NETLIST INC
Form 10-Q
May 12, 2011
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended April 2, 2011

or

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

For the transition period from to

Commission file number 001-33170

NETLIST, INC.

(Exact name of registrant as specified in its charter)

Delaware	**95-4812784**
State or other jurisdiction of incorporation or organization	(I.R.S. Employer Identification No.)

51 Discovery, Suite 150

Irvine, CA 92618

(Address of principal executive offices) (Zip Code)

(949) 435-0025

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

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

The number of shares outstanding of each of the registrant s classes of common stock as of the latest practicable date:

Common Stock, par value $0.001 per share

25,351,448 shares outstanding at May 2, 2011

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

FOR THE THREE MONTHS ENDED APRIL 2, 2011

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NETLIST, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(in thousands, except par value)

	(unaudited) April 2, 2011	(audited) January 1, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,361	$ 14,210
Investments in marketable securities		824
Accounts receivable, net	8,622	6,451
Inventories	7,302	4,509
Prepaid expenses and other current assets	740	1,396
Total current assets	28,025	27,390
Property and equipment, net	3,631	4,077
Long-term investments in marketable securities	898	890
Other assets	246	337
Total assets	$ 32,800	$ 32,694
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 8,371	$ 6,256
Accrued payroll and related liabilities	1,870	1,762
Accrued expenses and other current liabilities	435	454
Accrued engineering charges	1,101	638
Current portion of long-term debt	772	674
Total current liabilities	12,549	9,784
Long-term debt, net of current portion	871	1,063
Total liabilities	13,420	10,847
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.001 par value - 90,000 shares authorized; 25,351 (2011) and 25,284 (2010) shares issued and outstanding	25	25
Additional paid-in capital	89,421	89,074
Accumulated deficit	(69,963)	(67,141)
Accumulated other comprehensive loss	(103)	(111)
Total stockholders equity	19,380	21,847
Total liabilities and stockholders equity	$ 32,800	$ 32,694

See accompanying notes.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

Unaudited Condensed Consolidated Statements of Operations

(in thousands, except per share amounts)

	Three Months Ended April 2, 2011	Three Months Ended April 3, 2010
Net sales	$ 12,000	$ 7,890
Cost of sales(1)	8,196	6,072
Gross profit	3,804	1,818
Operating expenses:		
Research and development(1)	3,684	3,008
Selling, general and administrative(1)	2,917	2,570
Total operating expenses	6,601	5,578
Operating loss	(2,797)	(3,760)
Other (expense) income:		
Interest (expense) income, net	(25)	1
Other income, net		67
Total other (expense) income, net	(25)	68
Loss before benefit of income taxes	(2,822)	(3,692)
Benefit of income taxes		(727)
Net loss	$ (2,822)	$ (2,965)
Net loss per common share:		
Basic and diluted	$ (0.11)	$ (0.14)
Weighted-average common shares outstanding:		
Basic and diluted	24,881	20,688

(1) Amounts include stock-based compensation expense as follows:

Cost of sales	$ 13	$ 10
Research and development	142	46
Selling, general and administrative	198	326

See accompanying notes.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)

	Three Months Ended April 2, 2011	Three Months Ended April 3, 2010
Cash flows from operating activities:		
Net loss	$ (2,822)	$ (2,965)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	581	578
Amortization of deferred gain on sale and leaseback transaction		(29)
Stock-based compensation	353	382
Changes in operating assets and liabilities:		
Accounts receivable	(2,171)	(1,092)
Inventories	(2,793)	(1,697)
Income taxes receivable		(649)
Prepaid expenses and other current assets	825	(26)
Other assets	90	3
Accounts payable	2,090	1,331
Accrued payroll and related expenses	108	(574)
Accrued expenses and other current liabilities	(19)	(127)
Accrued engineering charges	463	371
Net cash used in operating activities	(3,295)	(4,494)
Cash flows from investing activities:		
Acquisition of property and equipment	(110)	(208)
Purchase of investments in marketable securities		(2,379)
Proceeds from maturities and sales of investments in marketable securities	825	60
Net cash provided by (used in) investing activities	715	(2,527)
Cash flows from financing activities:		
Borrowings on line of credit	500	1,000
Payments on line of credit	(500)	(1,000)
Proceeds from public offering, net		16,260
Proceeds from exercise of stock options and warrants, net of taxes remitted	(6)	90
Payments on debt	(263)	(34)
Net cash (used in) provided by financing activities	(269)	16,316
(Decrease) increase in cash and cash equivalents	(2,849)	9,295
Cash and cash equivalents at beginning of period	14,210	9,942
Cash and cash equivalents at end of period	$ 11,361	$ 19,237

See accompanying notes.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

APRIL 2, 2011

Note 1 Description of Business

Netlist, Inc. (the Company or Netlist) designs and manufactures high performance, logic-based memory subsystems for the datacenter server and high performance computing and communications markets. The Company s memory subsystems consist of combinations of dynamic random access memory integrated circuits (DRAM ICs or DRAM), NAND flash memory (NAND), application-specific integrated circuits (ASICs) and other components assembled on printed circuit boards (PCBs). Netlist primarily markets and sells its products to leading original equipment manufacturer (OEM) customers. The Company s solutions are targeted at applications where memory plays a key role in meeting system performance requirements. The Company leverages a portfolio of proprietary technologies and design techniques, including efficient planar design, alternative packaging techniques and custom semiconductor logic, to deliver memory subsystems with high memory density, small form factor, high signal integrity, attractive thermal characteristics and low cost per bit.

Note 2 Summary of Significant Accounting Policies

Basis of Presentation

The interim unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (the U.S.) for interim financial information and with the instructions to Securities and Exchange Commission (SEC) Form 10-Q and Article 8 of SEC Regulation S-X. These condensed consolidated financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. Therefore, these unaudited condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and notes thereto for the year ended January 1, 2011, included in the Company s Annual Report on Form 10-K filed with the SEC on March 3, 2011.

The condensed consolidated financial statements included herein as of April 2, 2011 are unaudited; however, they contain all normal recurring accruals and adjustments that, in the opinion of the Company s management, are necessary to present fairly the condensed consolidated financial position of the Company and its wholly-owned subsidiaries as of April 2, 2011, the condensed consolidated results of its operations for the three months ended April 2, 2011 and April 3, 2010, and the condensed consolidated cash flows for the three months ended April 2, 2011 and April 3, 2010. The results of operations for the three months ended April 2, 2011 are not necessarily indicative of the results to be expected for the full year or any future interim periods.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of Netlist, Inc. and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Fiscal Year

The Company operates under a 52/53-week fiscal year ending on the Saturday closest to December 31. For fiscal 2011, the Company s fiscal year is scheduled to end on December 31, 2011 and will consist of 52 weeks. Each of the Company s first three quarters in a fiscal year is comprised of 13 weeks.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, and the reported amounts of net sales and expenses during the reporting period. By their nature, these estimates and assumptions are subject to an inherent degree of uncertainty. Significant estimates made by management include, among others, provisions for uncollectible receivables and sales returns, warranty liabilities, valuation of inventories, fair value of financial instruments, impairment of long-lived assets, stock-based compensation expense and realization of deferred tax assets. The Company bases its estimates on historical experience, knowledge of current conditions and our beliefs of what could occur in the future considering available information. The Company reviews its estimates on an on-going basis. The actual results experienced by the Company may differ materially and adversely from its estimates. To the extent there are material differences between the estimates and the actual results, future results of operations will be affected.

Table of Contents

Revenue Recognition

The Company s revenues primarily consist of product sales of high-performance memory subsystems to OEMs. Revenues also include sales of excess component inventories to distributors and other users of memory integrated circuits (ICs). Such sales amounted to less than $0.1 million for each of the three months ended April 2, 2011 and April 3, 2010.

The Company recognizes revenues in accordance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 605. Accordingly, the Company recognizes revenues when there is persuasive evidence of an arrangement, product delivery and acceptance have occurred, the sales price is fixed or determinable, and collectibility of the resulting receivable is reasonably assured.

The Company generally uses customer purchase orders and/or contracts as evidence of an arrangement. Delivery occurs when goods are shipped for customers with FOB Shipping Point terms and upon receipt for customers with FOB Destination terms, at which time title and risk of loss transfer to the customer. Shipping documents are used to verify delivery and customer acceptance. The Company assesses whether the sales price is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund. Customers are generally allowed limited rights of return for up to 30 days, except for sales of excess component inventories, which contain no right-of-return privileges. Estimated returns are provided for at the time of sale based on historical experience or specific identification of an event necessitating a reserve. The Company offers a standard product warranty to its customers and has no other post-shipment obligations. The Company assesses collectibility based on the creditworthiness of the customer as determined by credit checks and evaluations, as well as the customer s payment history.

All amounts billed to customers related to shipping and handling are classified as revenues, while all costs incurred by the Company for shipping and handling are classified as cost of sales.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and short-term investments with original maturities of three months or less, other than short-term investments in securities that lack an active market.

Investments in Marketable Securities

The Company accounts for its investments in marketable securities in accordance with ASC Topic 320. The Company determines the appropriate classification of its investments at the time of purchase and reevaluates such designation at each balance sheet date. The Company s investments in marketable securities have been classified and accounted for as available-for-sale based on management s investment intentions relating to these securities. Available-for-sale securities are stated at fair value, generally based on market quotes, to the extent they are available. Unrealized gains and losses, net of applicable deferred taxes, are recorded as a component of other comprehensive income (loss). Realized gains and losses and declines in value judged to be other than temporary are determined based on the specific identification method and are reported in other income, net in the unaudited condensed consolidated statements of operations.

The Company generally invests its excess cash in domestic bank-issued certificates of deposit which carry federal deposit insurance, money market funds and highly liquid debt instruments of U.S. municipalities, corporations and the U.S. government and its agencies. All highly liquid investments with stated maturities of three months or less from the date of purchase are classified as cash equivalents; all investments with stated maturities of greater than three months are classified as investments in marketable securities.

Fair Value of Financial Instruments

The Company s financial instruments consist principally of cash and cash equivalents, investments in marketable securities, accounts receivable, accounts payable, accrued expenses and debt instruments. Other than for certain investments in auction rate securities and short-term corporate bonds (see Note 4), the fair value of the Company s cash equivalents and investments in marketable securities is determined based on quoted prices in active markets for identical assets or Level 1 inputs. Because of their short-term nature, short-term corporate bonds are not frequently traded. Although there are observable quotes for these securities, the markets are not considered active. Accordingly, the fair values of these investments are based on Level 2 inputs. The Company recognizes transfers between Levels 1 through 3 of the fair value hierarchy at the beginning of the reporting period. The Company believes that the carrying values of all other financial instruments approximate their current fair values due to their nature and respective durations.

Table of Contents

Allowance for Doubtful Accounts

The Company evaluates the collectibility of accounts receivable based on a combination of factors. In cases where the Company is aware of circumstances that may impair a specific customer s ability to meet its financial obligations subsequent to the original sale, the Company will record an allowance against amounts due, and thereby reduce the net recognized receivable to the amount the Company reasonably believes will be collected. For all other customers, the Company records allowances for doubtful accounts based primarily on the length of time the receivables are past due based on the terms of the originating transaction, the current business environment and its historical experience. Uncollectible accounts are charged against the allowance for doubtful accounts when all cost effective commercial means of collection have been exhausted.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents, investments in marketable securities, and accounts receivable.

The Company invests its cash equivalents primarily in money market mutual funds. Cash equivalents are maintained with high quality institutions, the composition and maturities of which are regularly monitored by management. The Company had $0.4 million of Federal Deposit Insurance Corporation insured cash and cash equivalents at April 2, 2011. Investments in marketable securities are generally in high-credit quality debt instruments. Such investments are made only in instruments issued or enhanced by high-quality institutions. The Company has not incurred any credit risk losses related to these investments.

The Company s trade accounts receivable are primarily derived from sales to OEMs in the computer industry. The Company performs credit evaluations of its customers financial condition and limits the amount of credit extended when deemed necessary, but generally requires no collateral. The Company believes that the concentration of credit risk in its trade receivables is moderated by its credit evaluation process, relatively short collection terms, the high level of credit worthiness of its customers (see Note 3), and foreign credit insurance. Reserves are maintained for potential credit losses, and such losses historically have not been significant and have been within management s expectations.

Inventories

Inventories are valued at the lower of actual cost to purchase or manufacture the inventory or the net realizable value of the inventory. Cost is determined on an average cost basis which approximates actual cost on a first-in, first-out basis and includes raw materials, labor and manufacturing overhead. At each balance sheet date, the Company evaluates its ending inventory quantities on hand and on order and records a provision for excess quantities and obsolescence. Among other factors, the Company considers historical demand and forecasted demand in relation to the inventory on hand, competitiveness of product offerings, market conditions and product life cycles when determining obsolescence and net realizable value. In addition, the Company considers changes in the market value of components in determining the net realizable value of its inventory. Provisions are made to reduce excess or obsolete inventories to their estimated net realizable values. Once established, write-downs are considered permanent adjustments to the cost basis of the excess or obsolete inventories.

Property and Equipment

Property and equipment are recorded at cost and depreciated on a straight-line basis over their estimated useful lives, which generally range from three to seven years. Leasehold improvements are recorded at cost and amortized on a straight-line basis over the shorter of their estimated useful lives or the remaining lease term.

Impairment of Long-Lived Assets

The Company evaluates the recoverability of the carrying value of long-lived assets held and used by the Company for impairment on at least an annual basis or whenever events or changes in circumstances indicate that their carrying value may not be recoverable. When such factors and circumstances exist, the Company compares the projected undiscounted future net cash flows associated with the related asset or group of assets over their estimated useful lives against their respective carrying amount. If the carrying value is determined not to be recoverable from future operating cash flows, the asset is deemed impaired and an impairment loss is recognized to the extent the carrying value exceeds the estimated fair value of the asset. The fair value of the asset or asset group is based on market value when available, or when unavailable, on discounted expected cash flows. The Company s management believes there is no impairment of long-lived assets as of April 2, 2011. There can be no assurance, however, that market conditions will not change or demand for the Company s products will continue, which could result in future impairment of long-lived assets.

Table of Contents

Warranties

The Company offers warranties generally ranging from one to three years, depending on the product and negotiated terms of the purchase agreements with customers. Such warranties require the Company to repair or replace defective product returned to the Company during the warranty period at no cost to the customer. Warranties are not offered on sales of excess component inventory. The Company records an estimate for warranty-related costs at the time of sale based on its historical and estimated product return rates and expected repair or replacement costs (see Note 3). Such costs have historically been consistent between periods and within management s expectations and the provisions established.

Stock-Based Compensation

The Company accounts for equity issuances to non-employees in accordance with ASC Topic 505. All transactions in which goods or services are the consideration received for the issuance of equity instruments are accounted for based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more reliably measurable. The measurement date used to determine the fair value of the equity instrument issued is the earlier of the date on which the third-party performance is complete or the date on which it is probable that performance will occur.

In accordance with ASC Topic 718, employee and director stock-based compensation expense recognized during the period is based on the value of the portion of stock-based payment awards that is ultimately expected to vest during the period. Given that stock-based compensation expense recognized in the condensed consolidated statements of operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. ASC Topic 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company s estimated average forfeiture rates are based on historical forfeiture experience and estimated future forfeitures.

The fair value of common stock option awards to employees and directors is calculated using the Black-Scholes option pricing model. The Black-Scholes model requires subjective assumptions regarding future stock price volatility and expected time to exercise, along with assumptions about the risk-free interest rate and expected dividends, all of which affect the estimated fair values of the Company s common stock option awards. The expected term of options granted is calculated as the average of the weighted vesting period and the contractual expiration date of the option. This calculation is based on the safe harbor method permitted by the SEC in instances where the vesting and exercise terms of options granted meet certain conditions and where limited historical exercise data is available. The expected volatility is based on the historical volatility of the Company s common stock. The risk-free rate selected to value any particular grant is based on the U.S. Treasury rate that corresponds to the expected term of the grant effective as of the date of the grant. The expected dividend assumption is based on the Company s history and management s expectation regarding dividend payouts. Compensation expense for common stock option awards with graded vesting schedules is recognized on a straight-line basis over the requisite service period for the last separately vesting portion of the award, provided that the accumulated cost recognized as of any date at least equals the value of the vested portion of the award.

The Company recognizes the fair value of restricted stock awards issued to employees and outside directors as stock-based compensation expense on a straight-line basis over the vesting period for the last separately vesting portion of the awards. Fair value is determined as the difference between the closing price of our common stock on the grant date and the purchase price of the restricted stock award, if any, reduced by expected forfeitures.

Income Taxes

Under ASC Topic 270, the Company is required to adjust its effective tax rate each quarter to be consistent with the estimated annual effective tax rate. The Company is also required to record the tax impact of certain discrete items, unusual or infrequently occurring, including changes in judgment about valuation allowances and effects of changes in tax laws or rates, in the interim period in which they occur. In addition, jurisdictions with a projected loss for the year or a year-to-date loss where no tax benefit can be recognized are excluded from the estimated annual effective tax rate. The impact of such an exclusion could result in a higher or lower effective tax rate during a particular quarter, based upon the mix and timing of actual earnings versus annual projections.

Deferred tax assets and liabilities are recognized to reflect the estimated future tax effects, calculated at currently effective tax rates, of future deductible or taxable amounts attributable to events that have been recognized on a cumulative basis in the condensed consolidated financial statements. A valuation allowance related to a net deferred tax asset is recorded when it is more likely than not that some portion of the deferred tax asset will not be realized.

Table of Contents

ASC Topic 740 prescribes a recognition threshold and measurement requirement for the financial statement recognition of a tax position that has been taken or is expected to be taken on a tax return and also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Under ASC Topic 740 the Company may only recognize or continue to recognize tax positions that meet a more likely than not threshold.

Research and Development Expenses

Research and development expenditures are expensed in the period incurred.

Collaborative Arrangement

The Company has entered into a collaborative arrangement with a partner in order to develop products using certain of the Company s proprietary technology. Under the arrangement, the development partner was granted a non-exclusive license to specified intellectual property for exclusive use in the development and production of ASIC chipsets for the Company. Both the Company and the development partner provided and continue to provide engineering project management resources at their own expense. The development partner is entitled to non-recurring engineering fees based upon the achievement of development milestones, and to a minimum portion of the Company s purchasing allocations for the component. Expenses incurred and paid to the development partner are included in research and development expense in the accompanying condensed consolidated statements of operations.

Comprehensive Loss

ASC Topic 220 establishes standards for reporting and displaying comprehensive income and its components in the condensed consolidated financial statements. Accumulated other comprehensive loss includes unrealized gains or losses on investments.

Risks and Uncertainties

The Company has invested a significant portion of its research and development budget into the design of ASIC devices, including the HyperCloud memory subsystem. This new design and the products it is incorporated into are subject to increased risks as compared to our existing products. The Company may be unable to achieve customer or market acceptance of the HyperCloud memory subsystem or other new products, or achieve such acceptance in a timely manner. The Company has experienced a longer qualification cycle than anticipated with its HyperCloud memory subsystems, and as of April 2, 2011 we have not shipped any production quantities. Further delays or any failure in placing or qualifying this product with customers would adversely impact the Company s results of operations.

The Company s operations in the People s Republic of China (PRC) are subject to various political, geographical and economic risks and uncertainties inherent to conducting business in China. These include, but are not limited to, (i) potential changes in economic conditions in the region, (ii) managing a local workforce that may subject the Company to uncertainties or certain regulatory policies, (iii) changes in other policies of the Chinese governmental and regulatory agencies, and (iv) changes in the laws and policies of the U.S. government regarding the conduct of business in foreign countries, generally, or in China, in particular. Additionally, the Chinese government controls the procedures by which its local currency, the Chinese Renminbi (RMB), is converted into other currencies and by which dividends may be declared or capital distributed for the purpose of repatriation of earnings and investments. If restrictions in the conversion of RMB or in the repatriation of earnings and investments through dividend and capital distribution restrictions are instituted, the Company s operations and operating results may be negatively impacted. Restricted net assets of the Company s subsidiary in the PRC totaled $1.6 million and $2.0 million at April 2, 2011 and January 1, 2011, respectively.

Foreign Currency Re-measurement

The functional currency of the Company s foreign subsidiary is the U.S. dollar. Local currency financial statements are re-measured into U.S. dollars at the exchange rate in effect as of the balance sheet date for monetary assets and liabilities and the historical exchange rate for nonmonetary assets and liabilities. Expenses are re-measured using the average exchange rate for the period, except items related to nonmonetary assets and liabilities, which are re-measured using historical exchange rates. All re-measurement gains and losses are included in determining net loss.

Table of Contents

Net Loss Per Share

Basic net loss per share is calculated by dividing net loss by the weighted-average common shares outstanding during the period, excluding unvested shares issued pursuant to restricted share awards under our share-based compensation plans. Diluted net loss per share is calculated by dividing the net loss by the weighted-average shares and dilutive potential common shares outstanding during the period. Dilutive potential shares consist of dilutive shares issuable upon the exercise or vesting of outstanding stock options and restricted stock awards, respectively, computed using the treasury stock method. In periods of losses, basic and diluted loss per share are the same, as the effect of stock options and unvested restricted share awards on loss per share is anti-dilutive.

Note 3 Supplemental Financial Information

Inventories

Inventories consist of the following (in thousands):

	April 2, 2011	January 1, 2011
Raw materials	$ 4,000	$ 2,631
Work in process	328	171
Finished goods	2,974	1,707
	$ 7,302	$ 4,509

Warranty Liability

The following table summarizes the activity related to the warranty liability (in thousands):

	Three Months Ended	
	April 2, 2011	April 3, 2010
Beginning balance	$ 194	$ 240
Charged to costs and expenses	98	40
Cost of warranty claims	(104)	(32)
Ending balance	$ 188	$ 248

The warranty liability is included as a component of accrued expenses and other current liabilities in the accompanying condensed consolidated balance sheets.

Facility Relocation Costs

The following table summarizes the activity related to the Company s accrual for facility relocation costs during the period indicated (in thousands):

	Three Months Ended	
	April 2, 2011	**April 3, 2010**
Beginning balance	$	$ 84
Reversal of accrual/reduction of costs		(28)
Net payments		(8)
Ending balance	$	$ 48

Table of Contents

As a result of the relocation of the Company s domestic headquarters and manufacturing facility during the third quarter of 2007, the Company vacated its previous manufacturing facility. The Company subleased this facility, but remained obligated under a noncancellable operating lease through November 2010. In accordance with ASC Topic 420, the Company recorded a net charge and related liability of approximately $134,000 in 2007, which approximated the estimated fair value of the net remaining lease payments. At the conclusion of the master lease and sublease terms, the Company determined that its original estimates regarding the net remaining lease payments exceeded its actual liability by approximately $33,000. Accordingly, the excess accrual was reversed, and the liability for facility relocation was reduced to zero at January 1, 2011.

In May 2009, the Company entered into an agreement to sublease a portion of its new domestic headquarters facility to another tenant at a discount from the rent required under its lease commitment. As a result, the Company recorded an additional charge of approximately $61,000. In February 2010, the sublessor vacated the space that it had subleased. The Company determined that the space could be used in its operations. As a result, the Company reversed approximately $28,000 of its accrual for facility relocation costs, and the liability was reduced to zero at January 1, 2011.

The expenses and reversal of accruals described above are included as a component of selling, general and administrative expense in the accompanying condensed consolidated statements of operations.

Comprehensive Loss

The components of comprehensive loss, net of taxes, consist of the following (in thousands):

	Three Months Ended	
	April 2, 2011	**April 3, 2010**
Net loss	$ (2,822)	$ (2,965)
Other comprehensive loss:		
Change in net unrealized loss on investments, net of tax	8	(35)
Total comprehensive loss	$ (2,814)	$ (3,000)

Accumulated other comprehensive loss reflected on the condensed consolidated balance sheets at April 2, 2011 and January 1, 2011, represents accumulated net unrealized losses on investments.

Computation of Net Loss Per Share

Basic and diluted net loss per share is calculated by dividing net loss by the weighted-average common shares outstanding during the period. The following table sets forth the computation of net loss per share (in thousands, except per share data):

	Three Months Ended	
	April 2, 2011	April 3, 2010
Numerator: Net loss	$ (2,822)	$ (2,965)
Denominator: Weighted-average common shares outstanding, basic and diluted	24,881	20,688
Net loss per share, basic and diluted	$ (0.11)	$ (0.14)

The following table sets forth potentially dilutive common share equivalents, consisting of shares issuable upon the exercise or vesting of outstanding stock options and restricted stock awards, respectively, and the exercise of warrants, computed using the treasury stock method. These potential common shares have been excluded from the diluted net loss per share calculations above as their effect would be anti-dilutive for the periods then ended (in thousands):

	Three Months Ended	
	April 2, 2011	April 3, 2010
Common share equivalents	1,614	2,270

The above common share equivalents would have been included in the calculation of diluted earnings per share had the Company reported net income for the periods then ended.

Table of Contents

Major Customers

The Company s product sales have historically been concentrated in a small number of customers. The following table sets forth sales to customers comprising 10% or more of the Company s net sales as follows:

	Three Months Ended	
	April 2, 2011	April 3, 2010
Customer:		
Customer A	70%	37%
Customer B	*%	31%
Customer C	*%	16%

* less than 10% of net sales

The Company s accounts receivable are concentrated with one customer at April 2, 2011 representing approximately 69% and two customers at January 1, 2011, representing approximately 75% and 13%, of aggregate gross receivables. A significant reduction in sales to, or the inability to collect receivables from, a significant customer could have a material adverse impact on the Company. The Company mitigates risk associated with foreign receivables by purchasing comprehensive foreign credit insurance.

Cash Flow Information

The following table sets forth supplemental disclosures of cash flow information and non-cash investing and financing activities (in thousands):

	Three Months Ended	
	April 2, 2011	April 3, 2010
Supplemental disclosure of cash flow information:		
Income taxes refunds received	$	$
Interest paid	$ 35	$ 21
Supplemental disclosure of non-cash investing and financing activities:		
Purchase of equipment not paid for at the end of the period	$ 25	$
Debt financed acquisition of assets	$ 169	$
Unrealized (gain) loss from investments in marketable securities	$ (8)	$ 35

Table of Contents

Note 4 Fair Value Measurements

The following tables detail the fair value measurements within the fair value hierarchy of the Company s investments in marketable securities (in thousands):

	Fair Value at April 2, 2011	Fair Value Measurements at April 2, 2011 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale debt securities:				
Money market mutual funds	$ 7,581	$ 7,581	$	$
Auction and variable floating rate notes	898			898
Total	$ 8,479	$ 7,581	$	$ 898

	Fair Value at January 1, 2011	Fair Value Measurements at January 1, 2011 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale debt securities:				
Money market mutual funds	$ 12,654	$ 12,654	$	$
Corporate notes and bonds	824		824	
Auction and variable floating rate notes	890			890
Total	$ 14,368	$ 12,654	$ 824	$ 890

The following tables summarize the Company s assets measured at fair value on a recurring basis as presented in the Company s condensed consolidated balance sheets at April 2, 2011 and January 1, 2011:

	Fair Value at April 2, 2011	Fair Value Measurements at April 2, 2011 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	$ 7,581	$ 7,581	$	$
Long-term marketable securities	898			898
Total assets measured at fair value	$ 8,479	$ 7,581	$	$ 898

	Fair Value at January 1, 2011	Fair Value Measurements at January 1, 2011 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

Cash equivalents	$	12,654	$	12,654	$		$	
Short-term marketable securities		824				824		
Long-term marketable securities		890						890
Total assets measured at fair value	$	14,368	$	12,654	$	824	$	890

Table of Contents

Fair value measurements using Level 3 inputs in the table above relate to the Company s investments in auction rate securities. Level 3 inputs are unobservable inputs used to estimate the fair value of assets or liabilities and are utilized to the extent that observable inputs are not available.

The following table provides a reconciliation of the beginning and ending balances for the Company s assets measured at fair value using Level 3 inputs (in thousands):

	Three Months Ended	
	April 2, 2011	April 3, 2010
Beginning balance	$ 890	$ 941
Unrealized gain (loss) included in other comprehensive loss	8	(35)
Ending balance	$ 898	$ 906

Note 5 Investments in Marketable Securities

Investments in marketable securities consist of the following (in thousands):

	April 2, 2011		
	Amortized Cost	Net Unrealized Gain (Loss)	Fair Value
Auction and variable floating rate notes	$ 1,001	$ (103)	$ 898

	January 1, 2011		
	Amortized Cost	Net Unrealized Gain (Loss)	Fair Value
Corporate notes and bonds	$ 824	$	$ 824
Auction and variable floating rate notes	1,001	(111)	890
	$ 1,825	$ (111)	$ 1,714

Realized gains and losses on the sale of investments in marketable securities are determined using the specific identification method. Net realized gains and losses recorded were not significant in any of the periods reported upon.

Table of Contents

The following table provides the breakdown of investments in marketable securities with unrealized losses (in thousands):