

GSI TECHNOLOGY INC  
Form 10-Q  
February 11, 2014  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**FORM 10-Q**

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

For the quarterly period ended December 31, 2013

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 001-33387

---

# GSI Technology, Inc.

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**77-0398779**

(IRS Employer Identification No.)

**1213 Elko Drive**

**Sunnyvale, California 94089**

(Address of principal executive offices, zip code)

**(408) 331-8800**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The number of shares of the registrant's common stock outstanding as of January 31, 2014: **27,514,019**



Table of Contents

**GSI TECHNOLOGY, INC.**

**FORM 10-Q FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2013**

	<b>Page</b>
<b><u>PART I FINANCIAL INFORMATION</u></b>	
<u>Item 1.</u>	<u>Financial Statements</u> 1
	<u>Condensed Consolidated Balance Sheets</u> 1
	<u>Condensed Consolidated Statements of Operations</u> 2
	<u>Condensed Consolidated Statements of Comprehensive Income</u> 3
	<u>Condensed Consolidated Statements of Cash Flows</u> 4
	<u>Notes to Condensed Consolidated Financial Statements</u> 5
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 16
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u> 22
<u>Item 4.</u>	<u>Controls and Procedures</u> 22
<b><u>PART II OTHER INFORMATION</u></b>	
<u>Item 1.</u>	<u>Legal Proceedings</u> 24
<u>Item 1A.</u>	<u>Risk Factors</u> 25
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 38
<u>Item 6.</u>	<u>Exhibits</u> 39
<u>Signatures</u>	40
<u>Exhibit Index</u>	41

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****GSI TECHNOLOGY, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)**

	Dec. 31, 2013	March 31, 2013
	(In thousands, except share and per share amounts)	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 42,040	\$ 41,120
Short-term investments	32,779	26,139
Accounts receivable, net	9,054	10,241
Inventories	9,221	13,809
Prepaid expenses and other current assets	4,090	4,945
Deferred income taxes	1,339	1,224
Total current assets	98,523	97,478
Property and equipment, net	9,625	10,774
Long-term investments	34,199	35,495
Other assets	2,387	2,098
Total assets	\$ 144,734	\$ 145,845
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Accounts payable	\$ 3,015	\$ 3,804
Accrued expenses and other liabilities	3,960	3,978
Deferred revenue	2,391	3,077
Total current liabilities	9,366	10,859
Income taxes payable	1,908	2,803
Total liabilities	11,274	13,662
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Preferred stock: \$0.001 par value authorized: 5,000,000 shares; issued and outstanding: none		
Common Stock: \$0.001 par value authorized: 150,000,000 shares; issued and outstanding: 27,521,248 and 27,065,209 shares, respectively	28	27
Additional paid-in capital	56,092	54,004
Accumulated other comprehensive income	22	45
Retained earnings	77,318	78,107
Total stockholders' equity	133,460	132,183
Total liabilities and stockholders' equity	\$ 144,734	\$ 145,845

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents**GSI TECHNOLOGY, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)**

	<b>Three Months Ended Dec. 31,</b>		<b>Nine Months Ended Dec. 31,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>(In thousands, except per share amounts)</b>			
Net revenues	\$ 13,778	\$ 17,514	\$ 45,732	\$ 50,307
Cost of revenues	8,410	10,170	25,496	28,994
Gross profit	5,368	7,344	20,236	21,313
Operating expenses:				
Research and development	2,780	2,858	8,728	8,568
Selling, general and administrative	4,490	3,891	13,710	9,764
Total operating expenses	7,270	6,749	22,438	18,332
Income (loss) from operations	(1,902)	595	(2,202)	2,981
Interest income, net	92	117	291	348
Other income (expense), net	(30)	(8)	(33)	28
Income (loss) before income taxes	(1,840)	704	(1,944)	3,357
Provision (benefit) for income taxes	(1,106)	(140)	(1,155)	461
Net income (loss)	\$ (734)	\$ 844	\$ (789)	\$ 2,896
Net income per share:				
Basic	\$ (0.03)	\$ 0.03	\$ (0.03)	\$ 0.11
Diluted	\$ (0.03)	\$ 0.03	\$ (0.03)	\$ 0.10
Weighted average shares used in per share calculations:				
Basic	27,667	26,963	27,495	27,152
Diluted	27,667	27,987	27,495	27,957

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

**GSI TECHNOLOGY, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(Unaudited)**

	<b>Three Months Ended Dec. 31,</b>		<b>Nine Months Ended Dec. 31,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>(In thousands)</b>			
Net income (loss)	\$ (734)	\$ 844	\$ (789)	\$ 2,896
Net unrealized gain (loss) on available-for-sale investments, net of tax	15	(38)	(23)	(46)
Comprehensive net income (loss)	\$ (719)	\$ 806	\$ (812)	\$ 2,850

The accompanying notes are an integral part of these condensed consolidated financial statements.



Table of Contents**GSI TECHNOLOGY, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	<b>Nine Months Ended Dec. 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(In thousands)</b>	
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ (789)	\$ 2,896
<b>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</b>		
Allowance for sales returns, doubtful accounts and other	(15)	
Provision for excess and obsolete inventories	1,642	544
Depreciation and amortization	1,486	1,847
Stock-based compensation	1,644	1,688
Deferred income taxes	(115)	63
Windfall tax benefits from stock options exercised	(280)	(20)
Amortization of bond premium on investments	640	792
<b>Changes in assets and liabilities:</b>		
Accounts receivable	1,202	1,917
Inventory	2,946	993
Prepaid expenses and other assets	439	941
Accounts payable	(789)	(1,730)
Accrued expenses and other liabilities	(582)	(516)
Deferred revenue	(686)	(201)
Net cash provided by operating activities	6,743	9,214
<b>Cash flows from investing activities:</b>		
Purchase of investments	(29,927)	(27,660)
Sales and maturities of short-term investments	23,912	22,673
Purchases of property and equipment	(253)	(313)
Net cash used in investing activities	(6,268)	(5,300)
<b>Cash flows from financing activities:</b>		
Repurchase of common stock	(2,536)	(3,626)
Windfall tax benefits from stock options exercised	280	20
Proceeds from issuance of common stock under employee stock plans	2,701	654
Net cash provided by (used in) financing activities	445	(2,952)
Net increase in cash and cash equivalents	920	962
Cash and cash equivalents at beginning of the period	41,120	31,634
Cash and cash equivalents at end of the period	\$ 42,040	\$ 32,596
<b>Non-cash investing activities:</b>		
Purchases of property and equipment through accounts payable and accruals	\$	\$ 91
<b>Supplemental cash flow information:</b>		
Net cash paid for income taxes	\$ 28	\$ 359

The accompanying notes are an integral part of these condensed consolidated financial statements.



Table of Contents

**GSI TECHNOLOGY, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**NOTE 1 THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Basis of presentation*

The accompanying unaudited condensed consolidated financial statements of GSI Technology, Inc. and its subsidiaries ( GSI or the Company ) have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, the interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. These interim financial statements contain all adjustments (which consist of only normal, recurring adjustments) that are, in the opinion of management, necessary to state fairly the interim financial information included therein. The Company believes that the disclosures are adequate to make the information not misleading. However, these financial statements should be read in conjunction with the audited consolidated financial statements and related notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2013.

The consolidated results of operations for the three months and nine months ended December 31, 2013 are not necessarily indicative of the results to be expected for the entire fiscal year.

*Significant accounting policies*

The Company s significant accounting policies are disclosed in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2013.

*Litigation and settlement costs*

From time to time, the Company is involved in legal actions. The Company currently is a party to pending legal proceedings which it is defending aggressively. See Note 6 for additional information regarding this pending litigation. There are many uncertainties associated with

## Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

any litigation, and the Company may not prevail. The litigation, regardless of its eventual outcome, will be costly and time consuming and, should the outcome be adverse to the Company, could result in the Company being required to pay significant monetary damages. If that occurs, our business, financial condition and results of operations could be materially and adversely affected. If information becomes available that causes us to determine that a loss in any of our pending litigation, or the settlement of such litigation, is probable, and we can reasonably estimate the loss associated with such events, we will record the loss in accordance with GAAP. However, the actual liability in any such litigation may be materially different from our estimates, which could require us to record additional costs.

### *Excess and Obsolete Inventory Write-Down*

The Company recorded write-downs of excess and obsolete inventories of \$1.1 million and \$253,000, respectively, for the three months ended December 31, 2013 and 2012 and \$1.6 million and \$544,000, respectively, for the nine months ended December 31, 2013 and 2012. The increased write-downs recorded in the three and nine months ended December 31, 2013 were taken in response to the decline in the business and in response to the fact that management's prior expectations regarding the recoverability of certain products, which were based on estimates of increasing demand for these products in anticipation of, and following the favorable ITC ruling on June 7, 2013 and the exit of a competitor from the SRAM market in the December 2012 quarter, did not materialize.

### **NOTE 2 NET INCOME (LOSS) PER COMMON SHARE**

The Company uses the treasury stock method to calculate the weighted average shares used in computing diluted net income per share. The following table sets forth the computation of basic and diluted net income (loss) per share:

	<b>Three Months Ended Dec. 31,</b>		<b>Nine Months Ended Dec. 31,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>(In thousands, except per share amounts)</b>			
Net income (loss)	\$ (734)	\$ 844	\$ (789)	\$ 2,896
<b>Denominators:</b>				
Weighted average shares Basic	27,667	26,963	27,495	27,152
Dilutive effect of employee stock options		1,024		805
Dilutive effect of employee stock purchase plan options				
Weighted average shares Dilutive	27,667	27,987	27,495	27,957
Net income (loss) per common share Basic	\$ (0.03)	\$ 0.03	\$ (0.03)	\$ 0.11
Net income (loss) per common share Diluted	\$ (0.03)	\$ 0.03	\$ (0.03)	\$ 0.10

Table of Contents

The following shares of common stock underlying outstanding stock options, determined on a weighted average basis, were excluded from the computation of diluted net income per share as they had an anti-dilutive effect:

	Three Months Ended Dec. 31,		Nine Months Ended Dec. 31,	
	2013	2012	2013	2012
	(In thousands)			
Shares underlying options	3,027	3,243	3,026	3,130

Table of Contents**NOTE 3 BALANCE SHEET DETAIL**

	Dec. 31, 2013		March 31, 2013
	(In thousands)		
<b>Inventories:</b>			
Work-in-progress	\$ 2,674	\$	4,236
Finished goods	6,002		8,772
Inventory at distributors	545		801
	\$ 9,221	\$	13,809

	Dec. 31, 2013		March 31, 2013
	(In thousands)		
<b>Accounts receivable, net:</b>			
Accounts receivable	\$ 9,155	\$	10,357
Less: Allowances for sales returns, doubtful accounts and other	(101)		(116)
	\$ 9,054	\$	10,241

	Dec. 31, 2013		March 31, 2013
	(In thousands)		
<b>Prepaid expenses and other current assets:</b>			
Prepaid tooling and masks	\$ 580	\$	1,230
Prepaid income taxes	2,144		2,037
Other receivables	388		557
Other prepaid expenses	978		1,121
	\$ 4,090	\$	4,945

	Dec. 31, 2013		March 31, 2013
	(In thousands)		
<b>Property and equipment, net:</b>			
Computer and other equipment	\$ 16,483	\$	16,344
Software	4,779		4,690
Land	3,900		3,900
Building and building improvements	2,256		2,256
Furniture and fixtures	110		110
Leasehold improvements	792		767
Construction in progress			51
	28,320		28,118
Less: Accumulated depreciation and amortization	(18,695)		(17,344)
	\$ 9,625	\$	10,774

Depreciation and amortization expense was \$443,000 and \$531,000, respectively, for the three months ended December 31, 2013 and 2012 and \$1,351,000 and \$1,712,000, respectively, for the nine months ended December 31, 2013 and 2012.

	Dec. 31, 2013		March 31, 2013
	(In thousands)		
<b>Other Assets:</b>			
Non-current deferred income taxes	\$ 1,696	\$	1,272
Intangibles, net	609		744

Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

Deposits		82		82
	\$	2,387	\$	2,098

Table of Contents

The following table summarizes the components of intangible assets and related accumulated amortization balances at December 31, 2013 (in thousands):

	Gross Carrying Amount		Accumulated Amortization		Net Carrying Amount
<b>Intangible assets:</b>					
Product designs	\$ 590	\$	(365)	\$	225
Patents	720		(347)		373
Software	80		(69)		11
<b>Total</b>	<b>\$ 1,390</b>	<b>\$</b>	<b>(781)</b>	<b>\$</b>	<b>609</b>

Amortization of intangible assets included in cost of revenues was \$45,000 and \$45,000, respectively, for the three months ended December 31, 2013 and 2012 and \$135,000 and \$135,000, respectively, for the nine months ended December 31, 2013 and 2012.

	Dec. 31, 2013		March 31, 2013
	(In thousands)		
<b>Accrued expenses and other liabilities:</b>			
Accrued compensation	\$ 2,238	\$	2,181
Accrued professional fees	701		560
Accrued commissions	299		353
Other accrued expenses	722		884
	<b>\$ 3,960</b>	<b>\$</b>	<b>3,978</b>

**NOTE 4 INCOME TAXES**

The current portion of the Company's unrecognized tax benefits was \$0 at both December 31, 2013 and March 31, 2013. The long-term portion at December 31, 2013 and March 31, 2013 was \$2,163,000 and \$2,803,000, respectively, of which the timing of the resolution is uncertain. As of December 31, 2013, \$544,000 of unrecognized tax benefits had been recorded as a reduction to net deferred tax assets. The unrecognized tax benefit balance of \$2,329,000 as of December 31, 2013 would affect the Company's effective tax rate if recognized. It is possible, however, that some months or years may elapse before an uncertain position for which the Company has established a reserve is resolved.

Management believes that it is reasonably possible that within the next twelve months the Company could have a reduction in uncertain tax benefits of up to \$775,000, including interest and penalties, related to positions taken with respect to credits and loss carryforwards on previously filed tax returns.

The Company's policy is to include interest and penalties related to unrecognized tax benefits within the provision for income taxes in the Condensed Consolidated Statements of Operations.



## Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

The Company is subject to taxation in the United States and various state and foreign jurisdictions. Fiscal years 2010 through 2013 remain open to examination by federal tax authorities, and fiscal years 2009 through 2013 remain open to examination by California tax authorities. In the three months ended June 30, 2012, the Company settled an examination by the California Franchise Tax Board. The tax provision for the nine month period ended December 31, 2012 includes a discrete benefit of \$168,000 associated with the net result of the settlement and the associated tax reserves, including interest to date. During the quarter ended December 31, 2013, the Company established a valuation allowance of \$371,000 for California research and development tax credit carryovers that are not expected to be utilized in future years.

The Company's estimated annual effective income tax rate was approximately 34.5% and 26.1% as of December 31, 2013 and 2012, respectively. The differences between the effective income tax rate and the applicable statutory U.S. income tax rate in each period were primarily due to the effects of tax credits, foreign tax rate differentials and tax free interest income, offset by stock-based compensation expense.

Table of Contents**NOTE 5 FINANCIAL INSTRUMENTS***Fair value measurements*

Authoritative accounting guidance for fair value measurements provides a framework for measuring fair value and related disclosure. The guidance applies to all financial assets and financial liabilities that are measured on a recurring basis. The guidance requires fair value measurement to be classified and disclosed in one of the following three categories:

Level 1: Valuations based on quoted prices in active markets for identical assets and liabilities. The fair value of available-for-sale securities included in the Level 1 category is based on quoted prices that are readily and regularly available in an active market. As of December 31, 2013, the Level 1 category included money market funds of \$7.0 million, which were included in cash and cash equivalents in the Condensed Consolidated Balance Sheet.

Level 2: Valuations based on observable inputs (other than Level 1 prices), such as quoted prices for similar assets at the measurement date; quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly. The fair value of available-for-sale securities included in the Level 2 category is based on the market values obtained from an independent pricing service that were evaluated using pricing models that vary by asset class and may incorporate available trade, bid and other market information and price quotes from well established independent pricing vendors and broker-dealers. As of December 31, 2013, the Level 2 category included short-term investments of \$32.8 million and long-term investments of \$34.2 million, which were comprised of certificates of deposit, corporate debt securities and government and agency securities.

Level 3: Valuations based on inputs that are unobservable and involve management judgment and the reporting entity's own assumptions about market participants and pricing. As of December 31, 2013, the Company had no Level 3 financial assets measured at fair value in the Condensed Consolidated Balance Sheet.

The fair value of financial assets and liabilities measured on a recurring basis is as follows (in thousands):

	Fair Value Measurements at Reporting Date Using			
		Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Dec. 31, 2013			
Assets:				
Money market funds	\$ 7,044	\$ 7,044	\$	\$
Marketable securities	66,978		66,978	
Total	\$ 74,022	\$ 7,044	\$ 66,978	\$

Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

Fair Value Measurements at Reporting Date Using

	March 31, 2013		Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)	
Assets:								
Money market funds	\$	10,445	\$	10,445	\$		\$	
Marketable securities		61,634				61,634		
Total	\$	72,079	\$	10,445	\$	61,634	\$	

Table of Contents**Short-term and long-term investments**

All of the Company's short-term and long-term investments are classified as available-for-sale. Available-for-sale debt securities with maturities greater than twelve months are classified as long-term investments when they are not intended for use in current operations. Investments in available-for-sale securities are reported at fair value with unrecognized gains (losses), net of tax, as a component of accumulated other comprehensive income in the Condensed Consolidated Balance Sheets. The Company had money market funds of \$7.0 million and \$10.4 million at December 31, 2013 and March 31, 2013, respectively, included in cash and cash equivalents in the Condensed Consolidated Balance Sheet. The Company monitors its investments for impairment periodically and records appropriate reductions in carrying values when declines are determined to be other-than-temporary.

The following table summarizes the Company's available-for-sale investments:

	Cost	Dec. 31, 2013		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
(In thousands)				
<b>Short-term investments:</b>				
State and municipal obligations	\$ 7,688	\$ 1		\$ 7,689
Corporate notes	3,018	7		3,025
Agency bonds	5,527	8		5,535
Certificates of deposit	14,999	5		15,004
Other	1,524	2		1,526
Total short-term investments	\$ 32,756	\$ 23	\$	\$ 32,779
<b>Long-term investments:</b>				
State and municipal obligations	\$ 9,048	\$ 2	\$	\$ 9,050
Corporate notes	7,408	27		7,435
Agency bonds	999		(2)	997
Certificates of deposit	10,751		(21)	10,730
Other	5,988		(1)	5,987
Total long-term investments	\$ 34,194	\$ 29	\$ (24)	\$ 34,199

	Cost	March 31, 2013		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
(In thousands)				
<b>Short-term investments:</b>				
State and municipal obligations	\$ 10,564	\$ 17	\$	\$ 10,581
Corporate notes	6,052	14		6,066
Certificates of deposit	9,480	12		9,492
Total short-term investments	\$ 26,096	\$ 43	\$	\$ 26,139
<b>Long-term investments:</b>				
State and municipal obligations	\$ 11,992	\$ 3	\$	\$ 11,995
Corporate notes	8,436	14		8,450
Certificates of deposit	9,008	18		9,026
Other	6,042		(18)	6,024
Total long-term investments	\$ 35,478	\$ 35	\$ (18)	\$ 35,495



Table of Contents

The Company's investment portfolio consists of both corporate and governmental securities that have a maximum maturity of three years. All unrealized gains are due to changes in interest rates and bond yields. Subject to normal credit risks, the Company has the ability to realize the full value of all these investments upon maturity.

The deferred tax liability related to unrecognized gains and losses on short-term and long-term investments was \$7,000 and \$14,000 at December 31, 2013 and March 31, 2013, respectively.

As of December 31, 2013, contractual maturities of the Company's available-for-sale non-equity investments were as follows:

	Cost	Fair Value
	(In thousands)	
Maturing within one year	\$ 32,756	\$ 32,779
Maturing in one to three years	34,194	34,199
Maturing in more than three years	\$ 66,950	\$ 66,978

The Company classifies its short-term investments as available-for-sale as they are intended to be available for use in current operations.

**NOTE 6 COMMITMENTS AND CONTINGENCIES*****Indemnification obligations***

The Company is a party to a variety of agreements pursuant to which it may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in the context of contracts entered into by the Company, under which the Company agrees to hold the other party harmless against losses arising from a breach of representations and covenants related to such matters as title to assets sold and certain intellectual property rights. In each of these circumstances, the Company's indemnification obligations are conditioned on the other party making a claim pursuant to the procedures specified in the particular contract, which procedures typically allow the Company to challenge the other party's claims. Further, the Company's obligations under these agreements may be limited in terms of time and/or amount, and in some instances, the Company may have recourse against third parties for certain payments made by it under these agreements.

It is not possible to predict the maximum potential amount of future payments that may be required under these or similar agreements due to the conditional nature of the Company's obligations and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements have not had a material effect on its business, financial condition, cash flows or results of operations.

***Product warranties***

The Company warrants its products to be free of defects generally for a period of three years. The Company estimates its warranty costs based on historical warranty claim experience and includes such costs in cost of revenues. Warranty costs were not significant for the three months or nine months ended December 31, 2013 or 2012.

***Legal proceedings***

In March 2011, Cypress Semiconductor Corporation, a semiconductor manufacturer, filed a lawsuit against the Company in the United States District Court for the District of Minnesota alleging that the Company's products, including its SigmaDDR and SigmaQuad families of Very Fast SRAMs, infringe five patents held by Cypress. The complaint seeks unspecified damages for past infringement and a permanent injunction against future infringement.

On June 10, 2011, Cypress filed a complaint against the Company with the United States International Trade Commission (the ITC). The ITC complaint, as subsequently amended, alleged infringement by the Company of three of the five patents involved in the District Court case and one additional patent and also alleged infringement by three of our distributors and 11 of our customers who allegedly incorporate our SRAMs in their products. The ITC complaint sought a limited exclusion order excluding the allegedly infringing SRAMs, and products containing them, from entry into the United States and permanent orders directing the Company and the other respondents to cease and desist from selling or distributing such products in the United States. On July 21, 2011, the ITC formally instituted an investigation in response to Cypress's

Table of Contents

complaint. On June 7, 2013, the ITC announced that the full Commission had affirmed the determination of Chief Administrative Judge Charles E. Bullock that GSI's SRAM devices, and products containing them, do not infringe the Cypress patents and that Cypress had failed to establish existence of a domestic industry that practices the patents. Moreover, the Commission reversed a portion of Judge Bullock's determination with respect to the validity of the patents, finding the asserted claims of one of the patents to have been anticipated by prior art and, therefore, invalid. The Commission ordered the investigation terminated, and Cypress did not appeal the ruling.

The Minnesota District Court case had been stayed pending the conclusion of the ITC proceeding. Following the termination of the ITC investigation, the stay was lifted. On May 1, 2013, Cypress filed an additional lawsuit in the United States District Court for the Northern District of California alleging infringement by our products of five additional Cypress patents. Like the Minnesota case, the complaint in the California lawsuit seeks unspecified damages for past infringement and a permanent injunction against future infringement. The Company filed answers in both cases denying liability and asserting affirmative defenses. On August 7, 2013, the parties stipulated that the claims in the Minnesota case with respect to three of the asserted patents would be dismissed without prejudice and that the claims with respect to the remaining two patents would be transferred to, and consolidated with, the California case. On August 20, 2013, the Court in the California case ordered the cases consolidated. Discovery in the case is proceeding.

The Company believes that it has strong defenses against Cypress' patent infringement claims and intends to continue to defend itself vigorously. However, the litigation process is inherently uncertain, and the Company may not prevail. Patent litigation is particularly complex and can extend for a protracted period of time, which can substantially increase the cost of such litigation. The Company has not recorded any loss contingency during fiscal 2011, fiscal 2012 or fiscal 2013 in connection with these legal proceedings as the Company cannot predict their outcome and cannot estimate the likelihood or potential dollar amount of any adverse results. However, an unfavorable outcome in these proceedings could have a material adverse impact on the Company's financial position, results of operations or cash flows for the period in which the outcome occurs and in future periods.

**NOTE 7 STOCK-BASED COMPENSATION**

As of December 31, 2013, 5,671,955 shares of common stock were available for grant under the Company's 2007 Equity Incentive Plan.

The following table summarizes the Company's stock option activities for the nine months ended December 31, 2013:

	Number of Shares Underlying Options Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Intrinsic Value
Balance at March 31, 2013	6,336,319		\$ 4.73	
Granted	678,483		6.42	
Exercised	(723,673)		2.97	\$ 2,386,568
Forfeited	(141,320)		6.01	
Balance at December 31, 2013	6,149,809		\$ 5.09	
Options vested and exercisable	3,748,121	4.78	\$ 4.56	\$ 7,989,938
Options vested and expected to vest	6,083,320	6.12	\$ 5.08	\$ 9,916,505



Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

The weighted average fair value per underlying share of options granted during the three months ended December 31, 2013 and 2012 was \$2.78 and \$2.43, respectively, and for the nine months ended December 31, 2013 and 2012 was \$2.73 and \$2.12, respectively.

Table of Contents

Options outstanding by exercise price at December 31, 2013 were as follows:

Exercise Price	Number of Shares Underlying Options Outstanding	Options Outstanding		Options Exercisable	
		Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number Vested and Exercisable	Weighted Average Exercise Price
\$2.43 - 3.38	647,144	\$ 3.01	4.78	647,144	\$ 3.01
\$3.43 - 3.94	498,291	\$ 3.55	5.27	498,291	\$ 3.55
\$4.00	697,038	\$ 4.00	5.43	697,038	\$ 4.00
\$4.17 - 4.50	652,634	\$ 4.26	5.84	369,545	\$ 4.32
\$4.81 - 4.92	511,335	\$ 4.87	8.19	132,690	\$ 4.88
\$5.50	817,333	\$ 5.50	2.86	817,333	\$ 5.50
\$5.59 - 5.76	622,280	\$ 5.70	7.55	206,845	\$ 5.71
\$6.00 - 6.54	818,658	\$ 6.32	7.38	158,299	\$ 6.34
\$6.63 - 7.00	771,476	\$ 6.86	8.33	158,221	\$ 6.93
\$9.20	113,620	\$ 9.20	7.08	62,715	\$ 9.20
	6,149,809			3,748,121	

Table of Contents

The following table summarizes stock-based compensation expense by line item in the Condensed Consolidated Statements of Operations, all relating to employee stock plans:

	Three Months Ended Dec. 31,		Nine Months Ended Dec. 31,	
	2013	2012	2013	2012
	(In thousands)			
Cost of revenues	\$ 86	\$ 68	\$ 282	\$ 245
Research and development	235	287	726	861
Selling, general and administrative	195	210	636	582
Total	\$ 516	\$ 565	\$ 1,644	\$ 1,688

As stock-based compensation expense recognized in the Condensed Consolidated Statement of Operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures in accordance with authoritative guidance. The Company estimates forfeitures at the time of grant and revises the original estimates, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The Company recognized related income tax benefits of \$35,000 and \$51,000, respectively, for the three months ended December 31, 2013 and 2012, and of \$81,000 and \$167,000, respectively, for the nine months ended December 31, 2013 and 2012. Windfall tax benefits realized from exercised stock options were \$280,000 and \$20,000, respectively, for the nine months ended December 31, 2013 and 2012. Compensation cost capitalized within inventory at December 31, 2013 was insignificant. As of December 31, 2013, the Company's total unrecognized compensation cost was \$4.0 million, which will be recognized over a weighted average period of 2.01 years. The Company calculated the fair value of stock-based awards in the periods presented using the Black-Scholes option pricing model and the following weighted average assumptions:

	Three Months Ended Dec. 31,		Nine Months Ended Dec. 31,	
	2013	2012	2013	2012
<b>Stock Option Plans:</b>				
Risk-free interest rate	1.43%	0.69%	0.91 - 1.51%	0.67 - 0.79%
Expected life (in years)	5.00	5.00	5.00	5.00
Volatility	46.6%	50.2%	46.6 - 48.4%	50.2 - 52.9%
Dividend yield	%	%	%	%
<b>Employee Stock Purchase Plan:</b>				
Risk-free interest rate	0.07%	0.14%	0.07 - 0.09%	0.14 - 0.15%
Expected life (in years)	0.50	0.50	0.50	0.50
Volatility	32.8%	47.3%	30.4 - 32.8%	23.4 - 47.3%
Dividend yield	%	%	%	%

Table of Contents**NOTE 8 SEGMENT AND GEOGRAPHIC INFORMATION**

Based on its operating management and financial reporting structure, the Company has determined that it has one reportable business segment: the design, development and sale of integrated circuits.

The following is a summary of net revenues by geographic area based on the location to which product is shipped:

	<b>Three Months Ended Dec. 31,</b>		<b>Nine Months Ended Dec. 31,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>(In thousands)</b>			
United States	\$ 4,123	\$ 4,951	\$ 14,507	\$ 14,152
China	3,465	2,746	9,736	11,054
Malaysia	2,310	5,929	7,865	13,662
Singapore	1,803	1,989	4,868	5,497
Netherlands	768	575	4,180	1,580
Rest of the world	1,309	1,324	4,576	4,362
	\$ 13,778	\$ 17,514	\$ 45,732	\$ 50,307

All sales are denominated in United States dollars.

Table of Contents

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

*This Quarterly Report on Form 10-Q, and in particular the following Management's Discussion and Analysis of Financial Condition and Results of Operations, includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These forward-looking statements involve risks and uncertainties. Forward-looking statements are identified by words such as anticipates, believes, expects, intends, may, will, and other similar expressions. In addition, any statements which refer to expectations, projections, or other characterizations of future events, or circumstances, are forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, including those set forth in this report under Risk Factors, those described elsewhere in this report, and those described in our other reports filed with the Securities and Exchange Commission (SEC). We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report, and we undertake no obligation to update these forward-looking statements after the filing of this report. You are urged to review carefully and consider our various disclosures in this report and in our other reports publicly disclosed or filed with the SEC that attempt to advise you of the risks and factors that may affect our business.*

**Overview**

We are a fabless semiconductor company that designs, develops and markets static random access memories, or SRAMs, that operate at speeds of less than 10 nanoseconds, which we refer to as Very Fast SRAMs, and low latency dynamic random access memories, or LLDRAMs. Our products are sold primarily to manufacturers of networking and telecommunications equipment. We are subject to the highly cyclical nature of the semiconductor industry, which has experienced significant fluctuations, often in connection with fluctuations in demand for the products in which semiconductor devices are used. Our revenues have been substantially impacted by significant fluctuations in sales to Cisco Systems, our largest customer, and we expect that future direct and indirect sales to Cisco Systems will continue to fluctuate significantly on a quarterly basis. The worldwide financial crisis and the resulting economic impact on the end markets we serve have adversely impacted our financial results since the second half of fiscal 2009, and we expect that the unsettled global economic environment will continue to affect our operating results in future periods. However, with no debt, substantial liquidity and a history of positive cash flows from operations, we believe we are in a better financial position than many other companies of our size.

*Revenues.* Our revenues are derived primarily from sales of our Very Fast SRAM products. Sales to networking and telecommunications original equipment manufacturers, or OEMs, accounted for 75% to 80% of our net revenues during our last three fiscal years. We also sell our products to OEMs that manufacture products for defense applications such as radar and guidance systems, for professional audio applications such as sound mixing systems, for test and measurement applications such as high-speed testers, for automotive applications such as smart cruise control and voice recognition systems, and for medical applications such as ultrasound and CAT scan equipment.

As is typical in the semiconductor industry, the selling prices of our products generally decline over the life of the product. Our ability to increase net revenues, therefore, is dependent upon our ability to increase unit sales volumes of existing products and to introduce and sell new products with higher average selling prices in quantities sufficient to compensate for the

Table of Contents

anticipated declines in selling prices of our more mature products. Although we expect the average selling prices of individual products to decline over time, we believe that, over the next several quarters, our overall average selling prices will increase due to a continuing shift in product mix to a higher percentage of higher price, higher density products. Our ability to increase unit sales volumes is dependent primarily upon increases in customer demand but, particularly in periods of increasing demand, can also be affected by our ability to increase production through the availability of increased wafer fabrication capacity from Taiwan Semiconductor Manufacturing Company, or TSMC, and Powerchip, our wafer suppliers, and our ability to increase the number of good integrated circuit die produced from each wafer through die size reductions and yield enhancement activities.

We may experience fluctuations in quarterly net revenues for a number of reasons. Historically, orders on hand at the beginning of each quarter are insufficient to meet our revenue objectives for that quarter and are generally cancelable up to 30 days prior to scheduled delivery. Accordingly, we depend on obtaining and shipping orders in the same quarter to achieve our revenue objectives. In addition, the timing of product releases, purchase orders and product availability could result in significant product shipments at the end of a quarter. Failure to ship these products by the end of the quarter may adversely affect our operating results. Furthermore, our customers may delay scheduled delivery dates and/or cancel orders within specified timeframes without significant penalty.

We sell our products through our direct sales force, international and domestic sales representatives and distributors. Revenues from product sales, except for sales to distributors, are generally recognized upon shipment, net of sales returns and allowances. Sales to consignment warehouses, who purchase products from us for use by contract manufacturers, are recorded upon delivery to the contract manufacturer. Sales to distributors are recorded as deferred revenues for financial reporting purposes and recognized as revenues when the products are resold by the distributors to the OEM. Sales to distributors are made under agreements allowing for returns or credits under certain circumstances. We therefore defer recognition of revenue on sales to distributors until products are resold by the distributor.

Cisco Systems, historically our largest OEM customer, purchases our products primarily through its consignment warehouses, SMART Modular Technologies, Jabil Circuit and Flextronics Technology, and also purchases some products through its contract manufacturers and directly from us. Historically, purchases by Cisco Systems have fluctuated from period to period. Based on information provided to us by Cisco Systems consignment warehouses and contract manufacturers, purchases by Cisco Systems represented approximately 19%, 29%, 41% and 37% of our net revenues in the nine months ended December 31, 2013 and in fiscal 2013, 2012 and 2011, respectively. Our revenues have been substantially impacted by the fluctuations in sales to Cisco Systems, and we expect that future direct and indirect sales to Cisco Systems will continue to fluctuate significantly on a quarterly basis and that such fluctuations may significantly affect our operating results in future periods. To our knowledge, none of our other OEM customers accounted for more than 10% of our net revenues in fiscal 2013, 2012 or 2011.

*Cost of Revenues.* Our cost of revenues consists primarily of wafer fabrication costs, wafer sort, assembly, test and burn-in expenses, the amortized cost of production mask sets, stock-based compensation and the cost of materials and overhead from operations. All of our wafer manufacturing and assembly operations, and a significant portion of our wafer sort testing operations, are outsourced. Accordingly, most of our cost of revenues consists of payments to TSMC, Powerchip and independent assembly and test houses. Because we do not have long-term, fixed-price supply contracts, our wafer fabrication and other outsourced manufacturing costs are subject to the cyclical fluctuations in demand for semiconductors. Cost of revenues also includes expenses related to supply chain management, quality assurance, and final product testing and documentation control activities conducted at our headquarters in Sunnyvale, California and our branch operations in Taiwan.

*Gross Profit.* Our gross profit margins vary among our products and are generally greater on our higher density products and, within a particular density, greater on our higher speed and industrial temperature products. We expect that our overall gross margins will fluctuate from period to period as a result of shifts in product mix, changes in average selling prices and our ability to control our cost of revenues, including costs associated with outsourced wafer fabrication and product assembly and testing.

*Research and Development Expenses.* Research and development expenses consist primarily of salaries and related expenses for design engineers and other technical personnel, the cost of developing prototypes, stock-based compensation and fees paid to consultants. We charge all research and development expenses to operations as incurred. We charge mask costs used in production to cost of revenues over a 12-month period. However, we charge costs related to pre-production mask sets, which are not used in production, to research and development expenses at the time they are incurred. These charges often arise as we transition to new process technologies and, accordingly, can cause research and development expenses to fluctuate on a quarterly basis. We believe that continued investment in research and development is critical to our long-term success, and we expect to continue to devote significant resources to product development activities. Accordingly, we expect that our research and development expenses will increase in future periods, although such expenses as a percentage of net revenues may fluctuate.

Table of Contents

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses consist primarily of commissions paid to independent sales representatives, salaries, stock-based compensation and related expenses for personnel engaged in sales, marketing, administrative, finance and human resources activities, professional fees, costs associated with the promotion of our products and other corporate expenses. We expect that our sales and marketing expenses will increase in absolute dollars in future if we are able to grow and expand our sales force but that, to the extent our revenues increase in future periods, these expenses will generally decline as a percentage of net revenues. We also expect that, in support of any future growth that we are able to achieve, general and administrative expenses will generally increase in absolute dollars. General and administrative expenses increased significantly in fiscal 2012, primarily as a result of substantial legal expenses related to our pending patent infringement and antitrust litigation with Cypress Semiconductor Corporation. These expenses have varied significantly from quarter to quarter, depending on the relative level of activity in the Cypress litigation. They were substantially reduced during the six months ended September 30, 2012 while the issuance of the initial determination in the ITC proceeding was pending, although they increased again in the following quarters as the parties filed and responded to petitions for review of the initial determination, which was issued on October 25, 2012, activities related to our pending antitrust litigation with Cypress entered the discovery phase and activity resumed in the federal court patent litigation that had been stayed pending the conclusion of the ITC proceeding. Whatever the outcome of our pending litigation with Cypress, we expect to continue to incur additional legal expenses as we pursue our two lawsuits against Cypress and other pending litigation. These expenses are likely to continue to fluctuate significantly from quarter to quarter and to be substantial during some quarters over the next one to two years.



Table of Contents**Results of Operations**

The following table sets forth statement of operations data as a percentage of net revenues for the periods indicated:

	Three Months Ended Dec. 31,		Nine Months Ended Dec. 31,	
	2013	2012	2013	2012
Net revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	61.0	58.1	55.8	57.6
Gross profit	39.0	41.9	44.2	42.4
Operating expenses:				
Research and development	20.2	16.3	19.1	17.0
Selling, general and administrative	32.6	22.2	30.0	19.4
Total operating expenses	52.8	38.5	49.1	36.4
Income (loss) from operations	(13.8)	3.4	(4.9)	6.0
Interest and other income (expense), net	0.4	0.6	0.6	0.7
Income (loss) before income taxes	(13.4)	4.0	(4.3)	6.7
Provision (benefit) for income taxes	(8.0)	(0.8)	(2.5)	0.9
Net income (loss)	(5.4)%	4.8%	(1.8)%	5.8%

*Net Revenues.* Net revenues decreased by 21.3% from \$17.5 million in the three months ended December 31, 2012 to \$13.8 million in the three months ended December 31, 2013 and by 9.1% from \$50.3 million in the nine months ended December 31, 2012 to \$45.7 million in the nine months ended December 31, 2013. The reduction in both periods reflects the continuing weakness in the global networking and telecommunications markets. Direct and indirect sales to Cisco Systems, our largest customer, decreased by \$4.0 million from \$6.5 million in the three months ended December 31, 2012 to \$2.5 million in the three months ended December 31, 2013 and by \$6.6 million from \$15.4 million in the nine months ended December 31, 2012 to \$8.8 million in the nine months ended December 31, 2013. Direct sales to Alcatel-Lucent increased by \$1.1 million from \$1.2 million in the three months ended December 31, 2012 to \$2.3 million in the three months ended December 31, 2013 and by \$3.5 million from \$5.1 million in the nine months ended December 31, 2012 to \$8.6 million in the nine months ended December 31, 2013. We believe that our net revenues in each of these periods were also negatively impacted by uncertainty regarding the outcome of our pending patent litigation with Cypress Semiconductor. We believe that the Commission's favorable final determination in the ITC proceeding has reduced this market uncertainty, although it is likely to continue to have some effect on our revenues over the next several quarters while our customers re-evaluate their SRAM sourcing strategies. Shipments of our SigmaQuad product line accounted for 41.2% of total shipments in the nine months ended December 31, 2013 compared to 35.2% of total shipments in the nine months ended December 31, 2012.

*Cost of Revenues.* Cost of revenues decreased by 17.5% from \$10.2 million in the three months ended December 31, 2012 to \$8.4 million in the three months ended December 31, 2013 and by 12.1% from \$29.0 million in the nine months ended December 31, 2012 to \$25.5 million in the nine months ended December 31, 2013. The decreases in both periods were primarily due to the corresponding decreases in net revenues, favorable product mix and reductions in variable manufacturing costs in both fiscal 2014 periods, offset by increases of \$863,000 and \$1.1 million in non-cash write-downs of excess or obsolete inventory in the three and nine month periods ended December 31, 2013, respectively. The increased write-downs recorded in the quarter ended December 31, 2013 adversely impacted gross margins by 6.2 percentage points in the quarter and 2.4 percentage points in the nine months ended December 31, 2013. These write-downs were taken to reflect the fact that management's prior expectations of increasing demand for our products following the favorable ITC ruling on June 7, 2013 and the exit of a competitor from the SRAM market in the December 2012 quarter did not materialize. Cost of revenues included stock-based compensation expense of \$86,000 and \$68,000, respectively, for the three months ended December 31, 2013 and 2012 and \$282,000 and \$245,000, respectively, for the nine months ended December 31, 2013 and 2012.

## Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

*Gross Profit.* Gross profit decreased by 26.9% from \$7.3 million in the three months ended December 31, 2012 to \$5.4 million in the three months ended December 31, 2013 and decreased by 5.1% from \$21.3 million in the nine months ended December 31, 2012 to \$20.2 million in the nine months ended December 31, 2013. Gross margin decreased from 41.9% in the three months ended December 31, 2012 to 39.0% in the three months ended December 31, 2013 and increased from 42.4% in the nine months ended December 31, 2012 to 44.2% in the nine months ended December 31, 2013. The changes in gross profit and gross margin were primarily related to changes in the mix of products and customers, the reduction in variable manufacturing expenses and the write-down of excess inventory discussed above.

*Research and Development Expenses.* Research and development expenses were essentially unchanged at \$2.9 million in the three months ended December 31, 2012 and \$2.8 million in the three months ended December 31, 2013. An increase of \$20,000 in payroll related expenses was more than offset by decreases in stock-based compensation, legal fees and facility related expenses. Research and development expenses included stock-based compensation expense of \$235,000 and \$287,000, respectively, for the three months ended December 31, 2013 and 2012. Research and development expenses

Table of Contents

increased 1.9% from \$8.6 million in the nine months ended December 31, 2012 to \$8.7 million in the nine months ended December 31, 2013. This increase was primarily due to increases of \$310,000 in payroll related expenses and \$97,000 in maintenance and repair expenses partially offset by decreases in facility related expenses and stock-based compensation. Research and development expenses included stock-based compensation expense of \$726,000 and \$861,000, respectively, for the nine months ended December 31, 2013 and 2012.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses increased 15.4% from \$3.9 million in the three months ended December 31, 2012 to \$4.5 million in the three months ended December 31, 2013. This increase was primarily due to an increase of \$889,000 in legal fees related to the pending patent infringement and antitrust litigation involving Cypress Semiconductor Corporation and other pending litigation, partially offset by a decrease in independent sales representative commissions. Selling, general and administrative expenses included stock-based compensation expense of \$195,000 and \$210,000, respectively, for the three months ended December 31, 2013 and 2012. Selling, general and administrative expenses increased 40.1% from \$9.8 million in the nine months ended December 31, 2012 to \$13.7 million in the nine months ended December 31, 2013. This increase was primarily related to an increase of \$4.1 million in legal fees related to the pending patent infringement and antitrust litigation involving Cypress Semiconductor and other pending litigation. Selling, general and administrative expenses included stock-based compensation expense of \$636,000 and \$582,000, respectively, for the nine months ended December 31, 2013 and 2012.

*Interest and Other Income (Expense), Net.* Interest and other income (expense), net decreased 43.1%, from \$109,000 in the three months ended December 31, 2012 to \$62,000 in the three months ended December 31, 2013. Interest income decreased by \$25,000 due to lower interest rates received on our cash and short-term and long-term investments. In addition, we experienced an exchange loss of \$30,000 for the three months ended December 31, 2013 compared to an exchange loss of \$8,000 for the three months ended December 31, 2012. Interest and other income (expense), net decreased 31.6% from \$376,000 in the nine months ended December 31, 2012 to \$258,000 in the nine months ended December 31, 2013. Interest income decreased by \$57,000 due to lower interest rates received on our cash and short-term and long-term investments. In addition, we experienced an exchange loss of \$34,000 for the nine months ended December 31, 2013 compared to an exchange gain of \$28,000 for the nine months ended December 31, 2012. The exchange gains and losses in each period were related to our Taiwan branch operations.

*Provision for Income Taxes.* The benefit for income taxes increased from \$140,000 in the three months ended December 31, 2012 to \$1.1 million in the three months ended December 31, 2013, and a provision of \$461,000 in the nine months ended December 31, 2012 increased to a benefit of \$1.2 million in the nine months ended December 31, 2013. These changes were due primarily to the changes in pre-tax income for the respective periods. During the three months ended June 30, 2012, we settled a tax audit for less than the amount previously provided for resulting in a tax benefit of \$168,000. During the quarter ended December 31, 2013, we established a valuation allowance of \$371,000 for California research and development tax credit carryovers that are not expected to be utilized in future years.

*Net Income (Loss).* Net income decreased from \$844,000 in the three months ended December 31, 2012 to a net loss of \$734,000 in the three months ended December 31, 2013 and from \$2.9 million in the nine months ended December 31, 2012 to a net loss of \$789,000 in the nine months ended December 31, 2013. These decreases were primarily due to the decreases in net revenues, gross profit and the changes in operating expenses discussed above.

**Liquidity and Capital Resources**

## Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

As of December 31, 2013, our principal sources of liquidity were cash, cash equivalents and short-term investments of \$74.8 million compared to \$67.3 million as of March 31, 2013.

Net cash provided by operating activities was \$6.7 million for the nine months ended December 31, 2013 compared to \$9.2 million for the nine months ended December 31, 2012. The primary sources of cash in the current nine month period were a reduction in inventory of \$2.9 million, and adjustments for stock-based compensation expense, depreciation expense and a provision for excess and obsolete inventory, partially offset by decreases in accounts payable and deferred revenue. We have allowed inventory levels to decrease in response to the slowdown in our business during fiscal 2013 and the first nine months of the current fiscal year.

Net cash used by investing activities was \$6.3 million in the nine months ended December 31, 2013 compared to \$5.3 million in the nine months ended December 31, 2012. Investment activities in the nine months ended December 31, 2013 consisted primarily of the purchase of agency bonds, state and municipal obligations, corporate notes and certificates of deposit of \$29.9 million, partially offset by the sales and maturities of investments of \$23.9 million. Investment activities in the nine months ended December 31, 2012 consisted primarily of the purchase of state and municipal obligations, corporate notes and certificates of deposit of \$27.7 million, partially offset by the sales and maturities of investments of \$22.7 million.

Net cash provided by financing activities in the nine months ended December 31, 2013 primarily consisted of the net proceeds from the sale of common stock pursuant to our employee stock plans, partially offset by the repurchase of \$2.5

Table of Contents

million of our common stock at an average purchase price of \$6.61. Net cash used by financing activities in the nine months ended December 31, 2012 primarily consisted of the repurchase of \$3.6 million of our common stock at an average purchase price of \$4.47, partially offset by the net proceeds from the sale of common stock pursuant to our employee stock plans.

We believe that our existing balances of cash, cash equivalents and short-term investments, and cash flow expected to be generated from our future operations will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 12 months, although we could be required, or could elect, to seek additional funding prior to that time. Our future capital requirements will depend on many factors, including revenue growth, if any, that we experience, the extent to which we utilize subcontractors, the levels of inventory and accounts receivable that we maintain, the timing and extent of spending to support our product development efforts and the expansion of our sales and marketing efforts and the extent of legal expenses that we incur in connection with pending litigation. Additional capital may also be required for the consummation of any acquisition of businesses, products or technologies that we may undertake. We cannot assure you that additional equity or debt financing, if required, will be available on terms that are acceptable or at all.

Table of Contents**Contractual Obligations**

The following table describes our contractual obligations as of December 31, 2013:

	Payments due by period				Total
	Up to 1 year	1 - 3 years	3 - 5 years	More than 5 years	
Facilities and equipment leases	\$ 213,000	\$ 114,000	\$	\$	\$ 327,000
Wafer, test and mask purchase obligations	4,262,000	632,000			4,894,000
	\$ 4,475,000	\$ 746,000	\$	\$	\$ 5,221,000

As of December 31, 2013, the current portion of our unrecognized tax benefits was \$0, and the long-term portion was \$2,163,000. The unrecognized tax benefits balance of \$2,329,000 as of December 31, 2013 would affect our effective tax rate if recognized. As of December 31, 2013, \$544,000 of unrecognized tax benefits have been recorded as a reduction of net deferred tax assets.

**Critical Accounting Policies and Estimates**

Our critical accounting policies and estimates are disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2013.

**Off-Balance Sheet Arrangements**

At December 31, 2013, we did not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Accordingly, we are not exposed to the type of financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

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

*Foreign Currency Exchange Risk.* Our revenues and expenses, except those expenses related to our operations in Taiwan, including subcontractor manufacturing expenses, are denominated in U.S. dollars. As a result, we have relatively little exposure for currency exchange risks, and foreign exchange gains and losses have been minimal to date. We do not currently enter into forward exchange contracts to hedge exposure denominated in foreign currencies or any other derivative financial instruments for trading or speculative purposes. In the future, if we feel our foreign currency exposure has increased, we may consider entering into hedging transactions to help mitigate that risk.

*Interest Rate Sensitivity.* We had cash, cash equivalents, short-term investments and long-term investments totaling \$109.0 million at December 31, 2013. These amounts were invested primarily in money market funds, state and municipal obligations, corporate notes and certificates of deposit. The cash, cash equivalents and short-term marketable securities are held for working capital purposes. We do not enter into investments for trading or speculative purposes. Due to the short-term nature of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. We believe a hypothetical 100 basis point increase or decrease in interest rates would not materially affect the fair value of our interest-sensitive financial instruments. Declines in interest rates, however, will reduce future investment income.

**Item 4.     *Controls and Procedures***

*Evaluation of Disclosure Controls and Procedures.*

Based on their evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act as of December 31, 2013, our Chief Executive Officer and Chief Financial Officer, have concluded that our disclosure controls and procedures were not effective as of the end of the period covered by this report as a result of the material weakness described below that existed in our internal control over financial reporting.

Table of Contents

These disclosure controls and procedures are used for the purpose of ensuring that the information required to be disclosed by us in this report is made known to our management by others on a timely basis, that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, in order to allow timely decisions regarding required disclosure, and that such information is recorded, processed, summarized, and reported by us within the time periods specified in the SEC's rules and instructions for Form 10-Q.

Notwithstanding the material weakness described below, our Chief Executive Officer and Chief Financial Officer have concluded that the condensed consolidated financial statements included in this report fairly present, in all material respects, our financial condition, results of operations and cash flows for the periods presented in conformity with accounting principles generally accepted in the United States.

*Material Weaknesses in Internal Control over Financial Reporting*

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. In connection with the completion of our third fiscal quarter-end closing and review procedures and the preparation of this report, certain errors were identified in the evaluation and calculation of our inventory write-downs that were the result of a material weakness that existed as of December 31, 2013.

Our management determined that we had not designed and maintained effective controls over the review of supporting information to determine the completeness and accuracy of our calculations for the write-down of excess or obsolete inventory, thereby affecting the valuation of our inventory as of December 31, 2013. Specifically, quarterly controls, including procedures for monitoring recoverability of older product inventory, did not fully take into account the fact that management's prior expectations of increasing demand in the current year for our products following the favorable ITC ruling on June 7, 2013 and the exit of a competitor from the SRAM market in December 2012 did not materialize and were not sufficiently precise to identify all potentially excess or obsolete inventory, taking into account reduced materiality thresholds following declines in our revenues and income (loss) before tax. Consequently, we did not initially write down the full amount of excess or obsolete inventory, and adjustments identified by our auditors as part of their quarterly review process were recorded to increase the inventory write-downs and to increase cost of sales by \$985,000 for the quarter and nine months ended December 31, 2013.

This control deficiency could result in a misstatement in our consolidated financial statements and disclosures that would result in a material misstatement in our annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, our management has determined that this control deficiency constitutes a material weakness. The Audit Committee of our Board of Directors has concurred with our management's determination.

*Management's Plan for Remediation*

Since the identification of the error in our third quarter financial statements and the material weakness that gave rise to the error, our management has been actively engaged in implementing a remediation plan to fully address the material weakness. To date, remediation efforts taken by management have focused on ensuring that all relevant information is considered in evaluating whether inventory should be written down and increasing the precision of our controls to fully take into account lower levels of materiality following the decline in our revenues and



income (loss) before tax.

Our management believes that these improvements in controls will remediate the material weakness. As we continue to evaluate and work to improve our internal control over financial reporting, management may determine that additional measures are required to address the material weakness or may decide to modify the remediation plan described above.

Internal control over financial reporting, no matter how well designed, has inherent limitations. Therefore, even those controls determined to be effective may not prevent or detect misstatements and can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of

Table of Contents

effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

*Changes in Internal Control over Financial Reporting.*

There were no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. The changes in our internal control over financial reporting that took place subsequent to the end of the quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting are discussed above under the heading "Management's Plan for Remediation".

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

In March 2011, Cypress Semiconductor Corporation, a semiconductor manufacturer, filed a lawsuit against us in the United States District Court for the District of Minnesota alleging that our products, including our SigmaDDR and SigmaQuad families of Very Fast SRAMs, infringe five patents held by Cypress. The complaint seeks unspecified damages for past infringement and a permanent injunction against future infringement.

On June 10, 2011, Cypress filed a complaint against us with the United States International Trade Commission (the "ITC"). The ITC complaint, as subsequently amended, alleged infringement by GSI of three of the five patents involved in the District Court case and one additional patent and also alleged infringement by three of our distributors and 11 of our customers who allegedly incorporate our SRAMs in their products. The ITC complaint sought a limited exclusion order excluding the allegedly infringing SRAMs, and products containing them, from entry into the United States and permanent orders directing GSI and the other respondents to cease and desist from selling or distributing such products in the United States. On July 21, 2011, the ITC formally instituted an investigation in response to Cypress's complaint. On June 7, 2013, the ITC announced that the full Commission had affirmed the determination of Chief Administrative Law Judge Charles E. Bullock that GSI's SRAM devices, and products containing them, do not infringe the Cypress patents and that Cypress had failed to establish the existence of a domestic industry that practices the patents. Moreover, the Commission reversed a portion of Judge Bullock's determination with respect to the validity of the patents, finding the asserted claims of one of the patents to have been anticipated by prior art and, therefore, invalid. The Commission ordered the investigation terminated, and Cypress did not appeal the ruling.

The Minnesota District Court case had been stayed pending the conclusion of the ITC proceeding. Following the termination of the ITC proceeding, the stay was lifted. On May 1, 2013, Cypress filed an additional lawsuit in the United States District Court for the Northern District of California alleging infringement by our products of five additional Cypress patents. Like the Minnesota case, the complaint in the California lawsuit seeks unspecified damages for past infringement and a permanent injunction against future infringement. We filed answers in both cases denying liability and asserting affirmative defenses. On August 7, 2013, the parties stipulated that the claims in the Minnesota case with respect to three of the asserted patents would be dismissed without prejudice and that the claims with respect to the remaining two patents would be transferred to, and consolidated with, the California case. On August 20, 2013, the Court in the California case ordered the cases consolidated. Discovery in the case is proceeding.

On July 22, 2011, we filed a complaint against Cypress in the United States District Court for the Northern District of California. Our complaint alleges that Cypress has conducted an unlawful combination and conspiracy to monopolize the market for certain high-performance SRAM devices, known as fast synchronous Quad Data Rate (or QDR) SRAMs and Double Data Rate (or DDR) SRAMs. The complaint alleges that the anti-competitive, collusive and conspiratorial conduct of Cypress and certain co-conspirators has violated Section 1 of the Sherman Act and also constitutes unlawful restraint of trade and unfair competition under applicable provisions of California law. The complaint seeks treble damages, in an amount to be determined at trial, a preliminary and permanent injunction prohibiting the continuation of the unfair and illegal business practices and recovery of GSI's attorneys' fees and costs. On July 6, 2012, the Court denied Cypress' motion to dismiss the complaint, upholding the sufficiency of the antitrust claims asserted, and discovery in the case is proceeding.

We believe that we have strong defenses against Cypress' infringement claims in the remaining California District Court case. We intend to continue to defend ourselves vigorously in that proceeding while vigorously continuing to prosecute our antitrust claims against Cypress. However, the litigation process is inherently uncertain, and we may not prevail. Patent litigation is particularly complex and can extend for a protracted period of time, which can substantially increase the cost of such litigation. We have incurred and expect to continue to incur substantial legal fees and expenses in connection with the Cypress patent and antitrust litigation, and we also expect the litigation to continue to divert the efforts and attention of some of our key management and technical personnel. As a result, the litigation has been, and will continue to be, costly and time

Table of Contents

consuming. In addition, we believe that uncertainty regarding the outcome of the litigation has caused some of our customers and potential customers to reduce purchases of our products and/or seek second sources of supply, which adversely affected our revenues during the past several quarters. We believe that the Commission's favorable final determination in the ITC proceeding has reduced this market uncertainty, although it is likely to continue to have some effect on our revenues over the next several quarters while our customers re-evaluate their SRAM sourcing strategies.

Should the outcome of the patent litigation be adverse to us, we could be required to pay significant monetary damages to Cypress and could be enjoined from selling those of our products found to infringe Cypress's patents unless and until we are able to negotiate a license from Cypress. Any such license arrangement with Cypress would likely require the payment of royalties which would increase our cost of revenues and reduce our gross profit. If we are required to pay significant monetary damages, are enjoined from selling any of our products or are required to make substantial royalty payments pursuant to any such license arrangement, our business would be significantly harmed.

**Item 1A. Risk Factors**

*Our future performance is subject to a variety of risks. If any of the following risks actually occur, our business, financial condition and results of operations could suffer and the trading price of our common stock could decline. Additional risks that we currently do not know about or that we currently believe to be immaterial may also impair our business operations. You should also refer to other information contained in this report, including our condensed consolidated financial statements and related notes. The risk factors described below do not contain any material changes from those previously disclosed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended March 31, 2013.*

***Unpredictable fluctuations in our operating results could cause our stock price to decline.***

Our quarterly and annual revenues, expenses and operating results have varied significantly and are likely to vary in the future. For example, in the eleven fiscal quarters ended December 31, 2013, we recorded net revenues of as much as \$23.0 million and as little as \$13.8 million and quarterly operating income of as much as \$4.1 million and, in three quarters, operating losses, including the operating loss of \$1.9 million in the quarter ended December 31, 2013. We therefore believe that period-to-period comparisons of our operating results are not a good indication of our future performance, and you should not rely on them to predict our future performance or the future performance of our stock price. In future periods, we may not have any revenue growth, or our revenues could decline. Furthermore, if our operating expenses exceed our expectations, our financial performance could be adversely affected. Factors that may affect periodic operating results in the future include:

- our ability to anticipate and conform to new industry standards;
- unpredictability of the timing and size of customer orders, since most of our customers purchase our products on a purchase order basis rather than pursuant to a long term contract;
- changes in our customers' inventory management practices;

- fluctuations in availability and costs associated with materials needed to satisfy customer requirements;
- manufacturing defects, which could cause us to incur significant warranty, support and repair costs, lose potential sales, harm our relationships with customers and result in write-downs;
- changes in our product pricing policies, including those made in response to new product announcements and pricing changes of our competitors;
- fluctuations in our quarterly operating expenses due to substantial litigation-related expenses in some quarters; and
- our ability to address technology issues as they arise, improve our products' functionality and expand our product offerings.

Our expenses are, to a large extent, fixed, and we expect that these expenses will increase in the future. We will not be able to adjust our spending quickly if our revenues fall short of our expectations. If this were to occur, our operating results would be harmed. If our operating results in future quarters fall below the expectations of market analysts and investors, the price of our common stock could fall.

Table of Contents

***Cisco Systems, our largest OEM customer, accounts for a significant percentage of our net revenues. If Cisco Systems, or any of our other major customers reduce the amount they purchase or stop purchasing our products, our operating results will suffer.***

Cisco Systems, historically our largest OEM customer, purchases our products through its consignment warehouses and its contract manufacturers and directly from us. Based on information provided to us by its consignment warehouses and contract manufacturers, purchases by Cisco Systems represented approximately 29%, 41% and 37% of our net revenues in fiscal 2013, 2012 and 2011, respectively, but represented approximately 19% of our net revenues in the nine months ended December 31, 2013. We expect that our operating results in any given period will continue to depend significantly on orders from our key OEM customers, particularly Cisco Systems, and our future success is dependent to a large degree on the business success of these OEMs over which we have no control. We do not have long-term contracts with Cisco Systems or any of our other major OEM customers, distributors or contract manufacturers that obligate them to purchase our products. We expect that future direct and indirect sales to Cisco Systems will continue to fluctuate significantly on a quarterly basis and that such fluctuations may significantly affect our operating results in future periods. If we fail to continue to sell to our key OEM customers, distributors or contract manufacturers in sufficient quantities, our business could be harmed.

***We have incurred significant losses in prior periods and may incur losses in the future.***

We have incurred significant losses in prior periods. For example, in fiscal 2003 and 2004, we incurred losses of \$7.4 million and \$670,000, respectively, and we incurred a loss of \$441,000 in the first quarter of fiscal 2014. Although we have operated profitably during each of the last nine fiscal years, there can be no assurance that our Very Fast SRAMs will continue to receive broad market acceptance or that we will be able to consistently achieve period-to-period revenue growth or profitability. Our failure to do so may result in additional losses in the future. In addition, we expect our operating expenses to increase as we expand our business. If our revenues do not grow to offset these expected increased expenses, our business will suffer.

***We depend upon the sale of our Very Fast SRAMs for most of our revenues, and a downturn in demand for these products could significantly reduce our revenues and harm our business.***

We derive most of our revenues from the sale of Very Fast SRAMs, and we expect that sales of these products will represent the substantial majority of our revenues for the foreseeable future. Our business depends in large part upon continued demand for our products in the markets we currently serve, and adoption of our products in new markets. Market adoption will be dependent upon our ability to increase customer awareness of the benefits of our products and to prove their high-performance and cost-effectiveness. We may not be able to sustain or increase our revenues from sales of our products, particularly if the networking and telecommunications markets were to experience another significant downturn in the future. Any decrease in revenues from sales of our products could harm our business more than it would if we offered a more diversified line of products.

***We are subject to the highly cyclical nature of the networking and telecommunications markets.***

Our products are incorporated into routers, switches, wireless local area network infrastructure equipment, wireless base stations and network access equipment used in the highly cyclical networking and telecommunications markets. For example, our operating results declined sharply in fiscal 2002 and 2003 as a result of the severe contraction in demand for networking and telecommunications equipment in which our products

are incorporated. Prior to this period of contraction, the networking and telecommunications markets experienced a period of rapid growth, which resulted in a significant increase in demand for our products. We expect that the networking and telecommunications markets will continue to be highly cyclical, characterized by periods of rapid growth and contraction. Our business and our operating results are likely to fluctuate, perhaps quite severely, as a result of this cyclicity.

*We are subject to pending patent infringement litigation.*

In March 2011, Cypress Semiconductor Corporation, a semiconductor manufacturer, filed a lawsuit against us in the United States District Court for the District of Minnesota alleging that our products, including our SigmaDDR and SigmaQuad families of Very Fast SRAMs, infringe five patents held by Cypress. The complaint seeks unspecified damages for past infringement and a permanent injunction against future infringement. The case was stayed pending the conclusion of an investigation by the International Trade Commission (the ITC) in response to a complaint filed by Cypress. In July 2013, following the termination of the ITC investigation, the stay was lifted. On May 1, 2013, Cypress filed a lawsuit in the United States District Court for the Northern District of California alleging infringement by our products of five additional Cypress patents. Like the Minnesota case, the complaint in the California lawsuit seeks unspecified damages for past infringement and a permanent injunction against future infringement. In August 2013, the Minnesota case was transferred to, and consolidated with, the California case.

Table of Contents

On July 22, 2011, we filed a complaint against Cypress in the United States District Court for the Northern District of California. Our complaint alleges that Cypress has conducted an unlawful combination and conspiracy to monopolize the market for certain high-performance SRAM devices, known as fast synchronous Quad Data Rate (or QDR) SRAMs and Double Data Rate (or DDR) SRAMs. The complaint alleges that the anti-competitive, collusive and conspiratorial conduct of Cypress and certain co-conspirators has violated Section 1 of the Sherman Act and also constitutes unlawful restraint of trade and unfair competition under applicable provisions of California law. The complaint seeks treble damages, in an amount to be determined at trial, a preliminary and permanent injunction prohibiting the continuation of the unfair and illegal business practices and recovery of GSI's attorneys' fees and costs. On July 6, 2012, the Court denied Cypress' motion to dismiss the complaint, upholding the sufficiency of the antitrust claims asserted, and discovery in the case is proceeding.

We believe that we have strong defenses against Cypress' patent infringement claims in the remaining California District Court case. We intend to continue to defend ourselves vigorously in that proceeding while vigorously continuing to prosecute our antitrust claims against Cypress. However, the litigation process is inherently uncertain, and we may not prevail. Patent litigation is particularly complex and can extend for a protracted period of time, which can substantially increase the cost of such litigation. We have incurred and expect to continue to incur substantial legal fees and expenses in connection with the Cypress patent and antitrust litigation. These expenses are likely to continue to fluctuate significantly from quarter to quarter and to be substantial in some quarters over the next one to two years. We also expect the litigation to continue to divert the efforts and attention of some of our key management and technical personnel. As a result, the litigation will be costly and time consuming. In addition, we believe that uncertainty regarding the outcome of the litigation has caused some of our customers and potential customers to reduce purchases of our products and/or seek second sources of supply, which adversely affected our revenues during the past several quarters. We believe that the Commission's favorable final determination in the ITC proceeding has reduced this market uncertainty, although it is likely to continue to have some effect on our revenues over the next several quarters while our customers re-evaluate their SRAM sourcing strategies.

Should the outcome of the patent litigation be adverse to us, we could be required to pay significant monetary damages to Cypress and could be enjoined from selling those of our products found to infringe Cypress's patents unless and until we are able to negotiate a license from Cypress. Any such license arrangement with Cypress would likely require the payment of royalties which would increase our cost of revenues and reduce our gross profit. If we are required to pay significant monetary damages, are enjoined from selling any of our products or are required to make substantial royalty payments pursuant to any such license arrangement, our business would be significantly harmed.

***The average selling prices of our products are expected to decline, and if we are unable to offset these declines, our operating results will suffer.***

Historically, the average unit selling prices of our products have declined substantially over the lives of the products, and we expect this trend to continue. A reduction in overall average selling prices of our products could result in reduced revenues and lower gross margins. Our ability to increase our net revenues and maintain our gross margins despite a decline in the average selling prices of our products will depend on a variety of factors, including our ability to introduce lower cost versions of our existing products, increase unit sales volumes of these products, and introduce new products with higher prices and greater margins. If we fail to accomplish any of these objectives, our business will suffer. To reduce our costs, we may be required to implement design changes that lower our manufacturing costs, negotiate reduced purchase prices from our independent foundries and our independent assembly and test vendors, and successfully manage our manufacturing and subcontractor relationships. Because we do not operate our own wafer foundry or assembly facilities, we may not be able to reduce our costs as rapidly as companies that operate their own foundries or facilities.

***Current unfavorable economic and market conditions, domestically and internationally, may adversely affect our business, financial condition, results of operations and cash flows.***



We have significant customer sales both in the United States and internationally. We are also reliant upon U.S. and international suppliers, manufacturing partners and distributors. We are therefore susceptible to adverse U.S. and international economic and market conditions, including the challenging economic conditions that have prevailed and continue to prevail in the United States and worldwide. The recent turmoil in the financial markets has resulted in higher borrowing costs and tightened credit markets which have made it more difficult (in some cases, prohibitively so) for many companies to fund their working capital obligations. If any of our manufacturing partners, customers, distributors or suppliers experiences serious financial difficulties or ceases operations, our business could be adversely affected. The adverse impact of the credit crisis on consumers, including higher unemployment rates, is also adversely impacting consumer spending, which adversely impacts demand for consumer products, including certain end products in which our SRAMs are embedded. In addition, ongoing economic turmoil has recently had an adverse affect on capital expenditures for network equipment, particularly in Europe, which has impacted sales to some of our largest customers. The difficulty that businesses (including our customers) may have in obtaining credit, the decreased consumer spending resulting from the credit market crisis, high unemployment rates and

Table of Contents

continued global economic and market turmoil are likely to continue to have an adverse impact on our business, financial condition, results of operations and cash flows, at least over the near term.

***We are dependent on a number of single source suppliers, and if we fail to obtain adequate supplies, our business will be harmed and our prospects for growth will be curtailed.***

We currently purchase several key components used in the manufacture of our products from single sources and are dependent upon supply from these sources to meet our needs. If any of these suppliers cannot provide components on a timely basis, at the same price or at all, our ability to manufacture our products will be constrained and our business will suffer. Most significantly, we obtain wafers for our Very Fast SRAM products from a single foundry, TSMC, and most of them are packaged at ASE. Wafers for our LLDRAM products are obtained exclusively from Powerchip. If we are unable to obtain an adequate supply of wafers from TSMC or Powerchip or find alternative sources in a timely manner, we will be unable to fulfill our customer orders and our operating results will be harmed. We do not have supply agreements with TSMC, Powerchip, ASE or any of our other independent assembly and test suppliers, and instead obtain manufacturing services and products from these suppliers on a purchase-order basis. Our suppliers, including TSMC and Powerchip, have no obligation to supply products or services to us for any specific product, in any specific quantity, at any specific price or for any specific time period. As a result, the loss or failure to perform by any of these suppliers could adversely affect our business and operating results.

Should any of our single source suppliers experience manufacturing failures or yield shortfalls, be disrupted by natural disaster or political instability, choose to prioritize capacity or inventory for other uses or reduce or eliminate deliveries to us, we likely will not be able to enforce fulfillment of any delivery commitments and we would have to identify and qualify acceptable replacements from alternative sources of supply. In particular, if TSMC is unable to supply us with sufficient quantities of wafers to meet all of our requirements, we would have to allocate our products among our customers, which would constrain our growth and might cause some of them to seek alternative sources of supply. Since the manufacturing of wafers and other components is extremely complex, the process of qualifying new foundries and suppliers is a lengthy process and there is no assurance that we would be able to find and qualify another supplier without materially adversely affecting our business, financial condition and results of operations.

***Because we outsource our wafer manufacturing and independent wafer foundry capacity is limited, we may be required to enter into costly long-term supply arrangements to secure foundry capacity.***

We do not have long-term supply agreements with TSMC or Powerchip, but instead obtain our wafers on a purchase order basis. In order to secure future wafer supply from TSMC or Powerchip or from other independent foundries, we may be required to enter into various arrangements with them, which could include:

- contracts that commit us to purchase specified quantities of wafers over extended periods;
- investments in and joint ventures with the foundries; or

- non-refundable deposits with or prepayments or loans to foundries in exchange for capacity commitments.

We may not be able to make any of these arrangements in a timely fashion or at all, and these arrangements, if any, may not be on terms favorable to us. Moreover, even if we are able to secure independent foundry capacity, we may be obligated to use all of that capacity or incur penalties. These penalties may be expensive and could harm our financial results.

*If we are unable to offset increased wafer fabrication costs by increasing the average selling prices of our products, our gross margins will suffer.*

If there is a significant upturn in the networking and telecommunications markets that results in increased demand for our products and competing products, the available supply of wafers may be limited. As a result, we could be required to obtain additional manufacturing capacity in order to meet increased demand. Securing additional manufacturing capacity may cause our wafer fabrication costs to increase. If we are unable to offset these increased costs by increasing the average selling prices of our products, our gross margins will decline.

*We rely heavily on distributors and our success depends on our ability to develop and manage our indirect distribution channels.*

A significant percentage of our sales are made to distributors and to contract manufacturers who incorporate our products into end products for OEMs. For example, in the nine months ended December 31, 2013 and in fiscal 2013, 2012 and 2011, our distributor Avnet Logistics accounted for 29%, 27%, 20% and 17%, respectively, of our net revenues. Avnet Logistics and our

Table of Contents

other existing distributors may choose to devote greater resources to marketing and supporting the products of other companies. Since we sell through multiple channels and distribution networks, we may have to resolve potential conflicts between these channels. For example, these conflicts may result from the different discount levels offered by multiple channel distributors to their customers or, potentially, from our direct sales force targeting the same equipment manufacturer accounts as our indirect channel distributors. These conflicts may harm our business or reputation.

***We may be unable to accurately predict future sales through our distributors, which could harm our ability to efficiently manage our resources to match market demand.***

Our financial results, quarterly product sales, trends and comparisons are affected by fluctuations in the buying patterns of the OEMs that purchase our products from our distributors. While we attempt to assist our distributors in maintaining targeted stocking levels of our products, we may not consistently be accurate or successful. This process involves the exercise of judgment and use of assumptions as to future uncertainties, including end user demand. Inventory levels of our products held by our distributors may exceed or fall below the levels we consider desirable on a going-forward basis. This could result in distributors returning unsold inventory to us, or in us not having sufficient inventory to meet the demand for our products. If we are not able to accurately predict sales through our distributors or effectively manage our relationships with our distributors, our business and financial results will suffer. Moreover, sales to our distributors are recorded as deferred revenue for financial accounting purposes and recognized as revenue when the products are resold by the distributor to their OEM customers. Accordingly, our distributors' management of their inventory can have a significant impact on our reported revenues and contribute to quarter-to-quarter revenue volatility.

***A small number of customers generally account for a significant portion of our accounts receivable in any period, and if any one of them fails to pay us, our operating results will suffer.***

At December 31, 2013, six customers accounted for 20%, 16%, 15%, 15%, 13% and 11% of our accounts receivable, respectively. If any of these customers do not pay us, our operating results will be harmed. Generally, we do not require collateral from our customers.

***We have disclosed a material weakness in our internal control over financial reporting relating to the evaluation and calculation of our inventory reserve. Our failure to remediate this material weakness or to otherwise maintain effective internal control over financial reporting and disclosure controls and processes could adversely affect our ability to report our financial condition and results of operations accurately and on a timely basis.***

In connection with the completion of our third fiscal quarter-end closing and review procedures and the preparation of this report, certain errors were identified in the evaluation and calculation of our inventory write-down for the quarter and nine month periods ended December 31, 2013 that were the result of a material weakness in our internal control over financial reporting. For a discussion of our internal control over financial reporting and a description of the identified material weakness, see Material Weakness in Internal Control over Financial Reporting under Item 4, Controls and Procedures.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis.

During our third fiscal quarter-end closing and review procedures our management determined that we had not designed and maintained effective controls over the review of supporting information to determine the completeness and accuracy of our calculations for the write-down of excess or obsolete inventory, thereby affecting the valuation of our inventory as of December 31, 2013. Specifically, quarterly controls, including procedures for monitoring older product inventory, were not maintained to fully take into account the fact that management's prior expectations of increasing demand in the current year for our products following the favorable ITC ruling on June 7, 2013 and the exit of a competitor from the SRAM market in December 2012 did not materialize and were not sufficiently precise to identify all potentially excess or obsolete inventory following declines our revenues and income (loss) before tax. Consequently we did not initially write down the full amount of excess or obsolete inventory, and additional adjustments were recorded to increase the inventory write-downs and to increase cost of sales by \$985,000 for the quarter and nine months ended December 31, 2013. While this control deficiency did not result in any material misstatement of our historical financial statements, it did result in adjustments identified by our auditors as part of their quality review process, and require corrections after our initial estimate of excess and obsolete inventory write-downs for the three month period ended December 31, 2013.

A material weakness in our internal control over financial reporting could adversely impact our ability to provide timely and accurate financial information. Our management may determine that additional measures are required to address the material weakness or may decide to modify the remediation plan. If we are unsuccessful in implementing or following our remediation plan, we may not be able to timely or accurately report our financial condition and results of operations or maintain effective disclosure controls and procedures. Any failure by us to adequately remediate this material weakness or to otherwise maintain effective internal control over financial reporting and disclosure controls and procedures could cause us to fail to meet our reporting obligations accurately and on a timely basis. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could adversely affect the trading price of our common stock.

Table of Contents

*Our acquisition of companies or technologies could prove difficult to integrate, disrupt our business, dilute stockholder value and adversely affect our operating results.*

In August 2009, we consummated the acquisition of substantially all of the assets related to the SRAM memory device product line of Sony Corporation. In the future, we may make additional acquisitions or investments in companies, assets or technologies that we believe are complementary or strategic. Prior to the Sony acquisition, we had not made any such acquisitions or investments, and therefore our experience as an organization in making such acquisitions and investments is limited. In connection with future acquisitions or investments we may make, we face numerous risks, including:

- difficulties in integrating operations, technologies, products and personnel;
  
- diversion of financial and managerial resources from existing operations;
  
- risk of overpaying for or misjudging the strategic fit of an acquired company, asset or technology;
  
- problems or liabilities stemming from defects of an acquired product or intellectual property litigation that may result from offering the acquired product in our markets;
  
- challenges in retaining key employees to maximize the value of the acquisition or investment;
  
- inability to generate sufficient return on investment;
  
- incurrence of significant one-time write-offs; and
  
- delays in customer purchases due to uncertainty.

If we proceed with additional acquisitions or investments, we may be required to use a considerable amount of our cash, or to finance the transaction through debt or equity securities offerings, which may decrease our financial liquidity or dilute our stockholders and affect the market price of our stock. As a result, if we fail to properly evaluate and execute acquisitions or investments, our business and prospects may be harmed.



Table of Contents

***Claims that we infringe third party intellectual property rights could seriously harm our business and require us to incur significant costs.***

In recent years, there has been significant litigation in the semiconductor industry involving patents and other intellectual property rights. We are currently involved in patent infringement litigation. See We are subject to pending patent infringement litigation above. We could become subject to additional claims or litigation in the future as a result of allegations that we infringe others' intellectual property rights or that our use of intellectual property otherwise violates the law. Claims that our products infringe the proprietary rights of others would force us to defend ourselves and possibly our customers, distributors or manufacturers against the alleged infringement. Any such litigation regarding intellectual property could result in substantial costs and diversion of resources and could have a material adverse effect on our business, financial condition and results of operations. Similarly, changing our products or processes to avoid infringing the rights of others may be costly or impractical. If any claims received in the future were to be upheld, the consequences to us would be severe and could require us to:

- stop selling our products that incorporate the challenged intellectual property;
  
- obtain a license to sell or use the relevant technology, which license may not be available on reasonable terms or at all;
  
- pay damages; or
  
- redesign those products that use the disputed technology.

Although patent disputes in the semiconductor industry have often been settled through cross-licensing arrangements, we may not be able in any or every instance to settle an alleged patent infringement claim through a cross-licensing arrangement. We have a more limited patent portfolio than many of our competitors. If a successful claim is made against us or any of our customers and a license is not made available to us on commercially reasonable terms or we are required to pay substantial damages or awards, our business, financial condition and results of operations would be materially adversely affected.

***Our business will suffer if we are unable to protect our intellectual property.***

Our success and ability to compete depends in large part upon protecting our proprietary technology. We rely on a combination of patent, trade secret, copyright and trademark laws and non-disclosure and other contractual agreements to protect our proprietary rights. These agreements and measures may not be sufficient to protect our technology from third-party infringement, or to protect us from the claims of others. Monitoring unauthorized use of our products is difficult and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. Our attempts to enforce our intellectual property rights could be time consuming and costly. Litigation may be necessary in order to enforce our intellectual property rights or to protect our trade secrets. If competitors are able to use our technology without our approval or compensation, our ability to compete effectively could be harmed.



*The market for Very Fast SRAMs is highly competitive.*

The market for Very Fast SRAMs, which are used primarily in networking and telecommunications equipment, is characterized by price erosion, rapid technological change, cyclical market patterns and heightened foreign and domestic competition. Several of our competitors offer a broad array of memory products and have greater financial, technical, marketing, distribution and other resources than we have. Some of our competitors maintain their own semiconductor fabrication facilities, which may provide them with capacity, cost and technical advantages over us. We cannot assure you that we will be able to compete successfully against any of these competitors. Our ability to compete successfully in this market depends on factors both within and outside of our control, including:

- real or perceived imbalances in supply and demand of Very Fast SRAMs;
- the rate at which OEMs incorporate our products into their systems;
- the success of our customers' products;
- our ability to develop and market new products; and
- the supply and cost of wafers.

Table of Contents

In addition, we are vulnerable to advances in technology by competitors, including new SRAM architectures and new forms of DRAM, or the emergence of new memory technologies that could enable the development of products that feature higher performance, lower cost or lower power capabilities. Additionally, the trend toward incorporating SRAM into other chips in the networking and telecommunications markets has the potential to reduce future demand for Very Fast SRAM products. There can be no assurance that we will be able to compete successfully in the future. Our failure to compete successfully in these or other areas could harm our business.

***We may experience difficulties in transitioning to smaller geometry process technologies and other more advanced manufacturing process technologies, which may result in reduced manufacturing yields, delays in product deliveries and increased expenses.***

In order to remain competitive, we expect to continue to transition the manufacture of our products to smaller geometry process technologies. This transition will require us to migrate to new manufacturing processes for our products and redesign certain products. The manufacture and design of our products is complex, and we may experience difficulty in transitioning to smaller geometry process technologies or new manufacturing processes. These difficulties could result in reduced manufacturing yields, delays in product deliveries and increased expenses. We are dependent on our relationships with TSMC and Powerchip to transition successfully to smaller geometry process technologies and to more advanced manufacturing processes. We cannot assure you that TSMC or Powerchip will be able to effectively manage these transitions or that we will be able to maintain our relationship with them. If we or TSMC or Powerchip experience significant delays or fail to implement these transitions, our business, financial condition and results of operations could be materially and adversely affected.

***Manufacturing process technologies are subject to rapid change and require significant expenditures for research and development.***

We continuously evaluate the benefits of migrating to smaller geometry process technologies in order to improve performance and reduce costs. Historically, these migrations to new manufacturing processes have resulted in significant initial design and development costs associated with pre-production mask sets for the manufacture of new products with smaller geometry process technologies. For example, in fiscal 2010 and 2011, we incurred \$650,000 and \$727,000, respectively, in research and development expense associated with pre-production mask sets which were not later used in production as part of the transition to our new 65 nanometer SRAM process technology and 72 nanometer DRAM process technology, respectively. We will incur similar expenses in the future as we continue to transition our products to smaller geometry processes. The transition costs inherent in the transition to new manufacturing process technologies will adversely affect our operating results and our gross margin.

***Our products are complex to design and manufacture and could contain defects, which could reduce revenues or result in claims against us.***

We develop complex products. Despite testing by us and our OEM customers, design or manufacturing errors may be found in existing or new products. These defects could result in a delay in recognition or loss of revenues, loss of market share or failure to achieve market acceptance. These defects may also cause us to incur significant warranty, support and repair costs, divert the attention of our engineering personnel from our product development efforts, result in a loss of market acceptance of our products and harm our relationships with our OEM customers. Our OEM customers could also seek and obtain damages from us for their losses. A product liability claim brought against us, even if unsuccessful, would likely be time consuming and costly to defend.

## Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

Defects in wafers and other components used in our products and arising from the manufacturing of these products may not be fully recoverable from TSMC or other suppliers. For example, in the quarter ended December 31, 2005, we incurred a charge of approximately \$900,000 related to the write-off of inventory resulting from an error in the assembly process at one of our suppliers. This write-off adversely affected our operating results for fiscal 2006.

Table of Contents

***Demand for our products may decrease if our OEM customers experience difficulty manufacturing, marketing or selling their products.***

Our products are used as components in our OEM customers' products. For example, Cisco Systems, our largest OEM customer, incorporates our products in a number of its networking routers and switches. Accordingly, demand for our products is subject to factors affecting the ability of our OEM customers to successfully introduce and market their products, including:

- capital spending by telecommunication and network service providers and other end users who purchase our OEM customers' products;
- the competition our OEM customers face, particularly in the networking and telecommunications industries;
- the technical, manufacturing, sales and marketing and management capabilities of our OEM customers;
- the financial and other resources of our OEM customers; and
- the inability of our OEM customers to sell their products if they infringe third-party intellectual property rights.

As a result, if OEM customers reduce their purchases of our products, our business will suffer.

***Downturns in the semiconductor industry may harm our revenues and margins.***

The semiconductor industry is highly cyclical. The industry has experienced significant downturns, often in connection with, or in anticipation of, maturing product cycles of both semiconductor companies and their customers' products and declines in general economic conditions. These downturns have been characterized by production overcapacity, high inventory levels and accelerated erosion of average selling prices. From time to time, the semiconductor industry also has experienced periods of increased demand and production capacity constraints. Our operating results may suffer during the down portion of these cycles. Downturns in the semiconductor industry could cause our stock price to be volatile, and a prolonged decline in the industry could adversely affect our revenues. If we are unable to control our inventory levels or expenses adequately in response to reduced net sales, our results of operations would be negatively impacted.

***If we do not successfully develop new products to respond to rapid market changes due to changing technology and evolving industry standards, particularly in the networking and telecommunications markets, our business will be harmed.***

If we fail to offer technologically advanced products and respond to technological advances and emerging standards, we may not generate sufficient revenues to offset our development costs and other expenses, which will hurt our business. The development of new or enhanced products is a complex and uncertain process that requires the accurate anticipation of technological and market trends. In particular, the networking and telecommunications markets are rapidly evolving and new standards are emerging. We are vulnerable to advances in technology by competitors, including new SRAM architectures, new forms of DRAM and the emergence of new memory technologies that could enable the development of products that feature higher performance or lower cost. We may experience development, marketing and other technological difficulties that may delay or limit our ability to respond to technological changes, evolving industry standards, competitive developments or end-user requirements. For example, because we have limited experience developing integrated circuits, or IC, products other than Very Fast SRAMs, our efforts to introduce new products may not be successful and our business may suffer. Other challenges that we face include:

- our products may become obsolete upon the introduction of alternative technologies;
- we may incur substantial costs if we need to modify our products to respond to these alternative technologies;
- we may not have sufficient resources to develop or acquire new technologies or to introduce new products capable of competing with future technologies;
- new products that we develop may not successfully integrate with our end-users' products into which they are incorporated;
- we may be unable to develop new products that incorporate emerging industry standards;
- we may be unable to develop or acquire the rights to use the intellectual property necessary to implement new technologies; and
- when introducing new or enhanced products, we may be unable to manage effectively the transition from older products.

Table of Contents

***Our products have lengthy sales cycles that make it difficult to plan our expenses and forecast results.***

Our products are generally incorporated in our OEM customers' products at the design stage. However, their decisions to use our products often require significant expenditures by us without any assurance of success, and often precede volume sales, if any, by a year or more. If an OEM customer decides at the design stage not to incorporate our products into their products, we will not have another opportunity for a design win with respect to that customer's product for many months or years, if at all. Our sales cycle can take up to 24 months to complete, and because of this lengthy sales cycle, we may experience a delay between increasing expenses for research and development and our sales and marketing efforts and the generation of volume production revenues, if any, from these expenditures. Moreover, the value of any design win will largely depend on the commercial success of our OEM customers' products. There can be no assurance that we will continue to achieve design wins or that any design win will result in future revenues.

***Any significant order cancellations or order deferrals could adversely affect our operating results.***

We typically sell products pursuant to purchase orders that customers can generally cancel or defer on short notice without incurring a significant penalty. Any significant cancellations or deferrals in the future could materially and adversely affect our business, financial condition and results of operations. Cancellations or deferrals could cause us to hold excess inventory, which could reduce our profit margins, increase product obsolescence and restrict our ability to fund our operations. We generally recognize revenue upon shipment of products to a customer. If a customer refuses to accept shipped products or does not pay for these products, we could miss future revenue projections or incur significant charges against our income, which could materially and adversely affect our operating results.

***If our business grows, such growth may place a significant strain on our management and operations and, as a result, our business may suffer.***

We are endeavoring to resume the expansion of our business, and any growth that we are successful in achieving could place a significant strain on our management systems, infrastructure and other resources. To manage such growth of our operations and increases in the number of our personnel, we will need to invest the necessary capital to continue to improve our operational, financial and management controls and our reporting systems and procedures. Our controls, systems and procedures may prove to be inadequate should we experience significant growth. In addition, we may not have sufficient administrative staff to support our operations. For example, we currently have only five employees in our finance department in the United States, including our Chief Financial Officer. Furthermore, our officers have limited experience in managing large or rapidly growing businesses. If our management fails to respond effectively to changes in our business, our business may suffer.

***Our international business exposes us to additional risks.***

Products shipped to destinations outside of the United States accounted for 68%, 69%, 77% and 70% of our net revenues in the nine months ended December 31, 2013 and in fiscal 2013, 2012 and 2011, respectively. Moreover, we operate a facility in Taiwan, and a substantial portion of our products is manufactured and tested in Taiwan. We intend to continue expanding our international business in the future. Conducting business outside of the United States subjects us to additional risks and challenges, including:

## Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

- compliance with a wide variety of foreign laws and regulations and unexpected changes in these laws;
- legal uncertainties regarding taxes, tariffs, quotas, export controls, competition, export licenses and other trade barriers;
- potential political and economic instability in, or foreign conflicts that involve or affect, the countries in which we, our customers and our suppliers are located;
- difficulties in collecting accounts receivable and longer accounts receivable payment cycles;
- difficulties and costs of staffing and managing personnel, distributors and representatives across different geographic areas and cultures, including assuring compliance with the U. S. Foreign Corrupt Practices Act and other U. S. and foreign anti-corruption laws;
- limited protection for intellectual property rights in some countries;

Table of Contents

- heightened price sensitivity from customers in emerging markets; and
- fluctuations in freight rates and transportation disruptions.

Moreover, our reporting currency is the U.S. dollar. However, a portion of our cost of revenues and our operating expenses is denominated in currencies other than the U.S. dollar, primarily the New Taiwanese dollar. As a result, appreciation or depreciation of other currencies in relation to the U.S. dollar could result in transaction gains or losses that could impact our operating results. We do not currently engage in currency hedging activities to reduce the risk of financial exposure from fluctuations in foreign exchange rates.

***TSMC and Powerchip, as well as our other independent suppliers and many of our OEM customers have operations in the Pacific Rim, an area subject to significant earthquake risk and adverse consequences related to the potential outbreak of contagious diseases such as the H1N1 Flu.***

The foundries that manufacture our Very Fast SRAM and LLDRAM products, TSMC and Powerchip, and all of the principal independent suppliers that assemble and test our products are located in Taiwan. Many of our customers are also located in the Pacific Rim. The risk of an earthquake in these Pacific Rim locations is significant. The occurrence of an earthquake or other natural disaster near the fabrication facilities of TSMC or our other independent suppliers could result in damage, power outages and other disruptions that impair their production and assembly capacity. Any disruption resulting from such events could cause significant delays in the production or shipment of our products until we are able to shift our manufacturing, assembling, packaging or production testing from the affected contractor to another third-party vendor. In such an event, we may not be able to obtain alternate foundry capacity on favorable terms, or at all.

The outbreak of SARS in 2003 curtailed travel to and from certain countries, primarily in the Asia-Pacific region, and limited travel within those countries. If there were to be another outbreak of a contagious disease, such as SARS or the H1N1 Flu, that significantly affected the Asia-Pacific region, the operations of our key suppliers could be disrupted. In addition, our business could be harmed if such an outbreak resulted in travel being restricted, as it was during parts of 2003, or if it adversely affected the operations of our suppliers or our OEM customers or the demand for our products or our OEM customers' products.

***Changes in Taiwan's political, social and economic environment may affect our business performance.***

Because much of the manufacturing and testing of our products is conducted in Taiwan, our business performance may be affected by changes in Taiwan's political, social and economic environment. For example, any political instability resulting from the relationship among the United States, Taiwan and the People's Republic of China could damage our business. Moreover, the role of the Taiwanese government in the Taiwanese economy is significant. Taiwanese policies toward economic liberalization, and laws and policies affecting technology companies, foreign investment, currency exchange rates, taxes and other matters could change, resulting in greater restrictions on our ability and our suppliers' ability to do business and operate facilities in Taiwan. If any of these changes were to occur, our business could be harmed and our stock price could decline.



*We are substantially dependent on the continued services and performance of our senior management and other key personnel.*

Our future success is substantially dependent on the continued services and continuing contributions of our senior management who must work together effectively in order to design our products, expand our business, increase our revenues and improve our operating results. Members of our senior management team have long-standing and important relationships with our key customers and suppliers. The loss of services of Lee-Lean Shu, our President and Chief Executive Officer, Robert Yau, our Vice President of Engineering, any other executive officer or other key employee could significantly delay or prevent the achievement of our development and strategic objectives. We do not have employment contracts with, nor maintain key person insurance on, any of our executive officers.

*If we are unable to recruit or retain qualified personnel, our business and product development efforts could be harmed.*

We must continue to identify, recruit, hire, train, retain and motivate highly skilled technical, managerial, sales and marketing and administrative personnel. Competition for these individuals is intense, and we may not be able to successfully recruit, assimilate or retain sufficiently qualified personnel. We may encounter difficulties in recruiting and retaining a sufficient number of qualified engineers, which could harm our ability to develop new products and adversely impact our relationships with existing and future end-users at a critical stage of development. The failure to recruit and retain necessary

Table of Contents

technical, managerial, sales, marketing and administrative personnel could harm our business and our ability to obtain new OEM customers and develop new products.

***We may need to raise additional capital in the future, which may not be available on favorable terms or at all, and which may cause dilution to existing stockholders.***

We may need to seek additional funding in the future. We do not know if we will be able to obtain additional financing on favorable terms, if at all. If we cannot raise funds on acceptable terms, if and when needed, we may not be able to develop or enhance our products, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, and we may be required to reduce operating costs, which could seriously harm our business. In addition, if we issue equity securities, our stockholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of our common stock.

***Some of our products are incorporated into advanced military electronics, and changes in international geopolitical circumstances and domestic budget considerations may hurt our business.***

Some of our products are incorporated into advanced military electronics such as radar and guidance systems. Military expenditures and appropriations for such purchases have risen significantly in recent years. However, as the current conflict in Afghanistan winds down, demand for our products for use in military applications may decrease and our operating results could suffer. Domestic budget considerations may also adversely affect our operating results. For example, if governmental appropriations for military purchases of electronic devices that include our products are reduced, our revenues will likely decline.

***Our operations involve the use of hazardous and toxic materials, and we must comply with environmental laws and regulations, which can be expensive, and may affect our business and operating results.***

We are subject to federal, state and local regulations relating to the use, handling, storage, disposal and human exposure to hazardous and toxic materials. If we were to violate or become liable under environmental laws in the future as a result of our inability to obtain permits, human error, accident, equipment failure or other causes, we could be subject to fines, costs, or civil or criminal sanctions, face property damage or personal injury claims or be required to incur substantial investigation or remediation costs, which could be material, or experience disruptions in our operations, any of which could have a material adverse effect on our business. In addition, environmental laws could become more stringent over time imposing greater compliance costs and increasing risks and penalties associated with violations, which could harm our business.

We also face increasing complexity in our product design as we adjust to new and future requirements relating to the materials composition of our products, including the restrictions on lead and other hazardous substances applicable to specified electronic products placed on the market in the European Union (Restriction on the Use of Hazardous Substances Directive 2002/95/EC, also known as the RoHS Directive). We also expect that our operations will be affected by other new environmental laws and regulations on an ongoing basis. Although we cannot predict the ultimate impact of any such new laws and regulations, they will likely result in additional costs, and could require that we change the design and/or manufacturing of our products, any of which could have a material adverse effect on our business.



Table of Contents

*The trading price of our common stock is subject to fluctuation and is likely to be volatile.*

The trading price of our common stock may fluctuate significantly in response to a number of factors, some of which are beyond our control, including:

- actual or anticipated declines in operating results;
  
- changes in financial estimates or recommendations by securities analysts;
  
- the institution of legal proceedings against us or significant developments in such proceedings;
  
- announcements by us or our competitors of financial results, new products, significant technological innovations, contracts, acquisitions, strategic relationships, joint ventures, capital commitments or other events;
  
- changes in industry estimates of demand for Very Fast SRAM products;
  
- the gain or loss of significant orders or customers;
  
- recruitment or departure of key personnel; and
  
- market conditions in our industry, the industries of our customers and the economy as a whole.

In recent years the stock market in general, and the market for technology stocks in particular, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. The market price of our common stock might experience significant fluctuations in the future, including fluctuations unrelated to our performance. These fluctuations could materially adversely affect our business relationships, our ability to obtain future financing on favorable terms or otherwise harm our business. In addition, in the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. This risk is especially acute for us because the extreme volatility of market prices of technology companies has resulted in a larger number of securities class action claims against them. Due to the potential volatility of our stock price, we may in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management's attention and resources. This could harm our business

and cause the value of our stock to decline.

***Our executive officers, directors and entities affiliated with them hold a substantial percentage of our common stock.***

As of December 31, 2013, our executive officers, directors and entities affiliated with them beneficially owned approximately 26% of our outstanding common stock. As a result, these stockholders will be able to exercise substantial influence over, and may be able to effectively control, matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, which could have the effect of delaying or preventing a third party from acquiring control over or merging with us.

***The provisions of our charter documents might inhibit potential acquisition bids that a stockholder might believe are desirable, and the market price of our common stock could be lower as a result.***

Our Board of Directors has the authority to issue up to 5,000,000 shares of preferred stock. Our Board of Directors can fix the price, rights, preferences, privileges and restrictions of the preferred stock without any further vote or action by our stockholders. The issuance of shares of preferred stock might delay or prevent a change in control transaction. As a result, the market price of our common stock and the voting and other rights of our stockholders might be adversely affected. The issuance of preferred stock might result in the loss of voting control to other stockholders. We have no current plans to issue any shares of preferred stock. Our charter documents also contain other provisions, which might discourage, delay or prevent a merger or acquisition, including:

- our stockholders have no right to remove directors without cause;
- our stockholders have no right to act by written consent;
- our stockholders have no right to call a special meeting of stockholders; and
- stockholders must comply with advance notice requirements to nominate directors or submit proposals for consideration at stockholder meetings.

Table of Contents

These provisions could also have the effect of discouraging others from making tender offers for our common stock. As a result, these provisions might prevent the market price of our common stock from increasing substantially in response to actual or rumored takeover attempts. These provisions might also prevent changes in our management.

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

**Stock Repurchase Program**

Our Board of Directors has authorized us to repurchase, at management's discretion, shares of our common stock. On August 20, 2013, the Board increased the dollar value of shares that may be repurchased by \$10 million. Under the repurchase program, we may repurchase shares from time to time on the open market or in private transactions. The specific timing and amount of the repurchases will be dependent on market conditions, securities law limitations and other factors. The repurchase program may be suspended or terminated at any time without prior notice. Below is summary of our common stock repurchases during the quarter ended December 31, 2013.

Period	Shares Repurchased	Average Price per Share	Value of Shares That May Yet Be Repurchased Under the Program
Beginning approximate dollar value available to be repurchased as of September 30, 2013			\$ 15,889,050
October 1 to October 31, 2013	15,758	\$ 6.95	\$ 109,460
November 1 to November 30, 2013	190,324	\$ 6.62	\$ 1,260,666
December 1 to December 31, 2013	177,395	\$ 6.56	\$ 1,163,679
Total shares repurchased	383,477		
Ending approximate dollar value that may be repurchased under the program as of December 31, 2013			\$ 13,355,245

Table of Contents

**Item 6. Exhibits**

<b>Exhibit Number</b>	<b>Name of Document</b>
31.1	Certification of Lee-Lean Shu, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Douglas M. Schirle, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Lee-Lean Shu, President and Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Douglas M. Schirle, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: February 11, 2014

GSI Technology, Inc.

By:

/s/ LEE-LEAN SHU  
Lee-Lean Shu  
*President, Chief Executive Officer and Chairman*

By:

/s/ DOUGLAS M. SCHIRLE  
Douglas M. Schirle  
*Chief Financial Officer*



Table of Contents

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Name of Document</b>
31.1	Certification of Lee-Lean Shu, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Douglas M. Schirle, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Lee-Lean Shu, President and Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Douglas M. Schirle, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document