QUALSTAR CORP
Form 10-Q
February 14, 2013

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

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

For the Quarterly Period Ended December 31, 2012

OR

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

For the Transition Period From to

Commission file number 000-30083

QUALSTAR CORPORATION

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

3990-B Heritage Oak Court, Simi Valley, CA 93063
(805) 583-7744

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

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

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

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

Total shares of common stock without par value outstanding at January 22, 2013 are 12,253,117.

QUALSTAR CORPORATION
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2012
INDEX

PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

QUALSTAR CORPORATION
CONDENSED BALANCE SHEETS
(In thousands)

	December 31, 2012 (Unaudited)	June 30, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$6,482	$7,381
Marketable securities, short-term	7,437	7,135
Receivables, net of allowances of $48 at December 31, 2012, and $38 at June 30, 2012	3,056	2,995
Inventories, net	3,991	4,475
Prepaid expenses and other current assets	213	151
Total current assets	$21,179	$22,137
Property and equipment, net	365	268
Marketable securities, long-term	3,924	6,369
Other assets	46	50
Total assets	$25,514	$28,824
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$1,242	$2,039
Accrued payroll and related liabilities	538	332
Other accrued liabilities	2,242	1,374
Total current liabilities	$4,022	$3,745
Other long term liabilities	26	26
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, no par value; 5,000 shares authorized; no shares issued	—	—
Common stock, no par value; 50,000 shares authorized, 12,253 shares issued and outstanding as of December 31, 2012 and June 30, 2012	18,905	18,878
Accumulated other comprehensive income	14	9
Retained earnings	2,547	6,166
Total shareholders' equity	$21,466	$25,053
Total liabilities and shareholders' equity	$25,514	$28,824

See notes to condensed financial statements.

1

QUALSTAR CORPORATION
CONDENSED STATEMENTS OF OPERATIONS
(Unaudited) (In thousands, except per share data)

	Three Months Ended December 31, 2012	Three Months Ended December 31, 2011	Six Months Ended December 31, 2012	Six Months Ended December 31, 2011
Net revenues	$3,355	$3,555	$6,808	$8,179
Cost of goods sold	2,086	2,728	4,595	5,638
Gross profit	$1,269	$827	$2,213	$2,541
Operating expenses:				
Engineering	742	650	1,408	1,298
Sales and marketing	804	448	1,335	909
General and administrative	919	741	1,659	1,333
Restructuring expense	511	-	1,393	-
Total operating expenses	$2,976	$1,839	$5,795	$3,540
Loss from operations	(1,707)	(1,012)	(3,582)	(999)
Other income (expense)	34	41	(37)	85
Loss before income taxes	(1,673)	(971)	(3,619)	(914)
Provision for income taxes	-	-	-	-
Net loss	$(1,673)	$(971)	$(3,619)	$(914)
Loss per common share:				
Basic and Diluted	$(0.14)	$(0.08)	$(0.30)	$(0.07)
Weighted average common shares outstanding:				
Basic and Diluted	12,253	12,253	12,253	12,253

See notes to condensed financial statements.

QUALSTAR CORPORATION
CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited) (In thousands)

	Six Months Ended December 31, 2012	2011
OPERATING ACTIVITIES:		
Net loss	$(3,619)	$(914)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	67	51
Provision for bad debts and returns, net	(2)	121
Provision for inventory reserve and adjustments	325	82
Stock based compensation	27	4
Loss on sale of marketable securities	34	38
Changes in operating assets and liabilities:		
Accounts receivable	(59)	50
Inventories	159	(665)
Prepaid expenses and other assets	(58)	99
Accounts payable	(796)	(52)
Accrued payroll and related liabilities	206	(182)
Other accrued liabilities	868	153
Net cash used in operating activities	$(2,848)	$(1,215)
INVESTING ACTIVITIES:		
Purchases of equipment	(164)	-
Purchases of marketable securities	(3,151)	(9,656)
Proceeds from the sale of marketable securities	5,264	10,687
Net cash provided by investing activities	$1,949	$1,031
FINANCING ACTIVITIES:		
Net cash used in financing activities	-	-
NET DECREASE IN CASH AND CASH EQUIVALENTS	$(899)	$(184)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	$7,381	$4,970
CASH AND CASH EQUIVALENTS, END OF PERIOD	$6,482	$4,786
SUPPLEMENTAL CASH FLOW DISCLOSURES:		
Income taxes paid	$7	$4

See notes to condensed financial statements.

QUALSTAR CORPORATION
CONDENSED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
SIX MONTHS ENDED DECEMBER 31, 2012
(Unaudited) (In thousands)

	Common Stock Shares	Common Stock Amount	Accumulated Other Comprehensive Income	Retained Earnings	Total
Balance at June 30, 2012	12,253	$18,878	$ 9	$6,166	$25,053
Share-based compensation		27			27
Comprehensive loss:					
Change in unrealized gains on investments			5		5
Net loss				(3,619)	(3,619)
Comprehensive loss					(3,614)
Balance at December 31, 2012	12,253	$18,905	$ 14	$2,547	$21,466

See notes to condensed financial statements

4

QUALSTAR CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS

Note 1 – Summary of Significant Accounting Policies

Basis of Presentation

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

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

Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with information included in the Qualstar Corporation Annual Report on Form 10-K for the fiscal year ended June 30, 2012, filed with the Securities and Exchange Commission ("SEC") on September 21, 2012.

Risks and Uncertainties

We are subject to a number of risks and uncertainties that may significantly impact our future operating results. These risks and uncertainties are discussed under Part II, Item 1A, "Risk Factors" included in this Form 10-Q. As our interim description of risks and uncertainties only includes any material changes to our annual description, we refer you to our risk factors previously disclosed in Item 1A of our annual report on Form 10-K for the fiscal year ended June 30, 2012, as filed with the U.S. Securities and Exchange Commission ("SEC").

Revenue Recognition

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

Revenue for established products that have previously satisfied a customer's acceptance requirements and provide for full payment tied to shipment is generally recognized upon shipment and passage of title. In limited cases where a prior history of customer acceptance cannot be demonstrated or sales where customer payment dates are not determinable or when collection is not reasonably assured, revenue is deferred until customer acceptance occurs or payment has been received. On the limited shipments where sales are not recognized, gross profit is generally recorded as deferred profit in our consolidated balance sheet representing the difference between the receivable recorded and the inventory shipped. The deferred revenue and deferred profit accounts are included in other accrued liabilities in the balance sheet. At December 31, 2012 we had deferred revenue of approximately $152,000 and deferred profit of approximately $18,000. At June 30, 2012 we had deferred revenue of approximately $156,000 and no deferred profit. See subsequent events footnote with regard to future recognition of service revenue.

QUALSTAR CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS- (Continued)

Marketable Securities

Marketable securities consist primarily of high-quality U.S. corporate securities, U.S. federal government debt securities, corporate and municipal bonds, collateralized mortgage obligations and asset backed securities. Our marketable securities portfolio consists of short-term securities with original maturities of greater than three months from the date of purchase and remaining maturities of less than one year and long-term securities with original maturities of greater than one year and less than five years. Marketable securities are classified as available for sale and are recorded at fair value using the specific identification method; unrealized gains and losses are reflected in other comprehensive income until realized; realized gains and losses are included in earnings when the underlying securities are sold and are derived using the specific identification method for determining the cost of securities sold. If the credit ratings of the security issuers deteriorate or if normal market conditions do not return in the near future, we may be required to reduce the value of our investments through an impairment charge and reflect them as long-term investments.

Fair Value of Financial Instruments

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

Allowance for Doubtful Accounts

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

Inventory Valuation

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

Warranty Obligations

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

QUALSTAR CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS- (Continued)

Legal and Other Contingencies

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

Share-Based Compensation

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

Accounting for Income Taxes

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

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

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

7

QUALSTAR CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS- (Continued)

Note 2 – Recent Accounting Pronouncements

Recently adopted accounting guidance

On July 1, 2012 we adopted ASU 2011-08, guidance issued by the Financial Accounting Standards Board ("FASB") on testing goodwill for impairment. The new guidance provides an entity the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity determines that this is the case, it is required to perform the currently prescribed two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized for that reporting unit (if any). If an entity determines that the fair value of a reporting unit is greater than its carrying amount, the two-step goodwill impairment test is not required. Adoption of this new guidance did not impact our financial statements.

On July 1, 2012 we adopted ASU 2011-05, guidance issued by the FASB on presentation of comprehensive income. The new guidance eliminates the current option to report other comprehensive income and its components in the statement of changes in stockholders' equity. Instead, an entity will be required to present either a continuous statement of net income and other comprehensive income or in two separate but consecutive statements. The new guidance also required entities to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. However, in December 2011, the FASB issued guidance which indefinitely defers the guidance related to the presentation of reclassification adjustments. Adoption of this new guidance did not have a material impact on our financial statements.

Recent accounting guidance not yet adopted

In July 2012, the FASB issued ASU 2012-02, guidance on testing indefinite-lived intangible assets for impairment. The new guidance provides an entity the option to first assess qualitative factors to determine whether it is necessary to perform quantitative impairment test, simplifying the guidance for testing the decline in the realizable value (impairment) of indefinite-lived intangible assets other than goodwill. Examples of intangible assets subject to the guidance include indefinite-lived trademarks, licenses, and distribution rights. An organization electing to perform a qualitative assessment is no longer required to calculate the fair value of an indefinite-lived intangible asset unless the organization determines, based on a qualitative assessment, that it is 'more likely than not' that the asset is impaired. The new guidance will be effective for us beginning July 1, 2013, and will not impact our financial statements upon adoption.

In December 2011, the FASB issued guidance enhancing disclosure requirements about the nature of an entity's right to offset and related arrangements associated with its financial instruments and derivative instruments. The new guidance requires the disclosure of the gross amounts subject to rights of set-off, amounts offset in accordance with the accounting standards followed, and the related net exposure. The new guidance will be effective for us beginning July 1, 2013, and will not materially impact our financial statements upon adoption.

Note 3 – Concentration of Credit Risk, Other Concentration Risks and Significant Customers

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

QUALSTAR CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS- (Continued)

Our financial results could be affected by changes in foreign currency exchange rates or weak economic conditions in foreign markets. As all sales are currently made in U.S. dollars, a strengthening of the dollar could make our products less competitive in foreign markets. Sales outside of North America represented approximately 52.3% of net revenues in the three months ended December 31, 2012, and 40.9% of net revenues in the three months ended December 31, 2011. Sales outside of North America represented approximately 44.3% of net revenues in the six months ended December 31, 2012, and 43.4% of net revenues in the six months ended December 31, 2011.

One customer accounted for 17.8% of the Company’s revenue for the three-month period ended December 31, 2012. The customer’s accounts receivable balance, net of specific allowances, totaled approximately 21.9% of net accounts receivable as of December 31, 2012. One customer accounted for 11.6% of the Company’s revenue for the three-month period ended December 31, 2011. The customer’s accounts receivable balance, net of specific allowances, totaled approximately 10.1% of net accounts receivable as of December 31, 2011.

One customer accounted for 9.8% of the Company’s revenue for the six-month period ended December 31, 2012. The customer’s accounts receivable balance, net of specific allowances, totaled approximately 21.9% of net accounts receivable as of December 31, 2012. One customer accounted for 11.1% of the Company’s revenue for the six-month period ended December 31, 2011. The customer’s accounts receivable balance, net of specific allowances, totaled approximately 10.1% of net accounts receivable as of December 31, 2011.

Note 4 – (Loss) Income per Share

Basic (loss) income per share has been computed by dividing net (loss) income by the weighted average number of common shares outstanding. Diluted (loss) income per share has been computed by dividing net (loss) income by the weighted average common shares outstanding plus dilutive securities or other contracts to issue common stock as if these securities were exercised or converted to common stock.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
In thousands (except per share amounts):				
Net loss (a)	$(1,673)	$(971)	$(3,619)	$(914)
Weighted average outstanding shares of common stock (b)	12,253	12,253	12,253	12,253
Dilutive potential common shares from employee stock options	—	—	—	—
Common stock and common stock equivalents (c)	12,253	12,253	12,253	12,253
Loss per share:				
Basic net loss per share (a)/(b)	$(0.14)	$(0.08)	$(0.30)	$(0.07)
Diluted net loss per share (a)/(c)	$(0.14)	$(0.08)	$(0.30)	$(0.07)

QUALSTAR CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS- (Continued)

Note 5 – Fair Value Measurements

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

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

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

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

QUALSTAR CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS- (Continued)

Note 6 – Cash, Cash Equivalents and Marketable Securities

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

The following tables summarize the Company's available-for-sale securities' adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category recorded as cash and cash equivalents or short-term or long-term marketable securities as of December 31, 2012 and June 30, 2012 (in thousands):

	December 31, 2012						
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash & Cash Equivalents	Short-term Marketable Securities	Long-term Marketable Securities
Level 1:							
Cash	517	-	-	517	517	-	-
Money Market Funds	5,965	-	-	5,965	5,965	-	-
U.S. Treasury Securities	2,013	-	-	2,013	-	2,013	-
Subtotal	$ 8,495	$ -	$ -	$ 8,495	$ 6,482	$ 2,013	$ -
Level 2:							
U.S. Agency Securities	-	-	-	-	-	-	-
Corporate securities	2,957	5	(1)	2,961	-	2,147	814
Municipal securities	4,231	14	-	4,245	-	2,026	2,219
Asset backed securities	822	1	-	823	-	710	113
Mortgage backed securities	1,324	-	(5)	1,319	-	541	778
Subtotal	$ 9,334	$ 20	$ (6)	$ 9,348	$ -	$ 5,424	$ 3,924
Total	$ 17,829	$ 20	$ (6)	$ 17,843	$ 6,482	$ 7,437	$ 3,924

QUALSTAR CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS- (Continued)

	June 30, 2012						
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash & Cash Equivalents	Short-term Marketable Securities	Long-term Marketable Securities
Level 1:							
Cash	635	-	-	635	635	-	-
Money Market Funds	6,746	-	-	6,746	6,746	-	-
U.S. Treasury Securities	2,524	-	(1)	2,523	-	1,508	1,015
Subtotal	$9,905	$ -	(1)	$9,904	$ 7,381	$ 1,508	1,015
Level 2:					-		
U.S. Agency Securities	753	1	-	754	-	754	-
Corporate securities	2,593	5	(1)	2,597	-	1,696	901
Municipal Securities	3,471	6	-	3,477	-	1,752	1,725
Asset backed securities	1,629	1	-	1,630	-	1,256	374
Mortgage backed securities	2,525	-	(2)	2,523	-	169	2,354
Subtotal	$10,971	$13	$(3)	$10,981	$ -	$ 5,627	$ 5,354
Total	$20,876	$13	$(4)	$20,885	$ 7,381	$ 7,135	$ 6,369

There were unrealized loss positions as of December 31, 2012. The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2012 and at June 30, 2012 (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
December 31, 2012	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate bonds	2,147	—	814	(1)	2,961	(1)
Government Sponsored Enterprise collateralized mortgage obligations	541	(5)	778	—	1,319	(5)
Total	$ 2,688	$ (5)	$ 1,592	$ (1)	$ 4,280	$ (6)

	Less Than 12 Months		12 Months or Greater		Total	
June 30, 2012	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
			(In thousands)			
US Treasury obligations and direct obligations of U.S. Government agencies	2,262	—	1,015	(1)	3,277	(1)
Corporate bonds	1,696	—	901	(1)	2,597	(1)
	169	(1)	2,354	(1)	2,523	(2)

Government Sponsored Enterprise collateralized mortgage obligations									
Total	$4,127	$(1	)	$4,270	$(3	)	$8,397	$(4	)

12

QUALSTAR CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS- (Continued)

Available-for-sale securities are recorded at market value. Unrealized holding gains and losses, net of the related income tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of shareholders' equity until realized. Dividend and interest income are recognized when earned. Realized gains and losses for securities classified as available-for sale are included in earnings when the underlying securities are sold and are derived using the specific identification method for determining the cost of securities sold. Loss on the sale of marketable securities for the six months ended December 31, 2012 and 2011 was $34,000 and $38,000, respectively. The gain in net unrealized gain on available-for-sale securities that has been included in the other comprehensive income of shareholder's equity during the six months ended December 31, 2012 was $5,000. The loss in net unrealized gain on available-for-sale securities that has been included in the other comprehensive income of shareholder's equity during the six months ended December 31, 2011 was $47,000.

Note 7 - Inventories

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

	December 31, 2012	June 30, 2012
Raw materials	$2,682	$3,961
Finished goods	2,077	2,235
Subtotal	4,759	6,196
Less: Inventory reserve	(768)	(1,721)
Net inventory balance - current	$3,991	$4,475

Gross inventories have declined by $1.4 million from June 30, 2012

Note 8 – Commitments and Contingencies

Accrued Warranty

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

Activity in the liability for product warranty for the periods presented is as follows (in thousands):

Six Months Ended
December 31,

2012