SIMPLETECH INC
Form 10-Q
May 14, 2003

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

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# FORM 10-Q

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

**For the quarterly period ended March 31, 2003**

**or**

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

**For the transition period from to**

**Commission File Number 000-31623**

# SIMPLETECH, INC.

(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| **CALIFORNIA** | **33-0399154** |

| | |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **3001 Daimler Street**<br>**Santa Ana, CA**<br>(Address of principal executive offices) | **92705-5812**<br>(Zip Code) |

**(949) 476-1180**
(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 ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes o No ý

The number of shares outstanding of the Registrant s common stock, par value $0.001, as of March 31, 2003 was 38,900,883.

**SIMPLETECH, INC.**

**INDEX TO FORM 10-Q FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2003**

Except as otherwise noted in this report, SimpleTech, the Company, we, us and our collectively refer to SimpleTech, Inc.

**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**SimpleTech, Inc.**

**Consolidated Balance Sheets**

**(in thousands, except share and per share amounts)**

**(unaudited)**

| | March 31, 2003 | December 31, 2002 |
|---|---|---|
| ASSETS: | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 31,857 | $ 33,992 |
| Marketable securities | 9,980 | 9,980 |
| Accounts receivable, net of allowances of $764 at March 31, 2003 and $782 at December 31, 2002 | 14,701 | 19,019 |
| Inventory, net | 10,776 | 14,141 |
| Income taxes receivable | 4,250 | 3,860 |
| Deferred income taxes | 28 | 28 |
| Other current assets | 998 | 59 |
| Total current assets | 72,590 | 81,079 |
| Furniture, fixtures and equipment, net | 9,710 | 10,169 |
| Intangible assets | 835 | 835 |
| Deferred income taxes | 2,378 | 2,378 |
| Total assets | $ 85,513 | $ 94,461 |
| | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY: | | |
| Current Liabilities: | | |
| Accounts payable | $ 9,131 | $ 16,381 |
| Current maturities of capital lease obligations | | 113 |
| Accrued and other liabilities | 3,992 | 4,152 |
| Total current liabilities | 13,123 | 20,646 |
| | | |
| Total liabilities | 13,123 | 20,646 |
| | | |
| Commitments and contingencies (Note 5) | | |
| | | |
| Shareholders' Equity: | | |
| Preferred stock, $0.001 par value, 20,000,000 shares authorized, no shares outstanding | | |
| Common stock, $0.001 par value, 100,000,000 shares authorized, 38,900,883 shares issued and outstanding as of March 31, 2003 and 38,725,800 shares issued and outstanding as of December 31, 2002 | 39 | 39 |
| Additional paid-in capital | 66,952 | 66,716 |
| Retained earnings | 5,399 | 7,060 |
| Total shareholders' equity | 72,390 | 73,815 |
| Total liabilities and shareholders' equity | $ 85,513 | $ 94,461 |

See accompanying notes to unaudited consolidated financial statements.

**SimpleTech, Inc.**

**Consolidated Statements of Operations**

**(in thousands, except share and per share amounts)**

**(unaudited)**

| | Three Months Ended March 31, 2003 | Three Months Ended March 31, 2002 |
|---|---|---|
| Net revenues | $ 40,918 | $ 50,952 |
| Cost of revenues | 33,987 | 39,476 |
| Gross profit | 6,931 | 11,476 |
| Sales and marketing | 5,372 | 4,837 |
| General and administrative | 2,514 | 3,031 |
| Research and development | 2,117 | 1,938 |
| In-process research and development | | 1,360 |
| Total operating expenses | 10,003 | 11,166 |
| (Loss) income from operations | (3,072) | 310 |
| Interest and other, net | 151 | 209 |
| (Loss) income before (benefit) provision for income taxes | (2,921) | 519 |
| (Benefit) provision for income taxes | (1,260) | 206 |
| Net (loss) income | $ (1,661) | $ 313 |
| | | |
| Net (loss) income per share: | | |
| Basic | $ (0.04) | $ 0.01 |
| Diluted | $ (0.04) | $ 0.01 |
| | | |
| Shares used in computation of net (loss) income per share: | | |
| Basic | 38,843 | 38,329 |
| Diluted | 38,843 | 40,575 |

See accompanying notes to unaudited consolidated financial statements.

**SimpleTech, Inc.**

**Consolidated Statements of Cash Flows**

**(in thousands)**

**(unaudited)**

| | Three Months Ended March 31, 2003 | Three Months Ended March 31, 2002 |
|---|---|---|
| Cash flow from operating activities: | | |
| Net (loss) income | $ (1,661) | $ 313 |
| Adjustments to reconcile net (loss) income to net cash used in operating activities: | | |
| Depreciation and amortization | 974 | 836 |
| Loss (gain) on sale of furniture, fixtures and equipment | (24) | 59 |
| Accounts receivable provisions | 583 | 331 |
| Inventory excess and obsolescence expense | 25 | 355 |
| In-process research and development | | 1,360 |
| Compensation related to stock options vesting | | 9 |
| Change in operating assets and liabilities: | | |
| Accounts receivable | 3,735 | (4,973) |
| Inventory | 3,340 | (9,789) |
| Other current assets | (1,329) | 2,431 |
| Accounts payable | (7,250) | 5,725 |
| Accrued and other liabilities | (160) | 739 |
| Net cash used in operating activities | (1,767) | (2,604) |
| | | |
| Cash flows from investing activities: | | |
| Purchase of furniture, fixtures and equipment | (555) | (2,206) |
| Proceeds from sale of furniture, fixtures and equipment | 64 | 191 |
| Acquisition of assets | | (2,295) |
| Net cash used in investing activities | (491) | (4,310) |
| | | |
| Cash flows from financing activities: | | |
| Repayment of borrowings from banks | | (192) |
| Payment on capital lease obligations | (113) | (107) |
| Proceeds from issuance of common stock | 236 | 239 |
| Net cash provided by (used in) financing activities | 123 | (60) |
| | | |
| Net decrease in cash | (2,135) | (6,974) |
| Cash and cash equivalents at beginning of period | 33,992 | 51,831 |
| Cash and cash equivalents at end of period | $ 31,857 | $ 44,857 |

See accompanying notes to unaudited consolidated financial statements.

**SIMPLETECH, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Note 1 Basis of Presentation**

The accompanying interim consolidated financial statements of SimpleTech, Inc., a California corporation (the Company ), are unaudited and have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all normal and recurring adjustments considered necessary for a fair presentation of the consolidated financial position of the Company at March 31, 2003 and the consolidated results of operations and cash flows for the three-month periods ended March 31, 2003 and 2002 have been included. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in the most recent Annual Report on Form 10-K filed with the SEC. The December 31, 2002 balances reported herein are derived from the audited consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2002. The results for the interim periods are not necessarily indicative of results to be expected for the full year.

The consolidated financial statements of the Company include the accounts of the Company s subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

**Note 2 - Summary of Significant Accounting Policies**

*Risks and Uncertainties:*

Financial instruments, which potentially subject the Company to a concentration of credit risk, principally consist of cash and cash equivalents and accounts receivable. As of March 31, 2003 and December 31, 2002, approximately 12% and 15%, respectively, of accounts receivable were concentrated with one customer. For the three-month periods ended March 31, 2003 and 2002, sales to CDW Computer Centers comprised 22% and 21%, respectively, of the Company s revenues. No other single customer accounted for more than 10% of accounts receivable at March 31, 2003 and December 31, 2002, or revenues for the three-month periods ended March 31, 2003 and 2002.

*Management Estimates:*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities (e.g., bad debt reserves and inventory reserves), 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. Actual results could differ from those estimates.

**Note 3 Net Income Per Share**

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding. In computing diluted earnings per share, the weighted average number of shares outstanding is adjusted to reflect the potentially dilutive securities. For the three months ended March 31, 2002, potentially dilutive securities consisted solely of options and resulted in potential common shares of 2,246,000. Further, options to purchase approximately 428,000 shares of common stock at prices ranging from $6.10 to $11.00 which were outstanding at March 31, 2002, would not have been included in the computation of diluted earnings per share for the three months ended March 31, 2002, because the exercise prices of these options were greater than the average market price of the Company's common stock. For the three months ended March 31, 2003, no potential common shares were included in the diluted per share amount as the effect would have been anti-dilutive.

Pursuant to SFAS No. 123, Accounting for Stock-Based Compensation, the Company has elected to continue the intrinsic value method of accounting for stock options granted to employees and directors in accordance with APB Opinion No. 25 and related interpretations in accounting for stock option plans. Had compensation cost been determined based on the fair value at the grant dates for stock options under the Plan consistent with the method promulgated by SFAS No. 123, the Company s net (loss) income for the three-month periods ended March 31, 2003 and 2002, would have resulted in the pro forma amounts below:

| **Three-Month Period Ended March 31,** | | **2003** | | **2002** |
|---|---|---|---|---|
| Net (loss) income, as reported | $ | (1,661) | $ | 313 |
| Add: Stock-based employee compensation expense included in reported net (loss) income, net of related tax effects | | | | 6 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | | (767) | | (566) |
| Pro forma net loss | $ | (2,428) | $ | (247) |
| | | | | |
| Earnings per share: | | | | |
| Basic as reported | $ | (0.04) | $ | 0.01 |
| Basic pro forma | $ | (0.06) | $ | (0.01) |
| | | | | |
| Diluted as reported | $ | (0.04) | $ | 0.01 |
| Diluted pro forma | $ | (0.06) | $ | (0.01) |

**Note 4 Supplemental Balance Sheet Information**

Inventory consists of the following:

| (in thousands) | March 31, 2003 | December 31, 2002 |
|---|---|---|
| Raw materials | $ 5,523 | $ 6,325 |
| Work-in-progress | 220 | 364 |
| Finished goods | 5,837 | 8,256 |
| | 11,580 | 14,945 |
| Valuation allowances | (804) | (804) |
| Inventory, net | $ 10,776 | $ 14,141 |

**Note 5 Legal Proceedings**

Reference is made to the Company s Annual Report on Form 10-K filed with the SEC on March 25, 2003 under the heading Legal Proceedings for a discussion of litigation involving the Company relating to (i) patent litigation with DPAC Technologies, Inc., (ii) patent litigation with Lemelson Medical, Education & Research Foundation, LLP and (iii) unfair trade practice with Lexar Media, Inc.

**DPAC Technologies, Inc. Patent Infringement**

On September 23, 1998, the Company filed a lawsuit against DPAC Technologies, Inc., formerly Dense-Pac Microsystems, Inc. ( DPAC ), in the United States District Court for the Central District of California for infringement of the Company s IC Tower stacking patent, U.S. Patent No. 5,514,907. DPAC filed an answer to the Company s complaint denying the Company s claim of infringement, asserted a defense of patent invalidity against the Company s IC Tower stacking patent and asserted a counterclaim against the Company alleging infringement of its stacking patent, U.S. Patent No. 4,956,694. On March 29, 2001, the court entered final judgment finding DPAC did not infringe the Company s patent and that the Company did not infringe DPAC s patent. The appeals court affirmed the final judgment on March 7, 2002. DPAC did not appeal the ruling in the Company s favor, and that ruling is now final. On September 3, 2002, the Company filed a petition for certiori with the U.S. Supreme Court. On October 7, 2002, the petition to the Supreme Court was granted and the matter was remanded to the Circuit Court of Appeals. DPAC filed a motion for summary affirmance with the Court of Appeals. On February 26, 2003, the Court of Appeals denied DPAC s motion and remanded the matter for trial to the United States District Court for the Central District of California. No trial date has been set by the District Court.

**Lemelson Medical, Education & Research Foundation, LLP Patent Infringement**

The Company received notice on November 26, 2001 that the Lemelson Medical, Education & Research Foundation, LLP ( Lemelson Foundation ) filed a complaint on November 13, 2001 against the Company and other defendants. The complaint was filed in the District Court of Arizona and alleges that the Company s manufacturing processes infringe several patents that the Lemelson Foundation allegedly owns. The complaint also states that these allegedly infringed patents relate to machine vision technology and bar coding technology. On March 7, 2002, the Company was served with the Lemelson Foundation complaint. Thereafter, the case was stayed pending the outcome of related cases against other parties involving the same patents. Because of the preliminary stage of this case, an estimate of potential damages, if any, would be premature and speculative, and the Company has not made any such estimate at this time.

**Lexar Media, Inc. Unfair Trade Practice and Patent Infringement**

On October 1, 2002, the Company filed a lawsuit against Lexar Media, Inc. in the Superior Court of Orange County, California for trade libel, libel per se, intentional interference with prospective economic advantage and California unfair competition, seeking unspecified damages, including punitive and trebled damages. The lawsuit arose from correspondence sent by Lexar Media to one of the Company s customers that alleged that certain of the Company s products infringe Lexar Media s patents. On October 30, 2002, Lexar Media removed the matter from the Orange County Superior Court to the United States District Court for the Central District of California. On November 14, 2002, the Company amended its complaint to add violation of the Sherman Antitrust Act, violation of the California Unfair Trade Practices Act and common law unfair competition as causes of action.

On November 6, 2002, Lexar Media filed a motion to dismiss the Company s complaint. On January 8, 2003, the Court denied Lexar s motion as to the initial four causes of actions and dismissed the violation of the Sherman Antitrust Act, violation of the California Unfair Trade Practices Act and common law unfair competition causes of actions against Lexar Media.

On March 20, 2003, Lexar Media filed a counter claim against the Company alleging that the Memory Stick products sold by the Company violate Lexar Media s U.S. patent No. 5,479,638. Lexar Media is seeking monetary damages in an amount to be stated later, an injunction against further infringement of its patent, attorneys fees and trebled damages. The Company purchases its Memory Stick products from I-O Data. Under the terms of the distribution agreement with I-O Data, I-O Data has agreed to indemnify, defend and hold the Company harmless from claims, damages, losses and costs which may arise from the alleged infringement by its products of third-party patents, trademarks or other proprietary rights. The Company has submitted this claim to I-O Data and I-O Data has assumed the Company s defense of, and agreed to indemnify the Company for liabilities related to, this lawsuit pursuant to the terms of the distribution agreement. Accordingly, the Company will remain the named party in this lawsuit, but I-O Data will manage the litigation including indemnifying the Company for costs, expenses and any judgments or settlements. This lawsuit is in the early stage of discovery and the court has set a trial date in April 2004.

**Other Legal Proceedings**

The Company is currently not a party to any other material legal proceedings. However, the Company is involved in other suits and claims in the ordinary course of business, and the Company may from time to time become a party to other legal proceedings arising in the ordinary course of business.

As is common in the industry, the Company currently has in effect a number of agreements in which the Company has agreed to defend, indemnify and hold harmless certain of its suppliers and customers from damages and costs which may arise from the infringement by the Company s products of third-party patents, trademarks or other proprietary rights. The scope of such indemnity varies, but may, in some instances, include indemnification for damages and expenses, including attorneys fees. The Company s insurance does not cover intellectual property infringement.

**Note 6 Segment Information:**

Historically, the Company has reported financial results for two reportable operating segments, Industrial and Commercial. In January 2002, the Company acquired the assets of Irvine Networks, which was subsequently renamed the Xiran Division, and reports the Division s operating results as a third operating segment.

The accounting policies for each of the reportable operating segments are the same as those described in Note 2 from the Company's Annual Report on Form 10-K and reflect the information used by the Company s management to evaluate the performance of its segments. For the Industrial and Commercial segments, the Company tracks separately net sales and gross profit, but does not track separately operating expenses, interest or income taxes. For the Xiran segment, which is not expected to produce revenues until 2004, the Company currently tracks operating expenses only. The Company does not maintain separate records to identify assets by operating segment.

Summarized financial information regarding the Company s three reportable segments is shown in the following table:

| (in thousands) | Three Months Ended March 31, 2003 Industrial | Commercial | Subtotal | Xiran | Consolidated |
| --- | --- | --- | --- | --- | --- |
| Net revenues | $ 9,147 | $ 31,771 | $ 40,918 | $ 0 | $ 40,918 |
| Cost of revenues | 6,562 | 27,425 | 33,987 | 0 | 33,987 |
| Gross profit | $ 2,585 | $ 4,346 | 6,931 | 0 | $ 6,931 |
| Operating expenses | | | 8,129 | 1,874 | 10,003 |
| Loss from operations | | | $ (1,198) | $ (1,874) | $ (3,072) |

| | Three Months Ended March 31, 2002 Industrial | Commercial | Subtotal | Xiran | Consolidated |
| --- | --- | --- | --- | --- | --- |
| Net revenues | $ 7,327 | $ 43,625 | $ 50,952 | $ 0 | $ 50,952 |
| Cost of revenues | 5,078 | 34,398 | 39,476 | 0 | 39,476 |
| Gross profit | $ 2,249 | $ 9,227 | 11,476 | 0 | 11,476 |
| Operating expenses | | | 8,654 | 2,512 | 11,166 |
| Income (loss) from operations | | | $ 2,822 | $ (2,512) | $ 310 |

For the three months ended March 31, 2003 and 2002, international sales comprised 21.7% and 12.0%, of the Company s revenues. During these periods, no single foreign country accounted for more than 10.0% of total revenues. All international sales during these periods were shipped from the Company s domestic warehouse to foreign customers.

## ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**Cautionary Statement**

Certain statements in this report, including statements regarding the Company s strategy, financial performance and revenue sources, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended, and are subject to the safe harbors created by those sections. These forward-looking statements are based on our current expectations, estimates and projections about our industry, management s beliefs, and certain assumptions made by us. Such statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors. The section entitled Risk Factors set forth in this Form 10-Q and similar discussions in filings with the Securities and Exchange Commission made from time to time, including other quarterly reports on Form 10-Q, our Annual Reports on Form 10-K, and in our other SEC filings, discuss some of the important risk factors that may affect our business, results of operations and financial condition.

The following discussion should be read in conjunction with the Company s consolidated financial statements and notes thereto.

**Overview**

**Simple Technology, Inc., incorporated in March 1990 and renamed SimpleTech, Inc. in May 2001, is a technology solutions provider offering products based on DRAM, SRAM and Flash memory technologies. Headquartered in Santa Ana, California, the company is a leader in the design, development, manufacturing and marketing of memory solutions.**

**After experiencing year-over-year revenue growth of 57.5% from 1998 to 1999 and 60.1% from 1999 to 2000, revenues declined 46.7% in 2001 and increased 7.5% in 2002. Revenues in 2001 and 2002 were negatively impacted due to softening macro-economic conditions, severe declines in the price of DRAM and Flash components and significantly reduced sales to customers in the communications and networking markets.**

**As a result of increased demand for Flash-based consumer electronics and industrial applications in which solid-state Flash-based storage displaces traditional storage, our Flash memory products as a percentage of our revenues increased steadily from 12.9% for 1999 to 31.0% in 2002. Flash memory product comprised 38.0% of our revenues in the first quarter of 2003 compared to 26.4% of our revenues in the first quarter of 2002. In November 2002, Semico Research Corporation projected data storage Flash industry revenues to grow at a compounded annual growth rate of 41% from 2001 to 2004.**

**In the first three months of 2003 and 2002, our highest margin division was our Industrial Division. In the first three months of 2003 and 2002, our highest profit margin product line was our IC Tower stacking product line. We track revenues and gross margins for our Industrial and Commercial Divisions. We do not track separately, and do not intend to track separately, operating expenses for our Industrial and Commercial Divisions. Conversely, we do track operating expenses for our Xiran Division. Although our Xiran Division is expected to ship beta-level prototype units to potential customers in the third quarter of 2003, it is not expected to generate revenues until 2004.**

**Historically, a small number of customers have accounted for a significant percentage of our revenues. Our ten largest customers accounted for an aggregate of 58.9% of our total revenues in the first quarter of 2003 compared to 58.1% of our total revenues in the first quarter of 2002. CDW Computer Centers accounted for 22.1% of our total revenues in the first quarter of 2003 compared to 21.2% of our total revenues in the first quarter of 2002. Other than CDW Computer Centers, no customer accounted for**

more than 10.0% of our total revenues in each of the first quarters of 2003 or 2002. The composition of our major customer base changes from quarter to quarter as the market demand for our products changes and we expect this variability will continue in the future. We expect that sales of our products to a small number of customers will continue to contribute materially to our revenues in the foreseeable future. The loss of, or a significant reduction in purchases by any of our major customers, could harm our business, financial condition and results of operations. See Risk Factors – Sales to a small number of customers represent a significant portion of our revenues and the loss of any key customer would materially reduce our sales.

**International sales of our products constituted 21.7% of our total revenues for the first quarter of 2003 compared to 12.0% of our total revenues for the first quarter of 2002. No single foreign country accounted for more than 10.0% of our revenues in the first quarter of 2003 or 2002. During the first quarters of 2003 and 2002, over 95.0% of our international sales were denominated in U.S. dollars. In addition, our purchases of IC components are currently denominated in U.S. dollars. However, we do face risks associated with doing business in foreign countries. See Risk Factors - We face risks associated with doing business in foreign countries, including foreign currency fluctuations and trade barriers, that could lead to a decrease in demand for our products or an increase in the cost of the components used in our products.**

**In the past, we have been impacted by seasonal purchasing patterns resulting in lower sales in the first and second quarters of each year. Other factors, including component price fluctuations, may distort the effect of seasonality. Our ability to adjust our short-term operating expenses in response to fluctuations in revenues is limited. As a result, should revenues decrease to a level lower than expected in any given period, our results of operations could be harmed.**

**Revenues are recognized at the time of shipment. We face risks associated with declines in the market value of our products, product returns, inventory obsolescence, price protection and rebates. See Risk Factors Product returns, order cancellations, inventory write-downs, price protection and rebates could adversely effect our results of operations.**

**Results of Operations Comparison of the first quarter of 2003 to the first quarter of 2002**

*Net Revenues.* Our revenues were $40.9 million in the first quarter of 2003, compared to $51.0 million in the same period in 2002. Revenues declined 19.8% due primarily to a 19.3% decline in average sales price in the first quarter of 2003. The decrease in our average sales price resulted from lower DRAM and Flash component prices in the first quarter of 2003 compared to the first quarter of 2002. Unit shipments in the first quarter of 2003 were relatively flat compared to the first quarter of 2002. The mix of products sold varies from quarter to quarter and may vary in the future, affecting our overall average sales prices and gross margins.

Our Industrial Division revenues increased 24.7% from $7.3 million in the first quarter of 2002 to $9.1 million in the first quarter of 2003. Industrial Division unit volume increased 31.6% during this period and Industrial Division average sales price decreased 6.4% in the first quarter of 2003. This increase in unit volume resulted primarily from increased shipments of DRAM and Flash memory products into new Industrial markets such as defense, casino gaming and in-flight entertainment. Our Commercial Division revenues decreased 27.1% from $43.6 million in the first quarter of 2002 to $31.8 million in the first quarter of 2003. Commercial Division revenues decreased due to a 22.0% decrease in average sales price in the first quarter of 2003 and a decrease in unit volume of 6.9%. The decrease in average sales price resulted primarily from lower DRAM and Flash component prices in the first quarter of 2003 compared to the first quarter of 2002.

Sales of our memory products are made under short-term cancelable purchase orders. We include in our backlog only those customer orders for which we have accepted purchase orders and to which we have assigned shipment dates within the upcoming six months. Since orders constituting our backlog are subject to change due to, among other things, customer cancellations and reschedulings, and our ability to procure necessary components, backlog is not necessarily an indication of future revenues. In addition, there can be no assurance that current backlog will necessarily lead to revenues in any future period. Our combined backlog was $4.4 million as of March 31, 2003, compared to $8.2 million as of March 31, 2002. Our Industrial Division backlog was $2.9 million as of March 31, 2003, compared to $7.5 million as of

March 31, 2002. Our Commercial Division backlog was $1.5 million as of March 31, 2003, compared to $729,000 as of March 31, 2002. Commercial Division backlog is typically nominal since substantially all commercial orders are filled on a same-day or next-day basis. Our ability to predict future sales is limited because a majority of our quarterly product revenues come from orders that are received and fulfilled in the same quarter

*Gross Profit.* Our gross profit was $6.9 million in the first quarter of 2003, compared to $11.5 million in the same period in 2002. Gross profit as a percentage of revenues was 16.9% in the first quarter of 2003, compared to 22.5% in the same period in 2002. The decrease in our gross profit as a percentage of revenues resulted from a more than 40% decline in DRAM and Flash component prices during the first quarter of 2003. Gross profit for our Industrial Division as a percentage of revenues was 28.3% in the first quarter of 2003, compared to 30.7% in the first quarter of 2002. This decrease in gross profit as a percentage of revenues for our Industrial Division resulted primarily from a negative shift in product mix. Gross profit as a percentage of revenues for our Commercial Division was 13.7% in the first quarter of 2003, compared to 21.2% in the first quarter of 2002. This decrease in gross profit as a percentage of revenues for our Commercial Division resulted from significant price declines in DRAM and Flash components during the first quarter of 2003.

*Sales and Marketing.* Sales and marketing expenses were primarily comprised of personnel costs and travel expenses for our domestic and international sales and marketing employees, commissions paid to internal salespersons and independent manufacturers representatives, shipping costs and marketing programs. Sales and marketing expenses were $5.4 million in the first quarter of 2003, compared to $4.8 million in the same period in 2002. Sales and marketing expenses as a percentage of revenues were 13.2% in the first quarter of 2003, compared to 9.4% in the same period in 2002. Sales and marketing expenses increased due primarily to increased sales and marketing efforts for the Xiran Division and expanded Commercial Division channel marketing programs in the first quarter of 2003.

*General and Administrative.* General and administrative expenses were primarily comprised of personnel costs for our executive and administrative employees, professional fees and facilities overhead. General and administrative expenses were $2.5 million in the first quarter of 2003, compared to $3.0 million in the same period in 2002. General and administrative expenses as a percentage of revenues were 6.1% in the first quarter of 2003 and 5.9% in the first quarter of 2002. General and administrative expenses decreased due primarily to reduced legal costs and reduced executive salaries in the first quarter of 2003.

*Research and Development.* Research and development expenses were primarily comprised of personnel costs for our engineering and design staff and the cost of new product development and prototype supplies. Research and development expenses were $2.1 million in the first quarter of 2003, compared to $1.9 million in the same period in 2002. Research and development expenses as a percentage of revenues were 5.1% in the first quarter of 2003, compared to 3.7% in the same period in 2002. The increase in research and development expenses resulted from a $388,000 increase in expenditures related to our Xiran Division, partially offset by a $209,000 decrease in expenditures related to our Industrial and Commercial Divisions.

*Non-recurring In-process Research and Development.* We did not have non-recurring in-process research and development expenses in the first quarter of 2003. Non-recurring in-process research and development expenses were $1.4 million in the first quarter of 2002 and related to our acquisition of the assets of Irvine Networks (Xiran Division) in January 2002.

*Interest Income, Net.* Interest income, net was $151,000 in the first quarter of 2003 and $209,000 in the first quarter of 2002. Interest income is comprised of interest earned on our cash, cash equivalents and marketable securities. Interest income was $151,000 in the first quarter of 2003 and $239,000 in the first quarter of 2002. This decrease in interest income resulted from lower interest rates and a reduced average cash balance in the first quarter of 2003 compared to the first quarter of 2002. Interest expense is comprised of interest related to equipment financing. Interest expense was $0 in the first quarter of 2003 and $30,000 in the first quarter of 2002.

*(Benefit) Provision for Income Taxes.* Benefit for income taxes was $1.3 million in the first quarter of 2003 including approximately $127,000 in research and development income tax credits. Provision for income taxes was $206,000 in the first quarter of 2002. We did not claim any research and development income tax credits in the first quarter of 2002. As a percentage of income before benefit for income taxes, benefit for income taxes was 43.1% in the first quarter of 2003. As a percentage of income before provision for income taxes, provision for income taxes was 39.7% in the first quarter of 2002.

*Net (Loss) Income.* Net loss was $1.7 million in the first quarter of 2003. Net income was $313,000 in the first quarter of 2002.

**Liquidity and Capital Resources**

As of March 31, 2003, we had working capital of $59.5 million, including $31.9 million of cash and cash equivalents and $10.0 million in marketable securities, compared to working capital of $60.4 million, including $34.0 million of cash and cash equivalents and $10.0 million in marketable securities as of December 31, 2002. Our cash and cash equivalents balance decreased over the first quarter of 2003 due primarily to a net loss of $1.7 million and purchases of furniture, fixtures and equipment of $555,000. Current assets were 5.5 times current liabilities at March 31, 2003, compared to 3.9 times current liabilities at December 31, 2002.

Net cash used in operating activities was $1.8 million for the first quarter of 2003 and resulted primarily from a net loss of $1.7 million and a $7.3 million decrease in accounts payable, partially offset by a $3.7 million decrease in account receivable and a $3.3 million decrease in inventory.

Net cash used in investing activities was $491,000 for the first quarter of 2003, attributable primarily to $555,000 in purchases of furniture, fixtures and equipment, partially offset by $64,000 in proceeds from the sale of furniture, fixtures and equipment. We expect to spend approximately $3.0 to $5.0 million on capital expenditures during the next 24 months, primarily for the purchase of manufacturing, testing and engineering equipment.

Net cash provided by financing activities was $123,000 for the first quarter of 2003 and resulted from the receipt of $236,000 in proceeds from the issuance of common stock, partially offset by payments of $113,000 related to equipment capital lease obligations.

In prior years, we entered into several capital leases to finance manufacturing and testing equipment. Our obligations under capital leases were paid down to zero at March 31, 2003 and had a balance of $113,000 at December 31, 2002, with interest rates ranging from 8.1% to 9.6% per annum.

We believe that our current assets, including cash and cash equivalents, and expected cash flow from operations will be sufficient to fund our operations for at least the next twelve months. However, it is possible that we may need or elect to raise additional funds to fund our activities beyond the next year or to consummate acquisitions of other businesses, products or technologies. We could raise such funds by selling more stock to the public or to selected investors, or by borrowing money. In addition, even though we may not need additional funds, we may still elect to sell additional equity securities or obtain credit facilities for other reasons. We cannot assure you that we will be able to obtain additional funds on commercially favorable terms, or at all. If we raise additional funds by issuing additional equity or convertible debt securities, the ownership percentages of existing shareholders would be reduced. In addition, the equity or debt securities that we issue may have rights, preferences or privileges senior to those of the holders of our common stock.

Although we believe we have sufficient capital to fund our activities for at least the next twelve months, our future capital requirements may vary materially from those now planned. The amount of capital that we will need in the future will depend on many factors, including:

the market acceptance of our products;

the levels of promotion and advertising that will be required to launch our new products and achieve and maintain a competitive position in the marketplace;

price discounts on our products to our customers;

our business, product, capital expenditure and research and development plans and product and technology roadmaps;

the levels of inventory and accounts receivable that we maintain;

capital improvements to new and existing facilities;

technological advances;

our competitors response to our products;

our pursuit of strategic transactions; and our relationships with suppliers and customers.

**Inflation**

**Inflation was not a material factor in either revenue or operating expenses during the first quarters of 2003 or 2002.**

**Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses for each period. The following represents a summary of our critical accounting policies, defined as those policies that we believe are: (a) the most important to the portrayal of our financial condition and results of operations, and (b) that require management s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effects of matters that are inherently uncertain.

*Reserves for inventory excess, obsolescence and lower of market values over costs* We generally purchase raw materials in quantities that we anticipate will be fully used in the near term. Changes in operating strategy, customer demand and unpredictable fluctuations in market values of raw materials can limit our ability to effectively utilize all of the raw materials purchased and sold through resulting finished goods to customers for a profit. We regularly monitor potential inventory excess, obsolescence and lower market values compared to costs and, when necessary, reduce the carrying amount of our inventory to its market value.

*Allowances for doubtful accounts and price protection* We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. Additionally, we maintain allowances for limited price protection rights for inventories of our products held by our customers as a result of recent sales transactions to them.

If we reduce the list price of our products, these customers may receive a credit from us. We estimate the impact of such pricing changes on a regular basis and adjust our allowances accordingly.

*Product returns* We offer a majority of our customers that purchase products through our commercial channels limited rights to return unsold inventory. In addition, while we may not be contractually obligated to accept returned products, we may determine that it is in our best interest to accept returns in order to maintain good relationships with our customers. We provide for estimated future returns of inventory at the time of sale based on historical experience, and actual results have been within our expectations.

*Income taxes* As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. The process incorporates an assessment of the current tax exposure together with temporary differences resulting from different treatment of transactions for tax and financial statement purposes. Such differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheet. The recovery of deferred tax assets from future taxable income must be assessed and, to the extent that recovery is not likely, we establish a valuation allowance. Increases in valuation allowances result in the recording of additional tax expense. Further, if our ultimate tax liability differs from the periodic tax provision reflected in the consolidated statements of operations, additional tax expense may be recorded.

*Litigation and other contingencies* Management regularly evaluates our exposure to threatened or pending litigation and other business contingencies. Because of the uncertainties related to the amount of loss from litigation and other business contingencies, the recording of losses relating to such exposures requires significant judgment about the potential range of outcomes. As additional information about current or future litigation or other contingencies becomes available, our management will assess whether such information warrants the recording of additional expense relating to our contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

*Valuation of long-lived assets* We assess the potential impairment of long-lived tangible and intangible assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Changes in our operating strategy can significantly reduce the estimated useful life of such assets.

**Risk Factors**

***This Report contains forward-looking statements based on the current expectations, assumptions, estimates and projections about our industry and us. These forward-looking statements involve risks and uncertainties. Our actual results could differ materially from those discussed in these forward-looking statements as a result of certain factors, as more fully described in this section and elsewhere in this Report. You should carefully consider the following risks before you decide to buy shares of our common stock. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties, including those risks set forth in Management s Discussion and Analysis of Financial Condition and Results of Operations above, may also adversely impact and impair our business. If any of the following risks actually occur, our business, results of operations or financial condition would likely suffer. In such case, the trading price of our common stock could decline, and you may lose all or part of the money you paid to buy our stock. We do not undertake to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.***

**Our quarterly operating results may fluctuate in future periods and, as a result, we may fail to meet expectations of investors and analysts, causing our stock price to fluctuate or decline.**

Our quarterly operating results have fluctuated in the past and we believe they will continue to do so in the future. Our future results of operations will depend on many factors including:

Fluctuating market demand for and declines in the average sales prices of our products;

Overproduction by suppliers of the components used in our products;

Our ability to procure required components or fluctuations in the cost of such components;

The effects of litigation;

Changes in our product and sales mix as well as seasonal demand for our products;

Market acceptance of new and enhanced versions of our products;

The timing of the introduction of new products or components and enhancements to existing products or components by us, our competitors or our suppliers;

Inventory obsolescence, product returns and price protections;

Manufacturing inefficiencies associated with the start-up of new products and volume production; and

Expenses associated with acquisitions.

Due to the above factors, quarterly revenues and results of operations are difficult to forecast, and we believe that period-to-period comparisons of our operating results are neither meaningful nor predictive of future performance. In one or more future quarters our results of operations may fall below the expectations of securities analysts and investors. In that event, the trading price of our common stock would likely decline.

In addition, the trading price of our common stock may materially decline regardless of our operating performance. The market price of our common stock has been subject to significant fluctuations since our initial public offering in September 2000. The stock market has experienced significant price and volume fluctuations that have affected the market prices of securities, particularly securities of technology companies. In the past, following periods of volatility in the market price of a particular company s securities, securities class action litigation has often been brought against that company. We may become involved in this type of litigation in the future. Litigation of this type is often expensive and can divert management s attention and resources.

**Declines in our average sales prices may result in declines in our revenues and gross profit.**

During the substantial majority of 2001, 2002 and the first quarter of 2003, overcapacity in the memory component market resulted in significant declines in component prices, which negatively impacted our average selling prices, revenues and gross profit. Declines in semiconductor prices could also affect the valuation of our inventory, which could harm our business. During periods of overcapacity, our ability to maintain or increase revenues will depend upon our ability to increase unit sales volumes of existing products and to introduce and sell new products in quantities sufficient to offset declines in sales prices. Our efforts to reduce costs and develop new products to offset the impact of further declines in average sales prices may not be successful. Declines in average sales prices would also result in more memory being built into products by OEMs, which would favor our largest competitors and reduce the demand for our Commercial Division memory products.

**Because we depend on a small number of suppliers for IC devices, any disruption in our supply relationships could harm our ability to fulfill orders.**

We are dependent on a small number of suppliers to supply Flash IC and DRAM IC devices. We have no long-term DRAM IC device supply contract and only have a limited supply contract with Hitachi for Flash IC devices. Although we have a limited contract with Hitachi, there can be no assurance that Hitachi can or will agree to supply the quantities of Flash IC devices we may need to meet our production goals. IC devices represent approximately 95% of our component costs. Our dependence on a small number of suppliers and our limited number of long-term supply contracts expose us to several risks, including the inability to obtain an adequate supply of components, price increases, late deliveries and poor component quality. Hitachi and Samsung supply substantially all of the IC devices used in our Flash memory products. In addition, Elpida, Micron and Samsung currently supply a majority of the DRAM IC devices used in our DRAM memory products. A disruption in or termination of our supply relationship with any of these significant suppliers by natural disaster or otherwise, or our inability to develop relationships with new suppliers, if required, would cause delays, disruptions or reductions in product shipments or require product redesigns which could damage relationships with our customers, and would increase our costs and/or prices. In particular, if our supply relationships with Hitachi or Samsung are disrupted or terminated, our ability to manufacture and sell our Flash products would be harmed and our Flash business would be adversely affected.

**We are subject to the cyclical nature of the semiconductor industry and a significant or prolonged downturn could continue to adversely affect our business.**

The semiconductor industry, including the memory markets in which we compete, is highly cyclical and characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life cycles and wide fluctuations in product supply and demand. The industry has experienced significant downturns, such as the one we are currently in, often connected with, or in anticipation of, maturing product cycles of both semiconductor companies and their customers products and declines in general economic conditions. These downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices. In the past two and a half years, a semiconductor downturn has negatively impacted our average selling prices, revenues and earnings. Any future downturns, or a worsening of the current downturn, could have a material adverse effect on our business and operating results.

**We may be unable to maintain a steady supply of components.**

The electronics industry has experienced in the past, and may experience in the future, shortages in IC devices, including DRAM, SRAM and Flash memory. We have experienced and may continue to experience delays in component deliveries and quality problems, which have caused and could in the future cause delays in product shipments. In addition, we have required and could in the future require the redesign of some of our products. From time to time, industry capacity has become constrained such that some vendors have placed their customers, ourselves included, on component allocation. This means that while we may have customer orders, we may not be able to obtain the materials that we need to fill those orders in a timely manner which could have a material adverse effect on our business and operating results.

**Increased worldwide production of DRAM or Flash components could lead to further declines in average selling prices.**

The transition to smaller geometries and the use of 300 millimeter wafers by semiconductor manufacturers, which is expected to accelerate over the next five years, could lead to a significant increase in the worldwide supply of DRAM and Flash components. Increases in the worldwide supply of DRAM and Flash components could also result from fab capacity expansions. Increases in worldwide supply of DRAM and Flash components, if not offset by increases in demand, could lead to further declines in the average selling prices of our products and have a material adverse effect on our business and operating results.

**Our limited experience in acquiring other businesses, product lines and technologies may make it difficult for us to overcome problems encountered in connection with any acquisitions we may undertake.**

We intend to pursue selective acquisitions to complement our internal growth. If we make any future acquisitions, we could issue stock that would dilute our shareholders percentage ownership, incur substantial debt, reduce our cash reserves or assume contingent liabilities. Although we completed the acquisition of assets of Irvine Networks, LLC, renamed our Xiran Division, in January 2002, our experience in acquiring other businesses, product lines and technologies is limited. In addition, the attention of our small management team may be diverted from our core business by our Irvine Networks acquisition or if we undertake a future acquisition. Our recent acquisition and potential acquisitions also involve numerous risks, including, among others:

Problems assimilating the purchased operations, technologies or products;

Costs associated with the acquisition;

Adverse effects on existing business relationships with suppliers and customers;

Risks associated with entering markets in which we have no or limited prior experience;

Potential loss of key employees of purchased organizations; and

Potential litigation arising from the acquired company s operations before the acquisition.

Our inability to overcome problems encountered in connection with such acquisitions could divert the attention of management, utilize scarce corporate resources and harm our business. In addition, we are unable to predict whether or when any prospective acquisition candidate will become available or the likelihood that any acquisition will be completed.

**Sales to a small number of customers represent a significant portion of our revenues and the loss of any key customer would materially reduce our sales.**

Our dependence on a small number of customers means that the loss of a major customer or any reduction in orders by a major customer would materially reduce our revenues. Historically, a relatively small number of customers have accounted for a significant percentage of our revenues. Our ten largest customers accounted for an aggregate of 58.9% of our total revenues in the first quarter of 2003 compared to 58.1% of our total revenues in the first quarter of 2002.

**Our ten largest Industrial Division customers accounted for an aggregate of 72.5% of our Industrial Division revenues, or 16.2% of our total revenues, in the first quarter of 2003 and 90.3% of our Industrial Division revenues, or 12.7% of our total revenues, in the first quarter of 2002. Our ten largest Commercial**

Division customers accounted for an aggregate of 65.2% of our Commercial Division revenues, or 50.6% of our total revenues, in the first quarter of 2003 and 60.1% of our Commercial Division revenues, or 51.6% of our total revenues, in the first quarter of 2002. Our largest Commercial Division customer in each of the first quarters of 2003 and 2002, CDW Computer Centers, accounted for 28.5% of our Commercial Division revenues, or 22.1% of our total revenues, in the first quarter of 2003 and 24.8% of our Commercial Division revenues, or 21.2% of our total revenues, in the first quarter of 2002. Other than CDW Computer Centers, no customer accounted for more than 10.0% of our total revenues in each of the first quarters of 2003 or 2002.

Consolidation in some of our customers industries may result in increased customer concentration and the potential loss of customers as a result of acquisitions. In addition, the composition of our major customer base changes from quarter to quarter as the market demand for our customers products changes, and we expect this variability will continue in the future. We expect that sales of our products to a small number of customers will continue to contribute materially to our revenues in the foreseeable future. The loss of, or a significant reduction in purchases by any of our major customers, could harm our business, financial condition and results of operations.

**Three of our beneficial shareholders have substantial influence over our operations and can significantly influence matters requiring shareholder approval.**

Manouch Moshayedi, Mike Moshayedi and Mark Moshayedi, each of whom is an executive officer and director of SimpleTech, are brothers and beneficially own approximately 78.8% of our common stock at March 31, 2003. As a result, they have the ability to control all matters requiring approval by our shareholders, including the election and removal of directors, approval of significant corporate transactions and the ability to control the decision of whether a change in control will occur.

**We are involved from time to time in claims and litigation over intellectual property rights, which may adversely affect our ability to manufacture and sell our products.**

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights. We believe that it may be necessary, from time to time, to initiate litigation against one or more third parties to preserve our intellectual property rights. In addition, from time to time, we have received, and may continue to receive in the future, notices that claim we have infringed upon, misappropriated or misused other parties proprietary rights, which claims could result in litigation. Such litigation would likely result in significant expense to us and divert the efforts of our technical and management personnel. In the event of an adverse result in such litigation, we could be required to pay substantial damages, cease the manufacture, use and sale of certain products, expend significant resources to develop non-infringing technology, discontinue the use of certain processes or obtain licenses to use the infringed technology. Such a license may not be available on commercially reasonable terms, if at all. Our failure to obtain a license or our failure to obtain a license on commercially reasonable terms could cause us to incur substantial costs and suspend manufacturing products using the infringed technology. If we obtain a license, we would likely be required to make royalty payments for sales under the license. Such payments would increase our costs of revenues and reduce our gross profit. In addition, any litigation, whether as plaintiff or as defendant, would likely result in significant expense to us and divert the efforts of our technical and management personnel, whether or not such litigation is ultimately determined in our favor. In addition, the results of any litigation are inherently uncertain.

In the event we desire to incorporate third-party technology into our products or our products are found to infringe on others patents or intellectual property rights, we may be required to license such patents or intellectual property rights. If we obtain licenses from third parties, we may be required to pay license fees or make royalty payments, which could reduce our gross margins. If we are unable to obtain a license from a third party for technology, we could incur substantial liabilities or be required to expend substantial resources redesigning our products to eliminate the infringement. There can be no assurance that we would be successful in redesigning our products or that we could obtain licenses on commercially reasonable terms, if at all. In addition, any development or license negotiations could require substantial expenditures of time and other resources by us.

We are currently a party to three lawsuits regarding intellectual property as further described under Legal Proceedings. The outcome of litigation is inherently uncertain and we cannot predict the outcome of these lawsuits with certainty. These lawsuits have diverted, and are expected to continue to divert, the efforts and attention of our key management and technical personnel. In addition, we have incurred, and expect to continue to incur, substantial legal fees and expenses in connection with these lawsuits. As a result, our defense of these lawsuits, regardless of their eventual outcomes, has been, and will continue to be, costly and time consuming. In addition, if our IC Tower stacking patent is found to be invalid, our ability to exclude competitors from making, using or selling the same or similar products to our IC Tower stacking products would cease. In addition, if we are found to infringe valid patents of others, we may be excluded from using the infringed technology without a license, which may not be available on commercially reasonable terms, if at all.

**If industry sales of products using Flash memory do not grow, our revenues, gross margins and profitability would be harmed.**

The market for consumer electronics incorporating data storage Flash memory is relatively new and emerging. The success of our Flash business will depend largely on the level of consumer interest in new and emerging consumer electronics utilizing Flash memory. If sales of products using Flash memory do not increase, we will be unable to grow our Flash business. In addition, if we are unable to anticipate and fulfill customer demand for our products, we may lose sales to our competitors.

**Demand for our products would decline if the market for Flash memory does not develop, or if a competing technology displaces Flash memory.**

There is currently an absence of a single Flash memory standard. It is possible that Flash memory standards other than those to which our products conform will emerge as the industry standard. If we are unable to anticipate and adequately allocate our resources in a timely and efficient manner toward the production and development of industry-standard Flash memory products, we may experience significant delays in releasing new and commercially viable products. These delays would provide a competitor a first-to-market opportunity and allow a competitor to achieve greater market share. Some of our competitors are in a better financial and marketing position from which to influence industry acceptance of a particular Flash memory s