NETLIST INC
Form 10-K
February 29, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 29, 2007

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, Irvine, CA 92618
(Address of principal executive offices) (Zip Code)

(949) 435-0025
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, par value $0.001 per share	The NASDAQ Global Market

Securities registered pursuant to Section 12(g) of the Act:

None
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No ý

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 ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. 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 the definitions 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 ý

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

The aggregate market value of the registrant's common stock held by non-affiliates, based on the closing price of the registrant's common stock as reported on The NASDAQ Global Market on June 29, 2007, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $35.2 million. For purposes of this calculation, it has been assumed that all shares of the registrant's common stock held by directors, executive officers and shareholders beneficially owning five percent or more of the registrant's common stock are held by affiliates. The treatment of these persons as affiliates for purposes of this calculation is not conclusive as to whether such persons are, in fact, affiliates of the registrant.

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

19,855,411 shares outstanding at February 15, 2008

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the registrant's Annual Meeting of Stockholders for 2008 have been incorporated by reference into Part III of this Annual Report on Form 10-K.

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PART I

Item 1. Business of Netlist, Inc.

Overview

We design, manufacture and sell high performance memory subsystems for the server, high performance computing and communications markets. Our memory subsystems consist of dynamic random access memory integrated circuits, or DRAM ICs, NAND and other components assembled on a printed circuit board, or PCB. We engage with our original equipment manufacturer, or OEM, customers from the earliest stages of new product definition, which provides us unique insight into their full range of system architecture and performance requirements. This close collaboration has also allowed us to develop a significant level of systems expertise. We leverage 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.

We were incorporated in Delaware in June 2000 and commenced operations in September 2000.

Memory Products

DRAM Modules

We offer a comprehensive lineup of DRAM ICs, memory modules utilizing a wide range of DRAM technologies from legacy Fast Page/Extended-Data-Out, or FP/EDO, and Synchronous DRAM, or SDRAM, to double-data-rate, or DDR, and DDR2 SDRAM and leading-edge high performance DDR3 SDRAM devices. These modules encompass a broad range of form factors and functions and more current dual in-line memory modules, or DIMMs, fully-buffered DIMMS, or FBDIMMS, small outline dual in-line memory modules, or SO-DIMMs, very low profile, or VLP, DIMMs and mini-DIMMs for space-constrained blade servers, or 1.75 inch thin computing servers, and networking applications. These memory modules come in configurations of up to 244 pins and densities of up to 8GB. We utilize advanced device and module-level packaging/stacking technologies to achieve cost-effective high-density solutions. We also accommodate custom module designs based on specific OEM requirements. Our advanced DDR, DDR2 and DDR3 memory modules are designed to operate with high performance devices available through the extensive use of electrical and thermal simulation and modeling. Our DDR, DDR 2 and DDR3 DIMMs are tested at-speed on high-end functional testers utilizing comprehensive test suites, enabling these modules to meet the stringent quality requirements of enterprise class systems.

Flash Modules

In 2007, we introduced our Industrial Flash products, which are based on state of the art single and dual channel 32 bit RISC microcontrollers that meet the requirements of the Industrial OEM's within the networking, telecom and storage applications. With product performance and sustained read across multiple form factors such as Compact Flash, our product line is designed to meet individualized customer requirements and complements our suite of DRAM products.

Selective 2007 Product Focus

4 Rank FBDIMM

FBDIMM technology poses a significant thermal challenge, especially in higher density DIMM due to the Advanced Memory Buffer, or AMB, and the number of DRAM on the module. We have effectively addressed the above challenges by leveraging many of our core-competencies. The low-power FBDIMM is designed by using a combination of efficient board design, component selection and a

cutting-edge thermal engineering. Our FBDIMM design uses the lowest power AMB and a 4-Rank x8 configuration. A high efficiency heat-sink effectively dissipates the heat even at higher memory system utilization, resulting in high performance and reliable memory operation.

We offer power efficient FBDIMM solutions in 2GB, 4GB and 8GB capacities at speeds up to PC2-6400 or 800MT/s. In addition to the thermal engineering, we use a set of sophisticated design techniques such as impedance matching, reduced capacitive loading and built-in air gaps (to eliminate cross talk and electro-magnetic coupling) to enable a high performance registered DIMM that delivers up to PC2-6400 performance.

Very Low Profile Registered DIMM

We pioneered the very low profile, or VLP, design using proprietary board-stacking technology. These modules find their applications in the thin form-factor systems like the Blade Servers and Telecom equipment. The VLP designs are available as 1GB, 2GB, 4GB, DDR1 and 2GB, 4GB, and 8GB DDR2 RDIMM.

Small Form Factor DIMM

1GB, 2GB and 4GB SO-DIMM are available as non-ECC modules in 200-pin connector form-factor. The 1GB and 2GB VLP and LP Mini-RDIMM are also available as ECC modules in 244-pin connector form-factor. Our small DIMM options help increase the capacities of the mobile clients, workstation, and communication systems at optimal cost.

Flash Memory Cards and Modules

We design and manufacture industrial flash memory products in a variety of form factors and capacities. Our wide range of flash memory products come in Compact-Flash, PC Card, Secure Digital with plans to support other form factors with a USB interface. Our flash modules are predominantly used in telecom equipment, printers, embedded controller applications, servers, switches and routers. Our relationships with numerous suppliers of flash and controller application specific integrated circuits allow us to offer a wide range of cost-effective products to our customers.

Technology

We have a portfolio of proprietary technologies and design techniques and have assembled an engineering team with expertise in semiconductor, printed circuit boards, memory subsystem and system design. Our technology competencies include:

Very Low Profile Designs. We were the first company to create a 1 gigabyte memory subsystem in a form factor of less than one inch in height. We believe our proprietary board design technology is particularly useful in the rapidly growing blade server market, where efficient use of motherboard space is critical. Our technology has allowed us to decrease the system board space required for memory, and improve thermal performance and operating speeds, by enabling our customers to use alternative methods of component layout.

Proprietary PCB Designs. We utilize advanced, proprietary techniques to optimize electronic signal strength and integrity within a PCB. These techniques include the use of 8- or 10-layer boards, matching conductive trace lengths, a minimized number of conductive connectors, or vias, and precise load balancing to, among other things, help reduce noise and crosstalk between adjacent traces. In addition, our proprietary designs for the precise placement of intra-substrate components allow us to assemble memory subsystems with significantly smaller physical size, enabling OEMs to develop products with smaller footprints for their customers.

Planar Design. Our planar solutions are designed to provide high density solutions in a more cost-effective manner than traditional chip-stacking. We believe traditional chip-stacking can represent a significant portion of the total cost of a memory subsystem. Our planar solutions achieve the same densities as chip-stacked modules but do so by leveraging our PCB design expertise to place ICs in two rows in the same plane rather than on top of each other. Our planar memory subsystem designs feature high memory capacity with improved thermal characteristics by dissipating heat uniformly throughout the PCB.

Advanced Planar Designs. We plan to extend our planar design capabilities to develop very high density memory subsystems. These advanced planar designs may allow us to build modular solutions at lower costs compared to other packaging technologies. Additionally, these advanced planar solutions may remove heat generated by memory components in a more effective manner and can be used to build memory subsystems in a number of densities and form factors.

IC Design Expertise. We have designed blocks of custom logic that can be implemented in a stand-alone IC or integrated with other functional blocks in other ICs. We use these custom logic blocks to effectively increase density and reduce costs by allowing the use of two current-generation, lower density DRAM ICs in lieu of a single next-generation higher density IC.

Innovative Design Verification Tools. We use our innovative and proprietary DRAM load simulators during the product development stage to carefully assess DRAM IC load balancing requirements in our memory subsystems. Our DRAM load simulators are mounted in a memory subsystem in place of DRAM ICs to test the electronic signal strength and integrity of the memory design without disrupting signal quality. This provides us with more accurate feedback than that provided by conventional means because we are able to measure the signals at the precise point of origination.

Thermal Management Designs. We design our memory subsystems to ensure effective heat dissipation. We use thermal cameras to obtain thermal profiles of the memory subsystem during the design phase, allowing us to rearrange components to enhance thermal characteristics and, if necessary, replace components that do not meet specifications. We use thermal simulation and modeling software to create comprehensive heat transfer models of our memory subsystems, which enables our engineers to quickly develop accurate solutions to potential thermal issues. We also develop and use proprietary heat spreaders to enhance the thermal management characteristics of our memory subsystems.

Customers

We primarily market and sell our products to leading OEMs in the server, high performance computing and communications markets. Our memory subsystems are incorporated into multiple platforms at IBM, Dell, Gateway, Lenovo, Hewlett-Packard and other OEMs. Consistent with the concentrated nature of the OEM customer base in our target markets, a small number of large customers have historically accounted for a significant portion of our net sales. Net sales to our three largest customers represented approximately 85%, 75% and 68% of our total net sales in 2007, 2006 and 2005, respectively. See Note 16 of Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this Report. Net sales to some of our OEM customers include memory modules that are qualified by us directly with the OEM customer and sold to electronic manufacturing services providers, or EMSs, for incorporation into products manufactured exclusively for the OEM customer. These net sales to EMSs have historically fluctuated period by period as a portion of the total net sales to these OEM customers.

Our sales are made primarily pursuant to standard purchase orders that may be rescheduled or canceled on relatively short notice. Thus, we do not have a significant backlog.

Customers are generally allowed limited rights of return for up to 30 days, except for sales of excess 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. We offer a standard product warranty to our customers and have no other post-shipment obligations. While these returns have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience similar return rates in the future. Any significant increase in product failure rates and the resulting product returns could have a material adverse effect on our operating results for the period or periods in which such returns materialize.

We offer warranties on our memory subsystems generally ranging from one to three years, depending on the product and negotiated terms of purchase agreements with our customers. Such warranties require us to repair or replace defective product returned to us during such warranty period at no cost to the customer. Our estimates for warranty related costs are recorded at the time of sale based on historical and estimated future product return rates and expected repair or replacement costs. While such costs have historically been within our expectations and the provisions established, unexpected changes in failure rates could have a material adverse impact on us, requiring additional warranty reserves, and adversely affecting our gross profit and gross margins.

Sales and Marketing

We market and sell our products through a direct sales force and a network of independent sales representatives. Our sales activities focus primarily on developing strong relationships at the technical, marketing and executive management levels within market-leading OEMs. These OEMs design systems for a variety of applications that require a significant number of high performance memory subsystems, representing substantial opportunities for us. We have been successful in developing OEM relationships through our ability to provide high performance memory subsystems. Our direct sales group and field application engineers work closely with our OEM customers at an early stage of their design cycles to solve their design challenges and to design our products into their systems.

We believe in the timely communication and exchange of information with our customers. We utilize well-trained, highly technical program management teams to successfully drive new product development and quickly respond to our customers' needs and expectations. Our program management teams provide quick response times and act as a single point-of-contact for routine issues during the sales process. Additionally, they address the long-term business and technology goals of our customers. We employ a team approach to business development whereby our sales team and independent representatives identify, qualify and prioritize customer prospects through offices in a number of locations worldwide.

Our marketing efforts are twofold: creating awareness of the benefits of our proprietary technologies and design techniques in the development of application-specific memory subsystems, and building our brand awareness with our current and potential customers.

Manufacturing

We currently manufacture all of our products at our facilities in Irvine, California and Suzhou in the People's Republic of China, or the PRC. Our advanced engineering and design capabilities, combined with our in-house manufacturing processes, allow us to assemble our memory subsystems reliably and in high volume. Our advanced, customized manufacturing facilities are capable of surface mount assembly, subsystem testing, system-level burn-in testing, programming, marking, labeling and packaging. At each stage of the production cycle, including product prototyping, qualification sample production and high-volume manufacturing and delivery, we focus on providing our customers with rapid response and short manufacturing turn-around times. Manufacturing cycle times for our products are typically one week or less, and in some cases as few as two days, from receipt of order.

During 2007, we expanded our manufacturing capabilities by opening our new facility in the PRC. This facility has been configured in the same manner as our Irvine facility and has significantly increased our manufacturing capacity. We believe that this facility enables us to achieve better operating leverage through lower material and labor costs. This facility also puts our products in closer proximity to a number of our end customers, allowing us to fulfill customer orders more quickly.

As of December 29, 2007, approximately $3.6 million of our net long-lived assets were located outside the United States in the PRC.

We acquire components and materials such as DRAM ICs directly from IC manufacturers and assemble them into finished subsystems. We believe that one of our key strengths is the efficient procurement and management of components for our subsystems, which benefits our customers in the form of lower costs and increased product availability. We have a limited number of suppliers, but we have developed strong supplier relationships with key DRAM IC manufacturers, which we believe gives us direct and ready access to the critical components that we need for our production activities. We typically qualify our products with our customers using multiple manufacturers of DRAM ICs. The flexibility to choose from several DRAM IC providers allows us to minimize product cost and maximize product availability.

We schedule production based on purchase order commitments and anticipated orders. We release raw materials to the manufacturing floor by means of an on-line shop floor control system, which allows for internal quality analysis, direct access to inventory information and production floor material tracking. We have a flexible manufacturing workforce which allows us to manage unforecasted demand. In addition we have the capability to sell excess quantities of DRAM ICs to mitigate inventory risks. Our sales of excess inventory generated approximately $1.9 million, or 2%, of our net sales for 2007 and approximately $11.4 million, or 8%, of our net sales for 2006.

Our Quality Assurance engineers work with our suppliers to ensure that the raw materials we receive meet our high quality standards. These engineers also perform onsite supplier factory audits and use our internal test and inspection systems to verify that purchased components and materials meet our specifications. Our supplier quality program and incoming material quality control program are important aspects of our overall manufacturing process.

We perform ongoing reliability testing on our memory subsystems and share the results of that testing with our customers. We believe that this improves the system design process and allows for the elimination of potential problems at the earliest possible stage. In addition, we have implemented procedures which require that all of our memory subsystems undergo functional and system burn-in testing prior to delivery to the customer. We complement our test capabilities with advanced imaging technology to inspect the quality of our microBGA assemblies.

We are certified in ISO 9001:2000 Quality Management Systems, ISO 14001:1996 Environmental Management Standards, and OSHAS 18001:1999 Occupational Health and Safety Management Systems.

Competition

Our products are primarily targeted for the server, high performance computing and communications markets. These markets are intensely competitive, as numerous companies vie for business opportunities at a limited number of large OEMs. Our primary competitors are memory module providers such as STEC, SMART Modular Technologies, Inc., and Viking Interworks, a division of Sanmina-SCI Corporation. We also face competition from semiconductor suppliers, including Qimonda, Samsung and Micron in a limited range of applications. As we enter new markets and pursue additional applications for our products, we may face competition from a larger number of competitors.

Certain of our competitors have substantially greater financial, technical, marketing, distribution and other resources, broader product lines, lower cost structures, greater brand recognition and longer standing relationships with customers and suppliers. Some of our competitors may also have a greater ability to influence industry standards than we do, as well as more extensive patent portfolios.

Some of our customers and suppliers may have proprietary products or technologies which are competitive with our products, or could develop internal solutions or enter into strategic relationships with, or acquire, existing high-density memory module providers. Any of these actions could reduce our customers' demand for our products. Some of our significant suppliers of memory ICs may be able to manufacture competitive products at lower costs by leveraging internal efficiencies, or could choose to reduce our supply of memory ICs, adversely affecting our ability to manufacture our memory subsystems on a timely basis, if at all.

Our ability to compete in our current target markets and in future markets will depend in large part on our ability to successfully develop, introduce and sell new and enhanced products on a timely and cost-effective basis, and to respond to changing market requirements. We believe that the principal competitive factors in the selection of high performance memory subsystems by potential customers are:

understanding of OEM system and business requirements;

timeliness of new product introductions;

design characteristics and performance;

quality and reliability;

track record of volume delivery;

credibility with the customer;

fulfillment capability and flexibility; and

price.

We believe that we compete favorably with respect to these factors. We expect, however, that our current and future competitors could develop competing products that could cause a decline in sales or loss of market acceptance of our products.

Research and Development

The market for high performance memory subsystems is constantly changing and therefore continuous development of new technology, processes and product innovation is mandatory to be successful as a leading supplier. We believe that the continued and timely development of new products and improvement of existing products are critical to maintaining our competitive position. Our team of engineers focus on developing new products with innovative thermal solutions, packaging solutions and improved electrical signal integrity that enhances reliability over the life of the system. Also, our engineers incorporate various new techniques and methodologies for testing as well as new processes for manufacturing our products.

Our engineering staff closely engages with our OEM partners and their engineering teams at early stages in their system development. This collaboration allows our engineers to understand the customer's system architecture, power budget, operating environment such as air flow and operating temperature and any mechanical constraints. Our engineers use this information to provide guidance and solutions to implement optimum memory subsystems to our OEM partners. An important aspect of our research and development effort is to understand the challenges faced by our OEM partners and provide cost effective solutions that satisfy their requirements by utilizing our industry knowledge, proprietary technologies and technical expertise.

We use advanced design tools in development of our products that allow us to model behavior of a signal trace on our memory modules as well as airflow and thermal profiles of all components in the system. These design tools enable real-time simulation for signal integrity and behavioral modeling of our designs using the Input/Output Buffer Information Specification (IBIS) of our suppliers' components. These simulation tools help us reduce or eliminate electronic signal reflections, clock skews, signal jitter and noise which can reduce system performance and reliability. Also, our engineers use thermal simulation tools to identify potential thermal problems arising from inadequate airflow necessary to cool the components in the system. These efforts allow our engineers to develop optimum thermal solutions for our customer base.

We believe that to remain competitive we must continue to focus on developing advanced memory subsystem technologies to address our customers' increasingly complex memory subsystem requirements. Our total expenditures for research and development were approximately $4.8 million, $3.3 million and $3.0 million for 2007, 2006 and 2005, respectively.

Intellectual Property

Our high performance memory subsystems are developed in part using our proprietary intellectual property, and we believe that the strength of our intellectual property rights will be important to the success of our business. We utilize patent and trade secret protection, confidentiality agreements with customers and partners, disclosure and invention assignment agreements with employees and consultants and other contractual provisions to protect our intellectual property and other proprietary information.

As of December 29, 2007, we had 7 patents issued and 9 patent applications pending. Assuming that they are properly maintained, one of our issued patents will expire in 2022, three will expire in 2024 and the other three will expire in 2025. Our issued patents and patent applications relate to PCB design and layout techniques, packaging techniques, and the use of custom logic in high performance memory subsystems. We intend to actively pursue the filing of additional patent applications related to our technology advancements. While we believe that our patent and other intellectual property rights are important to our success, our technical expertise and ability to introduce new products in a timely manner also will continue to be important factors in maintaining our competitive position. Accordingly, we believe that our business is not materially dependent upon any one claim in any of our pending patent applications.

Despite our precautions, a third party may reverse engineer, copy or otherwise obtain and use our products, services or technology without authorization, develop similar technology independently or design around any patents issued to us. There can be no assurance that our efforts taken to prevent misappropriation or infringement of our intellectual property by third parties have been or will be successful.

Employees

At February 1, 2008, we had approximately 190 employees (including 119 regular employees and 71 temporary employees). Approximately 75 of the regular employees were located in the U.S., and approximately 44 were located in other countries (mainly in China). We had 135 employees in operations, 18 employees in research and development, 21 employees in sales and marketing, and 16 employees engaged in other administrative functions. We use contract employees in our operations department from time to time to effectively manage our manufacturing workflow. As of February 1, 2008, our domestic operations department had 5 contract employees engaged full-time in manufacturing and our general and administrative departments had 6 contract employees. We are not party to any collective bargaining agreements with any of our employees. We have never experienced a work stoppage, and we believe our employee relations are good.

General Information

We maintain a website at *www.netlist.com* (this uniform resource locator, or URL, is an inactive textual reference only and is not intended to incorporate our website into this Form 10-K). We file reports with the Securities and Exchange Commission and make available, free of charge, on or through our website, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy and information statements and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. Our website also contains copies of our corporate governance policy, code of business conduct and ethics, insider trading policy and whistleblower policy, as well as copies of the charters for our audit committee, compensation committee and nominating and corporate governance committee.

Item 1A. Risk Factors

This Annual Report on Form 10-K includes forward-looking statements. These forward-looking statements generally are identified by words such as "believe", "expect", "anticipate", "estimate", "intend", "strategy", "may", "will likely" and similar words or phrases. A forward-looking statement is neither a prediction nor a guarantee of future events or circumstances, and those future events or circumstances may not occur. Investors should not place undue reliance on the forward-looking statements, which speak only as of the date of this Report. We are under no obligation to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise. These forward-looking statements are all based on currently available market, operating, financial and competitive information and are subject to various risks and uncertainties, including but not limited to the rapidly- changing nature of technology; evolving industry standards; introductions of new products by competitors; changes in end-user demand for technology solutions; our ability to attract and retain skilled personnel; our reliance on suppliers of critical components; fluctuations in the market price of critical components; and the political and regulatory environment in the PRC. Our actual future results and trends may differ materially depending on a variety of factors including, but not limited to, the risks and uncertainties discussed below. The risks below are not the only ones we face. Additional risks and risks that management currently considers immaterial may also have an adverse effect on us.

We have a limited operating history, and we expect a number of factors to cause our operating results to fluctuate on a quarterly and annual basis, which may make it difficult to predict our future performance.

Our limited operating history makes it difficult to predict our future performance. Our operating results have varied significantly in the past and will continue to fluctuate from quarter-to-quarter or year-to-year in the future due to a variety of factors, many of which are beyond our control. Factors relating to our business that may contribute to these quarterly and annual fluctuations include the following factors, as well as other factors described elsewhere in this Report:

- the loss of, or a significant reduction in sales to, a key customer;
- the cyclical nature of the industry in which we operate;
- a reduction in the demand for our high performance memory subsystems or the systems into which they are incorporated;
- changes in the prices of our products or in the cost of the materials that we use to build our products, including fluctuations in the market price of DRAM ICs and NAND;
- our inability to develop new or enhanced products that achieve customer or market acceptance in a timely manner;

the timing of introductions of competing products or technologies;

our ability to adequately finance future growth;

our ability to procure an adequate supply of key components, particularly DRAM ICs and NAND;

our failure to maintain the qualification of our products with our current customers or to qualify future products with our current or prospective customers;

our failure to produce products that meet the quality requirements of our customers;

our ability to effectively operate a new manufacturing facility in the PRC;

the loss of any of our key personnel;

delays in fulfilling orders for our products or a failure to fulfill orders;

disputes regarding intellectual property rights;

litigation involving our products;

our customers' failure to pay us on a timely basis; and;

changes in accounting principles or policies.

Due to the various factors mentioned above, and others, the results of any prior quarterly or annual periods should not be relied upon as an indication of our future operating performance.

Sales to a limited number of customers represent a significant portion of our net sales and the loss of, or a significant reduction in sales to, any one of these customers could materially harm our business.

Sales to certain of our OEM customers such as Dell, IBM and Hewlett Packard have historically represented a significant portion of our net sales. We currently expect that sales to Dell and Hewlett Packard will continue to represent a significant percentage of our net sales for at least the next 12 months. We do not have long-term agreements with these customers, or with any other customer. Any one of these customers could decide at any time to discontinue, decrease or delay their purchase of our products. In addition, the prices that these customers pay for our products could change at any time. The loss of Dell or Hewlett Packard as a customer, or a significant reduction in sales to any of them, would significantly reduce our net sales and adversely affect our operating results.

Our ability to maintain or increase our net sales to our key customers depends on a variety of factors, many of which are beyond our control. These factors include our customers' continued sales of servers and other computing systems that incorporate our memory subsystems and our customers' continued incorporation of our products into their systems.

Because of these and other factors, we cannot assure you that net sales to these customers will continue or that the amount of such net sales will reach or exceed historical levels in any future period. Because these customers account for a substantial portion of our net sales, the failure of any one of these customers to pay on a timely basis would negatively impact our cash flow.

A limited number of relatively large potential customers dominate the markets for our products.

Our target markets are characterized by a limited number of large companies. Consolidation in one or more of our target markets may further increase this industry concentration. As a result, we anticipate that sales of our products will continue to be concentrated among a limited number of large customers in the foreseeable future. We believe that our financial results will depend in significant part on our success in establishing and maintaining relationships with, and effecting substantial sales to,

these potential customers. Even if we establish these relationships, our financial results will be largely dependent on these customers' sales and business results.

The markets in which we compete are cyclical in nature, and any future downturn could adversely affect our business.

Sales of our products are dependent upon demand in the computing, networking, communications, printer, storage and industrial markets. These markets have been cyclical and are characterized by wide fluctuations in product supply and demand. These markets have experienced significant downturns, often connected with, or in anticipation of, maturing product cycles, reductions in technology spending and declines in general economic conditions. These downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and the erosion of average selling prices.

We may experience substantial period-to-period fluctuations in future operating results due to factors affecting the computing, networking, communications, printers, storage and industrial markets. A decline or significant shortfall in demand in any one of these markets could have a material adverse effect on the demand for our products. As a result, our sales will likely decline during these periods. During an industry downturn, there is also a higher risk that our trade receivables would be uncollectible. In addition, because many of our costs and operating expenses are relatively fixed, if we are unable to control our expenses adequately in response to reduced sales, our gross margins, operating income and cash flow would be negatively impacted.

A decline in the worldwide semiconductor market or a future decline in economic conditions or consumer confidence in any significant geographic area would also likely decrease the overall demand for our products, which could have a material adverse effect on us. More generally, any of these events could cause consumer confidence and spending to decrease or result in increased volatility to the United States economy and worldwide financial markets. Any of these occurrences could have a material adverse effect on our business, financial condition and results of operations.

We are subject to risks relating to product concentration and lack of market diversification.

In 2007 and 2006, we derived approximately 68% and 79%, respectively, of our net sales from sales of our high performance memory subsystems for use in the server market. We expect these memory subsystems to continue to account for a significant portion of our net sales in the near term. Continued market acceptance of these products for use in servers is critical to our success. If the demand for servers deteriorates or if the demand for our products to be incorporated in servers declines, our operating results would be adversely affected, and we would be forced to diversify our product portfolio and our target markets. We may not be able to achieve this diversification, and our inability to do so may adversely affect our business.

Our investments in auction rate securities are subject to risks which may cause losses and affect the liquidity of these investments.

We hold certain investments in auction rate securities which have failed, or may in the future fail, their respective auctions. An auction failure means that the parties wishing to sell their securities could not do so. As a result of failed auctions, our ability to liquidate and fully recover the carrying value of our investments in the near term may be limited or not exist. If the issuers of these investments are unable to close future auctions and their credit ratings deteriorate, we may in the future be required to record an impairment charge on these investments. We may be required to wait until market stability is restored for these investments or until the final maturity of the underlying notes (up to 30 years) to realize our investments' recorded value.

We have historically incurred losses and may continue to incur losses.

We incurred net losses each year from the inception of our business through fiscal 2005, as well as for the year ended December 29, 2007. Our cumulative net losses were $23.9 million and $16.3 million as of December 29, 2007 and December 30, 2006, respectively. We may not be able to achieve or maintain profitability on a quarterly or annual basis in the future.

The prices of DRAM ICs and NAND is volatile, and changes in their prices could adversely affect our gross margin.

The prices of our products are adjusted periodically based in part on the market price of DRAM ICs and NAND, which have historically constituted approximately 70% - 90% of the total cost of our memory subsystems. Once our prices with a customer are negotiated, we are generally unable to revise pricing with that customer until our next regularly scheduled price adjustment. Consequently, we are exposed to the risks associated with the volatility of the price of DRAM ICs and NAND during that period. If the market price for DRAM ICs and NAND increases, we generally cannot pass this price increase on to our customers for products purchased under an existing purchase order. As a result, our cost of sales could increase and our gross margins could decrease. Alternatively, if there is a decline in the price of DRAM ICs and NAND, we may need to reduce our selling prices for subsequent purchase orders, which may result in a decline in our expected net sales.

Customer demand is difficult to accurately forecast and any failure to optimally calibrate our production capacity and inventory levels to meet customer demand could adversely affect our revenues, gross margins and earnings.

We make significant decisions regarding the levels of business that we will seek and accept, production schedules, component procurement commitments, personnel needs and other resource requirements, based on our estimates of customer requirements. The short-term nature of commitments by many of our customers, the fact that our customers may cancel or defer purchase orders for any reason, and the possibility of unexpected changes in demand for our customers' products each reduce our ability to accurately estimate future customer requirements for our products.

If we underestimate customer demand, we may not have sufficient inventory of DRAM ICs and NAND on hand to manufacture enough product to meet that demand. We also may not have sufficient capacity at any given time to meet our customers' demands for rapid increases in production. These shortages of inventory and capacity will lead to delays in the delivery of our products, which could cause order cancellations, the loss of customers and a decrease in our net sales.

Conversely, if we overestimate customer demand, we may have excess raw material inventory of DRAM ICs and NAND. If there is a subsequent decline in the price of DRAM ICs and NAND, the value of our inventory will fall. As a result, we may need to write-down the value of our DRAM IC and NAND inventory, which may result in a significant decrease in our gross margin and financial condition. Also, to the extent that we manufacture products in anticipation of future demand that does not materialize, or in the event a customer cancels or reduces outstanding orders, we could experience an unanticipated increase in our finished goods inventory. In the past, we have had to write-down inventory due to obsolescence, excess quantities and declines in market value below our costs.

We use a small number of DRAM IC and NAND suppliers and are subject to risks of disruption in the supply of DRAM ICs and NAND.

Our ability to fulfill customer orders is dependent on a sufficient supply of DRAM ICs and NAND, which are an essential component of our memory subsystems. There is a relatively small number of suppliers of DRAM ICs and NAND, and we purchase from only a subset of these suppliers. We have no long-term DRAM or NAND supply contracts. Our dependence on a small number of

suppliers and the lack of any guaranteed sources of DRAM and NAND supply expose us to several risks, including the inability to obtain an adequate supply of DRAM ICs and NAND, price increases, delivery delays and poor quality.

The recent declines in customer demand and revenues has caused us to reduce our purchases of DRAM ICs and NAND. Should we not maintain sufficient purchase levels with some suppliers, our ability to obtain future supplies of raw materials may be impaired due to the practice of some suppliers to allocate their products to customers with the highest regular demand.

From time to time, shortages in DRAM ICs and NAND have required some suppliers to limit the supply of their DRAM ICs and NAND. As a result, we may be unable to obtain the DRAM ICs and NAND necessary to fill customers' orders for our products in a timely manner. If we are unable to obtain a sufficient supply of DRAM ICs and NAND to meet our customers' requirements, these customers may reduce future orders for our products or not purchase our products at all, which would cause our net sales to decline and harm our operating results. In addition, our reputation could be harmed, we may not be able to replace any lost business with new customers, and we may lose market share to our competitors.

Our customers qualify the DRAM ICs and NAND of our suppliers for use in their systems. If one of our suppliers should experience quality control problems, it may be disqualified by one or more of our customers. This would disrupt our supplies of DRAM ICs and NAND and reduce the number of suppliers available to us, and may require that we qualify a new supplier.

The flash memory market is constantly evolving and competitive, and we may not have rights to manufacture and sell certain types of products utilizing emerging flash formats, or we may be required to pay a royalty to sell products utilizing these formats.

The flash-based storage market is constantly undergoing rapid technological change and evolving industry standards. Many consumer devices, such as digital cameras, PDAs and smartphones, are transitioning to emerging flash memory formats, such as the Memory Stick, and xD Picture Card formats, which we do not currently manufacture and do not have rights to manufacture. Although we do not currently serve the consumer flash market, it is possible that certain OEMs may choose to adopt these higher-volume, lower-cost formats. This could result in a decline in demand, on a relative basis, for other products that we manufacture such as CompactFlash and embedded USB drives. If we decide to manufacture flash memory products utilizing emerging formats such as those mentioned, we will be required to secure licenses to give us the right to manufacture such products which may not be available at reasonable rates or at all. If we are not able to supply flash card formats at competitive prices or if we were to have product shortages, our net sales could be adversely impacted and our customers would likely cancel orders or seek other suppliers to replace us.

If the supply of other component materials used to manufacture our products is interrupted, or if our inventory becomes obsolete, our results of operations and financial condition could be adversely affected.

We use consumables and other components, including PCBs, to manufacture our memory subsystems. We sometimes procure PCBs and other components from single or limited sources to take advantage of volume pricing discounts. Material shortages or transportation problems could interrupt the manufacture of our products from time to time in the future. These delays in manufacturing could adversely affect our results of operations.

Frequent technology changes and the introduction of next-generation products also may result in the obsolescence of other items of inventory, such as our custom-built PCBs, which could reduce our gross margin and adversely affect our operating performance and financial condition. We may not be able to sell some products developed for one customer to another customer because our products are

often designed to address specific customer requirements, and even if we are able to sell these products to another customer, our margin on such products may be reduced.

We may lose our competitive position if we are unable to timely and cost-effectively develop new or enhanced products that meet our customers' requirements and achieve market acceptance.

Our industry is characterized by intense competition, rapid technological change, evolving industry standards and rapid product obsolescence. Evolving industry standards and technological change or new, competitive technologies could render our existing products obsolete. Accordingly, our ability to compete in the future will depend in a large part on our ability to identify and develop new or enhanced products on a timely and cost-effective basis, and to respond to changing customer requirements. In order to develop and introduce new or enhanced products, we need to:

identify and adjust to the changing requirements of our current and potential customers;

identify and adapt to emerging technological trends and evolving industry standards in our markets;

design and introduce cost-effective, innovative and performance-enhancing features that differentiate our products from those of our competitors;

develop relationships with potential suppliers of components required for these new or enhanced products;

qualify these products for use in our customers' products; and

develop and maintain effective marketing strategies.

Our product development efforts are costly and inherently risky. It is difficult to foresee changes or developments in technology or anticipate the adoption of new standards. Moreover, once these things are identified, if at all, we will need to hire the appropriate technical personnel, develop the product and identify and eliminate design flaws. As a result, we may not be able to successfully develop new or enhanced products, or we may experience delays in the development and introduction of new or enhanced products. Delays in product development and introduction could result in the loss of, or delays in generating, net sales and the loss of market share, as well as damage to our reputation. Even if we develop new or enhanced products, they may not meet our customers' requirements or gain market acceptance. Accordingly, we cannot assure you that our future product development efforts will result in the development of new or enhanced products or that such products will achieve market acceptance.

Our customers require that our products undergo a lengthy and expensive qualification process without any assurance of net sales.

Our prospective customers generally make a significant commitment of resources to test and evaluate our memory subsystems prior to purchasing our products and integrating them into their systems. This extensive qualification process involves rigorous reliability testing and evaluation of our products, which may continue for six months or longer and is often subject to delays. In addition to qualification of specific products, some of our customers may also require us to undergo a technology qualification if our product designs incorporate innovative technologies that the customer has not previously encountered. Such technology qualifications often take substantially longer than product qualifications and can take over a year to complete. Qualification by a prospective customer does not ensure any sales to that prospective customer. Even after successful qualification and sales of our products to a customer, changes in our products, our manufacturing facilities, our production processes or our component suppliers may require a new qualification process, which may result in additional delays. In addition, because the qualification process is both product-specific and platform-specific, our

existing customers sometimes require us to requalify our products, or to qualify our new products, for use in new platforms or applications. For example, as our OEM customers transition from prior generation DDR1 DRAM architectures to current generation DDR2 DRAM architectures, we must design and qualify new products for use by those customers. In the past, this process of design and qualification has taken up to six months to complete, during which time our net sales to those customers declined significantly. After our products are qualified, it can take several months before the customer begins production and we begin to generate net sales. We must devote substantial resources, including design, engineering, sales, marketing and management efforts, to qualify our products with prospective customers in anticipation of sales. If we delay or do not succeed in qualifying a product with a prospective customer, we will not be able to sell that product to that prospect, which would harm our operating results and business.

We may not be able to maintain our competitive position because of the intense competition in our targeted markets.

We participate in a highly competitive market, and we expect competition to intensify. Many of these competitors have longer operating histories, significantly greater resources and name recognition, a larger base of customers and longer-standing relationships with customers and suppliers than we have. As a result, some of these competitors are able to devote greater resources to the development, promotion and sale of products and are better positioned than we are to influence customer acceptance of their products over our products. These competitors also may be able to respond better to new or emerging technologies or standards and may be able to deliver products with comparable or superior performance at a lower price. For these reasons, we may not be able to compete successfully against these competitors.

In addition to the competitors described above, some of our OEM customers have their own internal design groups that may develop solutions that compete with ours. These design groups have some advantages over us, including direct access to their respective companies' technical information and technology roadmaps. Our OEM customers also have substantially greater resources, financial or otherwise, than we do, and may have lower cost structures than ours. As a result, they may be able to design and manufacture competitive products more efficiently or inexpensively. If any of these OEM customers are successful in competing against us, our sales could decline, our margins could be negatively impacted and we could lose market share, any or all of which could harm our business and results of operations.

We expect our competitors to continue to improve the performance of their current products, reduce their prices and introduce new or enhanced technologies that may offer greater performance and improved pricing. If we are unable to match or exceed the improvements made by our competitors, our market position would deteriorate and our net sales would decline. In addition, our competitors may develop future generations and enhancements of competitive products that may render our technologies obsolete or uncompetitive.

We also expect to face competition from new and emerging companies that may enter our existing or future markets. These potential competitors may have similar or alternative products which may be less costly or provide additional features.

The establishment and ongoing operation of our manufacturing facility in the People's Republic of China, or the PRC, could expose us to new and significant risks.

During fiscal 2007 we invested significant time and effort in establishing a new manufacturing facility in the PRC and preparing it for full-scale operations. Our new manufacturing facility became operational in July 2007 and was successfully qualified by certain key customers. The difficulties normally associated with this complicated process are compounded by language and cultural

differences, as well as the geographic distance from our current domestic facility in Irvine. Our management has limited experience in creating or overseeing foreign operations, and this new facility may divert substantial amounts of their time. We cannot assure you that we will be able to maintain control over product quality, delivery schedules, manufacturing yields and costs as we increase our output. We also have to manage a local workforce that may subject us to uncertainties or regulatory policies and we remain subject to risks related to managing the increased production capacity provided by the facility. Should anticipated demand not materialize, the costs related to having excess capacity would have an adverse impact on our gross margins and operating results.

As we continue to increase our operations in the PRC, some of our net sales in future periods may be denominated in Chinese Renminbi, or Yuan. The Chinese government controls the procedures by which Yuan is converted into other currencies, and conversion of Yuan generally requires government consent. As a result, Yuan may not be freely convertible into other currencies at all times. If the Chinese government institutes changes in currency conversion procedures, or imposes restrictions on currency conversion, those actions may negatively impact our operations and could reduce our operating results. In addition, fluctuations in the exchange rate between Yuan and U.S. dollars may adversely affect our expenses and results of operations as well as the value of our assets and liabilities. These fluctuations may also adversely affect the comparability of our period-to-period results. If we decide to declare dividends and repatriate funds from our Chinese operations, we will be required to comply with the procedures and regulations of applicable Chinese law. Any changes to these procedures and regulations, or our failure to comply with those procedures and regulations, could prevent us from making dividends and repatriating funds from our Chinese operations, which could adversely affect our financial condition. If we are able to make dividends and repatriate funds from our Chinese operations, these dividends would be subject to U.S. corporate income tax.

The PRC currently provides for favorable tax rates for certain foreign-owned enterprises operating in specified locations in the PRC. We have established our PRC facility in such a tax-favored location. Should the PRC government enact a revised tax structure, it is possible that we would not realize the tax benefits that we currently anticipate and this could adversely impact our operating results.

We depend on a few key employees, and if we lose the services of any of those employees or are unable to hire additional personnel, our business could be harmed.

To date we have been highly dependent on the experience, relationships and technical knowledge of certain key employees. We believe that our future success will be dependent on our ability to retain the services of these key employees, develop their successors, reduce our reliance on them, and properly manage the transition of their roles should departures occur.

The loss of these key employees could delay the development and introduction of, and negatively impact our ability to sell, our products and otherwise harm our business. We do not have employment agreements with any of these key employees other than Chun K. Hong, our President, Chief Executive Officer and Chairman of the Board. We do not carry "Key Man" life insurance on any of our key employees.

Our future success also depends on our ability to attract, retain and motivate highly skilled engineering, manufacturing, other technical and sales personnel. Competition for experienced personnel is intense. We may not be successful in attracting new engineers or other technical personnel, or in retaining or motivating our existing personnel. If we are unable to hire and retain engineers with the skills necessary to keep pace with the evolving technologies in our markets, our ability to continue to provide our current products and to develop new or enhanced products will be negatively impacted, which would harm our business. In addition, the shortage of experienced engineers, and other factors, may lead to increased recruiting, relocation and compensation costs for such engineers, which may

exceed our expectations and resources. These increased costs may make hiring new engineers difficult, or may reduce our margins.

As of December 29, 2007, approximately 36% of our workforce consisted of contract personnel. We invest considerable time and expense in training these contract employees. We may experience high turnover rates in our contract employee workforce, which may require us to expend additional resources in the future. If we convert any of these contract employees into permanent employees, we may have to pay finder's fees to the contract agency.

Our lack of a significant backlog of unfilled orders, and the difficulty inherent in forecasting customer demand, makes it difficult to forecast our short-term production requirements to meet that demand.

We do not have long-term purchase agreements with our customers. Instead, our customers generally place purchase orders no more than two weeks in advance of their desired delivery date, and these purchase orders generally have no cancellation or rescheduling penalty provisions. This fact, combined with the quick turn-around times that apply to each order, makes it difficult to forecast our production needs and allocate production capacity efficiently. Our production expense levels are based in part on our forecasts of our customers' future product requirements and to a large extent are fixed in the short term. As a result, we likely will be unable to adjust spending on a timely basis to compensate for any unexpected shortfall in those orders. Any significant shortfall of customer orders in relation to our expectations could hurt our operating results, cash flows and financial condition. Also, any rapid increases in production required by our customers could strain our resources and reduce our margins. If such a rapid increase were to occur at any given time, we may not have sufficient short-term manufacturing capacity to meet our customers' immediate demands.

We attempt to forecast the demand for the DRAM ICs and other components needed to manufacture our products. Lead times for components vary significantly and depend on various factors, such as the specific supplier and the demand and supply for a component at a given time. If we underestimate customer demand or if we have not provided for sufficient manufacturing capacity, we would not be able to manufacture a sufficient quantity of our products and could forego sales opportunities, lose market share and damage our customer relationships.

If we are unable to manufacture our products efficiently, our operating results could suffer.

We must continuously review and improve our manufacturing processes in an effort to maintain satisfactory manufacturing yields and product performance, lower our costs and otherwise remain competitive. As we manufacture more complex products, the risk of encountering delays or difficulties increases. The start-up costs associated with implementing new manufacturing technologies, methods and processes, including the purchase of new equipment, and any resulting manufacturing delays and inefficiencies, could negatively impact our results of operations.

If we need to add manufacturing capacity, an expansion of our existing manufacturing facility or establishment of a new facility could be subject to factory audits by our customers. Any delays or unexpected costs resulting from this audit process could adversely affect our net sales and results of operations. In addition, we cannot be certain that we will be able to increase our manufacturing capacity on a timely basis or meet the standards of any applicable factory audits.

If we fail to protect our proprietary rights, our customers or our competitors might gain access to our proprietary designs, processes and technologies, which could adversely affect our operating results.

We rely on a combination of patent protection, trade secret laws and restrictions on disclosure to protect our intellectual property rights. We have submitted a number of patent applications regarding our proprietary processes and technology. It is not certain when or if any of the claims in the remaining applications will be allowed. To date we have had only seven patents issued. We intend to continue

filing patent applications with respect to most of the new processes and technologies that we develop. However, patent protection may not be available for some of these processes or technologies.

It is possible that our efforts to protect our intellectual property rights may not:

- prevent challenges to, or the invalidation or circumvention of, our existing intellectual property rights;
- prevent our competitors from independently developing similar products, duplicating our products or designing around any patents that may be issued to us;
- prevent disputes with third parties regarding ownership of our intellectual property rights;
- prevent disclosure of our trade secrets and know-how to third parties or into the public domain;
- result in valid patents, including international patents, from any of our pending or future applications; or
- otherwise adequately protect our intellectual property rights.

Others may attempt to reverse engineer, copy or otherwise obtain and use our proprietary technologies without our consent. Monitoring the unauthorized use of our technologies is difficult. We cannot be certain that the steps we have taken will prevent the unauthorized use of our technologies. This is particularly true in foreign countries, such as the PRC, where we have established a new manufacturing facility and where the laws may not protect our proprietary rights to the same extent as applicable U.S. laws.

If some or all of the claims in our patent applications are not allowed, or if any of our intellectual property protections are limited in scope by a court or circumvented by others, we could face increased competition with regard to our products. Increased competition could significantly harm our business and our operating results.

We may be involved in costly legal proceedings to defend against claims that we infringe the intellectual property rights of others or to enforce or protect our intellectual property rights.

Lawsuits claiming that we are infringing others' intellectual property rights may be brought against us, and we may have to defend against claims of infringement or invalidity. We currently plan to explore new technologies and to develop new products for our existing markets, such as communications, and for new markets, such as networking. By making use of these new technologies and entering these new markets there is an increased likelihood that others might allege that our products infringe on their intellectual property rights. Litigation is inherently uncertain, and an adverse outcome could subject us to significant liability for damages or invalidate our proprietary rights. An adverse outcome also could force us to take specific actions, including causing us to:

- cease selling products that are claimed to be infringing a third party's intellectual property;
- pay royalties on past or future sales;
- seek a license from the third party intellectual property owner to use their technology in our products, which license may not be available on reasonable terms, or at all; or
- redesign those products that are claimed to be infringing a third party's intellectual property.

There is a limited pool of experienced technical personnel that we can draw upon to meet our hiring needs. As a result, a number of our existing employees have worked for our existing or potential competitors at some point during their careers, and we anticipate that a number of

our future employees will have similar work histories. In the past, some of these competitors have claimed that our employees misappropriated their trade secrets or violated non-competition or non-solicitation agreements. Some of our competitors may threaten or bring legal action involving similar claims against us or our existing employees or make such claims in the future to prevent us from hiring qualified candidates. Lawsuits of this type may be brought, even if there is no merit to the claim, simply as a strategy to drain our financial resources and divert management's attention away from our business.

We also may find it necessary to litigate against others, including our competitors, customers and former employees, to enforce our intellectual property and contractual and commercial rights including, in particular, our trade secrets, as well as to challenge the validity and scope of the proprietary rights of others. We could become subject to counterclaims or countersuits against us as a result of this litigation. Moreover, any legal disputes with customers could cause them to cease buying or using our products or delay their purchase of our products and could substantially damage our relationship with them.

Any litigation, regardless of its outcome, would be time consuming and costly to resolve, divert our management's time and attention and negatively impact our results of operations.

If we are required to obtain licenses to use third party intellectual property and we fail to do so, our business could be harmed.

Although some of the components used in our final products contain the intellectual property of third parties, we believe that our suppliers bear the sole responsibility to obtain any rights and licenses to such third party intellectual property. While we have no knowledge that any third party licensor disputes our belief, we cannot assure you that disputes will not arise in the future. The operation of our business and our ability to compete successfully depends significantly on our continued operation without claims of infringement or demands resulting from such claims, including demands for payments of money in the form of, for example, ongoing licensing fees.

We are also developing products to enter new markets, such as the industrial flash market. Similar to our current products, we may use components in these new products that contain the intellectual property of third parties. While we plan to exercise precautions to avoid infringing on the intellectual property rights of third parties, we cannot assure you that disputes will not arise.

If it is determined that we are required to obtain inbound licenses and we fail to obtain licenses, or if such licenses are not available on economically feasible terms, our business, operating results and financial condition could be significantly harmed.

If our products do not meet the quality standards of our customers, we may be forced to stop shipments of products until the quality issues are resolved.

Our customers require our products to meet strict quality standards. Should our products not meet such standards, our customers may discontinue purchases from us until we are able to resolve the quality issues that are causing us to not meet the standards, Such "quality holds" could have a significant adverse impact on our revenues and operating results.

If our products are defective or are used in defective systems, we may be subject to product recalls or product liability claims.

If our products are defectively manufactured, contain defective components or are used in defective or malfunctioning systems, we could be subject to product liability claims and product recalls, safety alerts or advisory notices. While we have product liability insurance coverage, it may not be adequate to satisfy claims made against us. We also may be unable to obtain insurance in the future at satisfactory rates or in adequate amounts. Product liability claims or product recalls, regardless of their ultimate outcome, could have an adverse effect on our business, financial condition and reputation, and on our ability to attract and retain customers. In addition, we may determine that it is in our best interest to accept product returns in circumstances where we are not contractually obligated to do so in order to maintain good relations with our customers. Accepting product returns may negatively impact our operating results.

If we acquire other businesses or technologies in the future, these acquisitions could disrupt our business and harm our operating results and financial condition.

We will evaluate opportunities to acquire businesses or technologies that might complement our current product offerings or enhance our technical capabilities. We have no experience in acquiring other businesses or technologies. Acquisitions entail a number of risks that could adversely affect our business and operating results, including:

- difficulties in integrating the operations, technologies or products of the acquired companies;
- the diversion of management's time and attention from the normal daily operations of the business;
- insufficient increases in net sales to offset increased expenses associated with acquisitions or acquired companies;
- difficulties in retaining business relationships with suppliers and customers of the acquired companies;
- the overestimation of potential synergies or a delay in realizing those synergies;
- entering markets in which we have no or limited experience and in which competitors have stronger market positions; and
- the potential loss of key employees of the acquired companies.

Future acquisitions also could cause us to incur debt or be subject to contingent liabilities. In addition, acquisitions could cause us to issue equity securities that could dilute the ownership percentages of our existing stockholders. Furthermore, acquisitions may result in material charges or adverse tax consequences, substantial depreciation, deferred compensation charges, in-process research and development charges, the amortization of amounts related to deferred stock-based compensation expense and identifiable purchased intangible assets or impairment of goodwill, any or all of which could negatively affect our results of operations.

If we do not effectively manage our growth, our resources, systems and controls may be strained and our results of operations may suffer.

We have expanded, and plan to continue to expand, our operations, both domestically and internationally. Any future growth may strain our resources, management information and telecommunication systems, and operational and financial controls. To manage our growth effectively, including the development of our new manufacturing facility in the PRC, we must continue to improve and expand our systems and controls. We may not be able to do this in a timely or cost-effective manner, and our current systems and controls may not be adequate to support our future operations. In addition, our officers have relatively limited experience in managing a rapidly growing business or a public company. As a result, they may not be able to provide the guidance necessary to continue our growth or maintain our market position. Any failure to manage our growth or improve or expand our existing systems and controls, or unexpected difficulties in doing so, could harm our business.

Our internal controls over financial reporting may not be effective, which could have a significant and adverse effect on our business.

Section 404 of the Sarbanes-Oxley Act of 2002 and the rules and regulations of the Securities an