

NETLIST INC
Form 10-Q
August 14, 2009
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 4, 2009

or

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

For the transition period from to

Commission file number 001-33170

NETLIST, INC.

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(Exact name of registrant as specified in its charter)

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Delaware
State or other jurisdiction of
incorporation or organization

95-4812784
(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)

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

Indicate by check mark whether the registrant has submitted electronically 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 No

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

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

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

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19,855,411 shares outstanding at July 31, 2009

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NETLIST, INC. AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

FOR THE THREE AND SIX MONTHS ENDED JULY 4, 2009

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NETLIST, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(in thousands, except par value)

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	(unaudited) July 4, 2009	(audited) January 3, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 10,106	\$ 15,214
Investments in marketable securities	9,096	5,199
Accounts receivable, net	1,523	1,917
Inventories	1,954	1,829
Income taxes receivable	651	1,880
Prepaid expenses and other current assets	759	761
Total current assets	24,089	26,800
Property and equipment, net	5,621	6,939
Long-term investments in marketable securities	979	960
Other assets	221	234
Total assets	\$ 30,910	\$ 34,933
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 2,455	\$ 1,786
Revolving line of credit	2,153	
Current portion of long-term debt	328	474
Current portion of deferred gain on sale and leaseback transaction	118	118
Accrued expenses and other current liabilities	2,713	2,083
Total current liabilities	7,767	4,461
Long-term debt, net of current portion	36	130
Deferred gain on sale and leaseback transaction, net of current portion	49	108
Total liabilities	7,852	4,699
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.001 par value - 90,000 shares authorized; 19,855 shares issued and outstanding	20	20
Additional paid-in capital	69,980	69,383
Accumulated deficit	(46,924)	(39,113)
Accumulated other comprehensive loss	(18)	(56)
Total stockholders' equity	23,058	30,234
Total liabilities and stockholders' equity	\$ 30,910	\$ 34,933

See accompanying notes.

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NETLIST, INC. AND SUBSIDIARIES

Unaudited Condensed Consolidated Statements of Operations

(in thousands, except per share amounts)

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	Three Months Ended		Six Months Ended	
	July 4, 2009	June 28, 2008	July 4, 2009	June 28, 2008
Net sales	\$ 3,173	\$ 18,429	\$ 5,335	\$ 31,533
Cost of sales(1)	2,929	15,770	5,628	25,743
Gross profit (loss)	244	2,659	(293)	5,790
Operating expenses:				
Research and development(1)	2,030	1,716	3,644	3,292
Selling, general and administrative(1)	2,120	3,310	4,055	6,778
Total operating expenses	4,150	5,026	7,699	10,070
Operating loss	(3,906)	(2,367)	(7,992)	(4,280)
Other income:				
Interest income, net	18	104	100	343
Other income (expense), net	(45)	23	130	(68)
Total other income (expense), net	(27)	127	230	275
Loss before provision (benefit) for income taxes	(3,933)	(2,240)	(7,762)	(4,005)
Provision (benefit) for income taxes	31	11	49	(1,170)
Net loss	\$ (3,964)	\$ (2,251)	\$ (7,811)	\$ (2,835)
Net loss per common share:				
Basic and diluted	\$ (0.20)	\$ (0.11)	\$ (0.39)	\$ (0.14)
Weighted-average common shares outstanding:				
Basic and diluted	19,855	19,855	19,855	19,839

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

Cost of sales	\$ 38	\$ 48	\$ 67	\$ 62
Research and development	48	62	106	85
Selling, general and administrative	204	265	424	472

See accompanying notes.

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NETLIST, INC. AND SUBSIDIARIES

Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)

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	Six Months Ended	
	July 4, 2009	June 28, 2008
Cash flows from operating activities:		
Net loss	\$ (7,811)	\$ (2,835)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,150	1,054
Amortization of deferred gain on sale and leaseback transaction	(59)	(59)
Deferred income taxes		(990)
Gain on disposal of assets	(118)	
Stock-based compensation	597	619
Changes in operating assets and liabilities:		
Accounts receivable	394	5,593
Inventories	(125)	(4,998)
Income taxes receivable	1,229	(195)
Prepaid expenses and other current assets	2	(583)
Other assets	13	44
Accounts payable	669	(1,745)
Accrued expenses and other current liabilities	630	(254)
Net cash used in operating activities	(3,429)	(4,349)
Cash flows from investing activities:		
Acquisition of property and equipment	(56)	(770)
Proceeds from sales of equipment	342	
Purchase of investments in marketable securities	(10,203)	(6,672)
Proceeds from maturities and sales of investments in marketable securities	6,325	17,500
Net cash (used in) provided by investing activities	(3,592)	10,058
Cash flows from financing activities:		
Borrowings on lines of credit	10,325	49,490
Payments on lines of credit	(8,172)	(48,700)
Payments on debt	(240)	(434)
Increase in restricted cash		(2,000)
Reversal of unrealized excess tax benefit from exercise of warrants		(4)
Net cash provided by (used in) financing activities	1,913	(1,648)
(Decrease) increase in cash and cash equivalents	(5,108)	4,061
Cash and cash equivalents at beginning of period	15,214	7,182
Cash and cash equivalents at end of period	\$ 10,106	\$ 11,243

See accompanying notes.

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NETLIST, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

July 4, 2009

Note 1 Description of Business

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Netlist, Inc. (the Company or Netlist) designs and manufactures high performance memory subsystems for the server, high performance computing and communications markets. The Company's memory subsystems consist of dynamic random access memory integrated circuits, NAND flash memory, or NAND, and other components assembled on a printed circuit board. Headquartered in Irvine, California, Netlist's solutions are targeted at applications where memory plays a key role in meeting system performance requirements. In 2007, the Company established a manufacturing facility in the People's Republic of China, (the PRC), which became operational in July 2007 upon the successful qualification of certain key customers.

Note 2 Summary of Significant Accounting Policies

Basis of Presentation

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The interim unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (the US) 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 financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the US 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 3, 2009, included in the Company s Annual Report on Form 10-K filed with the SEC on March 30, 2009.

The condensed consolidated financial statements included herein as of July 4, 2009 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 consolidated financial position of the Company and its wholly owned subsidiaries as of July 4, 2009 and January 3, 2009, the consolidated results of its operations for the three and six months ended July 4, 2009 and June 28, 2008, and the consolidated cash flows for the six months ended July 4, 2009 and June 28, 2008. The results of operations for the three and six months ended July 4, 2009 are not necessarily indicative of the results to be expected for the full year or any future interim periods.

Principles of Consolidation

The 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

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The Company operates under a 52/53-week fiscal year ending on the Saturday closest to December 31. For fiscal 2009, the Company's fiscal year end is scheduled to be January 2, 2010 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

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The preparation of financial statements in conformity with accounting principles generally accepted in the US requires management to make estimates and assumptions that affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant estimates made by management include, among others, valuation of investments in marketable securities, provisions for uncollectible receivables and sales returns, warranty liabilities, valuation of inventories, recoverability of long-lived assets, stock-based compensation expense and realization of deferred tax assets. The Company bases its estimates and assumptions on current facts, historical experience and various other factors that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the accrual of costs and expenses that are not readily apparent from other sources. 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.

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Revenue Recognition

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The Company's revenues primarily consist of product sales of high performance memory subsystems to original equipment manufacturers (OEMs). Revenues also include sales of excess inventories to distributors and other users of memory integrated circuits (ICs) totaling approximately \$0.1 million and \$0.1 million, respectively for the three and six months ended July 4, 2009, and approximately \$0.1 million and \$0.2 million, respectively, for the three and six months ended June 28, 2008.

The Company recognizes revenues in accordance with the SEC's Staff Accounting Bulletin No. 104, *Revenue Recognition* (SAB 104). Under the provisions of SAB 104, the Company recognizes revenues when there is persuasive evidence that 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 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.

A portion of the Company's shipments are made to third-party inventory warehouses, or hubs, and the Company recognizes revenue when the inventory is pulled from the hub for use in production by the customer. The Company receives a report from the customer on a daily basis indicating the inventories pulled from a hub for use by the customer, and performs a daily reconciliation of inventories shipped to and pulled by the customer to those inventories reflected on the customer's reports to ensure that sales are recognized in the appropriate periods.

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

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Cash and cash equivalents consist of cash and short-term investments with original maturities of three months or less.

Investments in Marketable Securities