Qualstar Corporation and Subsidiaries

Quarterly Report for the Periods Ended March 31, 2022 and 2021

Qualstar Corporation
1 Jenner, Suite 200
Irvine, CA 92618
Phone: +1 (805) 583-7744
www.qualstar.com

QUALSTAR CORPORATION AND SUBSIDIARIES

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Item 1. Financial Statements

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

	March 31, 2022	December 31, 2021
Assets		
Current assets:		
Cash and cash equivalents	$ 3,701	$ 4,095
Restricted cash	100	100
Accounts receivable, net	1,629	1,354
Inventories	2,375	2,276
Prepaid expenses and other current assets	374	304
Total current assets	8,179	8,129
Property and equipment, net	113	124
Right-of-use assets	272	300
Deferred tax assets	30	30
Other assets	21	24
Total assets	$ 8,615	$ 8,607
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 862	$ 977
Accrued payroll and related liabilities	138	188
Deferred service revenue	758	622
Lease liabilities, current	117	117
Other accrued liabilities	175	168
Total current liabilities	2,050	2,072
Long-term liabilities:		
Lease liabilities, long-term	176	204
Deferred service revenue, long-term	467	447
Other long-term liabilities	27	28
Total long-term liabilities	670	679
Total liabilities	2,720	2,751
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Preferred stock, no par value; 5,000,000 shares authorized; no shares issued	-	-
Common stock, no par value; 50,000,000 shares authorized; 1,884,033 shares issued and outstanding at both March 31, 2022 and December 31, 2021	18,789	18,789
Accumulated deficit	(12,894)	(12,933)
Total shareholders' equity	5,895	5,856
Total liabilities and shareholders' equity	$ 8,615	$ 8,607

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

	Three Months Ended March 31, 2022	Three Months Ended March 31, 2021
Net revenues	$ 2,410	$ 1,697
Cost of goods sold	1,687	1,251
Gross profit	723	446
Operating expenses:		
Engineering	50	174
Sales and marketing	323	405
General and administrative	312	288
Total operating expenses	685	867
Income (loss) from operations	38	(421)
Other income (expense), net	1	(1)
Income (loss) before income taxes	39	(422)
Provision for income taxes	-	-
Net income (loss)	$ 39	$ (422)
Earnings (loss) per share:		
Basic and diluted	$ 0.02	$ (0.22)
Weighted average common shares outstanding:		
Basic and diluted	1,884	1,952

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

	Common Stock		Accumulated	
Three Months Ended March 31, 2022	**Shares**	**Amount**	**Deficit**	**Total**
Balances at January 1, 2022	1,884	$ 18,789	$ (12,933)	$ 5,856
Net income	-	-	39	39
Balances at March 31, 2022	1,884	$ 18,789	$ (12,894)	$ 5,895

	Common Stock		Accumulated	
Three Months Ended March 31, 2021	**Shares**	**Amount**	**Deficit**	**Total**
Balances at January 1, 2021	1,950	$ 18,980	$ (13,363)	$ 5,617
Share-based compensation	3	10	-	10
Net (loss)	-	-	(422)	(422)
Balances at March 31, 2021	1,953	$ 18,990	$ (13,785)	$ 5,205

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

	Three Months Ended March 31, 2022	Three Months Ended March 31, 2021
Cash flows from operating activities:		
Net income (loss)	$ 39	$ (422)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	12	8
Share-based compensation	-	10
Adjustment to reconcile operating lease expense to cash paid	-	(1)
Changes in operating assets and liabilities:		
Accounts receivable	(275)	678
Inventories	(99)	184
Prepaid expenses and other assets	(70)	46
Accounts payable	(115)	(71)
Accrued payroll and related liabilities	(50)	(65)
Deferred service revenue	157	35
Other liabilities	7	42
Net cash provided by (used in) operating activities	(394)	444
Net increase (decrease) in cash, cash equivalents, and restricted cash	(394)	444
Cash, cash equivalents, and restricted cash at beginning of period	4,195	4,257
Cash, cash equivalents, and restricted cash at end of period	$ 3,801	$ 4,701
Reconciliation of cash, cash equivalents and restricted cash, end of period:		
Cash and cash equivalents, end of period	$ 3,701	$ 4,601
Restricted cash, end of period	100	100
Cash, cash equivalents and restricted cash, end of period	$ 3,801	$ 4,701
Supplemental disclosure of cash flow information:		
Income taxes paid	$ -	$ -
Interest paid	$ -	$ -

Note 1 – The Company and its Significant Accounting Policies

Business

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

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

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

Principles of Consolidation

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

Estimates and Assumptions

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

Public Health Threats

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

Revenue Recognition

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

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

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

Deferred service revenue is shown separately in the condensed consolidated balance sheets as current and long-term. At March 31, 2022 we had deferred service revenue of approximately $1,225,000. At December 31, 2021, we had deferred service revenue of approximately $1,069,000.

Cash and Cash Equivalents

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

Restricted Cash

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

Allowance for Doubtful Accounts

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

Inventories

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

Property and Equipment, net

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

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

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.

Shipping and Handling Costs

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

Engineering

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

Advertising

Advertising and promotion expenses include costs associated with direct and indirect marketing, trade shows and public relations. Qualstar expenses all costs of advertising and promotion as incurred.

Fair Value of Financial Instruments

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

Share-Based Compensation

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

Accounting for 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.

The Company did not record an income tax provision or benefit for the three-month periods ended March 31, 2022 and 2021, as the Company has net operating loss carryforwards available to offset taxable income.

Leases

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

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

Operating Segments

The Company operates in two segments, Data Storage and Power Supplies. Operating segments are identified as functional groups within an enterprise in 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 May 12, 2022, being the date these condensed consolidated financial statements were issued.

Note 2 – Balance Sheet Details

The following tables provide details of selected balance sheet accounts:

Inventories	March 31, 2022	December 31, 2021
	(In thousands)	
Raw materials	$ 134	$ 164
Finished goods	2,241	2,112
Net inventory balance	$ 2,375	$ 2,276

Property and equipment, net	March 31, 2022	December 31, 2021
	(In thousands)	
Machinery and equipment	$ 382	$ 382
Furniture and fixtures, and computer equipment	258	258
Leasehold improvements	119	119
	759	759
Less accumulated depreciation and amortization	(646)	(635)
Property and equipment, net	$ 113	$ 124

Depreciation and amortization expense for the three months ended March 31, 2022 and 2021 was $12,000 and $8,000, respectively.

Accrued payroll and related liabilities	March 31, 2022	December 31, 2021
	(In thousands)	
Accrued salaries, wages, and payroll taxes	$ 26	$ 82
Accrued vacation	112	106
Total accrued payroll and related liabilities	$ 138	$ 188

Other accrued liabilities	March 31, 2022	December 31, 2021
	(In thousands)	
Accrued warranty	$ 147	$ 142
Accrued outside commissions	19	26
Other accrued liabilities	9	-
Total other accrued liabilities	$ 175	$ 168

Note 3 – Shareholders' Equity

On September 1, 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 quarter ended March 31, 2022, the Company did not repurchase any shares. During the period from September 1, 2021 through March 31, 2022, the Company has repurchased 69,326 shares for an aggregate purchase price of $201,000.

Note 4 – Earnings Per Share

Basic earnings (loss) per share has been computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (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 March 31, 2022	Three Months Ended March 31, 2021
Net income (loss)	$ 39	$ (422)
Weighted average outstanding shares of common stock	1,884	1,952
Dilutive potential common shares from employee stock options	-	-
Common stock and common stock equivalents	1,884	1,952
Earnings (loss) per share:		
Basic earnings (loss) per share	$ 0.02	$ (0.22)
Diluted earnings (loss) per share	$ 0.02	$ (0.22)

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

Note 5 – Share-Based Compensation and Stock Incentive Plan

Share-Based Compensation

The Company did not incur share-based compensation expense associated with share-based compensation awards for the three-month periods ended March 31, 2022. The share-based compensation recorded during the three months ended March 31, 2021 was for shares of common stock issued to certain members of the Board of Directors as compensation for services in accordance with the Company's Outside Director Compensation Policy. No income tax benefit was recognized in the condensed consolidated statements of operations for share-based arrangements in any period presented. At March 31, 2022, the Company did not have any unrecognized compensation costs related to share-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 March 31, 2022. The 2017 Plan is administered by the Company's Board of Directors.

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

The following table summarizes stock option activity:

	Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at December 31, 2021	126,300	$ 7.08	5.59	$ -
Granted	-			
Exercised	-			
Forfeited, canceled or expired	-			
Outstanding at March 31, 2022	126,300	7.08	5.35	-
Exercisable at March 31, 2022	126,300	$ 7.08	5.35	$ -

Note 6 – Concentration of Credit Risk, Significant Customers, and Geographic Information

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.

Two customers each accounted for more than 10% of the Company's net revenue for the three-month period ended March 31, 2022. Two different customers accounted for more than 10% of the Company's net revenue for the three-month period ended March 31, 2021.

Our financial results could be affected by changes in foreign currency exchange rates or weak economic conditions in foreign markets. As all sales are currently made in U.S. dollars, a strengthening of the dollar could make our products less competitive in foreign markets.

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

	Three Months Ended March 31,			
	2022		2021	
North America	$ 1,789	74.2 %	$ 1,357	80.0 %
Europe	374	15.5	192	11.3
Asia Pacific	196	8.1	127	7.5
Other	51	2.1	21	1.2
	$ 2,410	100.0 %	$ 1,697	100.0 %

The primary suppliers of our data 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.

Note 7 – Commitments and Contingencies

Lease Agreements

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

The Company uses a portion of Interlink's Irvine, California office as its corporate headquarters, pursuant to which the Company pays a facility usage fee of approximately $4,600 per month. The Company also uses a portion of Interlink's Los Angeles, California office, pursuant to which the Company pays a facility usage fee of approximately $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 $3,700 per month.

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

The rate implicit in each lease is not readily determinable; we therefore use our incremental borrowing rate to determine the present value of the lease payments. The weighted average incremental borrowing rate used to determine the initial value of right-of-use (ROU) assets and lease liabilities as of January 1, 2019 was 4.33%, derived from borrowing rate quotes as obtained from the Company's business bank. No new ROU assets were capitalized during the three-month periods ended March 31, 2022 or 2021. 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 March 31, 2022, we have not recognized any impairment losses for our ROU assets.

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

At March 31, 2022, the Company had current and long-term operating lease liabilities of $117,000 and $176,000, respectively, and right-of-use assets of $272,000.

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

	Minimum Lease Payment
2023	$ 97
2024	133
2025	79
Total undiscounted future non-cancelable minimum lease payments	309
Less: Imputed interest	(16)
Present value of lease liabilities	$ 293

During the three months ended March 31, 2022 and 2021, the Company incurred approximately $44,000 and $37,000, respectively, of operating lease costs, which are included in operating expenses in our condensed consolidated statements of operations.

Legal and Other Contingencies

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

Note 8 – 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 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 months ended March 31, 2022 and 2021. 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 (loss) before taxes, and total assets were as follows:

	Three Months Ended March 31,	
	2022	2021
	(In thousands)	
Revenue		
Data Storage:		
Product	$ 1,319	$ 680
Service	260	288
Total Data Storage	1,579	968
Power Supplies	831	729
Revenue	$ 2,410	$ 1,697

	Three Months Ended March 31, 2022	Three Months Ended March 31, 2021
	(In thousands)	
Income (Loss) Before Taxes		
Data Storage	$ 107	$ (148)
Power Supplies	(68)	(274)
Income (loss) before taxes	$ 39	$ (422)

	March 31, 2022	December 31, 2021
	(In thousands)	
Total Assets		
Data Storage		
Cash and cash equivalents	$ 2,943	$ 3,474
Restricted cash	100	100
Accounts receivable, net	1,042	804
Inventories	2,109	1,936
Prepaid expenses and other current assets	252	185
Property and equipment, net	113	123
Right-of-use assets	272	300
Other assets	51	54
Total Data Storage assets	6,882	6,976
Power Supplies		
Cash and cash equivalents	758	621
Accounts receivable, net	587	550
Inventories	266	340
Prepaid expenses and other current assets	122	119
Property and equipment, net	-	1
Total Power Supplies assets	1,733	1,631
Total Assets	$ 8,615	$ 8,607

Note 9 – Related Party Transactions

Interlink Electronics, Inc.

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

	Three Months Ended March 31,			
	2022		2021	
	Due to Interlink	Due from Interlink	Due to Interlink	Due from Interlink
	(in thousands)			
Balance at January 1,	$ 85	$ 8	$ 52	$ 34
Billed (or accrued) to Interlink by Qualstar	-	22	-	24
Paid by Interlink to Qualstar	-	(22)	-	(57)
Billed (or accrued) to Qualstar by Interlink	185	-	208	-
Paid by Qualstar to Interlink	(251)	-	(145)	-
Balance at March 31,	$ 19	$ 8	$ 115	$ 1

BKF Capital Group, Inc.

BKF Capital Group, Inc. (OTCMKTS: BKFG) is a related party. Steven N. Bronson, our President and Chief Executive Officer and Director, is also the Chief Executive Officer and Chairman of the Board of BKF Capital. Ryan J. Hoffman, our Chief Financial Officer, is also the Chief Financial Officer of BKF Capital. BKF Capital, together with Mr. Bronson, has a controlling interest in Qualstar. We have consulting agreements with BKF Capital for certain of our respective employees and/or independent contractors that provide operational and general and administrative services to the other entity. We entered into a M&A advisory consulting services agreement with Bronson Financial LLC (“BF”), a wholly owned subsidiary of BKF Capital, in which BF provides M&A advisory consulting services to us. Qualstar and BKF Capital agree to reimburse, or be reimbursed by, one another for expenses paid by one company on behalf of the other. Transactions with BKF Capital are as follows:

	Three Months Ended March 31,			
	2022		2021	
	Due to BKF Capital	Due from BKF Capital	Due to BKF Capital	Due from BKF Capital
	(in thousands)			
Balance at January 1,	$ -	$ -	$ -	$ -
Billed (or accrued) to BKF Capital by Qualstar	-	-	-	-
Paid by BKF Capital to Qualstar	-	-	-	-
Billed (or accrued) to Qualstar by BKF Capital	30	-	-	-
Paid by Qualstar to BKF Capital	(30)	-	-	-
Balance at March 31,	$ -	$ -	$ -	$ -

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

Overview

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

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

The Company 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 adding more strategic partners that will expand our geographic footprint, increase our reach to additional industries, and increase our product development capabilities. The power supplies business unit is expanding its sales resources in an effort to grow 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 supplies business is 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.

RESULTS OF OPERATIONS - (Unaudited)

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

	Three Months Ended March 31,			
	2022		2021	
	$	%	$	%
Data storage revenues	$ 1,579	65.5 %	$ 968	57.0 %
Power supplies revenues	831	34.5	729	43.0
Net revenues	2,410	100.0	1,697	100.0
Cost of goods sold	1,687	70.0	1,251	73.7
Gross profit	723	30.0	446	26.3
Operating expenses:				
Engineering	50	2.1	174	10.3
Sales and marketing	323	13.4	405	23.9
General and administrative	312	12.9	288	17.0
Total operating expenses	685	28.4	867	51.1
Income (loss) from operations	38	1.6	(421)	(24.8)
Other income (expense), net	1	0.0	(1)	(0.1)
Income (loss) before taxes	39	1.6	(422)	(24.9)
Provision for income taxes	-	-	-	-
Net income (loss)	$ 39	1.6 %	$ (422)	(24.9) %

Net Revenues:

	Three months ended March 31,				Change	
	2022		2021			
	Amount	% of net revenue	Amount	% of net revenue	$	%
Data storage revenues	$ 1,579	65.5 %	$ 968	57.0 %	$ 611	63.1 %
Power supplies revenues	831	34.5	729	43.0	102	14.0
Net revenues	$ 2,410	100.0 %	$ 1,697	100.0 %	$ 713	42.0 %

The increase in net revenues for the three months ended March 31, 2022 compared to the prior year period is attributable to the segment-specific factors described below.

Segment Revenue

Data Storage – For the three months ended March 31, 2022 compared to the corresponding period in the prior year we experienced a 94% increase in our data storage product revenues attributable to an increase in shipments of our tape-based data storage products and solutions. Our data storage service revenues decreased as a result of an approximately 10% decline in technical support revenues for the three-month period ended March 31, 2022 as compared to corresponding prior year period.

Power Supplies – The increase in power supplies revenues in the three-month period ended March 31, 2022 compared to the corresponding period in the prior year was primarily due to increased demand from and shipments to our customers of our power supplies products and solutions in the current year.

Gross Profit:

	Three months ended March 31,				Change	
	2022		2021			
	Amount	% of net revenue	Amount	% of net revenue	$	%
Gross profit	$ 723	30.0 %	$ 446	26.3 %	$ 277	62.1 %

The gross profit and gross margin percentage increases for the three months ended March 31, 2022 compared to the corresponding period in the prior year are primarily due to increases in revenue in both our data storage and power supplies segments, as well as favorable changes in customer and product mix.

Operating Expenses:

	Three months ended March 31,				Change	
	2022		2021			
	Amount	% of net revenue	Amount	% of net revenue	$	%
Engineering	$ 50	2.1 %	$ 174	10.3 %	$ (124)	(71.3) %
Sales and marketing	323	13.4	405	23.9	(82)	(20.2)
General and administrative	312	12.9	288	17.0	24	8.3
Total operating expenses	$ 685	28.4 %	$ 867	51.1 %	$ (182)	(21.0) %

Engineering
Engineering expenses decreased for the three months ended March 31, 2022 compared to the same period in the prior year primarily due to a decrease in the number of engineering employees in the data storage segment and lower engineering and product-development costs and activities in the power supplies segment.

Sales and Marketing
Sales and marketing expenses decreased for the three months ended March 31, 2022 compared to the same period in the prior year primarily due to a decrease in sales and marketing employees and consultants.

General and Administrative
General and administrative costs increased for the three months ended March 31, 2022 compared to the same period in the prior year primarily due to increases in administrative personnel costs and professional fees.

Liquidity and Capital Resources
As of March 31, 2022, cash, cash equivalents, and restricted cash decreased $394,000 to $3,801,000 from $4,195,000 at December 31, 2021.

Operating Activities
Cash used in operating activities was $394 thousand for the three months ended March 31, 2022 compared to cash provided by operating activities of $444 thousand for the first quarter of the prior year. Cash used in operations for the three months ended March 31, 2022 was primarily the result of net income of $39 thousand, non-cash expenses of $12 thousand, and cash used in changes in operating assets and liabilities and $445 thousand. Cash provided by operations for the three months ended March 31, 2021 was primarily the result of $849 thousand of cash provided by changes in operating assets and liabilities and $17 thousand of non-cash expenses, offset by net loss of $422 thousand.

Investing Activities and Financing Activities
There was no cash provided by or used in investing or financing activities during the three months ended March 31, 2022 or 2021.

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.