 – INCOME TAXES

We did not record a provision or benefit for income taxes for the nine months ended September 30, 2018 and 2017, due to our prior year operating losses. The Company has recorded a full valuation allowance against its net deferred tax assets based on the Company's assessment regarding the realizable nature of these net deferred tax assets in future periods.

NOTE 10 – SEGMENT INFORMATION

In its operation of the business, management reviews certain financial information, including segmented internal profit and loss statements prepared on a basis consistent with U.S. GAAP. Our two segments are Power Supplies and Data Storage. The two segments discussed in this analysis are presented in the way we internally manage and monitor performance for the three and nine months ended September 30, 2018 and 2017. Our allocations of internal resources were made to the two business segments for the three and nine months ended September 30, 2018 and 2017. The types of products and services provided by each segment are summarized below:

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

Storage — The data storage industry is experiencing a tremendous increase in newly generated digital data due to Rich Media Content, Internet of Things, Data Mining and the Cloud. Tape based storage solution providers enable businesses to manage the massive growth of digital data assets in a cost-effective manner. Our tape-based data storage product lines address long-term archive, backup and recovery of electronic data. These products consist of networked libraries that store and move high density tape cartridges and high-speed tape drives that stream data to and from the tape cartridges. These optimized solutions allow the video centric markets such as media and entertainment, oil and gas, surveillance, digital security and medical imaging to achieve targeted data workflows.

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

	Three Months Ended		**Nine months Ended**	
	September 30,		**September 30,**	
	2018	**2017**	**2018**	**2017**
Revenue				
Power Supplies	$1,612	$1,542	$4,598	$4,655
Storage:				
Product	789	791	1,973	1,658
Service	753	422	2,749	1,148
Total storage	$1,542	$1,213	$4,722	$2,806
Revenue	$3,154	$2,755	$9,320	$7,461

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

	Three Months Ended September 30,		Nine months Ended September 30,	
	2018	**2017**	**2018**	**2017**
Income (loss) before Taxes				
Power Supplies	$164	$4	$181	$44
Storage	241	(152)	1,288	(75)
Income (loss) before taxes	$405	$(148)	$1,469	$(31)

	September 30, 2018 (unaudited)	December 31, 2017
Total Assets		
Power Supplies		
Cash and cash equivalents	$ 255	$ 721
Accounts receivable, net	1,248	831
Inventories, net	1,465	725
Property and equipment, net	51	64
Other assets	98	8
Total power supply assets	3,117	2,349
Storage		
Cash and cash equivalents	$ 4,576	$ 3,977
Restricted cash	100	100
Accounts receivable, net	798	971
Inventories, net	1,253	839
Prepaid expenses and other current assets	180	163
Property and equipment, net	69	108
Other assets	29	60
Total storage assets	7,005	6,218
Total Assets	$ 10,122	$ 8,567

NOTE 11 – 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”). 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 three months ended September 30, 2018 and 2017 was $4,000 and $3,000, respectively, and $12,000 and $8,000 for the nine months ended September 30, 2018 and 2017, respectively. Interlink owed Qualstar $1,000 and $2,000 at September 30, 2018 and December 31, 2017, respectively.

The Company reimburses Interlink for expenses paid on the Company’s behalf. Interlink occasionally pays travel and other expenses incurred by Qualstar. The Company reimbursed Interlink $50,000 and $1,000 for the three months ended September 30, 2018 and 2017, respectively, and $180,000 and $8,000 for the nine months ended September 30, 2018 and 2017, respectively. Qualstar did not owe Interlink any monies as of September 30, 2018. At December 31, 2017, Qualstar owed Interlink $17,000.

QUALSTAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

NOTE 12 – SUBSEQUENT EVENTS

None.

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

Statements in this Quarterly Report on Form 10-Q concerning the future business, operating results and financial condition of the Company including estimates, projections, statements relating to our business plans, objectives and operating results, and the assumptions upon which those statements are based, are 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 Part II, Item 1A of this report and in our Annual Report on Form 10-K for the year ended December 31, 2017 in "Item 1 Business," "Item 1A Risk Factors," and in "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations." Forward-looking statements are generally identified 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 o similar terminology. Except as required by law, we undertake no obligation to publicly update or revise any forward-looking statements to reflect the occurrence of events or circumstances in the future.

OVERVIEW

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

The Company is focused on expanding sales in both business units in two key areas: adding key customers and expanding its product portfolio. The data storage business is adding more strategic partners that will expand our geographic footprint and increase our reach to additional industries. The power supply business unit is expanding its customer base in specific market verticals, such as the gaming industry. In addition to adding new internally designed and private label products, the power supply business is focusing on providing value add services in establishing itself as an optimized product development manufacturer (OPDM) for current and future new customers. This will allow N2Power to act as a one-stop shop providing solutions for more complex power assembly units and chassis solutions for their OEM customers.

The Company continues to expand its product portfolio through internal development, private labeling and establishing worldwide partnerships with other power supply and data storage related companies. These new relationships will increase our product development engineering capabilities and help us stay at the forefront of both the data storage and power supply industries.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We describe our significant accounting policies in Note 1, "Summary of Significant Accounting Policies" of the accompanying Notes to Condensed Consolidated Financial Statements.

RESULTS OF OPERATIONS - (Unaudited)

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

	Three Months Ended September 30,				**Nine months Ended September 30,**			
	2018		**2017**		**2018**		**2017**	
	$	%	$	%	$	%	$	%
Power supply revenues	$1,612	51.1 %	$1,542	56.0 %	$4,598	49.3 %	$4,655	62.4 %
Storage revenues	1,542	48.9 %	1,213	44.0 %	4,722	50.7 %	2,806	37.6 %
Net revenues	3,154	100.0%	2,755	100.0%	9,320	100.0%	7,461	100.0%
Cost of goods sold	1,901	60.3 %	1,697	61.6 %	5,217	56.0 %	4,616	61.9 %
Gross profit	1,253	39.7 %	1,058	38.4 %	4,103	44.0 %	2,845	38.1 %
Operating expenses:								
Engineering	123	3.9 %	131	4.8 %	372	4.0 %	427	5.7 %
Sales and marketing	351	11.1 %	360	13.1 %	1,000	10.7 %	886	11.9 %
General and administrative	374	11.9 %	715	26.0 %	1,262	13.5 %	1,563	20.9 %
Total operating expenses	848	26.9 %	1,206	43.8 %	2,634	28.3 %	2,876	38.5 %
Income (loss) from operations	405	12.8 %	(148)	(5.4)%	1,469	15.8 %	(31)	(0.4)%
Other expense	-	- %	-	- %	-	- %	-	- %
Net income (loss)	$405	12.8 %	$(148)	(5.4)%	$1,469	15.8 %	$(31)	(0.4)%

<u>Comparison of the Three Months Ended September 30, 2018 and 2017 (unaudited)</u>

Change in Net Revenues:

Three months Ended September 30,

	2018			2017			Change	
	Amount	% of net revenue		Amount	% of net revenue		Amount	%
Power supply revenues	$1,612	51.1	%	$1,542	56.0	%	$70	4.5 %
Storage revenues	1,542	48.9	%	1,213	44.0	%	329	27.1%
Net revenues	$3,154	100.0	%	$2,755	100.0	%	$399	14.5%

The increase in net revenues for the three months ended September 30, 2018 compared to the prior year period is attributable to the segment-specific factors described below.

Segment Revenue

Power Supplies – The increase in power supply sales in the three months ended September 30, 2018 compared to the prior year period is primarily attributable to the increased orders from existing customers experiencing a rise in production.

Storage – For the three months ended September 30, 2018 compared to the prior year period we experienced growth in our service revenue, primarily due to the product development service revenue received from our recent 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:

	Three months Ended September 30,					
	2018		2017		Change	
	Amount	% of net revenue	Amount	% of net revenue	Amount	%
Gross profit	$1,253	39.7 %	$1,058	38.4 %	$195	18.4%

The gross profit increase for the three months ended September 30, 2018 compared to the prior year period is primarily attributed to the increased revenue in both business units with overhead costs, which are predominantly fixed, remaining relatively flat.

Operating Expenses:

	Three months Ended September 30,					
	2018		2017		Change	
	Amount	% of net revenue	Amount	% of net revenue	Amount	%
Engineering	$123	3.9 %	$131	4.8 %	$(8)	(6.1)%
Sales and marketing	$351	11.1 %	$360	13.1 %	$(9)	(2.5)%
General and administrative	$374	11.9 %	$715	26.0 %	$(341)	(47.7)%

Engineering

Engineering expenses decreased in the three months ended September 30, 2018 from the prior year period from a reduction of stock compensation, as the Company did not issue stock options in the current period.

Sales and Marketing

Sales and marketing expenses decreased during the three months ended September 30, 2018 from the prior year period, primarily from a reduction of stock compensation, as the Company did not issue stock options in the current period, offset by an increase in travel, tradeshows and promotion material.

General and Administrative

General and administrative costs decreased during the three months ended September 30, 2018 from the prior year period from a reduction of stock compensation, as the Company did not issue stock options in the current period. Also, there was a reduction in legal fees and other professional services.

Provision for Income Taxes: We did not record a provision or benefit for income taxes for each of the three and nine months ended September 30, 2018 and 2017, due to our prior year operating losses. There were no changes to the valuation allowance during the nine months ended September 30, 2018.

<u>Comparison of the Nine months Ended September 30, 2018 and 2017 (unaudited)</u>

Change in Net Revenues:

	Nine months Ended September 30,								
	2018			**2017**			**Change**		
	Amount	**% of net revenue**		**Amount**	**% of net revenue**		**Amount**	**%**	
Power supply revenues	$4,598	49.3	%	$4,655	62.4	%	$(57	)	(1.2)%
Storage revenues	4,722	50.7	%	2,806	37.6	%	1,916		68.3%
Net revenues	$9,320	100.0	%	$7,461	100.0	%	$1,859		24.9%

The increase in net revenues for the nine months ended September 30, 2018 compared to the prior year period is attributable to the segment-specific factors described below.

Segment Revenue

<u>Power Supplies</u> – The decrease in power supply sales in the nine months ended September 30, 2018 compared to the prior year period is primarily attributable to the current global electronic component shortage, which creates longer delivery times to fulfill our customer orders and accordingly reduced our revenue for the period. Additionally, key customers that incorporate our power supplies have variable production demands, which caused revenue fluctuations over the reporting period.

<u>Storage</u> – For the nine months ended September 30, 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. Our service revenue increased compared to the prior year period, primarily due to the product development service revenue received from our recent 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:

	Nine months Ended September 30,							
	2018			2017			Change	
	Amount	% of net revenue		Amount	% of net revenue		Amount	%
Gross profit	$4,103	44.0	%	$2,845	38.1	%	$1,258	44.2%

The gross profit increase for the nine months ended September 30, 2018 compared to the prior year period is primarily attributed to the increased data storage revenue offset with a reduction in power supply sales with overhead costs remaining relatively consistent.

Operating Expenses:

	Nine months Ended September 30,					
	2018		2017		Change	
	Amount	% of net revenue	Amount	% of net revenue	Amount	%
Engineering	$372	4.0 %	$427	5.7 %	$(55)	(12.9)%
Sales and marketing	$1,000	10.7 %	$886	11.9 %	$114	12.9 %
General and administrative	$1,262	13.5 %	$1,563	20.9 %	$(301)	(19.3)%

Engineering

Engineering expenses decreased in the nine months ended September 30, 2018 from the prior year period as a result of a reduction in stock compensation, as the Company did not issue stock options in the current period, and lower costs related to compliance testing.

Sales and Marketing

Sales and marketing expenses increased during the nine months ended September 30, 2018 from the prior year period, primarily as a result of an increase in headcount and increases in salaries, marketing consulting costs, promotional materials costs, tradeshow expenses and commission expenses.

General and Administrative

General and administrative costs decreased during the nine months ended September 30, 2018 from the prior year period primarily due to a reduction in stock compensation, as the Company did not issue stock options in the current year, and a reduction in professional services, offset by an increase in travel expenses.

Provision for Income Taxes: We did not record a provision or benefit for income taxes for each of the nine months ended September 30, 2018 and 2017, due to our prior year operating losses. There were no changes to the valuation allowance during the nine months ended September 30, 2018.

CONTRACTUAL OBLIGATIONS

The disclosures relating to our contractual obligations in our Annual Report on Form 10-K for the year ended December 31, 2017 has not materially changed since the report was filed.

OFF-BALANCE SHEET ARRANGEMENTS

As of the date of this Quarterly Report on Form 10-Q, we do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

LIQUIDITY AND CAPITAL RESOURCES

Operating Activities

Our principal source of liquidity is cash generated from operations. Net cash provided by operating activities was $112,000 for the nine months ended September 30, 2018 compared to the net cash provided by operating activities of $982,000 for the nine months ended September 30, 2017.

The cash provided by operating activities for the nine months ended September 30, 2018 of $112,000 consisted of the operating income for the period of $1,469,000, increased by non-cash adjustments of $297,000, and offset by changes in operating assets and liabilities of $1,654,000, largely due to the increase in inventory of $1,381,000 to support sales demand.

Investing Activities

Cash used by investing activities was $18,000 for the nine months ended September 30, 2018 relating to the purchase of software and equipment. For the nine months ended September 30, 2017, cash used in investing activities was $10,000.

Financing Activities

Cash provided by financing activities was $39,000 from the exercise of stock options during either the nine months ended September 30, 2018. Cash was not provided by or used in financing activities during the nine months ended September 30, 2017.

As of September 30, 2018, cash, restricted cash and cash equivalents increased $133,000 to $4,931,000 from $4,798,000 at December 31, 2017.

The Company’s efforts to control costs and increase revenues in prior periods are reflected in the positive cash flow in this quarter.

We believe that our existing cash and cash equivalents and cash flows from our operating activities will be sufficient to fund our working capital and capital expenditure needs for at least twelve months from the date of this report. We may utilize cash to invest in or acquire businesses, products or technologies that we believe are additive to the strategic expansion of the Company. We periodically evaluate other companies and technologies for possible investment or acquisition. In addition, we have made, and may in the future make, investments in companies with whom we have identified potential synergies. However, we have no present commitments or agreements with respect to any material investment in or acquisition of other businesses or technologies. In the event that we require additional capital to meet our business needs, there can be no assurance that additional funding will be available to us when needed or, if available, that it can be obtained on commercially reasonable terms.

ITEM 3. Qualitative and Quantitative Disclosures about Market Risk

Not applicable.

ITEM 4. Controls and Procedures

We maintain "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, that are designed to ensure that information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, as applicable, to allow timely decisions regarding required disclosure.

Evaluation of disclosure and controls and procedures

As of the end of the period covered by this report, 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 disclosure controls and procedures. Based on the evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that our disclosure controls and procedures are operating in an effective manner to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Changes in internal controls over financial reporting

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during our most recent quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there is only reasonable assurance that our controls will succeed in achieving their stated goals under all potential future conditions.

PART II — OTHER INFORMATION

ITEM 1. 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.

ITEM 1A. Risk Factors

Except as set forth below, during the nine months ended September 30, 2018, there have been no significant changes to the risk factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017.

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 in 2018, 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 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

ITEM 3. Defaults upon Senior Securities

None.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

		Incorporated by Reference				
Exhibit Number	**Exhibit Description**	**Form**	**File Number**	**Exhibit**	**Filing Date**	**Filed Herewith**
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
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					X
101.SCH	XBRL Taxonomy Extension Schema Document					X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document					X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document					X

101.LAB	XBRL Taxonomy Extension Label Linkbase Document	X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	X

**Furnished herewith

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: November 8, 2018 By: /s/ STEVEN N. BRONSON
Steven. N. Bronson
Chief Executive Officer and President
(Principal Executive Officer)