

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K**

(Mark One)

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

For the fiscal year ended January 2, 2021

or

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

For the transition period from _____ to _____

Commission file number 001-33170



NETLIST, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

95-4812784

(I.R.S. employer Identification No.)

**175 Technology Drive, Suite 150
Irvine, California**

(Address of principal executive offices)

92618

(Zip Code)

(949) 435-0025

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: **None**

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

Common Stock, par value \$0.001 per share

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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, or a smaller reporting 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 Act). Yes ☐ No ☒

The aggregate market value of voting and non-voting common equity held by non-affiliates as of June 26, 2020, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$77.6 million. Solely for purposes of this disclosure, shares of common stock held by executive officers and directors of the registrant as of such date have been excluded because such persons may be deemed to be affiliates. This determination of executive officers and directors as affiliates is not necessarily a conclusive determination for any other purposes.

As of March 22, 2021, there were 215,013,027 outstanding shares of the registrant's common stock.

DOCUMENTS INCORPORATED BY REFERENCE

None.

Netlist, Inc. and Subsidiaries

Form 10-K

For the Fiscal Year Ended January 2, 2021

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CAUTIONARY NOTE ABOUT FORWARD-LOOKING STATEMENTS

This report includes “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements other than historical facts and often address future events or our future performance. Words such as “anticipate,” “estimate,” “expect,” “project,” “intend,” “may,” “will,” “might,” “plan,” “predict,” “believe,” “should,” “could” and similar words or expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words.

Forward-looking statements contained in this report include statements about, among other things:

- specific and overall impacts of the COVID-19 pandemic on our financial condition and results of operations;
- our beliefs regarding the market and demand for our products or the component products we sell;
- our ability to develop and launch new products that are attractive to the market and stimulate customer demand for these products;
- our plans relating to our intellectual property, including our goals of monetizing, licensing, expanding and defending our patent portfolio;
- our expectations and strategies regarding outstanding legal proceedings and patent reexaminations relating to our intellectual property portfolio, including our pending proceedings against SK hynix Inc., a South Korean memory semiconductor supplier (“SK hynix”);
- our expectations with respect to any strategic partnerships or other similar relationships we may pursue;
- the competitive landscape of our industry;
- general market, economic and political conditions;
- our business strategies and objectives;
- our expectations regarding our future operations and financial position, including revenues, costs and prospects, and our liquidity and capital resources, including cash flows, sufficiency of cash resources, efforts to reduce expenses and the potential for future financings;
- our ability to remediate any material weakness and maintain effective internal control over financial reporting; and
- the impact of the above factors and other future events on the market price and trading volume of our common stock.

All forward-looking statements reflect management’s present assumptions, expectations and beliefs regarding future events and are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those expressed in or implied by any forward-looking statements. These risks, uncertainties and other factors include those described in Item 1A. Risk Factors of this Form 10-K. In light of these risks, uncertainties and other factors, our forward-looking statements should not be relied on as predictions of future events. Additionally, many of these risks and uncertainties are currently elevated by and may or will continue to be elevated by the COVID-19 pandemic. All forward-looking statements reflect our assumptions, expectations and beliefs only as of the date they are made, and except as required by law, we undertake no obligation to revise or update any forward-looking statements for any reason. We qualify all of our forward-looking statements by this cautionary note.

* * * * *

Unless the context indicates otherwise, all references to “Netlist,” our “Company,” “we,” “us,” or “our” in this report refer to Netlist, Inc., together with its consolidated subsidiaries, and all cross-references to notes in this Form 10-K refer to the identified note contained in our consolidated financial statements included in Part II, Item 8 of this Form 10-K. We own registered or unregistered trademark rights to NVvault®, HyperCloud®, HybriDIMM™, EXPRESSvault™, PreSight™, “memory at storage capacities, storage at memory speeds”™, Netlist® and our company logo. Although we do not use the “®” or “™” symbol in each instance in which one of our registered or common law trademarks appears in this report, this should not be construed as any indication that we will not assert our rights thereto to the fullest extent under applicable law. Any other service marks, trademarks or trade names appearing in this report are the property of their respective owners.

PART I

Item 1. Business

Overview

We provide high-performance modular memory subsystems to customers in diverse industries that require enterprise and storage class memory solutions to empower critical business decisions. We have a history of introducing disruptive new products, such as one of the first load-reduced dual in-line memory module ("LRDIMM") based on our distributed buffer architecture, which has been adopted by the industry for DDR4 LRDIMM. We were also one of the first to bring NAND flash memory ("NAND flash") to the memory channel with our NVvault non-volatile dual in-line memory modules ("NVDIMM") using software-intensive controllers and merging dynamic random access memory integrated circuits ("DRAM ICs" or "DRAM") and NAND flash to solve data bottleneck and data retention challenges encountered in high-performance computing environments. We also offer storage class memory products called HybriDIMM to address the growing need for real-time analytics in Big Data applications, in-memory databases, high performance computing and advanced data storage solutions. We publicly demonstrated a HybriDIMM prototype in August 2016 and sampled HybriDIMM to select customers in the second half of 2017. We are continuously developing and improving upon the HybriDIMM product while exploring opportunities with strategic partners.

Due to the ground-breaking product development work of our engineering teams, we have built a robust portfolio of over 130 issued and pending U.S. and foreign patents, many seminal, in the areas of hybrid memory, storage class memory, rank multiplication and load reduction. Since our inception, we have dedicated substantial resources to the development, protection and enforcement of technology innovations we believe are essential to our business. Our early pioneering work in these areas has been broadly adopted in industry-standard registered dual in-line memory modules ("RDIMM"), LRDIMM and in NVDIMM. Our objective is to continue to innovate in our field and invest further in our intellectual property portfolio, with the goal of monetizing our intellectual property through a combination of product sales and licensing, royalty or other revenue-producing arrangements, which may result from joint development or similar partnerships or defense of our patents through enforcement actions against parties we believe are infringing them.

We also resell solid state drives ("SSDs"), 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.

Our Industry

The global high-performance memory module market is driven by increasing demand from data center and enterprise storage applications for improved input/output performance, lower latency and data retention capabilities in the event of unexpected system failure. The proliferation of mobile devices, social media platforms, cognitive/artificial intelligence systems and cloud-based software applications is resulting in the creation of unprecedented amounts of unstructured data. In order to manage and analyze this data, we believe new computing and memory architectures need to be developed to satisfy the needs in the industry.

In high-performance computing environments, such as cloud-based computing and Big Data applications, a system's overall processing speed is limited to the ability of the central processing unit ("CPU") to access data cached in memory. Memory speeds have failed to keep pace with improvements in CPU processing speeds, resulting in buffering delays encountered in highly intensive computing environments. To mitigate challenges arising from differences in CPU and memory clock speeds, data center operators have increased the number of servers in their facilities as well as the memory content in each server. Memory capacity is expanded through the use of DIMMs, generally incorporating up to 16 GB of DRAM per module with today's technology and moving up to 64/128 GB of DRAM per module and beyond. Our technology enables an intelligent controller to be integrated onto the DIMM, in order to manage the rapid flow of data between the CPU and memory. The number of DIMMs incorporated into a server increases in correlation with the number of processing cores in the CPU. DDR4 DIMMs incorporate our load-reduction technology to mitigate

the trade-off between operating speed and memory capacity inherent in prior generations of server DIMM. These load-reduced DIMMs, or LRDIMMs, are now the predominant memory technology used in high-capacity servers and high-performance computing clusters.

Technical challenges arising from the production of DRAM using leading edge semiconductor manufacturing processes is limiting the material's long-term viability as the high-speed memory of choice in demanding computing environments. Conversely, NAND flash, while characterized by lower access speeds, is scaling down in cost and scaling up in density at a significantly better rate than DRAM. This has led the industry to explore alternative computer architectures and new memory materials capable of bridging DRAM's superior access speed with NAND flash's lower cost and higher densities. We expect memory subsystems relying on intelligent controller technology to leverage NAND flash will most effectively address the industry's growing need for high-speed data management and analytics.

Technology

Our portfolio of proprietary technologies and design techniques includes:

HybriDIMM Technology

HybriDIMM technology is, we believe, a breakthrough that allows for data that lives on a slower media, such as NAND flash, to coexist on the memory channel without breaking the deterministic nature of the memory channel. A proprietary software protocol controls the movement of data between DRAM and NAND flash on the DIMM while maintaining the integrity of the memory channel. HybriDIMM technology is material and protocol agnostic, allowing for leverage of future storage and memory technologies on the DIMM.

Distributed Buffer Architecture

We invented the distributed buffer architecture that enables the buffering of data signals along the bottom edge of the memory module using multiple data buffer devices distributed between the edge connector and the DRAM. The result is shorter data paths, improved signal integrity, and reduced latency compared to the industry-standard design for DDR3 LRDIMM. The memory industry has widely adopted our distributed architecture for DDR4 LRDIMM. Our HyperCloud product was our first LRDIMM product built on this distributed buffer architecture.

Design Expertise

We have designed special algorithms that can be implemented in stand-alone integrated circuits or integrated into other functional blocks in application-specific integrated circuits ("ASICs"). We utilize these algorithms in our HybriDIMM product to incorporate load reduction functionality. We also incorporate these algorithms in our NVvault product line, which is also known in the industry as NVDIMM-N.

Proprietary PCB Designs

We utilize advanced techniques to optimize electronic signal strength and integrity within a printed circuit board ("PCB"). These techniques include the use of 10-layer or 12-layer boards, matching conductive trace lengths, a minimized number of conductive connectors, or vias, and precise load balancing to, among other benefits, help reduce noise and crosstalk between adjacent traces. In addition, our proprietary designs for the precise placement of intra-substrate components allow us to assemble memory subsystems with significantly smaller physical size, enabling original equipment manufacturers ("OEMs") to develop products with smaller footprints for their customers.

Very Low Profile Designs

We believe we were the first company to create memory subsystems in a form factor of less than one inch in height. Our innovative very low profile ("VLP") DIMMs provide developers of server blades, storage bridge bay applications, telecommunications servers, switches and routers with a wide range of high performance memory options where efficient use of motherboard space is critical. Our technology has allowed us to decrease the system board space

required for memory, and improve thermal performance and operating speeds, by enabling our customers to use alternative methods of component layout.

Thermal Management Designs

We design our memory subsystems to ensure effective heat dissipation. We use thermal simulation and data to obtain thermal profiles of the memory subsystem during the design phase, allowing us to rearrange components to enhance thermal characteristics and, if necessary, replace components that do not meet specifications. We also develop and use proprietary heat spreaders to enhance the thermal management characteristics of our memory subsystems.

Products

Our commercially available memory subsystem products and other products that we sell include:

Component and Other Product Resales

Due to our relationships with memory channel customers, in addition to our own products, we resell certain component products that we purchase for the purpose of resale. We have purchased certain of these products, including SSDs, NAND flash and DRAM products, from Samsung under the terms of a joint development and license agreement (“JDLA”). We have also sourced these products from other suppliers to the extent sufficient product is not available from Samsung to meet customer demand or in the event of other Samsung supply issues. In 2020 and 2019, resales of these products represented approximately 66% and 77% of our net sales, respectively. Additionally, we sell excess component inventory to distributors and other users of memory integrated circuits.

Storage Class Memory

Using an industry standard DDR4 LRDIMM interface, we believe HybriDIMM is the industry’s first storage class memory product capable of operating in existing Intel x86 servers without BIOS and hardware changes. HybriDIMM unifies DRAM and NAND flash in a plug-and-play module, delivering terabyte storage capacities operating at DRAM-like nanosecond memory speeds. HybriDIMM’s architecture combines an on-DIMM co-processor with our software-defined data management algorithm. HybriDIMM’s feature set encompasses the NVDIMM functionalities adopted by the industry. HybriDIMM dramatically improves application performance by reducing data access latency by up to 1,000 times versus the fastest existing storage solution known to us.

Nonvolatile Memory

Our Vault product line enables customers to accelerate data running through their servers and storage and reliably protect enterprise-level cache, metadata and log data by providing near instantaneous recovery in the event of a system failure or power outage. Our nonvolatile memory offering includes:

NVvault DDR4 NVDIMM (“NV4”). NV4 is an NVDIMM-N that provides data acceleration and protection in the Joint Electron Device Engineering Council (“JEDEC”) standard DDR4 interface. It is designed to be integrated into industry standard server or storage solutions.

Specialty DIMMs and Embedded Flash

A small portion of our net product sales is from OEM sales of specialty memory modules and flash-based products, the majority of which are utilized in data center and industrial applications. When developing custom modules for an OEM system launch, we engage with our OEM customers from the earliest stages of new product development definition, providing us valuable insight into their full range of system architecture and performance requirements. This close collaboration has also allowed us to develop a significant level of systems expertise. We leverage a portfolio of proprietary technologies and design techniques, including efficient planar design, alternative packaging techniques and custom semiconductor logic, to deliver memory subsystems with persistence, high density, small form factor, high signal integrity, attractive thermal characteristics, reduced power consumption and low cost per bit.

Intellectual Property

We believe the strength of our intellectual property rights will be important to the success of our business. We utilize patent and trade secret protection, confidentiality agreements with customers and partners, disclosure and invention assignment agreements with employees and consultants and other contractual provisions to protect our technologies and other proprietary information. As of January 2, 2021, we had 98 U.S. and foreign issued patents and 33 pending U.S. and foreign patent applications. Assuming they are properly maintained and are not invalidated by reexamination proceedings, our patents will expire at various dates between 2022 and 2035. Our issued patents cover various aspects of our innovations and include various claim scopes and, as a result, we believe our business is not materially dependent on any one claim in any of our existing patents or pending patent applications.

We have devoted significant resources to develop and enforce our intellectual property portfolio. For instance, we have taken action to protect and defend our innovations by filing legal proceedings for patent infringement against SK hynix and its subsidiaries in the U.S. U.S. District Court for the Western District of Texas which remains ongoing. All of our patents involved in these proceedings cover key features of RDIMM and LRDIMM products.

Customers

We resell certain component products that we purchase for the purpose of resale to certain 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. We also market and sell our memory subsystem products, primarily to OEMs in the server, high-performance computing and communications markets.

Our target markets are characterized by a limited number of large companies, and consolidation in one or more of our target markets may further increase this concentration. As a result, sales to small numbers of customers have historically represented a substantial portion of our net product sales. Additionally, the composition of major customers and their respective contributions to our net product sales have fluctuated and will likely continue to fluctuate from period to period as our existing and prospective customers progress through the life cycle of the products they produce and sell and experience resulting fluctuations in their product demand. For further information about our customer concentrations, see Note 12 “Major Customers, Suppliers and Products” to our consolidated financial statements in Part II, Item 8 of this Form 10-K.

We do not have long-term agreements with any of our customers. Instead, our product sales are made primarily pursuant to stand-alone purchase orders that we often receive no more than two weeks in advance of the desired delivery date and that may be rescheduled or cancelled on relatively short notice, which reduces our backlog of firm orders. Customers are generally allowed limited rights of return for up to 30 days, except for sales of excess inventories, which contain no right-of-return privileges.

Additionally, we offer warranties on our memory subsystems generally ranging from one to three years, depending on the product and negotiated terms of purchase orders from our customers. These warranties require us to repair or replace defective products returned to us during such warranty period at no cost to the customer.

Sales and Marketing

We primarily market and sell our products and the component products we resell through a direct sales force and a network of independent sales representatives. Our sales activities focus primarily on developing strong relationships at the technical, marketing and executive management levels within existing and prospective customers in our target markets.

We utilize well-trained, highly technical program management teams to drive new product development and quickly respond to our customers' needs and expectations. Our program management teams provide quick response times and act as a single point-of-contact for customer's issues that may arise during the sales process. Additionally, they help us address the long-term business and technology goals of our customers. We employ a team approach to business

development whereby our sales team and independent representatives identify, qualify and prioritize customer prospects through offices in a number of locations worldwide.

Manufacturing and Supply

Manufacturing

We manufacture memory subsystem products at our facility in the PRC, which is certified in International Organization for Standardization (“ISO”) 9001:2008 Quality Management Systems and ISO 14001:2004 Environmental Management Standards. Our in-house manufacturing function, combined with our engineering and design capabilities, allows us to assemble our memory subsystems quickly and in high volume. Our manufacturing facility is capable of surface mount assembly, subsystem testing, system-level burn-in testing, programming, marking, labeling and packaging. Manufacturing cycle times for our memory subsystem products, from receipt of order, are typically one week or less and in some cases as short as two days.

We schedule production based on purchase order commitments and anticipated orders. We release raw materials to the manufacturing floor by means of an online shop floor control system, which allows for internal quality analysis, direct access to inventory information and production floor material tracking. We have a flexible manufacturing workforce, which allows us to manage unforecasted demand.

We perform ongoing reliability testing on our memory subsystems and share the results of that testing with our customers. In addition, we have implemented procedures that require all of our memory subsystems to undergo functional and system burn-in testing prior to delivery to a customer. We also supplement our test capabilities with advanced imaging technology to inspect the quality of our assemblies.

Supply

We acquire components and materials, such as field-programmable gate arrays (“FPGAs”), ASICs, DRAM ICs and NAND flash, directly from integrated circuit manufacturers and assemble them into our finished subsystem products. We also purchase some of these component products from Samsung under the terms of the JDLA, and from alternative suppliers, for the purpose of resale to customers directly.

We have developed supplier relationships with several manufacturers of these component products, and we typically qualify our memory subsystem products with our customers using multiple component manufacturers. However, our actual purchases of component products, both for integration into our products and for resale, are concentrated in a small number of suppliers, including an affiliate of Samsung, from which we obtained 28% and 37% of our total inventory purchases in 2020 and 2019, respectively, Memblaze Limited from which we obtained 14% of our total inventory purchases in 2020 and Techtronics (Singapore) Pte, Ltd from which we obtained 11% and 17% of our total inventory purchases in 2020 and 2019, respectively. For further information about our supplier concentrations, see Note 12 “Major Customers, Suppliers and Products” to our consolidated financial statements in Part II, Item 8 of this Form 10-K.

We order component products based primarily on forecasts of customer demand, which subjects us to certain inventory risks in the event our forecasts are not accurate. In order to mitigate these inventory risks, we seek to resell to distributors and other users of memory integrated circuits excess quantities of the component inventories we have purchased for integration in our memory subsystem products.

Our quality assurance engineers work with our suppliers to ensure that the raw materials we receive meet our quality standards. These engineers also perform on-site supplier factory audits and use our internal test and inspection systems to verify that purchased components and materials meet our specifications. Our supplier quality program and incoming material quality control program are important aspects of our manufacturing and sale processes.

Competition

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

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

We believe the principal competitive factors in the selection of memory subsystems or the component products we resell by existing and potential future customers are:

- price;
- timeliness of new value-add product introductions;
- development of advanced technologies;
- fulfillment capability and flexibility;
- understanding of system and business requirements;
- design characteristics and performance;
- quality and reliability;
- track record of volume delivery; and
- credibility with the customer

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

Research and Development

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

To this end, we have assembled a team of engineers with expertise in computer architectures, system memory, subsystem design and memory software, as well as PCB design, VLP design and thermal management. Our engineers also focus on developing and incorporating new techniques, methodologies and processes for testing and manufacturing

our products, and also collaborate with our customers to provide us with insights into and expertise in systems architecture, power budget, performance requirements, operating environment (such as air flow and operating temperature) and any mechanical constraints.

We have invested significant resources in our product research and development efforts. Our customers typically do not separately compensate us for design and engineering work involved in developing application-specific products for them.

Employees

As of January 2, 2021, we had approximately 70 full-time and part-time employees. Our future success will depend in part on our ability to attract, retain and motivate highly qualified technical, managerial and other personnel for whom competition is intense. We are not party to any collective bargaining agreements with any of our employees. We have never experienced a work stoppage, and we believe our employee relations are good.

Compliance with Environmental and Other Laws

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

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

General Information

We were incorporated in Delaware in June 2000 and commenced operations in September 2000. Our principal executive offices are located at 175 Technology Drive, Suite 150, Irvine, California 92618 and our telephone number at that address is (949) 435-0025. Our corporate website address is *www.netlist.com*.

We file reports with the Securities and Exchange Commission (“SEC”) and make available, free of charge, on or through our website, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy and information statements and amendments to these reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. All SEC filings are also available at the SEC’s website at *www.sec.gov*. Our website also contains copies of our corporate governance guidelines, code of business conduct and ethics, insider trading policy and whistleblower policy.

Item 1A. Risk Factors

Summary of Risk Factors

The risk factors summarized and detailed below could materially harm our business, operating results, financial condition, impair our future growth prospects and/or cause the price of our common stock to decline. These are not all of the risks we face and other factors not presently known to us or that we currently believe are immaterial may also affect our business if they occur. In assessing these risks, you should also review the other information contained in this report, including our consolidated financial statements and accompanying notes, and the other filings we make with the SEC. Material risks that may affect our business, operating results and financial condition include, but are not necessarily limited to, those relating to the following:

Risks Related to Our Business, Operations and Industry

- We face risks related to the impact of the COVID-19 pandemic and the related protective public health measures;
- We have historically incurred losses and may continue to incur losses;
- The vast majority of our revenues in recent periods have been generated from resales of component products, including products sourced from Samsung, and any decline in these product resales could significantly harm our performance;
- We are subject to risks relating to our focus on developing our HybriDIMM and NVvault products for our target customer markets;
- Sales to a small number of customers have historically represented a significant portion of our net product sales, and the loss of, or a significant reduction in sales to, any one of these customers could materially harm our business;
- We are subject to risks of disruption in the supply of component products;
- Our customers require that our products undergo a lengthy and expensive qualification process without any assurance of sales;
- If we are unable to timely and cost-effectively develop new or enhanced products that achieve customer and market acceptance or technologies we can monetize, our revenues and prospects could be materially harmed;
- We face intense competition in our industry, and we may not be able to compete successfully in our target markets;
- Our operating results may be adversely impacted by worldwide economic and political uncertainties and specific conditions in the markets we address and in which we or our strategic partners or competitors do business, including ongoing effects of the COVID-19 pandemic and the cyclical nature of and volatility in the memory market and semiconductor industry;
- Our lack of a significant backlog of unfilled orders and the difficulty inherent in estimating customer demand makes it difficult to forecast our short-term requirements, and any failure to optimally calibrate our production capacity and inventory levels to meet customer demand could adversely affect our revenues, gross margins and earnings;
- Declines in our average sale prices, driven by volatile prices for components and other factors, may result in declines in our revenues and gross profit;
- Our manufacturing operations involve significant risks;
- We depend on third parties to design and manufacture components for our products and the component products we resell, which exposes us to risks;
- If our products or the component products we resell do not meet quality standards or are defective or used in defective systems, we may be subject to quality holds, warranty claims, recalls or liability claims;
- If a standardized memory solution that addresses the demands of our customers is developed, our net product sales and market share may decline;
- Our indemnification obligations for the infringement by our products of the rights of others could require us to pay substantial damages;

- We depend on certain key employees, and our business could be harmed if we lose the services of any of these employees or are unable to attract and retain other qualified personnel;
- We rely on our internal and third-party sales representatives to market and sell our products and the component products we resell, and any failure by these representatives to perform as expected could reduce our sales;
- Our operations could be disrupted by power outages, natural disasters or other factors;
- Difficulties with our global information technology systems, including any unauthorized access, could harm our business;
- If we do not effectively manage any future growth we may experience, our resources, systems and controls may be strained and our results of operations may suffer; and
- If we acquire businesses or technologies or pursue other strategic transactions or relationships in the future, these transactions could disrupt our business and harm our operating results and financial condition.

Risks Related to Laws and Regulations

- We are exposed to additional business, regulatory, political, operational, financial and economic risks related to our international sales and operations;
- Our failure to comply with environmental and other applicable laws and regulations could subject us to significant fines and liabilities or cause us to incur significant costs;
- Regulations related to “conflict minerals” may cause us to incur additional expenses and could limit the supply and increase the cost of certain metals used in manufacturing our products;
- We have a material weakness in our internal control over financial reporting due to the lack of an independent audit committee. If we are unable to remediate the material weakness, or if we identify additional material weaknesses in the future or otherwise fail to maintain an effective system of internal controls, we may not be able to accurately or timely report our financial condition or results of operations, which may adversely affect our business; and
- We are required to comply with certain provisions of Section 404 of the Sarbanes-Oxley Act of 2002, as amended, that place significant demands on our resources.

Risks Related to Intellectual Property and Litigation

- We may be unsuccessful in monetizing our intellectual property portfolio;
- We are and expect to continue to be involved in other legal and administrative proceedings to enforce or protect our intellectual property rights and to defend against claims that we infringe the intellectual property rights of others;
- If our proprietary rights are not protected, our customers or our competitors might gain access to our proprietary designs, processes and technologies, which could adversely affect our operating results; and
- We may become involved in non-patent related litigation and administrative proceedings that may materially adversely affect us.

Risks Related to Capitalization and Financial Markets

- We may not have sufficient working capital to fund our planned operations, and, as a result, we may need to raise additional capital in the future, which may not be available when needed, on acceptable terms or at all;
- The price and trading volume of our common stock has and may continue to fluctuate significantly;
- We have incurred a material amount of indebtedness to fund our operations, the terms of which have required us to pledge substantially all of our assets as security. Our level of indebtedness and the terms of such indebtedness could adversely affect our operations and liquidity;

- There is a limited market for our common shares, and the trading price of our common shares is subject to volatility;
- Future issuances of our common stock or rights to purchase our common stock, including pursuant to our equity incentive plans, could result in additional dilution to the percentage ownership of our stockholders and could cause the price of our common stock to decline;
- Sales of our common stock, or the perception that such sales could occur, could cause the market price of our stock to drop significantly, regardless of the state of our business;
- Chun K. Hong has significant control over all corporate decisions that may not be in the best interest of our other stockholders;
- Anti-takeover provisions under our charter documents and Delaware law, as well as our rights agreement, could delay or prevent a change of control and could also limit the market price of our common stock; and
- We do not currently intend to pay dividends on our common stock, and any return to investors is expected to result, if at all, only from potential increases in the price of our common stock.

Risks Related to Our Business, Operations and Industry

We face risks related to the impact of the COVID-19 pandemic and the related protective public health measures.

COVID-19 has spread globally and has resulted in authorities imposing, and businesses and individuals implementing, numerous unprecedented measures to try to contain the virus, such as travel bans and restrictions, quarantines, shelter-in-place/stay-at-home and social distancing orders, and shutdowns. These measures have impacted and may further impact our workforce and operations, the operations of our customers, and those of our respective vendors, suppliers, and partners. The ultimate impact and efficacy of government measures and potential future measures is currently unknown. In addition, the continued spread of COVID-19, or the occurrence of other epidemics could result in a widespread health crisis that could adversely affect the economies and financial markets of many countries, resulting in an economic downturn that could affect demand for our products and further adversely impact our results of operations.

There are numerous uncertainties associated with the coronavirus outbreak, including the number of individuals who will become infected, whether a vaccine or cure that mitigates the effect of the virus will be synthesized, and, if so, when such vaccine or cure will be ready to be used, and the extent of the protective and preventative measures that have been put in place by both governmental entities and other businesses and those that may be put in place in the future. Any or all of the foregoing uncertainties could have a material adverse effect on our results of operations, financial position and/or cash flows.

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

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

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

The vast majority of our revenues in recent periods have been generated from resales of component products, including SSDs, NAND flash and DRAM products. We resell these component products to end-customers that are not

reached in the distribution models of the component manufacturers, including storage customers, appliance customers, system builders and cloud and datacenter customers.

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

We may experience supply shortages at any time and for a variety of reasons, including, among others, spikes in customer demand that cannot be satisfied, any problems that arise with Samsung's manufacturing operations or facilities that cause disruptions or delays, including from the recent COVID-19 pandemic, or any failure to comply with the terms of the JDLA regarding the supply of these products. If we choose, or if we are forced, to seek to supply the component products we resell from other suppliers, we may not be able to identify other suppliers that are available and able to produce the particular components with the specific product specifications and in the quantities our customers require, or we may not be able to make arrangements with any other suppliers in a timely manner to avoid delays in satisfying customer orders. Further, even if we are able to make arrangements with other suppliers for sufficient component products to replace any undersupply from Samsung, we may not be able to make these arrangements on financial and other terms comparable to those we have negotiated with Samsung under the JDLA. As a result, any inability to obtain sufficient component products from Samsung could increase our cost of sales for component product resales if we are forced to pay higher prices to obtain the products from other suppliers. Moreover, all of our supply arrangements for these component products, including the terms of the JDLA and any arrangements we may establish with other suppliers, are subject to the other supply and manufacturing risks discussed elsewhere in these risk factors.

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

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

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

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

- we are dependent on a limited number of suppliers for the SSDs, DRAM ICs, NAND flash and ASIC devices that are essential to the functionality of these products, and in the past, we have experienced supply

chain disruptions and shortages of SSDs, DRAM and NAND flash required to create these products as a result of issues that are specific to our suppliers or the industry as a whole;

- HybriDIMM and some of our other next-generation products may require additional time including the services and attention of key employees who have competing demands on their available time and may require capital investment to bring the products to market;
- our development and commercialization strategies for these products;
- we are required to demonstrate the quality and reliability of our products to and qualify them with our customers before purchases are made, which requires investments of time and resources in significant and unpredictable amounts prior to the receipt of any revenues from these customers; and
- our NVvault products or other new products, such as HybriDIMM, may contain currently undiscovered flaws, the correction of which could result in increased costs and time to market.

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

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

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

Our target markets are characterized by a limited number of large companies, and consolidation in one or more of these markets may further increase this concentration. As a result, sales to small numbers of customers have historically represented a substantial portion of our net product sales, and we expect this concentration to continue. Additionally, the composition of major customers and their respective contributions to our net product sales have fluctuated and will likely continue to fluctuate from period to period as our existing and prospective customers progress through the life cycle of the products they produce and sell and experience resulting fluctuations in their product demand. We believe our performance depends in significant part on our ability to establish and maintain relationships with and effect substantial sales to our large customers.

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

of price concessions or general declines in average sale prices, or difficulties collecting payments from any of our customers.

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

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

Our ability to fulfill customer orders for or produce qualification samples of our memory subsystem products, as well as orders for the component products we resell, is dependent on a sufficient supply of SSDs, FPGAs, ASICs, DRAM ICs and NAND flash, which are essential components of our memory subsystems. We have no long-term supply contracts for any of these component products. Further, there are a relatively small number of suppliers of these components, and we typically purchase from only a subset of these suppliers. As a result, our inventory purchases have historically been concentrated in a small number of suppliers, including an affiliate of Samsung, from which we obtained a large portion of our component products purchased for resale and our total inventory purchases in 2017 and 2019. We also use consumables and other components, including PCBs, to manufacture our memory subsystems, which we sometimes procure from single or limited sources to take advantage of volume pricing discounts.

From time to time, shortages in SSDs, DRAM ICs and NAND flash have required some suppliers to limit the supply of these components. In the past, we have experienced supply chain disruptions and shortages of SSDs, DRAM and NAND flash required to create certain of our memory subsystem products, and we have been forced to procure the component products we resell from other suppliers to the extent sufficient product is not available from Samsung to meet customer demand or in the event of other Samsung supply issues. We are continually working to secure adequate supplies of the components necessary to fill customers' orders in a timely manner. If we are unable to obtain a sufficient supply of SSDs, DRAM ICs, NAND flash or other essential components, as a result of a natural disaster, political unrest, military conflict, medical epidemics, such as the COVID-19 pandemic, climate change, economic instability, equipment failure or other cause, to avoid interruptions or failures in the delivery of our products as required by our customers or the delivery of these components to customers to whom we resell them directly, these customers may reduce future orders for these products or not purchase these products from us at all, which could cause our net product sales to decline and harm our operating results. In addition, our reputation could be harmed due to failures to meet our customers' demands and, even assuming we are successful in resolving supply chain disruptions, we may not be able to replace any lost business and we may lose market share to our competitors. Further, if our suppliers are unable to produce qualification samples of our products on a timely basis or at all, we could experience delays in the qualification process with existing or prospective customers, which could have a significant impact on our ability to sell our products. Moreover, if we are not able to obtain these components in the amounts needed on a timely basis and at commercially reasonable prices, we may not be able to develop or introduce new products, we may experience significant increases in our cost of sales if we are forced to procure components from alternative suppliers and are not able to negotiate favorable terms with these suppliers, or we may be forced to cease our sales of products dependent on the components or resales of the components we sell to customers directly.

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

Declines in customer demand for our products in recent periods have caused us to reduce our purchases of SSDs, DRAM ICs and NAND flash for use as components in our products. Such declines or other fluctuations could

continue in the future. If we fail to maintain sufficient purchase levels with some suppliers, our ability to obtain supplies of these raw materials may be impaired due to the practice of some suppliers of allocating their products to customers with the highest regular demand.

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

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

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

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

Likewise, changes in our products, our manufacturing facilities, our production processes or our component suppliers may require a new qualification process. For example, if our memory, SSDs, NAND flash and DRAM component suppliers discontinue production of these components, it may be necessary for us to design and qualify new products for our customers. As a result, some customers may require us, or we may decide, to purchase an estimated quantity of discontinued memory components necessary to ensure a steady supply of existing products until products with new components can be qualified. Purchases of this nature may affect our liquidity. Additionally, our forecasts of quantities required during the transition may be incorrect, which could adversely impact our results of operations through lost revenue opportunities or charges related to excess and obsolete inventory.

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

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

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

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

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

We may not be successful at any of these activities. As a result, we may not be able to successfully develop new or enhanced products or technology or we may experience delays in this process. Failures or delays in product development and introduction could result in the loss of, or delays in generating, net products sales or other revenues and the loss of key customer relationships. Even if we develop new or enhanced products or technologies, they may not meet our customers' requirements, gain market acceptance or attract monetization opportunities, as our product and technology development efforts are inherently risky due to the challenges of foreseeing changes or developments in technology, predicting changes in customer requirements or preferences or anticipating the adoption of new industry standards. Moreover, we have invested significant resources in our product and technology development efforts, which would be lost if we fail to generate revenues from these efforts. If any of these risks occur, our revenues, prospects and reputation could be materially adversely affected.

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

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

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

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

Our operating results may be adversely impacted by worldwide economic and political uncertainties and specific conditions in the markets we address and in which we or our strategic partners or competitors do business, including ongoing effects of the COVID-19 pandemic and the cyclical nature of and volatility in the memory market and semiconductor industry.

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

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

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

We cannot predict the timing, strength or duration of any economic slowdown or subsequent economic recovery, either generally or in our customer markets. If the economy or markets in which we operate experience such a slowdown, our business, financial condition and results of operations could be materially and adversely affected. The combination of our lengthy sales cycle coupled with any challenging macroeconomic conditions could compound the negative impact of any such downturn on the results of our operations.

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

We make significant decisions regarding the levels of business we will seek and accept, production schedules, component procurement, personnel needs and other resource requirements based on our estimates of customer demand. We do not have long-term agreements with any of our customers. Instead, our product sales are made primarily pursuant to stand-alone purchase orders that we often receive no more than two weeks in advance of the desired delivery date and that may be rescheduled or cancelled on relatively short notice. The short-term nature of the commitments by many of our customers and our customers' ability to cancel or defer purchase orders for any reason reduces our backlog of firm orders and our ability to accurately estimate future customer requirements for our products or the component products we resell. These facts, combined with the short turnaround times that apply to most orders, makes it difficult to predict our production and inventory needs and allocate production capacity and capital for inventory purchases effectively. As

a result, we attempt to forecast the demand for the components needed to manufacture our products and to resell to customers directly, but any such forecasts could turn out to be wrong. Further, lead times for components vary significantly and depend on various factors, such as the specific supplier and the demand and supply for a component at any given time.

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

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

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

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

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

The prices customers pay for the products we sell can fluctuate due to many factors, including, among others, competitive conditions in our key customer markets, changes in customer requirements or preferences, volatility in the market prices for SSDs, DRAM ICs, NAND flash and other component products, and changes in manufacturing efficiencies or capacities. Market prices for component products have historically constituted a substantial portion of the total cost of our memory subsystems and in recent periods have constituted the vast majority of the cost of resales of these products to customers directly. As a result, fluctuations in the prices for these component products, due to overcapacity in worldwide supply or increased manufacturing efficiencies, implementation of new manufacturing processes or expansion of manufacturing capacity by component suppliers, among other factors, significantly impact our costs to sell our products or component products.

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

Our manufacturing operations involve significant risks.

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

Additionally, we could experience a prolonged disruption, material malfunction, interruption or other loss of operations at our manufacturing facility for any number of reasons, including the occurrence of a contagious disease or illness, such as COVID-19, or catastrophic weather events, or we may need to add manufacturing capacity to satisfy any increased demand for our products. Under these circumstances, we may be forced to rely on third parties for our manufacturing needs, which could increase our manufacturing costs, decrease our gross margin, decrease our control over manufacturing processes, limit our ability to satisfy customer requirements and demand and delay new product development until we could secure a relationship with a third-party manufacturer, which we may not be able to do in a timely manner, on acceptable terms or at all. If any of these risks occur, our operations, performance and customer relationships could be severely harmed.

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

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

Components that are used in our products, as well as all of the component products we resell, are designed and manufactured by third parties. In addition, some of our memory subsystem products rely on significantly customized components. The ability and willingness of third parties to enter into these engagements with us and perform in accordance with these engagements is largely outside our control. If one or more of our design or manufacturing partners experiences a manufacturing disruption for any number of factors including labor disruptions, catastrophic weather events and the occurrence of a contagious disease or illness, such as COVID-19, fails to dedicate adequate resources to the production of the components we use in our products or the components we resell, experiences financial instability or otherwise fails to perform its obligations to us in a timely manner or at satisfactory quality levels, our ability to bring products to market or deliver products to our customers, as well as our reputation, could suffer and our business and prospects could be materially harmed. In the event of any failure by our component manufacturers, we may have no readily available alternative source of supply for these components, since, in our experience, the lead time needed to establish a relationship with a new design or manufacturing partner is substantial, and the time for our OEM customers to re-qualify our products with components from a new vendor is also significant. Additionally, even if an alternative manufacturer is available, we may not be able to engage the manufacturer on acceptable terms, which could result in increased costs, timing requirements or other adverse changes. Further, we may not be able to redesign the customized components used in our products to be manufactured by a new manufacturer, in which case we could infringe on the intellectual property of our current design or manufacturing partner when we manufacture the products with a new design or manufacturing partner. Such an occurrence could force us to stop selling certain of our products or could expose us to lawsuits, license payments or other liabilities.

Our dependence on third-party manufacturers exposes us to many other risks, including, among others: reduced control over delivery schedules, quality, manufacturing yields and costs; the potential lack of adequate capacity during periods of excess demand; limited warranties on products supplied to us; and potential infringement or misappropriation of our intellectual property or the intellectual property of others. We are dependent on our manufacturing partners to

manufacture components with acceptable quality and manufacturing yields, to deliver these components to us on a timely basis and at an acceptable cost and to allocate a portion of their manufacturing capacity sufficient to meet our needs. However, these component manufacturers may not be able to achieve these tasks. Additionally, our manufacturing partners may not continue to devote adequate resources to produce our products or the component products we resell, or continue to advance the process design technologies on which the customer qualifications of our products are based. Any of these risks could limit our ability to meet customer demand and materially adversely affect our business and operating results.

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

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

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

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

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

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

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

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

As is common in our industry, we have a number of agreements in which we have agreed to defend, indemnify and hold harmless our customers and suppliers from damages and costs that may arise from the infringement by our products of third-party patents, trademarks or other proprietary rights. The scope of these indemnities varies, the duration of these indemnities is generally perpetual after execution of an agreement, and the maximum potential amount of future payments we could be required to make under these indemnities is often unlimited. Any indemnification claims by customers could require us to incur significant legal fees and could potentially result in our payment of substantial

damages, and our insurance generally would not cover these fees or damages. As a result, the occurrence of any of these risks could have a material adverse effect on our business and results of operations.

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

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

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

A significant portion of our workforce consists of contract personnel. We invest considerable time and expense to train these contract personnel; however, they typically may terminate their relationships with us at any time. As a result, we may experience high turnover rates in this contract personnel workforce, which may require us to expend additional resources to attract, train and retain replacements. Additionally, if we convert any of these contract personnel to permanent employees, we may have to pay finder’s fees to the contract agency. These risks associated with our contract personnel workforce may involve increased costs or delays or failures in meeting customer requirements or developing new or enhanced products or technologies, any of which could materially adversely affect our business and operating performance.

We are also subject to employment laws and regulations, including the changing regulatory landscape. For example, in California, State Assembly Bill 5 (“AB5”), which went into effect in January 2020, codifies a test to determine whether a worker is an employee under California law. AB5 provides a mechanism for determining whether workers of a hiring entity are employees or independent contractors, but AB5 does not result in any immediate change in how workers are classified. If the State of California, cities or municipalities, or workers disagree with how a hiring entity classifies workers, AB5 sets forth the test for evaluating their classification. The legal and other costs associated with any misclassification of our personnel can be substantial and could materially adversely affect our results of operations and financial condition.

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

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

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

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

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

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

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

While our information technology systems include security measures designed to prevent unauthorized access, employee error, employee malfeasance or other causes, including intentional misconduct by computer hackers, could circumvent these measures and result in unauthorized access to these systems. Because the techniques used to gain unauthorized access to information technology systems evolve frequently and often are not recognized until successful, we may be unable to anticipate these techniques or implement adequate preventative measures in a timely manner. Any security breach could require significant resources to correct, if correction is possible, and could result in disruption to our business, misappropriation or loss of data, loss of confidence in us by our customers, damage to our reputation and legal liability. Further, any failure to implement appropriate security measures to protect our information or any breach

or other failure of our systems that results in unauthorized access, manipulation, disclosure or loss of this information could result in our violation of any U.S. or foreign data protection laws that are applicable to us, including the California Consumer Privacy Act which went into effect in January 2020. These laws and their interpretation and application are constantly evolving, and they could be interpreted and applied in a manner that is inconsistent with our current practices or they could become more stringent over time. Efforts to comply with applicable data protection laws or any new interpretations of their application could involve significant time and substantial costs or require us to change our business practices and compliance procedures, and any failures to so comply could subject us to substantial civil or criminal fines or sanctions. Any of these outcomes could have a material negative impact on our business, performance and prospects.

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

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

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

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

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

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

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

Risks Related to Laws and Regulations

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

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

Selling and manufacturing in foreign countries subjects us to additional risks not present with our domestic operations, as we are operating in business and regulatory environments in which we have limited experience and that may impose materially different requirements. Further, the geographic distance from our headquarters in Irvine, California, compounds the difficulties of maintaining a manufacturing operation in the PRC. For instance, we may not be able to maintain the desired amount of control over production capacity and timing, inventory levels, product quality, delivery schedules, manufacturing yields or costs. Moreover, we will need to continue to overcome language and cultural barriers to effectively conduct these international operations. Failures in any of these areas could result in legal consequences or production delays and increased turnaround times, which could adversely affect our business. In addition, changes to the labor or other laws of the PRC or the economic and political conditions in the PRC, including increased industrialization in recent years, natural disasters, public health crises, including the occurrence of a contagious disease or illness, such as COVID-19, and other catastrophic events, could increase the costs of employing a local workforce or conducting our manufacturing operations in the PRC. Any of these factors could negatively impact any cost savings we experience from locating our manufacturing facility in the PRC. Additionally, our management has limited experience creating or overseeing foreign operations generally, and the ongoing administration and operation of our PRC facility may require substantial amounts of time and attention by our management team, particularly if we encounter operational, legal or cultural difficulties or disruptions at our PRC facility.

To date, all of our net product sales have been denominated in U.S. dollars. In the future, however, some of our net product sales may be denominated in Chinese Renminbi (“RMB”). The Chinese government controls the procedures by which RMB is converted into other currencies, which generally requires government consent. As a result, RMB may not be freely convertible into other currencies at all times. If the Chinese government institutes changes in currency conversion procedures or imposes additional restrictions on currency conversion, our operations and our operating results could be negatively impacted. In addition, Chinese law imposes restrictions on the movement of funds outside of the PRC. If we need or decide to repatriate funds from our Chinese operations, we would be required to comply with the procedures and regulations of applicable Chinese law, and any failure to so comply could adversely affect our liquidity and financial condition. Further, if we are able to repatriate funds from our Chinese operations, these funds would be subject to U.S. taxes. In addition, fluctuations in the exchange rate between RMB and U.S. dollars may adversely affect our expenses, the value of our assets and liabilities and the comparability of our period-to-period results.

Our international operations and sales are subject to a number of additional risks, including, among others, timing and availability of export licenses; difficulties in accounts receivable collections; difficulties managing distributors; lack of a significant local sales presence in a number of markets; difficulties obtaining government approvals; compliance with anti-bribery, data protection and other applicable U.S. and foreign laws, including the U.S. Foreign Corrupt Practices Act and similar anti-bribery laws in the non-U.S. jurisdictions in which we operate, as well as a wide variety of other complex foreign laws, regulations and treaties; and potentially adverse tax consequences. In addition, the United States or foreign countries may implement quotas, duties, tariffs, taxes or other charges or restrictions on the importation or exportation of our products or the component products we resell, which could lead to a reduction in sales and profitability in that country. The implementation of tariffs by the United States on goods manufactured in other countries, including PRC, could cause the costs of our products to increase, which could significantly impair the gross profit we receive and thereby harm our operating results significantly.

In addition, international turmoil and the threat of future terrorist attacks have contributed to an uncertain political and economic climate, both in the United States and globally, and have negatively impacted the worldwide economy. The economies of the PRC and other countries in which we make sales have been volatile in recent years, resulting in significant fluctuations in local currencies and other instabilities. These conditions could continue or worsen, which could adversely affect our foreign operations and our performance. The occurrence of any of these risks related to our international operations, including our manufacturing facility in the PRC and our international sales, could have a material adverse effect on our business, financial condition and prospects for growth.

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

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

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

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

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

The due diligence activities required to determine the source and chain of custody of minerals contained in our products or used in their manufacture are time-consuming and may result in significant costs. Due to the size and complexity of our supply chain, we face significant challenges verifying the origins of the minerals used in our products or their manufacture. Further, these rules could affect the availability in sufficient quantities and at competitive prices of certain minerals used in our products and their manufacture, which could result in increased material and component costs and additional costs associated with potential changes to our products, processes or sources of supply.

Additionally, if we are unable to sufficiently verify the origin of the minerals used in our products through the due diligence measures we implement, we may not be able to satisfy customer preferences or requirements regarding the use of conflict minerals in the products they purchase, which could place us at a competitive disadvantage.

We have a material weakness in our internal control over financial reporting due to the lack of an independent audit committee. If we are unable to remediate the material weakness, or if we identify additional material weaknesses in the future or otherwise fail to maintain an effective system of internal controls, we may not be able to accurately or timely report our financial condition or results of operations, which may adversely affect our business.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim consolidated financial statements will not be prevented or detected on a timely basis. As described in Item 9A. Controls and Procedures, we have concluded that our internal control over financial reporting was ineffective as of January 2, 2021 due to a material weakness. The identified material weakness, at January 2, 2021, relates to the lack of an independent audit committee. While the control deficiency identified did not result in any identified misstatements, a reasonable possibility exists that a material misstatement to the annual or interim consolidated financial statements and disclosures will not be prevented or detected on a timely basis.

In an effort to remediate the identified material weakness and enhance our internal controls, our finance and accounting personnel are continuing to follow all of the same procedures that they undertook in preparation for independent audit committee meetings on a quarterly and annual basis. Our CEO and sole director will oversee these processes and review materials prepared by the finance and accounting staff as well as our independent auditors on a quarterly and annual basis. If our remedial measures are insufficient to address the material weakness, or if additional material weaknesses or significant deficiencies in our internal control over financial reporting occur in the future, we may not be able to timely or accurately report our results of operations or maintain effective disclosure controls and procedures. If we are unable to report financial information timely or accurately, or to maintain effective disclosure controls and procedures, we could be required to restate our financial statements and be subject to, among other things, regulatory or enforcement actions, securities litigation, limitations on our ability to access capital markets, debt rating agency downgrades or rating withdrawals, or loss in confidence of our investors, any one of which could adversely affect the valuation of our common stock and our business prospects. We can give no assurance that the measures we have taken and plan to take in the future will remediate the material weakness identified or that any additional material weaknesses will not arise in the future due to a failure to implement and maintain adequate internal control over financial reporting.

We are required to comply with certain provisions of Section 404 of the Sarbanes-Oxley Act of 2002, as amended, that place significant demands on our resources.

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

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

Risks Related to Intellectual Property and Litigation

We may be unsuccessful in monetizing our intellectual property portfolio.

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

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

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

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

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

As is common in the semiconductor industry, we have experienced substantial litigation regarding patent and other intellectual property rights. We are currently involved in litigation and proceedings at the U.S. Patent and Trademark Office ("USPTO") and Patent Trial and Appeal Board based on alleged third-party infringement of our patents, and lawsuits claiming we are infringing others' intellectual property rights also have been and may in the future be brought against us.

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

Moreover, our ability to continue to pursue this strategy depends on our ability to obtain and protect patents, which is governed by an uncertain process. In addition to the patent issuance process established by law and the procedures of the USPTO, we must also comply with administrative procedures of the JEDEC to protect our intellectual property within its industry standard-setting process. These procedures evolve over time, are subject to variability in

their application and may be inconsistent with each other. Any failure to comply with the USPTO's or JEDEC's administrative procedures could jeopardize our ability to claim that our patents have been infringed.

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

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

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

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

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

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

protection is limited as to duration and all of our issued patents will eventually expire, at which time the previously protected technologies would become widely available for use by third parties, including our competitors.

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

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

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

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

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

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

Risks Related to Capitalization and Financial Markets

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

To support our activities in the near term, we expect to rely on cash generated from our business and proceeds from issuances of debt and equity securities, including our equity line with Lincoln Park Capital Fund, LLC ("Lincoln Park"), and borrowing availability under our credit facility with Silicon Valley Bank ("SVB"). Taking into account our planned activities and sources of capital, we believe we have sufficient cash resources to satisfy our capital needs for at least the next 12 months. However, our estimates of our operating revenues and expenses and working capital requirements could be incorrect, and we may use our cash resources faster than we anticipate. Moreover, our convertible note issued to Samsung Venture Investment Co. ("SVIC") ("SVIC Note") will mature in December 2021, and if it is not converted into equity, we may not have adequate liquidity to repay the obligations thereunder unless we raise additional capital or enter into an amendment to the SVIC Note. While we believe that we will be able to raise such funds or obtain an amendment to the SVIC Note, there can be no assurance that this will occur. Further, some or all of our ongoing or planned investments may not be successful and could further deplete our capital without immediate, or any, cash returns.

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

- the costs associated with maintaining, defending and enforcing our intellectual property rights;
- the acceptance of, and demand for, our products and the component products we resell to customers;
- our success, and that of our strategic partners, in developing and selling products derived from our technology;
- the extent and timing of any investments in developing, marketing and launching new or enhanced products or technologies;
- the costs of developing, improving and maintaining our internal design, testing and manufacturing processes;
- our results of operations, including our levels of net product sales and any other revenues we may receive, including non-recurring engineering (“NRE”), license, royalty or other fees;
- the amount and timing of vendor payments and the collection of receivables, among other factors affecting our working capital;
- our receipt of cash proceeds from the exercise of outstanding stock options or warrants to acquire our common stock;
- the nature and timing of acquisitions or other strategic transactions or relationships in which we engage, if any; and
- the costs associated with the continued operation, and any future growth, of our business.

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

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

The price and trading volume of our common stock have been volatile and may continue to fluctuate significantly.

Our common stock has been publicly traded since November 2006. The price and trading volume of our common stock are volatile and have in the past fluctuated significantly. This volatility could continue, in which case an

active trading market in our common stock may not be sustained and stockholders may not be able to sell their shares at a desired time or a desired price.

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

- the ongoing impacts of the COVID-19 pandemic;
- the results of legal proceedings in which we are involved;
- our operating and financial performance and prospects;
- investor perceptions of us and the industry in which we operate;
- our ability to meet investor and analyst expectations for our operating results;
- the availability and level of research coverage of and market-making in our common stock;
- changes in buy/sell recommendations by analysts;
- any financial projections we may provide to the public, any changes to these projections or our failure to meet these projections;
- our announcement of significant strategic transactions or relationships or the initiation of legal proceedings, including patent infringement actions;
- general political, economic and market conditions, including volatility or uncertainty in these conditions; and
- the other risk factors described in this report.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

As of January 2, 2021, there were 195,977,567 shares of our common stock outstanding. In addition, 7,519,258 shares of our common stock are subject to outstanding stock options, 3,036,635 shares of our common stock are subject to outstanding unvested restricted stock units, 13,911,110 shares of our common stock are subject to outstanding warrants, and 13,230,246 shares of our common stock subject to an outstanding convertible note. All outstanding shares of our common stock are eligible for sale in the public market under applicable federal securities laws, subject in certain cases to the requirements of Rule 144 under the Securities Act of 1933, as amended (the “Securities Act”), and shares issued upon the exercise or conversion of outstanding stock options, warrants or convertible notes may also be eligible for sale in the public market, to the extent permitted by Rule 144 or other applicable securities laws and the provisions of the applicable stock option, warrant and convertible note agreements. If these shares are sold, or if it is perceived that they may be sold, in the public market, the trading price of our common stock could fall.

Chun K. Hong has significant control over all corporate decisions that may not be in the best interest of our other stockholders.

As of March 22, 2021, 3.3% of our outstanding common stock was held by our directors and officers, including 3.2% held by Chun K. Hong, our President, Chief Executive Officer and the sole member of our board of directors. As a result, Mr. Hong has the ability to exert substantial control over all matters requiring approval by our stockholders and our board of directors, including the election and removal of directors, any proposed merger, consolidation or sale of all or substantially all of our assets and other significant corporate transactions. This concentration of control could be disadvantageous to other stockholders with interests different from those of Mr. Hong.

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

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

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

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

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

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

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

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties

Our corporate headquarters is located in approximately 8,200 square feet of space in Irvine, California, under a lease that expires in July 2021. We also lease approximately 42,200 square feet of space for our manufacturing facility in the PRC under a lease that expires in June 2021. We believe our current facilities are adequate for our current and expected operations for the next 12 months and that additional space could be obtained if needed.

Item 3. Legal Proceedings

Certain legal proceedings in which we are involved are discussed in Part II, Item 8 of this Form 10-K in the Notes to Consolidated Financial Statements in Note 8 “Commitments and Contingencies” under the heading “Litigation and Patent Reexaminations,” and are incorporated herein by reference.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information

Our common stock began trading on The Nasdaq Global Market under the symbol "NLST" on November 30, 2006 and was transferred to The Nasdaq Capital Market effective on January 14, 2016. On September 27, 2018, our common stock was transferred to the OTCQX[®] Best Market. On August 11, 2020, our common stock was transferred to the OTCQB[®].

Holders

As of March 22, 2021, there were approximately 15 holders of record of our shares of common stock, plus an indeterminate number of additional stockholders whose shares of our common stock are held on their behalf by brokerage firms or other agents.

Dividend Policy

We have never declared or paid cash dividends on our capital stock in the past, and we have no intention of declaring or paying any such dividends in the foreseeable future. Additionally, our credit facility with SVB prohibits the payment of cash dividends without obtaining SVB's prior consent. Any declaration or payment of dividends in the future will be at the discretion of our board of directors, and will depend on our results of operations, capital requirements, legal and contractual restrictions and other factors deemed relevant by our board of directors.

Item 6. Selected Financial Data

Not applicable.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section contains forward-looking statements that reflect our plans, estimates and beliefs and involve numerous risks and uncertainties, including, but not limited to, those described in the "Risk Factors" section of this Form 10-K. Actual results may differ significantly from those contained in any forward-looking statements. You should carefully read the "Cautionary Note Regarding Forward-Looking Statements" and "Risk Factors" sections of this Form 10-K. The following discussion should be read in conjunction with our consolidated financial statements and accompanying notes included in Item 8 of this Form 10-K.

Our fiscal year is the 52- or 53-week period that ends on the Saturday nearest to December 31. Our fiscal year 2020 includes 53 weeks and ended on January 2, 2021 and its fiscal year 2019 included 52 weeks and ended on December 28, 2019. The first three quarters of fiscal year 2020 each includes 13 weeks and the fourth quarter includes 14 weeks. The four quarters of fiscal year 2019 each included 13 weeks. Unless otherwise stated, all information presented herein is based on our fiscal calendar, and references to particular years, quarters, months or periods refer to our fiscal years ended in January or December and the associated quarters, months and periods of those fiscal years.

Fiscal Year Highlights

Impact of COVID-19 on our Business

The impact of the coronavirus disease ("COVID-19") pandemic will have on our consolidated results of operations is uncertain. Although we initially observed demand increases in our products, we anticipate that the global health crisis caused by COVID-19 may negatively impact business activity across the globe. We will continue to actively monitor the situation and may take further actions altering our business operations that we determine are in the

best interests of our employees, customers, suppliers, and stakeholders, or as required by federal, state, or local authorities. It is not clear what the potential effects of such alterations or modifications may have on our business, consolidated results of operations, financial condition, and liquidity.

First Amendment to TRGP Agreement

On January 23, 2020, we entered into the first amendment to the investment agreement dated May 3, 2017 with TR Global Funding V, LLC (“TRGP”) (“TRGP Agreement”) to amend the recovery sharing formula related to claims against SK hynix, Inc. a South Korean memory semiconductor supplier (“SK hynix”), for alleged infringement of our patents. The TRGP Agreement generally provided that TRGP directly fund the costs incurred by us or on our behalf in connection with our first ITC action and certain U.S. district court proceedings against SK hynix.

Amendment to SVB Credit Agreement

On February 27, 2020, we entered into an amendment to a credit agreement dated October 31, 2009 with Silicon Valley Bank (“SVB”) (as the same may from time to time be amended, modified, supplemented or restated, the “SVB Credit Agreement”) to extend the maturity date of the borrowings under the SVB Credit Agreement from March 30, 2020 to April 30, 2021.

2019 Lincoln Park Purchase Agreement

On June 24, 2019, we entered into a purchase agreement (the “2019 Purchase Agreement”) with Lincoln Park Capital Fund, LLC (“Lincoln Park”), pursuant to which we have the right to sell to Lincoln Park up to an aggregate of \$10 million in shares of our common stock over the 36-month term of the 2019 Purchase Agreement subject to the conditions and limitations set forth in the 2019 Purchase Agreement. During 2020, Lincoln Park did not purchase shares of our common stock under the 2019 Purchase Agreement. Subsequent to January 2, 2021, Lincoln Park purchased an aggregate of 1,669,429 shares of our common stock for a net purchase price of \$1.6 million under the 2019 Purchase Agreement. In connection with the purchases, we issued to Lincoln Park an aggregate of 129,468 shares of our common stock as commitment shares in noncash transactions.

2020 Lincoln Park Purchase Agreement

On March 5, 2020, we entered into another purchase agreement (the “2020 Purchase Agreement”) with Lincoln Park, pursuant to which we had the right to sell to Lincoln Park up to an aggregate of \$20 million in shares of our common stock over the 36-month term of the 2020 Purchase Agreement subject to the conditions and limitations set forth in the 2020 Purchase Agreement. As consideration for entering into the 2020 Purchase Agreement, we issued to Lincoln Park 1,529,052 shares of our common stock as initial commitment shares in a noncash transaction on March 6, 2020 and would issue up to 917,431 additional shares of our common stock as additional commitment shares on a pro rata basis in connection with any additional purchases. We would not receive any cash proceeds from the issuance of these additional commitment shares.

During 2020, Lincoln Park purchased an aggregate of 23,400,122 shares of our common stock for a net purchase price of \$12.2 million under the 2020 Purchase Agreement. In connection with the purchases, during 2020, we issued to Lincoln Park an aggregate of 560,588 shares of our common stock as commitment shares in noncash transactions. Subsequent to January 2, 2021, Lincoln Park purchased an aggregate of 9,544,595 shares of our common stock for a net purchase price of \$7.8 million under the 2020 Purchase Agreement. In connection with the purchases, we issued to Lincoln Park an aggregate of 356,843 shares of our common stock as commitment shares in noncash transactions. In February 2021, we completed the sales under the 2020 Purchase Agreement.

Paycheck Protection Program Loan

On April 23, 2020, we entered into an unsecured promissory note with a principal amount of \$0.6 million through Hanmi Bank under the Paycheck Protection Program (“PPP”) (“PPP Loan”) administered by the Small Business Administration (“SBA”) and established as part of the Coronavirus Aid, Relief, and Economic Security Act (“CARES

Act”). The PPP Loan bears interest at 1.0% per annum and matures in April 2022 with the first six months of interest and principal payments deferred. The amount borrowed under the PPP Loan is eligible for forgiveness if we meet certain conditions. In February 2021, we applied for forgiveness of the PPP Loan.

Factors Affecting Our Performance

Trends in Net Sales

We have been substantially dependent on sales of single products or product categories. For instance, we have historically been dependent on sales of our memory subsystem products, and in recent periods, we have been dependent on our resales of component products. Demand for any of these products could increase or decrease at any time for a number of reasons, including new customer qualifications, changing customer requirements or preferences, product obsolescence, introduction of more advanced or otherwise superior products by us or our competitors, the ability of our customers to obtain these products or substitute products from alternate sources, customers increasing or reducing their need for these products generally, or a variety of other factors. We have no long-term agreements or other commitments with respect to sales of any of these products. As a result, any fluctuations in demand for these products from us would impact our sale levels and net sales.

In past years, we have experienced declines in demand for and sales of our memory subsystem products, and these declines could continue or intensify in the future. Contrastingly, we have recently experienced marked increases in component product resales. Because the cost of the component products we purchase for resale is added to our cost of sales for these products, our gross margin on resales of component products is generally significantly lower than our gross margin on sales of our memory subsystem products. As a result, increases or decreases in component product resales as a percentage of our total sales have a significant impact on our gross margins.

Next-generation HybriDIMM and some of our other next-generation products may require additional time and capital investments in order to commercialize, and our development and commercialization strategies for these products, including, for instance, our work with the Joint Electron Device Engineering Council (“JEDEC”) to facilitate broad industry adoption of this new technology, may not be successful. Our ability to obtain customer or market acceptance of these next-generation products will materially impact our net product sales and gross profits, as well as our ability to recoup our investments in developing these products.

Customer Composition and Concentrations

Our target markets are characterized by a limited number of large companies, and consolidation in one or more of these target markets may further increase this concentration. As a result, sales to small numbers of customers have historically represented a substantial portion of our net sales, and we expect this concentration to continue. Additionally, the composition of major customers and their respective contributions to our net sales have fluctuated and will likely continue to fluctuate from period to period as our existing and prospective customers progress through the life cycle of the products they produce and sell and experience resulting fluctuations in their product demand. We believe our performance depends in significant part on our ability to establish and maintain relationships with and effect substantial sales to our large customers. We do not have long-term agreements with any of our customers and, as result, any or all of them could decide at any time to increase, accelerate, decrease, delay or discontinue their purchase of our products or the component products we resell. These fluctuations in customer demand and concentrations could significantly impact our net sales.

Product Sale Prices

The prices customers pay for the products we sell can fluctuate due to many factors, including, among others, competitive conditions in our key customer markets, changes in customer requirements or preferences, volatility in the market prices for SSDs, merging dynamic random access memory integrated circuits (“DRAM ICs” or “DRAM”), NAND flash memory (“NAND flash”) and other component products, and changes in manufacturing efficiencies or capacities. Our industry has historically been characterized by declines in average sale prices. If sale price declines are

not offset by corresponding decreases in costs or increases in sales volume or sales of products with higher margins, these sale price declines could have a material adverse effect on our operating results.

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

In addition, because a large percentage of our sales are often from sales to a small number of customers, these customers may exert pressure on us to make concessions in the prices at which we sell products to them. These sale price concessions could have a material effect on our net sales.

Component Product Supply

Our ability to fulfill customer orders for our memory subsystem products or the component products we resell is dependent on a sufficient supply of SSDs, DRAM ICs, NAND flash and other component products. We have no long-term supply contracts for any of these component products. There are a relatively small number of suppliers of these components, and we typically purchase from only a subset of these suppliers.

From time to time, shortages in SSDs, DRAM ICs and NAND flash have required some suppliers to limit the supply of these components. In the past, we have experienced supply chain disruptions and shortages of DRAM and NAND flash required to create certain of our memory subsystem products, and we have been forced to procure the component products we resell from other suppliers to the extent sufficient product is not available from Samsung Electronics Co., Ltd. (“Samsung”) to meet customer demand or in the event of other Samsung supply issues. Supply shortages can occur at any time and for a variety of reasons, including, among others, spikes in customer demand that cannot be satisfied by our suppliers, any problems that arise with the supplier’s manufacturing operations or facilities that cause disruptions or delays, or any failure by the supplier to comply with the terms of its supply arrangements with us. If we are not able to obtain components in the amounts needed, on a timely basis and at commercially reasonable prices, we may lose customers due to order delivery interruptions or failures, which could impact our net sales, and we may experience increases in our cost of sales if we are forced to procure components from alternative suppliers and are not able to negotiate favorable terms with these suppliers. For example, with respect to Samsung, any inability to obtain sufficient component products from Samsung could increase our cost of sales for component product resales because we may not be able to make arrangements with other suppliers on financial and other terms comparable to those we have negotiated with Samsung under a joint development and license agreement (“JDLA”). As described above, we may or may not be able to pass any such cost increases through to our customers, in which case they could materially adversely impact our results by increasing our cost of sales without a corresponding increase in our net sales.

Product Demand Forecasting

Because of the short-term nature of the commitments by many of our customers and the short turnaround times that apply to most orders, as well as our customers’ ability to cancel or defer purchase orders for any reason, we are required to make component procurement decisions based on forecasts of customer demand for the products we sell.

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

market value below our costs. As a result, any significant shortfall of customer orders in relation to our expectations could hurt our operating results, cash flows and financial condition.

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

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

Intellectual Property Protection, Enforcement and Monetization

We dedicate substantial resources to developing technology innovations we believe are essential to our business. We intend to pursue monetization avenues for our intellectual property portfolio, potentially including licensing, royalty or other revenue-producing arrangements. However, we have not generated any such revenue stream from our intellectual property to date. If we are not successful in monetizing our intellectual property portfolio, we may never recoup our investments of time, capital and other resources in the development, maintenance, defense and enforcement of this portfolio, which could materially adversely affect our results of operations.

We also dedicate substantial resources to protecting and enforcing our intellectual property rights, including with patent infringement proceedings we file against third parties and defense of our patents against challenges made by way of reexamination and review proceedings at relevant government agencies. We expect these activities to continue for the foreseeable future, with no guarantee that any ongoing or future patent protection or litigation activities will be successful. We are also subject to litigation based on claims that we have infringed 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 our favor or settled, could materially adversely affect our business, financial condition and results of operations. Additionally, the outcome of pending or future litigation and related patent reviews and reexaminations, as well as any delay in their resolution, could affect our ability to continue to sell our products, protect against competition in the current and expected markets for our products or license or otherwise monetize our intellectual property rights in the future.

Business Risks and Uncertainties

Our performance, financial condition and prospects are affected by a number of factors and are exposed to a number of risks and uncertainties. We operate in a competitive and rapidly evolving industry in which new risks emerge from time to time, and it is not possible for us to predict all of the risks we may face, nor can we assess the impact of all factors on our business or the extent to which any factor or combination of factors could cause actual results to differ from our expectations. See the discussion in Part I, Item 1A. Risk Factors of this Form 10-K for more information.

Results of Operations

Net Sales and Gross Profit

Net sales, cost of sales and gross profit for 2020 and 2019 were as follows (dollars in thousands):

	2020	2019	Change
Net sales	\$ 47,234	\$ 26,103	81%
Cost of sales	40,503	23,533	72%
Gross profit	<u>\$ 6,731</u>	<u>\$ 2,570</u>	162%
Gross margin	<u>14%</u>	<u>10%</u>	

Net Sales

Net sales include resales of certain component products, including SSDs and DRAM products, and sales of our high-performance memory subsystems. In 2020 and 2019, resales of component products represented 66% and 77% of net sales, respectively.

Net sales increased 81% or \$21.1 million during 2020 compared to 2019 primarily as a result of a \$14.0 million overall increase in sales of NAND flash products (including a \$8.3 million increase in sales of Netlist's flash SSD products and a \$5.8 million increase in the resales of NAND flash products), a \$7.8 million overall increase in sales of other small outline dual in-line memory module ("SODIMM") and RDIMM products (a \$5.3 million increase in the resales of SODIMM and RDIMM products and a \$2.5 million increase in sales of our Specialty SODIMM and RDIMM products), partially offset by an aggregate of \$0.5 million increase in sales return reserve and customer discounts.

Our product sales were impacted by fluctuating customer concentrations. During 2020, there was one customer that accounted for more than 10% of our net sales, while during 2019, there were no customers who accounted for more than 10% of our net sales. During 2020 and 2019, our four largest customers accounted for an aggregate of 33% and 27% of our net sales, respectively.

Gross Profit and Gross Margin

Gross profit increased in 2020 compared to 2019 due primarily to higher sales and gross profits on the sales of enterprise SSD products. Gross margin (or gross profit as a percentage of net sales) fluctuates based on the change in our product mix over periods and the relative cost of the factory.

Operating Expenses

Operating expenses for 2020 and 2019 were as follows (dollars in thousands):

	2020	2019	Change
Research and development	\$ 2,953	\$ 2,383	24%
Percentage of net sales	6%	9%	
Intellectual property legal fees	\$ 2,368	\$ 4,131	(43)%
Percentage of net sales	5%	16%	
Selling, general and administrative	\$ 8,247	\$ 7,546	9%
Percentage of net sales	17%	29%	

Research and Development

Research and development expenses increased in 2020 compared to 2019 primarily as a result of an increase in employee headcount and overhead.

Intellectual Property Legal Fees

Intellectual property legal fees consist of legal fees incurred for patent filings, protection and enforcement. Although we expect intellectual property legal fees to generally increase over time as we continue to protect, defend and enforce and seek to expand our patent portfolio, these increases may not be linear but may occur in lump sums depending on the due dates of patent filings and their associated fees and the arrangements we may make with our legal advisors in connection with enforcement proceedings, which may include fee arrangements or contingent fee arrangements in which we would pay these legal advisors on a scaled percentage of any negotiated fees, settlements or judgments awarded to us based on if, how and when the fees, settlements or judgments are obtained. See Note 8 “Commitments and Contingencies” to the consolidated financial statements in Item 8 of this Form 10-K for further discussion.

Pursuant to the terms of the TRGP Agreement, the legal expenses we incurred for our first action against SK hynix at the ITC and our U.S. district court proceedings that were paid directly by TRGP were excluded in their entirety from our financial statements. As of January 2, 2021, accumulated deficit excluded \$1.7 million and \$10.2 million of such legal expenses incurred in 2018 and 2017, respectively. No further legal expenses will be paid by TRGP under this agreement. TPGP did not fund the legal expenses incurred for our second ITC action and our proceedings in international courts as well as other District Court proceedings. TRGP is not currently funding our legal expenses.

Intellectual property legal fees decreased in 2020 as compared to 2019 due primarily to lower legal expenses incurred to defend our patent portfolio internationally, including the costs incurred for our second ITC action and *inter partes* review of our patents before the U.S. Patent and Trademark Office and a current year reversal of legal fees due to certain law firms on the settlement of liabilities owing to them.

Selling, General and Administrative

Selling, general and administrative expenses slightly increased in 2020 compared to 2019 due primarily to an increase in sales and marketing payroll costs and related overhead and commissions and outside services, partially offset by a decrease in travel expenses.

Other Expense, Net

Other expense, net for 2020 and 2019 was as follows (dollars in thousands):

	2020	2019	Change
Interest expense, net	\$ (531)	\$ (945)	
Other income (expense), net	101	(4)	
Total other expense, net	<u>\$ (430)</u>	<u>\$ (949)</u>	(55)%

Interest expense, net, consists primarily of interest expense on the \$15 million secured convertible note issued to Samsung Venture Investment Co. (“SVIC”) (“SVIC Note”) in November 2015, a revolving line of credit under the SVB Credit Agreement, and an unsecured convertible note with an original principal amount of \$2.3 million issued to Iliad Research and Trading, L.P. in August 2018 (“Iliad Note”), along with the accretion of debt discounts and amortization of debt issuance costs on the SVIC Note and Iliad Note. The Iliad Note was fully converted to shares of our common stock during 2019 and there was no outstanding balance as of December 28, 2019. As a result, during 2020 compared to 2019, the interest expense decreased. Other income increased during 2020 as a result of a foreign exchange gain recognized upon the receipt of withholding tax refund from the Korean tax authority.

Liquidity and Capital Resources

Our primary sources of cash are historically proceeds from issuances of equity and debt securities and receipts from revenues, including from product sales. We have also funded our operations with a revolving line of credit under a bank credit facility, a funding arrangement for costs associated with certain of our legal proceedings against SK hynix and, to a lesser extent, equipment leasing arrangements.

The following table presents selected financial information as of and for the years ended January 2, 2021 and December 28, 2019 (in thousands):

	2020	2019
Cash and cash equivalents	\$ 13,326	\$ 8,966
Convertible promissory note and accrued interest, net.....	16,310	15,793
Total PPP Loan and accrued interest	641	—
Working capital	(2,726)	5,442
Net cash used in operating activities	(8,134)	(11,485)
Net cash used in investing activities	(43)	(83)
Net cash provided by financing activities	12,987	6,632

Cash Flows from Operating Activities

Net cash used in operating activities for 2020 was primarily a result of a net loss of \$7.3 million, adjusted for non-cash charges of \$2.1 million, which primarily consisted of stock-based compensation, non-cash lease expense, interest accrued on our convertible note and amortization of debt discounts. These non-cash activities are offset by net cash outflows from changes in working capital balances of \$2.9 million driven predominantly by a decrease in accounts payable due to lower legal expenses incurred to defend our patent portfolio internationally and a current year reversal of legal fees due to certain law firms on the settlement of all liabilities owing to them and prepaid expenses and other assets due to the settlement of refundable withholding tax from the Korean tax authority, partially offset by an increase in accounts receivable due to higher sales.

Net cash used in operating activities for 2019 was primarily a result of a net loss of \$12.5 million, adjusted for non-cash charges of \$2.6 million, which primarily consisted of stock-based compensation, non-cash lease expense, amortization of debt discounts and interest accrued on our convertible notes. These non-cash activities are offset by net cash outflows from changes in working capital balances of \$1.8 million driven predominantly by a \$0.8 million increase in accounts receivable due to higher sales in the fourth quarter of 2019, a \$0.6 million increase in inventories due to higher purchases to support increased sales, and a \$0.6 million decrease in accrued expenses and other liabilities primarily from the decrease in operating lease liabilities, partially offset by a decrease of \$0.5 million in prepaid expenses and other assets.

Cash Flows from Financing Activities

Net cash provided by financing activities for 2020 primarily consisted of \$12.2 million in net proceeds from issuance of common stock under the 2020 Lincoln Park Purchase Agreement, \$0.6 million in proceeds from the issuance of the PPP Loan and \$0.7 million in net borrowings under the SVB Credit Agreement, partially offset by \$0.4 million in payments of note payable to finance insurance policies.

Net cash provided by financing activities for 2019 primarily consisted of \$6.4 million in proceeds from issuance of common stock to Lincoln Park under the 2019 Lincoln Park Purchase Agreement and \$0.7 million in net borrowings under the SVB Credit Agreement, partially offset by \$0.4 million in payment of note payable to finance insurance policies.

Capital Resources

2019 Lincoln Park Purchase Agreement

On June 24, 2019, we entered into the 2019 Purchase Agreement with Lincoln Park, pursuant to which we have the right to sell to Lincoln Park up to an aggregate of \$10 million in shares of our common stock over the 36-month term of the 2019 Purchase Agreement subject to the conditions and limitations set forth in the 2019 Purchase Agreement. As of January 2, 2021, an aggregate of \$3.6 million in shares of our common stock was available for purchases over the remaining term under the 2019 Purchase Agreement.

2020 Lincoln Park Purchase Agreement

On March 5, 2020, we entered into the 2020 Purchase Agreement with Lincoln Park, pursuant to which we had the right to sell to Lincoln Park up to an aggregate of \$20 million in shares of our common stock over the 36-month term of the 2020 Purchase Agreement subject to the conditions and limitations set forth in the 2020 Purchase Agreement. In February 2021, we completed the sales under the 2020 Purchase Agreement.

TRGP Agreement

On May 3, 2017, we entered into the TRGP Agreement, which generally provided that TRGP directly fund the costs incurred by us or on our behalf in connection with our first ITC action and our U.S. district court proceedings against SK hynix. On January 23, 2020, we entered into an amendment to the TRGP Agreement to alter the recovery sharing formula related to claims against SK hynix.

SVB Credit Agreement

On October 31, 2009, we entered into an SVB Credit Agreement, which provides for a revolving line of credit of up to \$5.0 million. The borrowing base is limited to 85% of eligible accounts receivable, subject to certain adjustments as set forth in the SVB Credit Agreement. As of January 2, 2021, the borrowings under the SVB Credit Agreement bear interest at the Wall Street Journal “prime rate” plus 2.75% per annum and mature on April 30, 2021.

As of January 2, 2021, the outstanding borrowings under the SVB Credit Agreement were \$3.7 million with additional borrowing availability of \$0.1 million. During 2020, we made net borrowings of \$0.7 million under the SVB Credit Agreement.

Sufficiency of Cash Balances and Potential Sources of Additional Capital

We believe our existing balance of cash and cash equivalents together with cash receipts from revenues, borrowing availability under the SVB Credit Agreement, the equity financing available under the 2019 Lincoln Park Purchase Agreement, funds raised through other future debt and equity offerings and taking into account cash expected to be used in our operations, will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our capital requirements will depend on many factors, including, among others: the acceptance of, and demand for, our products; our levels of net product sales and any other revenues we may receive, including NRE, license, royalty or other fees; the extent and timing of any investments in developing, marketing and launching new or enhanced products or technologies; the costs of developing, improving and maintaining our internal design, testing and manufacturing processes; the costs associated with defending and enforcing our intellectual property rights; and the nature and timing of acquisitions and other strategic transactions in which we participate, if any. However, the SVIC Note will mature at the end of December 2021, and if it is not converted into equity, we may not have adequate liquidity to repay the obligations thereunder unless we raise additional capital or enter into an amendment to the SVIC Note. While we believe that we will be able to raise such funds or obtain an amendment to the SVIC Note, there can be no assurance that this will occur.

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

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

Off-Balance Sheet Arrangements.

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

Critical Accounting Policies

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make judgments, assumptions and estimates that affect the amounts reported. Note 2 “Summary of Significant Accounting Policies” of the notes to consolidated financial statements in Item 8 of this Form 10-K describes the significant accounting policies and methods used in the preparation of our consolidated financial statements. We base our estimates and assumptions on our historical experience, knowledge of current conditions and our beliefs of what could occur in the future considering available information. We review our estimates and assumptions on an ongoing basis. Actual results may differ from these estimates, which may result in material adverse effects on our consolidated operating results and financial position.

Allowance for Doubtful Accounts

We perform credit evaluations of our customers’ financial condition and limit the amount of credit extended to our customers as deemed necessary, but generally require no collateral. We evaluate the collectability of accounts receivable based on a combination of factors. In cases where we are aware of circumstances that may impair a specific customer’s ability to meet its financial obligations subsequent to the original sale, we will record an allowance against amounts due, and thereby reduce the net recognized receivable to the amount we reasonably believe will be collected. For accounts receivable from our international customers, we purchase comprehensive foreign credit insurance to mitigate risks related to the collectability. For all other customers, we record 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, general economic conditions, and our historical experience. Uncollectible accounts are charged against the allowance for doubtful accounts when all cost-effective commercial means of collection have been exhausted. Generally, our credit losses have been within expectations and the provisions established. However, we cannot guarantee that we will continue to experience credit loss rates similar to those experienced in the past.

Our 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 our accounts receivable, liquidity and future operating results.

Inventories

We value inventories at the lower of cost or the net realizable value. 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. On a regular basis, we evaluate inventory balances for excess quantities and obsolescence by analyzing estimated demand, inventory on hand, sales levels and other information and reduce inventory balances to net realizable value for excess and obsolete inventory based on this analysis. 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.

Impairment of Long-Lived Assets

We evaluate the recoverability of the carrying value of long-lived assets held and used by us in our 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, we compare 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 our customers and reductions in average sale 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.

Warranty Liability

We offer product warranties generally ranging from one to three years, depending on the product and negotiated terms of any purchase agreements with our customers. Such warranties require us to repair or replace defective product returned to us during the warranty period at no cost to the customer. Warranties are not offered on sales of component products. We record an estimate for warranty-related costs at the time of sale based on our historical and estimated future product return rates and expected repair or replacement costs. 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 us, requiring additional warranty reserves, and could adversely affect our gross profit and gross margins.

Stock-Based Compensation

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

Income Taxes

Deferred income tax assets and liabilities are recognized for temporary differences between the financial statement carrying amounts of assets and liabilities and the amounts that are reported in the income tax returns. Deferred taxes are evaluated for realization on a jurisdictional basis. We record valuation allowances to reduce deferred tax assets

to the amount that is more likely than not to be realized. In making this assessment, management analyzes future taxable income, reversing temporary differences and ongoing tax planning strategies. Should a change in circumstances lead to a change in judgment about the realizability of deferred tax assets in future years, we will adjust related valuation allowances in the period that the change in circumstances occurs, along with a corresponding increase or charge to income.

We 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 our position. The tax benefit recognized in the financial statements for a particular tax position is based on the largest benefit that is more likely than not to be realized. The amount of unrecognized tax benefits is adjusted as appropriate for changes in facts and circumstances, such as significant amendments to existing tax laws, new regulations or interpretations by the taxing authorities, new information obtained during a tax examination, or resolution of an examination. We recognize both accrued interest and penalties associated with uncertain tax positions as a component of provision for income taxes in the consolidated statements of operations.

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 our estimates, which could require us to record additional tax liabilities or to reduce previously recorded tax liabilities, as applicable.

Recent Accounting Pronouncements

See Note 2 “Summary of Significant Accounting Policies” of the Notes to Consolidated Financial Statements in Item 8 of this Form 10-K for further discussion

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 8. Financial Statements and Supplementary Data

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All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements and accompanying notes.

Netlist, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

(in thousands, except par value amounts)

	January 2, 2021	December 28, 2019
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 13,326	\$ 8,966
Restricted cash	3,200	2,750
Accounts receivable, net of allowances of \$157 (2020) and \$61 (2019)	4,680	3,672
Inventories	3,198	3,496
Prepaid expenses and other current assets	514	627
Total current assets	24,918	19,511
Property and equipment, net	182	286
Operating lease right-of-use assets	114	968
Other assets	58	1,376
Total assets	<u>\$ 25,272</u>	<u>\$ 22,141</u>
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current Liabilities:		
Accounts payable	\$ 5,327	\$ 9,134
Revolving line of credit	3,678	2,990
Accrued payroll and related liabilities	806	740
Accrued expenses and other current liabilities	777	793
Long-term debt due within one year	17,056	412
Total current liabilities	27,644	14,069
Long-term debt	146	15,793
Operating lease liabilities	—	498
Other liabilities	102	144
Total liabilities	27,892	30,504
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—450,000 shares authorized; 195,978 (2020) and 169,539 (2019) shares issued and outstanding	195	169
Additional paid-in capital	192,071	179,086
Accumulated deficit	(194,886)	(187,618)
Total stockholders' deficit	(2,620)	(8,363)
Total liabilities and stockholders' deficit	<u>\$ 25,272</u>	<u>\$ 22,141</u>

See accompanying notes to consolidated financial statements.

Netlist, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Year Ended	
	January 2, 2021	December 28, 2019
Net sales.....	\$ 47,234	\$ 26,103
Cost of sales.....	40,503	23,533
Gross profit.....	<u>6,731</u>	<u>2,570</u>
Operating expenses:		
Research and development.....	2,953	2,383
Intellectual property legal fees.....	2,368	4,131
Selling, general and administrative.....	8,247	7,546
Total operating expenses.....	<u>13,568</u>	<u>14,060</u>
Operating loss.....	<u>(6,837)</u>	<u>(11,490)</u>
Other expense, net:		
Interest expense, net.....	(531)	(945)
Other income (expense), net.....	101	(4)
Total other expense, net.....	<u>(430)</u>	<u>(949)</u>
Loss before provision for income taxes.....	(7,267)	(12,439)
Provision for income taxes.....	1	13
Net loss.....	<u>\$ (7,268)</u>	<u>\$ (12,452)</u>
Net loss per common share:		
Basic and diluted.....	<u>\$ (0.04)</u>	<u>\$ (0.08)</u>
Weighted-average common shares outstanding:		
Basic and diluted.....	<u>183,594</u>	<u>148,132</u>

See accompanying notes to consolidated financial statements.

Netlist, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT
(in thousands)

	Common Stock		Additional Paid-in	Accumulated	Total Stockholders'
	Shares	Amount	Capital	Deficit	Deficit
Balance, December 29, 2018	139,283	\$ 139	\$ 169,355	\$ (175,166)	\$ (5,672)
Net loss	—	—	—	(12,452)	(12,452)
Issuance of common stock, net, and commitment shares	20,387	20	6,332	—	6,352
Common stock issued on conversion of Iliad Note	9,167	9	2,439	—	2,448
Exercise of stock options	175	—	49	—	49
Stock-based compensation	—	—	989	—	989
Restricted stock units vested and distributed	749	1	(1)	—	—
Tax withholdings related to net share settlements of equity awards	(222)	—	(77)	—	(77)
Balance, December 28, 2019	169,539	169	179,086	(187,618)	(8,363)
Net loss	—	—	—	(7,268)	(7,268)
Issuance of common stock, net, and commitment shares	25,490	25	12,149	—	12,174
Issuance of warrants	—	—	145	—	145
Exercise of stock options	226	—	32	—	32
Exercise of warrants	256	—	—	—	—
Stock-based compensation	—	—	763	—	763
Restricted stock units vested and distributed	801	1	(1)	—	—
Tax withholdings related to net share settlements of equity awards	(334)	—	(103)	—	(103)
Balance, January 2, 2021	<u>195,978</u>	<u>\$ 195</u>	<u>\$ 192,071</u>	<u>\$ (194,886)</u>	<u>\$ (2,620)</u>

See accompanying notes to consolidated financial statements.

Netlist, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended	
	January 2, 2021	December 28, 2019
Cash flows from operating activities:		
Net loss.....	\$ (7,268)	\$ (12,452)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization.....	147	172
Interest accrued on convertible promissory notes.....	309	415
Amortization of debt discounts.....	212	480
Non-cash lease expense.....	489	534
Stock-based compensation.....	763	989
Issuance of warrants in lieu of payment.....	145	—
Changes in operating assets and liabilities:		
Accounts receivable.....	(1,008)	(755)
Inventories.....	298	(550)
Prepaid expenses and other assets.....	1,693	480
Accounts payable.....	(3,807)	(363)
Accrued payroll and related liabilities.....	66	136
Accrued expenses and other liabilities.....	(173)	(571)
Net cash used in operating activities.....	<u>(8,134)</u>	<u>(11,485)</u>
Cash flows from investing activities:		
Acquisition of property and equipment.....	<u>(43)</u>	<u>(83)</u>
Net cash used in investing activities.....	<u>(43)</u>	<u>(83)</u>
Cash flows from financing activities:		
Net borrowings under line of credit.....	688	697
Proceeds from issuance of long-term debt.....	637	—
Principal repayments under finance lease.....	(18)	(13)
Payments on note payable.....	(423)	(376)
Proceeds from issuance of common stock, net.....	12,174	6,352
Proceeds from exercise of stock options.....	32	49
Payments for taxes related to net share settlement of equity awards.....	(103)	(77)
Net cash provided by financing activities.....	<u>12,987</u>	<u>6,632</u>
Net change in cash, cash equivalents and restricted cash.....	4,810	(4,936)
Cash, cash equivalents and restricted cash at beginning of period.....	<u>11,716</u>	<u>16,652</u>
Cash, cash equivalents and restricted cash at end of period.....	<u>\$ 16,526</u>	<u>\$ 11,716</u>
Reconciliation of cash, cash equivalents and restricted cash at end of period:		
Cash and cash equivalents.....	\$ 13,326	\$ 8,966
Restricted cash.....	<u>3,200</u>	<u>2,750</u>
Cash, cash equivalents and restricted cash at end of period.....	<u>\$ 16,526</u>	<u>\$ 11,716</u>

See accompanying notes to consolidated financial statements.

Netlist, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Note 1—Description of Business

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

Due to the ground-breaking product development of its engineering teams, Netlist has built a robust portfolio of over 130 issued and pending U.S. and foreign patents, many seminal, in the areas of hybrid memory, storage class memory, rank multiplication and load reduction. Since its inception, the Company has dedicated substantial resources to the development, protection and enforcement of technology innovations it believes are essential to its business. The Company’s early pioneering work in these areas has been broadly adopted in industry-standard registered dual in-line memory module (“RDIMM”), LRDIMM and NVDIMM. Netlist’s objective is to continue to innovate in its field and invest further in its intellectual property portfolio, with the goal of monetizing its intellectual property through a combination of product sales and licensing, royalty or other revenue-producing arrangements, which may result from joint development or similar partnerships or defense of the Company’s patents through enforcement actions against parties it believes are infringing them.

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

Liquidity

The Company incurred net loss of \$7.3 million and \$12.5 million for 2020 and 2019, respectively. The Company has historically financed its operations primarily with revenues generated from operations, including product sales, and proceeds from issuances of debt and equity securities (see Notes 5 and 9). The Company has also funded its operations with a revolving line of credit under a bank credit facility and a funding arrangement for costs associated with certain of its legal proceedings (see Notes 4, 5 and 8).

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 bore interest at an annual rate of 8% and would have matured on August 27, 2020, unless earlier repurchased, redeemed or converted in accordance with its terms. During 2019, Iliad fully-converted the outstanding principal and accrued interest on the Iliad Note to shares of the Company’s common stock, and as a result, there were no outstanding principal and accrued interest on the Iliad Note as of December 28, 2019 (see Note 5).

On June 24, 2019, the Company entered into a purchase agreement (the “2019 Purchase Agreement”) with Lincoln Park Capital Fund, LLC (“Lincoln Park”), pursuant to which the Company has the right to sell to Lincoln Park up to an aggregate of \$10 million in shares of its common stock over the 36-month term of the 2019 Purchase Agreement subject to the conditions and limitations set forth in the 2019 Purchase Agreement (see Note 9).

On March 5, 2020, the Company entered into another purchase agreement (the “2020 Purchase Agreement”) with Lincoln Park, pursuant to which the Company had the right to sell to Lincoln Park up to an aggregate of \$20 million in shares of its common stock over the 36-month term of the 2020 Purchase Agreement subject to the conditions and limitations set forth in the 2020 Purchase Agreement (see Note 9).

On April 23, 2020, the Company entered into an unsecured promissory note with a principal amount of \$0.6 million through Hanmi Bank under the Paycheck Protection Program (“PPP”) (“PPP Loan”) administered by the Small Business Administration (“SBA”) and established as part of the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) (see Note 5).

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 receipts from revenues, borrowing availability under a bank credit facility (see Note 4), funds available to be raised from the 2019 Lincoln Park arrangement (see Note 9) and funds raised through the debt and equity offerings, will be sufficient to meet the Company’s anticipated cash needs for at least the next 12 months.

Note 2—Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). The Company has evaluated events occurring subsequent to January 2, 2021, through the filing date of this Annual Report on Form 10-K and concluded that there were no events that required recognition and disclosures, other than those discussed elsewhere in the notes hereto.

Principles of Consolidation

The 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’s fiscal year is the 52- or 53-week period that ends on the Saturday nearest to December 31. The Company’s fiscal year 2020 includes 53 weeks and ended on January 2, 2021 and its fiscal year 2019 included 52 weeks and ended on December 28, 2019. The first three quarters of fiscal year 2020 each includes 13 weeks and the fourth quarter includes 14 weeks. The four quarters of fiscal year 2019 each included 13 weeks. Unless otherwise stated, references to particular years, quarters, months and periods refer to the Company’s fiscal years ended in January or December and the associated quarters, months and periods of those fiscal years.

Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, net sales and expenses. Significant items subject to such estimates and assumptions include provisions for uncollectible receivables and sales returns, warranty liability, valuation of inventories, fair value of financial instruments, useful lives and impairment of property and equipment, inputs used to value stock-based compensation and convertible debt instruments and the realization of deferred tax assets. Actual results may differ materially from those estimates.

Recently Adopted Accounting Guidance

In the first quarter of 2020, the Company adopted the Financial Accounting Standards Board (“FASB”) Accounting Standards Update (“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)* (“ASU 2018-15”), which amends the accounting for implementation, setup, and other upfront costs in a hosting arrangement that is a service contract. The adoption of ASU 2018-15 did not have an impact on the Company’s consolidated financial statements.

In the first quarter of 2020, the Company adopted FASB ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement* (“ASU 2018-13”), which removes, modifies, and adds various disclosure requirements on fair value measurements in Topic 820. The adoption of ASU 2018-13 did not have an impact on the Company’s consolidated financial statements.

Recently Issued Accounting Guidance

In December 2019, the FASB issued ASU No. 2019-12, *Income Taxes (Topic 740) Simplifying the Accounting for Income Taxes*, which eliminates certain exceptions related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period and the recognition of deferred tax liabilities for outside basis differences. This ASU also clarifies and simplifies other aspects of the accounting for income taxes. The ASU will be effective for fiscal years beginning after December 15, 2020 and interim periods within those fiscal years and early adoption is permitted. Certain amendments of this ASU may be adopted on a retrospective basis, modified retrospective basis or prospective basis. The Company does not expect material impacts from adopting this ASU on its consolidated financial statements.

In August 2020, the FASB issued ASU No. 2020-06, *Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity’s Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity*. This ASU amends the guidance on convertible instruments and the derivatives scope exception for contracts in an entity’s own equity, and also improves and amends the related earnings per share guidance for both Subtopics. The ASU will be effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years and early adoption is permitted. The Company is currently evaluating the impact this guidance will have on its consolidated financial statements.

Revenue Recognition

Revenue is recognized when control is transferred to customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods and services. Revenue recognition is evaluated through the five steps outlined within the guidance. Substantially all of the Company’s net sales relate to products sold at a point in time through ship-and-bill performance obligations. At contract inception, an assessment of the goods and services promised in the contracts with customers is performed and a performance obligation is identified for each distinct promise to transfer to the customer a good or service (or bundle of goods or services). To identify the performance obligations, the Company considers all of the goods or services promised in the contract regardless of whether they are explicitly stated or are implied by customary business practices. Contracts with customers are comprised of customer purchase orders, invoices (including the Company’s standard terms and conditions) and written contracts.

Performance Obligations

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

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

The Company's revenue generating activities include variable consideration which is recorded as a reduction of the transaction price based upon expected amounts at the time revenue for the corresponding product sale is recognized. Common forms of variable consideration include limited rights of return for up to 30 days, except for sales of excess component inventories, which contain no right-of-return privileges and volume rebates for meeting established sales targets. 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.

Contract Assets and Liabilities

The Company continually evaluates whether the revenue generating activities and advanced payment arrangements with customers result in the recognition of contract assets or liabilities. Generally, the Company does not have material amounts of contract assets since revenue is recognized as control of goods is transferred or as services are performed. As of January 2, 2021, the Company recorded a contract liability of \$0.3 million related to volume rebates to a customer, which is included in accrued expenses and other current liabilities in the consolidated balance sheets. As of December 28, 2019, there was no such liability.

Warranties

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

replacement costs. Estimated future warranty costs are recorded in the period in which the sale is recorded and are included in cost of sales in the consolidated statements of operations.

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

The Company's restricted cash consists of cash to secure standby letters of credit (see Note 4).

Fair Value Measurements

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

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

The Company's financial instruments consist principally of cash and cash equivalents, restricted cash, a revolving line of credit, the PPP Loan and a convertible promissory note. Cash equivalents consist of short-term investments with original maturities of three months or less and restricted cash consists of cash to secure standby letters of credit (see Note 4). The carrying value of these instruments approximates their fair value due to their short-term nature. The fair value of the revolving line of credit, the PPP Loan and convertible promissory note is estimated by using current applicable rates for similar instruments as of the balance sheet date and an assessment of the credit rating. The carrying values of the revolving line of credit as of January 2, 2021 and December 28, 2019 and the PPP Loan as of January 2, 2021 approximate fair value because the interest rate yield is near current market rates for comparable debt instruments. The fair value of the convertible promissory note is estimated by using a discounted cash flow analysis using borrowing rates available to the Company for debt instruments with similar terms and maturities and is classified in Level 2 of the valuation hierarchy. The carrying value and estimated fair value of the senior secured convertible promissory note as of January 2, 2021 were \$14.8 million and \$12.1 million, respectively. The carrying value and estimated fair value of the senior secured convertible promissory note as of December 28, 2019 were \$14.6 million and \$11.7 million, respectively.

Accounts Receivable, net

The Company extends credit to its customers. An allowance for doubtful accounts is maintained for estimated losses resulting from the inability of the Company's customers to make required payments. The Company specifically analyzes the age of customer balances, historical bad debt experiences, customer creditworthiness and changes in customer payment terms when making estimates of the collectability of the Company's accounts receivable balances. If the Company determines that the financial condition of any of its customers has deteriorated, whether due to customer

specific or general economic issues, an increase in the allowance may be made. After all attempts to collect a receivable have failed, the receivable is written off.

Concentration of Credit Risk

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

The Company's accounts receivable are primarily derived from sales to original equipment manufacturers 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 accounts receivable is moderated by its credit evaluation process, relatively short collection terms, a high level of credit worthiness of its customers (see Note 12), foreign credit insurance, and letters of credit issued in its favor. The allowance for credit losses is maintained, and such losses historically have not been significant and have been within management's expectations.

Inventories

Inventories are valued at the lower of cost or the net realizable value. 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. The Company evaluates inventory balances for excess quantities and obsolescence on a regular basis by analyzing estimated demand, inventory on hand, sales levels and other information and reduce inventory balances to net realizable value for excess and obsolete inventory based on this analysis. At the point of the write-down recognition, a new, lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

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 income (expense), net in the consolidated statements of operations.

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 sales 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 management believes there is no impairment of long-lived assets as of January 2, 2021 and December 28, 2019.

Leases

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

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

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

Stock-Based Compensation

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

Income Taxes

Deferred income tax assets and liabilities are recognized for temporary differences between the financial statement carrying amounts of assets and liabilities and the amounts that are reported in the income tax returns. Deferred taxes are evaluated for realization on a jurisdictional basis. The Company records valuation allowances to reduce deferred tax assets to the amount that is more likely than not to be realized. In making this assessment, management analyzes future taxable income, reversing temporary differences and ongoing tax planning strategies. Should a change in circumstances lead to a change in judgment about the realizability of deferred tax assets in future years, the Company will adjust related valuation allowances in the period that the change in circumstances occurs, along with a corresponding increase or charge to income.

The Company recognizes 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 Company’s position. The tax benefit recognized in the financial statements for a particular tax position is based on the largest benefit

that is more likely than not to be realized. The amount of unrecognized tax benefits is adjusted as appropriate for changes in facts and circumstances, such as significant amendments to existing tax laws, new regulations or interpretations by the taxing authorities, new information obtained during a tax examination, or resolution of an examination. The Company recognizes both accrued interest and penalties associated with uncertain tax positions as a component of provision for income taxes in the consolidated statements of operations.

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.

Contingent Legal Expenses

Contingent legal fees are expensed in the 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.

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 2020 or 2019.

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. Diluted net loss per share is calculated by dividing the net loss by the weighted-average shares and dilutive potential common shares outstanding during the period. Dilutive potential shares consist of dilutive shares issuable upon the exercise of outstanding stock options and warrants computed using the treasury stock method, shares issuable under the conversion feature of a convertible note using the "if-converted" method, and shares issuable upon the vesting of RSAs and RSUs. In periods of net loss, basic and diluted loss per share are the same, as the effect of dilutive potential shares on loss per share is anti-dilutive.

Note 3—Supplemental Financial Information

Inventories

Inventories consisted of the following (in thousands):

	January 2, 2021	December 28, 2019
Raw materials	\$ 578	\$ 1,052
Work in process	2	25
Finished goods	2,618	2,419
	<u>\$ 3,198</u>	<u>\$ 3,496</u>

Property and Equipment, net

Property and equipment, net consisted of the following (in thousands):

	January 2, 2021	December 28, 2019
Machinery and equipment	\$ 7,811	\$ 7,867
Computer equipment and software	2,523	2,447
Leasehold improvements	737	737
Furniture and fixtures	55	55
	<u>11,126</u>	<u>11,106</u>
Less: accumulated depreciation and amortization	<u>(10,944)</u>	<u>(10,820)</u>
	<u>\$ 182</u>	<u>\$ 286</u>

Substantially all the Company's property and equipment, net, are located within the United States as of January 2, 2021 and December 28, 2019.

Other Assets

Other assets consisted of the following (in thousands):

	January 2, 2021	December 28, 2019
Refundable withholding tax	\$ —	\$ 1,320
Other assets	58	56
	<u>\$ 58</u>	<u>\$ 1,376</u>

Refundable withholding tax was the amount of tax withheld by the Company's customer in the Republic of Korea in November 2015 and was determined to be refundable from the Korean tax authority. During 2020, the Company received the full amount due from the Korean tax authority.

Disaggregation of Net Sales

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

	Year Ended	
	January 2, 2021	December 28, 2019
Resales of third-party products.....	\$ 31,031	\$ 19,982
Sale of the Company's modular memory subsystems.....	16,203	6,121
Total net sales.....	<u>\$ 47,234</u>	<u>\$ 26,103</u>

Net sales by country presented below are based on the billing location of the customer (in thousands):

	Year Ended	
	January 2, 2021	December 28, 2019
United States	\$ 35,826	\$ 19,919
China(1)	6,071	2,167
Other countries	5,337	4,017
Total net sales	<u>\$ 47,234</u>	<u>\$ 26,103</u>

(1) China includes Hong Kong and Taiwan.

The United States and China accounted for more than 10% of the Company's net sales for 2020. For 2019, the United States was the only country that accounted for more than 10% of the Company's net sales.

Net Loss Per Share

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

	Year Ended	
	January 2, 2021	December 28, 2019
Numerator: Net loss	\$ (7,268)	\$ (12,452)
Denominator: Weighted-average common shares outstanding—basic and diluted	183,594	148,132
Net loss per share—basic and diluted	<u>\$ (0.04)</u>	<u>\$ (0.08)</u>

The Company computed net loss per share using the two-class method required for unvested participating securities through the three months ended March 28, 2020. No allocation of undistributed earnings to participating securities was performed for periods with net loss as such securities do not have a contractual obligation to share in the loss of the Company.

The table below sets forth potentially dilutive weighted average common share equivalents, consisting of shares issuable upon the exercise of outstanding stock options and warrants using the treasury stock method, shares issuable upon conversion of the SVIC Note (see Note 5) using the “if-converted” method, and the vesting of RSAs and RSUs.

These potential weighted average common share equivalents have been excluded from the diluted net loss per share calculations above as their effect would be anti-dilutive (in thousands):

	Year Ended	
	January 2, 2021	December 28, 2019
Weighted average common share equivalents	<u>13,644</u>	<u>13,357</u>

Cash Flow Information

The following table shows supplemental disclosures of cash flow information and non-cash financing activities (in thousands):

	Year Ended	
	January 2, 2021	December 28, 2019
Supplemental disclosure of cash flow information:		
Cash paid for interest	<u>\$ 70</u>	<u>\$ 62</u>
Supplemental disclosure of non-cash financing activities:		
Common stock issued on conversion of convertible note payable and accrued interest	<u>\$ —</u>	<u>\$ 2,448</u>
Debt financing of insurance	<u>\$ 262</u>	<u>\$ 412</u>

Note 4—Credit Agreement

On October 31, 2009, the Company and Silicon Valley Bank (“SVB”) entered into a credit agreement (as the same may from time to time be amended, modified, supplemented or restated, the “SVB Credit Agreement”), which provides for a revolving line of credit up to \$5.0 million. The borrowing base is limited to 85% of the eligible accounts receivable, subject to certain adjustments. As of January 2, 2021, the borrowings under the SVB Credit Agreement bear interest based on the Wall Street Journal “prime rate” plus 2.75% and mature on April 30, 2021. The SVB Credit Agreement requires letters of credit to be secured by cash, which is classified as restricted cash in the accompanying consolidated balance sheets. As of January 2, 2021 and December 28, 2019, (i) outstanding letters of credit were \$3.2 million and \$2.8 million, respectively, (ii) outstanding borrowings were \$3.7 million and \$3.0 million, respectively, and (iii) availability under the revolving line of credit was \$0.1 million and \$0.2 million, respectively.

On April 12, 2017, the Company and SVB entered into an 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).

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 Samsung Venture Investment Co. (“SVIC”) (see Note 5). Certain of these lien priorities were modified in April and May 2017 in connection with the Company’s establishment of a funding arrangement with TRGP for certain of the Company’s litigation expenses in connection with certain of its legal proceedings against SK hynix, Inc., 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).

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 January 2, 2021, the Company was in compliance with its covenants under the SVB Credit Agreement.

Note 5—Debt

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

	<u>January 2, 2021</u>	<u>December 28, 2019</u>
Secured convertible note, due December 2021, including accrued interest of \$1,538 (2020) and \$1,233 (2019), respectively	\$ 16,538	\$ 16,233
Paycheck protection program loan, due April 2022, including accrued interest of \$4	641	—
Notes payable	251	412
Unamortized debt discounts and issuance costs	(228)	(440)
Total debt	17,202	16,205
Less: amounts due within one year	(17,056)	(412)
Long-term debt	<u>\$ 146</u>	<u>\$ 15,793</u>

Secured Convertible Note

On November 18, 2015, in connection with entering into the JDLA with Samsung, the Company issued to SVIC a 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. For 2020 and 2019, the Company amortized \$0.2 million and \$0.2 million, respectively, to interest expense in the accompanying consolidated statements of operations. The effective interest rate, including accretion of the SVIC Note to par and amortization of debt issuance costs, was approximately 3.4%. As of January 2, 2021 and December 28, 2019, the outstanding principal and accrued interest on the SVIC Note was \$16.5 million and \$16.2 million, respectively, and the outstanding SVIC Note balance, net of unamortized debt discounts and issuance costs, was \$16.3 million and \$15.8 million, respectively.

In connection with the SVIC Note, SVIC was granted a first priority security interest in the Company's patent portfolio and a second priority security interest in all of the Company's other tangible and intangible assets. Upon issuance of the SVIC Note, the Company, SVB and SVIC entered into an Intercreditor Agreement pursuant to which SVB and SVIC agreed to their relative security interests in the Company's assets. In May 2017, SVIC, SVB and TRGP entered into additional Intercreditor Agreements to modify certain of these lien priorities (see Note 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 Securities and Exchange Commission, 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 January 2, 2021, 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 bore interest at an annual rate of 8% and would have matured on August 27, 2020, unless earlier repurchased, redeemed or converted in accordance with its terms.

During 2019, Iliad fully converted the outstanding principal and accrued interest on the Iliad Note to shares of the Company's common stock as follows: (1) \$1.9 million of the outstanding principal and accrued interest on the Iliad Note to 7,778,270 shares of the Company's common stock at the Redemption Conversion Price and (2) \$0.5 million of the outstanding principal and accrued interest on the Iliad Note to 1,388,890 shares of the Company's common stock at the Lender Conversion Price. As a result of these conversions, as of December 28, 2019, there were no outstanding principal and accrued interest on the Iliad Note.

Paycheck Protection Program Loan

On April 23, 2020, the Company entered into the PPP Loan with a principal amount of \$0.6 million through Hanmi Bank under the PPP administered by the SBA and established as part of the CARES Act. The PPP Loan bears interest at 1.0% per annum and matures on April 23, 2022 with the first six months of interest and principal payments deferred. The amount borrowed under the PPP Loan is guaranteed by the SBA and is eligible for forgiveness in an amount equal to the sum of the eligible costs, including payroll, benefits, rent and utilities, incurred by the Company during the 24-week period beginning on the date the Company received the proceeds. The PPP Loan contains customary events of default, and the occurrence of an event of default may result in a claim for the immediate repayment of all amounts outstanding under the PPP Loan. In February 2021, the Company applied for forgiveness of the PPP Loan.

Contractual Maturities of Debt Obligations

The aggregate contractual maturities of all borrowings due subsequent to January 2, 2021, including accrued interest, are as follows (in thousands):

Fiscal Year	Amount
2021	\$ 17,284
2022	146
Total	<u>\$ 17,430</u>

Note 6—Leases

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

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

	Year Ended	
	January 2, 2021	December 28, 2019
Lease cost:		
Operating lease cost	\$ 565	\$ 623
Finance lease cost		
Amortization of right-of-use assets	\$ 19	\$ 14
Interest on lease liabilities	4	3
Total finance lease cost	<u>\$ 23</u>	<u>\$ 17</u>
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	\$ 561	\$ 592
Operating cash flows from finance leases	4	3
Financing cash flows from finance leases	18	13
Right-of-use assets obtained in exchange for lease obligations:		
Finance leases	\$ —	\$ 96
Lease modification to decrease ROU assets	365	—

Supplemental balance sheet information related to leases was as follows (in thousands):

	January 2, 2021	December 28, 2019
Operating Leases		
Operating lease right-of-use assets	<u>\$ 114</u>	<u>\$ 968</u>
Accrued expenses and other current liabilities	<u>\$ 118</u>	<u>\$ 511</u>
Operating lease liabilities	<u>—</u>	<u>498</u>
Total operating lease liabilities	<u>\$ 118</u>	<u>\$ 1,009</u>
Finance Leases		
Property and equipment, at cost	\$ 96	\$ 96
Accumulated depreciation	(34)	(14)
Property and equipment, net	<u>\$ 62</u>	<u>\$ 82</u>
Accrued expenses and other current liabilities	<u>\$ 19</u>	<u>\$ 18</u>
Other liabilities	46	65
Total finance lease liabilities	<u>\$ 65</u>	<u>\$ 83</u>

The following table includes supplemental information:

	January 2, 2021	December 28, 2019
Weighted Average Remaining Lease Term (in years)		
Operating lease	0.4	2.1
Finance lease	3.3	4.3
Weighted Average Discount Rate		
Operating lease	6.1%	7.9%
Finance lease	5.1%	5.1%

Maturities of lease liabilities as of January 2, 2021 were as follows (in thousands):

Fiscal Year	Operating Leases	Finance Leases
2021	\$ 120	\$ 22
2022	—	22
2023	—	22
2024	—	5
Total lease payments	120	71
Less: imputed interest	(2)	(6)
Total	<u>\$ 118</u>	<u>\$ 65</u>

Note 7—Income Taxes

United States and foreign loss before provision for income taxes was as follows (in thousands):

	Year Ended	
	January 2, 2021	December 28, 2019
United States	\$ (6,741)	\$ (11,916)
Foreign	(526)	(523)
	<u>\$ (7,267)</u>	<u>\$ (12,439)</u>

The provision for income taxes consisted of the following (in thousands):

	Year Ended	
	January 2, 2021	December 28, 2019
Current:		
Federal	\$ —	\$ —
State	1	13
Total current	<u>1</u>	<u>13</u>
Deferred:		
Federal	(1,402)	(2,256)
State	(415)	(769)
Foreign	67	166
Change in valuation allowance	<u>1,750</u>	<u>2,859</u>
Total deferred	<u>—</u>	<u>—</u>
Provision for income taxes	<u>\$ 1</u>	<u>\$ 13</u>

Income taxes differ from the amounts computed by applying the statutory federal income tax rate of 21% for 2020 and 2019. The reconciliation of this difference is as follows (in thousands):

	Year Ended	
	January 2, 2021	December 28, 2019
Statutory federal income tax rate	21%	21%
Change in valuation allowance	(19)%	(18)%
Other	<u>(2)%</u>	<u>(3)%</u>
Effective tax rate	<u>—%</u>	<u>—%</u>

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The significant components of the deferred tax assets and liabilities are as follows (in thousands):

	January 2, 2021	December 28, 2019
Deferred tax assets:		
Operating loss carryforward	\$ 33,564	\$ 32,014
Tax credit carryforwards	3,779	3,664
Reserves and allowances	707	643
Foreign operating loss carryforward	692	759
Stock-based compensation	236	368
Other	573	672
Total deferred tax assets.	<u>39,551</u>	<u>38,120</u>
Deferred tax liabilities:		
Operating lease right-of-use assets	(121)	(261)
Prepaid expenses	(31)	(161)
Basis difference in warrant and note	(57)	(106)
Total deferred tax liabilities.	<u>(209)</u>	<u>(528)</u>
Net deferred tax assets.	<u>39,342</u>	<u>37,592</u>
Valuation allowance	<u>(39,342)</u>	<u>(37,592)</u>
	<u>\$ —</u>	<u>\$ —</u>

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. As of January 2, 2021 and December 28, 2019, a valuation allowance of \$39.3 million and \$37.6 million, respectively, has been provided based on the Company’s assessment that it is more likely than not that sufficient taxable income will not be generated to realize the tax benefits of the temporary differences. The valuation allowance increased by \$1.7 million and \$2.9 million during 2020 and 2019, respectively. These increases in these years primarily relate to the increases in the net operating loss (“NOL”) carryforward.

As of January 2, 2021, the Company had (i) \$136.8 million of federal NOL carryforwards, of which \$104.2 million will expire from 2029 through 2037, and \$32.6 million of which will be carried forward indefinitely, (ii) \$76.5 million of state NOL carryforwards, which begin to expire in 2029, (iii) federal tax credit carryforwards of \$1.9 million, which begin to expire in 2026, and (iv) state tax credit carryforwards of \$1.9 million, which will be carried forward indefinitely. In addition, as of January 2, 2021, the Company had \$2.7 million of foreign NOL carryforwards from various jurisdictions, which begin to expire in 2021. Utilization of the NOL and tax credit carryforwards is subject to an annual limitation due to the ownership percentage change limitations provided by Section 382 of the Internal Revenue Code (the “Code”) and similar state and foreign law provisions. Under Section 382 of the Code, substantial changes in our ownership may limit the amount of NOL and tax credit carryforwards that are available to offset taxable income. The annual limitation would not automatically result in the loss of NOL and tax credit carryforwards but may limit the amount available in any given future period. Additional limitations on the use of these tax attributes could occur in the event of possible disputes arising in examination from various taxing authorities.

The Company files income tax returns with federal, state and foreign jurisdictions. The Company is no longer subject to Internal Revenue Service (“IRS”) or state examinations for periods prior to 2016, although certain carryforward attributes that were generated prior to 2016 may still be adjusted by the IRS.

The Company includes interest and penalties related to uncertain tax positions within the provision for income taxes. As of January 2, 2021 and December 28, 2019, the interest or penalties accrued related to unrecognized tax benefits were insignificant, and during 2020 and 2019, the interest and penalties related to uncertain tax position recorded were insignificant. As of January 2, 2021, the Company had no unrecognized tax benefits that would significantly change in the next 12 months.

Note 8—Commitments and Contingencies

Contingent Legal Expenses

The Company may retain the services of law firms that specialize in patent licensing and enforcement and patent law in connection with its licensing and enforcement activities. These law firms may be retained on a contingent fee basis whereby such law firms are paid on a scaled percentage of any negotiated fee, settlements or judgments awarded based on how and when the fees, settlements or judgments are obtained.

TRGP Agreement and Related Intercreditor Agreements

On May 3, 2017, the Company and TRGP entered into an investment agreement (the “TRGP Agreement”), which generally provided that TRGP directly fund the costs incurred by or on behalf of the Company in connection with the Company’s first action in the U.S. International Trade Commission (“ITC”) and its U.S. district court proceedings, but excluding all other proceedings (all such funded costs, collectively, the “Funded Costs”). In exchange for such funding, the Company agreed that, if the Company recovered any proceeds in connection with the funded SK hynix proceedings relating to certain patents, it would pay to TRGP the amount of the Funded Costs paid by TRGP plus an escalating premium based on when 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 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 and its amendment do not impose financial covenants on the Company. On January 23, 2020, the Company and TRGP entered into an amendment to the TRGP Agreement to alter the recovery sharing formula related to claims against SK hynix for alleged infringement of the Company’s patents.

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 relating to certain patents, 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 consolidated financial statements. During the years ended December 29, 2018 and December 30, 2017, the Company excluded legal expenses of \$1.8 million and \$10.2 million, respectively, as a result of TRGP’s payment of these expenses under the TRGP Agreement. No further legal expenses will be paid by TRGP under this agreement. Any settlement or other cash proceeds the Company may recover in the future in connection with the funded SK hynix proceedings may 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 amended TRGP Agreement at the time of any such recovery.

Litigation and Patent Reexaminations

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

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

Google Litigation

On December 4, 2009, the Company filed a patent infringement lawsuit against Google, Inc. ("Google") in the U.S. District Court for the Northern District of California (the "Northern District Court"), seeking damages and injunctive relief based on Google's alleged infringement of the Company's U.S. Patent No. 7,619,912 (the "'912 patent"), which relates generally to technologies to implement rank multiplication. In February 2010, Google answered the Company's complaint and asserted counterclaims against the Company seeking a declaration that the patent is invalid and not infringed, and claiming that the Company committed fraud, negligent misrepresentation and breach of contract based on the Company's activities in the Joint Electron Device Engineering Council ("JEDEC") standard-setting organization. The counterclaim seeks unspecified compensatory damages. Accruals have not been recorded for loss contingencies related to Google's counterclaim because it is not probable that a loss has been incurred and the amount of any such loss cannot be reasonably estimated. In October 2010, Google requested and was later granted an *Inter Partes* Reexamination of the '912 patent by the USPTO. The reexamination proceedings are described below. In connection with the reexamination request, the Northern District Court granted the Company's and Google's joint request to stay the '912 patent infringement lawsuit against Google until the completion of the reexamination proceedings. On January 31, 2019, the PTAB, in response to Google's rehearing request, denied rehearing of the PTAB's previous decision upholding the validity of claims in Netlist's '912 patent. On April 16, 2019, Google filed an appeal to this decision. On June 15, 2020, the United States Court of Appeals for the Federal Circuit affirmed the PTAB's previous decision upholding the validity of claims in Netlist's '912 patent. The Google litigation is now resuming with issuance of the '912 reexamination certificate and the scheduling of a Markman hearing for March 9, 2022.

Inphi Litigation

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

technology. Inphi denied infringement and claimed that the three patents are invalid. In June 2010, Inphi requested and was later granted *Inter Partes* Reexaminations of the '912, '537 and '274 patents by the USPTO. The reexamination proceedings are described below (except for the reexamination proceeding related to the '537 patent, which have concluded with the confirmation of all of the claims of such patent). In connection with the reexamination requests, Inphi filed a motion to stay the patent infringement lawsuit with the Central District Court until completion of the reexamination proceedings, which was granted. On April 16, 2019, Inphi filed an appeal to the PTAB's January 31, 2019 decision upholding the validity of claims in Netlist's '912 patent. On June 15, 2020, the United States Court of Appeals for the Federal Circuit affirmed the PTAB's previous decision upholding the validity of claims in Netlist's '912 patent.

'912 Patent Reexamination

As noted above, in April 2010, June 2010 and October 2010, Google and Inphi submitted requests for an *Inter Partes* Reexamination of the '912 patent by the USPTO, claiming that the '912 patent is invalid and requesting that the USPTO reject the patent's claims and cancel the patent. Additionally, in October 2010, Smart Modular, Inc. ("Smart Modular") submitted another such reexamination request. On January 18, 2011, the USPTO granted such reexamination requests, and in February 2011, the USPTO merged the Inphi, Google and Smart Modular '912 patent reexaminations into a single proceeding. On March 21, 2014, the USPTO issued an Action Closing Prosecution ("ACP"), an office action that states the USPTO examiner's position on patentability and closes further prosecution, and on June 18, 2014 the USPTO issued a Right of Appeal Notice ("RAN"), a notice that triggers the rights of the involved parties to file a notice of appeal to the ACP, each of which confirmed the patentability of 92 of the '912 patent's claims and rejected the patent's 11 other claims. The parties involved filed various notices of appeal, responses and requests, and on November 24, 2015, the PTAB held a hearing on such appeals. On May 31, 2016, the PTAB issued a decision affirming certain of the examiner's decisions and reversing others. On February 9, 2017, the PTAB granted the Company's request to reopen prosecution before the USPTO examiner and remanded the consolidated proceeding to the examiner to consider the patentability of certain of the pending claims in view of the PTAB's May 31, 2016 decision and comments from the parties. On October 3, 2017, the examiner issued a determination as to the patentability of certain of the pending claims, which were found to be unpatentable. On June 1, 2018, the PTAB reversed the Examiner and found the pending amended claims to be patentable. On July 2, 2018, Google requested rehearing of the PTAB's decision. On January 31, 2019 the PTAB, in response to Google's rehearing request, denied rehearing of the PTAB's previous decision upholding the validity of claims in Netlist's '912 patent. On April 16, 2019, Inphi and Google filed an appeal to the '912 patent decision. On June 15, 2020, the United States Court of Appeals for the Federal Circuit affirmed the PTAB's previous decision upholding the validity of claims in Netlist's '912 patent. The reexamination certificate for the '912 issued on February 8, 2021. 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.

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. The First and Second ITC Actions are no longer pending and the parallel Central District Court infringement proceedings are currently stayed pending further order of the court.

On March 17, 2020, Netlist filed legal proceedings alleging patent infringement against SK hynix in the U.S. District Court for the Western District of Texas based on the infringement of Netlist U.S. Patent No. 9,858,218 and U.S. Patent No. 10,474,595 by SK hynix RDIMM and LRDIMM memory products. The case has been assigned to

the Hon. Alan D. Albright and is Case No. 6:20-cv-00194-ADA. The Markman hearing in this case occurred on March 4, 2021 and the trial is scheduled for July 6, 2021.

On June 15, 2020, Netlist filed a second round of legal proceedings alleging patent infringement against SK hynix in the U.S. District Court for the Western District of Texas based on the infringement of Netlist U.S. Patent No. 10,217,523 by SK hynix LRDIMM memory products. The case has been assigned to the Hon. Alan D. Albright and is Case No. 6:20-cv-00525-ADA. The Markman hearing in this case occurred on March 4, 2021 and the trial is scheduled for July 6, 2021.

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 and SVB 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 consolidated balance sheets.

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 as of January 2, 2021 or December 28, 2019.

On April 17, 2017, the Company entered into a rights agreement (as amended from time to time, 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 (as amended on April 16, 2018, April 16, 2019 and August 14, 2020) will expire on the close of business on April 17, 2024.

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 the Company's 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

The Company has one class of common stock with a par value of \$0.001 per share. On August 7, 2020, the Company's stockholders approved an amendment to the Restated Certificate of Incorporation to increase the number of shares of the common stock authorized for issuance from 300,000,000 to 450,000,000.

2019 Lincoln Park Purchase Agreement

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

Pursuant to the 2019 Purchase Agreement, on any business day and as often as every other business day over the 36-month term of the 2019 Purchase Agreement, the Company has the right, from time to time, at its sole discretion and subject to certain conditions, to direct Lincoln Park to purchase up to 400,000 shares of its common stock, with such amount increasing as the closing sale price of its common stock increases; provided Lincoln Park's obligation under any single such purchase will not exceed \$1.0 million, unless the Company and Lincoln Park mutually agree to increase the maximum amount of such single regular purchase. If the Company directs Lincoln Park to purchase the maximum number of shares of common stock it then may sell in a regular purchase, then in addition to such regular purchase, and subject to certain conditions and limitations in the 2019 Purchase Agreement, the Company may direct Lincoln Park to purchase an additional amount of common stock that may not exceed the lesser of (i) 300% of the number of shares purchased pursuant to the corresponding regular purchase or (ii) 30% of the total number of shares of its common stock traded during a specified period on the applicable purchase date as set forth in the 2019 Purchase Agreement. Under certain circumstances and in accordance with the 2019 Purchase Agreement, the Company may direct Lincoln Park to purchase shares in multiple accelerated purchases on the same trading day.

The Company controls the timing and amount of any sales of its common stock to Lincoln Park. There is no upper limit on the price per share that Lincoln Park must pay for the Company's common stock under the 2019 Purchase Agreement, but in no event will shares be sold to Lincoln Park on a day the closing price is less than the floor price specified in the 2019 Purchase Agreement. In all instances, the Company may not sell shares of its common stock to Lincoln Park under the 2019 Purchase Agreement if that would result in Lincoln Park beneficially owning more than 9.99% of its common stock.

The 2019 Purchase Agreement does not limit the Company's ability to raise capital from other sources at the Company's sole discretion, except that, subject to certain exceptions, the Company may not enter into any Variable Rate Transaction (as defined in the 2019 Purchase Agreement, including the issuance of any floating conversion rate or variable priced equity-like securities) during the 36 months after the date of the 2019 Purchase Agreement. The Company has the right to terminate the 2019 Purchase Agreement at any time, at no cost to the Company.

During 2019, Lincoln Park purchased an aggregate of 19,044,762 shares of the Company's common stock for a net purchase price of \$6.4 million under the 2019 Purchase Agreement. In connection with the purchases, the Company

issued to Lincoln Park an aggregate of 523,633 shares of its common stock as additional commitment shares in noncash transactions. During 2020, Lincoln Park did not purchase shares of the Company's common stock under the 2019 Purchase Agreement. Subsequent to January 2, 2021, Lincoln Park purchased an aggregate of 1,669,429 shares of the Company's common stock for a net purchase price of \$1.6 million under the 2019 Purchase Agreement. In connection with the purchases, the Company issued to Lincoln Park an aggregate of 129,468 shares of its common stock as additional commitment shares in noncash transactions.

2020 Lincoln Park Purchase Agreement

On March 5, 2020, the Company entered into the 2020 Purchase Agreement with Lincoln Park, pursuant to which the Company had the right to sell to Lincoln Park up to an aggregate of \$20 million in shares of its common stock over the 36-month term of the 2020 Purchase Agreement subject to the conditions and limitations set forth in the 2020 Purchase Agreement. As consideration for entering into the 2020 Purchase Agreement, the Company issued to Lincoln Park 1,529,052 shares of its common stock as initial commitment shares in a noncash transaction on March 6, 2020 and would issue up to 917,431 additional shares of its common stock as additional commitment shares on a pro rata basis in connection with any additional purchases. The Company would not receive any cash proceeds from the issuance of these additional commitment shares.

Pursuant to the 2020 Purchase Agreement, on any business day and as often as every other business day over the 36-month term of the 2020 Purchase Agreement, the Company had the right, from time to time, at its sole discretion and subject to certain conditions, to direct Lincoln Park to purchase up to 400,000 shares of its common stock, with such amount increasing as the closing sale price of its common stock increases; provided Lincoln Park's obligation under any single such purchase would not exceed \$1.0 million, unless the Company and Lincoln Park mutually agreed to increase the maximum amount of such single regular purchase. If the Company directed Lincoln Park to purchase the maximum number of shares of common stock it then might sell in a regular purchase, then in addition to such regular purchase, and subject to certain conditions and limitations in the 2020 Purchase Agreement, the Company might direct Lincoln Park to purchase an additional amount of common stock that might not exceed the lesser of (i) 300% of the number of shares purchased pursuant to the corresponding regular purchase or (ii) 30% of the total number of shares of its common stock traded during a specified period on the applicable purchase date as set forth in the 2020 Purchase Agreement. Under certain circumstances and in accordance with the 2020 Purchase Agreement, the Company might direct Lincoln Park to purchase shares in multiple accelerated purchases on the same trading day.

The Company controlled the timing and amount of any sales of its common stock to Lincoln Park. There was no upper limit on the price per share that Lincoln Park must pay for the Company's common stock under the 2020 Purchase Agreement, but in no event would shares be sold to Lincoln Park on a day the closing price was less than the floor price specified in the 2020 Purchase Agreement. In all instances, the Company might not sell shares of its common stock to Lincoln Park under the 2020 Purchase Agreement if that would result in Lincoln Park beneficially owning more than 9.99% of its common stock.

The 2020 Purchase Agreement did not limit the Company's ability to raise capital from other sources at the Company's sole discretion, except that, subject to certain exceptions, the Company might not enter into any Variable Rate Transaction (as defined in the 2020 Purchase Agreement, including the issuance of any floating conversion rate or variable priced equity-like securities) during the 36 months after the date of the 2020 Purchase Agreement. The Company had the right to terminate the 2020 Purchase Agreement at any time, at no cost to the Company.

During 2020, Lincoln Park purchased an aggregate of 23,400,122 shares of the Company's common stock for a net purchase price of \$12.2 million, under the 2020 Purchase Agreement. In connection with the purchases, during 2020, the Company issued to Lincoln Park an aggregate of 560,588 shares of its common stock, as additional commitment shares in noncash transactions. Subsequent to January 2, 2021, Lincoln Park purchased an aggregate of 9,544,595 shares of the Company's common stock for a net purchase price of \$7.8 million under the 2020 Purchase Agreement. In connection with the purchases, the Company issued to Lincoln Park an aggregate of 356,843 shares of its common stock as additional commitment shares in noncash transactions. In February 2021, the Company completed the sales under the 2020 Purchase Agreement.

Warrants

Warrant activity during 2020 is as follows:

	Number of Shares (in thousands)	Weighted Average Exercise Price
Outstanding as of December 28, 2019	15,010	\$ 0.62
Granted	300	0.33
Exercised	(300)	0.11
Expired	(1,099)	1.00
Outstanding as of January 2, 2021	<u>13,911</u>	<u>0.59</u>

In August and December 2020, the Company issued warrants to purchase up to 175,000 and 125,000 shares of its common stock at exercise prices of \$0.20 and \$0.50 per share, respectively, to a consulting firm as partial consideration for their services rendered. During 2020, the Company issued 255,813 shares of its common stock upon the cashless exercise of 300,000 of its warrants. Subsequent to January 2, 2021, the Company issued (i) 6,078,754 shares of its common stock upon the exercise of 6,078,754 of its warrants for total cash proceeds of \$3.6 million and (ii) 429,496 shares of its common stock upon the cashless exercise of 500,000 of its warrants.

Note 10—Stock-Based Awards

The Company's Amended and Restated 2006 Equity Incentive Plan (the "Amended 2006 Plan") provides for broad-based equity grants to its employees and non-employee service providers. The Company also 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 January 2, 2021, the Company was authorized to issue a maximum of 16,205,566 shares of its common stock pursuant to awards granted under the Amended 2006 Plan. Pursuant to the terms of the Amended 2006 Plan, 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 January 2, 2021, the Company had 1,852,822 shares of common stock available for issuance pursuant to future awards to be granted under the Amended 2006 Plan.

Stock Options

Stock options granted under the Amended 2006 Plan generally vest at a rate of at least 25% per year over four years and expire 10 years from the date of grant. The weighted-average assumptions used in the Black-Scholes option pricing model and the resulting weighted-average grant date fair value of stock options granted were as follows:

	Year Ended	
	January 2, 2021	December 28, 2019
Expected term (in years)	6.26	6.06
Expected volatility	117%	108%
Risk-free interest rate	0.46%	1.92%
Expected dividends	\$ —	\$ —
Weighted-average grant date fair value per share	\$ 0.44	\$ 0.29

The following table summarizes the activity related to stock options during 2020:

	Number of Shares (in thousands)	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding as of December 28, 2019	7,357	\$ 1.17	5.54	\$ 127
Granted	1,620	\$ 0.51		
Exercised	(226)	\$ 0.14		
Expired or forfeited	(1,232)	\$ 0.80		
Outstanding as of January 2, 2021	<u>7,519</u>	\$ 1.12	5.21	\$ 430
Exercisable as of January 2, 2021	<u>5,693</u>	\$ 1.33	3.88	\$ 156
Vested and expected to vest as of January 2, 2021	<u>7,128</u>	\$ 1.16	4.97	\$ 378

There was no significant intrinsic value of options exercised during 2020 and 2019.

Restricted Stock Awards and Restricted Stock Units

RSAs granted under the Amended 2006 Plan vest annually on each anniversary of the grant date over a two-year term. RSUs granted for employees and consultants generally vest semi-annually from the grant date over a four-year term, and RSUs granted for independent directors fully-vested on the grant date. The following table summarizes the activity related to RSAs and RSUs during 2020:

	Number of Shares (in thousands)	Weighted- Average Grant-Date Fair Value per Share
Balance nonvested as of December 28, 2019	3,066	\$ 0.52
Granted	1,125	\$ 0.49
Vested	(1,064)	\$ 0.47
Forfeited	(90)	\$ 0.42
Balance nonvested as of January 2, 2021	<u>3,037</u>	\$ 0.53

Stock-Based Compensation

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

	Year Ended	
	January 2, 2021	December 28, 2019
Cost of sales	\$ 10	\$ 26
Research and development	196	213
Selling, general and administrative	557	750
Total	<u>\$ 763</u>	<u>\$ 989</u>

As of January 2, 2021, the Company had approximately \$1.9 million, net of estimated forfeitures, of unearned stock-based compensation, which it expects to recognize over a weighted-average period of approximately 2.6 years.

Note 11—Defined Contribution Plan

The Company has a defined contribution plan under Section 401(k) of the Code (“401(k)”) covering full-time domestic employees who meet certain eligibility requirements. Under the 401(k) plan, eligible employees may contribute up to 100% of their eligible compensation on either a pre-tax or after-tax Roth 401(k) basis, or up to the annual maximum allowed by the IRS. The Company may make matching contributions on the contributions of a participant on a discretionary basis. During 2020 and 2019, the Company did not make any matching contributions.

Note 12—Major Customers, Suppliers and Products

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

	Year Ended	
	January 2, 2021	December 28, 2019
Customer A	17%	*

* Less than 10% of total net sales

As of January 2, 2021, one customer represented approximately 50% of aggregate gross accounts receivable. As of December 28, 2019, one customer represented approximately 25% of aggregate gross accounts receivable. The loss of any of the Company’s significant customers or a reduction in sales to or difficulties collecting payments from any of these customers could significantly reduce the Company’s net sales and adversely affect its operating results. The Company mitigates risks associated with foreign receivables by purchasing comprehensive foreign credit insurance.

The Company resells certain component products to end-customers that are not reached in the distribution models of the component manufacturers, including storage customers, appliance customers, system builders and cloud and datacenter customers. For 2020 and 2019, resales of these products represented approximately 66% and 77%, respectively, of the Company’s net sales.

The Company’s purchases are typically concentrated in a small number of suppliers. The following table shows the percentage of purchases made from suppliers that each comprise 10% or more of total purchases:

	Year Ended	
	January 2, 2021	December 28, 2019
Supplier A	28%	37%
Supplier B	14%	*
Supplier C	11%	17%

* Less than 10% of purchases during the period

While the Company believes alternative suppliers may be available, its dependence on a small number of suppliers and the lack of any guaranteed sources for the essential components of its products and the components it resells exposes the Company to several risks, including the inability to obtain an adequate supply of these components, increases in their costs, delivery delays and poor quality. If the Company is not able to obtain these components in the amounts needed on a timely basis and at commercially reasonable prices, it may not be able to develop or introduce new products, it may experience significant increases in its cost of sales if it is forced to procure components from alternative suppliers and is not able to negotiate favorable terms with these suppliers, it may experience interruptions or failures in the delivery of its products, or it may be forced to cease sales of products dependent on the components or resales of the components it resells to customers directly. Any of these events could have a material adverse effect on the Company’s business, operating results and financial condition.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Sole Member of the Board of Directors
Netlist, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Netlist, Inc. and subsidiaries (the “Company”) as of January 2, 2021 and December 28, 2019, the related consolidated statements of operations, stockholders’ deficit, and cash flows for each of the years then ended, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of January 2, 2021 and December 28, 2019, and the results of its operations and its cash flows for each of the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the sole member of the board of directors and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of the critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Inventory Valuation

Critical Audit Matter Description

As described in Note 2 to the consolidated financial statements, inventories are valued at the lower of cost or the net realizable value. Management evaluates inventory balances for excess quantities and obsolescence on a regular basis by analyzing estimated demand, inventory on hand, sales levels and other information.

Auditing management's assessment of net realizable value for inventory was challenging because the determination of lower of cost or net realizable value and excess and obsolete inventory reserves is judgmental and considers a number of factors that are affected by market and economic conditions, such as forecasted product demand, dynamic pricing environments, product life cycles and industry supply and demand. Additionally, for certain newer products there is limited historical data with which to evaluate forecasts.

How the Critical Audit Matter Was Addressed in the Audit

We tested management's process for developing the estimates of the net realizable value of inventories and excess and obsolete inventory reserves, including evaluating management's assumptions of forecasted product demand and testing the completeness and accuracy of the underlying data used in the analyses. Evaluating management's product demand forecast for reasonableness involved considering historical sales by product, comparing prior period estimates to actual results of the same period, and considering macroeconomic trends within the industry that could impact the movement of the products provided by the Company. We performed procedures to compare recent sales transactions or market data to cost of inventories to assess that the carrying value of inventories was the lower of cost or net realizable value.

/s/ KMJ Corbin & Company LLP

We have served as the Company's auditor since 2005.

Irvine, California
March 26, 2021

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Our management conducted an evaluation, with the participation of our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Exchange Act) as of the end of the period covered by this report. Based on this evaluation, due to the elimination of our audit committee in August 2020, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were not effective as of January 2, 2021.

Notwithstanding the material weakness in our internal control over financial reporting, we have concluded that the consolidated financial statements included in this Form 10-K fairly present, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP").

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for our Company, as such term is defined in Rule 13a-15(f) under the Exchange Act. Our management conducted an evaluation, with the participation of our principal executive officer and principal financial officer, of the effectiveness of our internal control over financial reporting as of January 2, 2021, based on the criteria set forth in the *2013 Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management concluded that, due to the material weakness described below, our internal control over financial reporting was not effective as of January 2, 2021.

In designing our disclosure controls and procedures and internal control over financial reporting, our management recognizes that any control system, no matter how well-designed and operated, can provide only reasonable, not absolute, assurance of achieving the desired control objectives. Further, the design of our controls and procedures must reflect the fact that there are resource constraints, and management necessarily applies its judgment in evaluating the benefits of possible controls and procedures relative to their costs. Because of the inherent limitations, our disclosure and internal controls may not prevent or detect all instances of fraud, misstatements or other control issues, and our evaluations of disclosure and internal controls cannot provide assurance that all such control issues have been detected. In addition, projections of any evaluation of the effectiveness of disclosure or internal controls to future periods are subject to risks, including, among others, that controls may become inadequate because of changes in conditions or that compliance with policies or procedures may deteriorate.

Our management determined that we had a material weakness in internal control over financial reporting due to the ineffective oversight within the financial reporting process as a result of the elimination of an audit committee with a financial expert and lack of a majority of independent directors on our Board in August 2020.

This report does not include an attestation report of our independent registered public accounting firm regarding our internal control over financial reporting, in accordance with applicable SEC rules that permit us to provide only management's report in this report.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Remediation Initiatives

In an effort to remediate the identified material weakness and enhance our internal controls, we continue to maintain our financial reporting process we followed to prepare financial statements in accordance with U.S. GAAP for audit committee meetings on a quarterly and annual basis. Our Chief Executive Officer and sole director will oversee the process to ensure all required disclosures are made in our financial statements on a quarterly and annual basis.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

In order to proactively address the economic effects of the recent coronavirus, our Board of Directors (referred to as our “Board” or “Board of Directors”) evaluated various cost-cutting measures, including review of the Board and committee structure, operations and compensation of the members thereof. As a result of its evaluation and because we are no longer subject to Nasdaq rules, the Board determined it to be in the best interests of its stockholders to reduce the number of directors serving on the Board to one director and to dissolve all committees of the Board effective immediately after our 2020 Annual Meeting of Stockholders on August 7, 2020.

Each member of the Board is elected annually at a meeting of our stockholders and serves for a one-year term until the next annual meeting of our stockholders and until his or her successor is elected and qualified, or until an earlier resignation or removal. Each of our executive officers is appointed by, and serves at the direction of, our Board, subject to the terms of our employment agreement with our President and Chief Executive Officer, which is described under “Employment Agreements” in Item 11 of this Form 10-K, and which establishes, among other things, such executive officer’s term of office.

The table and narrative below provide, for our current director and executive officers, each such individual’s name; age as of March 22, 2021; current position(s) with our Company; tenure in such position(s); information about such individual’s business experience and qualifications, including principal occupation or employment and principal business of the employer, if any, for at least the past five years, and involvement in certain legal or administrative proceedings, if any; and, for our director, other public company director positions held currently or at any time in the last five years and the experiences, qualifications, attributes and skills that led to the conclusion that such individual should serve as a director of our Company. There is no arrangement or understanding between any director or executive officer and any other person(s) pursuant to which such director or executive officer was or is to be selected as a director or executive officer of our Company, and there are no family relationships between any of our directors or executive officers.

Name	Age	Position(s)
Chun K. Hong	60	President, Chief Executive Officer and Sole Director
Gail Sasaki	64	Vice President, Chief Financial Officer and Secretary

Chun K. Hong is one of the founders of Netlist and has been our President and Chief Executive Officer and a director since our inception in June 2000. Mr. Hong assumed the title of Chairman of the Board of Directors in January 2004. Prior to his tenure at Netlist, Mr. Hong has served in various other executive positions including President and Chief Operating Officer of Infinilink Corporation, a DSL equipment company, as Executive Vice President of Viking Components, Inc., a memory subsystems manufacturing company, and as General Manager of Sales at LG Semicon Co., Ltd., a public semiconductor manufacturing company in South Korea. Mr. Hong received his Bachelor of Science degree in economics from Virginia Commonwealth University and his Master of Science degree in technology management from Pepperdine University’s Graduate School of Management. As one of our founders and as our Chief Executive Officer, Mr. Hong brings to the Board extensive knowledge of our organization and our market.

Gail Sasaki has been our Vice President and Chief Financial Officer since January 2008 and our Secretary since August 2007. From 2006 to January 2008, Ms. Sasaki served as our Vice President of Finance. Prior to her tenure at Netlist, Ms. Sasaki served in various senior financial roles, including Chief Financial Officer of eMaiMai, Inc., a commercial technology company based in Hong Kong and mainland China; Chief Financial Officer, Senior Vice President of Finance, Secretary and Treasurer of eMotion, Inc. (a Kodak subsidiary and formerly Cinebase Software), a developer of business-to-business media management software and services, and Chief Financial Officer of MicroNet Technology, Inc., a leader in storage technology. Ms. Sasaki also spent seven years in public accounting leaving as an audit manager with Arthur Young (now known as Ernst & Young LLP). Ms. Sasaki earned a Bachelor’s degree from the University of California at Los Angeles, and a Master of Business Administration degree from the University of Southern California.

Board Committees

Prior to the dissolution of all committees of the Board on August 7, 2020, our Board had an Audit Committee, Compensation Committee, and Nominating and Corporate Governance Committee, each of which is described below and operated pursuant to a written charter adopted by our Board. The table below shows the membership of these committees during 2020 through August 6, 2020. Our 2019 fiscal year ended December 28, 2019.

<u>Name</u>	<u>Audit(1)</u>	<u>Compensation(2)</u>	<u>Nominating and Corporate Governance(3)</u>
Jun S. Cho	•		•
Kiho Choi (4).	Chair	•	
Blake A. Welcher	•	Chair	Chair

- (1) Messrs. Choi (Chair), Cho and Welcher served on this committee during 2020 until August 2020.
- (2) Messrs. Welcher (Chair) and Choi served on this committee during 2020 until August 2020.
- (3) Messrs. Welcher (Chair) and Cho served on this committee during 2020 until August 2020.
- (4) Our Board determined that Mr. Choi qualified as an “audit committee financial expert” in accordance with applicable SEC rules.

Audit Committee

The primary functions of our Audit Committee were, among other things, to:

- oversee our financial reporting process, including discussing with our independent registered public accounting firm the scope and plans for all annual audits and discussing with management and our independent registered public accounting firm the adequacy and effectiveness of our accounting and financial controls, systems to monitor and manage business risk, and legal and ethical compliance programs;
- review with management and our independent registered public accounting firm all of our audited and interim financial statements;
- review and approve in advance any transactions by us with related parties;
- appoint, terminate, replace, ensure the independence of and oversee our independent registered public accounting firm;
- pre-approve all audit services and, subject to a “de minimus” exception, all permissible non-audit services to be performed by the independent registered public accounting firm;
- be responsible for setting the corporate tone for quality financial reporting and sound business risk practices and ethical behavior; and
- establish procedures for the confidential and anonymous submission, receipt, retention and treatment of concerns or complaints regarding accounting, internal accounting controls and auditing matters.

Compensation Committee

The primary functions of our Compensation Committee were, among other things, to:

- review and approve, or make recommendations to the Board regarding, our programs and arrangements for our Section 16 executive officers, including salary, incentive compensation, equity compensation and perquisite programs;
- review the evaluation process and compensation structure for our non-Section 16 executive officers;
- assist the Board in developing and evaluating potential candidates for executive positions and oversee the development of executive succession plans; and
- review and act as administrator of our incentive compensation and other stock-based plans.

Nominating and Corporate Governance Committee

The primary functions of our Nominating and Corporate Governance Committee were, among other things, to:

- lead the search for individuals qualified to become members of the Board and select director nominees to be presented at our annual meetings of stockholders;
- review the standards to be applied by the Board in making determinations as to whether a director satisfies applicable independence requirements;
- review the Board's structure and the Board's committee structure and make recommendations as appropriate, including recommending to the Board the directors to serve as members of each Board committee;
- conduct an annual performance evaluation of the Board and its committees;
- advise the Board on candidates for the positions of Chairman of the Board, Lead Independent Director, Chief Executive Officer and other executive officer positions;
- develop, recommend to the Board and review a set of corporate governance guidelines and a code of business conduct and ethics; and
- review changes in legislation, regulations and other developments impacting corporate governance and make recommendations to the Board with respect to these matters and corporate governance matters generally.

Code of Business Conduct and Ethics

Our Board has adopted a Code of Business Conduct and Ethics that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, as well as all of our other executive officers and employees and all of our directors. Shareholders may download a free copy of our Code of Business Conduct and Ethics from our website (www.netlist.com). We intend to disclose on our website any amendments to or waivers from this code by posting the relevant material on our website (www.netlist.com) in accordance with SEC rules.

Item 11. Executive Compensation

2020 Compensation Adjustments

On March 6, 2020, our Compensation Committee approved compensation for our two named executive officers beginning calendar year 2020. The Compensation Committee approved a base salary of \$450,000 per annum for Chun K. Hong, our Chief Executive Officer, and \$275,000 per annum for Gail Sasaki, our Chief Financial Officer. In making this determination, the Compensation Committee considered that both officers had held their positions since our initial public offering in 2006 and that Mr. Hong had not received an increase in his base salary for 13 years and Ms. Sasaki had not received any increase in her base salary for 10 years. In its deliberations regarding the adjustments to base salary, the Compensation Committee considered the cost of living increases in the United States, California and Orange County, California during the period since the initial public offering as calculated according to various government and private publications. The final determination of base salary levels was made after considering the range of calculations as well as a number of other factors that the Compensation Committee determined to be relevant in the exercise of its business judgment. The Compensation Committee also established bonus targets for the officers of 100% of base salary dependent upon achieving agreed financial objectives. Finally, the Compensation Committee approved awards of 300,000 restricted stock units for Mr. Hong and 75,000 restricted stock units for Ms. Sasaki, subject to four-year vesting.

Executive Compensation

The table below provides information about the compensation awarded to, earned by or paid to each of the following individuals, which we refer to collectively as our "named executive officers," for 2020 and 2019: each person serving at any time during 2020 as our principal executive officer (our President and Chief Executive Officer, Mr. Hong); and our only other executive officer serving as such at any time during 2020 (our Vice President, Chief Financial Officer and Secretary, Ms. Sasaki).

Summary Compensation Table

Name and Principal Position	Year	Base Salary(\$)	Bonus(\$)	Stock Awards\$(1)	All Other Compensation\$(2)	Total(\$)
Chun K. Hong	2020	467,308	180,000	94,290	62,092	803,690
President and Chief Executive Officer.....	2019	323,000	—	408,004	51,486	782,490
Gail Sasaki.....	2020	285,577	103,125	23,573	22,254	434,529
Vice President, Chief Financial Officer and Secretary	2019	200,000	—	223,992	—	423,992

- (1) Represents the grant date fair value of the restricted stock units (“RSUs”) granted during the year calculated in accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 718, Compensation—Stock Compensation (“ASC 718”). The grant date fair value was determined using the fair value of the underlying shares of our common stock.
- (2) For 2020, the amount consists of (a) for Mr. Hong, \$10,936 for automobile rental payments, \$7,509 for other vehicle-related costs, \$24,600 for a country club membership, \$14,769 for a health club membership, and \$4,278 for income tax and estate planning costs incurred on Mr. Hong’s behalf, and (b) for Ms. Sasaki, the amount is for a health club membership. For 2019, the amount consists of \$10,936 for automobile rental payments, \$8,694 for other vehicle-related costs, \$22,052 for a country club membership, \$4,532 for a health club membership, and \$5,272 for income tax and estate planning costs incurred on Mr. Hong’s behalf.

Employment Agreements

We entered into an employment agreement with our President and Chief Executive Officer, Mr. Hong, in September 2006. This agreement provides for an initial base salary of \$323,000 plus other specified benefits, including the reimbursement of professional fees and expenses incurred in connection with income and estate tax planning and preparation, income tax audits and the defense of income tax claims; the reimbursement of membership fees and expenses for professional organizations and one country club; the reimbursement of employment-related legal fees; automobile rental payments and other vehicle-related expenses; and the reimbursement of health club membership fees and other similar health-related expenses. Mr. Hong may earn annual cash performance bonuses, at the discretion of our Compensation Committee or our Board, of up to 100% of his base salary based upon the achievement of individual and Company performance objectives.

Mr. Hong’s employment agreement automatically renews for additional one-year periods unless we provide or Mr. Hong provides notice of termination six months prior to the renewal date, but at all times Mr. Hong may terminate his employment upon six months’ advance written notice to us and we may terminate Mr. Hong’s employment upon 30 days’ advance written notice to Mr. Hong. If we terminate Mr. Hong’s employment without cause or if he resigns from his employment for good reason, which includes a termination or resignation upon a change of control of our Company, Mr. Hong would be entitled to receive continued payments of his base salary for one year, reimbursement of medical insurance premiums during that period unless he becomes employed elsewhere, a pro-rated portion of his annual performance bonus, and, if any severance payment is deemed to be an “excess parachute payment” within the meaning of Section 280G of the Code, an amount equal to any excise tax imposed under Section 4999 of the Code. In addition, upon any such termination or resignation, any unvested stock options held by Mr. Hong would immediately become fully vested and exercisable as of the effective date of the termination or resignation. If Mr. Hong’s employment is terminated due to death or disability, he or his estate would receive a lump-sum payment equal to half of his annual base salary and any stock options held by Mr. Hong would vest to the same extent as they would have vested one year thereafter. Additionally, if Mr. Hong’s employment is terminated due to death or disability, 25% of the shares subject to outstanding stock options, or such lesser amount as is then unvested, would immediately vest and become exercisable. If Mr. Hong resigns without good reason or is terminated for cause, we would have no further obligation to him other than to pay his base salary or other amounts earned by him through the date of resignation or termination.

For purposes of Mr. Hong's employment agreement:

- "cause" means a reasonable determination by the Board, acting in good faith based upon actual knowledge at the time, that Mr. Hong has (i) materially breached the terms of his employment agreement, or any other material agreement between us and Mr. Hong, including an arbitration agreement and a proprietary information and invention assignment agreement, (ii) committed gross negligence or engaged in serious misconduct in the execution of his assigned duties, (iii) been convicted of a felony or other serious crime involving moral turpitude, (iv) materially refused to perform any lawful duty or responsibility consistent with Mr. Hong's position with our Company, or (v) materially breached his fiduciary duty or his duty of loyalty to our Company;
- "good reason" means (i) the assignment to Mr. Hong, without his consent, of duties inconsistent with his position so as to constitute a diminution of status with our Company, including an assignment of Mr. Hong to a position other than President and Chief Executive Officer of our Company, (ii) our reduction of Mr. Hong's base salary as in effect at any time without Mr. Hong's consent, other than a decrease of up to (and including) 10% in connection with an adverse change in the business operations or financial condition of our Company, (iii) the occurrence of a change of control, or (iv) a requirement that Mr. Hong relocate (or report on a regular basis) to an office outside of Orange County without his consent; and
- a "change of control" means the occurrence of any of the following: (i) any person or entity is or becomes the beneficial owner (within the meaning of Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of our Company representing a percentage of the combined voting power of our then-outstanding securities that is greater than 50%, (ii) the following individuals cease for any reason to constitute a majority of the number of directors then serving: individuals who, on the date of Mr. Hong's employment agreement, constituted our Board and any new director (other than a director whose initial assumption of office is in connection with an actual or threatened election contest, including but not limited to a consent solicitation, relating to the election of directors of our Company) whose appointment or election by the Board or nomination for election by our stockholders is approved or recommended by a vote of at least two-thirds of the directors then still in office who either were directors on the date of Mr. Hong's employment agreement or whose appointment, election or nomination for election was previously so approved or recommended; (iii) there is consummated a merger or consolidation of our Company in which our Company does not survive or our Company survives but the shares of our common stock outstanding immediately prior to such merger or consolidation represent 50% or less of the voting power of our Company after such merger or consolidation; or (iv) our stockholders approve a plan of our complete liquidation or dissolution or there is consummated an agreement for our sale or disposition of all or substantially all of our assets, other than a sale or disposition of all or substantially all of our assets to an entity, at least 50% of the combined voting power of the voting securities of which are owned by our stockholders in substantially the same proportions as their ownership of our Company immediately prior to such sale.

We have not entered into an employment agreement with Ms. Sasaki, our Vice President, Chief Financial Officer and Secretary. For 2019, Ms. Sasaki received an annualized base salary of \$200,000. If Ms. Sasaki's employment is terminated due to death or disability, any stock options held by Ms. Sasaki would vest to the same extent as they would have vested one year thereafter. Additionally, if Ms. Sasaki's employment is terminated due to death or disability, 25% of the shares subject to outstanding stock options, or such lesser amount as is then unvested, would immediately vest and no additional shares would vest thereafter. Ms. Sasaki is eligible for a target cash bonus of 75% of her base salary, which is to be determined by our Board in its discretion based on various factors.

Cash Bonuses

For 2020, Mr. Hong and Ms. Sasaki received cash bonuses of \$180,000 and \$103,125, respectively, based on factors related to the Company's performance during such period. No cash bonuses were paid to either Mr. Hong or Ms. Sasaki for 2019.

Retirement Benefits

We maintain a savings plan that qualifies as a defined contribution plan under Section 401(k) of the Code, to which all of our employees, including our named executive officers, are able to contribute up to the limit prescribed by applicable tax rules on a before-tax basis. All of these employee contributions are fully-vested upon contribution. In addition, we may make matching contributions on the contributions of our employees on a discretionary basis. In 2020 and 2019, we did not make matching contributions.

Outstanding Equity Awards at Fiscal Year End

The following table shows information about the equity awards held by our named executive officers as of January 2, 2021:

Name	Grant Date	Option Awards				Stock Awards	
		Number of Securities Underlying Unexercised Options Exercisable(1)	Number of Securities Underlying Unexercised Options Unexercisable(1)	Option Exercise Price(\$)	Option Expiration Date	Number of Shares That Have Not Vested(2)	Market Value of Shares That Have Not Vested(\$)(2)
Chun K. Hong	3/17/2011	300,000	—	2.21	3/17/2021	—	—
	2/27/2012	300,000	—	3.59	2/27/2022	—	—
	2/11/2013	300,000	—	0.71	2/11/2023	—	—
	2/21/2014	300,000	—	2.05	2/21/2024	—	—
	1/6/2015	300,000	—	0.84	1/6/2025	—	—
	1/8/2016	300,000	—	0.70	1/18/2026	—	—
	2/14/2017	281,250	18,750	1.02	2/14/2027	—	—
	3/7/2019	—	—	—	—	464,062	279,783
	3/6/2020	—	—	—	—	262,500	158,261
Gail Sasaki	3/17/2011	75,000	—	2.21	3/17/2021	—	—
	2/27/2012	75,000	—	3.59	2/27/2022	—	—
	2/11/2013	75,000	—	0.71	2/11/2023	—	—
	2/21/2014	75,000	—	2.05	2/21/2024	—	—
	1/6/2015	75,000	—	0.84	1/6/2025	—	—
	1/18/2016	75,000	—	0.70	1/18/2026	—	—
	2/14/2017	70,312	4,688	1.02	2/14/2027	—	—
	3/18/2019	—	—	—	—	257,344	155,153
	3/6/2020	—	—	—	—	65,625	39,565

- (1) Represents stock option awards granted under the Netlist, Inc. Amended and Restated 2006 Equity Incentive Plan (the “Equity Plan”). These stock option awards that are not fully exercisable vest in 16 equal quarterly installments, subject to continued service on each vesting date, subject to accelerated vesting in certain circumstances as described under “Employment Agreements” above.
- (2) Represents RSUs granted under the Equity Plan. Restrictions on RSUs lapse in eight equal semi-annual installments from the grant date.

Director Compensation

Non-Employee Director Compensation

Our non-employee directors received annual cash compensation of \$30,000, which was paid in four equal quarterly installments, and additional cash payments of \$1,000 for each regularly scheduled Board meeting and each Board committee meeting not held on the same day as a Board meeting that was attended by the director. The Lead Independent Director and the Chair of our Audit Committee each received additional cash compensation of \$5,000 per

year. All of our directors, including our non-employee directors, were also reimbursed for their reasonable out-of-pocket expenses incurred in attending Board and Board committee meetings.

In addition, each of our non-employee directors was granted a stock option award to purchase up to 25,000 shares of our common stock upon his or her initial appointment or election to the Board, and a stock option award to purchase up to 20,000 shares of our common stock each year in which he or she continued to serve as a director. For awards granted to non-employee directors before 2017, all stock options vested in 16 equal quarterly installments, and for awards granted to non-employee directors in 2017 and thereafter, all stock options vested in one installment on the, earlier of, the one-year anniversary of the award or the day prior to the next annual shareholders meeting, in all cases subject to continued service on each vesting date. All stock option awards granted to non-employee directors were granted under our equity compensation plans then in effect and had an exercise price equal to the fair market value of our common stock on the grant date of the award.

Directors who were our employees received no additional compensation for their service as directors.

Director Compensation Table

The following table shows the compensation of our non-employee directors for 2020 prior to the dissolution of all committees in August 2020. Mr. Hong, our President and Chief Executive Officer, is not included in this table because he is our employee and receives no additional compensation for his service as a director. The compensation received by Mr. Hong as our employee is described in this Item 11 above.

<u>Name</u>	<u>Fees Earned or Paid in Cash(\$)</u>	<u>Stock Awards\$(1)</u>	<u>Total(\$)</u>
Jun S. Cho(2)	27,078	105,135	132,213
Kiho Choi.	27,078	—	27,078
Blake A. Welcher(3)	25,065	70,090	95,155

- (1) Represent the grant-date fair value of RSUs granted on August 10, 2020 calculated in accordance with ASC 718. The grant-date fair value was determined using the fair value of the underlying shares of our common stock. These RSUs fully-vested on the grant date.
- (2) At the end of Fiscal 2020, Mr. Cho held stock options to purchase 105,000 shares of our common stock.
- (3) At the end of Fiscal 2020, Mr. Welcher held stock options to purchase 125,000 shares of our common stock.

Equity Compensation Plans

We currently maintain one equity incentive plan, the Equity Plan. The Equity Plan initially became effective in 2006, was amended and restated in 2010, 2016 and 2019. Our Board and, when required, our stockholders have previously approved the Equity Plan, including all amendments and restatements of such plan. The terms of the Equity Plan are summarized below.

Share Reserve and Share Limits

Each January 1, the number of shares reserved for issuance under the Equity Plan will continue to be automatically increased by the lesser of (i) 2.5% of the shares then issued and outstanding, or (ii) 1,200,000 shares. As of March 22, 2021, there were 16,205,566 total shares reserved for issuance under the Equity Plan, including 10,073,535 shares subject to outstanding equity awards granted under this plan.

Any shares subject to an award or portion of an award which is forfeited, canceled or expired shall be deemed not to have been issued for purposes of determining the maximum aggregate number of shares which may be issued under the Equity Plan. Shares that have been issued under the Equity Plan pursuant to an award generally shall not be returned to the reserve under the Equity Plan and shall not become available for future issuance under the Equity Plan, except that if unvested shares are forfeited, or repurchased by us at the lower of their original purchase price or their fair market value at the time of repurchase, such shares shall become available for future grant under the Equity Plan. Shares

tendered or withheld in payment of an option exercise price shall not be returned to or become available for future issuance under the Equity Plan.

The maximum number of shares with respect to which options and stock appreciation rights may be granted to a participant during a calendar year is 1,000,000 shares (with an additional 1,000,000 shares of stock in connection with the participant's initial employment). For awards of restricted stock, restricted stock units, and performance units that are intended to be performance-based compensation under Section 162(m) of the Code, the maximum number of shares granted to a participant during a calendar year is 1,000,000 shares.

Administration

The Equity Plan is administered, with respect to grants of awards to employees, directors, officers, and consultants, by the administrator, which is defined as the Board or one or more committees designated by the Board. With respect to grants to officers and directors, the committee shall be constituted in such a manner as to satisfy applicable laws, including Rule 16b-3 under the Exchange Act and Section 162(m) of the Code. The Equity Plan is administered by the Compensation Committee of our Board, the composition of which satisfies such tax and SEC rules, subject to such committee's delegation to management to grant awards to certain eligible persons of up to 25,000 shares.

Eligibility

Persons eligible to receive awards under the Equity Plan include directors, officers and other employees of and consultants and advisors to our Company or any of our subsidiaries. As of January 2, 2021, approximately 70 officers and other employees of our Company and our subsidiaries (including all of the named executive officers) are eligible to receive awards under the Equity Plan.

Vesting

Although the Equity Plan provides the administrator with the discretion to determine the vesting schedule of any awards granted under the plan, stock option awards granted to employees under the Equity Plan typically vest over four years in either 16 equal quarterly installments or one installment of 25% of the shares subject to the award on the one-year anniversary of the grant date and 12 equal quarterly installments thereafter, subject to continued service on each vesting date. RSAs granted to employees under the Equity Plan vest annually on each anniversary of the grant date over a two-year term, and RSUs granted for employees and consultants under the Equity Plan typically vest semi-annually from the grant date over a four-year term, subject to continued service on each vesting date. RSUs granted for independent directors under the Equity Plan fully-vest on the grant date.

Adjustments Upon Corporate Transactions

The Equity Plan provides that, in the event of an "acquisition," as defined in the Equity Plan, the administrator may provide for the termination of outstanding awards under the Equity Plan, unless awards are assumed or replaced by the successor entity in the acquisition. Except as provided in an individual award agreement, for the portion of each award that is not assumed or replaced by the successor entity, such portion of the award may be vested and become exercisable in full or be released from any repurchase or forfeiture rights before the effective date of the acquisition, provided that the participant's continuous service has not terminated before such date.

Amendment, Suspension and Termination

The Equity Plan will be for a term of 10 years from its 2016 amendment and restatement, unless sooner terminated by the Board. The Board may at any time amend, suspend or terminate the Equity Plan, subject to obtaining stockholder approval for any amendment to the extent necessary to comply with applicable laws and rules.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Security Ownership of Certain Beneficial Owners and Management

The table below sets forth information regarding the ownership of our common stock, as of March 22, 2021 (the “Table Date”) unless otherwise indicated in the footnotes to the table, by (i) all persons known by us to beneficially own more than 5% of our common stock, (ii) each of our current directors, (iii) each of our named executive officers, and (iv) all of our directors and executive officers as a group. Unless otherwise indicated, each person named below possesses sole voting and investment power over all shares of common stock shown as beneficially owned by such person. Unless otherwise indicated, the address for each person named below is c/o Netlist, Inc., 175 Technology Drive, Suite 150, Irvine, CA 92618.

Name of Beneficial Owner	Shares Beneficially Owned	Percent of Class(1)
Chun K. Hong (2)	8,656,169	4.0%
Gail Sasaki (3)	712,421	*
All executive officers and directors as a group (2 persons) (4)	9,368,590	4.3%

* Represents beneficial ownership of less than 1%.

- (1) All ownership percentages are based on 215,013,027 shares of our common stock outstanding as of the Table Date.
- (2) Represents (i) 1,862,500 shares of common stock issuable upon the exercise of stock options that are or will be vested and exercisable within 60 days after the Table Date and (ii) 6,793,669 outstanding shares of common stock, of which 6,439,233 shares are held by Mr. Hong and his wife, Won K. Cha, as co-trustees of the Hong-Cha Community Property Trust. Mr. Hong and Ms. Cha possess shared voting and investment power over the shares of common stock held by the Hong-Cha Community Property Trust, and each disclaims beneficial ownership of such shares except to the extent of his or her pecuniary interest therein.
- (3) Represents (i) 450,000 shares of common stock issuable upon the exercise of stock options that are or will be vested and exercisable within 60 days after the Table Date and (ii) 262,421 outstanding shares of common stock.
- (4) Represents (i) 2,312,500 shares of common stock issuable upon the exercise of stock options that are or will be vested and exercisable within 60 days after the Table Date and (ii) 7,056,090 outstanding shares of common stock.

Securities Authorized for Issuance under Equity Compensation Plans

The following table provides information as of January 2, 2021 about compensation plans under which our equity securities are authorized for issuance:

Plan Category	Equity Compensation Plan Information		
	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights\$(1)	Number of securities remaining available for future equity compensation plans
Equity compensation plans approved by security holders.	10,155,893(2)	1.16	1,852,822(3)
Equity compensation plans not approved by security holders.	400,000(4)	0.34	—
Total	10,555,893	1.12	1,852,822

- (1) The weighted-average exercise price is calculated based solely on the exercise prices of the outstanding options and do not reflect the shares that will be issued upon the vesting of outstanding awards of RSUs, which have no exercise price.
- (2) This number includes the following outstanding awards granted under the Equity Plan: 7,119,258 shares subject to outstanding stock options and 3,036,635 shares subject to outstanding RSUs.
- (3) Subject to certain adjustments, as of January 2, 2021, we were authorized to issue a maximum of 16,205,566 shares of our common stock pursuant to awards granted under the Equity Plan.
- (4) Consists of 400,000 stock option awards outstanding as of January 2, 2021.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Related Party Transactions

Except as described below and except for employment arrangements and compensation for Board service, which are described in Item 11 above, since December 30, 2018, there has not been, nor is there currently proposed, any transaction or series of transactions in which our Company was or is to be a participant, in which the amount involved exceeds the lesser of \$120,000 or 1% of the average of our total assets at year-end for our last two completed fiscal years, and in which any director, officer or beneficial owner of more than 5% of our common stock, or member of any such person's immediate family, had or will have a direct or indirect material interest.

Our Vice President of Netlist Base and Commodity Sales (formally, our Vice President of Operations), Paik K. Hong, is the brother of Chun K. Hong, our President, Chief Executive Officer and Sole Director. For 2020, Mr. P. K. Hong earned cash salary of \$238,846 and cash bonus of \$256,200, received \$8,791 for a health club membership, and was granted 300,000 shares of restricted stock units with the grant-date fair value of \$153,000 measured in accordance with ASC 718. For 2019, Mr. P. K. Hong earned cash salary of \$225,001 and cash bonus of \$112,500 and was granted 411,750 shares of restricted stock units with the grant-date fair value of \$223,992 measured in accordance with ASC 718. The grant-date fair value was determined using the fair value of the underlying shares of our common stock.

We have entered into indemnification agreements with each of our director and executive officers. In general, these agreements require us to indemnify each such individual to the fullest extent permitted under Delaware law against certain liabilities that may arise by reason of their service for us, and to advance expenses incurred as a result of any such proceeding as to which any such individual could be indemnified.

Director Independence

Our common stock was listed on The Nasdaq Capital Market until September 27, 2018. On September 27, 2018, our common stock began trading on the OTCQX[®] Best Market. On August 11, 2020, our common stock began trading on the OTCQB[®]. OTCQX[®] Best Market and OTCQB[®] do not require that a majority of the board of directors be independent. Our Board continued to consider the independence of our directors under the listing standards of The Nasdaq Capital Market until August 6, 2020.

Our Board determined that each of our directors served at any time in 2019 through August 2020, other than our President and Chief Executive Officer, Mr. Hong, was independent. In addition, our Board determined that each director served in 2019 through August 2020 as a member of our Audit Committee, Compensation Committee or Nominating and Corporate Governance Committee were independent under the listing standards of The Nasdaq Capital Market.

Item 14. Principal Accounting Fees and Services

Fees Paid to Independent Registered Public Accounting Firm

The following table presents the aggregate fees billed to us by our independent registered public accounting firm, KMJ Corbin & Company LLP (“KMJ”), for 2020 and 2019:

	<u>2020(\$)</u>	<u>2019(\$)</u>
Audit Fees (1)	118,550	126,800
Audit-Related Fees (2)	—	—
Tax Fees (2)	—	—
All Other Fees (2)	—	—
Total Fees	<u>118,550</u>	<u>126,800</u>

- (1) Audit fees consist of fees billed to us for professional services rendered for the audit of our annual consolidated financial statements and the review of our interim condensed consolidated financial statements included in our quarterly reports. These fees also include fees billed to us for professional services that are normally provided in connection with statutory and regulatory filings or engagements, including the review of our registration statements on Form S-3 and Form S-8 and certain other related matters, such as the delivery of comfort letters and consents in connection with these registration statements.
- (2) KMJ did not bill to us any audit-related fees, tax fees or other fees in 2020 or 2019.

Pre-Approval Policies and Procedures

Prior to its dissolution, our Audit Committee’s charter required our Audit Committee to pre-approve all audit and permissible non-audit services to be performed for us by our independent registered public accounting firm, except for certain “de minimus” non-audit services that may be ratified by the Audit Committee in accordance with applicable SEC rules, in order to assure that the provision of such services is compatible with maintaining the independence of our independent registered public accounting firm. Our Audit Committee pre-approved all services performed by KMJ in 2020 and 2019.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Documents filed as part of this report

(1) All financial statements

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(2) Financial statement schedules

All financial statement schedules have been omitted, as they are not required, not applicable, or the required information is otherwise included.

(3) Exhibit listing

Exhibit No.	Description	Filed Herewith	Incorporated by Reference			
			Form	File No.	Exhibit	Filing Date
3.1	Restated Certificate of Incorporation of Netlist, Inc.		10-Q	001-33170	3.1	August 15, 2017
3.1.1	Certificate of Amendment to the Restated Certificate of Incorporation of Netlist, Inc.		10-Q	001-33170	3.1.1	August 15, 2017
3.1.2	Certificate of Amendment of the Restated Certificate of Incorporation of Netlist, Inc.		8-K	001-33170	3.1	August 17, 2018
3.1.3	Certificate of Designation of the Series A Preferred Stock of Netlist, Inc.		10-Q	001-33170	3.1.2	August 15, 2017
3.2	Amended and Restated Bylaws of Netlist, Inc.		8-K	001-33170	3.1	December 20, 2012
3.2.1	Certificate of Amendment to Amended and Restated Bylaws of Netlist, Inc.		8-K	001-33170	3.1	December 29, 2017
4.1	Description of the Registrant's Securities		10-K	001-33170	4.1	March 10, 2020
4.2	Form of Warrant issued pursuant to the Securities Purchase Agreement, dated July 17, 2013		8-K	001-33170	4.1	July 18, 2013
4.3	Senior Secured Convertible Promissory Note, dated November 18, 2015, issued by Netlist, Inc. to SVIC No. 28 New Technology Business Investment LLP		8-K	001-33170	4.1	November 19, 2015
4.4	Stock Purchase Warrant, dated November 18, 2015, issued by Netlist, Inc. to SVIC No. 28 New Technology Business Investment LLP		8-K	001-33170	4.2	November 19, 2015
4.5	Stock Purchase Warrant, dated November 18, 2015, issued by Netlist, Inc.		10-K	001-33170	4.4	March 31, 2017

Exhibit No.	Description	Filed Herewith	Incorporated by Reference			
			Form	File No.	Exhibit	Filing Date
4.6	Rights Agreement, dated as of April 17, 2017, by and between Netlist, Inc. and Computershare Trust Company, N.A., as rights agent		8-K	001-33170	4.1	April 17, 2017
4.7	Amendment No. 1 to Rights Agreement, dated as of April 16, 2018, by and between Netlist, Inc. and Computershare Trust Company, N.A., as rights agent.		8-K	001-33170	4.1	April 17, 2018
4.8	Amendment No. 2 to Rights Agreement, dated as of April 16, 2019, by and between the Company and Computershare Trust Company, N.A., as rights agent		8-K	001-33170	4.1	April 17, 2019
4.9	Amendment No. 3 to Rights Agreement, dated as of August 14, 2020, by and between Netlist, Inc. and Computershare Trust Company, as rights agent		8-K	001-33170	4.1	August 14, 2020
4.10	Form of Warrant Agreement to Purchase Common Stock issued pursuant to the Securities Purchase Agreement, dated September 12, 2018.		8-K	001-33170	4.1	September 14, 2018
10.1#	Form of Indemnity Agreement for officers and directors		S-1	333-136735	10.12	August 18, 2006
10.2#	Employment Agreement, dated September 5, 2006, between Netlist, Inc. and Chun K. Hong		S-1	333-136735	10.13	September 27, 2006
10.3#	Amended and Restated 2006 Equity Incentive Plan of Netlist, Inc.		10-K	001-33170	10.3	March 22, 2019
10.4#	Form of Restricted Stock Award Agreement issued pursuant to the Amended and Restated 2006 Equity Incentive Plan of Netlist, Inc.		10-Q	001-33170	10.2	May 17, 2010
10.5#	Form of Incentive Stock Option Award Agreement issued pursuant to the Amended and Restated 2006 Equity Incentive Plan of Netlist, Inc.		10-K	001-33170	10.6	March 31, 2017
10.6	Loan and Security Agreement, dated October 31, 2009, between Silicon Valley Bank and Netlist, Inc.		8-K	001-33170	10.1	November 2, 2009
10.7	Intercompany Subordination Agreement, dated October 31, 2009, among Silicon Valley Bank, Netlist, Inc., and Netlist Technology Texas, L.P.		8-K	001-33170	10.2	November 2, 2009
10.8	Guarantor Security Agreement, dated October 31, 2009, between Silicon Valley Bank and Netlist Technology Texas LP		8-K	001-33170	10.3	November 2, 2009
10.9	Intellectual Property Security Agreement, dated October 31, 2009, between Silicon Valley Bank and Netlist, Inc.		8-K	001-33170	10.4	November 2, 2009
10.10	Amendment to Loan Documents, dated March 24, 2010, between Silicon Valley Bank and Netlist, Inc.		10-Q	001-33170	10.1	May 7, 2010

Exhibit No.	Description	Filed Herewith	Incorporated by Reference			
			Form	File No.	Exhibit	Filing Date
10.11	Amendment to Loan Documents, dated June 30, 2010, between Silicon Valley Bank and Netlist, Inc.		10-Q	001-33170	10.2	August 12, 2010
10.12	Amendment to Loan Documents, dated September 30, 2010, between Silicon Valley Bank and Netlist, Inc.		10-Q	001-33170	10.1	November 16, 2010
10.13	Amendment to Loan Documents, dated May 11, 2011, between Silicon Valley Bank and Netlist, Inc.		10-Q	001-33170	10.1	May 12, 2011
10.14	Amendment to Loan Documents, dated August 10, 2011, between Silicon Valley Bank and Netlist, Inc.		10-Q	001-33170	10.1	August 15, 2011
10.15	Amendment to Loan Documents, dated May 14, 2012, between Silicon Valley Bank and Netlist, Inc.		10-Q	001-33170	10.1	May 15, 2012
10.16	Forbearance to Loan and Security Agreement, dated March 27, 2013, between Netlist, Inc. and Silicon Valley Bank		10-K	001-33170	10.32	March 29, 2013
10.17	Amendment to Loan Documents, dated July 17, 2013, between Netlist, Inc. and Silicon Valley Bank		10-Q	001-33170	10.6	November 12, 2013
10.18	Amendment to Loan Documents, dated September 30, 2014, between Netlist, Inc. and Silicon Valley Bank		10-K	001-33170	10.24	March 27, 2015
10.19	Senior Secured Convertible Promissory Note and Warrant Purchase Agreement, dated November 18, 2015, between Netlist, Inc. and SVIC No. 28 New Technology Business Investment LLP		8-K	001-33170	10.1	November 19, 2015
10.20	Registration Rights Agreement, dated November 18, 2015, between Netlist, Inc. and SVIC No. 28 New Technology Business Investment LLP		8-K	001-33170	10.2	November 19, 2015
10.21	Amendment to Loan Documents, dated January 29, 2016, between Netlist, Inc. and Silicon Valley Bank		8-K	001-33170	10.1	February 1, 2016
10.22	Amendment to Loan and Security Agreement, dated March 27, 2017, between Netlist, Inc. and Silicon Valley Bank		8-K	001-33170	10.1	March 29, 2017
10.23	Amendment to Loan and Security Agreement, dated April 12, 2017, by and between Netlist, Inc. and Silicon Valley Bank		10-Q	001-33170	10.1	August 15, 2017
10.24	Amendment to Loan and Security Agreement, dated March 20, 2018, by and between Netlist, Inc. and Silicon Valley Bank		8-K	001-33170	10.1	March 26, 2018

Exhibit No.	Description	Filed Herewith	Incorporated by Reference			
			Form	File No.	Exhibit	Filing Date
10.25	Amendment to Loan and Security Agreement, dated March 21, 2019, by and between Netlist, Inc. and Silicon Valley Bank		10-K	001-33170	10.25	March 22, 2019
10.26	Amendment to Loan and Security Agreement, dated February 27, 2020, by and between Netlist, Inc. and Silicon Valley Bank		10-K	001-33170	10.26	March 10, 2020
10.27§	Investment Agreement, dated May 3, 2017, by and between Netlist, Inc. and TR Global Funding V, LLC		10-Q	001-33170	10.2	August 15, 2017
10.28	Security Agreement, dated May 3, 2017, by and between Netlist, Inc. and TR Global Funding V, LLC		10-Q	001-33170	10.3	August 15, 2017
10.29	Intercreditor Agreement, dated May 3, 2017, by and between SVIC No. 28 New Technology Business Investment L.L.P. and TR Global Funding V, LLC and consented and agreed to by Netlist, Inc.		10-Q	001-33170	10.4	August 15, 2017
10.30	Intercreditor Agreement, dated May 3, 2017, by and between Silicon Valley Bank and TR Global Funding V, LLC and consented and agreed to by Netlist, Inc.		10-Q	001-33170	10.5	August 15, 2017
10.31	Amended and Restated Intercreditor Agreement, dated April 20, 2017, by and between SVIC No. 28 New Technology Business Investment L.L.P and Silicon Valley Bank and consented and agreed to by Netlist, Inc.		10-Q	001-33170	10.6	August 15, 2017
10.32	Purchase Agreement, dated June 24, 2019, between Netlist, Inc. and Lincoln Park Capital Fund, LLC		8-K	001-33170	1.1	June 24, 2019
10.33	Purchase Agreement, dated March 5, 2020, between Netlist, Inc. and Lincoln Park Capital Fund, LLC		10-K	001-33170	10.37	March 10, 2020
21.1	Subsidiaries of Netlist, Inc.	X				
23	Consent of KMJ Corbin & Company LLP	X				
31.1	Rule 13a-14(a) / 15d-14(a) Certification of Chief Executive Officer	X				
31.2	Rule 13a-14(a) / 15d-14(a) Certification of Chief Financial Officer	X				
32+	Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer	X				
101.INS	XBRL Instance Document	X				
101.SCH	XBRL Taxonomy Extension Schema Document	X				
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	X				
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	X				

<u>Exhibit No.</u>	<u>Description</u>	<u>Filed Herewith</u>	<u>Incorporated by Reference</u>			
			<u>Form</u>	<u>File No.</u>	<u>Exhibit</u>	<u>Filing Date</u>
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	X				
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	X				

+ Furnished herewith.

Management contract or compensatory plan or arrangement.

§ Confidential treatment has been granted with respect to portions of this exhibit.

Item 16. Form 10-K Summary.

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 26, 2021

Netlist, Inc.

By: /s/ Chun K. Hong
Chun K. Hong
President, Chief Executive Officer and Sole Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Chun K. Hong</u> Chun K. Hong	President, Chief Executive Officer and Sole Director (Principal Executive Officer)	March 26, 2021
<u>/s/ Gail Sasaki</u> Gail Sasaki	Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 26, 2021