NETLIST INC
Form 10-Q
November 13, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 29, 2018

or

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

For the transition period from _____ to _____

Commission file number 001-33170

NETLIST, INC.

(Exact name of registrant as specified in its charter)

Delaware	95-4812784
State or other jurisdiction of incorporation or organization	(I.R.S. Employer Identification No.)

175 Technology Drive, Suite 150

Irvine, CA 92618

(Address of principal executive offices) (Zip Code)

(949) 435-0025

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

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

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

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

As of November 9, 2018, there were 139,252,639 shares of the registrant's common stock outstanding.

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NETLIST, INC. AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 29, 2018

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NETLIST, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(in thousands, except par value)

	September 29, 2018 (unaudited)	December 30, 2017 (audited)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 18,187	$ 6,720
Restricted cash	1,250	2,800
Accounts receivable, net of reserves of $39 (2018) and $44 (2017)	3,226	2,997
Inventories	3,879	4,105
Prepaid expenses and other current assets	517	303
Total current assets	27,059	16,925
Property and equipment, net	322	459
Other assets	1,394	1,406
Total assets	$ 28,775	$ 18,790
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current Liabilities:		
Accounts payable	$ 9,656	$ 6,120
Revolving line of credit	2,597	2,024
Accrued payroll and related liabilities	503	807
Accrued expenses and other current liabilities	331	338
Total current liabilities	13,087	9,289
Convertible promissory notes and accrued interest, net of debt discount	17,084	14,766
Long-term warranty liability	70	61
Total liabilities	30,241	24,116
Commitments and contingencies		
Stockholders' deficit:		
Preferred stock, $0.001 par value - 10,000 shares authorized: Series A preferred stock, $0.001 par value; 1,000 shares authorized; none issued and outstanding	-	-
Common stock, $0.001 par value - 300,000 shares authorized; 139,253 (2018) and 79,314 (2017) shares issued and outstanding	138	80

Additional paid-in capital	169,176	152,640
Accumulated deficit	(170,780)	(158,046)
Total stockholders' deficit	(1,466)	(5,326)
Total liabilities and stockholders' deficit	$ 28,775	$ 18,790

See accompanying notes.

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NETLIST, INC. AND SUBSIDIARIES

Unaudited Condensed Consolidated Statements of Operations

(in thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Net revenues	$ 7,203	$ 9,010	$ 24,508	$ 29,840
Cost of sales(1)	6,617	8,285	23,061	27,791
Gross profit	586	725	1,447	2,049
Operating expenses:				
Research and development(1)	535	1,159	2,326	4,142
Intellectual property legal fees	2,760	749	6,359	2,129
Selling, general and administrative(1)	1,745	1,780	5,021	5,645
Total operating expenses	5,040	3,688	13,706	11,916
Operating loss	(4,454)	(2,963)	(12,259)	(9,867)
Other expense, net:				
Interest expense, net	(183)	(135)	(463)	(421)
Other (expense) income, net	(7)	-	(12)	2
Total other expense, net	(190)	(135)	(475)	(419)
Loss before provision for income taxes	(4,644)	(3,098)	(12,734)	(10,286)
Provision for income taxes	-	-	-	1
Net loss	$ (4,644)	$ (3,098)	$ (12,734)	$ (10,287)
Net loss per common share:				
Basic and diluted	$ (0.04)	$ (0.05)	$ (0.13)	$ (0.16)
Weighted-average common shares outstanding:				
Basic and diluted	115,402	65,644	96,516	63,056

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

Cost of sales	$ 7	$ 4	$ 19	$ 33
Research and development	46	78	182	258
Selling, general and administrative	104	213	370	649
Total stock-based compensation	$ 157	$ 295	$ 571	$ 940

See accompanying notes.

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NETLIST, INC. AND SUBSIDIARIES

Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)

	Nine Months Ended September 29, 2018	September 30, 2017
Cash flows from operating activities:		
Net loss	$ (12,734)	$ (10,287)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	209	214
Interest accrued on convertible promissory notes	241	225
Amortization of debt discounts and issuance costs	192	162
Stock-based compensation	571	940
Issuance of warrant in lieu of payment	69	-
Changes in operating assets and liabilities:		
Accounts receivable	(229)	(1,329)
Inventories	226	(1,226)
Prepaid expenses and other assets	142	271
Accounts payable	3,534	3,738
Accrued payroll and related liabilities	(304)	(435)
Accrued expenses and other liabilities	2	53
Net cash used in operating activities	(8,081)	(7,674)
Cash flows from investing activities:		
Acquisition of property and equipment	(72)	(78)
Net cash used in investing activities	(72)	(78)
Cash flows from financing activities:		
Net borrowings under line of credit	573	1,894
Proceeds from issuance of debt, net of $170 discount	2,100	-
Debt issuance costs	(23)	-
Payments on debt	(344)	(348)
Proceeds from issuance of common stock, net	15,764	4,431
Proceeds from exercise of stock options and warrants	-	182
Net cash provided by financing activities	18,070	6,159
Net change in cash, cash equivalents and restricted cash	9,917	(1,593)
Cash, cash equivalents and restricted cash at beginning of period	9,520	12,576
Cash, cash equivalents and restricted cash at end of period	$ 19,437	$ 10,983
Reconciliation of cash, cash equivalents and restricted cash at end of period:		
Cash and cash equivalents	$ 18,187	$ 8,583
Restricted cash	1,250	2,400
Cash, cash equivalents and restricted cash at end of period	$ 19,437	$ 10,983

See accompanying notes.

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 29, 2018

Note 1—Description of Business

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

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

Netlist was incorporated in June 2000 and is headquartered in Irvine, California. The Company has established a manufacturing facility in the People’s Republic of China (“PRC”), which became operational in July 2007. The Company operates in one reportable segment, which is the design and manufacture of high-performance memory subsystems for the server, high-performance computing and communications markets. On September 27, 2018, the Company transferred the listing of its common stock to OTCQX from The Nasdaq Capital Market.

Liquidity

The Company incurred net losses of $4.6 million and $12.7 million for the three and nine months ended September 29, 2018, respectively, and $13.4 million and $11.2 million for the fiscal years ended December 30, 2017 and December 31, 2016, respectively. The Company has historically financed its operations primarily with revenues generated from operations, including product sales, proceeds from issuances of equity and debt securities including convertible debt and a non-recurring engineering ("NRE") fee from its Joint Development and License Agreement ("JDLA") with Samsung Electronics Co., Ltd. ("Samsung"), as discussed below. The Company has also funded its operations with a revolving line of credit under a bank credit facility, a funding arrangement for costs associated with certain of its legal proceedings and, to a lesser extent, equipment leasing arrangements (see Notes 5, 6 and 8).

On August 22, 2017, the Company completed an underwritten public offering (the "2017 Offering"), pursuant to which it sold 8,500,000 shares of its common stock at a price to the public of $0.60 per share. The net proceeds to the Company from the 2017 Offering were $4.4 million, after deducting underwriting discounts and commissions and offering expenses paid by the Company.

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On November 14, 2017, the Company entered into an At Market Issuance Sales Agreement (the “Sales Agreement”) with B. Riley FBR, Inc. (the “Agent”) to sell shares of its common stock, with aggregate gross proceeds of up to $9.0 million, from time to time, through an “at-the-market” equity offering program under which the Agent acted as sales agent (the “ATM Program”) (see Note 9). On August 29, 2018, the Company completed the offering under the ATM Program after raising net proceeds of approximately $8.6 million through the sale of 40,680,368 shares of its common stock, after deducting sales commissions and other offering expenses paid by the Company. During the nine months ended September 29, 2018, the Company received net proceeds of approximately $5.8 million through the sale of 31,786,146 shares of its common stock, after deducting sales commissions and other offering expenses paid by the Company.

On May 17, 2018, the Company entered into a Board approved arm’s length Share Purchase Agreement with a trust controlled by C.K. Hong, the Company’s President, Chief Executive Officer and Chairman of the Board, pursuant to which the Company sold to Mr. Hong’s trust 5,405,405 shares of its common stock at a price per share of $0.148 (which equals the most recent consolidated closing bid price of its common stock, as reported by the Nasdaq Capital Market, as of the signing of the agreement) (See Note 9). The net proceeds received by the Company were $0.8 million.

On August 27, 2018, the Company entered into a Securities Purchase Agreement with Iliad Research and Trading, L.P. (“Iliad”) (“Iliad Purchase Agreement”), pursuant to which the Company issued a convertible promissory note in the principal amount of $2.3 million (“Iliad Note”) with an original issue discount of $0.2 million. The Iliad Note bears interest at an annual rate of 8% and matures on August 27, 2020, unless earlier repurchased, redeemed or converted in accordance with its terms (See Note 6).

On September 12, 2018, the Company entered into a Securities Purchase Agreement with certain investors, pursuant to which the Company issued and sold to the investors in a registered offering an aggregate of 22,222,220 shares of its common stock and warrants to purchase up to an aggregate of 11,111,110 shares of its common stock at a per share purchase price of $0.45 per share (See Note 9). The net proceeds to the Company from this offering were approximately $9.2 million, after deducting placement agent fees and offering costs paid by the Company. The warrant becomes exercisable 181 days following the date of its issuance, has a term of five years commencing on the date when it first becomes exercisable, and has an exercise price of $0.655 per share.

Inadequate working capital would have a material adverse effect on the Company’s business and operations and could cause the Company to fail to execute its business plan, fail to take advantage of future opportunities or fail to respond to competitive pressures or customer requirements. A lack of sufficient funding may also require the Company to significantly modify its business model and/or reduce or cease its operations, which could include implementing cost-cutting measures or delaying, scaling back or eliminating some or all of its ongoing and planned investments in corporate infrastructure, research and development projects, business development initiatives and sales and marketing activities, among other activities. While the Company’s estimates of its operating revenues and expenses and working capital requirements could be incorrect and the Company may use its cash resources faster than it anticipates, management believes the Company’s existing cash balance, together with cash provided by the Company’s operations and borrowing availability under a bank credit facility (see Note 5) and funds raised through the debt and equity offerings, will be sufficient to meet the Company's anticipated cash needs for at least the next 12 months.

Note 2—Summary of Significant Accounting Policies

Significant Accounting Policies

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and the instructions to the Securities and Exchange Commission's ("SEC") Form 10-Q and Article 8 of the SEC's Regulation S-X. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC. Therefore, these condensed consolidated financial statements should be read in conjunction with

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the audited consolidated financial statements and notes thereto as of and for the year ended December 30, 2017, included in the Company’s Annual Report on Form 10-K filed with the SEC on March 30, 2018 and Form 10-K/A as of April 30, 2018, as amended to include in Part III the information that was to be incorporated by reference from the definitive proxy statement for the 2018 annual meeting of our stockholders in reliance on General Instruction G(3) to Form 10-K, because such proxy statement was not expected to be filed until July of 2018 in connection with a date for such annual meeting in August 2018.

The accompanying condensed consolidated financial statements as of and for the three and nine months ended September 29, 2018 are unaudited. In the opinion of management, all adjustments for the fair presentation of the Company’s condensed consolidated financial statements have been made. The adjustments are of a normal recurring nature except as otherwise noted. The results of operations for the interim periods are not necessarily indicative of the results to be expected for other periods or the full fiscal year.

Principles of Consolidation

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

Fiscal Year

The Company operates under a 52 or 53 week fiscal year ending on the Saturday closest to December 31. For 2018, the Company’s fiscal year is scheduled to end on December 29, 2018 and will consist of 52 weeks, and each of the Company’s quarters within such fiscal year will be comprised of 13 weeks.

Use of Estimates

The preparation of the accompanying condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the condensed consolidated financial statements, and the reported amounts of net revenues and expenses during the reporting period. By their nature, these estimates and assumptions are subject to an inherent degree of uncertainty. The Company bases its estimates and assumptions on its historical experience, knowledge of current conditions and the Company’s belief of what could occur in the future considering available information. The Company reviews its estimates and assumptions on an ongoing basis. Actual results may differ materially from these estimates, which may result in material adverse effects on the Company’s consolidated operating results and financial position.

The Company believes the following critical accounting policies involve its more significant assumptions and estimates used in the preparation of the accompanying condensed consolidated financial statements: provisions for uncollectible receivables and sales returns; warranty liability; valuation of inventories; fair value of financial instruments; recoverability of long-lived assets; valuation of stock-based transactions; estimates for completion of NRE and other revenue milestones and the realization of deferred tax assets. The Company bases its estimates on historical experience, knowledge of current conditions and the Company’s belief of what could occur in the future considering available information. The Company reviews its estimates on an ongoing basis. Actual results may differ materially from these estimates which may result in material adverse effects on the Company’s operating results and financial position.

Revenue Recognition

Our net sales are generated primarily from (i) resales of NAND flash, DRAM products and other component products to end-customers that are not reached in the distribution models of the component manufacturers, including storage customers, appliance customers, system builders and cloud and datacenter customers and (ii) sales of high-performance modular memory subsystems primarily to original equipment manufacturers (“OEMs”) in the server, high-performance computing and communications markets.

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The Company's products are sold through ship-and-bill performance obligations, and the revenue is recognized at the point in time when the ownership is transferred to customers. Customers are generally allowed limited rights of return for up to 30 days, except for sales of excess component inventories, which contain no right-of-return privileges. Product returns are estimated at the time of sale using the expected value method and are recorded as a reduction in sales. The Company offers a standard product warranty to its customers and has no other post-shipment obligations. All amounts billed to customers related to shipping and handling are included in net sales, while costs incurred by the Company for shipping and handling are included in cost of sales. See Note 3.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and short-term investments with original maturities of three months or less.

Restricted Cash

Restricted cash consists of cash to secure standby letters of credit. Restricted cash was $1.3 million as of September 29, 2018 and related to three standby letters of credit. Restricted cash was $2.8 million as of December 30, 2017 and related to three standby letters of credit.

Fair Value of Financial Instruments

The Company follows Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 820, Fair Value Measurement, to account for the fair value of certain assets and liabilities. ASC Topic 820 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. ASC Topic 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, ASC Topic 820 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. An active market is defined as a market in which transactions for the assets or liabilities occur with sufficient frequency and volume to provide pricing information on an ongoing basis. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, which are typically based on an entity’s own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company’s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

The Company’s financial instruments consist principally of cash and cash equivalents, restricted cash, accounts receivable, accounts payable, accrued expenses, a revolving line of credit, and convertible promissory notes. The Company considers the carrying values of cash and cash equivalents, restricted cash, accounts receivable, accounts payable, and accrued expenses to approximate the fair value for these financial instruments based upon an evaluation of the underlying characteristics, market data and because of the short period of time between origination of the instruments and their expected realization. The Company estimates the fair values of its revolving line of credit and convertible promissory notes by using current applicable rates for similar instruments as of the balance sheet date and an assessment of its credit rating. The carrying value of the Company’s revolving line of credit at September 29, 2018 and December

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30, 2017 approximates fair value because the Company's interest rate yield is near current market rates for comparable debt instruments. The Company estimates the fair value of its convertible promissory notes by using a discounted cash flow analysis using borrowing rates available to the Company for debt instruments with similar terms and maturities. The Company has determined that the valuation of its convertible promissory notes is classified in Level 2 of the fair value hierarchy. The carrying value and estimated fair value of a senior secured convertible promissory note as of September 29, 2018 were $14.3 million and $11.8 million, respectively. The carrying value and estimated fair value of a senior secured convertible promissory note as of December 30, 2017 were $14.1 million and $12.3 million, respectively. The carrying value and estimated fair value of an unsecured convertible note, issued on August 27, 2018, were $1.9 million and $1.8 million as of September 29, 2018, respectively.

Allowance for Doubtful Accounts

The Company performs credit evaluations of its customers' financial condition and limits the amount of credit extended to its customers as deemed necessary, but generally requires no collateral. The Company evaluates the collectability of accounts receivable based on a combination of factors. In cases where the Company is aware of circumstances that may impair a specific customer's ability to meet its financial obligations subsequent to the original sale, the Company will record an allowance against amounts due, and thereby reduce the net recognized receivable to the amount the Company reasonably believes will be collected. For all other customers, the Company records allowances for doubtful accounts based primarily on the length of time the receivables are past due based on the terms of the originating transaction, the current business environment, and its historical experience. Uncollectible accounts are charged against the allowance for doubtful accounts when all cost-effective commercial means of collection have been exhausted. Generally, the Company's credit losses have been within expectations and the provisions established. However, the Company cannot guarantee that it will continue to experience credit loss rates similar to those experienced in the past.

The Company's accounts receivable are generally highly concentrated among a small number of customers, and a significant change in the liquidity or financial position of one of these customers could have a material adverse effect on the collectability of its accounts receivable, liquidity and future operating results.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents, and accounts receivable.

The Company invests its cash equivalents primarily in money market accounts. Cash equivalents are maintained with high quality institutions, the composition and maturities of which are regularly monitored by management. At times, deposits held with financial institutions may exceed the amount of insurance provided by the Federal Deposit

Insurance Corporation and the Securities Investor Protection Corporation.

The Company’s trade accounts receivable are primarily derived from sales to OEMs in the server, high-performance computing and communications markets, as well as from sales to storage customers, appliance customers, system builders and cloud and datacenter customers. The Company performs credit evaluations of its customers’ financial condition and limits the amount of credit extended when deemed necessary, but generally requires no collateral. The Company believes the concentration of credit risk in its trade receivables is moderated by its credit evaluation process, relatively short collection terms, a high level of credit worthiness of its customers (see Note 4), foreign credit insurance, and letters of credit issued in its favor. Reserves are maintained for potential credit losses, and such losses historically have not been significant and have been within management’s expectations.

Inventories

Inventories are valued at the lower of actual cost to purchase or manufacture the inventory or the net realizable value of the inventory. Cost is determined on an average cost basis which approximates actual cost on a first-in, first-out basis and includes raw materials, labor and manufacturing overhead. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. At each balance sheet date, the Company evaluates its ending inventory quantities on hand and on order and records a provision

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for excess quantities and obsolescence. Among other factors, the Company considers historical demand and forecasted demand in relation to inventory on hand, competitiveness of product offerings, market conditions and product life cycles when determining obsolescence and net realizable value. In addition, the Company considers changes in the market value of components in determining the net realizable value of its inventory. Once established, lower of cost or net realizable value write-downs are considered permanent adjustments to the cost basis of the excess or obsolete inventories.

Property and Equipment

Property and equipment are recorded at cost and depreciated on a straight-line basis over their estimated useful lives, which generally range from three to seven years. Leasehold improvements are recorded at cost and amortized on a straight-line basis over the shorter of their estimated useful lives or the remaining lease term. Expenditures for repairs and maintenance are expensed as incurred. Upon retirement or sale, the cost and related accumulated depreciation and amortization of disposed assets are removed from the accounts and any resulting gain or loss is included in other expense, net.

Impairment of Long-Lived Assets

The Company evaluates the recoverability of the carrying value of long-lived assets held and used by the Company in its operations for impairment on at least an annual basis or whenever events or changes in circumstances indicate that their carrying value may not be recoverable. When such factors and circumstances exist, the Company compares the projected undiscounted future net cash flows associated with the related asset or group of assets over their estimated useful lives against their respective carrying amount. These projected future cash flows may vary significantly over time as a result of increased competition, changes in technology, fluctuations in demand, consolidation of the Company’s customers and reductions in average selling prices. If the carrying value is determined not to be recoverable from future operating cash flows, the asset is deemed impaired and an impairment loss is recognized to the extent the carrying value exceeds the estimated fair value of the asset. The fair value of the asset or asset group is based on market value when available, or when unavailable, on discounted expected cash flows. The Company’s management believes there is no impairment of long-lived assets as of September 29, 2018. However, market conditions could change or demand for the Company’s products could decrease, which could result in future impairment of long-lived assets.

Warranty Liability

The Company offers standard product warranties generally ranging from one to three years, depending on the product and negotiated terms of any purchase agreements with its customers and has no other post-shipment obligations. Such warranties require the Company to repair or replace defective product returned to the Company during the warranty period at no cost to the customer. Warranties are not offered on sales of excess component inventory, and the Company does not offer separately priced extended warranty or product maintenance contracts. The Company records an estimate for warranty related costs at the time of sale in cost of sales based on its historical and estimated future product return rates and expected repair or replacement costs (see Note 4). While such costs have historically been within management's expectations and the provisions established, unexpected changes in failure rates could have a material adverse impact on the Company, requiring additional warranty reserves and could adversely affect the Company's gross profit and gross margins.

Stock-Based Compensation

Prior to the early-adoption of FASB ASU No. 2018-07, Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting ("ASU 2018-07") in the second quarter of 2018, the Company accounted for equity issuances to non-employees in accordance with ASC Topic 505, Equity. All transactions in which goods or services were the consideration received for the issuance of equity instruments were accounted for based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever was more reliably measurable. The measurement date used to determine the estimated fair value of the equity instrument issued was the earlier of the date on which the third-party performance was complete or the date on which it was

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probable that performance would occur. Upon the adoption of ASU No. 2018-07, the Company accounts for all stock-based awards in accordance with ASC Topic 718.

In accordance with ASC Topic 718, stock-based compensation expense recognized during the period is based on the value of the portion of stock-based payment awards that is ultimately expected to vest during the period. Given that stock-based compensation expense recognized in the accompanying condensed consolidated statements of operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. The Company estimates its forfeitures at the time of grant and revises such estimates, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company's estimated average forfeiture rates are based on historical forfeiture experience and estimated future forfeitures.

The estimated fair value of common stock option awards is calculated using the Black-Scholes option pricing model. The Black-Scholes model requires subjective assumptions regarding future stock price volatility and expected time to exercise, along with assumptions about the risk-free interest rate and expected dividends, all of which affect the estimated fair values of the Company's common stock option awards. The expected term of options granted is calculated as the weighted-average of the vesting period and the contractual expiration date of the option. This calculation is in accordance with ASC Topic 718, as amended by certain SEC guidance providing for a safe harbor method in instances where the vesting and exercise terms of options granted meet certain conditions and where limited historical exercise data is available. The expected volatility is based on the historical volatility of the Company's common stock. The risk-free rate selected to value any particular grant is based on the U.S. Treasury rate that corresponds to the expected term of the grant effective as of the date of the grant. The expected dividend assumption is based on the Company's history and management's expectation regarding dividend payouts. Compensation expense for common stock option awards with graded vesting schedules is recognized on a straight-line basis over the requisite service period for the last separately vesting portion of the award, provided that the accumulated cost recognized as of any date at least equals the value of the vested portion of the award.

If there are any modifications or cancellations of the underlying vested or unvested stock-based awards, the Company may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense, or record additional expense for vested stock-based awards. Future stock-based compensation expense and unearned stock- based compensation may increase to the extent that the Company grants additional stock options or other stock-based awards.

Income Taxes

Deferred tax assets and liabilities are recognized to reflect the estimated future tax effects, calculated at currently effective tax rates, of future deductible or taxable amounts attributable to events that have been recognized on a cumulative basis in the accompanying consolidated financial statements. A valuation allowance related to a net deferred tax asset is recorded when it is more likely than not that some portion of the deferred tax asset will not be realized. Deferred tax liabilities, deferred tax assets and valuation allowances are classified as non-current in the accompanying condensed consolidated balance sheets.

ASC Topic 740, Income Taxes, prescribes a recognition threshold and measurement requirement for the financial statement recognition of a tax position that has been taken or is expected to be taken on a tax return and also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Under ASC Topic 740, the Company may only recognize or continue to recognize tax positions that meet a “more likely than not” threshold.

The application of tax laws and regulations is subject to legal and factual interpretation, judgment and uncertainty. Tax laws and regulations may change as a result of changes in fiscal policy, changes in legislation, the evolution of regulations and court rulings. Therefore, the actual liability for U.S. or foreign taxes may be materially different from the Company’s estimates, which could require the Company to record additional tax liabilities or to reduce previously recorded tax liabilities, as applicable.

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Contingent Legal Expense

Contingent legal fees are expensed in the condensed consolidated statements of operations in the period that the related revenues are recognized. In instances where there are no recoveries from potential infringers, no contingent legal fees are paid; however, the Company may be liable for certain out of pocket legal costs incurred pursuant to the underlying legal services agreement.

Research and Development Expenses

Research and development expenditures are expensed in the period incurred.

Interest Expense

Interest expense consists primarily of interest associated with our debt instruments, including fees related to the term loans, accretion of debt discounts and amortization of debt issuance costs. The Company recognizes the accretion of debt discounts and the amortization of interest costs using the interest method.

Foreign Currency Remeasurement

The functional currency of the Company's foreign subsidiaries is the U.S. dollar. Local currency financial statements are remeasured into U.S. dollars at the exchange rate in effect as of the balance sheet date for monetary assets and liabilities and the historical exchange rate for nonmonetary assets and liabilities. Expenses are remeasured using the average exchange rate for the period, except items related to nonmonetary assets and liabilities, which are remeasured using historical exchange rates. All remeasurement gains and losses are included in determining net loss. Transaction gains and losses were not significant during the three and nine months ended September 29, 2018 and September 30, 2017.

Net Loss Per Share

Basic net loss per share is calculated by dividing net loss by the weighted-average common shares outstanding during the period, excluding unvested shares issued pursuant to restricted share awards under the Company's share-based compensation plans. Diluted net loss per share is calculated by dividing the net loss by the weighted-average shares and dilutive potential common shares outstanding during the period. Dilutive potential shares consist of dilutive shares issuable upon the exercise or vesting of outstanding stock options, warrants and restricted stock awards, computed using the treasury stock method and shares issuable upon conversion of the Samsung Venture Investment Co. (“SVIC”) Note and Iliad Note (see Note 6), computed using the “if-converted” method. In periods of losses, basic and diluted loss per share are the same, as the effect of stock options, warrants and unvested restricted share awards on loss per share is anti-dilutive.

Business Risks and Uncertainties

The Company’s results of operations, liquidity and financial condition are exposed to a number of risks and uncertainties. See the discussion in “Risk Factors” in Part II, Item 1A of this Quarterly Report on Form 10-Q in which these condensed consolidated financial statements are included for more discussion.

Adoption of New Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes nearly all existing revenue recognition guidance, including industry-specific guidance. Subsequent to the issuance of ASU No. 2014-09, the FASB clarified the guidance through several Accounting Standards Updates; hereinafter the collection of revenue guidance is referred to as “Topic 606.” Topic 606 is based on the principle that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Topic 606 also requires additional disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts,

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including significant judgments and changes in judgments and assets recognized from costs incurred to fulfill a contract. The Company adopted Topic 606 on December 31, 2017 using the modified retrospective transition method; accordingly, Topic 606 has been applied to the fiscal 2018 financial statements and disclosures going forward, but the comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. We expect the impact of the adoption of Topic 606 to be immaterial to our operating results on an ongoing basis. See Note 3, "Revenue Recognition," for additional details on this implementation and the required disclosures.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"), which is intended to reduce the existing diversity in practice in how certain cash receipts and cash payments are classified in the statement of cash flows. In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230), Restricted Cash ("ASU 2016-18"), which enhances and clarifies the guidance on the classification and presentation of restricted cash in the statement of cash flows. The Company adopted these standards in the first quarter of 2018 by using the retrospective transition method, which required the following disclosures and changes to the presentation of its consolidated financial statements: cash, cash equivalents and restricted cash reported on the condensed consolidated statements of cash flows now includes restricted cash of $2.8 million, $2.4 million and $3.1 million as of December 30, 2017, September 30, 2017 and December 31, 2016, respectively, as well as previously reported cash and cash equivalents.

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740), Intra-Entity Transfers of Assets Other Than Inventory ("ASU 2016-16"), which requires entities to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. This amends current U.S. GAAP which prohibits recognition of current and deferred income taxes for all types of intra-entity asset transfers until the asset has been sold to an outside party. ASU 2016-16 is effective for fiscal years beginning after December 15, 2017, including interim periods therein with early application permitted. The Company adopted ASU 2016-16 in the first quarter of 2018 by using the modified retrospective transition approach, which did not have an impact on its consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting ("ASU 2017-09"), which provides clarity and reduces diversity in practice, costs and complexity when calculating stock compensation, on a change to the terms and conditions of a share-based award. ASU 2017-09 is effective beginning after December 15, 2017 for annual reporting periods, and interim periods within those annual periods. The Company adopted ASU 2017-09 in the first quarter of 2018, which did not have an impact on its consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07, Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting, which expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees, which is currently addressed in FASB ASC Topic 505, Equity. ASU 2018-07 specifies that Topic 718 applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in a grantor's own operations by issuing share-based payment awards. The amendments also clarify that Topic 718 does not apply to share-based payments used to effectively provide (1) financing to the issuer or (2) awards granted in conjunction with selling goods or services to customers as part of a contract accounted for under Topic 606. ASU 2018-07 is effective for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. Early adoption is permitted, but no earlier than an entity's adoption date of Topic 606, Revenue from Contracts with Customers. The Company adopted ASU 2018-07 on April 1, 2018, which did not have a material impact on its consolidated financial statements.

Recently Issued Accounting Pronouncements

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

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

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), as amended ("ASC 842"), which amends a number of aspects of lease accounting, including requiring lessees to recognize operating leases with a term greater than one year on their balance sheet as a right-of- use asset and corresponding liability, measured at the present value of the lease payments. ASC 842 is effective for interim and annual reporting periods beginning after December 15, 2018 (fiscal year 2019 for the Company), with early adoption permitted. ASC 842 should be applied under a modified retrospective transition approach with an option to apply the guidance either at the beginning of the earliest comparative period presented in the adoption-period financial statements, or to apply the new guidance at the adoption date. The Company is currently evaluating the impact of adopting ASC 842 on its consolidated financial statements.

Note 3—Revenue Recognition

In May 2014, the FASB issued Topic 606, which modifies how all entities recognize revenue. Topic 606 outlines a comprehensive five-step revenue recognition model based on the principle that an entity should recognize revenue to depict the transfer of promised goods or services to customers at an amount that reflects the consideration the entity expects to be entitled to in exchange for those goods or services. The Company adopted Topic 606 on December 31, 2017 using the modified retrospective transition method. For the three and nine months ended September 29, 2018 and September 30, 2017, the vast majority of the revenue was derived from the sale of tangible products for which the Company recognizes revenue at a point in time. The contracts that relate to these product shipments are predominantly purchase orders that have firm purchase commitments generally only for a short period of time. As a result, the adoption of Topic 606 did not have a material effect on our condensed consolidated financial statements, and no cumulative catch-up adjustment to the opening balance of accumulated deficit was required. The Company used the related practical expedients that allowed it to omit disclosure of the transaction price allocated to remaining unsatisfied obligations and an explanation of when it expects to recognize the related revenue. In adopting Topic 606, the Company applied the new guidance only to contracts that were not completed on December 30, 2017.

Revenues are recognized when control is transferred to customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods and services. Revenue recognition is evaluated through the following five steps: (i) identification of the contract, or contracts, with a customer; (ii) identification of the performance obligations in the contract; (iii) determination of the transaction price; (iv) allocation of the transaction price to the performance obligations in the contract; and (v) recognition of revenue when or as a performance obligation is satisfied.

Nature of Goods and Services

The Company derives revenue primarily from: (i) resales of NAND flash, DRAM products and other component products to end-customers that are not reached in the distribution models of the component manufacturers, including storage customers, appliance customers, system builders and cloud and datacenter customers; (ii) sales of high-performance modular memory subsystems primarily to OEMs in the server, high-performance computing and communications markets; and (iii) engineering services. However, the Company had no engineering services revenues for the three and nine months ended September 29, 2018 and September 30, 2017.

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Substantially all of the Company's net product revenues relate to products sold at a point in time through ship-and-bill performance obligations. At contract inception, an assessment of the goods and services promised in the contracts with customers is performed and a performance obligation is identified for each distinct promise to transfer to the customer a good or service (or bundle of goods or services). To identify the performance obligations, the Company considers all of the goods or services promised in the contract regardless of whether they are explicitly stated or are implied by customary business practices. Contracts with customers are comprised of customer purchase orders, invoices (including the Company's standard terms and conditions), and written contracts.

Revenue Disaggregation

The Company operates in one reportable segment, which is the design, manufacture and sale of high-performance memory subsystems for the server, high-performance computing and communications markets and component products purchased for the purpose of resale. The Company evaluates financial performance on a Company-wide basis.

The Company considers sales disaggregated at the product and service level to depict how the nature, amount, timing and uncertainty of revenues and cash flows are impacted by changes in economic factors. The following table disaggregates the sales by major source for the three and nine months ended September 29, 2018:

Product Sales

	Three Months Ended September 29, 2018	Nine Months Ended September 29, 2018
	(in thousands)	
Resales of third-party products	$ 5,089	$ 18,531
Sale of the Company's modular memory subsystems	2,114	5,977
Total net product sales	$ 7,203	$ 24,508

Performance Obligations

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

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

Significant Payment Terms

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

Variable Consideration

Customers are generally allowed limited rights of return for up to 30 days, except for sales of excess component inventories, which contain no right-of-return privileges. Product returns give rise to variable consideration that decreases the transaction price. Estimates of variable consideration and determination of whether to include estimated amounts in the transaction price are based largely on an assessment of the anticipated performance and all information (historical, current and forecasted) that is reasonably available.

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

Warranties

The Company offers a standard product warranty to customers of its memory subsystem products and has no other post-shipment obligations. The Company's liability associated with this warranty is, at its option, to repair the product, replace the product, or provide the customer with a credit.

The Company establishes provisions for estimated warranties. Estimated future warranty costs are recorded in the period in which the sale is recorded and are included in cost of sales in the accompanying condensed consolidated statements of operations. The Company calculates its accrual requirements based on historic warranty loss experience that is periodically adjusted for recent actual experience, including the timing of claims during the warranty period and actual costs incurred.

The Company does not offer separately priced extended warranty or product maintenance contracts.

Contract Assets

Typically, the Company invoices the customer and recognizes revenue once the Company has satisfied its performance obligation. Accordingly, the contract assets comprise accounts receivable. Generally, the Company does not have material amounts of other contract assets since revenue is recognized as control of goods is transferred or as services are performed.

Contract Liabilities (Deferred Revenue)

Contract liabilities are recorded when cash payments are received in advance of the Company's performance. There were no such contract liabilities (deferred revenue) as of September 29, 2018.

Practical Expedients and Exemptions

The Company has elected the following practical expedients allowed under Topic 606:

- Payment terms with its customers, which are one year or less, are not considered a significant financing component.

- Shipping and handling fees and costs incurred in connection with products sold are recorded in cost of sales and are not considered a performance obligation to its customers.

- Performance obligations on its orders are generally satisfied within one year from a given reporting date and, therefore, the Company omits disclosure of the transaction price allocated to remaining performance obligations on open orders.

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- The Company expenses incremental direct costs of obtaining a contract (sales commissions) when incurred because the amortization period is generally 12 months or less. The Company does not incur costs to fulfill a customer contract that meet the requirements for capitalization.

- The Company has applied the portfolio approach to its ship-and-bill contracts that have similar characteristics as it reasonably expects that the effects on the financial statements of applying this guidance to the portfolio of contracts would not differ materially from applying this guidance to the individual contracts within the portfolio.

Note 4—Supplemental Financial Information

Inventories

Inventories consisted of the following as of the dates presented:

	September 29, 2018	December 30, 2017
	(in thousands)	
Raw materials	$1,625	$ 768
Work in process	72	88
Finished goods	2,182	3,249
	$3,879	$ 4,105

Warranty Liabilities

The following table summarizes activities related to warranty liabilities in the periods presented:

	Nine Months Ended	
	September 29, 2018	September 30, 2017
	(in thousands)	
Beginning balance	$ 152	$ 89

Estimated cost of warranty claims charged to cost of sales	235	162
Cost of actual warranty claims	(211)	(119)
Ending balance	176	132
Less: current portion	(106)	(79)
Long-term warranty liability	$ 70	$ 53

The allowance for warranty liabilities expected to be incurred within one year is included in accrued expenses and other current liabilities in the accompanying condensed consolidated balance sheets. The allowance for warranty liability expected to be incurred after one year is classified as long-term warranty liability in the accompanying condensed consolidated balance sheets.

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Computation of Net Loss Per Share

The following table sets forth the computation of basic and diluted net loss per share of common stock:

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
	(in thousands, except per share data)			
Basic and diluted net loss per share:				
Numerator: Net loss	$ (4,644)	$ (3,098)	$ (12,734)	$ (10,287)
Denominator: Weighted-average common shares outstanding, basic and diluted	115,402	65,644	96,516	63,056
Basic and diluted net loss per share	$ (0.04)	$ (0.05)	$ (0.13)	$ (0.16)

The table below sets forth potentially dilutive weighted average common share equivalents, consisting of shares issuable upon the exercise or vesting of outstanding stock options and restricted stock awards, respectively, and the exercise of warrants, computed using the treasury stock method, and shares issuable upon conversion of the SVIC Note and the Iliad Note (see Note 6) using the “if-converted” method. These potential weighted average common share equivalents have been excluded from the diluted net loss per share calculations above as their effect would be anti-dilutive:

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
	(in thousands)		(in thousands)	
Weighted average common share equivalents	15,125	12,803	13,506	12,941

Major Customers and Products

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

Three Months Ended		Nine Months Ended	
September 29,	September 30,	September 29,	September 30,

	2018		2017		2018		2017	
Customer:								
Customer A	16	%	13	%	19	%	*	%
Customer B	12	%	*	%	*	%	*	%
Customer C	11	%	*	%	*	%	*	%
Customer D	11	%	*	%	*	%	*	%
Customer E	*	%	10	%	*	%	*	%

*Less than 10% of net revenues during the period.

The Company's accounts receivable are concentrated with three customers at September 29, 2018 representing 24%, 13% and 11% of aggregate gross receivables, respectively. At December 30, 2017, three customers represented 15%, 13% and 12% of aggregate gross receivables, respectively. The loss of any of the significant customers or a reduction in revenues to or difficulties collecting payments from any of these customers could significantly reduce the net sales and adversely affect its operating results. The Company tries to mitigate risks associated with foreign receivables by purchasing comprehensive foreign credit insurance.

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The Company resells certain component products to end-customers that are not reached in the distribution models of the component manufacturers, including storage customers, appliance customers, system builders and cloud and datacenter customers. For the three and nine months ended September 29, 2018 and September 30, 2017, resales of these products represented approximately 71%, 76%, 75% and 86%, respectively, of the net revenues.

Cash Flow Information

The following table sets forth supplemental disclosures of cash flow information and non-cash financing activities for the periods presented:

	Nine Months Ended	
	September 29, 2018	September 30, 2017
	(in thousands)	
Supplemental disclosure of non-cash financing activities:		
Debt financing of insurance	$ 344	$ 220

Note 5—Credit Agreement

SVB Credit Agreement

On October 31, 2009, the Company and Silicon Valley Bank (“SVB”) entered into a credit agreement (as amended, the “SVB Credit Agreement”). Pursuant to the terms of the SVB Credit Agreement, the Company is eligible to borrow, in a revolving line of credit, up to the lesser of (i) 85% of its eligible accounts receivable (increased from 80% as of August 29, 2018), or (ii) $5.0 million, subject to certain adjustments as set forth in the SVB Credit Agreement. The SVB Credit Agreement requires letters of credit to be secured by cash, which is classified as restricted cash in the accompanying condensed consolidated balance sheets. As of September 29, 2018 and December 30, 2017, (i) outstanding letters of credit were $1.3 million and $2.8 million, respectively, (ii) outstanding borrowings were $2.6 million and $2.0 million, respectively, and (iii) availability under the revolving line of credit was $0.2 million and $0.1 million, respectively.

On January 29, 2016, the Company and SVB entered into an amendment to the SVB Credit Agreement to, among other things, adjust the rate at which advances under the SVB Credit Agreement accrue interest to the Wall Street Journal “prime rate” plus 2.75% (prior to such amendment, advances accrued interest at a rate equal to SVB’s most recently announced “prime rate” plus 2.75%).

On March 27, 2017, the Company and SVB entered into another amendment to the SVB Credit Agreement to, among other things, (i) extend the maturity date of advances under the SVB Credit Agreement to April 1, 2018, (ii) modify the Company's financial covenants under the SVB Credit Agreement to remove all prior financial standards and replace them with a liquidity ratio standard, (iii) remove or amend certain termination, anniversary and unused facility fees payable by the Company under the SVB Credit Agreement, and (iv) make certain other administrative changes. On April 12, 2017, the Company and SVB entered into a further amendment to the SVB Credit Agreement to, among other things, obtain SVB's consent in connection with the Company's rights agreement with Computershare Trust Company, N.A., as rights agent (see Note 9), and make certain administrative changes in connection with the Company's funding arrangement with TR Global Funding V, LLC, an affiliate of TRGP Capital Management, LLC ("TRGP") (see Note 8). On March 20, 2018, the Company and SVB entered into another amendment to the SVB Credit Agreement to among other things, (i) extend the maturity date of advances under the SVB Credit Agreement to March 31, 2019 and (ii) revise certain inventory reporting requirements under the SVB Credit Agreement. On August 29, 2018, the SVB Credit Agreement was amended further to increase the borrowing based of accounts receivable to 85% from 80% or $5.0 million, subject to certain adjustments set forth in the SVB Credit Agreement.

For all periods before April 20, 2017, all obligations under the SVB Credit Agreement were secured by a first priority security interest in the Company's tangible and intangible assets, other than its patent portfolio, which was subject to a first priority security interest held by SVIC (see Note 6). Certain of these lien priorities were modified in April and May 2017 in connection with the Company's establishment of a funding arrangement with TRGP for certain

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of the Company's litigation expenses in connection with certain of its legal proceedings against SK hynix, a South Korean memory semiconductor supplier ("SK hynix"). On May 3, 2017, TRGP entered into an intercreditor agreement with each of SVIC and SVB, and on April 20, 2017, SVIC and SVB entered into an intercreditor agreement with each other (such intercreditor agreements, collectively, the "Intercreditor Agreements"). Pursuant to the terms of the Intercreditor Agreements, SVB's security interests in the Company's assets have been modified as follows: SVB has a first priority security interest in all of the Company's tangible and intangible assets other than its patent portfolio and its claims underlying and any proceeds it may receive from the SK hynix proceedings; a second priority security interest in the Company's patent portfolio other than the patents that are the subject of the SK hynix proceedings; and a third priority security interest in the Company's patents that are the subject of the SK hynix proceedings. See Note 8 for additional information about the funding arrangement with TRGP, the Intercreditor Agreements and the Company's legal proceedings against SK hynix.

The SVB Credit Agreement subjects the Company to certain affirmative and negative covenants, including financial covenants with respect to the Company's liquidity and restrictions on the payment of dividends. As of September 29, 2018, the Company was in compliance with its covenants under the SVB Credit Agreement.

Note 6—Debt

The Company's debt consisted of the following as of the dates presented:

	September 29, 2018	December 30, 2017
	(in thousands)	
Senior secured convertible note, due December 2025, including accrued interest	$ 15,859	$ 15,634
Unsecured convertible note, due August 2020, including accrued interest	2,287	-
Unamortized debt discounts and issuance costs	(1,062)	(868)
	$ 17,084	$ 14,766

Senior Secured Convertible Note

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

The SVIC Warrant was valued at $1.2 million, based on its relative fair value, and was recorded as a debt discount. The Company also recorded $0.2 million of debt issuance costs as a debt discount for professional services fees rendered in connection with the transaction. These amounts are being amortized to interest expense over the term of the SVIC Note using the interest method. During the three and nine months ended September 29, 2018 and September 30, 2017, interest expense related to the amortization of the issuance costs associated with the liability component was not material. As of September 29, 2018, the outstanding principal and accrued interest on the SVIC Note was $15.9 million, and the outstanding SVIC Note balance, net of unamortized debt discounts and issuance costs, was $15.2 million.

In connection with the SVIC Note, SVIC was granted a first priority security interest in the Company's patent portfolio and a second priority security interest in all of the Company's other tangible and intangible assets. Upon issuance of the SVIC Note, the Company, SVB and SVIC entered into an Intercreditor Agreement pursuant to which SVB and SVIC agreed to their relative security interests in the Company's assets. In May 2017, SVIC, SVB and TRGP

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entered into additional Intercreditor Agreements to modify certain of these lien priorities (see Note 8). Additionally, upon issuance of the SVIC Note and the SVIC Warrant, the Company and SVIC entered into a Registration Rights Agreement pursuant to which the Company is obligated to register with the SEC, upon demand by SVIC, the shares of the Company's common stock issuable upon conversion of the SVIC Note or upon exercise of the SVIC Warrant.

The SVIC Note subjects the Company to certain affirmative and negative operating covenants. As of September 29, 2018, the Company was in compliance with its covenants under the SVIC Note.

Unsecured Convertible Note

On August 27, 2018, the Company entered into the Iliad Purchase Agreement, pursuant to which the Company issued the $2.3 million Iliad Note with an original issue discount of $0.2 million. The Iliad Note bears interest at an annual rate of 8% and matures on August 27, 2020, unless earlier repurchased, redeemed or converted in accordance with its terms.

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

The number of Redemption Conversion Shares equals the portion of the applicable Redemption Amount being converted divided by the lesser of the Lender Conversion Price or the Market Price, that is 85% of the Company's lowest closing bid price during the 20 trading days immediately preceding the applicable redemption date, provided that the Market Price shall not be less than $0.11 per share (the "Redemption Price Floor"). In the event any applicable redemption conversion price is below the Redemption Price Floor then either: (i) the Company will honor the redemption conversion at the then effective redemption conversion price for a Redemption Amount not to exceed $0.15 million if the redemption conversion price is equal to or greater than $0.06 or (ii) the Company will pay the applicable Redemption Amount up to $0.15 million in cash and not in Redemption Conversion Shares.

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

As of September 29, 2018, the outstanding principal and accrued interest on the Iliad Note was $2.3 million, and the outstanding Iliad Note balance, net of unamortized debt discounts and issuance costs, was $1.9 million.

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

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Interest Expense

Interest expense, including amortization of debt discounts and issuance costs, net of interest income, was as follows during the periods presented:

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
	(in thousands)		(in thousands)	
Interest expense:				
SVB	$ 10	$ 5	$ 34	$ 26
SVIC	159	129	416	387
Iliad	16	-	16	-
Others	-	4	4	20
	185	138	470	433
Interest income	(2)	(3)	(7)	(12)
	$ 183	$ 135	$ 463	$ 421

Note 7—Income Taxes

The following table sets forth the Company's provision for income taxes, along with the corresponding effective tax rates, for the periods presented:

	Three Months Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
	(in thousands)		(in thousands)	
Provision for income taxes	$ -	$ -	$ -	$ 1
Effective tax rate	- %	- %	- %	(0.01) %

The Company evaluates whether a valuation allowance should be established against its deferred tax assets based on the consideration of all available evidence using a "more likely than not" standard. In making such judgments, significant weight is given to evidence that can be objectively verified. Due to uncertainty of future utilization, the Company has provided a full valuation allowance as of September 29, 2018 and December 30, 2017. Accordingly, no benefit has been recognized for net deferred tax assets. The Company's effective tax rate differs from the federal statutory tax rate of 21% and 34% for the nine months ended September 29, 2018 and September 30, 2017, respectively, due to providing the full valuation allowance against net deferred tax assets.

The Company did not have any unrecognized tax benefits as of September 29, 2018 and December 30, 2017.

Note 8—Commitments and Contingencies

TRGP Agreement and Related Intercreditor Agreements

On May 3, 2017, the Company and TRGP entered into an investment agreement (the “TRGP Agreement”), which generally provides that TRGP will directly fund the costs incurred by or on behalf of the Company in connection with certain its legal proceedings against SK hynix (see “Litigation and Patent Reexaminations” in this Note 8 below), including costs incurred since January 1, 2017 and costs to be incurred in the future in the Company’s first action in the U.S. International Trade Commission (“ITC”) and its U.S. district court proceedings, but excluding the Company’s second ITC action and its proceedings in international courts (all such funded costs, collectively, the “Funded Costs”). In exchange for such funding, the Company has agreed that, if the Company recovers any proceeds in connection with the funded SK hynix proceedings, it will pay to TRGP the amount of the Funded Costs paid by TRGP plus an escalating premium based on when any such proceeds are recovered, such that the premium will equal a specified low-to-mid double-digit percentage of the amount of the Funded Costs and such percentage will increase by a specified low double-

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digit amount each quarter after a specified date until any such proceeds are recovered. In addition, pursuant to the terms of a separate security agreement between the Company and TRGP dated May 3, 2017 (the "Security Agreement"), the Company has granted to TRGP (i) a first priority lien on, and security in, the claims underlying the funded SK hynix proceedings and any proceeds that may be received by the Company in connection with these proceedings, and (ii) a second priority lien on, and security in, the Company's patents that are the subject of the funded SK hynix proceedings.

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

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

Legal expenses incurred by the Company but paid by TRGP pursuant to the terms of the TRGP Agreement are excluded from the Company's consolidated financial statements in each period in which the TRGP Agreement remains in effect. For the nine months ended September 29, 2018, the Company excluded legal expenses of $1.7 million ($11.9 million since January 1, 2017 through September 29, 2018), as a result of TRGP's payment of these expenses under the TRGP Agreement. Any settlement or other cash proceeds the Company may recover in the future in connection with the funded SK hynix proceedings would be reduced by the aggregate amount of legal expenses excluded by the Company as a result of TRGP's payment of these expenses under the TRGP Agreement, plus the premium amount due to TRGP under the terms of the TRGP Agreement at the time of any such recovery.

Litigation and Patent Reexaminations

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

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monetize its intellectual property portfolio. The Company is also subject to litigation based on claims that it has infringed on the intellectual property rights of others.

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

Google Litigation

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

Inphi Litigation

On September 22, 2009, the Company filed a patent infringement lawsuit against Inphi Corporation ("Inphi") in the U.S. District Court for the Central District of California (the "Central District Court"). The complaint, as amended, alleges that Inphi is contributorily infringing and actively inducing the infringement of U.S. patents owned by the Company, including the '912 patent, U.S. Patent No. 7,532,537 (the "'537 patent"), which relates generally to memory modules with load isolation and memory domain translation capabilities, and U.S. Patent No. 7,636,274 (the "'274 patent"), which is related to the '537 patent and relates generally to load isolation and memory domain translation technologies. The Company is seeking damages and injunctive relief based on Inphi's use of the Company's patented technology. Inphi denied infringement and claimed that the three patents are invalid. In June 2010, Inphi requested and was later granted Inter Partes Reexaminations of the ‘912, ‘537 and ‘274 patents by the USPTO. The reexamination proceedings are described below (except for the reexamination proceeding related to the ‘537 patent, which have concluded with the confirmation of all of the claims of such patent). In connection with the reexamination requests, Inphi filed a motion to stay the patent infringement lawsuit with the Central District Court until completion of the reexamination proceedings, which was granted.

‘912 Patent Reexamination

As noted above, in April 2010, June 2010 and October 2010, Google and Inphi submitted requests for an Inter Partes Reexamination of the ‘912 patent by the USPTO, claiming that the ‘912 patent is invalid and requesting that the USPTO reject the patent’s claims and cancel the patent. Additionally, in October 2010, Smart Modular, Inc. (“Smart Modular”) submitted another such reexamination request. On January 18, 2011, the USPTO granted such reexamination requests, and in February 2011, the USPTO merged the Inphi, Google and Smart Modular ‘912 patent reexaminations into a single proceeding. On March 21, 2014, the USPTO issued an Action Closing Prosecution (“ACP”), an office action that states the USPTO examiner’s position on patentability and closes further prosecution, and on June 18, 2014

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the USPTO issued a Right of Appeal Notice ("RAN"), a notice that triggers the rights of the involved parties to file a notice of appeal to the ACP, each of which confirmed the patentability of 92 of the '912 patent's claims and rejected the patent's 11 other claims. The parties involved filed various notices of appeal, responses and requests, and on November 24, 2015, the PTAB held a hearing on such appeals. On May 31, 2016, the PTAB issued a decision affirming certain of the examiner's decisions and reversing others. On February 9, 2017, the PTAB granted the Company's request to reopen prosecution before the USPTO examiner and remanded the consolidated proceeding to the examiner to consider the patentability of certain of the pending claims in view of the PTAB's May 31, 2016 decision and comments from the parties. On October 3, 2017, the examiner issued a determination as to the patentability of certain of the pending claims, which were found to be unpatentable. On June 1, 2018, the PTAB reversed the Examiner and found the pending amended claims to be patentable. On July 2, 2018, Google requested rehearing of the PTAB's decision. The proceeding will now return to the PTAB for reconsideration of its decision. Accruals have not been recorded for loss contingencies related to the '912 patent reexamination proceedings because it is not probable that a loss has been incurred and the amount of any such loss cannot be reasonably estimated.

'627 Patent Reexamination

In September 2011, Smart Modular submitted a request for an Inter Partes Reexamination by the USPTO of the Company's U.S. Patent No. 7,864,627 (the "'627 patent"), related to the '912 patent, claiming that the '627 patent is invalid and requesting that the USPTO reject the patent's claims and cancel the patent. On November 16, 2011, the request was granted. On March 27, 2014 and June 27, 2014, the USPTO issued an ACP and a RAN, respectively, each of which rejected all of the '627 patent's claims. The parties involved filed various notices of appeal, responses and requests, and on November 24, 2015, the PTAB held a hearing on such appeals. On May 31, 2016, the PTAB issued a decision affirming the decisions of the examiner. On February 9, 2017, the PTAB granted the Company's request to reopen prosecution before the USPTO examiner and remanded the proceeding to the examiner to consider the patentability of certain of the pending claims in view of the PTAB's May 31, 2016 decision and comments from the parties. On October 2, 2017, the examiner issued a determination as to the patentability of the pending claims, which were found to be unpatentable. On June 1, 2018, the PTAB reversed the Examiner and found the pending amended claims to be patentable. Smart Modular did not appeal this decision to the Federal Circuit. On October 3, 2018, the USPTO issued a Notice of Intent to Issue a Reexam Certificate. Accruals have not been recorded for loss contingencies related to the '627 patent reexamination proceedings because it is not probable that a loss has been incurred and the amount of any such loss cannot be reasonably estimated.

'274 Patent Reexamination

As noted above, in April 2010 and June 2010, Inphi submitted requests for an Inter Partes Reexamination of the '274 patent by the USPTO. On August 27, 2010, the request was granted. In March 2012 and June 2012, the USPTO issued an ACP and a RAN, respectively, each of which confirmed the patentability of many of the '274 patent's claims. The parties involved filed various notices of appeal, responses and requests, and on November 20, 2013, the PTAB held a hearing on such appeals. On January 16, 2014, the PTAB issued a decision affirming the examiner in part, but reversing the examiner on new grounds and rejecting all of the patent's claims. On September 11, 2015, the USPTO examiner issued a determination rejecting the amended claims. On January 23, 2017, the USPTO granted-in-part the

Company’s petition to enter comments in support of its positions in the proceeding. On May 9, 2017, the PTAB issued a decision on appeal affirming the rejection of all claims. Netlist requested rehearing of the PTAB’s decision on June 6, 2017. The PTAB denied the rehearing request on August 8, 2017. On October 6, 2017, Netlist appealed the decision to the Court of Appeals for the Federal Circuit, which Netlist dismissed on March 19, 2018, thereby terminating the proceedings with the rejection of all ‘274 patent claims becoming final. Accruals have not been recorded for loss contingencies related to the ‘274 patent reexamination proceedings because it is not probable that a loss has been incurred and the amount of any such loss cannot be reasonably estimated.

Smart Modular ‘295 Patent Litigation and Reexamination

On September 13, 2012, Smart Modular filed a patent infringement lawsuit against the Company in the U.S. District Court for the Eastern District of California (the “Eastern District Court”). The complaint alleges that the Company willfully infringes and actively induces the infringement of certain claims of U.S. Patent No. 8,250,295 (“the ‘295 patent”) issued to Smart Modular and seeks damages and injunctive relief. The Company answered Smart

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Modular’s complaint in October 2012, denying infringement of the ‘295 patent, asserting that the ‘295 patent is invalid and unenforceable, and asserting counterclaims against Smart Modular. Accruals have not been recorded for loss contingencies related to Smart Modular’s complaint because it is not probable that a loss has been incurred and the amount of any such loss cannot be reasonably estimated.

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

Smart Modular and SanDisk Litigation

On July 1 and August 23, 2013, the Company filed complaints against Smart Modular, Smart Storage Systems (which was subsequently acquired by SanDisk Corporation (“SanDisk”)), Smart Worldwide Holdings (“Smart Worldwide”) and Diablo Technologies (“Diablo”) in the Central District Court, seeking, among other things, damages and other relief for alleged infringement of several of the Company’s patents by the defendants based on the manufacture and sale of the ULLtraDIMM memory module, alleged antitrust violations by Smart Modular and Smart Worldwide, and alleged trade secret misappropriation and trademark infringement by Diablo. The trade secret misappropriation and trademark infringement claims against Diablo were fully adjudicated on August 17, 2016 and are no longer pending.

On August 23, 2013, Smart Modular and Diablo each filed a complaint in the San Francisco Division of the Northern District Court seeking declaratory judgment of non-infringement and invalidity of the patents asserted in the Company’s complaint. Based on various motions filed by the parties, on November 26, 2013, the Central District Court severed and transferred the patent claims related to the ULLtraDIMM memory module to the Northern District Court.

On February 12, 2014, the Northern District Court granted the parties’ joint stipulation dismissing Smart Modular without prejudice. Between June 18, 2014 and August 23, 2014, SanDisk, Diablo, and Smart Modular filed numerous petitions in the USPTO requesting Inter Partes Review of the Company’s asserted patents. All of the reviews associated with U.S. Patent Nos. 8,516,187; 8,301,833; 8,516,185 have been resolved in the Company’s favor and are no longer pending. The reviews associated with U.S. Patent Nos. 8,001,434; 8,359,501; 7,881,150; and 8,081,536, and the appeals therefrom, have concluded. On April 9, 2015, the Northern District Court stayed the infringement proceedings as to the Company’s patents asserted against the ULLtraDIMM pending resolution of all outstanding patent review decisions on appeal related to the patents asserted in this case.

SK hynix Litigation

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

On October 3, 2016, the ITC instituted an investigation of the trade practices of SK hynix and certain of its subsidiaries in connection with the First ITC Action, and held a hearing on the merits of the investigation from May 8, 2017 until May 11, 2017. On November 14, 2017, the ITC issued a final initial determination for the First ITC Action, finding no infringement of the asserted patents and no violation of Section 337 of the Tariff Act, and on January 16,

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2018, the ITC issued a final determination for the First ITC Action, affirming the findings of no infringement and no violation and terminating the investigation. The Company is appealing this final determination to the Court of Appeals for the Federal Circuit.

On January 11, 2018, the ITC set a 19-month target date of July 3, 2019 for an investigation related to the Second ITC Action, with a final initial determination for the Second ITC Action being filed no later than March 1, 2019. Based on this target date, the ITC scheduled a hearing on the merits of the investigation related to the Second ITC Action to begin on November 9, 2018 and conclude on November 19, 2018. On April 12, 2018, the ITC granted SK hynix's motion for summary determination of non-infringement and terminated the Second ITC Action in its entirety. On April 23, 2018, the Company filed a petition seeking ITC review of this decision. On May 29, 2018, the ITC Commission remanded the Second ITC Action back to the ALJ to resolve the parties' claim construction disputes and continue the investigation. On June 14, 2018, the ITC extended the target date for the final determination to August 5, 2019, with a final initial determination due by April 5, 2019. Based on this extended target date, the ITC scheduled a hearing on the merits to begin on December 14, 2018 and conclude on December 21, 2018. On September 13, 2018, the ITC rescheduled the hearing on the merits to begin on January 14, 2019 and conclude on January 18, 2019.

Between December 30, 2016 and January 20, 2017, SK hynix filed numerous petitions in the USPTO requesting Inter Partes Review of certain of the Company's patents, including the patents asserted in the First ITC Action and the Central District Court proceedings, which have now concluded and certain of which are now on appeal to the Court of Appeals for the Federal Circuit. Between December 19, 2017 and February 7, 2018, SK hynix filed additional petitions in the USPTO requesting Inter Partes Review of the patents asserted in the Second ITC Action which are now proceeding and are scheduled to conclude no later than August 2019.

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

On July 11, 2017, the Company filed legal proceedings for patent infringement against SK hynix and certain of its distributors in the courts of Germany and the PRC based on the alleged infringement by SK hynix's LRDIMM products of certain of the Company's patents in those jurisdictions. On January 25, 2018, the court in Germany held a preliminary hearing and set a trial date of December 6, 2018. In December 2017, SK hynix filed petitions challenging the validity of the patents asserted by the Company in Germany and the PRC. On June 3, 2018, the patent asserted in the PRC was found to be invalid. On June 19, 2018, the Company withdrew the patent infringement suits filed in the PRC.

Other Contingent Obligations

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

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Note 9—Stockholders' Equity

Serial Preferred Stock

The Company's authorized capital stock includes 10,000,000 shares of serial preferred stock, with a par value of $0.001 per share. No shares of preferred stock were outstanding at September 29, 2018 or December 30, 2017.

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

Each Right entitles the registered holder, subject to the terms of the Rights Agreement, to purchase from the Company, when exercisable and subject to adjustment, one unit consisting of one one-thousandth of a share (a "Unit") of Series A Preferred Stock of the Company (the "Preferred Stock"), at a purchase price of $6.56 per Unit, subject to adjustment. Subject to the provisions of the Rights Agreement, including certain exceptions specified therein, a distribution date for the Rights (the "Distribution Date") will occur upon the earlier of (i) 10 business days following a public announcement that a person or group of affiliated or associated persons (an "Acquiring Person") has acquired or otherwise obtained beneficial ownership of 15% or more of the then outstanding shares of the Company's common stock, and (ii) 10 business days (or such later date as may be determined by the Company's board of directors) following the commencement of a tender offer or exchange offer that would result in a person or group becoming an Acquiring Person. The Rights are not exercisable until the Distribution Date and, unless earlier redeemed or exchanged by the Company pursuant to the terms of the Rights Agreement, will expire on the earlier of (i) the close of business on April 17, 2018, the first anniversary of the adoption of the Rights Agreement, and (ii) the date of any settlement, adjudication, dismissal with prejudice, abandonment by the Company or other conclusive and final resolution of the Company's legal proceedings against SK hynix (see Note 8).

On April 16, 2018, the Company entered into an amendment (the "Amendment") to the Rights Agreement. The Amendment amends the definition of "Expiration Date" in the Rights Agreement to incorporate all of the Company's legal proceedings against SK hynix, and amends the definition of "Final Expiration Date" in the Rights Agreement to mean the close of business on April 17, 2019. Accordingly, the Amendment extends the final expiration of the Rights issued pursuant to the Rights Agreement from April 17, 2018 to April 17, 2019. As a result, and pursuant to the Amendment, the Rights will expire and become unexercisable on or before, in accordance with the terms of the Rights Agreement, the close of business on April 17, 2019.

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

Common Stock

On May 31, 2017, the Company's stockholders approved an amendment to the Restated Certificate of Incorporation ("Amended Certificate of Incorporation") to increase the number of shares of the Company's common stock authorized for issuance from 90,000,000 to 150,000,000. The Amended Certificate of Incorporation was amended further to increase the number of shares of the common stock authorized for issuance to 300,000,000 upon the approval by the stockholders on August 15, 2018.

On August 22, 2017, the Company completed an underwritten public offering (the "2017 Offering"), pursuant to which it sold 8,500,000 shares of its common stock at a price to the public of $0.60 per share. The net proceeds to the

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Company from the 2017 Offering were $4.4 million, after deducting underwriting discounts and commissions and offering expenses paid by the Company.

On November 14, 2017, the Company entered into the Sales Agreement with the Agent to sell shares of its common stock, with aggregate gross proceeds of up to $9.0 million, from time to time, through the ATM Program. Under the Sales Agreement, the Company set the parameters for the sale of shares, including the number of shares to be issued, the time period during which sales were requested to be made, limitation on the number of shares that could be sold in any one trading day and any minimum price below which sales could not be made. On August 29, 2018, the Company completed the offering under the ATM Program after raising net proceeds of approximately $8.6 million through the sale of 40,680,368 shares of its common stock, after deducting sales commissions and other offering expenses paid by the Company. During the nine months ended September 29, 2018, the Company received net proceeds of approximately $5.8 million through the sale of 31,786,146 shares of its common stock, after deducting sales commissions and other offering expenses paid by the Company.

On May 17, 2018, the Company entered into a Board approved arm’s length purchase agreement with a trust controlled by C.K. Hong, the Company’s President, Chief Executive Officer and Chairman of the Board, pursuant to which the Company sold to Mr. Hong’s trust 5,405,405 shares of the Company’s common stock, par value $0.001 per share, at a price per share of $0.148 (which equals the most recent consolidated closing bid price of the Company’s common stock, as reported by The Nasdaq Capital Market, as of the signing of the Purchase Agreement). The aggregate net proceeds received by the Company were $0.8 million.

On September 12, 2018, the Company entered into a Securities Purchase Agreement with certain investors, pursuant to which the Company issued and sold to the investors in a registered offering (“2018 Offering”) an aggregate of 22,222,220 shares of its common stock and warrants to purchase up to an aggregate of 11,111,110 shares of its common stock at a per share purchase price of $0.45 per share. The 2018 Offering closed on September 14, 2018. The net proceeds to the Company from the 2018 Offering were approximately $9.2 million, after deducting placement agent fees and offering costs paid by the Company. The warrant becomes exercisable 181 days following the date of its issuance, has a term of five years commencing on the date when it first becomes exercisable, and has an exercise price of $0.655 per share. The exercise price and the number of warrant shares issuable upon exercise of warrant are subject to adjustment in the event of, among other things, certain transactions affecting the Company’s common stock (including without limitation stock splits and stock dividends), and certain fundamental transactions (including without limitation a merger or other sale-of-company transaction).

Stock-Based Compensation

The Company has stock-based compensation awards outstanding pursuant to its Amended and Restated 2006 Equity Incentive Plan, as re-approved by its stockholders on June 8, 2016 (the “Amended 2006 Plan”), under which a variety of stock-based awards, including stock options, may be granted to employees and non-employee service providers of the Company. In addition to awards granted pursuant to the Amended 2006 Plan, the Company periodically grants equity-based awards outside the Amended 2006 Plan to certain new hires as an inducement to enter into employment with the Company.

Subject to certain adjustments, as of September 29, 2018, the Company was authorized to issue a maximum of 12,605,566 shares of its common stock pursuant to awards granted under the Amended 2006 Plan. Pursuant to the terms of the Amended 2006 Plan, the maximum number of shares of common stock subject to the plan automatically increased on the first day of each calendar year from January 1, 2007 through January 1, 2016, by the lesser of (i) 5.0% of the number of shares of common stock issued and outstanding as of the first day of the applicable calendar year, and (ii) 1,200,000 shares of common stock, subject to adjustment for certain corporate actions. Beginning January 1, 2017, the automatic annual increase to the number of shares of common stock that may be issued pursuant to awards granted under the Amended 2006 Plan is equal to the lesser of (i) 2.5% of the number of shares of common stock issued and outstanding as of the first day of the applicable calendar year, and (ii) 1,200,000 shares of common stock, subject to adjustment for certain corporate actions. As of September 29, 2018, the Company had 2,562,899 shares of common stock available for issuance pursuant to future awards to be granted under the Amended 2006 Plan. Stock options granted

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under the Amended 2006 Plan generally vest at a rate of at least 25% per year over four years and expire 10 years from the date of grant. Restricted stock awards vest in two equal annual installments over two years.

The following table summarizes the Company's stock option activities during the nine months ended September 29, 2018:

	Options Outstanding	
	Number of Shares	Weighted-Average