

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 September 28, 2019

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.)

**175 Technology Drive, 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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value \$0.001 per share	NLST	None

As of October 30, 2019, there were 164,052,725 outstanding shares of the registrant's common stock.

NETLIST, INC. AND SUBSIDIARIES

Form 10-Q

For the Quarter Ended September 28, 2019

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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)**

	<b>(unaudited) September 28, 2019</b>	<b>December 29, 2018</b>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 6,386	\$ 14,802
Restricted cash	2,250	1,850
Accounts receivable, net of allowances of \$43 (2019) and \$39 (2018)	2,488	2,917
Inventories	2,398	2,946
Prepaid expenses and other current assets	703	677
Total current assets	14,225	23,192
Property and equipment, net	313	279
Operating lease right-of-use assets	1,133	—
Other assets	1,375	1,394
Total assets	\$ 17,046	\$ 24,865
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
Current Liabilities:		
Accounts payable	\$ 8,520	\$ 9,497
Revolving line of credit	1,515	2,293
Accrued payroll and related liabilities	475	604
Accrued expenses and other current liabilities	808	343
Convertible promissory note and accrued interest, net	997	—
Note payable	—	376
Total current liabilities	12,315	13,113
Convertible promissory note and accrued interest, net	15,665	17,346
Operating lease liabilities	630	—
Other liabilities	146	78
Total liabilities	28,756	30,537
Commitments and contingencies		
Stockholders' deficit:		
Preferred stock, \$0.001 par value—10,000 shares authorized: Series A preferred stock, \$0.001 par value; 1,000 shares authorized; none issued and outstanding	—	—
Common stock, \$0.001 par value—300,000 shares authorized; 154,097 (2019) and 139,283 (2018) shares issued and outstanding	154	139
Additional paid-in capital	173,979	169,355
Accumulated deficit	(185,843)	(175,166)
Total stockholders' deficit	(11,710)	(5,672)
Total liabilities and stockholders' deficit	\$ 17,046	\$ 24,865

See accompanying notes.

## NETLIST, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Operations (Unaudited)  
(in thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	September 28, 2019	September 29, 2018	September 28, 2019	September 29, 2018
Net sales	\$ 6,116	\$ 7,203	\$ 16,733	\$ 24,508
Cost of sales	5,666	6,617	15,600	23,061
Gross profit	450	586	1,133	1,447
Operating expenses:				
Research and development	583	535	1,738	2,326
Intellectual property legal fees	979	2,760	3,567	6,359
Selling, general and administrative	1,747	1,745	5,724	5,021
Total operating expenses	3,309	5,040	11,029	13,706
Operating loss	(2,859)	(4,454)	(9,896)	(12,259)
Other expense, net:				
Interest expense, net	(245)	(183)	(775)	(463)
Other expense, net	(4)	(7)	(5)	(12)
Total other expense, net	(249)	(190)	(780)	(475)
Loss before provision for income taxes	(3,108)	(4,644)	(10,676)	(12,734)
Provision for income taxes	—	—	1	—
Net loss	\$ (3,108)	\$ (4,644)	\$ (10,677)	\$ (12,734)
Net loss per common share:				
Basic and diluted	\$ (0.02)	\$ (0.04)	\$ (0.07)	\$ (0.13)
Weighted-average common shares outstanding:				
Basic and diluted	148,058	115,402	142,624	96,516

See accompanying notes.

NETLIST, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Stockholders' Deficit (Unaudited)  
(in thousands)

	Series A Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Deficit
	Shares	Amount	Shares	Amount			
Balance, December 29, 2018	—	\$ —	139,283	\$ 139	\$ 169,355	\$ (175,166)	\$ (5,672)
Stock-based compensation	—	—	—	—	342	—	342
Exercise of stock options	—	—	43	—	16	—	16
Restricted stock units vested and distributed	—	—	340	—	—	—	—
Common stock issued on conversion of Iliad Note	—	—	1,042	1	374	—	375
Net loss	—	—	—	—	—	(4,050)	(4,050)
Balance, March 30, 2019	—	—	140,708	140	170,087	(179,216)	(8,989)
Stock-based compensation	—	—	—	—	197	—	197
Exercise of stock options	—	—	19	—	6	—	6
Tax withholdings related to net share settlements of equity awards	—	—	(92)	—	—	—	—
Issuance of commitment shares	—	—	818	1	(1)	—	—
Common stock issued on conversion of Iliad Note	—	—	724	1	224	—	225
Net loss	—	—	—	—	—	(3,519)	(3,519)
Balance, June 29, 2019	—	—	142,177	142	170,513	(182,735)	(12,080)
Stock-based compensation	—	—	—	—	243	—	243
Restricted stock units vested and distributed	—	—	409	—	—	—	—
Tax withholdings related to net share settlements of equity awards	—	—	(130)	—	(39)	—	(39)
Issuance of common stock, net	—	—	8,394	8	2,449	—	2,457
Common stock issued on conversion of Iliad Note	—	—	3,247	4	813	—	817
Net loss	—	—	—	—	—	(3,108)	(3,108)
Balance, September 28, 2019	—	\$ —	154,097	\$ 154	\$ 173,979	\$ (185,843)	\$ (11,710)

## NETLIST, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Stockholders' Deficit (Unaudited) (Continued)  
(in thousands)

	Series A Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Deficit
	Shares	Amount	Shares	Amount			
Balance, December 30, 2017	—	\$ —	79,314	\$ 80	\$ 152,640	\$ (158,046)	\$ (5,326)
Stock-based compensation	—	—	—	—	241	—	241
Issuance of common stock, net	—	—	6,101	5	1,789	—	1,794
Net loss	—	—	—	—	—	(4,673)	(4,673)
Balance, March 31, 2018	—	—	85,415	85	154,670	(162,719)	(7,964)
Stock-based compensation	—	—	—	—	173	—	173
Issuance of restricted stock	—	—	525	—	—	—	—
Issuance of common stock, net	—	—	16,393	17	2,801	—	2,818
Warrants issued in lieu of payments	—	—	—	—	12	—	12
Net loss	—	—	—	—	—	(3,417)	(3,417)
Balance, June 30, 2018	—	—	102,333	102	157,656	(166,136)	(8,378)
Stock-based compensation	—	—	—	—	157	—	157
Issuance of common stock, net	—	—	36,920	36	11,116	—	11,152
Warrants issued in lieu of payments	—	—	—	—	57	—	57
Estimated fair value of conversion option, in connection with convertible debt	—	—	—	—	190	—	190
Net loss	—	—	—	—	—	(4,644)	(4,644)
Balance, September 28, 2018	—	\$ —	139,253	\$ 138	\$ 169,176	\$ (170,780)	\$ (1,466)

## NETLIST, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (Unaudited)  
(in thousands)

	Nine Months Ended	
	September 28, 2019	September 29, 2018
Cash flows from operating activities:		
Net loss	\$ (10,677)	\$ (12,734)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	132	209
Interest accrued on convertible promissory notes	332	241
Amortization of debt discounts	401	192
Non-cash lease expense	417	—
Stock-based compensation	782	571
Issuance of warrant in lieu of payment	—	69
Changes in operating assets and liabilities:		
Accounts receivable	429	(229)
Inventories	548	226
Prepaid expenses and other current assets	(7)	142
Accounts payable	(977)	3,534
Accrued payroll and related liabilities	(129)	(304)
Accrued expenses and other current liabilities	(483)	2
Net cash used in operating activities	<u>(9,232)</u>	<u>(8,081)</u>
Cash flows from investing activities:		
Acquisition of property and equipment	(70)	(72)
Net cash used in investing activities	<u>(70)</u>	<u>(72)</u>
Cash flows from financing activities:		
Net (repayments) borrowings under line of credit	(778)	573
Proceeds from issuance of debt, net of \$170 discount	—	2,100
Debt issuance costs	—	(23)
Payments on debt	(376)	(344)
Proceeds from issuance of common stock, net	2,457	15,764
Proceeds from exercise of stock options	22	—
Payments for taxes related to net share settlement of equity awards	(39)	—
Net cash provided by financing activities	<u>1,286</u>	<u>18,070</u>
Net change in cash, cash equivalents and restricted cash	(8,016)	9,917
Cash, cash equivalents and restricted cash at beginning of period	16,652	9,520
Cash, cash equivalents and restricted cash at end of period	<u>\$ 8,636</u>	<u>\$ 19,437</u>
Reconciliation of cash, cash equivalents and restricted cash at end of period:		
Cash and cash equivalents	\$ 6,386	\$ 18,187
Restricted cash	2,250	1,250
Cash, cash equivalents and restricted cash at end of period	<u>\$ 8,636</u>	<u>\$ 19,437</u>

See accompanying notes.

## NETLIST, INC. AND SUBSIDIARIES

### Notes to Condensed Consolidated Financial Statements (Unaudited)

#### Note 1—Description of Business

Netlist, Inc. and its wholly-owned subsidiaries (collectively the “Company” or “Netlist”) provides high-performance modular memory subsystems to customers in diverse industries that require enterprise and storage class memory solutions to empower critical business decisions. The Company has a history of introducing disruptive new products, such as one of the first load-reduced dual in-line memory modules (“LRDIMM”) based on its distributed buffer architecture, which has been adopted by the industry for DDR4 LRDIMM. The Company was also one of the first to bring NAND flash memory (“NAND flash”) to the memory channel with its NVvault non-volatile dual in-line memory modules (“NVDIMM”) using software-intensive controllers and merging dynamic random access memory integrated circuits (“DRAM ICs” or “DRAM”) and NAND flash to solve data bottleneck and data retention challenges encountered in high-performance computing environments. The Company has introduced a new generation of storage class memory products called HybriDIMM™ to address the growing need for real-time analytics in Big Data applications, in-memory databases, high performance computing and advanced data storage solutions. The Company also resells NAND flash, DRAM products and other component products to end-customers that are not reached in the distribution models of the component manufacturers, including storage customers, appliance customers, system builders and cloud and datacenter customers.

Due to the ground-breaking product development of its engineering teams, Netlist has built a robust portfolio of over 100 issued and pending U.S. and foreign patents, many seminal, in the areas of hybrid memory, storage class memory, rank multiplication and load reduction. Since its inception, the Company has dedicated substantial resources to the development, protection and enforcement of technology innovations it believes are essential to its business. The Company’s early pioneering work in these areas has been broadly adopted in industry-standard registered dual in-line memory module (“RDIMM”) LRDIMM and NVDIMM. Netlist’s objective is to continue to innovate in its field and invest further in its intellectual property portfolio, with the goal of monetizing its intellectual property through a combination of product sales and licensing, royalty or other revenue-producing arrangements, which may result from joint development or similar partnerships or defense of the Company’s patents through enforcement actions against parties it believes are infringing them.

Netlist was incorporated in June 2000 and is headquartered in Irvine, California. The Company has established a manufacturing facility in the People’s Republic of China (“PRC”), which became operational in July 2007. The Company operates in one reportable segment, which is the design and manufacture of high-performance memory subsystems for the server, high-performance computing and communications markets.

#### *Liquidity*

The Company incurred net losses of \$3.1 million and \$10.7 million for the three and nine months ended September 28, 2019, respectively, and \$17.1 million and \$13.4 million for the fiscal years ended December 29, 2018 and December 30, 2017, respectively. The Company has historically financed its operations primarily with revenues generated from operations, including product sales and proceeds from issuances of equity and debt securities including convertible debt (see Note 5). The Company has also funded its operations with a revolving line of credit under a bank credit facility, and a funding arrangement for costs associated with certain of its legal proceedings (see Notes 4, 5 and 7).

On June 24, 2019, the Company entered into a purchase agreement (the “Purchase Agreement”) with Lincoln Park Capital Fund, LLC (“Lincoln Park”), pursuant to which the Company has the right to sell to Lincoln Park up to an aggregate of \$10 million in shares of its common stock over the 36-month term of the Purchase Agreement subject to the conditions and limitations set forth in the Purchase Agreement (see Note 8).

Inadequate working capital would have a material adverse effect on the Company’s business and operations and could cause the Company to fail to execute its business plan, fail to take advantage of future opportunities or fail to respond to competitive pressures or customer requirements. A lack of sufficient funding may also require the Company



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to significantly modify its business model and/or reduce or cease its operations, which could include implementing cost-cutting measures or delaying, scaling back or eliminating some or all of its ongoing and planned investments in corporate infrastructure, research and development projects, business development initiatives and sales and marketing activities, among other activities. While the Company's estimates of its operating revenues and expenses and working capital requirements could be incorrect and the Company may use its cash resources faster than it anticipates, management believes the Company's existing cash balance together with cash receipts from revenues, borrowing availability under a bank credit facility (see Note 4), funds available to be raised from the Lincoln Park arrangement (see Note 8) and funds raised through the debt and equity offerings, will be sufficient to meet the Company's anticipated cash needs for at least the next 12 months.

### **Note 2—Summary of Significant Accounting Policies**

#### ***Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto as of and for the year ended December 29, 2018, included in the Company's Annual Report on Form 10-K filed with the SEC on March 22, 2019.

In the opinion of management, all adjustments for the fair presentation of the Company's condensed consolidated financial statements have been made. The adjustments are of a normal recurring nature except as otherwise noted. The results of operations for the interim periods are not necessarily indicative of the results to be expected for other periods or the full fiscal year. The Company has evaluated events occurring subsequent to September 28, 2019, through the filing date of this Quarterly Report on Form 10-Q and concluded that there were no events that required recognition and disclosures, other than those discussed elsewhere in the notes hereto.

#### ***Principles of Consolidation***

The accompanying 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 or 53 week fiscal year ending on the Saturday closest to December 31. For 2019, the Company's fiscal year is scheduled to end on December 28, 2019 and will consist of 52 weeks, and each of the Company's quarters within such fiscal year will be comprised of 13 weeks.

#### ***Use of Estimates***

The preparation of the accompanying condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported. Actual results may differ materially from those estimates.

#### ***Revenue Recognition***

Revenue is recognized when control is transferred to customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods and services. Revenue recognition is evaluated through the five steps outlined within the guidance. Substantially all of the Company's net sales relate to products sold at a point in time through ship-and-bill performance obligations. At contract inception, an assessment of the goods and services promised in the contracts with customers is performed and a performance obligation is identified for each distinct promise to transfer to the customer a good or service (or bundle of goods or services). To identify the performance

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obligations, the Company considers all of the goods or services promised in the contract regardless of whether they are explicitly stated or are implied by customary business practices. Contracts with customers are comprised of customer purchase orders, invoices (including the Company's standard terms and conditions) and written contracts.

### *Performance Obligations*

Net sales and related cost of sales are primarily the result of promises to transfer products to customers. For performance obligations related to substantially all of the ship-and-bill products, control transfers at a point in time when title transfers upon shipment of the product to the customer, and for some sales, control transfers when title is transferred at time of receipt by the customer. Once a product has shipped or has been delivered, the customer is able to direct the use of, and obtain substantially all of the remaining benefits from, the asset. The Company considers control to have transferred upon shipment or delivery, because the Company has a present right to payment at that time, the customer has legal title to the asset, the Company has transferred physical possession of the asset, and the customer has the significant risks and rewards of ownership of the asset.

Amounts billed to its customers for shipping and handling are recorded in net product revenues. Shipping and handling costs incurred by the Company are included in cost of sales in the accompanying condensed consolidated statements of operations.

### *Significant Payment Terms*

For ship-and-bill type contracts with customers, the invoice states the final terms of the sale, including the description, quantity, and price of each product purchased. Payment terms are typically due within 30 days after delivery but, in limited instances, can range up to 60 days after delivery. Accordingly, the Company's contracts with customers do not include a significant financing component.

### *Variable Consideration*

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. Product returns give rise to variable consideration that decreases the transaction price. Estimates of variable consideration and determination of whether to include estimated amounts in the transaction price are based largely on an assessment of the anticipated performance and all information (historical, current and forecasted) that is reasonably available.

Returns for products sold are estimated using the expected value method and are recorded as a reduction in reported revenues at the time of sale based upon historical product return experience and is adjusted for known trends to arrive at the amount of consideration to which the Company expects to receive. Estimated amounts are included in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved.

### *Warranties*

The Company offers standard product warranties generally ranging from one to three years to its memory subsystem products customers, depending on the negotiated terms of any purchase agreements, and has no other post-shipment obligations or separately priced extended warranty or product maintenance contracts. These warranties require the Company to repair or replace defective product returned to the Company during the warranty period at no cost to the customer. Warranties are not offered on sales of component products. The Company records an estimate for warranty related costs at the time of sale based on its historical and estimated future product return rates and expected repair or replacement costs. Estimated future warranty costs are recorded in the period in which the sale is recorded and are included in cost of sales in the accompanying condensed consolidated statements of operations.

### ***Fair Value Measurements***

The Company accounts for certain assets and liabilities at fair value. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. The Company categorizes each of its fair value measurements in one of those three levels based on the lowest level input that is significant to the fair value measurement in its entirety.

- *Level 1* – inputs are based on unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. An active market is defined as a market in which transactions for the assets or liabilities occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- *Level 2* – inputs are based on quoted prices of similar instruments in active markets, quoted prices for identical or similar instruments in market that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- *Level 3* – inputs are generally unobservable inputs for the asset or liability, which are typically based on management’s estimates of assumptions that market participants would use in pricing the assets and liabilities. The fair values are therefore determined using model-based techniques, including option pricing models and discounted cash flow models.

The Company’s financial instruments consist principally of cash and cash equivalents, restricted cash, a revolving line of credit, and convertible promissory notes. The Company considers the carrying values of cash and cash equivalents and restricted cash to approximate the fair value for these financial instruments based upon an evaluation of the underlying characteristics, market data and because of the short period of time between origination of the instruments and their expected realization. The Company estimates the fair values of its revolving line of credit and convertible promissory notes by using current applicable rates for similar instruments as of the balance sheet date and an assessment of its credit rating. The carrying value of the Company’s revolving line of credit at September 28, 2019 and December 29, 2018 approximates fair value because the Company’s interest rate yield is near current market rates for comparable debt instruments. The Company estimates the fair value of its convertible promissory notes by using a discounted cash flow analysis using borrowing rates available to the Company for debt instruments with similar terms and maturities. The Company has determined that the valuation of its convertible promissory notes is classified in Level 2 of the fair value hierarchy. The carrying value and estimated fair value of a senior secured convertible promissory note as of September 28, 2019 were \$14.5 million and \$11.7 million, respectively. The carrying value and estimated fair value of a senior secured convertible promissory note as of December 29, 2018 were \$14.3 million and \$11.7 million, respectively. The carrying value and estimated fair value of the unsecured convertible note were \$1.0 million and \$0.7 million, respectively, as of September 28, 2019. The carrying value and estimated fair value of the unsecured convertible note were \$2.0 million and \$1.7 million, respectively, as of December 29, 2018.

### ***Concentration of Credit Risk***

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents, and accounts receivable. The Company invests its cash equivalents primarily in money market mutual funds. Cash equivalents are maintained with high quality institutions, the composition and maturities of which are regularly monitored by management. At times, deposits held with financial institutions may exceed the amount of insurance provided by the Federal Deposit Insurance Corporation and the Securities Investor Protection Corporation.

The Company’s trade accounts receivable are primarily derived from sales to OEMs in the server, high-performance computing and communications markets, as well as from sales to storage customers, appliance customers, system builders and cloud and datacenter customers. The Company performs credit evaluations of its customers’ financial condition and limits the amount of credit extended when deemed necessary, but generally requires no collateral. The Company believes the concentration of credit risk in its trade receivables is moderated by its credit evaluation process, relatively short collection terms, a high level of credit worthiness of its customers (see Note 3), foreign credit insurance, and letters of credit issued in its favor. Reserves are maintained for potential credit losses, and such losses historically have not been significant and have been within management’s expectations.

### ***Leases***

The Company determines if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use (“ROU”) assets, accrued expenses and other current liabilities, and operating lease liabilities on its condensed consolidated balance sheets. Finance leases are included in property and equipment, accrued expenses and other current liabilities, and other liabilities in its condensed consolidated balance sheets.

ROU assets represent the right of the Company to use an underlying asset for the lease term and lease liabilities represent the obligation of the Company to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of the Company’s leases do not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. The Company uses the implicit rate when readily determinable. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. The lease terms may include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

The Company has lease agreements with lease and non-lease components, which are accounted for as a single lease component. The Company does not present short-term leases on the balance sheet, as those leases have a lease term of twelve months or less at inception and do not contain purchase options or renewal terms that the Company is reasonably certain to exercise.

### ***Stock-Based Compensation***

Stock-based awards are comprised principally of stock options, restricted stock and restricted stock units (“RSUs”). Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as an expense over the requisite service period, which is the vesting period, on a straight-line basis, net of estimated forfeitures. The Company uses the Black-Scholes option pricing model to determine the grant date fair value of stock options. The model requires the Company to estimate the expected volatility and expected term of the stock options, which are highly complex and subjective variables. The expected volatility is based on the historical volatility of the Company’s common stock. The expected term is computed using the simplified method as the Company’s best estimate given its lack of actual exercise history. The risk-free rate selected to value any particular grant is based on the U.S. Treasury rate that corresponds to the expected term of the grant effective as of the date of the grant. The expected dividend assumption is based on the Company’s history and management’s expectation regarding dividend payouts. The grant-date fair value of restricted stock and RSUs equals the closing price of the Company’s common stock on the grant date.

### ***Net Loss Per Share***

The Company computes net loss per share using the two-class method required for participating securities. The Company considers restricted stock awards to be participating securities because holders of such shares have nonforfeitable dividend rights in the event of the Company’s declaration of a dividend for common shares. Under the two-class method, undistributed earnings are allocated to common stock and the participating securities according to their respective participating rights in undistributed earnings, as if all the earnings for the period had been distributed. No allocation of undistributed earnings to participating securities was performed for periods with net losses as such securities do not have a contractual obligation to share in the losses of the Company.

Basic net loss per share is calculated by dividing net loss by the weighted-average common shares outstanding during the period following the two-class method. Diluted net loss per share is calculated by dividing the net loss by the weighted-average shares and dilutive potential common shares outstanding during the period. Dilutive potential shares consist of dilutive shares issuable upon the exercise of outstanding stock options and warrants computed using the treasury stock method, shares issuable under the conversion feature of convertible notes using the “if-converted” method, and shares issuable upon the vesting of restricted stock awards. In periods of losses, basic and diluted loss per share are

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the same, as the effect of stock options, warrants, convertible notes and unvested restricted stock awards on loss per share is anti-dilutive.

### ***Adoption of New Accounting Pronouncements***

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-02, *Leases* (Topic 842), as amended (“ASC 842”), which modifies lease accounting for lessees to increase transparency and comparability by recording lease assets and liabilities for operating leases and disclosing key information about leasing arrangements. The Company adopted ASC 842 effective December 30, 2018 using a modified retrospective method and did not restate comparative periods. As permitted under the transition guidance, the Company carried forward the assessment of whether its contracts contain or are leases, classification of its leases and remaining lease terms. The Company also used hindsight in determining lease terms. Based on the lease portfolio as of December 30, 2018, the Company recognized approximately \$1.5 million of operating lease right-of-use assets and operating lease liabilities on its condensed consolidated balance sheet upon adoption, primarily relating to real estate. No adjustments were required to be made to accumulated deficit upon adoption.

### ***Recently Issued Accounting Pronouncements***

In August 2018, the FASB issued ASU No. 2018-15, *Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (a consensus of the FASB Emerging Issues Task Force)*, which amends the accounting for implementation, setup, and other upfront costs in a hosting arrangement that is a service contract. ASU 2018-15 is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. Early adoption is permitted including adoption in any interim period. The Company does not expect a significant impact as a result of adopting this update on its consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*, which removes, modifies, and adds various disclosure requirements on fair value measurements in Topic 820. ASU 2018-13 is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2019. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Early adoption is permitted upon issuance of this update. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this update and delay adoption of the additional disclosures until their effective date. The Company does not expect a significant impact as a result of adopting this update on its consolidated financial statements.

### **Note 3—Supplemental Financial Information**

#### ***Inventories***

Inventories consisted of the following (in thousands):

	September 28, 2019	December 29, 2018
Raw materials	\$ 843	\$ 1,072
Work in process	23	25
Finished goods	1,532	1,849
	<u>\$ 2,398</u>	<u>\$ 2,946</u>

**Computation of Net Loss Per Share**

The following table sets forth the computation of basic and diluted net loss per share of common stock (in thousands, except per share data):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 28, 2019</b>	<b>September 29, 2018</b>	<b>September 28, 2019</b>	<b>September 29, 2018</b>
<b>Net loss per share—basic and diluted:</b>				
Numerator: Net loss	\$ (3,108)	\$ (4,644)	\$ (10,677)	\$ (12,734)
Denominator: Weighted-average common shares outstanding—basic and diluted	148,058	115,402	142,624	96,516
Net loss per share—basic and diluted	\$ (0.02)	\$ (0.04)	\$ (0.07)	\$ (0.13)

No allocation of undistributed earnings to participating securities was performed for periods with net losses as such securities do not have a contractual obligation to share in the losses of the Company.

The table below sets forth potentially dilutive weighted average common share equivalents, consisting of shares issuable upon the exercise of outstanding stock options and warrants using the treasury stock method, shares issuable upon conversion of the SVIC Note and the Iliad Note (see Note 5) using the “if-converted” method, and the vesting of restricted stock awards. These potential weighted average common share equivalents have been excluded from the diluted net loss per share calculations above as their effect would be anti-dilutive (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 28, 2019</b>	<b>September 29, 2018</b>	<b>September 28, 2019</b>	<b>September 29, 2018</b>
Weighted average common share equivalents	16,120	15,125	16,212	13,506

**Disaggregation of Net Sales**

The following table shows disaggregated net sales by major source (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 28, 2019</b>	<b>September 29, 2018</b>	<b>September 28, 2019</b>	<b>September 29, 2018</b>
Resales of third-party products	\$ 5,180	\$ 5,089	\$ 13,725	\$ 18,531
Sale of the Company's modular memory subsystems	936	2,114	3,008	5,977
Total net sales	\$ 6,116	\$ 7,203	\$ 16,733	\$ 24,508

**Major Customers and Products**

The Company’s net sales have historically been concentrated in a small number of customers. The following table sets forth the percentage of net sales made to customers that each comprise 10% or more of total net sales:

	Three Months Ended		Nine Months Ended	
	September 28, 2019	September 29, 2018	September 28, 2019	September 29, 2018
<b>Customer:</b>				
Customer A	13 %	16 %	11 %	19 %
Customer B	10 %	* %	* %	* %
Customer C	* %	12 %	* %	* %
Customer D	* %	11 %	* %	* %
Customer E	* %	11 %	* %	* %

\* Less than 10% of net sales during the period.

The Company’s accounts receivable are concentrated with two customers as of September 28, 2019 representing 14% and 21%, respectively, of aggregate gross receivables. As of December 29, 2018, two customers represented 22% and 15%, respectively, of aggregate gross receivables. The loss of any of the significant customers or a reduction in sales to or difficulties collecting payments from any of these customers could significantly reduce the net sales and adversely affect the operating results of the Company. The Company tries to mitigate risks associated with foreign receivables by purchasing comprehensive foreign credit insurance.

The Company resells certain component products to end-customers that are not reached in the distribution models of the component manufacturers, including storage customers, appliance customers, system builders and cloud and datacenter customers. For the three and nine months ended September 28, 2019 and September 29, 2018, resales of these products represented approximately 85%, 82%, 71% and 76%, respectively, of net sales.

**Cash Flow Information**

The following table sets forth supplemental disclosure of non-cash financing activities:

	Nine Months Ended	
	September 28, 2019	September 29, 2018
Common stock issued on conversion of convertible note payable and accrued interest	\$ 1,417	\$ —
Debt financing of insurance	\$ —	\$ 344

**Note 4—Credit Agreement**

**SVB Credit Agreement**

On October 31, 2009, the Company and Silicon Valley Bank (“SVB”) entered into a credit agreement (as amended, the “SVB Credit Agreement”). Pursuant to the terms of the SVB Credit Agreement, the Company is eligible to borrow, in a revolving line of credit, up to the lesser of (i) 85% of its eligible accounts receivable (increased from 80% as of August 29, 2018), or (ii) \$5.0 million, subject to certain adjustments as set forth in the SVB Credit Agreement. The SVB Credit Agreement requires letters of credit to be secured by cash, which is classified as restricted cash in the accompanying condensed consolidated balance sheets. As of September 28, 2019 and December 29, 2018, (i) outstanding letters of credit were \$2.3 million and \$1.9 million, respectively, (ii) outstanding borrowings were \$1.5 million and \$2.3 million, respectively, and (iii) availability under the revolving line of credit was \$0.1 million and \$0.2 million, respectively.

On January 29, 2016, the Company and SVB entered into an amendment to the SVB Credit Agreement to, among other things, adjust the rate at which advances under the SVB Credit Agreement accrue interest to the Wall Street

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Journal “prime rate” plus 2.75% (prior to such amendment, advances accrued interest at a rate equal to SVB’s most recently announced “prime rate” plus 2.75%).

On March 27, 2017, the Company and SVB entered into another amendment to the SVB Credit Agreement to, among other things, (i) extend the maturity date of advances under the SVB Credit Agreement to April 1, 2018, (ii) modify the Company’s financial covenants under the SVB Credit Agreement to remove all prior financial standards and replace them with a liquidity ratio standard, (iii) remove or amend certain termination, anniversary and unused facility fees payable by the Company under the SVB Credit Agreement, and (iv) make certain other administrative changes. On April 12, 2017, the Company and SVB entered into a further amendment to the SVB Credit Agreement to, among other things, obtain SVB’s consent in connection with the Company’s rights agreement with Computershare Trust Company, N.A., as rights agent (see Note 8), and make certain administrative changes in connection with the Company’s funding arrangement with TR Global Funding V, LLC, an affiliate of TRGP Capital Management, LLC (“TRGP”) (see Note 7). On March 20, 2018, the Company and SVB entered into another amendment to the SVB Credit Agreement to among other things, (i) extend the maturity date of advances under the SVB Credit Agreement to March 31, 2019 and (ii) revise certain inventory reporting requirements under the SVB Credit Agreement. On August 29, 2018, the SVB Credit Agreement was amended further to increase the borrowing based of accounts receivable to 85% from 80% or \$5.0 million, subject to certain adjustments set forth in the SVB Credit Agreement. On March 21, 2019, the SVB Credit Agreement was amended further to (i) extend the maturity date of the advances to March 30, 2020 and (ii) remove the inventory reporting requirements.

For all periods before April 20, 2017, all obligations under the SVB Credit Agreement were secured by a first priority security interest in the Company’s tangible and intangible assets, other than its patent portfolio, which was subject to a first priority security interest held by SVIC (see Note 5). Certain of these lien priorities were modified in April and May 2017 in connection with the Company’s establishment of a funding arrangement with TRGP for certain of the Company’s litigation expenses in connection with certain of its legal proceedings against SK hynix, a South Korean memory semiconductor supplier (“SK hynix”). On May 3, 2017, TRGP entered into an intercreditor agreement with each of SVIC and SVB, and on April 20, 2017, SVIC and SVB entered into an intercreditor agreement with each other (such intercreditor agreements, collectively, the “Intercreditor Agreements”). Pursuant to the terms of the Intercreditor Agreements, SVB’s security interests in the Company’s assets have been modified as follows: SVB has a first priority security interest in all of the Company’s tangible and intangible assets other than its patent portfolio and its claims underlying and any proceeds it may receive from the SK hynix proceedings; a second priority security interest in the Company’s patent portfolio other than the patents that are the subject of the SK hynix proceedings; and a third priority security interest in the Company’s patents that are the subject of the SK hynix proceedings (see Note 7).

The SVB Credit Agreement subjects the Company to certain affirmative and negative covenants, including financial covenants with respect to the Company’s liquidity and restrictions on the payment of dividends. As of September 28, 2019, the Company was in compliance with its covenants under the SVB Credit Agreement.

**Note 5—Debt**

The Company’s debt consisted of the following (in thousands):

	September 28, 2019	December 29, 2018
Senior secured convertible note, due December 2021, including accrued interest of \$1,159 (2019) and \$934 (2018), respectively	\$ 16,159	\$ 15,934
Unsecured convertible note, due August 2020, including accrued interest of \$1 (2019) and \$62 (2018)	1,022	2,332
Note payable	—	376
Unamortized debt discounts and issuance costs	(519)	(920)
	16,662	17,722
Less: current portion	(997)	(376)
	<u>\$ 15,665</u>	<u>\$ 17,346</u>



### ***Senior Secured Convertible Note***

On November 18, 2015, in connection with entering into the JDLA with Samsung, the Company issued to SVIC a Senior Secured Convertible Note (“SVIC Note”) and Stock Purchase Warrant (“SVIC Warrant”). The SVIC Note has an original principal amount of \$15.0 million, accrues interest at a rate of 2.0% per year, is due and payable in full on December 31, 2021, and is convertible into shares of the Company’s common stock at a conversion price of \$1.25 per share, subject to certain adjustments, on the maturity date of the SVIC Note. Upon a change of control of the Company prior to the maturity date of the SVIC Note, the SVIC Note may, at the Company’s option, be assumed by the surviving entity or be redeemed upon the consummation of such change of control for the principal and accrued but unpaid interest as of the redemption date. The SVIC Warrant grants SVIC a right to purchase 2,000,000 shares of the Company’s common stock at an exercise price of \$0.30 per share, subject to certain adjustments, is only exercisable in the event the Company exercises its right to redeem the SVIC Note prior to its maturity date, and expires on December 31, 2025.

The SVIC Warrant was valued at \$1.2 million, based on its relative fair value, and was recorded as a debt discount. The Company also recorded \$0.2 million of debt issuance costs as a debt discount for professional services fees rendered in connection with the transaction. These amounts are being amortized to interest expense over the term of the SVIC Note using the interest method. During the three and nine months ended September 28, 2019 and September 29, 2018, interest expense related to the amortization of the issuance costs associated with the liability component was not material. As of September 28, 2019, the outstanding principal and accrued interest on the SVIC Note was \$16.2 million, and the outstanding SVIC Note balance, net of unamortized debt discounts and issuance costs, was \$15.7 million.

In connection with the SVIC Note, SVIC was granted a first priority security interest in the Company’s patent portfolio and a second priority security interest in all of the Company’s other tangible and intangible assets. Upon issuance of the SVIC Note, the Company, SVB and SVIC entered into an Intercreditor Agreement pursuant to which SVB and SVIC agreed to their relative security interests in the Company’s assets. In May 2017, SVIC, SVB and TRGP entered into additional Intercreditor Agreements to modify certain of these lien priorities (see Note 7). Additionally, upon issuance of the SVIC Note and the SVIC Warrant, the Company and SVIC entered into a Registration Rights Agreement pursuant to which the Company is obligated to register with the SEC, upon demand by SVIC, the shares of the Company’s common stock issuable upon conversion of the SVIC Note or upon exercise of the SVIC Warrant.

The SVIC Note subjects the Company to certain affirmative and negative operating covenants. As of September 28, 2019, the Company was in compliance with its covenants under the SVIC Note.

### ***Unsecured Convertible Note***

On August 27, 2018, the Company entered into a Securities Purchase Agreement with Iliad Research and Trading, L.P. (“Iliad”) (the “Iliad Purchase Agreement”), pursuant to which the Company issued a convertible promissory note in the principal amount of \$2.3 million (“Iliad Note”) with an original issue discount of \$0.2 million. The Iliad Note bears interest at an annual rate of 8% and matures on August 27, 2020, unless earlier repurchased, redeemed or converted in accordance with its terms.

The Iliad Note provides Iliad with the right to convert, at any time, all or any part of the outstanding principal and accrued but unpaid interest into shares of the Company’s common stock at a conversion price of \$0.36 per share (“Lender Conversion Price”). Further, beginning on April 1, 2019, the Iliad Note also provides Iliad with the right to redeem all or any portion of the Iliad Note (“Redemption Amount”) up to a maximum monthly amount of \$0.35 million. The payments of each Redemption Amount may either be made in cash, by converting such Redemption Amount into shares of the Company’s common stock (“Redemption Conversion Shares”), or a combination thereof, at the Company’s election.

The number of Redemption Conversion Shares equals the portion of the applicable Redemption Amount being converted divided by the lesser of the Lender Conversion Price or the Market Price, that is 85% of the Company’s lowest closing bid price during the 20 trading days immediately preceding the applicable redemption date (“Redemption Conversion Price”), provided that the Market Price shall not be less than \$0.11 per share (the “Redemption Price Floor”). In the event any applicable redemption conversion price is below the Redemption Price Floor then either: (i) the

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Company will honor the redemption conversion at the then effective redemption conversion price for a Redemption Amount not to exceed \$0.15 million if the redemption conversion price is equal to or greater than \$0.06 per share or (ii) the Company will pay the applicable Redemption Amount up to \$0.15 million in cash and not in Redemption Conversion Shares.

The \$2.1 million of proceeds received from the issuance of the Iliad Note was initially allocated between long-term debt (the liability component) at \$1.9 million and additional paid-in capital (the equity component) at \$0.2 million, within the condensed consolidated balance sheet. The carrying amount of the liability component was calculated using the fair value of a similar liability without a conversion feature. The carrying amount of the equity component, representing the conversion option, was determined by deducting the fair value of the liability component from the proceeds received. The amount allocated to the equity component along with the original issue discount and fees paid to Iliad is amortized to interest expense over the expected life of 14 months using the interest method. The equity component is not remeasured as long as it continues to meet the conditions for equity classification. The issuance costs incurred related to the issuance of the Iliad Note were not material.

As of September 28, 2019, the outstanding principal and accrued interest on the Iliad Note was \$1.0 million, and the outstanding Iliad Note balance, net of unamortized debt discounts and issuance costs, was \$1.0 million.

During the three and nine months ended September 28, 2019, Iliad converted \$0.8 million and \$0.9 million, respectively, of the outstanding principal and accrued interest on the Iliad Note to 3,247,000 shares and 3,624,074 shares, respectively, of the Company's common stock at the Redemption Conversion Price. In addition, during the nine months ended September 28, 2019, Iliad converted \$0.5 million of the outstanding principal and accrued interest on the Iliad Note to 1,388,890 shares of the Company's common stock at the Lender Conversion Price. Iliad did not convert any outstanding principal and accrued interest on the Iliad Note at the Lender Conversion Price during the three months ended September 28, 2019. Subsequent to September 28, 2019, Iliad converted \$0.7 million of the outstanding principal and accrued interest on the Iliad Note to 2,905,873 shares of the Company's common stock at the Redemption Conversion Price.

The Iliad Note is not secured and does not have any financial covenants requirements for which the Company needs to comply. The Company makes certain customary representations and warranties and has agreed to customary covenants and obligations. The Iliad Purchase Agreement and Iliad Note contain customary events of default upon the occurrence and during the continuance of which all obligations under the Iliad Purchase Agreement and Iliad Note may be declared immediately due and payable.

### **Note 6—Leases**

The Company has operating and finance leases primarily associated with office facilities, manufacturing facility and certain equipment. The determination of which discount rate to use when measuring the lease obligation was deemed a significant judgment.

Lease cost and supplemental cash flow information related to operating leases was as follows (in thousands):

	<b>Three Months Ended September 28, 2019</b>	<b>Nine Months Ended September 28, 2019</b>
Lease cost		
Operating lease cost	\$ 158	\$ 476
Cash paid for amounts included in the measurement of lease liabilities		
Operating cash flows from operating leases	\$ 155	\$ 450
Right-of-use assets obtained in exchange for lease obligations		
Finance leases	\$ —	\$ 96

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For the three and nine months ended September 28, 2019, finance lease costs and cash flows from finance lease were immaterial.

Supplemental balance sheet information related to leases was as follows:

(in thousands)	September 28, 2019
<b>Operating Leases</b>	
Operating lease right-of-use assets	\$ 1,133
Accrued expenses and other current liabilities	\$ 550
Operating lease liabilities	630
Total operating lease liabilities	<u>\$ 1,180</u>
<b>Finance Leases</b>	
Property and equipment, at cost	\$ 96
Accumulated depreciation	(9)
Property and equipment, net	\$ 87
Accrued expenses and other current liabilities	\$ 18
Other long-term liabilities	70
Total finance lease liabilities	<u>\$ 88</u>
<b>Weighted Average Remaining Lease Term (in years)</b>	
Operating lease	2.2
Finance lease	4.5
<b>Weighted Average Discount Rate</b>	
Operating lease	7.7 %
Finance lease	5.1 %

Maturities of lease liabilities as of September 28, 2019 were as follows (in thousands):

Fiscal Year	Operating Leases	Finance Leases
2019 (remaining 3 months)	\$ 157	\$ 5
2020	596	22
2021	376	22
2022	163	22
2023	—	22
Thereafter	—	5
Total lease payments	<u>1,292</u>	<u>98</u>
Less: imputed interest	(112)	(10)
Total	<u>\$ 1,180</u>	<u>\$ 88</u>

A summary of future minimum lease payments under operating lease as of December 29, 2018 was as follows (in thousands):

Fiscal Year	Amount
2019	\$ 399
2020	208
Total minimum lease payments	<u>\$ 607</u>

## **Note 7—Commitments and Contingencies**

### ***TRGP Agreement and Related Intercreditor Agreements***

On May 3, 2017, the Company and TRGP entered into an investment agreement (the “TRGP Agreement”), which generally provides that TRGP will directly fund the costs incurred by or on behalf of the Company in connection with certain legal proceedings against SK hynix (see “Litigation and Patent Reexaminations” in this Note 7 below), including costs incurred since January 1, 2017 and costs to be incurred in the future in the Company’s first action in the U.S. International Trade Commission (“ITC”) and its U.S. district court proceedings, but excluding the Company’s second ITC action and its proceedings in international courts (all such funded costs, collectively, the “Funded Costs”). In exchange for such funding, the Company has agreed that, if the Company recovers any proceeds in connection with the funded SK hynix proceedings, it will pay to TRGP the amount of the Funded Costs paid by TRGP plus an escalating premium based on when any such proceeds are recovered, such that the premium will equal a specified low-to-mid double-digit percentage of the amount of the Funded Costs and such percentage will increase by a specified low double-digit amount each quarter after a specified date until any such proceeds are recovered. In addition, pursuant to the terms of a separate security agreement between the Company and TRGP dated May 3, 2017 (the “Security Agreement”), the Company has granted to TRGP (i) a first priority lien on, and security in, the claims underlying the funded SK hynix proceedings and any proceeds that may be received by the Company in connection with these proceedings, and (ii) a second priority lien on, and security in, the Company’s patents that are the subject of the funded SK hynix proceedings.

The TRGP Agreement does not impose financial covenants on the Company. Termination events under the TRGP Agreement include, among others, any failure by the Company to make payments to TRGP thereunder upon receipt of recoveries in the SK hynix proceedings; the occurrence of certain bankruptcy events; certain breaches by the Company of its covenants under the TRGP Agreement or the related Security Agreement; and the occurrence of a change of control of the Company. If any such termination event occurs, subject to certain cure periods for certain termination events, TRGP would have the right to terminate its obligations under the TRGP Agreement, including its obligation to make any further payments of Funded Costs after the termination date. In the event of any such termination by TRGP, the Company would continue to be obligated to pay TRGP the portion of any proceeds the Company may recover in connection with the SK hynix proceedings that TRGP would have been entitled to receive absent such termination, as described above, and TRGP may also be entitled to seek additional remedies pursuant to the dispute resolution provisions of the TRGP Agreement.

In connection with the TRGP Agreement, in May 2017, TRGP, SVIC and SVB entered into the Intercreditor Agreements. Pursuant to the terms of the Intercreditor Agreements, TRGP, SVB and SVIC have agreed to their relative security interest priorities in the Company’s assets, such that: (i) TRGP has a first priority security interest in the Company’s claims underlying the funded SK hynix proceedings and any proceeds that may be received by the Company in connection with these proceedings, and a second priority security interest in the Company’s patents that are the subject of the funded SK hynix proceedings, (ii) SVIC has a first priority security interest in the Company’s complete patent portfolio and a second priority security interest in all of the Company’s other tangible and intangible assets (other than the Company’s claims underlying and any proceeds it may receive from the SK hynix proceedings funded under the TRGP Agreement), and (iii) SVB has a first priority security interest in all of the Company’s tangible and intangible assets other than its patent portfolio and its claims underlying and any proceeds it may receive from the SK hynix proceedings funded under the TRGP Agreement, a second priority security interest in the Company’s patent portfolio other than the patents that are the subject of the SK hynix proceedings funded under the TRGP Agreement, and a third priority security interest in the Company’s patents that are the subject of the SK hynix proceedings funded under the TRGP Agreement. The Company consented and agreed to the terms of each of the Intercreditor Agreements.

Legal expenses incurred by the Company but paid by TRGP pursuant to the terms of the TRGP Agreement are excluded from the Company’s consolidated financial statements. During the years ended December 29, 2018 and December 30, 2017, the Company excluded legal expenses of \$1.8 million and \$10.2 million, respectively, as a result of TRGP’s payment of these expenses under the TRGP Agreement. The Company does not anticipate any further legal expenses will be paid by TRGP under this agreement. During the three and nine months ended September 28, 2019, there were no legal expenses excluded as a result of TRGP’s payment of these expenses under the TRGP Agreement. Any settlement or other cash proceeds the Company may recover in the future in connection with the funded SK hynix

proceedings would be reduced by the aggregate amount of legal expenses excluded by the Company as a result of TRGP's payment of these expenses under the TRGP Agreement, plus the premium amount due to TRGP under the terms of the TRGP Agreement at the time of any such recovery.

### ***Litigation and Patent Reexaminations***

The Company owns numerous patents and continues to seek to grow and strengthen its patent portfolio, which covers various aspects of the Company's innovations and includes various claim scopes. The Company plans to pursue avenues to monetize its intellectual property portfolio, in which it would generate revenue by selling or licensing its technology, and it intends to vigorously enforce its patent rights against alleged infringers of such rights. The Company dedicates substantial resources to protecting and enforcing its intellectual property rights, including with patent infringement proceedings it files against third parties and defense of its patents against challenges made by way of reexamination and review proceedings at the U.S. Patent and Trademark Office ("USPTO") and Patent Trial and Appeal Board ("PTAB"). The Company expects these activities to continue for the foreseeable future, with no guarantee that any ongoing or future patent protection or litigation activities will be successful, or that the Company will be able to monetize its intellectual property portfolio. The Company is also subject to litigation based on claims that it has infringed on the intellectual property rights of others.

Any litigation, regardless of its outcome, is inherently uncertain, involves a significant dedication of resources, including time and capital, and diverts management's attention from other activities of the Company. As a result, any current or future infringement claims or patent challenges by or against third parties, whether or not eventually decided in the Company's favor or settled, could materially adversely affect the Company's business, financial condition and results of operations. Additionally, the outcome of pending or future litigation and related patent reviews and reexaminations, as well as any delay in their resolution, could affect the Company's ability to continue to sell its products, protect against competition in the current and expected markets for its products or license or otherwise monetize its intellectual property rights in the future.

#### *Google Litigation*

On December 4, 2009, the Company filed a patent infringement lawsuit against Google, Inc. ("Google") in the U.S. District Court for the Northern District of California (the "Northern District Court"), seeking damages and injunctive relief based on Google's alleged infringement of the Company's U.S. Patent No. 7,619,912 (the "'912 patent"), which relates generally to technologies to implement rank multiplication. In February 2010, Google answered the Company's complaint and asserted counterclaims against the Company seeking a declaration that the patent is invalid and not infringed, and claiming that the Company committed fraud, negligent misrepresentation and breach of contract based on the Company's activities in the Joint Electron Device Engineering Council ("JEDEC") standard-setting organization. The counterclaim seeks unspecified compensatory damages. Accruals have not been recorded for loss contingencies related to Google's counterclaim because it is not probable that a loss has been incurred and the amount of any such loss cannot be reasonably estimated. In October 2010, Google requested and was later granted an *Inter Partes* Reexamination of the '912 patent by the USPTO. The reexamination proceedings are described below. In connection with the reexamination request, the Northern District Court granted the Company's and Google's joint request to stay the '912 patent infringement lawsuit against Google until the completion of the reexamination proceedings. On January 31, 2019, the PTAB, in response to Google's rehearing request, denied rehearing of the PTAB's previous decision upholding the validity of claims in Netlist's '912 patent. On April 16, 2019, Google filed an appeal to this decision.

#### *Inphi Litigation*

On September 22, 2009, the Company filed a patent infringement lawsuit against Inphi Corporation ("Inphi") in the U.S. District Court for the Central District of California (the "Central District Court"). The complaint, as amended, alleges that Inphi is contributorily infringing and actively inducing the infringement of U.S. patents owned by the Company, including the '912 patent, U.S. Patent No. 7,532,537 (the "'537 patent"), which relates generally to memory modules with load isolation and memory domain translation capabilities, and U.S. Patent No. 7,636,274 (the "'274 patent"), which is related to the '537 patent and relates generally to load isolation and memory domain translation.

technologies. The Company is seeking damages and injunctive relief based on Inphi's use of the Company's patented technology. Inphi denied infringement and claimed that the three patents are invalid. In June 2010, Inphi requested and was later granted *Inter Partes* Reexaminations of the '912, '537 and '274 patents by the USPTO. The reexamination proceedings are described below (except for the reexamination proceeding related to the '537 patent, which have concluded with the confirmation of all of the claims of such patent). In connection with the reexamination requests, Inphi filed a motion to stay the patent infringement lawsuit with the Central District Court until completion of the reexamination proceedings, which was granted. On April 16, 2019, Inphi filed an appeal to the PTAB's January 31, 2019 decision upholding the validity of claims in Netlist's '912 patent.

#### *'912 Patent Reexamination*

As noted above, in April 2010, June 2010 and October 2010, Google and Inphi submitted requests for an *Inter Partes* Reexamination of the '912 patent by the USPTO, claiming that the '912 patent is invalid and requesting that the USPTO reject the patent's claims and cancel the patent. Additionally, in October 2010, Smart Modular, Inc. ("Smart Modular") submitted another such reexamination request. On January 18, 2011, the USPTO granted such reexamination requests, and in February 2011, the USPTO merged the Inphi, Google and Smart Modular '912 patent reexaminations into a single proceeding. On March 21, 2014, the USPTO issued an Action Closing Prosecution ("ACP"), an office action that states the USPTO examiner's position on patentability and closes further prosecution, and on June 18, 2014 the USPTO issued a Right of Appeal Notice ("RAN"), a notice that triggers the rights of the involved parties to file a notice of appeal to the ACP, each of which confirmed the patentability of 92 of the '912 patent's claims and rejected the patent's 11 other claims. The parties involved filed various notices of appeal, responses and requests, and on November 24, 2015, the PTAB held a hearing on such appeals. On May 31, 2016, the PTAB issued a decision affirming certain of the examiner's decisions and reversing others. On February 9, 2017, the PTAB granted the Company's request to reopen prosecution before the USPTO examiner and remanded the consolidated proceeding to the examiner to consider the patentability of certain of the pending claims in view of the PTAB's May 31, 2016 decision and comments from the parties. On October 3, 2017, the examiner issued a determination as to the patentability of certain of the pending claims, which were found to be unpatentable. On June 1, 2018, the PTAB reversed the Examiner and found the pending amended claims to be patentable. On July 2, 2018, Google requested rehearing of the PTAB's decision. On January 31, 2019 the PTAB, in response to Google's rehearing request, denied rehearing of the PTAB's previous decision upholding the validity of claims in Netlist's '912 patent. On April 16, 2019, Inphi and Google filed an appeal to the '912 patent decision. Accruals have not been recorded for loss contingencies related to the '912 patent reexamination proceedings because it is not probable that a loss has been incurred and the amount of any such loss cannot be reasonably estimated.

#### *'627 Patent Reexamination*

In September 2011, Smart Modular submitted a request for an *Inter Partes* Reexamination by the USPTO of the Company's U.S. Patent No. 7,864,627 (the "'627 patent"), related to the '912 patent, alleging that the '627 patent is invalid and requesting that the USPTO reject the patent's claims. On November 16, 2011, the USPTO granted Smart Modular's request and initiated reexamination. By June 27, 2014, the USPTO's patent examiner had rejected all of the '627 patent's claims. The Company appealed the examiner's rejections to the PTAB, and on May 31, 2016, the PTAB issued a decision affirming some of the examiner's rejections. On July 31, 2016, the Company submitted a request to the PTAB to reopen prosecution before the examiner to amend the claims. On February 9, 2017, the PTAB granted the Company's request to reopen prosecution and remanded the proceeding to the examiner to consider the patentability of the amended claims in view of the PTAB's May 31, 2016 decision and comments from Smart Modular. On October 2, 2017, the examiner issued a determination that the amended claims should also be rejected. On June 1, 2018, the PTAB reversed the examiner and found the amended claims to be patentable. Smart Modular did not appeal this latest PTAB decision to the Federal Circuit. On October 3, 2018, the USPTO issued a Notice of Intent to Issue a Reexam Certificate, and on November 5, 2018, the USPTO issued Reexamination Certificate No. 7,864,627 concluding the reexamination. The original '627 patent had eighteen claims, and during the reexamination, five were canceled (claims 1, 4, 15, 19, 20) and the remaining fifteen were amended (claims 2, 3, 5-12, 14-18) into their current form as issued in the reexamination certificate. Accruals have not been recorded for loss contingencies related to the '627 patent reexamination proceedings because it is not probable that a loss has been incurred and the amount of any such loss cannot be reasonably estimated.



*'274 Patent Reexamination*

As noted above, in April 2010 and June 2010, Inphi submitted requests for an *Inter Partes* Reexamination of the '274 patent by the USPTO. On August 27, 2010, the request was granted. In March 2012 and June 2012, the USPTO issued an ACP and a RAN, respectively, each of which confirmed the patentability of many of the '274 patent's claims. The parties involved filed various notices of appeal, responses and requests, and on November 20, 2013, the PTAB held a hearing on such appeals. On January 16, 2014, the PTAB issued a decision affirming the examiner in part but reversing the examiner on new grounds and rejecting all of the patent's claims. On September 11, 2015, the USPTO examiner issued a determination rejecting the amended claims. On January 23, 2017, the USPTO granted-in-part the Company's petition to enter comments in support of its positions in the proceeding. On May 9, 2017, the PTAB issued a decision on appeal affirming the rejection of all claims. Netlist requested rehearing of the PTAB's decision on June 6, 2017. The PTAB denied the rehearing request on August 8, 2017. On October 6, 2017, Netlist appealed the decision to the Court of Appeals for the Federal Circuit, which Netlist dismissed on March 19, 2018, thereby terminating the proceedings with the rejection of all '274 patent claims becoming final. Accruals have not been recorded for loss contingencies related to the '274 patent reexamination proceedings because it is not probable that a loss has been incurred and the amount of any such loss cannot be reasonably estimated.

*Smart Modular '295 Patent Litigation and Reexamination*

On September 13, 2012, Smart Modular filed a patent infringement lawsuit against the Company in the U.S. District Court for the Eastern District of California (the "Eastern District Court"). The complaint alleges that the Company willfully infringes and actively induces the infringement of certain claims of U.S. Patent No. 8,250,295 ("the '295 patent") issued to Smart Modular and seeks damages and injunctive relief. The Company answered Smart Modular's complaint in October 2012, denying infringement of the '295 patent, asserting that the '295 patent is invalid and unenforceable, and asserting counterclaims against Smart Modular. Accruals have not been recorded for loss contingencies related to Smart Modular's complaint because it is not probable that a loss has been incurred and the amount of any such loss cannot be reasonably estimated.

On December 7, 2012, the USPTO granted the Company's request for the reexamination of the '295 patent. On April 29, 2014, the USPTO examiner issued an ACP confirming some claims and rejecting others, and on August 4, 2015, the examiner issued a RAN confirming all pending claims. On September 4, 2015, the Company appealed to the PTAB. The parties involved filed various notices of appeal, responses and requests, and on September 22, 2016, the PTAB held a hearing on such appeals. On November 14, 2016, the PTAB issued a decision reversing the examiner and rejected all of the pending claims. On January 23, 2017, Smart Modular filed a request to reopen prosecution. The parties had the opportunity present evidence and arguments and the examiner issued a determination on May 8, 2017, which found all pending claims to be unpatentable. On December 12, 2017, the PTAB agreed with the examiner and found all pending claims to be unpatentable. Smart Modular appealed the PTAB's decision to the Court of Appeals for the Federal Circuit. On March 28, 2018, the Eastern District Court stayed the proceedings related to the '295 patent. On January 18, 2019, the Company and Smart Modular filed a Joint Motion to Dismiss with Prejudice, terminating the proceedings related to the '295 patent in the Eastern District Court.

*Smart Modular and SanDisk Litigation*

On July 1 and August 23, 2013, the Company filed complaints against Smart Modular, SMART Storage Systems (which was subsequently acquired by SanDisk Corporation ("SanDisk")), Smart Worldwide Holdings ("Smart Worldwide") and Diablo Technologies ("Diablo") in the Central District Court, seeking, among other things, damages and other relief for alleged infringement of several of the Company's patents by the defendants based on the manufacture and sale of the ULLtraDIMM memory module, alleged antitrust violations by Smart Modular and Smart Worldwide, and alleged trade secret misappropriation and trademark infringement by Diablo. More particularly, the Company asserted claims from U.S. Patent Nos. 7,881,150; 8,001,434; 8,081,536; 8,301,833; 8,359,501; 8,516,185; and 8,516,187 (the "Asserted Patents").

On August 23, 2013, Smart Modular and Diablo each filed a complaint in the Oakland Division of the Northern District Court seeking declaratory judgment of non-infringement and invalidity of the Asserted Patents. Based on various motions filed by the parties, on November 26, 2013, the Central District Court severed and transferred the patent claims

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related to the ULLtraDIMM memory module to the Northern District Court. On February 12, 2014, the Northern District Court granted the parties' joint stipulation dismissing all claims against Smart Modular without prejudice. On April 15, 2014, the Northern District Court granted the parties' joint stipulation dismissing all claims against Smart Worldwide without prejudice.

Between June 18, 2014 and August 23, 2014, SanDisk, Diablo, and Smart Modular filed numerous petitions in the USPTO requesting *Inter Partes* Review ("IPR") of the Company's Asserted Patents. On April 9, 2015, the Northern District Court stayed the proceedings as to the Company's patent infringement claims pending resolution of all outstanding IPRs. The trade secret misappropriation and trademark infringement claims against Diablo were fully adjudicated on August 17, 2016 (during the pendency of the IPR's) and are no longer pending.

All of the IPRs filed by SanDisk, Diablo and SMART Modular associated with the Asserted Patents with Patent Nos. ending in '185, '187 and '833 have been resolved in the Company's favor and are no longer pending. The IPRs associated with the Asserted Patents with Patent Nos. ending in '150, '434, '501 and '536, and the appeals therefrom, have also concluded, with the Board confirming the patentability of several asserted claims. The litigation, however, remains stayed pending resolution of IPRs filed by Hynix on the same or related patents. On December 8, 2017, Diablo filed for bankruptcy, and on November 9, 2018, the Northern District Court dismissed all claims against Diablo without prejudice. The Company's patent infringement claims as to all Asserted Patents remain pending against SMART Storage Systems and SanDisk, subject to the stay.

### *SK hynix Litigation*

On September 1, 2016, the Company filed legal proceedings for patent infringement against SK hynix in the ITC (the "First ITC Action") and the Central District Court. These proceedings are based on the alleged infringement by SK hynix's RDIMM and LRDIMM enterprise memory products of six of the Company's U.S. patents. On October 31, 2017, the Company filed additional legal proceedings for patent infringement against SK hynix in the ITC (the "Second ITC Action") based on the alleged infringement by SK hynix's RDIMM and LRDIMM products of two additional U.S. patents owned by the Company. In all of the ITC proceedings, the Company has requested exclusion orders that direct U.S. Customs and Border Protection to stop allegedly infringing SK hynix RDIMM and LRDIMM products from entering the United States. In the Central District Court proceedings, the Company is primarily seeking damages.

On October 3, 2016, the ITC instituted an investigation of the trade practices of SK hynix and certain of its subsidiaries in connection with the First ITC Action, and held a hearing on the merits of the investigation from May 8, 2017 until May 11, 2017. On November 14, 2017, the ITC issued a final initial determination for the First ITC Action, finding no infringement of the asserted patents and no violation of Section 337 of the Tariff Act, and on January 16, 2018, the ITC issued a final determination for the First ITC Action, affirming the findings of no infringement and no violation and terminating the investigation. The Company is appealing this final determination to the Court of Appeals for the Federal Circuit with a hearing scheduled for December 5, 2019.

On January 11, 2018, the ITC set a 19-month target date of July 3, 2019 for an investigation related to the Second ITC Action, with a final initial determination for the Second ITC Action being filed no later than March 1, 2019. Based on this target date, the ITC scheduled a hearing on the merits of the investigation related to the Second ITC Action to begin on November 9, 2018 and conclude on November 19, 2018. On April 12, 2018, the ITC granted SK hynix's motion for summary determination of non-infringement and terminated the Second ITC Action in its entirety. On April 23, 2018, the Company filed a petition seeking ITC review of this decision. On May 29, 2018, the ITC Commission remanded the Second ITC Action back to the Administrative Law Judge ("ALJ") to resolve the parties' claim construction disputes and continue the investigation. On June 14, 2018, the ITC extended the target date for the final determination to August 5, 2019, with a final initial determination due by April 5, 2019. Based on this extended target date, the ITC scheduled a hearing on the merits to begin on December 14, 2018 and conclude on December 21, 2018. On September 13, 2018, the ITC rescheduled the hearing on the merits to begin on January 14, 2019 and conclude on January 18, 2019. On January 29, 2019, due to the government shutdown, the ITC again rescheduled the hearing on the merits to begin on March 11, 2019 and conclude on March 15, 2019. On February 8, 2019, Chief Administrative Law Judge of the ITC issued an Order in Investigation No. 337-TA-1089 denying SK hynix's motion for "Summary Determination of Non Infringement of Netlist's U.S. Patent No. 9,535,623 Based On Issue Preclusion." On March 12,



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2019, the ALJ postponed the trial due to reasons unrelated to the dispute between the parties. The trial recommenced on July 15, 2019 and ended on July 19, 2019. On October 21, 2019, the ITC issued an initial determination for the Second ITC Action, finding infringement by SK hynix of asserted Netlist U.S. Patent No. 9,606,907 (the “‘907 Patent”) resulting in a violation of Section 337 of the Tariff Act. The final determination by the ITC will be rendered on February 21, 2020.

Between December 30, 2016 and January 20, 2017, SK hynix filed numerous petitions in the USPTO requesting IPR of certain of the Company’s patents, including the patents asserted in the First ITC Action and the Central District Court proceedings, which have now concluded and certain of which are now on appeal to the Court of Appeals for the Federal Circuit. Between December 19, 2017 and February 7, 2018, SK hynix filed additional petitions in the USPTO requesting IPR of the patents asserted in the Second ITC Action which are now proceeding. On March 21, 2019, the PTAB issued a Final Written Decision finding Netlist’s U.S. Patent No. 9,535,623 invalid. Netlist has filed notice of intent to appeal. On June 27, 2019, the PTAB issued Final Written Decisions on two IPR proceedings regarding Netlist’s U.S. Patent No. 9,606,907 (the “‘907 Patent”) based on the reference Ellsberry, holding that claims 1-39 and 42-65 of the ‘907 Patent are unpatentable, but claims 40 and 41 are not unpatentable. On July 12, 2019, Netlist filed a Motion to Terminate under 35 U.S.C. § 315(e)(1) the remaining two IPR proceedings regarding the ‘907 Patent based on the references Halbert and Amidi. On July 19, 2019, SK hynix filed and served their opposition to Netlist’s Motion To Terminate. The PTAB issued a decision to Terminate IPR IPR2018-0036 on August 5, 2019.

On July 17, 2017, the Central District Court granted in part SK hynix’s request to stay the infringement proceedings pending further order of the court.

On July 11, 2017, the Company filed legal proceedings for patent infringement against SK hynix and certain of its distributors in the courts of Germany and the PRC based on the alleged infringement by SK hynix’s LRDIMM products of certain of the Company’s patents in those jurisdictions. On January 25, 2018, the court in Germany held a preliminary hearing and then held the trial on December 6, 2018. In December 2017, SK hynix filed petitions challenging the validity of the patents asserted by the Company in Germany and the PRC. On June 3, 2018, the patent asserted in the PRC was found to be invalid. On June 19, 2018, the Company withdrew the patent infringement suits filed in the PRC. On January 31, 2019, the court in Germany dismissed the infringement action, and ordered the Company to bear the costs of the action. Netlist has elected not to appeal the German court’s finding.

### *Other Contingent Obligations*

In the ordinary course of its business, the Company has made certain indemnities, commitments and guarantees pursuant to which it may be required to make payments in relation to certain transactions. These include, among others: (i) intellectual property indemnities to the Company’s customers and licensees in connection with the use, sale and/or license of Company products; (ii) indemnities to vendors and service providers pertaining to claims based on the Company’s negligence or willful misconduct; (iii) indemnities involving the accuracy of representations and warranties in certain contracts; (iv) indemnities to directors and officers of the Company to the maximum extent permitted under the laws of the State of Delaware; (v) indemnities to TRGP, SVIC, SVB and Iliad pertaining to all obligations, demands, claims, and liabilities claimed or asserted by any other party in connection with transactions contemplated by the applicable investment or loan documents, as applicable; and (vi) indemnities or other claims related to certain real estate leases, under which the Company may be required to indemnify property owners for environmental and other liabilities or may face other claims arising from the Company’s use of the applicable premises. The duration of these indemnities, commitments and guarantees varies and, in certain cases, may be indefinite. The majority of these indemnities, commitments and guarantees do not provide for any limitation of the maximum potential for future payments the Company could be obligated to make. Historically, the Company has not been obligated to make significant payments as a result of these obligations, and no liabilities have been recorded for these indemnities, commitments and guarantees in the accompanying condensed consolidated balance sheets.

## **Note 8—Stockholders' Equity**

### ***Serial Preferred Stock***

The Company's authorized capital stock includes 10,000,000 shares of serial preferred stock, with a par value of \$0.001 per share. No shares of preferred stock were outstanding at September 28, 2019 or December 29, 2018.

On April 17, 2017, the Company entered into a rights agreement (the "Rights Agreement") with Computershare Trust Company, N.A., as rights agent. In connection with the adoption of the Rights Agreement and pursuant to its terms, the Company's board of directors authorized and declared a dividend of one right (each, a "Right") for each outstanding share of the Company's common stock to stockholders of record at the close of business on May 18, 2017 (the "Record Date"), and authorized the issuance of one Right for each share of the Company's common stock issued by the Company (except as otherwise provided in the Rights Agreement) between the Record Date and the Distribution Date (as defined below).

Each Right entitles the registered holder, subject to the terms of the Rights Agreement, to purchase from the Company, when exercisable and subject to adjustment, one unit consisting of one one-thousandth of a share (a "Unit") of Series A Preferred Stock of the Company (the "Preferred Stock"), at a purchase price of \$6.56 per Unit, subject to adjustment. Subject to the provisions of the Rights Agreement, including certain exceptions specified therein, a distribution date for the Rights (the "Distribution Date") will occur upon the earlier of (i) 10 business days following a public announcement that a person or group of affiliated or associated persons (an "Acquiring Person") has acquired or otherwise obtained beneficial ownership of 15% or more of the then-outstanding shares of the Company's common stock, and (ii) 10 business days (or such later date as may be determined by the Company's board of directors) following the commencement of a tender offer or exchange offer that would result in a person or group becoming an Acquiring Person. The Rights are not exercisable until the Distribution Date and, unless earlier redeemed or exchanged by the Company pursuant to the terms of the Rights Agreement, will expire on the earlier of (i) the close of business on April 17, 2018, the first anniversary of the adoption of the Rights Agreement, and (ii) the date of any settlement, adjudication, dismissal with prejudice, abandonment by the Company or other conclusive and final resolution of the Company's legal proceedings against SK hynix (see Note 7).

In connection with the adoption of the Rights Agreement, the Company's board of directors approved a Certificate of Designation of the Series A Preferred Stock (the "Certificate of Designation") designating 1,000,000 shares of its serial preferred stock as Series A Preferred Stock and setting forth the rights, preferences and limitations of the Preferred Stock. The Company filed the Certificate of Designation with the Secretary of State of the State of Delaware on April 17, 2017.

On April 16, 2018, the Company entered into an amendment (the "Amendment") to the Rights Agreement, which amended the definition of "Expiration Date" in the Rights Agreement to incorporate all of the Company's legal proceedings against SK hynix, and amended the definition of "Final Expiration Date" in the Rights Agreement to mean the close of business on April 17, 2019. On April 17, 2019, the Company entered into a second amendment (the "Second Amendment") to the Rights Agreement, which further amended the definition of "Expiration Date" in the Rights Agreement to extend the final expiration for an additional two years to April 17, 2021. As a result, the Rights will expire and become unexercisable on or before the close of business on April 17, 2021.

### ***Common Stock Purchase Agreement***

On June 24, 2019, the Company entered into the Purchase Agreement with Lincoln Park, pursuant to which the Company has the right to sell to Lincoln Park up to an aggregate of \$10 million in shares of its common stock subject to the conditions and limitations set forth in the Purchase Agreement. As consideration for entering into the Purchase Agreement, the Company issued to Lincoln Park 818,420 shares of its common stock as initial commitment shares in a noncash transaction on June 24, 2019 and will issue up to 818,420 additional shares of its common stock as additional commitment shares on a pro rata basis in connection with any additional purchases. The Company will not receive any cash proceeds from the issuance of these additional commitment shares. During the three and nine months ended September 28, 2019, Lincoln Park purchased an aggregate of 8,189,364 shares of the Company's common stock for a net

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purchase price of \$2.5 million. In connection with the purchases, the Company issued to Lincoln Park an aggregate of 204,771 shares of its common stock as additional commitment shares in a noncash transaction.

Pursuant to the Purchase Agreement, on any business day and as often as every other business day over the 36-month term of the Purchase Agreement, the Company has the right, from time to time, at its sole discretion and subject to certain conditions, to direct Lincoln Park to purchase up to 400,000 shares of its common stock, with such amount increasing as the closing sale price of its common stock increases; provided Lincoln Park's obligation under any single such purchase will not exceed \$1.0 million, unless the Company and Lincoln Park mutually agree to increase the maximum amount of such single purchase (each, a "Regular Purchase"). If the Company directs Lincoln Park to purchase the maximum number of shares of common stock it then may sell in a Regular Purchase, then in addition to such Regular Purchase, and subject to certain conditions and limitations in the Purchase Agreement, the Company may direct Lincoln Park to purchase an additional amount of common stock that may not exceed the lesser of (i) 300% the number of shares purchased pursuant to the corresponding Regular Purchase or (ii) 30% of the total number of shares of its common stock traded during a specified period on the applicable purchase date as set forth in the Purchase Agreement ("Accelerated Purchase"). Under certain circumstances and in accordance with the Purchase Agreement, the Company may direct Lincoln Park to purchase shares in multiple Accelerated Purchases on the same trading day.

Subsequent to September 28, 2019, Lincoln Park purchased an aggregate of 9,655,398 shares of the Company's common stock for a net purchase price of \$3.5 million. In connection with the purchases, the Company issued to Lincoln Park an aggregate of 283,506 shares of its common stock as additional commitment shares in a noncash transaction.

The Company controls the timing and amount of any sales of its common stock to Lincoln Park. There is no upper limit on the price per share that Lincoln Park must pay for the Company's common stock under the Purchase Agreement, but in no event will shares be sold to Lincoln Park on a day the closing price is less than the floor price specified in the Purchase Agreement. In all instances, the Company may not sell shares of its common stock to Lincoln Park under the Purchase Agreement if that would result in Lincoln Park beneficially owning more than 9.99% of its common stock.

The Purchase Agreement does not limit the Company's ability to raise capital from other sources at the Company's sole discretion, except that, subject to certain exceptions, the Company may not enter into any Variable Rate Transaction (as defined in the Purchase Agreement, including the issuance of any floating conversion rate or variable priced equity-like securities) during the 36 months after the date of the Purchase Agreement. The Company has the right to terminate the Purchase Agreement at any time, at no cost to the Company.

### ***Warrants***

As of September 28, 2019, there were outstanding warrants to purchase an aggregate of 15,010,012 shares of the Company's common stock with a weighted-average exercise price of \$0.62. There were no activities during the nine months ended September 28, 2019.

### **Note 9—Stock-Based Awards**

Subject to certain adjustments, as of September 28, 2019, the Company was authorized to issue a maximum of 13,805,566 shares of its common stock pursuant to awards granted under its Amended and Restated 2006 Incentive Plan ("Amended 2006 Plan"). As of September 28, 2019, the Company had 1,160,322 shares of common stock available for issuance pursuant to future awards to be granted under the Amended 2006 Plan.

[Table of Contents](#)**Stock Options**

Stock options granted under the Amended 2006 Plan generally vest at a rate of at least 25% per year over four years and expire 10 years from the date of grant. The following table summarizes the Company's stock option activities during the nine months ended September 28, 2019:

	<b>Number of Shares (in thousands)</b>	<b>Weighted- Average Exercise Price</b>
Outstanding at December 29, 2018	8,186	\$ 1.18
Granted	595	0.35
Exercised	(62)	0.36
Expired or forfeited	(1,182)	1.02
Outstanding at September 28, 2019	<u>7,537</u>	1.15

**Restricted Stock Awards**

Restricted stock vests annually on each anniversary of the grant date over a two-year term. RSUs granted for employees and consultants generally vest semi-annually from the grant date over a four-year term, and RSUs granted for independent directors fully-vest on the grant-date. The activities of all restricted stock awards during the nine months ended September 28, 2019 are as follows:

	<b>Number of Shares (in thousands)</b>	<b>Weighted- Average Grant-Date Fair Value per Share</b>
Outstanding at December 29, 2018	525	\$ 0.25
Granted	3,727	0.55
Vested	(1,012)	0.47
Forfeited	(113)	0.54
Outstanding at September 28, 2019	<u>3,127</u>	0.52

**Stock-Based Compensation Expense**

The following table summarizes the stock-based compensation expense by line item in the condensed consolidated statements of operations (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 28, 2019</b>	<b>September 29, 2018</b>	<b>September 28, 2019</b>	<b>September 29, 2018</b>
Cost of sales	\$ 6	\$ 7	\$ 20	\$ 19
Research and development	67	46	163	182
Selling, general and administrative	170	104	599	370
Total	<u>\$ 243</u>	<u>\$ 157</u>	<u>\$ 782</u>	<u>\$ 571</u>

As of September 28, 2019, the Company had approximately \$1.8 million, net of estimated forfeitures, of unearned stock-based compensation, which it expects to recognize over a weighted-average period of approximately 3.0 years.

## **Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

*Unless the context indicates otherwise, all references to “Netlist,” the “Company,” “we,” “us,” or “our” in this discussion and analysis of our financial condition and results of operations (the “MD&A”) and elsewhere in this report refer to Netlist, Inc., together with its consolidated subsidiaries.*

*The following MD&A should be read together with our unaudited condensed consolidated financial statements and the related notes included in Part I, Item 1 of this report, as well as the MD&A included in our Annual Report on Form 10-K for our fiscal year ended December 29, 2018, including the audited consolidated financial statements and related notes included in such report (the “2018 Annual Report”), which was filed with the Securities and Exchange Commission (the “SEC”) on March 22, 2019. In preparing this MD&A, we presume that readers have access to and have read the MD&A included in the 2018 Annual Report, pursuant to Instruction 2 to paragraph (b) of Item 303 of Regulation S-K promulgated by the SEC.*

### **Forward-Looking Statements**

*This discussion and analysis includes “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements other than historical facts and often address future events or our future performance. Words such as “anticipate,” “estimate,” “expect,” “project,” “intend,” “may,” “will,” “might,” “plan,” “predict,” “believe,” “should,” “could” and similar words or expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. Forward-looking statements contained in this discussion and analysis include statements about, among other things: our beliefs regarding the market and demand for our products or the component products we resell; our ability to develop and launch new products that are attractive to the market and stimulate customer demand for these products; our plans relating to our intellectual property, including our goals of monetizing, licensing, expanding and defending our patent portfolio; our expectations and strategies regarding outstanding legal proceedings and patent reexaminations relating to our intellectual property portfolio, including our pending proceedings against SK hynix Inc., a South Korean memory semiconductor supplier (“SK hynix”); our expectations with respect to any strategic partnerships or other similar relationships we may pursue; our business strategies and objectives; and our expectations regarding our future operations and financial position, including revenues, costs and prospects, and our liquidity and capital resources, including cash flows, sufficiency of cash resources, efforts to reduce expenses and the potential for future financings. All forward-looking statements reflect management’s present assumptions, expectations and beliefs regarding future events and are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those expressed in or implied by any forward-looking statements. These risks and uncertainties include those described under “Risk Factors” in Part II, Item 1A of this report. In addition, we operate in a competitive and rapidly evolving industry in which new risks emerge from time to time, and it is not possible for us to predict all of the risks we may face, nor can we assess the impact of all factors on our business or the extent to which any factor or combination of factors could cause actual results to differ from our expectations. In light of these risks, uncertainties and other factors, our forward-looking statements should not be relied on as predictions of future events. All forward-looking statements reflect our assumptions, expectations and beliefs only as of the date they are made, and except as required by law, we undertake no obligation to revise or update any forward-looking statements for any reason.*

### **Overview**

We provide high-performance modular memory subsystems to customers in diverse industries that require enterprise and storage class memory solutions to empower critical business decisions. We have a history of introducing disruptive new products, such as one of the first load reduced dual in-line memory modules (“LRDIMM”) based on our distributed buffer architecture, which has been adopted by the industry for DDR4 LRDIMM. We were also one of the first to bring NAND flash memory (“NAND flash”) to the memory channel with our NVvault non-volatile dual in-line memory modules (“NVDIMM”) using software-intensive controllers and merging dynamic random access memory integrated circuits (“DRAM ICs” or “DRAM”) and NAND flash to solve data bottleneck and data retention challenges encountered in high-performance computing environments. We offer a new generation of storage class memory products called HybriDIMM to address the growing need for real-time analytics in Big Data applications, in-memory databases, high performance computing and advanced data storage solutions. We also resell NAND flash, DRAM products and

other component products to end-customers that are not reached in the distribution models of the component manufacturers, including storage customers, appliance customers, system builders and cloud and datacenter customers.

Due to the ground-breaking product development of our engineering teams, we have built a robust portfolio of over 100 issued and pending U.S. and foreign patents, many seminal, in the areas of hybrid memory, storage class memory, rank multiplication and load reduction. Since our inception, we have dedicated substantial resources to the development, protection and enforcement of technology innovations we believe are essential to our business. Our early pioneering work in these areas has been broadly adopted in industry-standard registered dual in-line memory modules (“RDIMM”), LRDIMM and in NVDIMM. Our objective is to continue to innovate in our field and invest further in our intellectual property portfolio, with the goal of monetizing our intellectual property through a combination of product sales and licensing, royalty or other revenue-producing arrangements, which may result from joint development or similar partnerships or defense of our patents through enforcement actions against parties we believe are infringing them.

For the three and nine months ended September 28, 2019, our net sales were \$6.1 million and \$16.7 million, respectively, our gross profits were \$0.5 million and \$1.1 million, respectively, and our net losses were \$3.1 million and \$10.7 million, respectively. We have historically financed our operations primarily with proceeds from issuances of equity and debt securities and cash receipts from revenues, including from product sales and a non-recurring engineering (“NRE”) fee from our November 2015 joint development and license agreement (“JDLA”) with Samsung Electronics Co., Ltd (“Samsung”). We have also funded our operations with a revolving line of credit and term loans under a bank credit facility, a funding arrangement for costs associated with certain of our legal proceedings against SK hynix and, to a lesser extent, equipment leasing arrangements. See “Liquidity and Capital Resources” below for more information.

## **Recent Developments**

### *Developments relating to SK hynix Proceedings*

We have taken action to protect and defend our innovations by filing legal proceedings for patent infringement against SK hynix and two of its subsidiaries in the U.S. International Trade Commission (“ITC”), U.S. district court and the courts of Germany. On January 31, 2019, the court in Germany found there was no infringement of the Utility Model asserted and dismissed the case. We do not intend to appeal this ruling. In our two separate ITC actions against SK hynix, we have requested exclusion orders that direct U.S. Customs and Border Protection to stop allegedly infringing SK hynix RDIMM and LRDIMM products from entering the United States. In our U.S. district court and international court proceedings, we are primarily seeking damages. All of our patents involved in these proceedings cover key features of RDIMM and LRDIMM products.

On January 16, 2018, the ITC issued a final determination regarding our first ITC action against SK hynix filed in September 2016, in which it concluded there was no infringement of the patents in this action and terminated the ITC’s investigation related to these proceedings. We are appealing this final determination to the Court of Appeals for the Federal Circuit and oral arguments for this appeal are scheduled for December 5, 2019 at the Court of Appeals for the Federal Circuit.

In our second ITC action against SK hynix, on April 12, 2018, the ITC granted SK hynix’s motion for summary determination of non-infringement and terminated the investigation in its entirety. On April 23, 2018, the Company filed a petition seeking ITC review of this decision. On May 29, 2018, the ITC Commission remanded the Second ITC Action back to the ALJ to resolve the parties’ claim construction disputes and continue the investigation. On June 14, 2018, the ITC extended the target date for the final determination to August 5, 2019, with a final initial determination due by April 5, 2019. Based on this extended target date, the ITC scheduled a hearing on the merits to begin on December 14, 2018 and conclude on December 21, 2018. On September 13, 2018, the ITC rescheduled the hearing on the merits to begin on January 14, 2019 and conclude on January 18, 2019. On January 29, 2019, due to the government shutdown, the ITC again rescheduled the hearing on the merits to begin on March 11, 2019 and conclude on March 15, 2019. On March 12, 2019 the ALJ postponed the trial due to reasons unrelated to the dispute between the parties. The trial recommenced on July 15, 2019 and ended on July 19, 2019. An initial determination regarding our second ITC action against SK hynix was issued on October 21, 2019. In the initial determination, the Chief Administrative Law Judge held there was a violation of Section 337 of the Tariff Act of 1930 as amended with respect to U.S. Patent No. 9,606,907 and there was

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no violation with respect to U.S. Patent No. 9,535,623. A final determination regarding our second ITC action against SK Hynix is expected to be issued on February 21, 2020.

### *Lincoln Park Purchase Agreement*

On June 24, 2019, we entered into a purchase agreement (the “Purchase Agreement”) with Lincoln Park Capital Fund, LLC (“Lincoln Park”), pursuant to which we have the right to sell to Lincoln Park up to an aggregate of \$10 million in shares of our common stock over the 36-month term of the Purchase Agreement subject to the conditions and limitations set forth in the Purchase Agreement. As consideration for entering into the Purchase Agreement, we issued to Lincoln Park 818,420 shares of our common stock as initial commitment shares in a noncash transaction on June 24, 2019 and will issue up to 818,420 additional shares of our common stock as additional commitment shares on a pro rata basis in connection with any additional purchases. We will not receive any cash proceeds from the issuance of these additional commitment shares. During the three months ended September 28, 2019, Lincoln Park purchased an aggregate of 8,189,364 shares of the Company’s common stock for a net purchase price of \$2.5 million. In connection with the purchases, the Company issued to Lincoln Park an aggregate of 204,771 shares of its common stock as additional commitment shares in a noncash transaction.

Subsequent to September 28, 2019, Lincoln Park purchased an aggregate of 9,655,398 shares of our common stock for a net purchase price of \$3.5 million. In connection with the purchases, we issued to Lincoln an aggregate of 283,506 shares of our common stock as commitment shares in a noncash transaction.

### *Conversion of Iliad Note*

During the three months ended September 28, 2019, Iliad Research and Trading, L.P. (“Iliad”) converted \$1.0 million of the outstanding principal and accrued interest on the unsecured convertible promissory note we issued to Iliad on August 27, 2018 (“Iliad Note”) to 3,247,000 shares of our common stock at the Redemption Conversion Price, as defined in a Securities Purchase Agreement dated August 27, 2018 (“Iliad Purchase Agreement”). Iliad did not convert any outstanding principal and accrued interest on the Iliad Note at the Lender Conversion Price, as defined the Iliad Purchase Agreement. In addition, subsequent to September 28, 2019, Iliad converted \$0.7 million of the outstanding principal and accrued interest on the Iliad Note to 2,905,873 shares of our common stock at the Redemption Conversion Price.

## **Factors Affecting Our Performance and Business Risks and Uncertainties**

Our performance, financial condition and prospects are affected by a number of factors and are exposed to a number of risks and uncertainties. See the discussion of certain major factors affecting our performance in the MD&A included in our 2018 Annual Report, and see the discussion of certain risks that we face under “Risk Factors” in Part II, Item 1A of this report.

## **Critical Accounting Policies and Use of Estimates**

The preparation of our condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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. We base our estimates and assumptions on our historical experience, knowledge of current conditions and our beliefs of what could occur in the future considering available information. We review our estimates and assumptions on an ongoing basis. Actual results may differ from our estimates, which may result in material adverse effects on our consolidated operating results and financial position.

Our critical accounting policies and estimates are discussed in Note 2 to the condensed consolidated financial statements included in this report and the MD&A included in our 2018 Annual Report. Effective December 30, 2018, we adopted the requirements of Financial Accounting Standards Board Accounting Standards Codification Topic 842



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(“ASC 842”), *Leases*, using the modified retrospective transition method as further described in Note 2, *Adoption of New Accounting Pronouncements* and Note 6, *Leases* to our condensed consolidated financial statements. Except for the adoption of ASC 842, there have been no other significant changes to our critical accounting policies as disclosed in our 2018 Annual Report.

**Results of Operations**

The following table presents each line item of our condensed consolidated statement of operations as a percentage of net sales for the three and nine months ended September 28, 2019 and September 29, 2018:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 28, 2019</b>	<b>September 29, 2018</b>	<b>September 28, 2019</b>	<b>September 29, 2018</b>
Net sales	100 %	100 %	100 %	100 %
Cost of sales	93	92	93	94
Gross profit	7	8	7	6
Operating expenses:				
Research and development	10	7	10	9
Intellectual property legal fees	16	38	21	26
Selling, general and administrative	29	24	34	20
Total operating expenses	54	70	66	56
Operating loss	(47)	(62)	(59)	(50)
Other expense, net:				
Interest expense, net	(4)	(3)	(5)	(2)
Other expense, net	—	—	—	—
Total other expense, net	(4)	(3)	(5)	(2)
Loss before provision for income taxes	(51)	(64)	(64)	(52)
Provision for income taxes	—	—	—	—
Net loss	(51)%	(64)%	(64)%	(52)%

**Net Sales, Cost of Sales and Gross Margin**

The following table presents net sales, cost of sales and gross margin for the three and nine months ended September 28, 2019 and September 29, 2018 (in thousands, except percentages):

	<b>Three Months Ended</b>			<b>Nine Months Ended</b>		
	<b>September 28, 2019</b>	<b>September 29, 2018</b>	<b>% Change</b>	<b>September 28, 2019</b>	<b>September 29, 2018</b>	<b>% Change</b>
Net sales	\$ 6,116	\$ 7,203	(15%)	\$ 16,733	\$ 24,508	(32%)
Cost of sales	5,666	6,617	(14%)	15,600	23,061	(32%)
Gross profit	\$ 450	\$ 586	(23%)	\$ 1,133	\$ 1,447	(22%)
Gross margin	7.4%	8.1%		6.8%	5.9%	

*Net Sales*

Net sales consist of resales of certain component products, including NAND flash and DRAM products, and sales of our high-performance memory subsystems, net of a provision for estimated returns under our right of return policies, which generally range up to 30 days. Product sales are made primarily pursuant to stand-alone purchase orders, which generally have no cancellation or rescheduling penalty provisions. Our customers typically provide us with non-binding forecasts of future product demand over specific periods of time, but they generally place orders with us no more than two weeks in advance of the desired delivery date. Selling prices are typically negotiated monthly, based on competitive market conditions and the then-current price of relevant component products, including DRAM ICs and



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NAND flash. We often ship products to our customers' international manufacturing sites, but all of our sales to date have been denominated in U.S. dollars.

The component products we resell include products we purchase for the purpose of resale, as well as excess component inventory we purchase for, but do not use in, our memory subsystems. In addition, we resell excess component inventory to distributors and other users of memory integrated circuits, but these sales have historically been, and we expect will continue to be, a relatively small percentage of our net product sales. We also sell our memory subsystem products, primarily to original equipment manufacturers ("OEMs"). Sales of our memory subsystem products have declined in recent periods, and we expect these declines could continue unless and until our next-generation products gain significantly greater customer and market acceptance.

For the three months ended September 28, 2019, our net sales decreased by \$1.1 million as compared to the three months ended September 29, 2018 primarily as a result of a \$0.9 million overall decrease in sales of other small outline dual in-line memory module ("SODIMM") and RDIMM products (a \$1.7 million decrease in sales of our Specialty SODIMM and RDIMM products, partially offset by a \$0.7 million increase in the resales of SODIMM and RDIMM products).

For the nine months ended September 28, 2019, our net sales decreased by \$7.8 million as compared to the nine months ended September 29, 2018 primarily as a result of a \$6.0 million overall decrease in sales of SODIMM and RDIMM products (a \$3.1 million decrease in the resales of SODIMM and RDIMM products and a \$2.9 million decrease in sales of our Specialty SODIMM and RDIMM products) and a \$1.3 million decrease in sales of NAND flash.

Our product sales in all periods presented were impacted by fluctuating customer concentrations. During the three months ended September 28, 2019 and September 29, 2018, there were two and four customers that accounted for more than 10% of our net sales, with an aggregate of 23% and 49% of our net sales, respectively. During the nine months ended September 28, 2019 and September 28, 2018, one customer accounted for more than 10% of our net sales, with an aggregate of 11% and 19% of our net sales, respectively.

### *Cost of Sales and Gross Margin*

Our cost of sales includes the cost of materials (including component products), labor and other manufacturing costs, depreciation and amortization of equipment expenses, inventory valuation provisions, stock-based compensation expenses, occupancy costs and other allocated fixed costs.

For resales of component products, including NAND flash and DRAM products, cost of sales includes the cost of the products we purchase for resale. We purchase these products from Samsung under the terms of the JDLA and from other suppliers on the terms we negotiate with these suppliers. For sales of our memory subsystem products, cost of sales also includes the DRAM ICs and NAND flash we purchase and incorporate into these products. As a result, the DRAM ICs and NAND flash we purchase for resale or for use in our products constitute a significant portion of our cost of sales in any period. Our cost of sales fluctuates between periods based on the cost to us to purchase DRAM ICs and NAND flash. We attempt to pass through these DRAM IC and NAND flash cost fluctuations to our customers, but any inability to do so negatively impacts our gross margin.

For the three and nine months ended September 28, 2019 as compared to the three and nine months ended September 29, 2018, our cost of sales decreased primarily as a result of decreased net sales. Our gross margin fluctuates based on the change in our product mix over periods and the cost of the factory. For the three months ended September 28, 2019, our gross margin decreased to 7.4% from 8.1% as compared to the three months ended September 29, 2018 due to the lower sales and gross margin of our Specialty SODIMM and RDIMM products, partially offset by the higher gross margin for the resale of SODIMM, RDIMM and NAND flash products. For the nine months ended September 28, 2019, our gross margin increased to 6.8% from 5.9% as compared to the nine months ended September 29, 2018 due to the higher gross margin for our Specialty SODIMM and RDIMM products and resales of SODIMM, RDIMM and NAND products.

**Operating Expenses**

Operating expenses for the three and nine months ended September 28, 2019 and September 29, 2018 were as follows (in thousands, except percentages):

	Three Months Ended			Nine Months Ended		
	September 28, 2019	September 29, 2018	% Change	September 28, 2019	September 29, 2018	% Change
Research and development	\$ 583	\$ 535	9%	\$ 1,738	\$ 2,326	(25%)
Intellectual property legal fees	979	2,760	(65%)	3,567	6,359	(44%)
Selling, general and administrative	1,747	1,745	0%	5,724	5,021	14%
Total operating expenses	\$ 3,309	\$ 5,040		\$ 11,029	\$ 13,706	

*Research and Development*

Research and development (“R&D”) expenses consist primarily of employee and independent contractor compensation and related costs, stock-based compensation expenses, NRE fees that we pay to third parties, computer-aided design software license costs, reference design development costs, depreciation or rental of evaluation equipment expenses, and occupancy and other allocated overhead costs. Also included in research and development expenses are the costs of materials and overhead related to the production of engineering samples of new products under development or products used solely in the research and development process. Our customers typically do not separately compensate us for design and engineering work involved in developing application-specific products for them. All R&D costs are expensed as incurred.

R&D expenses slightly increased for the three months ended September 28, 2019 compared to the three months ended September 29, 2018, primarily as a result of an increase in employee headcount, overhead and travel expenses, partially offset by a decrease in professional service fees. R&D expenses decreased for the nine months ended September 28, 2019 compared to the nine months ended September 29, 2018 primarily as a result of a decrease in overall headcount, overhead and travel expenses.

*Intellectual Property Legal Fees*

Intellectual property legal fees consist of legal fees incurred for patent filings, protection and enforcement. Intellectual property legal fees are generally expensed as incurred. Although we expect intellectual property legal fees to generally increase over time as we continue to protect, defend and enforce and seek to expand our patent portfolio, these increases may not be linear but may occur in lump sums depending on the due dates of patent filings and their associated fees and the arrangements we may make with our legal advisors in connection with enforcement proceedings, which may include fee arrangements such as with TR Global Funding V, LLC, an affiliate of TRGP Capital Management, LLC (“TRGP”) (see Note 7 to the condensed consolidated financial statements included in Part I, Item 1 of this report) or contingent fee arrangements in which we would pay these legal advisors on a scaled percentage of any negotiated fees, settlements or judgments awarded to us based on if, how and when the fees, settlements or judgments are obtained.

We expect our intellectual property legal fees may show different trends for so long as the TRGP Agreement (as defined below) remains in effect. Pursuant to the terms of the TRGP Agreement, the legal expenses we incurred that were paid directly by TRGP were excluded in their entirety from our financial statements. In addition, any settlement or other cash proceeds we may recover in the future in connection with the SK hynix proceedings funded by TRGP would be reduced by the aggregate amount of legal expenses we exclude as a result of TRGP’s payment of these expenses, plus the premium amount due to TRGP under the terms of the TRGP Agreement at the time of any such recovery. Additionally, we expect our intellectual property legal fees would be significantly higher in the period in which a recovery from the SK hynix proceedings covered by the TRGP Agreement, if any, occurs.

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The decrease in intellectual property legal fees for the three and nine months ended September 28, 2019 as compared to the three and nine months ended September 29, 2018 resulted primarily from a decrease in legal expenses incurred to defend our patent portfolio internationally, including the costs incurred for our second ITC action.

*Selling, General and Administrative*

Selling, general and administrative (“SG&A”) expenses primarily consist of employee compensation and related costs, stock-based compensation expenses, independent sales representative commissions, professional service fees, promotional and other selling and marketing expenses, and occupancy and other allocated overhead costs. Selling expenses also includes the cost of materials and overhead related to products manufactured for customer qualifications, since working through the product approval and qualification process with OEMs and other potential customers of our memory subsystem products can comprise a significant portion of our selling effort for these products.

SG&A expenses for the nine months ended September 28, 2019 as compared to the nine months ended September 29, 2018 increased primarily as a result of an increase by \$0.9 million in sales and marketing headcount costs plus related overhead and travel expenses. SG&A expenses was consistent for the three months ended September 28, 2019 as compared to the nine months ended September 29, 2018.

*Other Expense, Net*

Other expense, net for the three and nine months ended September 28, 2019 and September 29, 2018 was as follows (in thousands, except percentages):

	Three Months Ended			Nine Months Ended		
	September 28, 2019	September 29, 2018	% Change	September 28, 2019	September 29, 2018	% Change
Interest expense, net	\$ (245)	\$ (183)	34%	\$ (775)	\$ (463)	67%
Other expense, net	(4)	(7)	(43%)	(5)	(12)	(58%)
Total other expense, net	\$ (249)	\$ (190)	31%	\$ (780)	\$ (475)	64%

Interest expense, net, consists primarily of interest expense on a revolving line of credit under the SVB Credit Agreement, the \$15 million senior secured convertible note issued to Samsung Venture Investment Co. (“SVIC”) (“SVIC Note”) in November 2015 and the Iliad Note issued in August 2018, along with the accretion of debt discounts and amortization of debt issuance costs on the SVIC Note and Iliad Note. The increase for the three and nine months ended September 28, 2019 compared to the three and nine months ended September 29, 2018 was primarily driven by the accretion of debt discounts and amortization of debt issuance costs related to the Iliad Note. Other expense, net, was not material during the periods.

**Liquidity and Capital Resources**

The following tables present selected financial information for the period presented (in thousands):

	September 28, 2019	December 29, 2018
Cash and cash equivalents	\$ 6,386	\$ 14,802
Convertible promissory notes and accrued interest, net	16,662	17,346
Working capital	1,910	10,079

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	Nine Months Ended	
	September 28, 2019	September 29, 2018
Net cash used in operating activities	\$ (9,232)	\$ (8,081)
Net cash used in investing activities	(70)	(72)
Net cash provided by financing activities	1,286	18,070

*Working Capital*

Our working capital decreased by \$8.2 million during the nine months ended September 28, 2019, primarily due to a \$8.4 million decrease in cash and cash equivalents, partially offset by a \$1.0 million decrease in accounts payable primarily related to legal fees to defend our intellectual property and classification of the Iliad Note of \$1.0 million to current from noncurrent.

*Cash Flows from Operating Activities*

For the nine months ended September 28, 2019, net cash used in operating activities primarily resulted from a net loss of \$10.7 million, adjusted for net non-cash charges of \$2.1 million, which primarily consisted of stock-based compensation, interest accrued on our convertible notes, depreciation and amortization, amortization of debt discounts and non-cash lease expense. These non-cash activities are offset by net cash outflows from changes in working capital balances of \$0.6 million driven predominantly by a \$1.0 million decrease in accounts payable due to lower purchases and legal fees and payments made toward outstanding legal fees and a \$0.5 million decrease in accrued expenses and other current liabilities primarily from the recognition of current portion of operating lease liabilities of \$0.5 million, partially offset by a decrease of \$0.5 million and \$0.4 million in inventories and accounts receivable, respectively.

For the nine months ended September 29, 2018, net cash used in operating activities primarily resulted from a net loss of \$12.7 million adjusted for net non-cash charges of \$1.3 million. These non-cash charges primarily consisted of stock-based compensation, interest accrued on our convertible notes, depreciation and amortization and amortization of debt discounts. These non-cash activities are offset by net cash inflows from changes in working capital balances of \$3.4 million driven predominantly from an increase in accounts payable due to an increase in legal fees.

*Cash Flows from Investing Activities*

Net cash used in investing activities for the nine months ended September 28, 2019 and September 29, 2018 was the result of our purchases of property and equipment during the periods.

*Cash Flows from Financing Activities*

For the nine months ended September 28, 2019, net cash provided by financing activities primarily consisted of \$2.5 million in proceeds from issuance of common stock to Lincoln Park, partially offset by \$0.8 million in net repayments under the SVB Credit Agreement and \$0.4 million in payments of outstanding debt.

For the nine months ended September 29, 2018, net cash provided by financing activities primarily consisted of \$9.2 million in net proceeds from the 2018 Offering, \$5.8 million in net proceeds from the ATM Program, \$2.1 million from the issuance of the Iliad Note, \$0.8 million from the issuance of common stock to a trust controlled by our President, Chief Executive Officer and Chairman of the Board, and \$0.6 million in net borrowings under the SVB Credit Agreement, partially offset by \$0.3 million in payments of outstanding debt.

**Capital Resources**

Sources of cash have historically consisted of proceeds from issuances of equity and debt securities and receipts from revenues, including from product sales and the NRE fee from our JDLA with Samsung. We have also funded our operations with a revolving line of credit under a bank credit facility, a funding arrangement for costs associated with certain of our legal proceedings against SK hynix and, to a lesser extent, equipment leasing arrangements. See "Recent

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Development” above within this Item 2. MD&A for the information about the Lincoln Park Purchase Agreement we entered into on June 24, 2019.

### *SVB Credit Agreement*

On October 31, 2009, we entered into an SVB Credit Agreement, which provides us with the borrowing of up to the lesser of 85% of eligible accounts receivable or \$5.0 million, subject to certain adjustments as set forth in the SVB Credit Agreement. The borrowings under the SVB Credit Agreement bear interest at the Wall Street Journal “prime rate” plus 2.75% per annum. Pursuant to the amendment dated March 21, 2019, the maturity date was extended to March 30, 2020.

As of September 28, 2019 and December 29, 2018, the outstanding borrowings under the SVB Credit Agreement were \$1.5 million and \$2.3 million, respectively, with the borrowing availability of \$0.1 million and \$0.2 million, respectively. During the nine months ended September 28, 2019 and September 29, 2018, net repayments and borrowings we made under the SVB Credit Agreement were \$0.8 million and \$0.6 million, respectively.

### *Sufficiency of Cash Balances and Potential Sources of Additional Capital*

We believe our existing balance of cash and cash equivalents together with cash receipts from revenues, borrowing availability under the SVB Credit Agreement, the equity financing available under the Lincoln Park Purchase Agreement and taking into account cash expected to be used in our operations, will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our capital requirements will depend on many factors, including, among others: the acceptance of, and demand for, our products; our levels of net product sales and any other revenues we may receive, including NRE, license, royalty or other fees; the extent and timing of any investments in developing, marketing and launching new or enhanced products or technologies; the costs of developing, improving and maintaining our internal design, testing and manufacturing processes; the costs associated with defending and enforcing our intellectual property rights; and the nature and timing of acquisitions and other strategic transactions in which we participate, if any.

Although we expect to rely in the near term on our existing cash and cash equivalents balance and our primary source of cash described above, our estimates of our operating revenues and expenses and working capital requirements could be incorrect, and we may use our cash resources faster than we anticipate. Further, some or all of our ongoing or planned investments may not be successful and could result in further losses. Until we can generate sufficient revenues to finance our cash requirements from our operations, which we may never do, we may need to increase our liquidity and capital resources by one or more measures, which may include, among others, reducing operating expenses, restructuring our balance sheet by negotiating with creditors and vendors, entering into strategic partnerships or alliances, raising additional financing through the issuance of debt, equity or convertible securities or pursuing alternative sources of capital, such as through asset or technology sales or licenses or other alternative financing arrangements. We may not be able to obtain capital when needed, on terms acceptable to us or at all.

Inadequate working capital would have a material adverse effect on our business and operations and could cause us to fail to execute our business plan, fail to take advantage of future opportunities or fail to respond to competitive pressures or customer requirements. A lack of sufficient funding may also require us to significantly modify our business model and/or reduce or cease our operations, which could include implementing cost-cutting measures or delaying, scaling back or eliminating some or all of our ongoing and planned investments in corporate infrastructure, research and development projects, business development initiatives and sales and marketing activities, among other activities. Modification of our business model and operations could result in an impairment of assets, the effects of which cannot be determined. Furthermore, if we continue to issue equity or convertible debt securities to raise additional funds, our existing stockholders may experience significant dilution, and the new equity or debt securities may have rights, preferences and privileges that are superior to those of our existing stockholders. If we incur additional debt, it may increase our leverage relative to our earnings or to our equity capitalization or have other material consequences. If we pursue asset or technology sales or licenses or other alternative financing arrangements to obtain additional capital, our operational capacity may be limited and any revenue streams or business plans that are dependent on the sold or licensed assets may be reduced or eliminated. Moreover, we may incur substantial costs in pursuing any future capital-raising

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transactions, including investment banking, legal and accounting fees, printing and distribution expenses and other similar costs, which would reduce the benefit of the capital received from the transaction.

***Off-Balance Sheet Arrangements***

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditure or capital resources that is material to investors.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Not applicable.

**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures*

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in reports we file or submit under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

Our management conducted an evaluation, with the participation of our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Exchange Act) as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of September 28, 2019.

*Changes in Internal Control over Financial Reporting*

During our fiscal quarter ended September 28, 2019, there were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Inherent Limitations on Controls**

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple errors. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and any design may not succeed in achieving its stated goals under all potential conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. This being said, we are not aware of any fraudulent activity.

In addition, projections of any evaluation of effectiveness to future periods are subject to risks that controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with the controls.

## **PART II. — OTHER INFORMATION**

### **Item 1. Legal Proceedings**

The information under “Litigation and Patent Reexaminations” in Note 7 to the condensed consolidated financial statements included in Part I, Item 1 of this report is incorporated herein by reference.

### **Item 1A. Risk Factors**

*Investing in our securities involves a high degree of risk. Before making any investment decision with respect to our securities, you should carefully consider each of the following risk factors and the other information in this report. Each of these risk factors, either alone or together, could adversely affect our business, operating results, financial condition, ability to access capital resources and future growth prospects, as well as the value of an investment in our securities. As a result, you could lose some or all of any investment you have made or may make in our securities. In assessing these risks, you should also review the other information contained in this report, including our consolidated financial statements and the related notes, and the other filings we make with the Securities and Exchange Commission (“SEC”). The risks described below are not the only ones we face. Additional risks of which we are not presently aware or that we currently believe are immaterial may also impair our business operations and financial position.*

#### **Risks Related to Our Common Stock**

***The price and trading volume of our common stock has and may continue to fluctuate significantly.***

Our common stock has been publicly traded since November 2006. The price and trading volume of our common stock are volatile and have in the past fluctuated significantly. This volatility could continue, in which case an active trading market in our common stock may not be sustained and stockholders may not be able to sell their shares at a desired time or a desired price.

The market price at which our common stock trades may be influenced by many factors, including, among others, the following:

- the results of legal proceedings in which we are involved;
- our operating and financial performance and prospects;
- investor perceptions of us and the industry in which we operate;
- our ability to meet investor and analyst expectations for our operating results;
- the availability and level of research coverage of and market-making in our common stock;
- changes in buy/sell recommendations by analysts;
- any financial projections we may provide to the public, any changes to these projections or our failure to meet these projections;
- our announcement of significant strategic transactions or relationships or the initiation of legal proceedings, including patent infringement actions;
- general political, economic and market conditions, including volatility or uncertainty in these conditions; and



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- the other risk factors described in this report.

In addition, shares of our common stock and the public stock markets in general have experienced, and may continue to experience, extreme price and trading volume volatility, at times irrespective of the state of the business of any particular company. These fluctuations may adversely affect the market price of our common stock. Further, following periods of volatility in the overall market and the market price of a particular company's securities, securities litigation can sometimes be instituted against the company. Securities litigation, like other types of litigation, is expensive and time-consuming, and if such litigation is instituted against us in the future, we may incur substantial costs, management's attention and resources may be diverted, and we could be subject to damages in the event of unfavorable results.

***There is a limited market for our common shares, and the trading price of our common shares is subject to volatility.***

Netlist common shares began trading on the OTCQX in October 2018, following the decision to move trading of our common stock from The Nasdaq Capital Market. Because our stock is no longer listed on a registered national securities exchange, we are subject to certain "blue sky" laws of the various states which impose restrictions on our ability to offer and sell our securities. These "blue sky" laws may make it more difficult for us to raise capital or to issue our common stock for equity compensation or other strategic purposes, which could adversely affect our ability to fund our operations or to attract and retain employees. In addition, our stock may be defined as a "penny stock" under Rule 3a51-1 under the Exchange Act. "Penny stocks" are subject to Rule 15g-9, which imposes additional sales practice requirements on broker-dealers that sell low-priced securities to persons other than established customers and institutional accredited investors. For transactions covered by this rule, a broker-dealer must make a special suitability determination for the purchaser and have received the purchaser's written consent to the transaction prior to sale. Consequently, the rule may affect the ability of broker-dealers to sell our common stock and affect the ability of holders to sell their shares of our common stock in the secondary market. To the extent our common stock is subject to the penny stock regulations, the market liquidity for the shares will be adversely affected.

***Future issuances of our common stock or rights to purchase our common stock, including pursuant to our equity incentive plans, could result in additional dilution to the percentage ownership of our stockholders and could cause the price of our common stock to decline.***

We have historically funded our operations in large part with proceeds from equity and convertible debt financings, and we expect to continue to do so in the future. In addition to capital-raising purposes, we may also issue securities from time to time at prices and on other terms as we determine for acquiring other businesses or assets in exchange for shares of our common stock or other securities, issuing securities to collaborators in connection with strategic partnerships, attracting and retaining employees with equity compensation, or other purposes. If we sell common stock or other equity or convertible debt securities in the future, our then-existing stockholders could be materially diluted by such issuances and new investors could gain rights, preferences and privileges senior to the holders of our common stock, which could cause the price of our common stock to decline.

***Sales of our common stock, or the perception that such sales could occur, could cause the market price of our stock to drop significantly, regardless of the state of our business.***

As of September 28, 2019, there were 154,097,443 shares of our common stock outstanding, 7,536,758 shares of our common stock subject to outstanding stock options, 2,864,429 shares of our common stock subject to outstanding unvested restricted stock units, 15,010,012 shares of our common stock subject to outstanding warrants, and 15,767,704 shares of our common stock subject to outstanding convertible notes. All outstanding shares of our common stock are eligible for sale in the public market under applicable federal securities laws, subject in certain cases to the requirements of Rule 144 under the Securities Act of 1933, as amended, and shares issued upon the exercise or conversion of outstanding stock options, warrants or convertible notes may also be eligible for sale in the public market, to the extent permitted by Rule 144 or other applicable securities laws and the provisions of the applicable stock option, warrant and convertible note agreements. If these shares are sold, or if it is perceived that they may be sold, in the public market, the trading price of our common stock could fall.



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***Our principal stockholders have significant voting power and may take actions that may not be in the best interest of our other stockholders.***

As of October 30, 2019, 6.3% of our outstanding common stock was held by our directors and officers, including 5.8% held by Chun K. Hong, our President, Chief Executive Officer and Chairman of our board of directors. As a result, Mr. Hong has the ability to exert substantial influence over all matters requiring approval by our stockholders, including the election and removal of directors, any proposed merger, consolidation or sale of all or substantially all of our assets and other significant corporate transactions. This concentration of control could be disadvantageous to other stockholders with interests different from those of Mr. Hong.

***Anti-takeover provisions under our charter documents and Delaware law, as well as our rights agreement, could delay or prevent a change of control and could also limit the market price of our common stock.***

Our certificate of incorporation and bylaws contain provisions that could delay or prevent a change of control of our Company or changes in our board of directors that our stockholders might consider favorable, including:

- our board of directors is authorized, without prior stockholder approval, to designate and issue preferred stock, commonly referred to as “blank check” preferred stock, which may have rights senior to those of our common stock;
- stockholder action by written consent is prohibited;
- nominations for election to our board of directors and the submission of matters to be acted upon by stockholders at a meeting are subject to advance notice requirements; and
- our board of directors is expressly authorized to make, alter or repeal our bylaws.

In addition, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which may prohibit certain business combinations with stockholders owning 15% or more of our outstanding voting stock. Further, in April 2017, we adopted a rights agreement that would, under certain specified circumstances and for so long as the rights issued under the rights agreement are outstanding, give the holders of our common stock the right to acquire additional shares of our capital stock, which would make it more difficult for a third party to acquire a significant percentage of our outstanding capital stock or attempt a hostile takeover of our Company.

These and other provisions in our certificate of incorporation and bylaws and of Delaware law, as well as the existence of our rights agreement, could make it more difficult for stockholders or potential acquirers to obtain control of our board of directors or initiate actions that are opposed by our board of directors, including a merger, tender offer, proxy contest or other change of control transaction involving our Company. Any delay or prevention of a change of control transaction or changes in our board of directors could prevent the consummation of a transaction in which our stockholders could receive a substantial premium over the then-current market price for our common stock. In addition, these anti-takeover provisions could reduce the price that investors are willing to pay for shares of our common stock.

***We do not currently intend to pay dividends on our common stock, and any return to investors is expected to result, if at all, only from potential increases in the price of our common stock.***

We intend to use all available funds to finance our operations. Accordingly, while all decisions about dividends are at the discretion of our board of directors, we have never declared or paid cash dividends on our capital stock in the past, and we have no intention of declaring or paying any such dividends in the foreseeable future. As a result, any return to investors is expected to result, if at all, only from potential increases in the price of our common stock.

## **Risks Related to Our Business**

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

Since the inception of our business in 2000, we have only experienced one fiscal year (2006) with profitable results. In order to regain profitability, or to achieve and sustain positive cash flows from operations, we must reduce operating expenses and/or increase our revenues and gross margins. Although we have in the past engaged in a series of cost reduction actions, such expense reductions alone will not make us profitable or allow us to sustain profitability if it is achieved, and eliminating or reducing strategic initiatives could limit our opportunities and prospects. Our ability to achieve profitability will depend on increased revenue growth from, among other things, increased demand for our memory subsystems and other product offerings and our ability to monetize our intellectual property. We may not be successful in any of these pursuits, and we may never achieve profitability or sustain profitability if achieved.

### ***Our results of operations fluctuate significantly and are difficult to predict.***

Our operating results have fluctuated significantly in the past, and we expect they will continue to fluctuate from period to period due to a variety of factors, many of which are beyond our control. Factors relating to our business that may contribute to these fluctuations include, among others, the amount and timing of sales of products, the prices we charge for products, changes in product mix, customer mix or other similar factors, the rate and timing of our billing and collections cycles and the timing and amount of our commitments and other payments, as well as the other risk factors described in this report. In addition, our results may be impacted by events that do not recur regularly, in the same amounts or at all in other periods, including events that may result in our incurrence of cash or non-cash charges or gains in certain periods.

These fluctuations in our operating results may render period-to-period comparisons less meaningful, and investors should not rely on the results of any one period as an indicator of future performance. Moreover, these fluctuations in our operating results could cause our performance in any particular period to fall below the expectations of investors or securities analysts or any guidance we have provided to the public, which could negatively affect the trading price of our common stock.

### ***We may not have sufficient working capital to fund our planned operations, and, as a result, we may need to raise additional capital in the future, which may not be available when needed, on acceptable terms or at all.***

To support our activities in the near term, we expect to rely on cash generated from our business operations and proceeds from issuances of debt and equity securities, and borrowing availability under our credit facility with Silicon Valley Bank (“SVB”). Taking into account our planned activities and sources of capital, we believe we have sufficient cash resources to satisfy our capital needs for at least the next 12 months. However, our estimates of our operating revenues and expenses and working capital requirements could be incorrect, and we may use our cash resources faster than we anticipate. Further, some or all of our ongoing or planned investments may not be successful and could further deplete our capital without immediate, or any, cash returns.

Our capital requirements will depend on many factors, including, among others:

- the costs associated with maintaining, defending and enforcing our intellectual property rights;
- the acceptance of, and demand for, our products and the component products we resell to customers;
- our success, and that of our strategic partners, in developing and selling products derived from our technology;
- the extent and timing of any investments in developing, marketing and launching new or enhanced products or technologies;

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- the costs of developing, improving and maintaining our internal design, testing and manufacturing processes;
- our results of operations, including our levels of net product revenues and any other revenues we may receive, including non-recurring engineering (“NRE”), license, royalty or other fees;
- the amount and timing of vendor payments and the collection of receivables, among other factors affecting our working capital;
- our receipt of cash proceeds from the exercise of outstanding stock options or warrants to acquire our common stock;
- the nature and timing of acquisitions or other strategic transactions or relationships in which we engage, if any; and
- the costs associated with the continued operation, and any future growth, of our business.

Until we can generate sufficient revenues to finance our cash requirements from our operations, which we may never do, we may need to increase our liquidity and capital resources by one or more measures, which may include, among others, reducing operating expenses, restructuring our balance sheet by negotiating with creditors and vendors, entering into strategic partnerships or alliances, raising additional financing through the issuance of debt, equity or convertible securities or pursuing alternative sources of capital, such as through asset or technology sales or licenses or other alternative financing arrangements. Further, even if our near-term liquidity expectations prove correct, we may still seek to raise capital through one or more of these financing alternatives. However, we may not be able to obtain capital when needed or desired, on terms acceptable to us or at all.

Inadequate working capital would have a material adverse effect on our business and operations and could cause us to fail to execute our business plan, fail to take advantage of future opportunities or fail to respond to competitive pressures or customer requirements. A lack of sufficient funding may also require us to significantly modify our business model and/or reduce or cease our operations, which could include implementing cost-cutting measures or delaying, scaling back or eliminating some or all of our ongoing and planned investments in corporate infrastructure, research and development projects, legal proceedings, business development initiatives and sales and marketing activities, among other activities. Modification of our business model and operations could result in an impairment of assets, the effects of which cannot be determined. Furthermore, if we continue to issue equity or convertible debt securities to raise additional funds, our existing stockholders may experience significant dilution, and the new equity or debt securities may have rights, preferences and privileges that are superior to those of our existing stockholders. Additionally, because our common stock is no longer listed on The Nasdaq Capital Market, the challenges and risks of equity financings may significantly increase, including potentially increasing the dilution of any such financing or decreasing our ability to effect such a financing at all. If we incur additional debt, it may increase our leverage relative to our earnings or to our equity capitalization or have other material consequences. If we pursue asset or technology sales or licenses or other alternative financing arrangements to obtain additional capital, our operational capacity may be limited and any revenue streams or business plans that are dependent on the sold or licensed assets may be reduced or eliminated. Moreover, we may incur substantial costs in pursuing any future capital-raising transactions, including investment banking, legal and accounting fees, printing and distribution expenses and other similar costs, which would reduce the benefit of the capital received from the transaction.

### ***We may be unsuccessful in monetizing our intellectual property portfolio.***

We dedicate substantial resources to developing technology innovations we believe are essential to our business. We intend to pursue monetization avenues for our intellectual property portfolio, potentially including licensing, royalty or other revenue-producing arrangements. However, we have not generated any such revenue stream from our intellectual property to date, and we may never be successful in achieving this objective.

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Although we may pursue agreements with third parties to commercially license certain of our products or technologies, we may never successfully enter into any such agreement. Further, the terms of any such agreements we may reach with third-party licensees are uncertain and may not provide sufficient royalty or other licensing revenues to us to justify our costs of developing and maintaining the licensed intellectual property or may otherwise include terms that are not favorable to us. Additionally, the pursuit of licensing arrangements would require by its nature that we relinquish certain of our rights to our technologies and intellectual property that we license to third parties, which could limit our ability to base our own products on such technologies or could reduce the economic value we receive from such technologies and intellectual property. Additionally, the establishment of arrangements to monetize our intellectual property may be more difficult or costly than expected, may require additional personnel and investments and may be a significant distraction for management.

Our ability to establish licensing, royalty or similar revenues, and maintain or increase any such revenues we are able to establish, depends on a variety of factors, including, among others, the novelty, utility, performance, quality, breadth, depth and overall perceived value of our intellectual property portfolio, all as compared to that of our competitors, as well as our sales and marketing capabilities. Even if we are able to secure these revenues, they may be negatively affected by factors that are entirely or partially outside our control, including reductions in our customers' sales prices, sales volumes and the general state of their business, as well as the terms of the license arrangements.

If we are not successful in monetizing our intellectual property portfolio, we may never recoup our investments of time, capital and other resources in the development, maintenance, defense and enforcement of this portfolio, which could materially harm our financial condition and prospects.

***We have incurred a material amount of indebtedness to fund our operations, the terms of which have required us to pledge substantially all of our assets as security. Our level of indebtedness and the terms of such indebtedness could adversely affect our operations and liquidity.***

We have incurred debt under our convertible note issued to Samsung Venture Investment Co. ("SVIC"), our credit facility with SVB, and our funding arrangement with TR Global Funding V, LLC, an affiliate of TRGP Capital Management ("TRGP"). In connection with these debt and other arrangements, we have granted security interests to SVIC, SVB and TRGP in our various assets, such that all of our tangible and intangible assets, including our complete patent portfolio, are subject to one or more outstanding liens held by one or more of these parties.

The SVIC and SVB debt instruments and the TRGP investment agreement contain customary representations, warranties and indemnification provisions, as well as affirmative and negative covenants that, among other things, restrict our ability to:

- incur additional indebtedness or guarantees;
- incur liens;
- make investments, loans and acquisitions;
- consolidate or merge;
- sell or exclusively license assets, including capital stock of subsidiaries;
- alter our business;
- change any provision of our organizational documents;
- engage in transactions with affiliates;

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- make certain decisions regarding certain of our outstanding legal proceedings without consulting with or obtaining consent from certain of these parties; and
- pay dividends or make distributions.

The SVIC and SVB debt instruments and the TRGP investment agreement also include events of default, including, among other things, payment defaults, any breach by us of representations, warranties or covenants, certain bankruptcy events and certain material adverse changes. If an event of default were to occur under any of these instruments or agreements and we were unable to obtain a waiver for the default, the counterparties could, among other remedies, accelerate our obligations under the debt instrument or other agreement and exercise their rights to foreclose on their security interests, which would cause substantial harm to our business and prospects.

Additionally, incurrence and maintenance of this or other debt could have material adverse consequences on our business and financial condition, such as:

- requiring us to dedicate a portion of our cash flows from operations and other capital resources to debt service, thereby reducing our ability to fund working capital, capital expenditures and other cash requirements;
- increasing our vulnerability to adverse economic and industry conditions;
- limiting our flexibility in planning for or reacting to changes and opportunities in our business and industry, which may place us at a competitive disadvantage; and
- limiting our ability to incur additional debt when needed, on acceptable terms or at all.

***We are and expect to continue to be involved in legal proceedings at the ITC to try to stop allegedly infringing SK hynix RDIMM and LRDIMM products from entering the United States, as well as legal proceedings in U.S. and international courts to seek damages for the alleged patent infringement. Our involvement in these proceedings, as well as steps we have taken to implement certain of our strategies in connection with these proceedings, subject us to a number of risks.***

We have taken action to protect and defend our innovations by filing legal proceedings for patent infringement against SK hynix, Inc., a South Korean memory semiconductor supplier (“SK hynix”) and two of its subsidiaries in the U.S. International Trade Commission (“ITC”), U.S. district court and the courts of Germany and the People’s Republic of China (the “PRC”). In our two separate ITC actions, we have requested exclusion orders that direct U.S. Customs and Border Protection to stop allegedly infringing SK hynix registered dual in-line memory modules (“RDIMM”) and load reduced dual in-line memory modules (“LRDIMM”) products from entering the United States. In our U.S. district court and international court proceedings, we are primarily seeking damages.

Our first ITC action was resolved in January 2018 with a final determination of no infringement of the patents asserted in this action. The Company is appealing this final determination to the Court of Appeals for the Federal Circuit. In our second ITC action, the ITC terminated the investigation in April 2018, but then restarted the investigation in May 2018 following a Remand order from the ITC Commission and it remains ongoing. Although our U.S. and international court proceedings remain ongoing, the loss of the first ITC action could negatively impact our prospects for positive results in these other proceedings. The decision to pursue an appeal in the first ITC action, or to continue pressing forward with the second ITC action, will require significant resources, including capital expenditures and management attention. Moreover, if we are not successful in the appeal of the first ITC action, or if we do not achieve a positive result in the second ITC action, then we will have invested significant time and funds in these ITC actions that will not be recovered with any cash returns.

On January 31, 2019, the Munich District Court (the “Court”) dismissed an action brought by us against SK hynix Inc. and Hewlett-Packard GmbH regarding the infringement of our German utility model. In its judgment the

Court followed a different claim construction than advocated by us whereby it did not find our utility model to be infringed.

Our remaining proceedings against SK hynix, as with any intellectual property litigation, are expensive and time-consuming, regardless of the merits of the claims, and could divert management's attention from our other activities. Even if we are successful at the ITC, we would then need to enforce the order, which could also be expensive, time-consuming and a diversion to management. In addition, lawsuits in the ITC and in courts are subject to inherent uncertainties due to the complexity of the technical issues involved and various other factors, and we may not be successful in any of our actions. For example, if we are countersued by SK hynix and lose the suit, we could be required to pay substantial damages or lose some of our intellectual property protections. Furthermore, we may not be able to reach a settlement with SK hynix to license our patent portfolio, and even if we are able to reach a settlement, the terms of the arrangement may not be as favorable as we anticipated. Any of the foregoing could cause us to incur significant costs, decrease the perceived value of our intellectual property and materially adversely affect our business, financial condition or results of operations.

We have taken steps intended to solidify our position and strategy in connection with our proceedings against SK hynix. In May 2017, we established a funding arrangement with TRGP, which generally provides that TRGP will directly fund the costs incurred by us or on our behalf in connection with certain of our SK hynix proceedings (including our first ITC action and our U.S. district court proceedings, but excluding our second ITC action and our proceedings in international courts), and in exchange for such funding, we have agreed to pay to TRGP the amount of its funding plus an escalating premium if and when we recover any proceeds from the funded proceedings, and we have granted to TRGP a first-priority lien on the claims underlying the funded proceedings and any proceeds received from the funded proceedings and a second-priority lien on our patents that are the subject of the funded proceedings. We established this funding arrangement in order to provide us with increased security that we will be able to vigorously pursue our claims against SK hynix through their final resolution, but the arrangement also involves certain risks, including, among others, our obligation to use a portion of any proceeds we may receive from these proceedings to repay the funded amounts at a premium, which premium would increase the longer the proceedings remain unresolved, and our obligation to consult with or obtain consent from TRGP in connection with certain decisions or other matters relating to the SK hynix proceedings. Further, our arrangement with TRGP only covers fees incurred in connection with certain of our outstanding proceedings against SK hynix, and we are responsible for funding costs related to our other outstanding proceedings and any future actions we may file. As a result, our ability to fund all of our proceedings against SK hynix may be limited to our own cash resources, in which case we may be forced to severely limit our pursuit of these claims and/or our other operations.

In addition, in April 2017, we adopted a rights agreement to implement a standard "poison pill." In general terms, for so long as the rights issued under the rights agreement are outstanding, the rights agreement prevents any person or group from acquiring a significant percentage of our outstanding capital stock or attempting a hostile takeover of our Company by significantly diluting the ownership percentage of such person or group. The rights agreement expires on the earlier of the complete resolution of all our proceedings against SK hynix and April 17, 2021. As a result, the rights agreement has a significant anti-takeover effect. Our board of directors approved the rights agreement as part of our strategy in connection with our proceedings against SK hynix, with the intent of disconnecting our market capitalization from the damages calculations and any settlement negotiations that may develop in connection with these proceedings. However, the rights agreement may not have the intended, or any, impact on these proceedings or any related settlement negotiations, but would have the anti-takeover effect of any standard "poison pill" and thus would involve the risks associated with these anti-takeover effects, which are described elsewhere in these risk factors.

***We are and expect to continue to be involved in other legal and administrative proceedings to enforce or protect our intellectual property rights and to defend against claims that we infringe the intellectual property rights of others.***

As is common in the semiconductor industry, we have experienced substantial litigation regarding patent and other intellectual property rights. We are currently involved in litigation and proceedings at the U.S. Patent and Trademark Office ("USPTO") and Patent Trial and Appeal Board ("PTAB") based on alleged third-party infringement

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of our patents, and lawsuits claiming we are infringing others' intellectual property rights also have been and may in the future be brought against us.

Our business strategy includes litigating claims against others, such as our competitors and customers, to enforce our intellectual property, contractual and commercial rights, including, in particular, our patent portfolio and our trade secrets, as well as to challenge the validity and scope of the proprietary rights of others. This or other similar proceedings could also subject us to counterclaims or countersuits against us, or the parties we sue could seek to invalidate our patents or other intellectual property rights through reexamination or similar processes at the USPTO or similar bodies. Further, any legal disputes with customers could cause them to cease buying or using our products or the component products we resell or delay their purchase of these products and could substantially damage our relationship with them.

Moreover, our ability to continue to pursue this strategy depends on our ability to obtain and protect patents, which is governed by an uncertain process. In addition to the patent issuance process established by law and the procedures of the USPTO, we must also comply with administrative procedures of the Joint Electron Device Engineering Council ("JEDEC") to protect our intellectual property within its industry standard-setting process. These procedures evolve over time, are subject to variability in their application and may be inconsistent with each other. Any failure to comply with the USPTO's or JEDEC's administrative procedures could jeopardize our ability to claim that our patents have been infringed.

Making use of new technologies and entering new markets increases the likelihood that others might allege that our products or the component products we resell infringe their intellectual property rights. The likelihood of this type of lawsuit may also be increased due to the limited pool of experienced technical personnel that we can draw on to meet our hiring needs. As a result, a number of our existing employees have worked for our existing or potential competitors at some point during their careers, and we anticipate a number of our future employees will have similar work histories. Moreover, lawsuits of this type may be brought, even if there is no merit to the claim, as a strategy to prevent us from hiring qualified candidates, drain our financial resources and divert management's attention away from our business.

Litigation is inherently uncertain. An adverse outcome in existing or any future litigation could force us to, among other things:

- relinquish patents or other protections of our technologies if they are invalidated, which would enable our competitors and others to freely use this technology;
- compete with products that rely on technologies and other intellectual property rights that we believe we have the right to protect from third-party use;
- accept terms of an arrangement to license our technologies to a third party that are not as favorable as we might expect;
- receive little or no returns for our time and capital investments in the litigation;
- cease manufacturing and/or selling products or using certain processes that are claimed to be infringing a third party's intellectual property;
- pay damages (which in some instances may be three times actual damages), including royalties on past or future sales, if we are found to infringe a third party's intellectual property;
- seek a license from a third-party intellectual property owner to use its technology in our products or the component products we resell, which may not be available on reasonable terms or at all; or
- redesign any products that are claimed to be infringing a third party's intellectual property, which may not be possible to do in a timely manner, without incurring significant costs or at all.



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Moreover, any litigation, regardless of its outcome, involves a significant dedication of resources, including time and capital, and diverts management's attention from our other activities. As a result, any current or future infringement claims or patent challenges by or against third parties, whether or not eventually decided in our favor or settled, could materially adversely affect our business, financial condition and results of operations. Additionally, the outcome of pending or future litigation and related patent reviews and reexaminations, as well as any delay in their resolution, could affect our ability to continue to sell our products, protect against competition in the current and expected markets for our products or license or otherwise monetize our intellectual property rights in the future.

***The vast majority of our revenues in recent periods have been generated from resales of component products, including primarily products sourced from Samsung, and any decline in these product resales could significantly harm our performance.***

The vast majority of our revenues in recent periods have been generated from resales of component products, including NAND flash and DRAM products. We resell these component products to end-customers that are not reached in the distribution models of the component manufacturers, including storage customers, appliance customers, system builders and cloud and datacenter customers.

These component product resales are subject to a number of risks. For example, demand for these products could decline at any time for a number of reasons, including, among others, changing customer requirements or preferences, product obsolescence, introduction of more advanced or otherwise superior competing products by our competitors, the ability of our customers to obtain these products or substitute products from alternate sources (including from the manufacturer directly), customers reducing their need for these products generally, or the other risk factors described in this report. We have no long-term agreements or other commitments with respect to sales of these or any of the other products we sell. As a result, any decrease in demand for these products from us would reduce our sale levels and could materially adversely impact our revenues.

We may experience supply shortages at any time and for a variety of reasons, including, among others, spikes in customer demand that cannot be satisfied, any problems that arise with Samsung's manufacturing operations or facilities that cause disruptions or delays, or any failure to comply with the terms of the JDLA regarding the supply of these products. If we choose, or if we are forced, to seek to supply the component products we resell from other suppliers, we may not be able to identify other suppliers that are available and able to produce the particular components with the specific product specifications and in the quantities our customers require, or we may not be able to make arrangements with any other suppliers in a timely manner to avoid delays in satisfying customer orders. Further, even if we are able to make arrangements with other suppliers for sufficient component products to replace any undersupply from Samsung, we may not be able to make these arrangements on financial and other terms comparable to those we have negotiated with Samsung under the JDLA. As a result, any inability to obtain sufficient component products from Samsung could increase our cost of sales for component product resales if we are forced to pay higher prices to obtain the products from other suppliers. Moreover, all of our supply arrangements for these component products, including the terms of the JDLA and any arrangements we may establish with other suppliers, are subject to the other supply and manufacturing risks discussed elsewhere in these risk factors.

Increased reliance on product resales also has a substantial impact on our results of operations. Because the cost of the component products we purchase for resale is added to our cost of sales for these products, our gross margin on resales of component products is significantly lower than our gross margin on sales of our own memory subsystem products. As a result, increased resales of component products as a percentage of our total product revenues have a significant negative impact on our gross margin and gross profit. This gross margin and gross profit differential between memory product sales and component product resales would be amplified if our costs to purchase component products were to increase.

The occurrence of any one or more of these risks could cause our performance to materially suffer.



***We are subject to risks relating to our focus on developing our HybriDIMM and NVvault products for our target customer markets.***

We have historically derived revenues from sales of our high-performance modular memory subsystems to original equipment manufacturers (“OEMs”) in the server, high-performance computing and communications markets. Although we expect these memory subsystems to continue to account for a portion of our revenues, we have experienced declines in sales of these products in recent periods, and these declines could continue or intensify in the future. We believe market acceptance of these products or derivative products that incorporate our core memory subsystem technology is critical to our success, and any continued decline in sales of these products could have a material adverse impact on our performance and long-term prospects.

We have invested significant research and development time and capital in the design of ASIC and hybrid devices, including our NVvault family of products and our next-generation HybriDIMM memory subsystem. These products are subject to significant risks, including:

- we are dependent on a limited number of suppliers for the DRAM ICs, NAND flash and ASIC devices that are essential to the functionality of these products, and in the past, we have experienced supply chain disruptions and shortages of DRAM and NAND flash required to create these products as a result of issues that are specific to our suppliers or the industry as a whole;
- HybriDIMM and some of our other next-generation products may require additional time including the services and attention of key employees who have competing demands on their available time and may require capital investment to bring the products to market;
- our development and commercialization strategies for these products;
- we are required to demonstrate the quality and reliability of our products to and qualify them with our customers before purchases are made, which requires investments of time and resources in significant and unpredictable amounts prior to the receipt of any revenues from these customers; and
- our NVvault products or other new products, such as HybriDIMM, may contain currently undiscovered flaws, the correction of which could result in increased costs and time to market.

These and other risks associated with our memory subsystem products could impair our ability to obtain customer or market acceptance of these products or obtain such acceptance in a timely manner, which would reduce our achievable revenues from these products and limit our ability to recoup our investments in developing these technologies.

Additionally, if the demand for servers deteriorates, if the demand for our products to be incorporated in servers continues to decline, or if demand for our products deteriorates because customers in our other target markets change their requirements or preferences or otherwise reduce their need for these types of products generally, our operating results would be adversely affected, and we would be forced to diversify our product portfolio and our target customer markets in order to try to replace revenues lost from the further decreases in product sales. We may not be able to achieve this diversification, and any inability to do so may adversely affect our business, operating performance and prospects.

***Sales to a small number of customers have historically represented a significant portion of our net product revenues, and the loss of, or a significant reduction in sales to, any one of these customers could materially harm our business.***

Our target markets are characterized by a limited number of large companies, and consolidation in one or more of these markets may further increase this concentration. As a result, sales to small numbers of customers have historically represented a substantial portion of our net product revenues, and we expect this concentration to continue. Additionally, the composition of major customers and their respective contributions to our net product revenues have

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fluctuated and will likely continue to fluctuate from period to period as our existing and prospective customers progress through the life cycle of the products they produce and sell and experience resulting fluctuations in their product demand. We believe our performance depends in significant part on our ability to establish and maintain relationships with and effect substantial sales to our large customers.

We do not have long-term agreements with any of our customers and, as result, any or all of them could decide at any time to decrease, delay or discontinue their purchase of our products or the component products we resell. In addition, the prices customers pay for products are subject to fluctuations, and large or key customers may exert pressure on us to make concessions in the prices at which we sell products to them. Further, we may not be able to sell some of our products developed for one customer to a different customer because our products are often customized to address specific customer requirements, and even if we are able to sell these products to another customer, our margin on these products may be reduced. Additionally, although customers are generally allowed only limited rights of return after purchasing our products or the component products we resell, we may determine that it is in our best interest to accept returns from certain large or key customers even if we are not contractually obligated to accept them in order to maintain good relations with these customers. Any returns beyond our expectations could negatively impact our operating results. Moreover, because a few customers often account for a substantial portion of our net product revenues, the failure of any one of these customers to pay on a timely basis would negatively impact our cash flows. As a result, our net product revenues and operating results could be materially adversely affected by the loss of any of our customers, particularly our large or key customers, a decrease in product sales to any of our customers, including as a result of normal fluctuations in demand or other factors, reductions in the prices at which we sell products to any of our customers, including as a result of price concessions or general declines in average sale prices, or difficulties collecting payments from any of our customers.

Our ability to maintain or increase our product sales to our key customers depends on a variety of factors, many of which are beyond our control. These factors include our customers' continued sales of servers and other computing systems that incorporate our memory subsystems, our customers' continued incorporation of our products or the component products we resell into their systems, and our customers' sales activity and business results. Because of these and other factors, sales to these customers may not continue and the amount of such sales may not reach or exceed historical levels in any future period.

### ***We are subject to risks of disruption in the supply of component products.***

Our ability to fulfill customer orders for or produce qualification samples of our memory subsystem products, as well as orders for the component products we resell, is dependent on a sufficient supply of FPGAs, ASICs, DRAM ICs and NAND flash, which are essential components of our memory subsystems. We have no long-term supply contracts for any of these component products. Further, there are a relatively small number of suppliers of these components, and we typically purchase from only a subset of these suppliers. As a result, our inventory purchases have historically been concentrated in a small number of suppliers, including an affiliate of Samsung, from which we obtained a large portion of our component products purchased for resale and our total inventory purchases in 2017. We also use consumables and other components, including PCBs, to manufacture our memory subsystems, which we sometimes procure from single or limited sources to take advantage of volume pricing discounts.

From time to time, shortages in DRAM ICs and NAND flash have required some suppliers to limit the supply of these components. In the past, we have experienced supply chain disruptions and shortages of DRAM and NAND flash required to create certain of our memory subsystem products, and we have been forced to procure the component products we resell from other suppliers to the extent sufficient product is not available from Samsung to meet customer demand or in the event of other Samsung supply issues. We are continually working to secure adequate supplies of the components necessary to fill customers' orders in a timely manner. If we are unable to obtain a sufficient supply of DRAM ICs, NAND flash or other essential components to avoid interruptions or failures in the delivery of our products as required by our customers or the delivery of these components to customers to whom we resell them directly, these customers may reduce future orders for these products or not purchase these products from us at all, which could cause our net product revenues to decline and harm our operating results. In addition, our reputation could be harmed due to failures to meet our customers' demands and, even assuming we are successful in resolving supply chain disruptions, we may not be able to replace any lost business and we may lose market share to our competitors. Further, if our suppliers

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are unable to produce qualification samples of our products on a timely basis or at all, we could experience delays in the qualification process with existing or prospective customers, which could have a significant impact on our ability to sell our products. Moreover, if we are not able to obtain these components in the amounts needed on a timely basis and at commercially reasonable prices, we may not be able to develop or introduce new products, we may experience significant increases in our cost of sales if we are forced to procure components from alternative suppliers and are not able to negotiate favorable terms with these suppliers, or we may be forced to cease our sales of products dependent on the components or resales of the components we sell to customers directly.

Our dependence on a small number of suppliers and the lack of any guaranteed sources for the essential components of our products and the components we resell expose us to several risks, including the inability to obtain an adequate supply of these components, increases in their costs, delivery delays and poor quality. Additionally, our customers qualify certain of the components provided by our suppliers for use in their systems. If one of our suppliers experiences quality control or other problems, it may be disqualified by one or more of our customers. This would disrupt our supplies of these components, and would also reduce the number of suppliers available to us and may require that we qualify a new supplier, which we may not be able to do.

Declines in customer demand for our products in recent periods have caused us to reduce our purchases of DRAM ICs and NAND flash for use as components in our products. Such declines or other fluctuations could continue in the future. If we fail to maintain sufficient purchase levels with some suppliers, our ability to obtain supplies of these raw materials may be impaired due to the practice of some suppliers of allocating their products to customers with the highest regular demand.

Frequent technology changes and the introduction of next-generation versions of component products may also result in the obsolescence of our inventory on-hand, which could involve significant time and costs to replace, reduce our net product revenues and gross margin and adversely affect our operating performance and financial condition.

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

Our prospective customers generally test and evaluate our memory subsystems before purchasing our products and integrating them into their systems. This extensive qualification process involves rigorous reliability testing and evaluation of our products, which may continue for nine months or longer and is often subject to delays. In addition to qualification of specific products, some of our customers may also require us to undergo a technology qualification if our product designs incorporate innovative technologies that the customer has not previously encountered. Such technology qualifications often take substantially longer than product qualifications and can take over a year to complete. Even after our products are qualified with existing or new customers, the customer may take several months to begin purchasing the product or may decide not to purchase the product at all, as qualification does not ensure product sales. As a result, we could receive no or limited revenues from a customer even after our investment of time and resources in the qualification process with this customer, which could adversely affect our operating results.

Even after successful qualification and sales of our products to a customer, because the qualification process is both product-specific and platform-specific, our existing customers sometimes require us to re-qualify our products or to qualify our new products for use in new platforms or applications. For example, as our OEM customers transition from prior generation architectures to current generation architectures, we must design and qualify new products for use by these customers. Our net product revenues to these customers can decline significantly during this re-qualification process.

Likewise, changes in our products, our manufacturing facilities, our production processes or our component suppliers may require a new qualification process. For example, if our memory, NAND flash and DRAM component suppliers discontinue production of these components, it may be necessary for us to design and qualify new products for our customers. As a result, some customers may require us, or we may decide, to purchase an estimated quantity of discontinued memory components necessary to ensure a steady supply of existing products until products with new components can be qualified. Purchases of this nature may affect our liquidity. Additionally, our forecasts of quantities

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required during the transition may be incorrect, which could adversely impact our results of operations through lost revenue opportunities or charges related to excess and obsolete inventory.

We must devote substantial resources, including design, engineering, sales, marketing and management efforts, to qualify our products with prospective customers in anticipation of sales. Significant delays or other difficulties in the qualification process could result in an inability to keep pace with rapid technology change or new competitive products. If we experience delays or do not succeed in qualifying a product with an existing or prospective customer, we would not be able to sell that product to that customer, which may result in excess and obsolete inventory that we may not be able to sell to another customer and could reduce our net product revenues and customer base, any of which could materially harm our operating results and business.

***If we are unable to timely and cost-effectively develop new or enhanced products that achieve customer and market acceptance or technologies we can monetize, our revenues and prospects could be materially harmed.***

Our industry is characterized by rapid technological change, evolving industry standards and rapid product obsolescence. As a result, continuous development of new technology, processes and product innovations is necessary in order to be successful. We believe the continued and timely development of new products and technologies and improvement of existing products and technologies are critical to our business and prospects for growth.

In order to develop and introduce new or enhanced products and technologies, we need to:

- retain and continue to attract new engineers with expertise in memory subsystems and our key technology competencies;
- identify and adjust to the changing requirements and preferences of our existing and potential future customers and markets;
- identify and adapt to emerging technological trends and evolving industry standards in our markets;
- continue to develop and enhance our design tools, manufacturing processes and other technologies on which we rely to produce new products or product enhancements;
- design and introduce cost-effective, innovative and performance-enhancing features that differentiate our products and technologies from those of our competitors;
- secure licenses to enable us to use any technologies, processes or other rights essential to the manufacture or use of any new products or product enhancements we may develop, which licenses may not be available when needed, on acceptable terms or at all;
- maintain or develop new relationships with suppliers of components required for any new or enhanced products and technologies;
- qualify any new or enhanced products for use in our customers' products; and
- develop and maintain effective commercialization and marketing strategies.

We may not be successful at any of these activities. As a result, we may not be able to successfully develop new or enhanced products or technology or we may experience delays in this process. Failures or delays in product development and introduction could result in the loss of, or delays in generating, net products sales or other revenues and the loss of key customer relationships. Even if we develop new or enhanced products or technologies, they may not meet our customers' requirements, gain market acceptance or attract monetization opportunities, as our product and technology development efforts are inherently risky due to the challenges of foreseeing changes or developments in technology, predicting changes in customer requirements or preferences or anticipating the adoption of new industry

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standards. Moreover, we have invested significant resources in our product and technology development efforts, which would be lost if we fail to generate revenues from these efforts. If any of these risks occur, our revenues, prospects and reputation could be materially adversely affected.

### ***We face intense competition in our industry, and we may not be able to compete successfully in our target markets.***

Our products are primarily targeted to OEMs in the server, high-performance computing and communications markets. In addition, we resell certain component products to storage customers, appliance customers, system builders and cloud and datacenter customers. These markets are intensely competitive, as numerous companies vie for business opportunities at a limited number of large OEMs and other customers. We face competition from DRAM suppliers, memory module providers and logic suppliers for many of our products, including EXPRESSvault, NVvault and HybridDIMM. We also face competition from the manufacturers and distributors of the component products we resell to customers, as these manufacturers and distributors could decide at any time to sell these component products to these customers directly. Additionally, if and to the extent we enter new markets or pursue licensing arrangements to monetize our technologies and intellectual property portfolio, we may face competition from a large number of competitors that produce solutions utilizing similar or competing technologies.

Some of our customers and suppliers may have proprietary products or technologies that are competitive with our products or the components we resell to them, or could develop internal solutions or enter into strategic relationships with, or acquire, other high-density memory module or component providers. Any of these actions could reduce our customers' demand for our products or the component products we resell. Additionally, some of our significant suppliers could choose to sell component products to customers directly, which would adversely affect our ability to resell these products, or may choose to manufacture competitive memory subsystem products themselves or reduce our supply of essential components of our products, which could adversely affect our ability to manufacture and sell our memory subsystems.

We believe our ability to compete in our current target markets and potential future markets will depend in part on our ability to successfully and timely develop, introduce and sell at attractive prices new and enhanced products or technologies and otherwise respond to changing market requirements, which we may not be able to do faster and better than our competitors. Moreover, many of our competitors have substantially greater financial, technical, marketing, distribution and other resources, broader product lines, lower cost structures, greater brand recognition, more influence on industry standards, more extensive or established patent portfolios and longer standing relationships with customers and suppliers. We may not be able to compete effectively against any of these organizations. If we are unable to compete effectively, then our market position and prospects could deteriorate and our revenues could decline.

### ***If our proprietary rights are not protected, our customers or our competitors might gain access to our proprietary designs, processes and technologies, which could adversely affect our operating results.***

We rely on a combination of patent protection, trade secret laws and restrictions on disclosure to protect our intellectual property and other proprietary rights. We have submitted a number of patent applications regarding our proprietary processes and technology, many of which have resulted in issued patents. For our pending patent applications, it is uncertain when or if any of the claims in these applications will be allowed or result in issued patents, in which case the technologies or processes sought to be patented would remain unprotected from use by third parties. In addition, although we intend to continue filing patent applications with respect to new processes and technologies we develop, patent protection may not be available for some of these processes or technologies. Further, even if we are successful in obtaining patent protection, these protections could be limited in scope by the USPTO, a court or applicable foreign authorities or challenged by third parties by way of review or reexamination proceedings and subsequently invalidated, which would reduce the protections these patents are able to provide. Moreover, patent protection is limited as to duration and all of our issued patents will eventually expire, at which time the previously protected technologies would become widely available for use by third parties, including our competitors.

Despite our efforts to protect our intellectual property rights, these efforts may not:

- prevent challenges to or the invalidation or circumvention of our intellectual property rights;

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- keep our competitors or other third parties from independently developing similar products or technologies, duplicating, reverse engineering or otherwise using our products or technologies without our authorization or designing around any patents that may be issued to us;
- prevent disputes with third parties regarding ownership of our intellectual property rights;
- prevent disclosure of our trade secrets and know-how to third parties or into the public domain;
- result in valid patents, including international patents, from any of our pending or future applications; or
- otherwise adequately protect our intellectual property rights.

Moreover, monitoring for any unauthorized use of our technologies is costly, time-consuming and difficult. This is particularly true in foreign countries, such as the PRC, where we have established a manufacturing facility and where the laws may not protect our proprietary rights to the same extent as applicable U.S. laws.

If some or all of the claims in our patent applications are not allowed, if any of our issued patents or other intellectual property protections are limited, invalidated or circumvented by third parties, or if we are not able to obtain extensions of existing patents upon their expiration or issuance of new patents to maintain protections provided by expiring patents, we could face increased competition for our products and technologies and be unable to execute on our strategy of monetizing our intellectual property. Any of these outcomes could significantly harm our business, operating results and prospects.

***Our operating results may be adversely impacted by worldwide economic and political uncertainties and specific conditions in the markets we address and in which we or our strategic partners or competitors do business, including the cyclical nature of and volatility in the memory market and semiconductor industry.***

Changes in domestic and global economic and political conditions make it difficult for our customers, our vendors and us to accurately forecast and plan future business activities, and these conditions have caused and could continue to cause U.S. and foreign businesses to slow or decrease spending on our products and the products we resell.

In addition, sales of our products and the products we resell are dependent on demand by customers in our target markets. These markets are characterized by wide fluctuations in product supply and demand and have been cyclical in the past, which may result in substantial period-to-period fluctuations in our operating results. In addition, these markets have in the past experienced significant downturns, often connected with or in anticipation of maturing product cycles, reductions in technology spending and declines in general economic conditions. During these downturns, product demand diminishes, production capacity exceeds demand, inventory levels increase and average sale prices decline, all of which would materially adversely impact our business and operating results. In addition, because many of our costs and operating expenses are relatively fixed, if we are unable to control our expenses adequately in response to reduced product demand and sales, our gross margins and cash flows would be negatively impacted. Further, such a downturn could decrease the perceived value of our intellectual property portfolio and reduce our ability to pursue our intellectual property monetization objectives.

During challenging economic times, our customers may face challenges gaining timely access to sufficient credit, which could impair their ability to make timely payments to us. This may negatively affect our liquidity and cash flows and require us to increase our allowance for doubtful accounts. Furthermore, our vendors may face similar issues gaining access to credit, which may limit their ability to supply components or provide trade credit to us.

We cannot predict the timing, strength or duration of any economic slowdown or subsequent economic recovery, either generally or in our customer markets. If the economy or markets in which we operate experience such a slowdown, our business, financial condition and results of operations could be materially and adversely affected. The

combination of our lengthy sales cycle coupled with any challenging macroeconomic conditions could compound the negative impact of any such downturn on the results of our operations.

***Our lack of a significant backlog of unfilled orders and the difficulty inherent in estimating customer demand makes it difficult to forecast our short-term requirements, and any failure to optimally calibrate our production capacity and inventory levels to meet customer demand could adversely affect our revenues, gross margins and earnings.***

We make significant decisions regarding the levels of business we will seek and accept, production schedules, component procurement, personnel needs and other resource requirements based on our estimates of customer demand. We do not have long-term agreements with any of our customers. Instead, our product sales are made primarily pursuant to stand-alone purchase orders that we often receive no more than two weeks in advance of the desired delivery date and that may be rescheduled or cancelled on relatively short notice. The short-term nature of the commitments by many of our customers and our customers' ability to cancel or defer purchase orders for any reason reduces our backlog of firm orders and our ability to accurately estimate future customer requirements for our products or the component products we resell. These facts, combined with the short turnaround times that apply to most orders, makes it difficult to predict our production and inventory needs and allocate production capacity and capital for inventory purchases effectively. As a result, we attempt to forecast the demand for the components needed to manufacture our products and to resell to customers directly, but any such forecasts could turn out to be wrong. Further, lead times for components vary significantly and depend on various factors, such as the specific supplier and the demand and supply for a component at any given time.

Our production expense and component purchase levels are to a large extent fixed in the short term. As a result, we may be unable to adjust spending on a timely basis to compensate for any unexpected shortfall in customer orders. If we overestimate customer demand, we may have excess component or finished goods inventory, which may not be able to be used in other products or resold and may become obsolete before any such use or resale. If there is a subsequent decline in the prices of components, the value of our inventory would fall and we may be required to write-down the value of our component inventory, which may result in a significant increase in our cost of sales and decrease in our gross margin. In the past, we have had to write-down inventory due to obsolescence, excess quantities and declines in market value below our costs. As a result, any significant shortfall of customer orders in relation to our expectations could hurt our operating results, cash flows and financial condition.

Conversely, any rapid increases in demand by our customers could strain our resources. If we underestimate customer demand, we may not have sufficient inventory of necessary components on hand to meet that demand and we may need to try to procure additional quantities, which may not be available or may only be available at high prices or on otherwise unfavorable terms. We also may not have sufficient manufacturing capacity at any given time to meet any demands for rapid increases in production of our memory subsystem products. Any shortages of inventory or manufacturing capacity could lead to delays in the delivery of products, which may force us to forego sales opportunities, reduce our net product revenues and damage our customer relationships.

In addition, if our product demand forecasts are wrong, we may understate or overstate the provision required for excess and obsolete inventory. If our inventories are determined to be overvalued, we would be required to recognize additional expense in our cost of sales at the time of the determination. Conversely, if our inventories are determined to be undervalued, we may have over-reported our costs of sales in previous periods and would be required to recognize additional gross profit at the time the inventories are sold.

***Declines in our average sale prices, driven by volatile prices for components and other factors, may result in declines in our revenues and gross profit.***

Our industry has historically been characterized by declines in average sale prices. If sale price declines are not offset by corresponding decreases in costs or increases in sales volume or sales of products with higher margins, these sale price declines could have a material adverse effect on our operating results.

The prices customers pay for the products we sell can fluctuate due to many factors, including, among others, competitive conditions in our key customer markets, changes in customer requirements or preferences, volatility in the



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market prices for DRAM ICs, NAND flash and other component products, and changes in manufacturing efficiencies or capacities. Market prices for component products have historically constituted a substantial portion of the total cost of our memory subsystems and in recent periods have constituted the vast majority of the cost of resales of these products to customers directly. As a result, fluctuations in the prices for these component products, due to overcapacity in worldwide supply or increased manufacturing efficiencies, implementation of new manufacturing processes or expansion of manufacturing capacity by component suppliers, among other factors, significantly impact our costs to sell our products or component products.

Once our prices with a customer are negotiated, we are generally unable to revise pricing with that customer until our next regularly scheduled price adjustment. As a result, if market prices for essential components increase, we generally cannot pass the price increases through to our customers for products purchased under an existing purchase order. Consequently, we are exposed to the risks associated with the volatility of prices for these components and our cost of sales could increase and our gross margins could decrease in the event of sudden price increases. Alternatively, if there are declines in the prices of these components, we may be required to reduce our selling prices for subsequent purchase orders, which may result in a decline in our net product revenues.

### ***Our manufacturing operations involve significant risks.***

We maintain a manufacturing facility in the PRC at which we produce most of our products. These manufacturing activities require significant resources to maintain. For instance, we must continuously review and improve our manufacturing processes in order to maintain satisfactory manufacturing yields and product performance, try to lower our costs and otherwise remain competitive. As we manufacture new and more complex products, the risk of encountering delays, difficulties or higher costs increases. In addition, the start-up costs associated with implementing new manufacturing technologies, methods and processes, including the purchase of new equipment and any resulting manufacturing delays and inefficiencies, could negatively impact our results of operations.

Additionally, we could experience a prolonged disruption, material malfunction, interruption or other loss of operations at our manufacturing facility, or we may need to add manufacturing capacity to satisfy any increased demand for our products. Under these circumstances, we may be forced to rely on third parties for our manufacturing needs, which could increase our manufacturing costs, decrease our gross margin, decrease our control over manufacturing processes, limit our ability to satisfy customer requirements and demand and delay new product development until we could secure a relationship with a third-party manufacturer, which we may not be able to do in a timely manner, on acceptable terms or at all. If any of these risks occur, our operations, performance and customer relationships could be severely harmed.

We also may need to expand our existing manufacturing facility or establish a new facility in the future. Any need to expand or replace our manufacturing facility would be expensive and time-consuming and could also subject us to factory audits by our customers that could themselves result in delays, unexpected costs or customer losses if we cannot meet the standards of any such audits. Further, we may not be able to replace or increase our manufacturing capacity at all. The occurrence of any of these events could have a material adverse effect on our business, financial condition and results of operations.

### ***We depend on third parties to design and manufacture components for our products and the component products we resell, which exposes us to risks.***

Components that are used in our products, as well as all of the component products we resell, are designed and manufactured by third parties. In addition, some of our memory subsystem products rely on significantly customized components. The ability and willingness of third parties to enter into these engagements with us and perform in accordance with these engagements is largely outside our control. If one or more of our design or manufacturing partners experiences a manufacturing disruption, fails to dedicate adequate resources to the production of the components we use in our products or the components we resell, experiences financial instability or otherwise fails to perform its obligations to us in a timely manner or at satisfactory quality levels, our ability to bring products to market or deliver products to our customers, as well as our reputation, could suffer and our business and prospects could be materially harmed. In the event of any failure by our component manufacturers, we may have no readily available alternative source of supply for



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these components, since, in our experience, the lead time needed to establish a relationship with a new design or manufacturing partner is substantial, and the time for our OEM customers to re-qualify our products with components from a new vendor is also significant. Additionally, even if an alternative manufacturer is available, we may not be able to engage the manufacturer on acceptable terms, which could result in increased costs, timing requirements or other adverse changes. Further, we may not be able to redesign the customized components used in our products to be manufactured by a new manufacturer, in which case we could infringe on the intellectual property of our current design or manufacturing partner when we manufacture the products with a new design or manufacturing partner. Such an occurrence could force us to stop selling certain of our products or could expose us to lawsuits, license payments or other liabilities.

Our dependence on third-party manufacturers exposes us to many other risks, including, among others: reduced control over delivery schedules, quality, manufacturing yields and costs; the potential lack of adequate capacity during periods of excess demand; limited warranties on products supplied to us; and potential infringement or misappropriation of our intellectual property or the intellectual property of others. We are dependent on our manufacturing partners to manufacture components with acceptable quality and manufacturing yields, to deliver these components to us on a timely basis and at an acceptable cost and to allocate a portion of their manufacturing capacity sufficient to meet our needs. However, these component manufacturers may not be able to achieve these tasks. Additionally, our manufacturing partners may not continue to devote adequate resources to produce our products or the component products we resell, or continue to advance the process design technologies on which the customer qualifications of our products are based. Any of these risks could limit our ability to meet customer demand and materially adversely affect our business and operating results.

***If our products or the component products we resell do not meet quality standards or are defective or used in defective systems, we may be subject to quality holds, warranty claims, recalls or liability claims.***

Our customers require our products and the component products we resell to meet strict quality standards. If the products fail to meet these standards, our customers may discontinue purchases from us until we are able to resolve the quality issues that are causing these failures, which we may not be able to do. These “quality holds” can be costly and time-consuming to resolve. In addition, if the products we sell are defectively manufactured, contain defective components or are used in defective or malfunctioning systems, we could be subject to warranty and product liability claims, product recalls, safety alerts or advisory notices.

Although we generally attempt to contractually limit our exposure to incidental and consequential damages, if these contract provisions are not enforced or if liabilities arise that are not effectively limited, we could incur substantial costs in defending or settling product liability claims. While we currently have product liability insurance, it may not provide coverage under certain circumstances and it may not be adequate to satisfy claims made against us. We also may be unable to maintain insurance in the future at satisfactory rates or in adequate amounts.

Warranty and product liability claims, product “quality holds,” product recalls, safety alerts or advisory notices, regardless of their coverage by insurance or their ultimate outcome, could have a material adverse effect on our business, performance and financial condition, as well as our ability to attract and retain customers.

***If a standardized memory solution that addresses the demands of our customers is developed, our net product revenues and market share may decline.***

Many of our memory subsystems are specifically designed for our OEM customers’ high-performance systems. In a drive to reduce costs and assure supply of their memory module demand, our OEM customers may endeavor to design JEDEC standard DRAM modules into their new products. Although we also manufacture JEDEC modules, this trend could reduce the demand for our higher-priced customized memory solutions, which would have a negative impact on our operating results. In addition, the adoption of a JEDEC standard module instead of a previously custom module might allow new competitors to participate in a share of our customers’ memory module business that previously belonged to us.

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If our OEM customers were to adopt JEDEC standard modules, our future business may be limited to identifying the next generation of high-performance memory demands of OEM customers and developing solutions that address these demands. Until fully implemented, any next generation of products may constitute a significantly smaller market, which could reduce our revenues and harm our competitive position.

***We may become involved in non-patent related litigation and administrative proceedings that may materially adversely affect us.***

From time to time, we may become involved in various legal proceedings relating to matters incidental to the ordinary course of our business, including commercial, employment, class action, whistleblower and other litigation and claims, as well as governmental and other regulatory investigations and proceedings. Such matters can be time-consuming, divert management's attention and resources and cause us to incur significant expenses. Furthermore, because litigation is inherently unpredictable, the results of these actions could subject us to monetary damages or other liabilities and have a material adverse effect on our business, results of operations and financial condition.

***Our indemnification obligations for the infringement by our products of the rights of others could require us to pay substantial damages.***

As is common in our industry, we have a number of agreements in which we have agreed to defend, indemnify and hold harmless our customers and suppliers from damages and costs that may arise from the infringement by our products of third-party patents, trademarks or other proprietary rights. The scope of these indemnities varies, the duration of these indemnities is generally perpetual after execution of an agreement, and the maximum potential amount of future payments we could be required to make under these indemnities is often unlimited. Any indemnification claims by customers could require us to incur significant legal fees and could potentially result in our payment of substantial damages, and our insurance generally would not cover these fees or damages. As a result, the occurrence of any of these risks could have a material adverse effect on our business and results of operations.

***We depend on certain key employees, and our business could be harmed if we lose the services of any of these employees or are unable to attract and retain other qualified personnel.***

To date, we have been highly dependent on the experience, relationships and technical knowledge of certain key employees. We believe our future success will be dependent on our ability to retain the services of these key employees, develop their successors and properly manage the transition of their roles should departures occur. The loss of these key employees or their inability to continue to provide their services could delay the development and introduction of new or enhanced products or technologies, negatively impact our ability to sell our existing products, limit our ability to pursue our other business goals and strategies and otherwise harm our business. We do not have employment agreements with any of our employees other than Chun K. Hong, our President, Chief Executive Officer and Chairman of our board of directors, and as a result most of our employees may terminate their employment with us at any time. We maintain "Key Man" life insurance on Mr. Hong, but we do not carry "Key Man" life insurance on any of our other employees.

Our future success also depends on our ability to attract, retain and motivate highly skilled engineering, manufacturing and other technical and sales personnel. Competition for these personnel is intense. We may not be successful in attracting new engineers or other technical personnel or in retaining or motivating our existing personnel. If we are unable to hire and retain personnel with the skills necessary to keep pace with the evolving technologies in our markets, our ability to continue to provide our existing products and to develop new or enhanced products and technologies would be negatively impacted, which could harm our business. In addition, a general shortage of experienced engineers or other technical personnel could lead to increased recruiting, relocation and compensation costs to attract new recruits, which may increase our operating expenses or make these hires more difficult or impossible if increased recruiting costs exceed our resources.

A significant portion of our workforce consists of contract personnel. We invest considerable time and expense to train these contract personnel; however, they typically may terminate their relationships with us at any time. As a result, we may experience high turnover rates in this contract personnel workforce, which may require us to expend additional resources to attract, train and retain replacements. Additionally, if we convert any of these contract personnel

to permanent employees, we may have to pay finder's fees to the contract agency. These risks associated with our contract personnel workforce may involve increased costs or delays or failures in meeting customer requirements or developing new or enhanced products or technologies, any of which could materially adversely affect our business and operating performance.

***We rely on our internal and third-party sales representatives to market and sell our products and the component products we resell, and any failure by these representatives to perform as expected could reduce our sales.***

We primarily market and sell our products and the component products we resell through a direct sales force and a network of independent sales representatives. We have expended significant resources to build our internal sales and marketing function, but compared to many of our competitors, we have relatively little experience creating a sales and marketing platform and developing a team to implement it. We may be unsuccessful in these efforts.

Our sales representatives generally may terminate their relationships with us at any time. As a result, our performance depends in part on our ability to retain existing and attract additional sales representatives that will be able to effectively market and support our products or the component products we resell, especially in markets in which we have not previously distributed these products. Our efforts to attract, train and retain these sales representatives to be knowledgeable about our industry, products and technologies are costly and time-consuming. If these efforts fail, our investments in these sales representatives may not produce the expected or any benefits and our ability to market and sell our products or the component products we resell may be limited, which could materially harm our financial condition and operating results. Further, our reliance on independent sales representatives subjects us to risks, as we have very little control over their activities and they are generally free to market and sell other, potentially competing, products. As a result, these independent sales representatives could devote insufficient time or resources to marketing our products or the component products we resell, could market them in an ineffective manner or could otherwise be unsuccessful in selling adequate quantities of these products.

***We are exposed to additional business, regulatory, political, operational, financial and economic risks related to our international sales and operations.***

We sell products to foreign corporations and deliver products to facilities located in foreign countries. To facilitate this process and to meet the long-term projected demand for our products, we have established a manufacturing facility in the PRC that performs most of the manufacturing activities for our memory subsystem products.

Selling and manufacturing in foreign countries subjects us to additional risks not present with our domestic operations, as we are operating in business and regulatory environments in which we have limited experience and that may impose materially different requirements. Further, the geographic distance from our headquarters in Irvine, California, compounds the difficulties of maintaining a manufacturing operation in the PRC. For instance, we may not be able to maintain the desired amount of control over production capacity and timing, inventory levels, product quality, delivery schedules, manufacturing yields or costs. Moreover, we will need to continue to overcome language and cultural barriers to effectively conduct these international operations. Failures in any of these areas could result in legal consequences or production delays and increased turnaround times, which could adversely affect our business. In addition, changes to the labor or other laws of the PRC or the economic and political conditions in the PRC, including increased industrialization in recent years, could increase the costs of employing a local workforce or conducting our manufacturing operations in the PRC. Any of these factors could negatively impact any cost savings we experience from locating our manufacturing facility in the PRC. Additionally, our management has limited experience creating or overseeing foreign operations generally, and the ongoing administration and operation of our PRC facility may require substantial amounts of time and attention by our management team, particularly if we encounter operational, legal or cultural difficulties or disruptions at our PRC facility.

To date, all of our net product revenues have been denominated in U.S. dollars. In the future, however, some of our net product revenues may be denominated in Chinese Renminbi ("RMB"). The Chinese government controls the procedures by which RMB is converted into other currencies, which generally requires government consent. As a result, RMB may not be freely convertible into other currencies at all times. If the Chinese government institutes changes in currency conversion procedures or imposes additional restrictions on currency conversion, our operations and our

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operating results could be negatively impacted. In addition, Chinese law imposes restrictions on the movement of funds outside of the PRC. If we need or decide to repatriate funds from our Chinese operations, we would be required to comply with the procedures and regulations of applicable Chinese law, and any failure to so comply could adversely affect our liquidity and financial condition. Further, if we are able to repatriate funds from our Chinese operations, these funds would be subject to U.S. taxes. In addition, fluctuations in the exchange rate between RMB and U.S. dollars may adversely affect our expenses, the value of our assets and liabilities and the comparability of our period-to-period results.

Our international operations and sales are subject to a number of additional risks, including, among others, timing and availability of export licenses; difficulties in accounts receivable collections; difficulties managing distributors; lack of a significant local sales presence in a number of markets; difficulties obtaining government approvals; compliance with anti-bribery, data protection and other applicable U.S. and foreign laws, including the U.S. Foreign Corrupt Practices Act and similar anti-bribery laws in the non-U.S. jurisdictions in which we operate, as well as a wide variety of other complex foreign laws, regulations and treaties; and potentially adverse tax consequences. In addition, the United States or foreign countries may implement quotas, duties, tariffs, taxes or other charges or restrictions on the importation or exportation of our products or the component products we resell, which could lead to a reduction in sales and profitability in that country. This risk of increased trade barriers or charges has become more pronounced because the trade policies of the current U.S. presidential administration, including withdrawal from the Trans-Pacific Partnership, imposition of tariffs on Chinese goods and services and recent revisions to the North American Free Trade Agreement, could threaten or otherwise have a significant negative effect on our ability to continue to conduct our international operations in the same manner and at the same costs as we have in the past. The recent implementation of tariffs by the United States on goods manufactured in other countries, including PRC, could cause the costs of our products to increase, which could significantly impair the gross profit we receive and thereby harm our operating results significantly.

In addition, international turmoil and the threat of future terrorist attacks have contributed to an uncertain political and economic climate, both in the United States and globally, and have negatively impacted the worldwide economy. The economies of the PRC and other countries in which we make sales have been volatile in recent years, resulting in significant fluctuations in local currencies and other instabilities. These conditions could continue or worsen, which could adversely affect our foreign operations and our performance.

The occurrence of any of these risks related to our international operations, including our manufacturing facility in the PRC and our international sales, could have a material adverse effect on our business, financial condition and prospects for growth.

### ***Our operations could be disrupted by power outages, natural disasters or other factors.***

Due to the geographic concentration of our manufacturing operations in our PRC facility and our small number of component suppliers, including Samsung for many of the component products we resell, a disruption resulting from equipment or power failures, quality control issues, human errors, government intervention or natural disasters, including earthquakes and floods, could require significant costs to repair and could interrupt or interfere with product manufacture and sale and cause significant delays in product shipments, which could harm our customer relationships, financial condition and results of operations. In the past, our PRC facility has suffered water damage as a result of heavy rains and floods, which forced us to temporarily halt manufacturing at the facility while necessary repairs or equipment replacements were made. This incident caused us to incur additional expenses because we were forced to shift our manufacturing activities to a third-party facility in the PRC to mitigate the disruption in product shipments to our customers. If manufacturing at the PRC facility is disrupted for similar or other reasons in the future, we may again be subject to increased expenses in order to engage a third-party manufacturer, or, if we are not able to secure alternative manufacturing capabilities, our ability to sell products and our relationships with our customers could be materially harmed. Additionally, we may be forced to bear significant costs in order to repair any damage to our manufacturing equipment and facility. Any of these outcomes could have a material adverse effect on our business and results of operations.

***Difficulties with our global information technology systems, including any unauthorized access, could harm our business.***

We store key data about our business, including certain customer data, information about our and our customer's intellectual property and other proprietary information, on our global information technology systems. Any failure or malfunctioning of our global information technology systems, errors or misuse by system users, difficulties migrating stand-alone systems to our centralized systems or inadequacy of the systems in addressing the needs of our operations could disrupt our ability to timely and accurately manufacture and ship products, divert management's and key employees' attention from other business matters and involve significant costs and other resources to repair or otherwise resolve, any of which could have a material adverse effect on our business, financial condition and results of operations. Any such event could also disrupt our ability to timely and accurately process, report and evaluate key operating metrics and key components of our results of operations, financial position and cash flows and could adversely affect our ability to complete other important business processes, such as maintenance of our disclosure controls and procedures and internal control over financial reporting.

While our information technology systems include security measures designed to prevent unauthorized access, employee error, employee malfeasance or other causes, including intentional misconduct by computer hackers, could circumvent these measures and result in unauthorized access to these systems. Because the techniques used to gain unauthorized access to information technology systems evolve frequently and often are not recognized until successful, we may be unable to anticipate these techniques or implement adequate preventative measures in a timely manner. Any security breach could require significant resources to correct, if correction is possible, and could result in disruption to our business, misappropriation or loss of data, loss of confidence in us by our customers, damage to our reputation and legal liability. Further, any failure to implement appropriate security measures to protect our information or any breach or other failure of our systems that results in unauthorized access, manipulation, disclosure or loss of this information could result in our violation of any U.S. or foreign data protection laws that are applicable to us. These laws and their interpretation and application are constantly evolving, and they could be interpreted and applied in a manner that is inconsistent with our current practices or they could become more stringent over time. Efforts to comply with applicable data protection laws or any new interpretations of their application could involve significant time and substantial costs or require us to change our business practices and compliance procedures, and any failures to so comply could subject us to substantial civil or criminal fines or sanctions. Any of these outcomes could have a material negative impact on our business, performance and prospects.

***Our failure to comply with environmental and other applicable laws and regulations could subject us to significant fines and liabilities or cause us to incur significant costs.***

We are subject to various and frequently changing U.S. federal, state and local and foreign laws and regulations relating to the protection of the environment, including laws governing the discharge of pollutants into the air and water, the management and disposal of hazardous substances and wastes and the clean-up of contaminated sites. In particular, some of our manufacturing processes may require us to handle and dispose of hazardous materials from time to time. For example, in the past our manufacturing operations have used lead-based solder in the assembly of our products. Today, we use lead-free soldering technologies in our manufacturing processes, as this is required for products entering the European Union. We could incur substantial costs, including clean-up costs, civil or criminal fines or sanctions and third-party claims for property damage or personal injury, as a result of violations of or noncompliance with these and other environmental laws and regulations. Although we have not incurred significant costs to date to comply with these laws and regulations, new laws or changes to current laws and regulations to make them more stringent could require us to incur significant costs to remain in compliance.

We also may be subject to a variety of laws and regulations relating to other matters, including workplace health and safety, labor and employment, foreign business practices (including the U.S. Foreign Corrupt Practices Act and applicable foreign anti-bribery laws), data protection, public reporting and taxation, among others. It is difficult and costly to manage the requirements of every authority having jurisdiction over our various activities and to comply with their varying standards. Additionally, any changes to existing regulations or adoption of new regulations may result in significant additional expense to us or our customers. Further, our failure to comply with any applicable laws and regulations may result in a variety of administrative, civil and criminal enforcement measures, including monetary

penalties or imposition of sanctions or other corrective requirements, any of which could materially adversely affect our reputation and our business.

***Regulations related to “conflict minerals” may cause us to incur additional expenses and could limit the supply and increase the cost of certain metals used in manufacturing our products.***

The U.S. Congress has enacted laws, and the SEC has adopted rules, requiring disclosure of specified minerals, known as conflict minerals, that are necessary to the functionality or production of products manufactured or contracted to be manufactured by public companies. These laws and rules require companies to verify and disclose whether or not such minerals, as used in a company’s products or their manufacture, originate from the Democratic Republic of Congo or an adjoining country. Because our products contain certain conflict minerals and we or our manufacturers use these conflict minerals in the manufacture of our products, we are required to comply with these laws and disclosure rules. To comply, we are required to conduct a reasonable country of origin inquiry each year and, depending on the results of that inquiry, we may be required to exercise due diligence on the source and chain of custody of conflict minerals contained in or used to manufacture our products. Such due diligence must conform to a nationally or internationally recognized due diligence framework. We are also required to file a disclosure report with the SEC each year relating to our conflict mineral use.

The due diligence activities required to determine the source and chain of custody of minerals contained in our products or used in their manufacture are time-consuming and may result in significant costs. Due to the size and complexity of our supply chain, we face significant challenges verifying the origins of the minerals used in our products or their manufacture. Further, these rules could affect the availability in sufficient quantities and at competitive prices of certain minerals used in our products and their manufacture, which could result in increased material and component costs and additional costs associated with potential changes to our products, processes or sources of supply. Additionally, if we are unable to sufficiently verify the origin of the minerals used in our products through the due diligence measures we implement, we may not be able to satisfy customer preferences or requirements regarding the use of conflict minerals in the products they purchase, which could place us at a competitive disadvantage.

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

Section 404 of the Sarbanes-Oxley Act of 2002 and the related rules and regulations of the SEC, which we collectively refer to as Section 404, require us to evaluate our internal control over financial reporting and require management to report on the effectiveness of this internal control as of the end of each fiscal year. In addition, if and when we are no longer a “smaller reporting company” under applicable SEC rules, Section 404 will require us to obtain an attestation report from our independent registered public accounting firm as to our internal control over financial reporting.

Effective internal control is necessary for us to produce accurate and reliable financial reports and is important in our efforts to prevent financial fraud. In the course of our Section 404 evaluations, we or our independent registered public accounting firm may identify significant deficiencies or material weaknesses in our internal control over financial reporting. If we fail to maintain an effective system of internal control over financial reporting or if management or our independent registered public accounting firm discover significant deficiencies or material weaknesses, we may be unable to produce accurate and reliable financial reports or prevent fraud, which could result in a loss of customer or investor confidence in us or our public disclosures and negatively impact our stock price. Any of these outcomes could harm our financial condition and results of operations.

Further, our Section 404 evaluations may lead us to conclude that enhancements, modifications or changes to our internal control over financial reporting are necessary or desirable. Implementing any such changes would divert the attention of management, involve significant time and costs and negatively impact our financial reporting functions during the transition, any of which could have a material negative effect on our results of operations and financial condition.

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

Any future growth we may experience could strain our resources, management, information and telecommunication systems and operating and financial controls. To manage future growth effectively, including any expansion of volume in our manufacturing facility in the PRC, we must be able to improve and expand our systems and controls, which we may not be able to do in a timely or cost-effective manner. In addition, our management team has relatively limited experience managing a rapidly growing business. As a result, they may not be able to manage any future growth we may experience. A failure to manage any growth we may experience or improve or expand our existing systems and controls, or unexpected difficulties in doing so, could harm our business and results of operations.

***If we acquire businesses or technologies or pursue other strategic transactions or relationships in the future, these transactions could disrupt our business and harm our operating results and financial condition.***

From time to time, we evaluate opportunities to acquire businesses or technologies or pursue other strategic transactions or relationships, including collaboration or joint development arrangements, that might complement our current product offerings or enhance our intellectual property portfolio or technical capabilities. We have no experience acquiring other businesses or technologies.

Acquisitions and other strategic transactions or relationships entail a number of risks that could adversely affect our business and operating results, including, among others:

- difficulties integrating the operations, technologies or products of acquired companies or working with third parties with which we may partner on joint development or collaboration relationships;
- the diversion of management's time and attention from the daily operations of our business;
- insufficient increases in revenues to offset increased expenses associated with an acquisition or strategic transaction or relationship;
- difficulties retaining business relationships with our existing suppliers and customers or the suppliers and customers of an acquired company;
- overestimation of potential synergies or other benefits, or a delay in realizing these synergies or other benefits;
- entering markets in which we have no or limited experience and in which competitors have stronger market positions;
- the potential loss of key employees of our Company or an acquired company;
- exposure to contingent liabilities of an acquired company;
- depletion of cash resources to fund an acquisition or other strategic transaction or establish a strategic relationship, or dilution of existing stockholders or increased leverage relative to our earnings or to our equity capitalization if we issue debt or equity securities for these purposes;
- adverse tax consequences; and
- incurrence of material charges, such as depreciation, deferred compensation charges, in-process research and development charges, the amortization of amounts related to deferred stock-based compensation expense and identifiable purchased intangible assets or impairment of goodwill.



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If any of these risks occur, we may not be able to realize the intended benefits of an acquisition or strategic transaction or relationship, and our operating results, financial condition and business prospects could be materially negatively affected.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

On August 27, 2018, the Company entered into a Securities Purchase Agreement with Iliad Research and Trading, L.P. (“Iliad”) (the “Iliad Purchase Agreement”), pursuant to which the Company issued a convertible promissory note in the principal amount of \$2.3 million (“Iliad Note”) with an original issue discount of \$0.2 million. The Iliad Note bears interest at an annual rate of 8% and matures on August 27, 2020, unless earlier repurchased, redeemed or converted in accordance with its terms.

The Iliad Note provides Iliad with the right to convert, at any time, all or any part of the outstanding principal and accrued but unpaid interest into shares of the Company’s common stock at a conversion price of \$0.36 per share (“Lender Conversion Price”). Further, beginning on April 1, 2019, the Iliad Note also provides Iliad with the right to redeem all or any portion of the Iliad Note (“Redemption Amount”) up to a maximum monthly amount of \$0.35 million. The payments of each Redemption Amount may either be made in cash, by converting such Redemption Amount into shares of the Company’s common stock (“Redemption Conversion Shares”), or a combination thereof, at the Company’s election.

During the three and nine months ended September 28, 2019, Iliad converted \$0.8 million and \$0.9 million, respectively, of the outstanding principal and accrued interest on the Iliad Note to 3,247,000 shares and 3,624,074 shares, respectively, of the Company’s common stock at the Redemption Conversion Price, as defined in the Iliad Purchase Agreement. In addition, during the nine months ended September 28, 2019, Iliad converted \$0.5 million of the outstanding principal and accrued interest on the Iliad Note to 1,388,890 shares of the Company’s common stock at the Lender Conversion Price. Iliad did not convert any outstanding principal and accrued interest on the Iliad Note at the Lender Conversion Price during the three months ended September 28, 2019. Subsequent to September 28, 2019, Iliad converted \$0.7 million of the outstanding principal and accrued interest on the Iliad Note to 2,905,873 shares of the Company’s common stock at the Redemption Conversion Price.

The issuance and sale of the shares of common stock by the Company upon exercise of the Lender’s redemption rights was made without registration under the Securities Act of 1933, as amended (the “Act”), in reliance on the exemptions provided by Section 4(a)(2) of the Act and Regulation D promulgated thereunder, based on the offering of such securities to one investor, the lack of any general solicitation or advertising in connection with such issuance, the representation of such investor to the Company that it was an accredited investor (as that term is defined in Rule 501(a) of Regulation D of the Act), and the representation of such investor that it purchased the Iliad Note for its own account and without a view to distribute it. All issuances of shares of the Company’s common stock upon exercise of the Lender’s redemption rights occurred after the Lender had held the Iliad Note for more than six months in satisfaction of the holding period requirements of Rule 144, promulgated under the Act.

**Item 6. Exhibits**

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference		
			Form	File No.	Filing Date
3.1	<a href="#">Restated Certificate of Incorporation of Netlist, Inc.</a>		10-Q	001-33170	08/15/2017
3.1.1	<a href="#">Certificate of Amendment to the Restated Certificate of Incorporation of Netlist, Inc.</a>		8-K	001-33170	08/17/2018
3.1.2	<a href="#">Certificate of Designation of the Series A Preferred Stock of Netlist, Inc.</a>		10-Q	001-33170	08/15/2017
3.2	<a href="#">Amended and Restated Bylaws of Netlist, Inc.</a>		8-K	001-33170	12/20/2012
4.1	<a href="#">Form of Warrant Agreement to Purchase Common Stock.</a>		8-K	001-33170	09/14/2018



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Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference		
			Form	File No.	Filing Date
31.1	<a href="#">Certification of Principal Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</a>	X			
31.2	<a href="#">Certification of Principal Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</a>	X			
32+	<a href="#">Certification by Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</a>	X			
101.INS	XBRL Instance Document	X			
101.SCH	XBRL Taxonomy Extension Schema Document	X			
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	X			
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	X			
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	X			
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	X			

+ Furnished herewith.



**CERTIFICATION PURSUANT TO RULE 13A-14(A) AND RULE 15D-14(A) OF THE SECURITIES EXCHANGE  
ACT AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Chun K. Hong, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Netlist, Inc., a Delaware corporation (the “Registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and
5. The Registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Date: November 5, 2019

/s/ Chun K. Hong

Chun K. Hong  
President, Chief Executive Officer and Chairman of the Board  
(Principal Executive Officer)

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**CERTIFICATION PURSUANT TO RULE 13A-14(A) AND RULE 15D-14(A) OF THE SECURITIES EXCHANGE  
ACT AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Gail Sasaki, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Netlist, Inc., a Delaware corporation (the “Registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and
5. The Registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Date: November 5, 2019

/s/ Gail Sasaki  
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Gail Sasaki  
Vice President and Chief Financial Officer  
(Principal Financial Officer)

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**CERTIFICATIONS PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Netlist, Inc., a Delaware corporation (“Netlist”) for the quarter ended September 28, 2019 (the “Report”), Chun K. Hong, president, chief executive officer and chairman of the board of Netlist, and Gail Sasaki, vice president and chief financial officer of Netlist, each hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to his or her knowledge:

- (1) the Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Netlist, Inc.

Date: November 5, 2019

/s/ Chun K. Hong  
Chun K. Hong  
President, Chief Executive Officer and Chairman of the Board  
(Principal Executive Officer)

Date: November 5, 2019

/s/ Gail Sasaki  
Gail Sasaki  
Vice President and Chief Financial Officer  
(Principal Financial Officer)

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