

NETLIST INC  
Form 10-Q  
August 12, 2010  
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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 3, 2010

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.

(Exact name of registrant as specified in its charter)

**Delaware**

State or other jurisdiction of incorporation or organization

**95-4812784**

(I.R.S. Employer Identification No.)

**51 Discovery, Suite 150**

**Irvine, CA 92618**

(Address of principal executive offices) (Zip Code)

**(949) 435-0025**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  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

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

Common Stock, par value \$0.001 per share

25,266,327 shares outstanding at July 30, 2010

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**NETLIST, INC. AND SUBSIDIARIES**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE THREE AND SIX MONTHS ENDED JULY 3, 2010**

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****NETLIST, INC. AND SUBSIDIARIES****Condensed Consolidated Balance Sheets****(in thousands, except par value)**

	<b>(unaudited)</b> <b>July 3,</b> <b>2010</b>	<b>(audited)</b> <b>January 2,</b> <b>2010</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 16,993	\$ 9,942
Investments in marketable securities	5,211	3,949
Accounts receivable, net	7,119	4,273
Inventories	4,259	2,232
Prepaid expenses and other current assets	687	854
Total current assets	34,269	21,250
Property and equipment, net	4,085	4,779
Long-term investments in marketable securities	902	941
Other assets	242	221
Total assets	\$ 39,498	\$ 27,191
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 6,179	\$ 4,057
Accrued payroll and related liabilities	1,839	2,332
Accrued expenses and other current liabilities	507	605
Accrued engineering charges	1,431	661
Current portion of long-term debt	92	108
Deferred gain on sale and leaseback transaction	49	108
Total current liabilities	10,097	7,871
Long-term debt, net of current portion	10	51
Total liabilities	10,107	7,922
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.001 par value - 90,000 shares authorized; 25,266 (2010) and 20,111 (2009) shares issued and outstanding	25	20
Additional paid-in capital	88,435	71,332
Accumulated deficit	(58,965)	(52,026)
Accumulated other comprehensive loss	(104)	(57)
Total stockholders' equity	29,391	19,269
Total liabilities and stockholders' equity	\$ 39,498	\$ 27,191

See accompanying notes.

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## NETLIST, INC. AND SUBSIDIARIES

## Unaudited Condensed Consolidated Statements of Operations

(in thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Net sales	\$ 9,304	\$ 3,173	\$ 17,194	\$ 5,335
Cost of sales(1)	7,486	2,929	13,558	5,628
Gross profit (loss)	1,818	244	3,636	(293)
Operating expenses:				
Research and development(1)	3,190	2,030	6,198	3,644
Selling, general and administrative(1)	2,607	2,120	5,177	4,055
Total operating expenses	5,797	4,150	11,375	7,699
Operating loss	(3,979)	(3,906)	(7,739)	(7,992)
Other income (expense):				
Interest income, net	3	18	4	100
Other income (expense), net	4	(45)	71	130
Total other income (expense), net	7	(27)	75	230
Loss before provision (benefit) for income taxes	(3,972)	(3,933)	(7,664)	(7,762)
Provision (benefit) for income taxes	2	31	(725)	49
Net loss	\$ (3,974)	\$ (3,964)	\$ (6,939)	\$ (7,811)
Net loss per common share:				
Basic and diluted	\$ (0.16)	\$ (0.20)	\$ (0.31)	\$ (0.39)
Weighted-average common shares outstanding:				
Basic and diluted	24,780	19,855	22,734	19,855

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

Cost of sales	\$ 12	\$ 38	\$ 22	\$ 67
Research and development	117	48	163	106
Selling, general and administrative	297	204	623	424

See accompanying notes.

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## NETLIST, INC. AND SUBSIDIARIES

## Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)

	Six Months Ended	
	July 3, 2010	July 4, 2009
Cash flows from operating activities:		
Net loss	\$ (6,939)	\$ (7,811)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,130	1,150
Amortization of deferred gain on sale and leaseback transaction	(59)	(59)
Gain on disposal of assets		(118)
Stock-based compensation	808	597
Changes in operating assets and liabilities:		
Accounts receivable	(2,846)	394
Inventories	(2,027)	(125)
Income taxes receivable		1,229
Prepaid expenses and other current assets	167	2
Other assets	(21)	13
Accounts payable	2,078	669
Accrued payroll and related expenses	(493)	35
Accrued expenses and other current liabilities	(98)	84
Accrued engineering charges	770	511
Net cash used in operating activities	(7,530)	(3,429)
Cash flows from investing activities:		
Acquisition of property and equipment	(392)	(56)
Proceeds from sales of equipment		342
Purchase of investments in marketable securities	(2,380)	(10,203)
Proceeds from maturities and sales of investments in marketable securities	1,110	6,325
Net cash used in investing activities	(1,662)	(3,592)
Cash flows from financing activities:		
Borrowings on line of credit	2,000	10,325
Payments on line of credit	(2,000)	(8,172)
Proceeds from public offering, net	16,210	
Proceeds from exercise of stock options and warrants	90	
Payments on debt	(57)	(240)
Net cash provided by financing activities	16,243	1,913
Increase (decrease) in cash and cash equivalents	7,051	(5,108)
Cash and cash equivalents at beginning of period	9,942	15,214
Cash and cash equivalents at end of period	\$ 16,993	\$ 10,106
Supplemental disclosure of non-cash investing activities:		
Unrealized losses (gains) from investments in marketable securities	\$ 47	\$ (38)
Increase in purchases of property and equipment accrued in accounts payable	\$ 44	\$

See accompanying notes.





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**NETLIST, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**July 3, 2010**

**Note 1 Description of Business**

Netlist, Inc. (the Company or Netlist) designs, manufactures and sells high-performance, logic-based memory subsystems for the server, storage and communications equipment markets. The Company's memory subsystems consist of combinations of dynamic random access memory integrated circuits, NAND flash memory, application-specific integrated circuits (ASICs) and other components assembled on printed circuit boards. The Company primarily markets and sells its products to leading original equipment manufacturer (OEM) customers. Netlist's solutions are targeted at applications where memory plays a key role in meeting system performance requirements.

**Note 2 Summary of Significant Accounting Policies**

*Basis of Presentation*

The interim unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (the U.S.) for interim financial information and with the instructions to Securities and Exchange Commission (SEC) Form 10-Q and Article 8 of SEC Regulation S-X. These financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. Therefore, these unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the year ended January 2, 2010, included in the Company's Annual Report on Form 10-K filed with the SEC on February 19, 2010.

The condensed consolidated financial statements included herein as of July 3, 2010 are unaudited; however, they contain all normal recurring accruals and adjustments that, in the opinion of the Company's management, are necessary to present fairly the condensed consolidated financial position of the Company and its wholly owned subsidiaries as of July 3, 2010, the condensed consolidated results of its operations for the three and six months ended July 3, 2010 and July 4, 2009, and the condensed consolidated cash flows for the six months ended July 3, 2010 and July 4, 2009. The results of operations for the three and six months ended July 3, 2010 are not necessarily indicative of the results to be expected for the full year or any future interim periods.

*Reclassifications*

Certain amounts in the 2009 financial statements have been reclassified to conform with the current year presentation.

*Principles of Consolidation*

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

*Fiscal Year*

The Company operates under a 52/53-week fiscal year ending on the Saturday closest to December 31. For fiscal 2010, the Company's fiscal year is scheduled to end on January 1, 2011 and will consist of 52 weeks. Each of the Company's first three quarters in a fiscal year is comprised of 13 weeks.

*Use of Estimates*

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

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*Revenue Recognition*

The Company's revenues primarily consist of product sales of high-performance memory subsystems to OEMs. Revenues also include sales of excess component inventories to distributors and other users of memory integrated circuits ( ICs ). Such sales amounted to less than \$0.1 million for each of the three and six months ended July 3, 2010, and totaled approximately \$0.1 million for each of the three and six months ended July 4, 2009.

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

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

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

*Cash and Cash Equivalents*

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

*Investments in Marketable Securities*

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

are reported in other income, net in the unaudited condensed consolidated statements of operations.

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

*Fair Value of Financial Instruments*

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

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*Allowance for Doubtful Accounts*

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