Qualstar Corporation and Subsidiaries

Annual Report
for the Year Ended December 31, 2021

Qualstar Corporation
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Irvine, CA 92618
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Business

Overview

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

Qualstar Corporation was incorporated in California in 1984 and has five wholly owned subsidiaries. The N2Power, Inc. subsidiary (N2Power) operates the Company's power supplies business. The Qualstar Corporation Singapore Private Limited subsidiary gives the Company an engineering footprint in Singapore, and participates in serving our Asian contract manufacturers, distribution partners, and customers. The Qualstar Limited (U.K.) subsidiary expands the Company's data storage business in Europe and Africa. And, the Q-Smart Data Private Limited (Singapore) and Q-Smart Data Limited (China) subsidiaries pursue new business opportunities in Asia.

The Company is focused on expanding sales in both business units in two key areas: adding key customers and expanding its product portfolios. The data storage business is expanding its geographic footprint and adding more strategic partners in order to increase our reach to additional customers and industries and increase our product development capabilities. The power supplies business is expanding its sales resources and partners in an effort to grow its customer base in specific market verticals. In addition to adding new internally designed and private label products, the power supplies business is also focusing on providing value-add services in establishing itself as an optimized product development manufacturer 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 its OEM customers.

We sell our products globally through authorized resellers, distributers, and directly to OEMs. Our data storage products are manufactured by our OEM suppliers in other parts of the world and configured to order by us at our facility in Camarillo, California, or at our facility in Shenzhen, China, or by our fulfilment and logistics partner in Warsaw, Poland. N2Power utilizes contract manufacturers in Asia to produce our power solutions products.

Our principal executive office is located at 1 Jenner, Suite 200, Irvine, California 92618, and the telephone number is (805) 583-7744. Our website address is www.qualstar.com.

Market Information

The Company's common stock is quoted on the OTCPink marketplace of the OTC Markets Group under the symbol "QBAK". As of March 28, 2022, the Company had approximately 23 shareholders of record of its common stock.

Other Information

The Company's securities were registered under Section 12(g) of the Securities Exchange Act of 1934 (the "Exchange Act"). In May 2020, we filed Form 15-12g to terminate the registration and reporting obligations under Section 12(g) of the Exchange Act. Since then, we make available our annual financial statements, quarterly financial statements, and other significant reports and amendments to such reports, free of charge, on our website as soon as reasonably practicable after such reports are prepared. Our website address is www.qualstar.com.

INDEX TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

QUALSTAR CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)
(unaudited)

	December 31, 2021	December 31, 2020
Assets		
Current assets:		
Cash and cash equivalents	$ 4,095	$ 4,157
Restricted cash	100	100
Accounts receivable, net	1,354	1,379
Inventories	2,276	1,910
Prepaid expenses and other current assets	304	164
Total current assets	8,129	7,710
Property and equipment, net	124	103
Right-of-use assets	300	428
Deferred tax assets	30	30
Other assets	24	35
Total assets	$ 8,607	$ 8,306
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 977	$ 666
Accrued payroll and related liabilities	188	214
Deferred service revenue	622	600
Lease liabilities, current	117	254
PPP loan	-	258
Other accrued liabilities	168	183
Total current liabilities	2,072	2,175
Long-term liabilities:		
Lease liabilities, long term	204	198
Deferred service revenue, long-term	447	274
Other long-term liabilities	28	42
Total long-term liabilities	679	514
Total liabilities	2,751	2,689
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Preferred stock, no par value; 5,000,000 shares authorized; no shares issued	-	-
Common stock, no par value; 50,000,000 shares authorized; shares issued and outstanding 1,884,033 at December 31, 2021, and 1,950,025 at December 31, 2020	18,789	18,980
Accumulated deficit	(12,933)	(13,363)
Total shareholders' equity	5,856	5,617
Total liabilities and shareholders' equity	$ 8,607	$ 8,306

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

	Three Months Ended December 31,		Year Ended December 31,	
	2021	2020	2021	2020
Net revenues	$ 2,443	$ 2,280	$ 9,164	$ 8,097
Cost of goods sold	1,460	2,187	5,997	5,790
Gross profit	983	93	3,167	2,307
Operating expenses:				
Engineering	76	159	451	501
Sales and marketing	370	509	1,476	1,516
General and administrative	101	431	809	1,551
Total operating expenses	547	1,099	2,736	3,568
Income (loss) from operations	436	(1,006)	431	(1,261)
Other income (expense), net	3	(2)	2	7
Income (loss) before income taxes	439	(1,008)	433	(1,254)
Provision for income taxes	3	4	3	4
Net income (loss)	$ 436	$ (1,012)	$ 430	$ (1,258)
Earnings (loss) per share:				
Basic	$ 0.23	$ (0.52)	$ 0.22	$ (0.65)
Diluted	$ 0.23	$ (0.52)	$ 0.22	$ (0.65)
Weighted average common shares outstanding:				
Basic	1,888	1,929	1,934	1,926
Diluted	1,888	1,929	1,934	1,926

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

	Common Stock			Accumulated		
Three Months Ended December 31, 2021	**Shares**		**Amount**		**Deficit**		**Total**
Balances at September 30, 2021	1,892	$	18,807	$	(13,369)	$	5,438
Share repurchases	(8)		(18)		-		(18)
Share-based compensation	-		-		-		-
Net income (loss)	-		-		436		436
Balances at December 31, 2021	1,884	$	18,789	$	(12,933)	$	5,856

	Common Stock				Accumulated		
Year Ended December 31, 2021	**Shares**		**Amount**		**Deficit**		**Total**
Balances at December 31, 2020	1,950	$	18,980	$	(13,363)	$	5,617
Share repurchases	(69)		(201)		-		(201)
Share-based compensation	3		10		-		10
Net income (loss)	-		-		430		430
Balances at December 31, 2021	1,884	$	18,789	$	(12,933)	$	5,856

	Common Stock				Accumulated		
Three Months Ended December 31, 2020	**Shares**		**Amount**		**Deficit**		**Total**
Balances at September 30, 2020	1,925	$	18,848	$	(12,351)	$	6,497
Share-based compensation	25		132		-		132
Net income (loss)	-		-		(1,012)		(1,012)
Balances at December 31, 2020	1,950	$	18,980	$	(13,363)	$	5,617

	Common Stock				Accumulated		
Year Ended December 31, 2020	**Shares**		**Amount**		**Deficit**		**Total**
Balances at December 31, 2019	1,925	$	18,848	$	(12,105)	$	6,743
Share-based compensation	25		132		-		132
Net income (loss)	-		-		(1,258)		(1,258)
Balances at December 31, 2020	1,950	$	18,980	$	(13,363)	$	5,617

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

	Year Ended December 31, 2021		Year Ended December 31, 2020	
Cash flows from operating activities:				
Net income (loss)	$	430	$	(1,258)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:				
Depreciation and amortization		35		42
Share-based compensation		10		132
Adjustment to reconcile operating lease expense to cash paid		(4)		(4)
Gain on forgiveness of PPP loan		(521)		-
Changes in operating assets and liabilities:				
Accounts receivable		25		987
Inventories		(366)		630
Prepaid expenses and other assets		(129)		144
Accounts payable		311		(363)
Accrued payroll and related liabilities		(26)		23
Deferred service revenue		194		(75)
Other liabilities		(27)		(198)
Net cash provided by (used in) operating activities		(68)		60
Cash flows from investing activities:				
Purchases of property and equipment		(56)		(24)
Net cash used in investing activities		(56)		(24)
Cash flows from financing activities:				
Share repurchases		(201)		-
Proceeds received from PPP loan		263		258
Net cash provided by financing activities		62		258
Net increase (decrease) in cash, cash equivalents, and restricted cash		(62)		294
Cash, cash equivalents, and restricted cash at beginning of period		4,257		3,963
Cash, cash equivalents, and restricted cash at end of period	$	4,195	$	4,257
Reconciliation of cash, cash equivalents and restricted cash, end of period:				
Cash and cash equivalents, end of period	$	4,095	$	4,157
Restricted cash, end of period		100		100
Cash, cash equivalents and restricted cash, end of period	$	4,195	$	4,257
Supplemental disclosure of cash flow information:				
Income taxes paid	$	2	$	9
Interest paid	$	-	$	-

Note 1 – Significant Accounting Policies

Business

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

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We sell our products globally through authorized resellers, distributers, and directly to OEMs. Our data storage products are manufactured by our OEM suppliers in other parts of the world and configured to order by us at our facility in Camarillo, California, or at our facility in Shenzhen, China, or by our fulfilment and logistics partner in Warsaw, Poland. N2Power utilizes contract manufacturers in Asia to produce our power solutions products.

Principles of Consolidation

The 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: N2Power, Inc., Qualstar Corporation Singapore Private Limited, Qualstar Limited (U.K.), Q-Smart Data Private Limited (Singapore), and Q-Smart Data Limited (China). All significant intercompany accounts and transactions have been eliminated in consolidation.

Estimates and Assumptions

Preparing financial statements in accordance with accounting principles generally accepted in the United States of America (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples include estimates of loss contingencies, product life cycles and inventory obsolescence, bad debts, sales returns, warranty costs, share-based compensation forfeiture rates, the tax consequences of events that have been recognized in our consolidated financial statements or tax returns, and determining when investment impairments are other-than-temporary. Actual results and outcomes may differ from management’s estimates and assumptions.

Public Health Threats

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

Revenue Recognition

The Company recognizes revenue when its customer obtains control of promised goods or services, in an amount that reflects the consideration which we expect to receive in exchange for those goods or services. To determine revenue recognition for arrangements that the Company determines are within the scope of ASC 606, we perform the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) we satisfy a performance obligation. The five-step model is applied to contracts when it is probable that we will collect the consideration we are entitled to in exchange for the goods or services transferred to the customer. At contract inception, once the contract is determined to be within the scope of ASC 606, we assess the goods or services promised within each contract and determine those that are performance obligations and assess whether each promised good or service is distinct. We then recognize revenue in the amount of the transaction price that is allocated to the respective performance obligation when (or as) the performance obligation is satisfied.

Title and risk of loss generally pass to our customers upon shipment. In limited circumstances where either title or risk of loss pass upon destination, we defer revenue recognition until such events occur. We derive revenues from two primary sources: products and services. Product revenue includes the shipment of product according to the agreement with our customers for data storage products and power supplies. Services include customer support (technical support), installations, consulting, and design services. A contract may include both product and services. Rarely, contracts with customers contain multiple performance obligations. For these contracts, the Company accounts for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations on a relative standalone selling price basis. Standalone selling prices are typically estimated based on observable transactions when these services are sold on a standalone basis.

A variety of technical services can be contracted by our customers for a designated period of time. The service contracts allow customers to call Qualstar for technical support, replace defective parts and to have onsite service provided by Qualstar's third party contract service provider. We record revenue for contract services at the amount of the service contract, but such amount is deferred at the beginning of the service term and amortized ratably over the term of the contract.

Deferred service revenue is shown separately in the consolidated balance sheets as current and long term. At December 31, 2021 we had deferred service revenue of approximately $1,069,000. At December 31, 2020 we had deferred service revenue of approximately $874,000.

Cash and Cash Equivalents

Qualstar classifies as cash equivalents only cash and those investments that are highly liquid, interest-earning investments with original maturities of three months or less from the date of purchase.

Restricted Cash

At December 31, 2021 and 2020, $100,000 in cash was restricted for use as collateral for the Company's credit cards.

Concentration of Credit Risk, Other Concentration Risks and Significant Customers

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

We have no auction rate securities or derivative financial instruments in our investment portfolio. Cash and other investments may be in excess of FDIC insurance limits.

Our financial results could be affected by changes in foreign currency exchange rates or weak economic conditions in foreign markets. As all sales are currently made in U.S. dollars, a strengthening of the dollar could make our products less competitive in foreign markets. Sales outside North America represented approximately 25% and 41% of net revenues for the years ended December 31, 2021 and 2020, respectively.

One customer accounted for greater than 10% of the Company’s revenues for the year ended December 31, 2021. No customer accounted for greater than 10% of the Company’s revenues for the year ended December 31, 2020.

Suppliers

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

Allowance for Doubtful Accounts

The allowance for doubtful accounts reflects our best estimate of probable losses inherent in the accounts receivable balance. We determine the allowance based on known troubled accounts, historical experience, and other currently available evidence.

Inventories

Inventories are stated at the lower of cost (first in, first out basis) or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis.

Property and Equipment, net

Property and equipment are recorded at cost less accumulated depreciation and amortization. Depreciation expense is computed using the straight-line method. Leasehold improvements are amortized over the shorter of the estimated useful life of the asset or the term of the lease. Estimated useful lives are as follows:

Machinery and equipment	5-7 years
Furniture and fixtures	5-7 years
Leasehold improvements	3-5 years
Computer equipment	3-5 years

Expenditures for normal maintenance and repairs are charged to expense as incurred, and improvements are capitalized. Upon the sale or retirement of property or equipment, the asset cost and related accumulated depreciation are removed from the respective accounts and any gain or loss is included in the results of operations.

Long-Lived Assets

Qualstar evaluates long-lived assets for potential impairment whenever events or changes in circumstances indicate the carrying amount of any asset may not be recoverable. An impairment loss would be recognized when the estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition is less than the carrying amount. If impairment is indicated, the amount of the loss to be recorded is based upon an estimate of the difference between the carrying amount and the fair value of the asset. Fair value is based upon discounted cash flows expected to result from the use of the asset and its eventual disposition and other valuation methods. No impairment losses of long-lived assets were recognized during the periods presented.

Shipping and Handling Costs

Qualstar records all customer charges for outbound shipping and handling to freight revenue. All inbound and outbound shipping and fulfillment costs are classified as costs of goods sold.

Warranty Obligations

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

We provide a three-year warranty on all XLS and RLS libraries and a two-year warranty on our Q-Series libraries. This includes replacement of components, or if necessary, complete libraries. XLS libraries sold in North America also include one year of on-site service. Customers may purchase on-site service if they are located in the United States and selected countries in Europe, Asia Pacific and Latin America. All customers may purchase extended warranty service coverage upon expiration of the standard warranty.

We provide a three-year warranty on all power supplies that includes repair or, if necessary, replacement of the power supply.

Engineering

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

Advertising

Advertising and promotion expenses include costs associated with direct and indirect marketing, trade shows and public relations. Qualstar expenses all costs of advertising and promotion as incurred. Advertising and promotion expenses for the years ended December 31, 2021 and 2020 were approximately $28,000 and $12,000, respectively.

Legal and Other Contingencies

The Company is subject to a variety of claims and legal proceedings that arise from time to time in the ordinary course of business. Although management currently believes that resolving claims against us, individually or in the aggregate, will not have a material adverse impact on our consolidated financial statements, these matters are subject to inherent uncertainties and management's view of these matters may change in the future. An estimated loss from a loss contingency such as a legal proceeding or claim is accrued by a charge to income if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Disclosure of a contingency is required if there is at least a reasonable possibility that a loss has been incurred. Changes in these factors could materially impact our consolidated financial statements. No loss contingency was recorded as of December 31, 2021 and 2020.

Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, which include cash equivalents, accounts receivable, accounts payable, lease liabilities, and the PPP loan, approximate their fair values.

Share-Based Compensation

Share-based compensation cost is measured at the grant date based on fair value of the award and is recognized as expense over the applicable vesting period of the stock award using the straight-line method.

Income Taxes

Income taxes are accounted for using the liability method. Under this method, deferred tax liabilities and assets are recognized for the expected future tax consequences of temporary differences between the financial statement and tax bases of assets and liabilities, and for the expected future tax benefit to be derived from tax credits and loss carryforwards. Current income tax expense or benefit represents the amount of income taxes expected to be payable or refundable for the current year. A valuation allowance is established when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Leases

The Company accounts for its leases under ASC 842, *Leases*. Under this guidance, arrangements meeting the definition of a lease are classified as operating or financing leases, and are recorded on the consolidated balance sheet as both a right-of-use asset and lease liability, calculated by discounting fixed lease payments over the lease term at the rate implicit in the lease or the Company's incremental borrowing rate. Lease liabilities are increased by interest and reduced by payments each period, and the right-of-use asset is amortized over the lease term. For operating leases, interest on the lease liability and the amortization of the right-of-use asset result in straight-line rent expense over the lease term. For finance leases, interest on the lease liability and the amortization of the right-of-use asset results in front-loaded expense over the lease term. Variable lease expenses are recorded when incurred.

In calculating the right-of-use asset and lease liability, the Company has elected to combine lease and non-lease components. The Company excludes short-term leases having initial terms of 12 months or less as an accounting policy election and recognizes rent expense on a straight-line basis over the lease term.

Earnings Per Share

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

Operating Segments

The Company operates in two segments, Data Storage and Power Supplies. Operating segments are identified as functional groups within an enterprise for which discrete financial information is utilized by the chief operating decision maker in allocating resources and assessing performance. In the case of Qualstar, the chief operating decision maker is its President and Chief Executive Officer. This position maintains decision-making control over, and assesses the performance of, the two divisional levels of the Company.

Recent accounting guidance not yet adopted

We reviewed all recently issued, but not yet effective, accounting pronouncements and concluded none are expected to be applicable or material to our consolidated financial statements.

Subsequent Events

The Company has evaluated subsequent events through March 28, 2022, being the date these consolidated financial statements were issued.

Note 2 – Balance Sheet Details

Inventories

Inventories are comprised as follows:

Inventories	December 31, 2021	December 31, 2020
	(In thousands)	
Raw materials	$ 164	$ 101
Finished goods	2,218	1,809
Net inventory balance	$ 2,382	$ 1,910

Property and Equipment, net

The components of property and equipment are as follows:

Property and equipment, net	December 31, 2021	December 31, 2020
	(In thousands)	
Machinery and equipment	$ 382	$ 609
Furniture and fixtures, and computer equipment	258	260
Leasehold improvements	119	78
	759	947
Less accumulated depreciation and amortization	(635)	(844)
Property and equipment, net	$ 124	$ 103

Depreciation and amortization expense for the years ended December 31, 2021 and 2020 was $35,000 and $42,000, respectively.

Accrued Payroll and Related Liabilities

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

Accrued payroll and related liabilities	December 31, 2021	December 31, 2020
	(In thousands)	
Accrued salaries, wages, and payroll taxes	$ 82	$ 99
Accrued vacation	106	115
Total accrued payroll and related liabilities	$ 188	$ 214

Other Accrued Liabilities

The components of other accrued liabilities are as follows:

Other accrued liabilities	December 31, 2021	December 31, 2020
	(In thousands)	
Accrued warranty	$ 142	$ 144
Accrued outside commissions	26	31
Other accrued liabilities	-	8
Total other accrued liabilities	$ 168	$ 183

Note 3 – Paycheck Protection Program Loans

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

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

Note 4 – Income Taxes

The provision for income taxes is comprised of the following:

	Year Ended December 31, 2021	Year Ended December 31, 2020
	(In thousands)	
Current:		
Federal	$ -	$ -
State	3	4
Foreign	-	-
Current income tax provision (benefit)	3	4
Deferred:		
Federal	-	-
State	-	-
Foreign	-	-
Deferred income tax provision (benefit)	-	-
Net income tax provision (benefit)	$ 3	$ 4

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

	Year Ended December 31, 2021	Year Ended December 31, 2020
Statutory federal income tax provision (benefit)	21.0 %	21.0 %
State income taxes, net of federal income tax benefit	(1.3)	3.3
Foreign income taxes, net of federal income tax benefit	4.9	-
PPP loan forgiveness – exempt income	(25.1)	-
Deferred tax adjustment – NOL / share-based compensation	(0.1)	(13.9)
Valuation allowance	0.1	(8.9)
Other	1.2	(1.5)
Effective income tax rate	0.7 %	- %

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

	December 31, 2021	December 31, 2020
	(In thousands)	
Deferred tax assets:		
Net operating loss carry forwards	$ 8,166	$ 8,097
Engineering credit carry forwards	1,920	1,920
Inventory reserves	508	567
Allowance for bad debts and returns	2	4
Share-based compensation	96	95
Capitalized inventory costs, and other accruals	229	267
Total gross deferred tax assets	10,921	10,950
Less valuation allowance on deferred tax assets	(10,810)	(10,803)
Net deferred tax assets	111	147
Deferred tax liabilities:		
Depreciation and other	(2)	(3)
Right-of-use assets	(79)	(114)
Total deferred tax liabilities	(81)	(117)
Net deferred taxes	$ 30	$ 30

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

The Company records a valuation allowance against its net deferred income tax assets when, in management's judgment, it is more likely than not that the deferred income tax assets will not be realized in the foreseeable future. For the years ended December 31, 2021 and 2020, the Company placed a valuation allowance on net deferred tax assets. With the exception of a small amount of the California net operating loss ("NOL") carryforward, the Company continues to fully offset its deferred tax assets with a valuation allowance. With regard to California deferred tax assets, because Qualstar files on a separate company basis, and because Qualstar expects to generate income in the foreseeable future applicable to California, the Company reduced a portion of the valuation allowance related to Qualstar's separate company NOL carryforwards.

The Company had NOL carryforwards for federal income tax purposes of approximately $32.1 million as of December 31, 2021 and $31.9 million as of December 31, 2020. The Company had NOL carryforwards for state income tax purposes of approximately $21.6 million as of December 31, 2021 and $21.1 million as of December 31, 2020. The Company had engineering and other credit carryforwards for tax purposes of $2.7 million as of December 31, 2021 and $2.7 million as of December 31, 2020.

If not utilized, the federal NOL will begin to expire in 2026, and other tax credits will expire beginning in 2024. If not utilized, the state NOL will begin to expire in 2022. The state engineering credit has no limit on the carryforward period.

For U.S. purposes, the Company completed an evaluation, as of December 31, 2017, of the NOL and credit carryforward utilization limitations under Internal Revenue Code, as amended (the "Code") Section 382 and 383, change of ownership rules. Code Sections 382 and 383 impose certain limitations on the use of NOL or credit carryforwards in certain situations, including when a company has a change in ownership as defined in such sections. As of December 31, 2017, the Company has determined that it has not had a change in ownership within the meaning of Code Sections 382 and 383. Management, at the date of this filing, is of the opinion that its NOL and credit carryforwards should not be limited, pursuant to Sections 382 and 383, as to the amount of such carryforwards that can be utilized each year.

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

	Year Ended December 31, 2021	Year Ended December 31, 2020
	(In thousands)	
Balance at beginning of year	$ 27	$ 29
Increases related to tax positions taken in current year	-	-
Increases related to tax positions taken in prior year	-	-
Decreases due to lapse of statute of limitations and other adjustments	-	(2)
Related interest and penalties, net of federal tax benefit	-	-
Balance at end of year	$ 27	$ 27

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

The Company's policy is to include interest and penalties on uncertain tax positions in income tax expense, but they are not significant for the years ended December 31, 2021 and 2020. The Company files its tax returns by the laws of the jurisdictions in which it operates. The Company's federal tax returns for the years 2018 and subsequent and California tax returns for the years 2017 and subsequent, are still subject to examination. Various state and foreign jurisdictions' tax years remain open to examination as well, though the Company believes any additional assessment will be immaterial to its consolidated financial statements. The Company does not have any open examinations as of December 31, 2021. For the years ended December 31, 2021 and 2020, the operations of Qualstar Corporation Singapore Private Limited, Qualstar Limited, Q-Smart Data Private Limited (Singapore), and Q-Smart Data Limited (China) were not material for tax purposes and had no significant impact on the tax provision.

Note 5 – Stockholders' Equity

Preferred Stock

The Company's Articles of Incorporation allow for the issuance of up to 5,000,000 shares of preferred stock. The Board of Directors has authority to fix the rights, preferences, privileges and restrictions, including voting rights, of these shares of preferred stock without any vote or action by the shareholders. At December 31, 2021 and 2020, there were no outstanding shares of preferred stock.

Common Stock

The Company's Articles of Incorporation allow for the issuance of up to 50,000,000 shares of common stock. At December 31, 2021 and 2020, there were 1,884,033 and 1,950,025 shares of common stock outstanding, respectively.

Stock Repurchase Program

In September 2021, the board of directors approved a stock repurchase program (the "Stock Repurchase Program") to repurchase shares of the Company's common stock. The Stock Repurchase Program permits the Company to repurchase up to a maximum of 500,000 shares of common stock at an aggregate purchase price of up to $1,500,000. Under the Stock Repurchase Program, during the year ended December 31, 2021, the Company repurchased 69,326 shares for an aggregate purchase price of $201,000.

Note 6 – Stock Based Compensation

Stock Incentive Plan

The Company's 2017 Stock Incentive Plan (the "2017 Plan") permits the award of stock options (both incentive and non-qualified options), stock appreciation rights, restricted stock, restricted stock units, unrestricted stock, performance shares, dividend equivalent rights and cash-based awards to employees (including executive officers), directors and consultants of the Company and its subsidiaries. The 2017 Plan authorizes the issuance of an aggregate of 300,000 shares of common stock, of which 173,700 shares remain available for issuance as of December 31, 2021. The 2017 Plan is administered by the Compensation Committee of the Company's Board of Directors.

With respect to options, the fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model that uses various assumptions, such as volatility, expected term and risk-free interest rate. Expected volatilities are based on the historical volatility of the Company's stock. The Company uses historical data to estimate option exercise and employee termination in determining forfeiture rates. The expected term of options granted is estimated based on the vesting term of the award, historical employee exercise behavior, expected volatility of the Company's stock and an employee's average length of service. The risk-free interest rate used in this model correlates to a U.S. constant rate Treasury security with a contractual life that approximates the expected term of the option award.

The following table summarizes stock option activity:

	Shares		Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (years)		Aggregate Intrinsic Value
Outstanding at December 31, 2020	140,633	$	7.18	6.47	$	-
Granted	-		-			
Exercised	-		-			
Forfeited, canceled or expired	(14,333)		8.07			
Outstanding at December 31, 2021	126,300		7.08	5.59		-
Exercisable at December 31, 2021	126,300	$	7.08	5.59	$	-

Restricted Stock Units

On October 29, 2019, the Company granted to Steven N. Bronson, the Company's President and Chief Executive Officer, 50,000 restricted stock units (the "Restricted Stock Units") for shares of the Company's common stock under the terms of the Company's 2017 Stock Option and Incentive Plan and an associated restricted stock unit agreement with Mr. Bronson. The Restricted Stock Units were awarded pursuant to that certain employment agreement entered into between the Company and Mr. Bronson on April 13, 2019. For each of the fiscal years ended December 31, 2019 and December 31, 2020, Restricted Stock Units for 25,000 shares of the Company's common stock shall vest and the underlying common stock shall become issuable subject to the Company's achievement of financial and performance objectives for the applicable fiscal year established by the Company's Compensation Committee. Subject to the satisfaction of certain conditions, unvested Restricted Stock Units would also have vested and the underlying common stock would have become issuable upon Mr. Bronson's death or disability, in the event the Company were to have terminated Mr. Bronson's employment without cause or if Mr. Bronson were to have terminated his employment with the Company for good reason, and in the event of a change in control of the Company. The Compensation Committee approved vesting for the first 25,000 shares on December 18, 2019, and the second 25,000 shares on December 18, 2020. Share-based compensation of $132,500 and $139,000 was recorded in the years ended December 31, 2020 and

2019, respectively, for the vesting of these shares. No income tax benefit was recognized in the statements of operations for share-based arrangements in any period presented.

Note 7 – Earnings Per Share

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

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

	Three Months Ended December 31,		Year Ended December 31,	
	2021	2020	2021	2020
Net income (loss)	$ 436	$ (1,012)	$ 430	$ (1,258)
Weighted average outstanding shares of common stock	1,888	1,929	1,934	1,926
Dilutive potential common shares from employee stock options	-	-	-	-
Common stock and common stock equivalents	1,888	1,929	1,934	1,926
Earnings (loss) per share:				
Basic earnings (loss) per share	$ 0.23	$ (0.52)	$ 0.22	$ (0.65)
Diluted earnings (loss) per share	$ 0.23	$ (0.52)	$ 0.22	$ (0.65)

For the three months ended December 31, 2021 and 2020, respectively, 126,300 and 145,633 outstanding stock options were excluded from the calculation of diluted earnings per share as their inclusion would have been anti-dilutive. For the years ended December 31, 2021 and 2020, respectively, 140,633 and 161,333 outstanding stock options were excluded from the calculation of diluted earnings per share as their inclusion would have been anti-dilutive.

Note 8 – Commitments and Contingencies

Lease Agreements

The Company leases a 9,910 square foot facility in Camarillo, California. The term of the lease is 5 years and two months, expiring July 31, 2024. The rent on this facility started at $9,910 per month and increases 3% annually ($10,614 per month as of December 31, 2021). Qualstar permits Interlink Electronics Inc. ("Interlink") to use a portion of this facility and is reimbursed for the space and other related expenses on a monthly basis. As described in Note 11, Interlink is a related party.

The Company uses a portion of Interlink's Irvine, California office as its corporate headquarters, pursuant to which the Company pays a facility usage fee of approximately $4,600 per month.

The Company leases a 7,287 square foot facility in Shenzhen, China. The term of the lease is 1 year and 5 months, expiring May 31, 2022. The rent on this facility is approximately $3,500 per month, increasing to approximately $3,700 per month in 2022.

The Company's leases do not require any contingent rental payments, impose any financial restrictions, or contain any residual value guarantees. Variable expenses generally represent the Company's share of the landlord's operating expenses. The Company does not have any leases classified as financing leases.

The rate implicit in each lease is not readily determinable; we therefore use our incremental borrowing rate to determine the present value of the lease payments. The weighted average incremental borrowing rate used to determine the initial value of right-of-use (ROU) assets and lease liabilities as of January 1, 2019 was 4.33%, derived from borrowing rate quotes as obtained from the Company's business bank. No new ROU assets were capitalized during the years ended December 31, 2021 or 2020. Certain of our contracts for real estate may contain both lease and non-lease components which we have elected to treat as a single lease component.

Right-of-use assets for operating leases are periodically reduced by impairment losses. We use the long-lived assets impairment guidance in ASC Subtopic 360-10, *Property, Plant, and Equipment – Overall*, to determine whether a ROU asset is impaired, and if so, the amount of the impairment loss to recognize. As of December 31, 2021, we have not recognized any impairment losses for our ROU assets.

We monitor for events or changes in circumstances that require a reassessment of our leases. When a reassessment results in the remeasurement of a lease liability, a corresponding adjustment is made to the carrying amount of the corresponding ROU asset unless doing so would reduce the carrying amount of the ROU asset to an amount less than zero. In that case, the amount of the adjustment that would result in a negative ROU asset balance is recorded in profit or loss.

At December 31, 2021, the Company had current and long-term operating lease liabilities of $117,000 and $204,000, respectively, and right-of-use assets of $300,000.

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

	Minimum Lease Payment
2022	$ 129
2023	133
2024	79
2025	-
2026	-
Thereafter	-
Total undiscounted future non-cancelable minimum lease payments	341
Less: Imputed interest	(20)
Present value of lease liabilities	$ 321

During the three months ended December 31, 2021 and 2020, the Company incurred approximately $44,000 and $37,000, respectively, of operating lease costs, which are included in operating expenses in our condensed consolidated statement of operations. During the years ended December 31, 2021 and 2020, the Company incurred approximately $168,000 and $158,000, respectively, of operating lease costs, which are included in operating expenses in our condensed consolidated statement of operations.

Legal Proceedings

The Company is subject to a variety of claims and legal proceedings that arise from time to time in the ordinary course of our business. Although management currently believes that resolving claims against us, individually or in the aggregate, will not have a material adverse impact on our 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. No accrual was necessary as of December 31, 2021 and 2020.

Benefit Plan

The Company has a voluntary deferred compensation plan (the "Plan") qualifying for treatment under Internal Revenue Code Section 401(k). All employees are eligible to participate in the Plan following three months of service of employment and may contribute up to 100% of their compensation on a pre-tax basis, not to exceed the annual IRS maximum. The Company, at the discretion of management, may make matching contributions in an amount equal to 25% of the first 6% of compensation contributed by eligible participants. Qualstar did not make any matching contributions during the years ended December 31, 2021 or 2020.

Note 9 – Geographic Information, Concentrations, and Credit Risk

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

	Three Months Ended December 31,				Year Ended December 31,			
	2021		2020		2021		2020	
North America	$ 1,782	72.9 %	$ 1,473	64.6 %	$ 6,898	75.3 %	$ 4,785	59.1 %
Europe	402	16.5	490	21.5	1,533	16.7	2,213	27.3
Asia Pacific	259	10.6	311	13.6	703	7.7	1,058	13.1
Other	-	0.0	6	0.3	30	0.3	41	0.5
	$ 2,443	100.0 %	$ 2,280	100.0 %	$ 9,164	100.0 %	$ 8,097	100.0 %

No customers accounted for greater than 10% of the Company's revenue for either the three-month period ended December 31, 2021, or the three-month period ended December 31, 2020.

One customer accounted for greater than 10% of the Company's revenue for the year ended December 31, 2021. No customers accounted for greater than 10% of the Company's revenue for the year ended December 31, 2020.

We do not 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.

Note 10 – Segment Information

In its operation of the business, management reviews certain financial information, including segmented internal profit and loss statements prepared on a basis consistent with GAAP. Our two segments are Data Storage and Power Supplies. The two segments discussed in this analysis are presented in the way we internally manage and monitor performance for 2021 and 2020. The types of products and services provided by each segment are summarized below:

Data 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.

Power Supplies — The Company designs and markets high-efficiency switching power supplies. We utilize contract manufacturers in Asia to produce our power supplies 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.

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

	Three Months Ended December 31,		Year Ended December 31,	
	2021	2020	2021	2020
	(In thousands)			
Revenue				
Data Storage:				
Product	$ 1,362	$ 1,234	$ 4,619	$ 3,879
Service	305	309	1,171	1,530
Total Data Storage	1,667	1,543	5,790	5,409
Power Supplies	776	737	3,374	2,688
Revenue	$ 2,443	$ 2,280	$ 9,164	$ 8,097

	Three Months Ended December 31,		Year Ended December 31,	
	2021	2020	2021	2020
	(In thousands)			
Income (Loss) before Taxes				
Data Storage	$ 540	$ (123)	$ 728	$ 280
Power Supplies	(101)	(885)	(295)	(1,534)
Income (loss) before taxes	$ 439	$ (1,008)	$ 433	$ (1,254)

	December 31, 2021	December 31, 2020
	(In thousands)	
Total Assets		
Data Storage		
Cash and cash equivalents	$ 3,474	$ 3,901
Restricted cash	100	100
Accounts receivable, net	804	829
Inventories	1,936	1,191
Prepaid expenses and other current assets	185	136
Property and equipment, net	123	101
Right-of-use assets	300	428
Other assets	54	65
Total Data Storage assets	6,976	6,751
Power Supplies		
Cash and cash equivalents	621	256
Accounts receivable, net	550	550
Inventories	340	719
Prepaid expenses and other current assets	119	28
Property and equipment, net	1	2
Total Power Supplies assets	1,631	1,555
Total Assets	$ 8,607	$ 8,306

Note 11 – Related Party Transactions

Interlink Electronics, Inc.

Interlink Electronics, Inc. (NASDAQ: LINK) ("Interlink") is a related party. Steven N. Bronson, our President and Chief Executive Officer and Director, is also Chairman of the Board, President and Chief Executive Officer of Interlink. Ryan J. Hoffman, our Chief Financial Officer, is also the Chief Financial Officer of Interlink. Mr. Bronson, together with BKF Capital Group, Inc. (OTCMKTS: BKFG) which he controls, has a controlling interest in both Qualstar and Interlink. We have a facilities agreement with Interlink to allow Interlink to use of a portion of our Camarillo, California office and warehouse facility, for which we have agreed to split substantially all rent and facilities-related costs on an apportioned basis according to the approximate relative usage levels by each entity. We also have a facilities agreement with Interlink to allow us to use of a portion of Interlink's Irvine, California office facility, for which we have agreed to split substantially all rent and facilities-related costs on an apportioned basis according to the approximate relative usage levels by each entity. In addition, we have consulting agreements with Interlink for certain of our respective employees and/or independent contractors that provide certain operational, sales, marketing, general and administrative services to the other entity. Qualstar and Interlink also agree to reimburse, or be reimbursed by, one another for expenses paid by one company on behalf of the other. Transactions with Interlink are as follows:

	Three Months Ended December 31,			
	2021		2020	
	Due to Interlink	Due from Interlink	Due to Interlink	Due from Interlink
	(in thousands)			
Balance at October 1,	$ 16	$ -	$ 13	$ 5
Billed (or accrued) to Interlink by Qualstar	-	26	-	51
Paid by Interlink to Qualstar	-	(18)	-	(22)
Billed (or accrued) to Qualstar by Interlink	200	-	265	-
Paid by Qualstar to Interlink	(131)	-	(226)	-
Balance at December 31,	$ 85	$ 8	$ 52	$ 34

	Year Ended December 31,			
	2021		2020	
	Due to Interlink	Due from Interlink	Due to Interlink	Due from Interlink
	(in thousands)			
Balance at January 1,	$ 52	$ 34	$ 24	$ 12
Billed (or accrued) to Interlink by Qualstar	-	102	-	123
Paid by Interlink to Qualstar	-	(128)	-	(101)
Billed (or accrued) to Qualstar by Interlink	892	-	645	-
Paid by Qualstar to Interlink	(860)	-	(617)	-
Balance at December 31,	$ 84	$ 8	$ 52	$ 34

BKF Capital Group, Inc.

BKF Capital Group, Inc. (OTCMKTS: BKFG) is a related party. Steven N. Bronson, our President and Chief Executive Officer and Director, is also the Chief Executive Officer and Chairman of the Board of BKF Capital. Ryan J. Hoffman, our Chief Financial Officer, is also the Chief Financial Officer of BKF Capital. BKF Capital, together with Mr. Bronson, has a controlling interest in Qualstar. We have consulting agreements with BKF Capital for certain of our respective employees and/or independent contractors that provide operational and general and administrative services to the other entity. We entered into a M&A advisory consulting services agreement with Bronson Financial LLC ("BF"), a wholly owned subsidiary of BKF Capital, in which BF provides M&A advisory consulting services to us. We previously had a facilities agreement with BKF Capital under which BKF Capital was allowed to use a portion of our Camarillo, California office facility, for which we had agreed to split substantially all rent and lease-related costs on an apportioned basis according to the approximate relative usage levels by each entity. Qualstar and BKF Capital agree to reimburse, or be reimbursed by, one another for expenses paid by one company on behalf of the other. Transactions with BKF Capital are as follows:

	Three Months Ended December 31,			
	2021		2020	
	Due to BKF Capital	Due from BKF Capital	Due to BKF Capital	Due from BKF Capital
	(in thousands)			
Balance at October 1,	$ -	$ -	$ -	$ -
Billed (or accrued) to BKF Capital by Qualstar	-	-	-	2
Paid by BKF Capital to Qualstar	-	-	-	(2)
Billed (or accrued) to Qualstar by BKF Capital	30	-	-	-
Paid by Qualstar to BKF Capital	(30)	-	-	-
Balance at December 31,	$ -	$ -	$ -	$ -

	Year Ended December 31,			
	2021		2020	
	Due to BKF Capital	Due from BKF Capital	Due to BKF Capital	Due from BKF Capital
	(in thousands)			
Balance at January 1,	$ -	$ -	$ -	$ -
Billed (or accrued) to BKF Capital by Qualstar	-	6	-	5
Paid by BKF Capital to Qualstar	-	(6)	-	(5)
Billed (or accrued) to Qualstar by BKF Capital	60	-	-	-
Paid by Qualstar to BKF Capital	(60)	-	-	-
Balance at December 31,	$ -	$ -	$ -	$ -

QUALSTAR CORPORATION AND SUBSIDIARIES

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

Overview

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

Qualstar Corporation was incorporated in California in 1984 and has five wholly owned subsidiaries. The N2Power, Inc. subsidiary (N2Power) operates the Company's power supplies business. The Qualstar Corporation Singapore Private Limited subsidiary gives the Company an engineering footprint in Singapore, and participates in serving our Asian contract manufacturers, distribution partners, and customers. The Qualstar Limited (U.K.) subsidiary expands the Company's data storage business in Europe and Africa. And, the Q-Smart Data Private Limited (Singapore) and Q-Smart Data Limited (China) subsidiaries pursue new business opportunities in Asia.

We sell our products globally through authorized resellers, distributers, and directly to OEMs. Our data storage products are manufactured by our OEM suppliers in other parts of the world and configured to order by us at our facility in Camarillo, California, or at our facility in Shenzhen, China, or by our fulfilment and logistics partner in Warsaw, Poland. N2Power utilizes contract manufacturers in Asia to produce our power solutions products.

Results of Operations - (Unaudited)

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

	Three Months Ended December 31,				Year Ended December 31,			
	2021		2020		2021		2020	
	$	%	$	%	$	%	$	%
Data storage revenues	$ 1,667	68.2 %	$ 1,543	67.7 %	$ 5,790	63.2 %	$ 5,409	66.8 %
Power supplies revenues	776	31.8 %	737	32.3 %	3,374	36.8 %	2,688	33.2 %
Net revenues	2,443	100.0 %	2,280	100.0 %	9,164	100.0 %	8,097	100.0 %
Cost of goods sold	1,460	59.8 %	2,187	95.9 %	5,997	65.4 %	5,790	71.5 %
Gross profit	983	40.2 %	93	4.1 %	3,167	34.6 %	2,307	28.5 %
Operating expenses:								
Engineering	76	3.1 %	159	7.0 %	451	4.9 %	501	6.2 %
Sales and marketing	370	15.1 %	509	22.3 %	1,476	16.1 %	1,516	18.7 %
General and administrative	101	4.1 %	431	18.9 %	809	8.8 %	1,551	19.2 %
Total operating expenses	547	22.4 %	1,099	48.2 %	2,736	29.9 %	3,568	44.1 %
Income (loss) from operations	436	17.8 %	(1,006)	(44.1) %	431	4.7 %	(1,261)	(15.6) %
Other income (expense), net	3	0.1 %	(2)	(0.1) %	2	0.0 %	7	0.1 %
Income (loss) before taxes	439	18.0 %	(1,008)	(44.2) %	433	4.7 %	(1,254)	(15.5) %
Provision for income taxes	3	0.1 %	4	0.2 %	3	0.0 %	4	0.0 %
Net income (loss)	$ 436	17.8 %	$ (1,012)	(44.4) %	$ 430	4.7 %	$ (1,258)	(15.5) %

Net Revenues:

	Three months ended December 31,				Change	
	2021		2020			
	Amount	% of net revenue	Amount	% of net revenue	$	%
Data storage revenues	$ 1,667	68.2 %	$ 1,543	67.7 %	$ 124	8.0 %
Power supplies revenues	776	31.8	737	32.3	39	5.3
Net revenues	$ 2,443	100.0 %	$ 2,280	100.0 %	$ 163	7.1 %

	Year ended December 31,				Change	
	2021		2020			
	Amount	% of net revenue	Amount	% of net revenue	$	%
Data storage revenues	$ 5,790	63.2 %	$ 5,409	66.8 %	$ 381	7.0 %
Power supplies revenues	3,374	36.8	2,688	33.2	686	25.5
Net revenues	$ 9,164	100.0 %	$ 8,097	100.0 %	$ 1,067	13.2 %

The increases in net revenues for the three months and year ended December 31, 2021 compared to the prior year periods is attributable to the segment-specific factors described below.

Segment Revenue

Data Storage – For the three months and year ended December 31, 2021 compared to the corresponding prior year periods we reported increases in our data storage product revenues of approximately 10% and 19%, respectively, primarily attributable to the macro-economic effect of the COVID-19 pandemic on our customers in the prior year. Our data storage service revenues were approximately flat for the three months ended December 31, 2021 compared to the corresponding period in the prior year, and decreased by approximately 23% for the year ended December 31, 2021 as compared to the prior year as a result of the termination in 2020 of our partnership with Sony Imaging Products & Solutions Inc. for the development of an enterprise class optical disk archive library.

Power Supplies – The increase in power supplies revenues in the three months and year ended December 31, 2021 compared to the corresponding periods in the prior year was primarily due to the impact that the COVID-19 pandemic had on many of our customers in the prior year, as well as our fulfillment of a nonroutine, high-volume purchase by one of our customers during the current year.

Gross Profit:

	Three months ended December 31,				Change	
	2021		2020			
	Amount	% of net revenue	Amount	% of net revenue	$	%
Gross profit	$ 983	40.2 %	$ 93	4.1 %	$ 890	nm %

	Year ended December 31,				Change	
	2021		2020			
	Amount	% of net revenue	Amount	% of net revenue	$	%
Gross profit	$ 3,167	34.6 %	$ 2,307	28.5 %	$ 860	37.3 %

The gross profit and gross margin percentage improvements for the three months and year ended December 31, 2021 compared to the corresponding periods in the prior year is primarily attributed to the increases in revenues and favorable changes in revenue mix between data storage products and services and power supplies products.

Operating Expenses:

	Three months ended December 31,				Change	
	2021		2020			
	Amount	% of net revenue	Amount	% of net revenue	$	%
Engineering	$ 76	3.1 %	$ 159	7.0 %	$ (83)	(52.2) %
Sales and marketing	370	15.1	509	22.3	(139)	(27.3)
General and administrative	101	4.1	431	18.9	(330)	(76.6)
Total operating expenses	$ 547	22.4 %	$ 1,099	48.2 %	$ (552)	(50.2) %

	Year ended December 31,				Change	
	2021		2020			
	Amount	% of net revenue	Amount	% of net revenue	$	%
Engineering	$ 451	4.9 %	$ 501	6.2 %	$ (50)	(10.0) %
Sales and marketing	1,476	16.1	1,516	18.7	(40)	(2.6)
General and administrative	809	8.8	1,551	19.2	(742)	(47.8)
Total operating expenses	$ 2,736	29.9 %	$ 3,568	44.1 %	$ (832)	(23.3) %

Engineering

Engineering expenses decreased for both the three months and year ended December 31, 2021 compared to the same periods in the prior year primarily due to a decrease in the number of engineering employees in both the data storage segment and the power supplies segment in the current year periods compared to the prior year periods.

Sales and Marketing

Sales and marketing expenses decreased for the three months and year ended December 31, 2021 compared to the same periods in the prior year primarily due to a decrease in sales and marketing employees and consultants in the current year periods compared to the prior year periods.

General and Administrative

General and administrative costs decreased for the three months and year ended December 31, 2021 compared to the same periods in the prior year primarily due to decreases in administrative, professional, and legal fees, as well as the approximately $258,000 gain/benefit recorded in connection with forgiveness of the first draw PPP loan, which was recorded in the second quarter of 2021, and the approximate $263,000 gain/benefit recorded in connection with forgiveness of the second draw PPP loan, which was recorded in the fourth quarter of 2021.

Provision for Income Taxes

The provision for income taxes in the years ended December 31, 2021 and 2020 is comprised substantially of state minimum taxes.

Liquidity and Capital Resources

Cash, cash equivalents, and restricted cash decreased $62,000 to $4,195,000 at December 31, 2021 from $4,257,000 at December 31, 2020.

Operating Activities

Cash used in operating activities was $68 thousand for the year ended December 31, 2021 compared cash provided by operating activities of $60 thousand for the year ended December 31, 2020. Cash used in operations in 2021 was primarily related to net income of $430 thousand offset by non-cash expenses of $41, non-cash gain on forgiveness of PPP loan of $521 thousand, and cash used from changes in operating assets and liabilities of $18 thousand. Cash provided by operations in 2020 was primarily related to net loss of $1,258 thousand offset by non-cash expenses of $170 thousand and proceeds from changes in operating assets and liabilities of $1,148 thousand.

Investing Activities

Cash used in investing activities was $56 thousand for the year ended December 31, 2021 compared to $24 thousand for the year ended December 31, 2020. Our investing activities in both years primarily included warehouse equipment, and furniture, fixtures, and computer equipment.

Financing Activities

Cash provided by financing activities for the year ended December 31, 2021 consisted of $263,000 of proceeds from second draw PPP loans received during the second quarter of 2021, offset by $201,000 of cash used to repurchase shares of the Company's common stock under a stock repurchase program approved by the board of directors. Cash provided by financing activities during the year ended December 31, 2020 consisted of $258,000 of proceeds from a first draw PPP loan received during the second quarter of 2020.

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.