QUALSTAR CORP
Form 10-Q
November 10, 2014

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 September 30, 2014

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 000-30083

QUALSTAR CORPORATION

CALIFORNIA	**95-3927330**
(State of incorporation)	(I.R.S. Employer Identification No.)

3990-B Heritage Oak Court, Simi Valley, CA 93063

(805) 583-7744

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

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

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

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

Total shares of common stock without par value outstanding at November 7, 2014 are 12,253,117.

QUALSTAR CORPORATION

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2014

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

QUALSTAR CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	September 30, 2014 (Unaudited)	June 30, 2014 (Audited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,266	$ 5,462
Marketable securities, short-term	450	1,763
Accounts receivables, net of allowances of $92 at September 30, 2014, and at June 30, 2014	1,800	1,412
Inventories	3,046	3,177
Prepaid expenses and other current assets	401	241
Total current assets	11,963	12,055
Property and equipment, net	653	663
Other assets	67	67
Total assets	$ 12,683	$ 12,785
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable	$ 1,213	$ 952
Accrued payroll and related liabilities	341	322
Deferred service revenue, short term	1,015	954
Other accrued liabilities	1,085	1,174
Total current liabilities	3,654	3,402
Other long term liabilities	17	17
Deferred service revenue, long term	173	243

Total long term liabilities	190	260
Commitments and contingencies		
Shareholders’ equity:		
Preferred stock, no par value; 5,000 shares authorized; no shares issued	-	-
Common stock, no par value; 50,000 shares authorized, 12,253 shares issued and outstanding as of September 30, 2014 and June 30, 2014	18,981	18,943
Accumulated other comprehensive income	1	1
Accumulated deficit	(10,143)	(9,821)
Total shareholders’ equity	8,839	9,123
Total liabilities and shareholders’ equity	$ 12,683	$ 12,785

See notes to condensed consolidated financial statements.

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QUALSTAR CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited)

(In thousands, except per share data)

	Three Months Ended September 30, 2014	2013
Net revenues	$3,320	2,191
Cost of goods sold	2,094	1,730
Gross profit	$1,226	$461
Operating expenses:		
Engineering	359	874
Sales and marketing	505	733
General and administrative	684	1,394
Total operating expenses	$1,548	$3,001
Loss from operations	(322)	(2,540)
Other income	-	13
Loss before income taxes	(322)	(2,527)
Provision for income taxes	-	-
Net loss	$(322)	$(2,527)
Change in unrealized gains on investments	-	10
Comprehensive loss	$(322)	(2,517)
Loss per common share:		
Basic and diluted	$(0.03)	$(0.21)
Weighted average common shares outstanding:		
Basic and diluted	12,253	12,253

See notes to condensed consolidated financial statements.

QUALSTAR CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013
OPERATING ACTIVITIES:		
Net loss	$(322)	$(2,527)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	45	46
Loss on disposal of assets	5	-
Provision for inventory reserve and adjustments	(188)	(133)
Stock based compensation	38	4
Loss on sale of marketable securities	9	-
Changes in operating assets and liabilities:		
Accounts receivable	(387)	943
Receivable from CTS for manufacturing inventories	-	644
Inventories	319	(1,050)
Prepaid expenses and other current assets	(160)	63
Accounts payable	261	149
Accrued payroll and related liabilities	19	(92)
Deferred service revenue	(9)	334
Other accrued liabilities	(89)	(304)
Total adjustments	(137)	604
Net cash used in operating activities	$(459)	$(1,923)
INVESTING ACTIVITIES:		
Purchases of equipment	(40)	(86)
Proceeds from the sale of marketable securities	1,303	1,688
Net cash provided by investing activities	$1,263	$1,602
NET INCREASE(DECREASE) IN CASH AND CASH EQUIVALENTS	$804	$(321)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$5,462	$1,966
CASH AND CASH EQUIVALENTS, END OF PERIOD	$6,266	$1,645
SUPPLEMENTAL CASH FLOW DISCLOSURES:		
Income taxes paid	$-	$-

See notes to condensed consolidated financial statements.

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QUALSTAR CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

THREE MONTHS ENDED SEPTEMBER 30, 2014

(Unaudited)

(In thousands)

	Common Stock		Accumulated Other Comprehensive	Accumulated	
	Shares	Amount	Income	Deficit	Total
Balance at June 30, 2014	12,253	$18,943	$ 1	$ (9,821)	$9,123
Share-based compensation	-	38	-	-	38
Comprehensive loss:					
Change in unrealized gains on investments	-	-	-	-	-
Net loss	-	-	-	(322)	(322)
Comprehensive loss	-	-	-		(322)
Balance at September 30, 2014	12,253	$18,981	$ 1	$ (10,143)	$8,839

See notes to condensed consolidated financial statements.

QUALSTAR CORPORATION AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

In the opinion of management, the accompanying unaudited condensed consolidated financial statements, including balance sheets and related interim statements of comprehensive loss, cash flows, and shareholders' equity, include all adjustments, consisting primarily of normal recurring items, which are necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP").

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Examples include estimates of loss contingencies, product life cycles and inventory obsolescence, bad debts, sales returns, share-based compensation, forfeiture rates, the potential outcome of future tax consequences of events that have been recognized in our financial statements or tax returns, and determining when investment impairments are other-than-temporary. Actual results and outcomes may differ from management's estimates and assumptions.

Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with information included in the Qualstar Corporation Annual Report on Form 10-K for the fiscal year ended June 30, 2014, filed with the U.S. Securities and Exchange Commission ("SEC") on September 29, 2014.

Risks and Uncertainties

We are subject to a number of risks and uncertainties that may significantly impact our future operating results. These risks and uncertainties are discussed under Part II, Item 1A, "Risk Factors" included in this Form 10-Q. As our interim description of risks and uncertainties only includes any material changes to our annual description, we refer you to our risk factors previously disclosed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended June 30, 2014, as filed with the SEC.

Revenue Recognition

We recognize revenue when there is persuasive evidence that an arrangement exists, title and risk of loss have passed, delivery has occurred or the services have been rendered, the sales price is fixed or determinable and collection of the related receivable is reasonably assured. Title and risk of loss generally pass to our customers upon shipment. In limited circumstances where either title or risk of loss pass upon destination or acceptance or when collection is not reasonably assured, we defer revenue recognition until such events occur.

Revenue for established products that have previously satisfied a customer's acceptance requirements and provide for full payment tied to shipment is generally recognized upon shipment and passage of title. In limited cases where a prior history of customer acceptance cannot be demonstrated or sales where customer payment dates are not determinable or when collection is not reasonably assured, revenue is deferred until customer acceptance occurs or payment has been received. On the limited shipments where sales are not recognized, gross profit is generally recorded as deferred profit in our consolidated balance sheet representing the difference between the receivable recorded and the inventory shipped.

Deferred revenue is shown separately in the balance sheet, and deferred profit is included in other accrued liabilities in the balance sheet. At September 30, 2014, we had deferred revenue of approximately $1,188,000, and deferred profit of approximately $4,000. At June 30, 2014, we had deferred revenue of approximately $1,197,000 and deferred profit of approximately $8,000.

QUALSTAR CORPORATION AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

Marketable Securities

Marketable securities consist primarily of high-quality U.S. corporate securities, U.S. federal government debt securities, corporate and municipal bonds. Our marketable securities portfolio consists of short-term securities with original maturities of greater than three months from the date of purchase and remaining maturities of less than one year. Marketable securities are classified as “available-for-sale” and are recorded at fair value using the specific identification method; unrealized gains and losses are reflected in other comprehensive income until realized; realized gains and losses are included in earnings when the underlying securities are sold and are derived using the specific identification method for determining the cost of securities sold. If the credit ratings of the security issuers deteriorate or if market conditions deteriorate, we may be required to reduce the value of our investments through an impairment charge.

Fair Value of Financial Instruments

We measure fair value on all financial assets and liabilities and nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least quarterly). See “Note 5 – Fair Value Measurements.”

Allowance for Doubtful Accounts

We estimate our allowance for doubtful accounts based on an assessment of the collectability of specific accounts and the overall condition of accounts receivable. In evaluating the adequacy of the allowance for doubtful accounts, we analyze specific trade receivables, historical bad debts, customer credits, customer credit-worthiness and changes in customers’ payment terms and patterns. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make additional payments, then we may need to make additional allowances. Likewise, if we determine that we could realize more of our receivables in the future than previously estimated, we would adjust the allowance to increase income in the period we made this determination.

Inventory Valuation

We record inventories at the lower of cost or market value. We assess the value of our inventories periodically based upon numerous factors including expected product or material demand, current market conditions, technological obsolescence, current cost and net realizable value. If necessary, we write down our inventory for estimated obsolescence, potential shrinkage, or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If technology changes more rapidly than expected, or market conditions become less favorable than those projected by management, additional inventory write-downs may be required.

Warranty Obligations

We provide for the estimated cost of product warranties at the time revenue is recognized. We engage in extensive product quality programs and processes, including active monitoring and evaluation of product failure rates, material usage and estimation of service delivery costs incurred in correcting a product failure. However, should actual product failure rates, material usage, or service delivery costs differ from our estimates; revisions to the estimated warranty liability would be required. Historically our warranty costs have not been significant.

Legal and Other Contingencies

The outcomes of legal proceedings and claims brought against us are subject to significant uncertainty. An estimated loss from a loss contingency such as a legal proceeding or claim is accrued by a charge to income if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. When legal costs that the entity expects to incur in defending itself in connection with a loss contingency accrual are expected to be material, the loss should factor in all costs and, if the legal costs are reasonably estimable, they should be accrued in accordance with ASC 450, regardless of whether a liability can be estimated for the contingency itself. Disclosure of a contingency is required if there is at least a reasonable possibility that a loss has been incurred. Changes in these factors could materially impact our financial statements. We have accrued $244,000 for such contingencies.

QUALSTAR CORPORATION AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

Share-Based Compensation

Share-based compensation is accounted for in accordance with ASC 718, “Compensation – Stock Compensation.” We use the Black-Scholes option-pricing model to determine fair value of the award at the date of grant and recognize compensation expense over the vesting period. The inputs we use for the model require the use of judgment, estimates and assumptions regarding the expected volatility of the stock, the expected term the average employee will hold the option prior to the date of exercise, expected future dividends, and the amount of share-based awards that are expected to be forfeited. Changes in these inputs and assumptions could occur and actual results could differ from these estimates, and our results of operations could be impacted.

Accounting for Income Taxes

We estimate our tax liabilities based on current tax laws in the statutory jurisdictions in which we operate in accordance with ASC 740, “Income Taxes.” These estimates include judgments about deferred tax assets and liabilities resulting from temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes, as well as about the realization of deferred tax assets. We may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained upon examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. ASC 740 also provides guidance on derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures.

We maintain a valuation allowance to reduce our deferred tax assets due to the uncertainty surrounding the timing of realizing the benefits of net deferred tax assets in future years. We have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for such a valuation allowance. In the event we were to determine that we would be able to realize all or part of our net deferred tax asset in the future, the valuation allowance would be decreased accordingly.

We may periodically undergo examinations by the federal and state regulatory authorities and the Internal Revenue Service. We may be assessed additional taxes and/or penalties contingent on the outcome of these examinations. Our previous examinations have not resulted in any unfavorable or significant assessments.

NOTE 2 – RECENT ACCOUNTING PRONOUNCEMENTS

Recent accounting guidance not yet adopted

In March 2013, the FASB issued ASU 2013-05, which applies to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) within a foreign entity. The new guidance will be effective for us beginning July 1, 2015, and is not expected to impact our consolidated financial statements.

In July 2013, the FASB issued ASU 2013-11, which provides guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The new guidance will be effective for us beginning July 1, 2015, and is not expected to impact our consolidated financial statements.

QUALSTAR CORPORATION AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

In May 2014, the FASB issued ASU 2014-09 to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRS that will remove inconsistencies and weaknesses in revenue requirements, provide a more robust framework for addressing revenue issues, improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets, provide more useful information to users of financial statements through improved disclosure requirements, and simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. The new guidance will be effective for us beginning July 1, 2015, and is not expected to impact our consolidated financial statements.

In June 2014, the FASB issued ASU 2014-12 to resolve the diverse accounting treatment of share-based payment awards that require specific performance targets to be achieved in order for employees to become eligible to vest in the awards. The new guidance will be effective for us beginning July 1, 2015, and is not expected to impact our consolidated financial statements.

NOTE 3 – SIGNIFICANT CUSTOMERS, CONCENTRATION OF CREDIT RISK, AND GEOGRAPHIC INFORMATION

We are exposed to interest rate risks. Our investment income is sensitive to changes in the general level of U.S. interest rates, particularly since the majority of our investments are in shorter duration fixed income securities. We have no outstanding debt nor do we utilize auction rate securities or derivative financial instruments in our investment portfolio.

Our financial results could be affected by changes in foreign currency exchange rates or weak economic conditions in foreign markets. As all sales are currently made in U.S. dollars, a strengthening of the dollar could make our products less competitive in foreign markets. Sales within North America represented approximately 52.6% of net revenues in the three months ended September 30, 2014, and 61.2% of net revenues in the three months ended September 30, 2013. Sales outside North America represented approximately 47.4% of net revenues in the three months ended September 30, 2014, and 38.8% of net revenues in the three months ended September 30, 2013.

One customer accounted for 10.7% of the Company's revenue for the three-month period ended September 30, 2014. The customer's accounts receivable balance, totaled approximately 11.1% of net accounts receivable as of September 30, 2014. One customer accounted for 14.8% of the Company's revenue for the three-month period ended September 30, 2013. The customer's accounts receivable balances, totaled approximately 5.7% of net accounts receivable as of September 30, 2013.

NOTE 4 – LOSS PER SHARE

Basic loss per share has been computed by dividing net loss by the weighted average number of common shares outstanding. Diluted loss per share has not been computed as the effect is antidilutive.

The following table sets forth the computation of basic and diluted net loss per share for the periods indicated:

	Three Months Ended September 30,	
	2014	2013
In thousands (except per share amounts):		
Net loss (a)	$(322)	$(2,527)
Weighted average outstanding shares of common stock (b)	12,253	12,253
Dilutive potential common shares from employee stock options	-	-
Common stock and common stock equivalents (c)	12,253	12,253
Loss per share:		
Basic net loss per share (a)/(b)	$(0.03)	$(0.21)
Diluted net loss per share (a)/(c)	$(0.03)	(0.21)

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QUALSTAR CORPORATION AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

NOTE 5 – FAIR VALUE MEASUREMENTS

Fair value is the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated observable market data for substantially the full term of the assets or liabilities.

Level 3 – Inputs that are generally unobservable and typically reflect management’s estimate of assumptions that market participants would use in pricing the asset or liability.

NOTE 6 – CASH, CASH EQUIVALENTS AND MARKETABLE SECURITIES RECORDED AT FAIR VALUE

All highly liquid investments with maturities of three months or less at the date of purchase are classified as cash equivalents. The Company’s marketable debt securities have been classified and accounted for as available-for-sale. Management determines the appropriate classification of its investments at the time of purchase and re-evaluates the available-for-sale designations as of each balance sheet date. The Company classifies its marketable debt securities as either short-term or long-term based on each instrument’s underlying contractual maturity date. Marketable debt securities with maturities of 12 months or less are classified as short-term and marketable debt securities with maturities greater than 12 months are classified as long-term.

Available-for-sale securities are recorded at market value. Unrealized holding gains and losses, net of the related income tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of shareholders' equity until realized. Dividend and interest income are recognized when earned. Realized gains and losses for securities classified as available-for-sale are included in earnings when the underlying securities are sold and are derived using the specific identification method for determining the cost of securities sold. Realized loss on marketable securities for the three months ended September 30, 2014 was $9,000 and for the three months ended September 30, 2013 there was no loss.

The following tables summarize the Company's available-for-sale securities' adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category recorded as cash and cash equivalents or short-term marketable securities as of September 30, 2014 and June 30, 2014 (in thousands):

	September 30, 2014					
	Adjusted Cost	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**	**Cash & Cash Equivalents**	**Short-term Marketable Securities**
Level 1:						
Cash	596	-	-	596	596	-
Money Market Funds	5,670	-	-	5,670	5,670	-
Subtotal	$6,266	$ -	$ -	$6,266	$ 6,266	$ -
Level 2:						
Corporate securities	399	1	-	400	-	400
Municipal securities	50	-	-	50	-	50
Subtotal	$449	$ 1	$ -	$450	$ -	$ 450
Total	$6,715	$ 1	$ -	$6,716	$ 6,266	$ 450

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QUALSTAR CORPORATION AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

	June 30, 2014					
	Adjusted Cost	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**	**Cash & Cash Equivalents**	**Short-term Marketable Securities**
Level 1:						-
Cash	617	-	-	617	617	-
Money Market Funds	4,845	-	-	4,845	4,845	-
Subtotal	$5,462	$ -	$ -	$5,462	$ 5,462	$ -
Level 2:						
U.S. Agency Securities	332	-	-	332	-	332
Corporate securities	1,354	1	-	1,355	-	1,355
Municipal securities	76	-	-	76	-	76
Subtotal	$1,762	$ 1	$ -	$1,763	-	$ 1,763
Total	$7,224	$ 1	$ -	$7,225	$ 5,462	$ 1,763

NOTE 7 - BALANCE SHEET DETAILS

The following tables provide details of selected balance sheet accounts (in thousands):

Inventories

Inventories are stated at the lower of cost (first-in, first-out basis) or market. Inventories are comprised as follows (in thousands):

	September 30,	**June 30,**

	2014	2014
Raw materials	$ 2,937	$3,116
Finished goods	3,207	3,347
Subtotal	6,144	6,463
Less: Inventory reserve	(3,098)	(3,286)
Net inventory balance	$ 3,046	$3,177

Other Accrued Liabilities

	September 30, 2014	June 30, 2014
Accrued sales tax	$ 10	$17
Accrued commissions	68	48
Accrued audit fees	87	88
Accrued marketing coop expenses	27	28
Accrued legal expense	244	251
Deferred rent	72	83
Lease abandonment	364	445
Accrued royalty	49	45
Warranty reserve	159	159
Other accruals	5	10
Total other accrued liabilities	$ 1,085	$1,174

Costs related to the unused square footage under the current lease were expensed in prior periods. The lease abandonment liability relates to the remaining contractual lease through December 2015.

QUALSTAR CORPORATION AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

NOTE 8 – COMMITMENTS AND CONTINGENCIES

Accrued Warranty

We provide for the estimated costs of hardware warranties at the time the related revenue is recognized. We estimate the costs based on historical and projected product failure rates, historical and projected repair costs, and knowledge of specific product failures (if any). The specific hardware warranty terms and conditions for tape libraries generally include parts and labor over a three-year period. The warranty for power supplies generally is three years. We regularly re-evaluate our estimates to assess the adequacy of the recorded warranty liabilities and adjust the amounts as necessary.

Activity in the liability for product warranty, which is included in other accrued liabilities in the condensed balance sheets, for the periods presented, is as follows (in thousands):

	Three Months Ended September 30,	
	2014	**2013**
Beginning balance	$159	$190
Cost of warranty claims	(14)	(14)
Accruals for product warranties	14	(2)
Ending balance	$159	$174

NOTE 9 – COMPREHENSIVE LOSS

For the three months ended September 30, 2014 and 2013, comprehensive loss amounted to approximately $322,000 and $2,517,000, respectively. There is no change between net loss and comprehensive loss for the three months ended September 30, 2014. For the three months ended September 30, 2013 net loss and comprehensive loss changed $10,000, which relates to the changes in the unrealized gains that the Company recorded for its available-for-sale marketable securities.

QUALSTAR CORPORATION AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

NOTE 10 – STOCK BASED COMPENSATION

The Company recorded share-based compensation associated with outstanding stock options and restricted stock grants during the three months ended September 30, 2014 and September 30, 2013 of approximately $38,000 and $4,000, respectively. No income tax benefit was recognized in the statements of comprehensive loss for share-based arrangements in any period presented.

Stock Options

On August 8, 2014, in accordance with Mr. Bronson's employment agreement for year ended June 30, 2014, the board of directors granted to Mr. Bronson stock options to purchase 100,000 shares of common stock with an exercise price of $1.23. The stock options granted are fully vested on the date of grant and have a term of five years, expiring on August 20, 2019, unless exercised sooner. As a result of the stock options issued to Mr. Bronson, the Company recognized $27,000 non- cash stock compensation expense in the three months ended September 30, 2014.

The Company did not grant any stock options during the three months ended September 30, 2013.

Restricted Stock Awards

The following table summarizes all restricted stock awards activity (in thousands, except per share amounts):

Restricted Stock Awards	**Shares**	**Weighted Average**

		Fair Value Price per Share
Nonvested at June 30, 2014	100,000	$ 1.61
Granted (1)	—	—
Vested	—	—
Forfeited or expired		
Nonvested at September 30, 2014	100,000	$ 1.61

(1) Restricted stock was granted on April 1, 2014 to Daniel K. Jan of 100,000 shares to vest 33,333 on April 1, 2017; 33,333 to vest April 1, 2018 and 33,334 to vest April 1, 2019. The award is part of his employment agreement and the grant price is the closing price of the stock on April 1, 2014 of $1.61. The unvested shares are forfeited upon termination of his employment.

At June 30, 2014, the unrecognized compensation cost related to the non-vested share based compensation for restricted stock is $151,000.

NOTE 11 – LEGAL PROCEEDINGS

Overland Storage, Inc.

On June 28, 2012, Overland Storage, Inc. ("Overland") filed a patent infringement lawsuit against Qualstar Corporation (and others) in the U.S. District Court in the Southern District of California, alleging that certain of our automated tape libraries infringe claims of U.S. Patent No. 6,328,766. The lawsuit is entitled: *Overland Storage, Inc. (Plaintiff/Counterclaim Defendant) v. Qualstar Corporation (Defendant/Counterclaim Plaintiff)*, and assigned Case No. 12-cv-1605-JLS-BLM. Overland is seeking injunctive relief as well as the recovery of unspecified monetary damages. We do not believe we infringe the Overland patent and we intend to defend ourselves vigorously. Due to the inherent uncertainty of litigation, we cannot identify probable or estimable damages related to the lawsuit at this time.

Lawrence D. Firestone and others

On August 12, 2013, Qualstar filed a complaint against former Chief Executive Officer Lawrence D. Firestone and others for breach of fiduciary duty, breach of duty of loyalty, breach of duty of care and the commission of corporate waste that is currently pending in the Superior Court of the State of California, County of Los Angeles. The lawsuit is entitled: *Qualstar Corporation v. Lawrence D. Firestone, Stanley Corker, Carl W. Gromada, Robert A. Meyer, Robert Rich, Daniel Molhoek, Allen Alley, Gerald Laber, Steven Wagner, and DOES 1 through 10, inclusive,* and assigned Case No.: BC 514889. Qualstar is seeking to enjoin the payment of Defendant Firestone's severance package and the recovery of monetary damages to be proven at trial. On April 17, 2014, Defendant Firestone filed a cross-complaint against Qualstar for wrongful termination of employment in breach of contract, employer's breach of the implied covenant of good faith and fair dealing, breach of contract, and conversion. Due to the inherent uncertainty of litigation, we cannot identify probable or estimable damages related to the cross-complaint at this time. Also on April 17, 2014, Qualstar voluntarily withdrew its claims against Defendant Gerald Laber, without prejudice. On April 18, 2014, the Court denied motions filed by the remaining Defendants that had been seeking the dismissal of all causes of action against all Defendants. Subsequent to the April 18, 2014 hearing, Qualstar moved to dismiss the cross-complaint filed by Defendant Firestone. Defendants Allen Alley and Daniel Molhoek again moved to dismiss all causes of action against them in Qualstar's complaint. The Court heard oral argument on both Qualstar's and Mr. Alley's and Mr. Molhoek's demurrers on September 22, 2014. The Court overruled Mr. Alley's and Mr. Molhoek's demurrer seeking the dismissal of the claims alleged against them in Qualstar's complaint. The Court granted Qualstar's demurrer to Mr. Firestone's cross-complaint in part, as to the claims for employer's breach of the implied covenant of good faith and fair dealing and conversion, and denied it in part, as to the claim for wrongful termination of employment in breach of contract. All parties held a mediation session on October 9, 2014, in an attempt to resolve the claims set forth in both Qualstar's Complaint and Defendant Lawrence D. Firestone's Cross-Complaint. The discussions started thereat are ongoing. At this time, no evaluation can be made as to the likelihood of favorable or unfavorable outcome in this litigation, should it not be mutually resolved. Furthermore, due to the uncertainty of litigation, we cannot identify probable or estimable damages related to the lawsuit at this time.

QUALSTAR CORPORATION AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

On March 11, 2014, Qualstar filed a complaint against Needham & Company, LLC (“Needham”) entitled: *Qualstar Corporation v. Needham & Company, LLC,* pending in the Supreme Court of the State of New York, New York County and assigned index number 650773/14. Qualstar asserted claims against Needham for breach of contract, breach of the covenant of good faith and fair dealing, unjust enrichment and negligence based on Needham’s provision of financial advisory services to Qualstar, between January 2013 and February 2013, in connection with the unsolicited partial tender offer for Qualstar submitted by BKF Capital Group, Inc. Needham has moved to dismiss the complaint and the court has not yet ruled on Needham’s motion to dismiss. At this time no evaluation can be made as to the likelihood of a favorable or unfavorable outcome in this action.

We also are subject to a variety of other claims and legal proceedings that arise from time to time in the ordinary course of our business. Although management currently believes that resolving claims against us, individually or in the aggregate, will not have a material adverse impact on our financial statements, these matters are subject to inherent uncertainties and management’s view of these matters may change in the future. We accrue loss contingencies in connection with our commitments and contingencies, including litigation, when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. As of September 30, 2014, we had accrued aggregate current liabilities of $244,000 in probable fees and costs related to our contingent legal matters.

NOTE 12 – INCOME TAXES

We did not record a provision or benefit for income taxes for the threee months ended September 30, 2014 and 2013. The Company has recorded a full valuation allowance against its net deferred tax assets based on the Company’s assessment regarding the realizability of these net deferred tax assets in future periods.

NOTE 13 – SEGMENT INFORMATION

In its operation of the business, management reviews certain financial information, including segmented internal profit and loss statements prepared on a basis consistent with U.S. GAAP. Our two segments are Power Supplies and Storage. The two segments discussed in this analysis are presented in the way we internally managed and monitored performance for the three months ended September 30, 2014 and 2013. Allocations for internal resources were made for the three months ended September 30, 2014 and 2013. The power supplies segment tracks certain assets separately, and all others are recorded in the storage segment for internal reporting presentations. The types of products and services provided by each segment are summarized below:

Power Supplies — We design, develop, and sell small, open frame, high efficiency switching power supplies. These power supplies are used to convert AC line voltage to DC voltages, or DC voltages to other DC voltages for use in a wide variety of electronic equipment such as telecommunications equipment, machine tools, routers, switches, wireless systems and gaming devices.

Data Storage — We design, develop and sell automated magnetic tape libraries used to store, retrieve and manage electronic data primarily in network computing environments. Tape libraries consist of cartridge tape drives, tape cartridges and robotics to move the cartridges from their storage locations to the tape drives under software control. Our tape libraries provide data storage solutions for organizations requiring backup, recovery and archival storage of critical data.

QUALSTAR CORPORATION AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

Segment revenue, loss before taxes and total assets were as follows (in thousands):

	Three Months Ended September 30,	
	2014	**2013**
Revenue		
Power Supplies	$1,399	$953
Data Storage:		
Product	1,367	824
Service	554	414
Total data storage	$1,921	$1,238
Total revenue	$3,320	$2,191

	Three Months Ended September 30,	
	2014	**2013**
Loss before Taxes		
Power Supplies	$(269)	$(318)
Data Storage	(53)	(2,209)
Total loss before taxes	$(322)	$(2,527)

	September 30, 2014	**June 30, 2014**
Total Assets		

Cash and marketable securities:		
Cash and cash equivalents	$ 6,266	$5,462
Marketable securities	450	1,763
Total cash and marketable securities	$ 6,716	$7,225
Other assets:		
Power Supplies	2,168	2,329
Data Storage	3,799	3,231
Total other assets	$ 5,967	$5,560
Total assets	$ 12,683	$12,785

QUALSTAR CORPORATION AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)-(Continued)

NOTE 14 – RELATED PARTY TRANSACTIONS

The Company entered into a license agreement, dated May 1, 2014 (the “License Agreement”) with BKF Capital Group, Inc. (“BKF”). Pursuant to the License Agreement, commencing on May 1, 2014, BKF shall have a license to occupy and use one furnished office, telephone and other services, located at Qualstar’s executive offices. Pursuant to the License Agreement, BKF shall pay to Qualstar a license fee $1,200 per month. For the three months ended September 30, 2014, BFK paid $3,600 to Qualstar as license fees. Steven N. Bronson, the Company’s Chairman and CEO, is also the Chairman, CEO and majority shareholder of BKF.

The Company has agreed to reimburse Interlink Electronics, Inc.(“Interlink”), for expenses paid on behalf of the Company. Steven N. Bronson is also the Chairman and CEO and a majority shareholder of Interlink. For the three months ended September 30, 2014 the Company reimbursed Interlink $21,000, and Interlink reimbursed the Company $7,000 for such expenses.

NOTE 15 – SUBSEQUENT EVENTS

On October 8, 2014, the board of directors approved the issuance of a stock option to Steven N. Bronson to purchase 100,000 shares of Qualstar common stock at an exercise price of $1.27. The stock options shall vest on June 30, 2015 and have a term of five years, expiring on June 30, 2020.

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

Statements in this Quarterly Report on Form 10-Q concerning the future business, operating results and financial condition of Qualstar including estimates, projections, statements relating to our business plans, objectives and operating results, and the assumptions upon which those statements are based, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements inherently are subject to risks and uncertainties, some of which we cannot predict or quantify. Our actual results may differ materially from the results projected in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in Part II, Item 1A of this report and in our Annual Report on Form 10-K for the fiscal year ended June 30, 2014 in "Item 1 Business," "Item 1A Risk Factors," and in "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations." You generally can identify forward-looking statements by the use of forward-looking terminology such as "believes," "may," "expects," "intends," "estimates," "anticipates," "plans," "seeks," or "continues," or the negative thereof or variations t similar terminology. Except as required by law, we undertake no obligation to publicly update or revise any forward-looking statements to reflect the occurrence of events or circumstances in the future.

OVERVIEW

Qualstar Corporation and its Subsidiary ("Qualstar", the "Company", "we", "us" or "our") is a leading provider of high efficiency and high density power solutions marketed under the N2Power brand, and of data storage systems marketed under the Qualstar brand. Qualstar is organized into two strategic business units, power solutions and storage systems. Power solutions products include ultra-small high efficiency switching power supplies that provide power unique solutions to original equipment manufacturers for a wide range of markets; including telecommunications networking, industrial, gaming, test equipment, LED/lighting, medical as well as other market applications. Data storage system products include highly scalable automated magnetic tape libraries used to store, retrieve and manage electronic data primarily in the network computing environment and provide solutions for organizations requiring backup, recovery and archival storage of critical electronic information.

On June 30, 2014, Qualstar formed Qualstar Corporation Singapore Private Limited, a Singapore corporation. This entity will enable us to hire and expand our engineering and product development staff in Singapore to support Qualstar's overall product expansion. We also plan to use this entity to seek out and secure potentially strategic relationships with Singapore based companies, technology institutes and colleges on joint development product initiatives.

In July 2002, Qualstar purchased the assets of N2Power, Incorporated, a supplier of ultra-small high efficiency open frame switching power supplies. Power supplies are sold with the N2Power brand name as well as under a private label brand name to OEMs to incorporate into computer based products for telephony, industrial, gaming, test equipment and other applications. N2Power is a division of Qualstar.

Qualstar continues to focus on returning the Company to profitability. The two key elements of this strategy are cost reduction and sales growth. In order to grow sales, the Company has expanded our product portfolio in both the data storage business and power supplies.

In the first three months of fiscal 2015, the Company has increased production to meet the demand of our data storage sales. Our data storage segment added the Crossroads Systems ReadVerify Appliance (RVA) to its Qualstar storage product portfolio. Our power supply segment has expanded its AC-DC power supply offerings by adding the high-efficiency slim line DIN Rail Power Supplies and Medically Certified Power Supplies Series to its N2 Power brand product portfolio.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We describe our significant accounting policies in Note 1, "Summary of Significant Accounting Policies" of the accompanying Notes to Condensed Financial Statements.

RESULTS OF OPERATIONS

(Unaudited)

(In thousands, except for percentages)

	Three Months Ended September 30,									
	2014					2013				
	$			%		$			%	
Power supply revenues	$	1,399		42.1	%	$	953		43.5	%
Storage revenues		1,921		57.9	%		1,238		56.5	%
Net revenues		3,320		100.0	%		2,191		100.0	%
Cost of goods sold		2,094		63.1	%		1,730		79.0	%
Gross profit		1,226		36.9	%		461		21.0	%
Operating expenses:										
Engineering		359		10.8	%		874		39.9	%
Sales and marketing		505		15.2	%		733		33.5	%
General and administrative		684		19.8	%		1,394		63.6	%
Total operating expenses		1,548		45.8	%		3,001		137.0	%
Loss from operations		(322	)	(8.9	)%		(2,540	)	(115.9	)%
Other income (expense)		-		-			13		0.6	%
Net loss	$	(322	)	(8.9	)%	$	(2,527	)	(115.3	)%

The percentages in the table are based on net revenues.

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Three Months Ended September 30, 2014 Compared to Three Months Ended September 30, 2013

Net Revenues

Net revenues increased to $3.3 million for the three months ended September 30, 2014 from $2.2 million for the three months ended September 30, 2013, an increase of $1.1 million, or 50.0%.

Segment Revenue

Power Supplies – Net revenues from power supplies were $1.4 million for the three months ended September 30, 2014 compared with $1.0 million for the three months ended September 30, 2013, an increase of $0.4 million, or 40.0%.

Data Storage – Net revenues from data storage were $1.9 million for the three months ended September 30, 2014 compared with $1.2 million for the three months ended September 30, 2013, an increase of $0.7 million, or 58.3%.

Gross Profit - Gross profit increased to $1.2 million for the three months ended September 30, 2014 from $0.5 million for the three months ended September 30, 2013. This increase of $0.7 million, or 140.0%, is primarily attributed to the $0.4 million reserve for excess and obsolete inventory taken in the three months ended September 30, 2013 and a recovery of the reserve in the three months ended September 30, 2014 of $0.2 million.

Engineering: Engineering expenses decreased by $515,000, or 58.9%, to $359,000 for the three months ended September 30, 2014 from $874,000 for the three months ended September 30, 2013. This decrease is primarily attributed to a reduction in salaries as we reduced headcount and consultant expenses and closed the Colorado facility.

Sales and Marketing: Sales and marketing expenses decreased by $228,000 or 31.1%, to $505,000 for the three months ended September 30, 2014 from $733,000 for the three months ended September 30, 2013. The decrease is primarily attributed to a reduction in salaries and commissions as we reduced headcount and a reduction in advertising and promotional expenses.

General and Administrative: General and administrative expenses decreased by $710,000 or 50.9%, to $684,000 for the three months ended September 30, 2014 from $1.4 million for the three months ended September 30, 2013. The decrease is primarily attributed to a reduction in salaries as we reduced headcount and decreased legal expenses.

Other Income. For the three months ended September 30, 2014, the net other income was $0 from $13,000 for the three months ended September 30, 2013 due to a reduction in investment income.

Provision for Income Taxes. We did not record a provision or benefit for income taxes for the three months ended September 30, 2014 or 2013.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used in operating activities was $459,000 in the three months ended September 30, 2014, primarily attributed to the $322,000 net loss for the period, an increase of $387,000 in accounts receivables, a $160,000 increase in prepaid expenses, partially offset by a decrease of $319,000 in total net inventory and an increase of $261,000 of accounts payable. Net cash used in operating activities was $1.9 million in the three months ended September 30, 2013, primarily attributed to the net loss for the period, an increase in inventory, accounts payable, and a decrease in accounts receivable.

Cash provided by investing activities was $1.3 million in the three months ended September 30, 2014, is primarily attributed to the sale of marketable securities of $1.3 million, partially offset by $39,000 cash used to purchase equipment. Cash provided by investing activities was $1.6 million in the three months ended September 30, 2013, attributed to proceeds from the sale marketable securities of $1.6 million, partially offset by $86,000 cash used to purchase equipment.

Cash was not used in financing activities during the three months ended September 30, 2014 or 2013.

As of September 30, 2014, we had $6.3 million in cash and cash equivalents and $0.4 million in marketable securities. The increase in cash from June 30, 2014 consisted of approximately $1.3 million provided by sale of marketable securities.

We believe that our existing cash and cash equivalents and cash flows from our operating activities, plus funds available from the sale of our marketable securities, will be sufficient to fund our working capital and capital expenditure needs for the next 12 months. We may utilize cash to invest in or acquire businesses, products or technologies that we believe are strategic. We periodically evaluate other companies and technologies for possible investment or acquisition by us. In addition, we have made and may in the future make investments in companies with whom we have identified potential synergies. However, we have no present commitments or agreements with respect to any material investment in or acquisition of other businesses or technologies.

ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

We develop products in the United States and sell them worldwide. We manufacture products in the United States and Asia. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. As all sales are currently made in U.S. dollars, a strengthening of the U.S. dollar could make our products less competitive in foreign markets. Our interest income is sensitive to changes in the general level of U.S. interest rates, particularly since the majority of our investments are in short-term instruments. We have no outstanding debt nor do we utilize derivative financial instruments. Therefore, no quantitative tabular disclosures are required.

ITEM 4. CONTROLS AND PROCEDURES

We maintain "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, that are designed to ensure that information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our principal executive officer to allow timely decisions regarding required disclosure.

Evaluation of disclosure and controls and procedures.

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's Disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based on the evaluation, the Company's Chief Executive Officer and Chief Financial Officer has concluded that the Company's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that the Company’s disclosure controls and procedures are operating in an effective manner to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Changes in internal controls over financial reporting.

There have been no changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the Company's most recent quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there is only reasonable assurance that the Company's controls will succeed in achieving their stated goals under all potential future conditions.

PART II — OTHER INFORMATION

ITEM 1. Legal Proceedings

On June 28, 2012, Overland Storage, Inc. (“Overland”) filed a patent infringement lawsuit against Qualstar Corporation (and others) in the U.S. District Court in the Southern District of California, alleging that certain of our automated tape libraries infringe claims of U.S. Patent No. 6,328,766. The lawsuit is entitled: *Overland storage, Inc. (Plaintiff/Counterclaim Defendant) v. Qualstar Corporation (Defendant/Counterclaim Plaintiff)*, and assigned Case No. 12-cv-1605-JLS-BLM. Overland is seeking injunctive relief as well as the recovery of unspecified monetary damages. We do not believe we infringe the Overland patent and we have filed a counterclaim. Due to the inherent uncertainty of litigation, we cannot identify probable or estimable damages related to the lawsuit at this time.

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17, 2014, Qualstar voluntarily withdrew its claims against Defendant Gerald Laber, without prejudice. On April 18, 2014, the Court denied motions filed by the remaining Defendants that had been seeking the dismissal of all causes of action against all Defendants. Subsequent to the April 18, 2014 hearing, Qualstar moved to dismiss the cross-complaint filed by Defendant Firestone. Defendants Allen Alley and Daniel Molhoek again moved to dismiss all causes of action against them in Qualstar’s complaint. The Court heard oral argument on both Qualstar’s and Mr. Alley’s and Mr. Molhoek’s demurrers on September 22, 2014. The Court overruled Mr. Alley’s and Mr. Molhoek’s demurrer seeking the dismissal of the claims alleged against them in Qualstar’s complaint. The Court granted Qualstar’s demurrer to Mr. Firestone’s cross-complaint in part, as to the claims for employer’s breach of the implied covenant of good faith and fair dealing and conversion, and denied it in part, as to the claim for wrongful termination of employment in breach of contract. All parties held a mediation session on October 9, 2014, in an attempt to resolve the claims set forth in both Qualstar’s Complaint and Defendant Lawrence D. Firestone’s Cross-Complaint. The discussions started thereat are ongoing. At this time, no evaluation can be made as to the likelihood of favorable or unfavorable outcome in this litigation, should it not be mutually resolved. Furthermore, due to the uncertainty of litigation, we cannot identify probable or estimable damages related to the lawsuit at this time.

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We also are subject to a variety of other claims and legal proceedings that arise from time to time in the ordinary course of our business. Although management currently believes that resolving claims against us, individually or in the aggregate, will not have a material adverse impact on our financial statements, these matters are subject to inherent uncertainties and management’s view of these matters may change in the future. We accrue loss contingencies in connection with our commitments and contingencies, including litigation, when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. As of September 30, 2014, we had accrued aggregate current liabilities of $207,000 in probable fees and costs related to our contingent legal matters.

ITEM 1A. Risk Factors

There have been no significant changes to the risk factors disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2014.

ITEM 5. Other Information

ITEM 6. EXHIBITS

Exhibit No.	Exhibit Index
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal 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

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.

QUALSTAR CORPORATION

Dated: November 10, 2014 By: /s/ STEVEN N. BRONSON
Steven. N. Bronson
Chief Executive Officer and President
(Principal Executive Officer)