

GSI TECHNOLOGY INC
Form 10-Q
November 02, 2018
[Table of Contents](#)

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018

or

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

For the transition period from to

Commission File Number 001-33387

Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

GSI Technology, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

77-0398779

(IRS Employer Identification No.)

1213 Elko Drive

Sunnyvale, California 94089

(Address of principal executive offices, zip code)

(408) 331-8800

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

Emerging growth company

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

Exchange Act.

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

The number of shares of the registrant's common stock outstanding as of October 31, 2018: 21,947,624

Table of Contents

GSI TECHNOLOGY, INC.

FORM 10-Q FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2018

	Page
 <u>PART I — FINANCIAL INFORMATION</u>	
<u>Item 1.</u> <u>Financial Statements</u>	2
<u>Condensed Consolidated Balance Sheets</u>	2
<u>Condensed Consolidated Statements of Operations</u>	3
<u>Condensed Consolidated Statements of Comprehensive Loss</u>	4
<u>Condensed Consolidated Statements of Cash Flows</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
<u>Item 2.</u> <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	19
<u>Item 3.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>	25
<u>Item 4.</u> <u>Controls and Procedures</u>	25
 <u>PART II — OTHER INFORMATION</u>	
<u>Item 1A.</u> <u>Risk Factors</u>	25
<u>Item 2.</u> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	41
<u>Item 6.</u> <u>Exhibits</u>	42
<u>Signatures</u>	43

Table of Contents

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2018	March 31, 2018
	(In thousands, except share and per share amounts)	
ASSETS		
Cash and cash equivalents	\$ 37,890	\$ 40,241
Short-term investments	18,662	18,124
Accounts receivable, net	7,839	5,279
Inventories	5,212	5,547
Prepaid expenses and other current assets	2,454	2,080
Total current assets	72,057	71,271
Property and equipment, net	9,312	8,172
Long-term investments	8,960	7,923
Goodwill	7,978	7,978
Intangible assets, net	2,839	2,989
Other assets	1,200	1,207
Total assets	\$ 102,346	\$ 99,540
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable	\$ 2,545	\$ 1,841
Accrued expenses and other liabilities	6,237	5,563
Total current liabilities	8,782	7,404
Income taxes payable	619	619

Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

Other accrued expenses	4,824	4,702
Total liabilities	14,225	12,725
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock: \$0.001 par value authorized: 5,000,000 shares; issued and outstanding: none	—	—
Common Stock: \$0.001 par value authorized: 150,000,000 shares; issued and outstanding: 21,947,624 and 21,407,247 shares, respectively	22	21
Additional paid-in capital	30,677	27,391
Accumulated other comprehensive loss	(126)	(142)
Retained earnings	57,548	59,545
Total stockholders' equity	88,121	86,815
Total liabilities and stockholders' equity	\$ 102,346	\$ 99,540

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

Table of Contents

GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands, except per share amounts)			
Net revenues	\$ 12,832	\$ 9,647	\$ 24,098	\$ 20,334
Cost of revenues	4,801	4,789	10,279	9,872
Gross profit	8,031	4,858	13,819	10,462
Operating expenses:				
Research and development	5,752	4,160	10,602	8,495
Selling, general and administrative	2,673	2,492	5,270	5,290
Total operating expenses	8,425	6,652	15,872	13,785
Loss from operations	(394)	(1,794)	(2,053)	(3,323)
Interest income, net	154	99	292	196
Other income (expense), net	(9)	4	(124)	5
Loss before income taxes	(249)	(1,691)	(1,885)	(3,122)
Provision for income taxes	102	49	112	130
Net loss	\$ (351)	\$ (1,740)	\$ (1,997)	\$ (3,252)
Net loss per share:				
Basic	\$ (0.02)	\$ (0.08)	\$ (0.09)	\$ (0.16)
Diluted	\$ (0.02)	\$ (0.08)	\$ (0.09)	\$ (0.16)
Weighted average shares used in per share calculations:				
Basic	21,844	21,037	21,707	20,922
Diluted	21,844	21,037	21,707	20,922

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

Table of Contents

GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
Net loss	\$ (351)	\$ (1,740)	\$ (1,997)	\$ (3,252)
Net unrealized gain on available-for-sale investments	26	7	16	1
Total comprehensive loss	\$ (325)	\$ (1,733)	\$ (1,981)	\$ (3,251)

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

Table of Contents

GSI TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended September 30, 2018 2017 (In thousands)	
Cash flows from operating activities:		
Net loss	\$ (1,997)	\$ (3,252)
Adjustments to reconcile net loss to net cash used in operating activities:		
Allowance for sales returns, doubtful accounts and other	44	(2)
Provision for excess and obsolete inventories	794	739
Depreciation and amortization	698	625
Stock-based compensation	1,094	986
Amortization of premium on investments	(11)	47
Changes in assets and liabilities:		
Accounts receivable	(2,604)	999
Inventory	(459)	(2)
Prepaid expenses and other assets	(367)	(151)
Accounts payable	613	297
Accrued expenses and other liabilities	1,575	(571)
Net cash used in operating activities	(620)	(285)
Cash flows from investing activities:		
Purchase of investments	(9,598)	(5,248)
Maturities of short-term investments	8,050	7,500
Decrease in MikaMonu escrow deposit	—	479
Purchases of property and equipment	(1,656)	(328)
Net cash provided by (used in) investing activities	(3,204)	2,403
Cash flows from financing activities:		
Payment of MikaMonu escrow deposit	—	(479)
Payment of contingent consideration	(720)	—
Proceeds from issuance of common stock under employee stock plans	2,193	2,063
Net cash provided by financing activities	1,473	1,584
Net increase (decrease) in cash and cash equivalents	(2,351)	3,702
Cash and cash equivalents at beginning of the period	40,241	33,736

Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

Cash and cash equivalents at end of the period	\$ 37,890	\$ 37,438
Non-cash financing activities:		
Purchases of property and equipment through accounts payable and accruals	137	47
Supplemental cash flow information:		
Net cash paid (received) for income taxes	\$ (7)	\$ 30

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

Table of Contents

GSI TECHNOLOGY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1—THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The accompanying unaudited condensed consolidated financial statements of GSI Technology, Inc. and its subsidiaries (“GSI” or the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, the interim financial statements do not include all of the information and footnotes required by GAAP for annual financial statements. These interim financial statements contain all adjustments (which consist of only normal, recurring adjustments) that are, in the opinion of management, necessary to state fairly the interim financial information included therein. The Company believes that the disclosures are adequate to make the information not misleading. However, these financial statements should be read in conjunction with the audited consolidated financial statements and related notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended March 31, 2018.

The consolidated results of operations for the six months ended September 30, 2018 are not necessarily indicative of the results to be expected for the entire fiscal year.

Significant accounting policies

Except for the accounting policy for revenue recognition, which was updated as a result of adopting a new accounting standard related to revenue recognition, there have been no material changes to our significant accounting policies that were disclosed in the Company’s Annual Report on Form 10-K for the fiscal year ended March 31, 2018.

See “Recent accounting pronouncements” below for additional information on the impact of the adoption of the new accounting standard for revenue recognition on the Company’s consolidated financial statements.

Recent accounting pronouncements

In August 2018, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2018-13, “Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement”. The standard amends the disclosure requirements for recurring and nonrecurring fair value measurements by removing, modifying, and adding certain disclosures. The standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted. The Company does not anticipate the adoption of this guidance to have a material impact on its consolidated financial statements and related disclosures.

In August 2018, the SEC adopted the final rule under SEC Release No. 33-10532, “Disclosure Update and Simplification”, amending certain disclosure requirements that were redundant, duplicative, overlapping, outdated or superseded. In addition, the amendments expanded the disclosure requirements on the analysis of stockholders' equity for interim financial statements. Under the amendments, an analysis of changes in each caption of stockholders' equity presented in the balance sheet must be provided in a note or separate statement. The analysis should present a reconciliation of the beginning balance to the ending balance of each period for which a statement of comprehensive income is required to be filed. The Company anticipates its first presentation of changes in shareholders' equity will be included in its Form 10-Q for the quarter ended June 30, 2019.

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment". The standard eliminates the second step in the goodwill impairment

Table of Contents

test which requires an entity to determine the implied fair value of the reporting unit's goodwill. Instead, an entity should recognize an impairment loss if the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, with the impairment loss not to exceed the amount of goodwill allocated to the reporting unit. The standard is effective for annual and interim goodwill impairment tests conducted in fiscal years beginning after December 15, 2019, with early adoption permitted. The Company does not anticipate the adoption of this guidance to have a material impact on its consolidated financial statements and related disclosures.

In November 2016, the FASB issued ASU No. 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash". ASU 2016-18 requires entities to include in their cash and cash-equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash and restricted cash equivalents. As a result, companies will no longer present transfers between cash and cash equivalents, and restricted cash and restricted cash equivalents in the statement of cash flows. The Company adopted ASU 2016-18 in the quarter ended June 30, 2018. Implementation of this guidance did not have a material impact on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," ASU 2016-13 replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For trade and other receivables, loans, and other financial instruments, the Company will be required to use a forward-looking expected loss model rather than the incurred loss model for recognizing credit losses which reflects losses that are probable. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, with early adoption permitted beginning April 1, 2019. Application of the amendments is through a cumulative-effect adjustment to retained earnings as of the effective date. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. All leases create an asset and a liability for the lessee in accordance with FASB Concepts Statement No. 6, "Elements of Financial Statements," and, therefore, recognition of those lease assets and lease liabilities represents a change of previous GAAP, which did not require lease assets and lease liabilities to be recognized for most leases. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those years. Early adoption is permitted. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous GAAP. Although the Company is currently evaluating the impact the pronouncement will have on its consolidated financial statements and related disclosures, the Company expects that most of its operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon adoption.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." ASU 2016-01 requires equity investments to be measured at fair value with changes in fair value recognized in net income and simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. The accounting standard update also updates certain presentation and disclosure requirements. The Company adopted ASU 2016-01 in the quarter ended June 30, 2018. Implementation of this guidance did not have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" and has subsequently issued several supplemental and/or clarifying ASUs (collectively, "ASC 606"). The new accounting

standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The new standard requires a company to recognize revenue as control of goods or services transfers to a customer at an amount that reflects the expected consideration to be received in exchange for those goods or services. It defines a five-step approach for recognizing revenue, which may require a company to use more judgment and make more estimates than under the current standard. The Company adopted ASC 606 on April 1, 2018 using the modified retrospective transition method.

Table of Contents

The Company determines revenue recognition through the following steps: (1) identification of the contract with a customer; (2) identification of the performance obligations in the contract; (3) determination of the transaction price; (4) allocation of the transaction price to the performance obligations in the contract; and (5) recognition of revenue when, or as, we satisfy a performance obligation.

The adoption of ASC 606 was applied to all contracts and did not have a significant impact on the Company's retained earnings as the timing of Company's revenue recognition under the new standard coincides with the way the Company previously recognized revenue. There was no impact on the opening retained earnings balance as of April 1, 2018 due to the adoption of ASC 606.

The majority of the Company's customer contracts, which may be in the form of purchase orders, contracts or purchase agreements, contain performance obligations for delivery of agreed upon products. Delivery of all performance obligations contained within a contract with a customer typically occurs at the same time (or within the same accounting period). Transfer of control typically occurs at the time of shipment or at the time the product is pulled from consignment as that is the point at which delivery has occurred, title and the risks and rewards of ownership have passed to the customer, and the Company has a right to payment. Thus, the Company will generally recognize revenue upon shipment of the product.

Because all of the Company's performance obligations relate to contracts with a duration of less than one year, the Company elected to apply the optional exemption practical expedient provided in ASC 606 and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period.

The Company adjusts the transaction price for variable consideration. Variable consideration is not typically significant and primarily results from stock rotation rights and quick pay discounts provided to our distributors. As a practical expedient, the Company is recognizing the incremental costs of obtaining a contract, specifically commission expenses that have a period of benefit of less than twelve months, as an expense when incurred. Additionally, the Company has adopted an accounting policy to recognize shipping costs that occur after control transfers to the customer as a fulfillment activity.

The Company's contracts with customers do not typically include extended payment terms. Payment terms vary by contract type and type of customer and generally range from 30 to 60 days from shipment. Additionally, the Company has right to payment upon shipment.

The Company records revenue net of sales tax, value added tax, excise tax and other taxes collected concurrent with product sales. The impact of such taxes on products sales is immaterial. The Company has also elected to recognize the cost for freight and shipping when control over the products sold passes to customers and revenue is recognized.

The Company warrants its products to be free of defects generally for a period of three years. The Company estimates its warranty costs based on historical warranty claim experience and includes such costs in cost of revenues. Warranty costs and the accrued warranty liability were not material as of September 30, 2018.

The majority of the Company's revenue is derived from sales of SRAM products which represent approximately 98% of total revenues in the six months ended September 30, 2018.

The majority of the Company's revenue is derived from sales to distributors and contract manufacturers which represented approximately 59% and 39% of net revenue, respectively, for the six months ended September 30, 2018.

Nokia, the Company's largest customer, purchases products directly from the Company and through contract manufacturers and distributors. Based on information provided to the Company by its contract manufacturers and distributors, purchases by Nokia represented approximately 47% of the Company's net revenues in the six months ended September 30, 2018.

Table of Contents

The Company historically deferred recognition of revenue on shipments to its distributors under prior revenue guidance because it lacked fixed and determinable pricing for contracts in which the distributors had rights to price concessions from the Company upon shipment to the distributors' customers. During fiscal 2018, the Company revised all of its distribution agreements to eliminate the uncertainty in pricing, allowing the Company to recognize revenue at the time of shipment to the distributors. As a result, the implementation of the new revenue guidance did not have a significant impact on the Company's consolidated financial statements. See "Note 9 - Segment and Geographic Information" for revenue by shipment destination.

NOTE 2—NET LOSS PER COMMON SHARE

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands, except per share amounts)			
Net loss	\$ (351)	\$ (1,740)	\$ (1,997)	\$ (3,252)
Denominators:				
Weighted average shares—Basic	21,844	21,037	21,707	20,922
Dilutive effect of employee stock options	—	—	—	—
Dilutive effect of employee stock purchase plan options	—	—	—	—
Weighted average shares—Dilutive	21,844	21,037	21,707	20,922
Net loss per common share—Basic	\$ (0.02)	\$ (0.08)	\$ (0.09)	\$ (0.16)
Net loss per common share—Diluted	\$ (0.02)	\$ (0.08)	\$ (0.09)	\$ (0.16)

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

Three Months Ended September 30,		Six Months Ended September 30,	
2018	2017	2018	2017

Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

	(In thousands)			
Shares underlying options and ESPP shares	3,438	2,565	3,228	2,602

Table of Contents

NOTE 3—BALANCE SHEET DETAIL

	September 30, 2018	March 31, 2018
	(In thousands)	
Inventories:		
Work-in-progress	\$ 2,401	\$ 2,226
Finished goods	2,811	3,321
	\$ 5,212	\$ 5,547

	September 30, 2018	March 31, 2018
	(In thousands)	
Accounts receivable, net:		
Accounts receivable	\$ 7,946	\$ 5,342
Less: Allowances for sales returns, doubtful accounts and other	(107)	(63)
	\$ 7,839	\$ 5,279

	September 30, 2018	March 31, 2018
	(In thousands)	
Prepaid expenses and other current assets:		
Prepaid tooling and masks	\$ 595	\$ 163
Escrow deposit	750	750
Other receivables	491	370
Other prepaid expenses and other current assets	618	797
	\$ 2,454	\$ 2,080

Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

	September 30, 2018	March 31, 2018
	(In thousands)	
Property and equipment, net:		
Computer and other equipment	\$ 18,984	\$ 17,845
Software	4,139	4,072
Land	3,900	3,900
Building and building improvements	3,665	2,310
Furniture and fixtures	102	82
Leasehold improvements	815	766
Construction in progress	23	965
	31,628	29,940
Less: Accumulated depreciation	(22,316)	(21,768)
	\$ 9,312	\$ 8,172

Depreciation expense was \$297,000 and \$241,000 for the three months ended September 30, 2018 and 2017, respectively, and \$548,000 and \$469,000 for the six months ended September 30, 2018 and 2017, respectively. The construction in progress relates primarily to a facility expansion at our Sunnyvale headquarters and was placed in service in fiscal 2019.

Table of Contents

	September 30, 2018	March 31, 2018
	(In thousands)	
Other assets:		
Escrow deposit	\$ 1,000	\$ 1,000
Non-current deferred income taxes	75	75
Deposits	125	132
	\$ 1,200	\$ 1,207

The escrow deposit at both September 30, 2018 and March 31, 2018 includes approximately \$1.0 million placed in escrow in connection with the Company's acquisition of MikaMonu Group Ltd. ("MikaMonu") on November 23, 2015.

The following tables summarize the components of intangible assets and related accumulated amortization balances at September 30, 2018 and March 31, 2018 (in thousands):

	As of September 30, 2018		
	Gross Carrying Amount	Accumulated amortization	Net Carrying Amount
Intangible assets:			
Product designs	\$ 590	\$ (590)	\$ —
Patents	4,220	(1,381)	2,839
Software	80	(80)	—
Total	\$ 4,890	\$ (2,051)	\$ 2,839

	As of March 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible assets:			
Product designs	\$ 590	\$ (590)	\$ —
Patents	4,220	(1,231)	2,989
Software	80	(80)	—

Total	\$ 4,890	\$ (1,901)	\$ 2,989
-------	----------	------------	----------

Amortization of intangible assets included in cost of revenues was \$72,000 and \$78,000 for the three months ended September 30, 2018 and 2017, respectively, and \$150,000 and \$156,000 for the six months ended September 30, 2018 and 2017, respectively.

As of September 30, 2018, the estimated future amortization expense of intangible assets in the table above is as follows (in thousands):

Fiscal year ending March 31,	
2019 (remaining six months)	\$ 117
2020	233
2021	233
2022	233
2023	233
Thereafter	1,790
Total	\$ 2,839

Table of Contents

	September 30, 2018	March 31, 2018
	(In thousands)	
Accrued expenses and other liabilities:		
Accrued compensation	\$ 3,198	\$ 2,786
Accrued professional fees	30	31
Accrued commissions	313	299
Contingent consideration	367	1,102
Accrued retention payment	353	291
Mask accrual	986	—
Miscellaneous accrued expenses	990	1,054
	\$ 6,237	\$ 5,563

	September 30, 2018	March 31, 2018
	(In thousands)	
Other accrued expenses:		
Contingent consideration	\$ 4,471	\$ 4,411
Other long-term accrued liabilities	353	291
	\$ 4,824	\$ 4,702

NOTE 4—GOODWILL

Goodwill represents the difference between the purchase price and the estimated fair value of the identifiable assets acquired and liabilities assumed in a business combination. The Company tests for goodwill impairment on an annual basis, or more frequently if events or changes in circumstances indicate that the asset is more likely than not impaired. The Company has one reporting unit. The Company assesses goodwill for impairment on an annual basis on the last

day of February in the fourth quarter of its fiscal year.

The Company had a goodwill balance of \$8.0 million as of both March 31, 2018 and September 30, 2018. The goodwill resulted from the acquisition of MikaMonu Group Ltd. in fiscal 2016.

The Company utilized a two-step quantitative analysis to complete its annual impairment test during the fourth quarter of fiscal 2018 and concluded that there was no impairment, as the fair value of its sole reporting unit exceeded its carrying value. The Company determined that the second step of the impairment test was not necessary. No triggering event took place subsequent to the fiscal 2018 annual assessment that necessitated a quantitative impairment analysis for the Company's one reporting unit.

NOTE 5—INCOME TAXES

The current portion of the Company's unrecognized tax benefits was \$0 at both September 30, 2018 and March 31, 2018. The long-term portion at September 30, 2018 and March 31, 2018 was \$619,000 and \$619,000, respectively, of which the timing of the resolution is uncertain. As of September 30, 2018, \$2.3 million of unrecognized tax benefits had been recorded as a reduction to net deferred tax assets. As of September 30, 2018, the Company's net deferred tax assets of \$7.0 million were subject to a valuation allowance of \$6.9 million. As of March 31, 2018, the Company's net deferred tax assets of \$6.0 million were subject to a valuation allowance of \$5.9 million.

On December 22, 2017, the "Tax Cuts and Jobs Act" ("H.R. 1") was signed into law, significantly impacting several sections of the Internal Revenue Code. Following the enactment of H.R. 1, the SEC staff issued SAB 118, which provides guidance on accounting for the tax effects of the law. SAB 118 provides a measurement period that should not extend beyond one year from the enactment date of H.R. 1 for companies to complete the accounting under ASC 740. In accordance with SAB 118, the Company must reflect the income tax effects of those aspects of H.R. 1 for which the accounting under ASC 740 is complete. To the extent that the Company's accounting for certain income tax effects of H.R. 1 is incomplete but the Company is able to determine a reasonable

Table of Contents

estimate, the Company must record a provisional estimate in the financial statements. If the Company cannot determine a provisional estimate to be included in the financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax law that were in effect immediately before the enactment of H.R. 1.

H.R. 1 includes significant changes to the U.S. corporate income tax system, including a permanent reduction in the corporate income tax rate from 35% to 21%, limitations on the deductibility of interest expense and executive compensation and the transition of U.S. international taxation from a worldwide tax system to a territorial tax system. We re-measured certain deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future. The re-measurement of our deferred tax balance of \$1.1 million was offset by application of our valuation allowance. We calculated our best estimate of the impact of H.R. 1 in the fiscal 2018 year-end income tax provision, including the impact of the one-time transition tax, in accordance with our understanding of H.R. 1 and guidance available as of the date of this filing and recorded a tax expense of \$367,000 in the year ended March 31, 2018 related to the transition tax associated with deemed repatriation of foreign earnings. As the Company completes the analysis of H.R. 1, collects and prepares necessary data, and interprets any additional guidance, the Company may make adjustments to its initial assessment. Pursuant to Staff Accounting Bulletin No. 118, adjustments to the provisional amounts recorded by the Company that are identified within a subsequent measurement period of up to one year from the enactment date will be included as an adjustment to tax expense from continuing operations in the period the amounts are determined.

The Company's original estimate may be materially impacted by a number of additional considerations, including but not limited to the issuance of the final regulations and the Company's ongoing analysis of the new law.

H.R. 1 subjects a U.S. shareholder to tax on global intangible low-taxed income (GILTI) earned by certain foreign subsidiaries. The FASB Staff Q&A, Topic 740, No. 5, Accounting for Global Intangible Low-Taxed Income, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred.

At September 30, 2018, the Company has estimated the impact of the GILTI income inclusion as part of the Company's estimate of its fiscal 2019 income taxes. Due to the Company's valuation allowance in the United States, it is projected that there will be no net income tax effect related to GILTI in the Company's fiscal year ending March 31, 2019.

Management believes that within the next twelve months the Company will not have a significant reduction in uncertain tax benefits, including interest and penalties, related to positions taken with respect to credits and loss carryforwards on previously filed tax returns.

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

The Company is subject to taxation in the United States and various state and foreign jurisdictions. Fiscal years 2013 through 2018 remain open to examination by federal tax authorities, and fiscal years 2011 through 2018 remain open to examination by California tax authorities.

The Company's estimated annual effective income tax rate was approximately (5.1%) and (11.8%) as of September 30, 2018 and 2017, respectively. The annual effective tax rates as of September 30, 2018 and 2017 vary from the United States statutory income tax rate primarily due to valuation allowances in the United States, whereby pre-tax losses do not result in the recognition of corresponding income tax benefits and expenses, the foreign tax differential, and the impact of recent tax reform.

Table of Contents

NOTE 6—FINANCIAL INSTRUMENTS

Fair value measurements

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

Level 1: Valuations based on quoted prices in active markets for identical assets and liabilities. The fair value of available-for-sale securities included in the Level 1 category is based on quoted prices that are readily and regularly available in an active market. As of September 30, 2018, the Level 1 category included money market funds of \$6.5 million, which were included in cash and cash equivalents on the Condensed Consolidated Balance Sheets.

Level 2: Valuations based on observable inputs (other than Level 1 prices), such as quoted prices for similar assets at the measurement date; quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly. The fair value of available-for-sale securities included in the Level 2 category is based on the market values obtained from an independent pricing service that were evaluated using pricing models that vary by asset class and may incorporate available trade, bid and other market information and price quotes from well-established independent pricing vendors and broker-dealers. As of September 30, 2018, the Level 2 category included short-term investments \$18.7 million and long-term investments of \$9.0 million, which were comprised of certificates of deposit, government and agency securities.

Level 3: Valuations based on inputs that are unobservable and involve management judgment and the reporting entity's own assumptions about market participants and pricing. As of September 30, 2018, the Company's Level 3 financial instruments measured at fair value on the Condensed Consolidated Balance Sheets consisted of the contingent consideration liability related to the acquisition of MikaMonu. The fair value of the contingent consideration liability was initially determined as of the acquisition date using unobservable inputs. These inputs include the estimated amount and timing of future cash flows, the probability of success (achievement of the various contingent events) and a risk-adjusted discount rate of approximately 14.8% used to adjust the probability-weighted cash flows to their present value. Subsequent to the acquisition date, at each reporting period, the contingent consideration liability is re-measured to fair value with changes recorded in selling, general and administrative expenses in the Consolidated Statements of Operations. The change in fair value for the six month period ended September 30, 2018 was an increase of \$74,000. This increase was offset by a \$750,000 milestone payout, which included a \$30,000 change in fair value from the \$720,000 contingent consideration liability recognized at the acquisition date.

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

		Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets and Liabilities			Significant Other Observable Inputs	Significant Unobservable Inputs
		September 30, 2018	(Level 1)	(Level 2)	(Level 3)	
Assets:						
Money market funds	\$ 6,465	\$ 6,465	\$ —	\$ —		
Marketable securities	27,622	—	27,622	—		
Total	\$ 34,087	\$ 6,465	\$ 27,622	\$ —		
Liabilities:						
Contingent consideration	\$ 4,838	\$ —	\$ —	\$ 4,838		

Table of Contents

		Fair Value Measurements at Reporting Date Using Quoted Prices		
		in Active Markets for Identical Assets and Liabilities	Significant Other Observable Inputs	Significant Unobservable Inputs
	March 31, 2018	(Level 1)	(Level 2)	(Level 3)
Assets:				
Money market funds	\$ 6,788	\$ 6,788	\$ —	\$ —
Marketable securities	26,047	—	26,047	—
Total	\$ 32,835	\$ 6,788	\$ 26,047	\$ —
Liabilities:				
Contingent consideration	\$ 5,514	\$ —	\$ —	\$ 5,514

Short-term and long-term investments

All of the Company's short-term and long-term investments are classified as available-for-sale. Available-for-sale debt securities with maturities greater than twelve months are classified as long-term investments when they are not intended for use in current operations. Investments in available-for-sale securities are reported at fair value with unrecognized gains (losses), net of tax, as a component of accumulated other comprehensive loss in the Condensed Consolidated Balance Sheets. The Company had money market funds of \$6.5 million and \$6.8 million at September 30, 2018 and March 31, 2018, respectively, included in cash and cash equivalents on the Condensed Consolidated Balance Sheets. The Company monitors its investments for impairment periodically and records appropriate reductions in carrying values when declines are determined to be other-than-temporary.

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

	September 30, 2018		Fair Value
	Gross Unrealized Gains	Gross Unrealized Losses	
Cost			
(In thousands)			
Short-term investments:			

Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

Certificates of deposit	\$ 12,750	\$ —	\$ (53)	\$ 12,697
Foreign government obligations	5,971	—	(6)	5,965
Total short-term investments	\$ 18,721	\$ —	\$ (59)	\$ 18,662
Long-term investments:				
Certificates of deposit	\$ 6,250	\$ —	\$ (36)	\$ 6,214
Agency bonds	1,502	—	(9)	1,493
Foreign government obligations	1,257	—	(4)	1,253
Total long-term investments	\$ 9,009	\$ —	\$ (49)	\$ 8,960

Table of Contents

	March 31, 2018			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Short-term investments:				
Agency bonds	\$ 3,996	\$ —	\$ (1)	\$ 3,995
Foreign government obligations	5,428	—	(21)	5,407
Certificates of deposit	8,750	—	(28)	8,722
Total short-term investments	\$ 18,174	\$ —	\$ (50)	\$ 18,124
Long-term investments:				
Certificates of deposit	\$ 8,000	\$ —	\$ (77)	\$ 7,923
Total long-term investments	\$ 8,000	\$ —	\$ (77)	\$ 7,923

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

The deferred tax asset related to unrecognized gains and losses on short-term and long-term investments was \$24,000 and \$29,000 at September 30, 2018 and March 31, 2018, respectively.

As of September 30, 2018, contractual maturities of the Company's available-for-sale investments were as follows:

	Cost	Fair Value
	(In thousands)	
Maturing within one year	\$ 18,721	\$ 18,662
Maturing in one to three years	9,009	8,960
	\$ 27,730	\$ 27,622

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

NOTE 7—COMMITMENTS AND CONTINGENCIES

Indemnification obligations

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

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

Table of Contents

Product warranties

The Company warrants its products to be free of defects generally for a period of three years. The Company estimates its warranty costs based on historical warranty claim experience and includes such costs in cost of revenues. Warranty costs and the accrued warranty liability were not material as of September 30, 2018 and March 31, 2018 and for the three months and six months ended September 30, 2018 or 2017.

NOTE 8—STOCK-BASED COMPENSATION

As of September 30, 2018, 3,737,158 shares of common stock were available for grant under the Company's 2016 Equity Incentive Plan.

The following table summarizes the Company's stock option activities for the six months ended September 30, 2018:

	Shares Available for Grant	Number of Shares Underlying Options Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Intrinsic Value
Balance at March 31, 2018	4,444,301	7,874,267		\$ 5.45	
Granted	(748,483)	748,483		\$ 6.81	
Exercised	—	(488,058)		\$ 3.83	\$ 1,602,159
Forfeited	41,340	(83,625)		\$ 5.42	
Balance at September 30, 2018	3,737,158	8,051,067	5.75	\$ 5.67	
Options vested and exercisable		5,032,445	4.10	\$ 5.42	\$ 7,719,498
Options vested and expected to vest		7,969,921	5.71	\$ 5.66	\$ 10,564,833

The weighted average fair value per underlying share of options granted during the three months ended September 30, 2018 and 2017 was \$2.42 and \$2.53, respectively, \$2.45 and \$2.54 for the six months ended September 30, 2018 and 2017, respectively.

Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

Options outstanding by exercise price at September 30, 2018 were as follows:

Exercise Price	Number of Shares Underlying Options Outstanding	Options Outstanding		Options Exercisable	
		Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number Vested and Exercisable	Weighted Average Exercise Price
\$ 2.43 - 4.00	1,102,370	\$ 3.63	3.00	916,306	\$ 3.66
\$ 4.17 - 4.90	831,835	\$ 4.55	4.03	814,510	\$ 4.55
\$ 4.92 - 4.99	1,188,036	\$ 4.98	7.13	277,710	\$ 4.97
\$ 5.13 - 5.59	1,000,499	\$ 5.31	6.06	889,317	\$ 5.32
\$ 5.69 - 6.28	949,182	\$ 6.03	4.70	756,949	\$ 6.00
\$ 6.45 - 6.70	1,215,401	\$ 6.63	7.12	545,508	\$ 6.55
\$ 6.82 - 7.26	1,375,234	\$ 7.04	6.64	703,939	\$ 6.91
\$ 7.40 - 7.70	151,620	\$ 7.54	9.08	19,626	\$ 7.40
\$ 8.09	128,310	\$ 8.09	9.33	-	\$ -
\$ 9.20	108,580	\$ 9.20	2.34	108,580	\$ 9.20
	8,051,067	\$	5.75	5,032,445	\$ 5.42

Table of Contents

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

	Three Months Ended September 30, 2018		Six Months Ended September 30, 2018	
	2017		2017	
	(In thousands)			
Cost of revenues	\$ 61	\$ 66	\$ 114	\$ 113
Research and development	321	284	644	551
Selling, general and administrative	170	158	336	322
Total	\$ 552	\$ 508	\$ 1,094	\$ 986

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

No tax benefit related to stock-based compensation was recognized in the six months ended September 30, 2018 due to a full valuation allowance. There were no windfall tax benefits realized from exercised stock options in either of these periods. Compensation cost capitalized within inventory at September 30, 2018 was immaterial. As of September 30, 2018, the Company's total unrecognized compensation cost was \$4.8 million, which will be recognized over a weighted average period of 2.26 years. The Company calculated the fair value of stock-based awards in the periods presented using the Black-Scholes option pricing model and the following weighted average assumptions:

	Three Months Ended September 30, 2018		2017		Six Months Ended September 30, 2018		2017	
Stock Option Plans:								
Risk-free interest rate	2.85 %	1.84 %	2.78-	2.85 %	1.84-	1.91 %		
Expected life (in years)	5.00	5.00		5.00		5.00		
Volatility	35.9 %	36.5 %	35.6-	35.9 %		36.5 %		
Dividend yield	— %	— %		— %		— %		
Employee Stock Purchase Plan:								
Risk-free interest rate	— %	— %		2.09 %		1.04 %		
Expected life (in years)	—	—		0.50		0.50		

Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

Volatility	— %	— %	37.7 %	51.1 %
Dividend yield	— %	— %	— %	— %

Table of Contents

NOTE 9—SEGMENT AND GEOGRAPHIC INFORMATION

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

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2018	2017	2018	2017
	(In thousands)			
United States	\$ 4,329	\$ 4,710	\$ 8,819	\$ 9,415
China	1,008	1,598	2,016	2,948
Singapore	3,017	1,498	5,021	3,700
Netherlands	2,143	782	4,542	1,984
Germany	1,992	726	2,945	1,556
Rest of the world	343	333	755	731
	\$ 12,832	\$ 9,647	\$ 24,098	\$ 20,334

All sales are denominated in United States dollars.

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

This Quarterly Report on Form 10-Q, and in particular the following Management's Discussion and Analysis of Financial Condition and Results of Operations, includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements involve risks and uncertainties. Forward-looking statements are identified by words such as "anticipates," "believes," "expects," "intends," "may," "will," and other similar expressions. In addition, any statements which refer to expectations, projections, or other characterizations of future events or circumstances are forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, including those set forth in this report under "Risk

Factors,” those described elsewhere in this report, and those described in our other reports filed with the Securities and Exchange Commission (“SEC”). We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report, and we undertake no obligation to update these forward-looking statements after the filing of this report. You are urged to review carefully and consider our various disclosures in this report and in our other reports publicly disclosed or filed with the SEC that attempt to advise you of the risks and factors that may affect our business.

Overview

We are a fabless semiconductor company that designs, develops and markets static random access memories, or SRAMs, that operate at speeds of less than 10 nanoseconds, which we refer to as Very Fast SRAMs, and low latency dynamic random access memories, or LLDRAMs, primarily for the networking and telecommunications markets. We are subject to the highly cyclical nature of the semiconductor industry, which has experienced significant fluctuations, often in connection with fluctuations in demand for the products in which semiconductor devices are used. Our revenues have been substantially impacted by significant fluctuations in sales to our largest customer, Nokia. We expect that future direct and indirect sales to Nokia will continue to fluctuate significantly on a quarterly basis. The networking and telecommunications market has accounted for a significant portion of our net revenues in the past and has declined during the past several years and is expected to continue to decline. However, with no debt, substantial liquidity and a history of positive cash flows from operations, we believe we are in a better financial position than many other companies of our size.

Revenues. Our revenues are derived primarily from sales of our Very Fast SRAM products. Sales to networking and telecommunications OEMs accounted for 55% to 66% of our net revenues during our last three fiscal years. We also sell our products to OEMs that manufacture products for military and aerospace applications such as radar and guidance systems, missiles and satellites, for professional audio applications such as sound mixing

Table of Contents

systems, for test and measurement applications such as high-speed testers, for automotive applications such as smart cruise control and voice recognition systems, and for medical applications such as ultrasound and CAT scan equipment.

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

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

We sell our products through our direct sales force, international and domestic sales representatives and distributors. Sales to consignment warehouses, who purchase products from us for use by contract manufacturers, are recorded upon delivery to the contract manufacturer. Sales to certain distributors were previously made under agreements allowing for returns or credits under certain circumstances. We therefore deferred recognition of revenue on sales to those distributors under these terms until products were resold by the distributor. During fiscal 2018, prior to the implementation of ASC 606, we revised our distribution agreements to these distributors to eliminate ship from stock and debits and price protection. Under these revised distribution agreements, selling prices were fixed and determinable on the date of shipment and revenue was recognized upon shipment.

Nokia was our largest customer in fiscal 2018, 2017 and 2016. Nokia purchases products directly from us and through contract manufacturers and distributors. Based on information provided to us by its contract manufacturers and our distributors, purchases by Nokia represented approximately 47%, 36%, 41% and 32% of our net revenues in the six months ended September 30, 2018 and in fiscal 2018, 2017 and 2016, respectively. Our revenues have been substantially impacted by significant fluctuations in sales to Nokia, and we expect that future direct and indirect sales to Nokia will continue to fluctuate substantially on a quarterly basis and that such fluctuations may significantly affect our operating results in future periods. To our knowledge, none of our other OEM customers accounted for more than 10% of our net revenues in the six months ended September 30, 2018 and in fiscal 2018, 2017 or 2016.

Cost of Revenues. Our cost of revenues consists primarily of wafer fabrication costs, wafer sort, assembly, test and burn-in expenses, the amortized cost of production mask sets, stock-based compensation and the cost of materials and overhead from operations. All of our wafer manufacturing and assembly operations, and a significant portion of our wafer sort testing operations, are outsourced. Accordingly, most of our cost of revenues consists of payments to TSMC, Powerchip and independent assembly and test houses. Because we do not have long-term, fixed-price supply

contracts, our wafer fabrication and other outsourced manufacturing costs are subject to the cyclical fluctuations in demand for semiconductors. Cost of revenues also includes expenses related to supply chain management, quality assurance, and final product testing and documentation control activities conducted at our headquarters in Sunnyvale, California and our branch operations in Taiwan.

Gross Profit. Our gross profit margins vary among our products and are generally greater on our higher density products and, within a particular density, greater on our higher speed and industrial temperature products.

Table of Contents

We expect that our overall gross margins will fluctuate from period to period as a result of shifts in product mix, changes in average selling prices and our ability to control our cost of revenues, including costs associated with outsourced wafer fabrication and product assembly and testing.

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

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist primarily of commissions paid to independent sales representatives, salaries, stock-based compensation and related expenses for personnel engaged in sales, marketing, administrative, finance and human resources activities, professional fees, costs associated with the promotion of our products and other corporate expenses. We expect that our sales and marketing expenses will increase in absolute dollars in future periods if we are able to grow and expand our sales force but that, to the extent our revenues increase in future periods, these expenses will generally decline as a percentage of net revenues. We also expect that, in support of any future growth that we are able to achieve, general and administrative expenses will generally increase in absolute dollars.

Results of Operations

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2018	2017	2018	2017
Net revenues	100.0 %	100.0 %	100.0 %	100.0 %
Cost of revenues	37.4	49.6	42.6	48.5

Edgar Filing: GSI TECHNOLOGY INC - Form 10-Q

Gross profit	62.6	50.4	57.4	51.5
Operating expenses:				
Research and development	44.9	43.1	44.0	41.8
Selling, general and administrative	20.8	25.8	21.9	26.0
Total operating expenses	65.7	68.9	65.9	67.8
Loss from operations	(3.1)	(18.5)	(8.5)	(16.3)
Interest and other income, net	1.2	1.1	0.7	1.0
Loss before income taxes	(1.9)	(17.4)	(7.8)	(15.3)
Provision for income taxes	0.8	0.5	0.5	0.6
Net loss	(2.7)	(17.9)	(8.3)	(15.9)

Net Revenues. Net revenues increased by 33.0% from \$9.6 million in the three months ended September 30, 2017 to \$12.8 million in the three months ended September 30, 2018 and by 18.5% from \$20.3 million in the six months ended September 30, 2017 to \$24.1 million in the six months ended September 30, 2018. The overall average selling price of all units shipped in the quarter ended September 30, 2018 increased by 12.6% compared to the quarter ended September 30, 2017 and by 8.3% in the six months ended September 30, 2018 compared to the six months ended September 30, 2017. The increase in the average selling price in each fiscal 2019 period was due to a change in product mix, as we sold more higher density, higher average selling price products in the fiscal 2019 periods compared to the prior fiscal year periods. Direct and indirect sales to Nokia, currently our largest customer, increased from \$2.8 million in the three months ended September 30, 2017 to \$6.0 million in the three months ended

Table of Contents

September 30, 2018 and from \$7.3 million in the six months ended September 30, 2017 to \$11.2 million in the six months ended September 30, 2018. Shipments of our SigmaQuad product line accounted for 66.4% of total shipments in the three months ended September 30, 2018 compared to 39.4% of total shipments in the three months ended September 30, 2017 and 63.2% of total shipments in the six months ended September 30, 2018 compared to 45.5% of total shipments in the six months ended September 30, 2017. The increase in SigmaQuad shipments was primarily due to the increase in sales to Nokia discussed above.

Cost of Revenues. Cost of revenues were unchanged at \$4.8 million in both the three months ended September 30, 2017 and in the three months ended September 30, 2018 and increased by 4.1% from \$9.9 million in the six months ended September 30, 2017 to \$10.3 million in the six months ended September 30, 2018. Cost of revenues included stock-based compensation expense of \$61,000 and \$66,000 for the three months ended September 30, 2018 and 2017, respectively and \$114,000 and \$113,000 for the six months ended September 30, 2018 and 2017, respectively.

Gross Profit. Gross profit increased by 65.3% from \$4.9 million in the three months ended September 30, 2017 to \$8.0 million in the three months ended September 30, 2018 and by 32.1% from \$10.5 million in the six months ended September 30, 2017 to \$13.8 million in the six months ended September 30, 2018.

Gross margin increased from 50.4% in the three months ended September 30, 2017 to 62.4% in the three months ended September 30, 2018 and from 51.5% in the six months ended September 30, 2017 to 57.4% in the six months ended September 30, 2018. The increase in gross profit in each period is primarily related to the increases in net revenues discussed above. The increases in gross margin are primarily related to changes in the mix of products and customers and changes in the level of charges for inventory reserves booked in each period.

Research and Development Expenses. Research and development expenses increased by 38.3% from \$4.2 million in the three months ended September 30, 2017 to \$5.8 million in the three months ended September 30, 2018. This increase was primarily due to increases of \$986,000 in non-production mask sets, \$204,000 in outside consultant expenses and \$169,000 in payroll related expenses all related to our associative processor development activities. Research and development expenses included stock-based compensation expense of \$321,000 and \$284,000 for the three months ended September 30, 2018 and 2017, respectively. Research and development expenses increased 24.8% from \$8.5 million in the six months ended September 30, 2017 to \$10.6 million in the six months ended September 30, 2018. The increase was primarily due to increases of \$986,000 in non-production mask sets, \$460,000 in outside consultant expenses and \$394,000 in payroll related expenses, all related to our associative processor development activities. Research and development expenses included stock-based compensation expense of \$644,000 and \$551,000 for the six months ended September 30, 2018 and 2017, respectively.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased by 7.3% from \$2.5 million in the three months ended September 30, 2017 to \$2.7 million in the three months ended September 30, 2018. This increase was primarily related to an increase of \$115,000 for independent sales representatives commissions, due to the increased net revenues discussed above, and \$43,000 for payroll related expenses. Selling,

general and administrative expenses included stock-based compensation expense of \$170,000 and \$158,000 for the three months ended September 30, 2018 and 2017, respectively. Selling, general and administrative expenses were unchanged at \$5.3 million in the six months ended September 30, 2017 and in the six months ended September 30, 2018. A decrease in professional fees of \$264,000 was offset by increases in payroll related expenses, travel related expenses and facility related expenses. Selling, general and administrative expenses included stock-based compensation expense of \$336,000 and \$322,000 for the six months ended September 30, 2018 and 2017, respectively.

Interest and Other Income (Expense), Net. Interest and other income (expense), net increased 40.8% from income of \$103,000 in the three months ended September 30, 2017 to \$145,000 in the three months ended September 30, 2018. Interest income increased by \$55,000 due to higher interest rates received on our cash and short-term and long-term investments. Foreign exchange gains were \$4,000 for the three months ended September 30, 2017 as compared to foreign exchange losses of \$9,000 for the three months ended September 30, 2018. The exchange gains and losses in each period were related to our Taiwan branch operations and our operations in Israel. Interest and other income (expense), net decreased 16.4% from income of \$201,000 in the six months ended September 30, 2017 to \$168,000 in the six months ended September 30, 2018. Interest income increased by \$96,000

Table of Contents

due to higher interest rates received on our cash and short-term and long-term investments. We had a foreign exchange gain of \$5,000 for the six months ended September 30, 2017 compared to foreign exchange losses \$124,000 for the six months ended September 30, 2018. The exchange gains and losses in each period were related to our Taiwan branch operations and our operations in Israel.

Provision for Income Taxes. The provision for income taxes increased 108.2% from \$49,000 in the three months ended September 30, 2017 to \$102,000 in the three months ended September 30, 2018 and the provision decreased 13.8% from \$130,000 in the six months ended September 30, 2017 to \$112,000 in the six months ended September 30, 2018. These changes were primarily due to fluctuations in the relative mix of income among our operating jurisdictions.

Net Loss. Net loss was \$1.7 million in the three months ended September 30, 2017 compared \$351,000 in the three months ended September 30, 2018 and was \$3.3 million in the six months ended September 30, 2017 compared to \$2.0 million in the six months ended September 30, 2018. These fluctuations were primarily due to the changes in net revenues, gross profit and operating expenses discussed above.

Liquidity and Capital Resources

As of September 30, 2018, our principal sources of liquidity were cash, cash equivalents and short-term investments of \$56.6 million compared to \$58.4 million as of March 31, 2018.

Net cash used in operating activities was \$620,000 for the six months ended September 30, 2018 compared to net cash used in operating activities of \$285,000 for the six months ended September 30, 2017. The primary uses of cash in the current six month period were a net loss of \$2.0 million and an increase in accounts receivable of \$2.6 million. Accounts receivable increased primarily due to the timing of payments received from customers and the increased level of shipments during the current six month period compared to the prior year, primarily related to shipments to Nokia, our largest customer. Primary sources of cash in the six months ended September 30, 2018 were an increase in accrued expenses and other liabilities of \$1.6 million and non-cash items including stock-based compensation of \$1.1 million, a provision for excess and obsolete inventories of \$794,000, and depreciation and amortization expenses of \$698,000. The increase in accrued expenses and other liabilities included an accrual for approximately \$1.0 million related to a non-production mask set for our initial APU product. The primary uses of cash in the six month period ended September 30, 2017 were a net loss of \$3.3 million and the reduction of accrued expenses and other liabilities of \$571,000. The primary sources of cash in the six month period ended September 30, 2017 were a decrease in accounts receivable of \$999,000 and non-cash items including stock-based compensation of \$986,000, a provision for excess and obsolete inventories of \$739,000 and depreciation and amortization expenses of \$625,000.

Net cash used in investing activities was \$3.2 million in the six months ended September 30, 2018 compared to net cash provided by investing activities of \$2.4 million in the six months ended September 30, 2017. Investment activities in the six months ended September 30, 2018 primarily consisted of the purchase of agency bonds and certificates of deposit of \$9.6 million, partially offset by the maturity of agency bonds and certificates of deposit of \$8.1 million and the purchase of property and equipment of \$1.7 million. Investment activities in the six months ended September 30, 2017 consisted primarily of the maturity of certificates of deposit of \$7.5 million, partially offset by the purchase of agency bonds and certificates of deposit of \$5.2 million.

Net cash provided by financing activities in the six months ended September 30, 2018 consisted of the net proceeds from the sale of common stock pursuant to our employee stock plans of \$2.2 million partially offset by a payment of contingent consideration related to our acquisition of MikaMonu in November 2015 in the amount of \$720,000. Net cash provided by financing activities in the six months ended September 30, 2017 primarily consisted of the net proceeds from the sale of common stock pursuant to our employee stock plans of \$2.1 million, partially offset the by release of an escrow deposit related to our acquisition of MikaMonu in the amount of \$479,000.

The Company's estimated annual effective income tax rate was approximately (5.1%) as of September 30, 2018. The statutory Federal tax rate for the year ending March 31, 2019 will be 21% compared to 31.5% for the fiscal year ended March 31, 2018. These tax-related estimates may differ from actual results, possibly materially,

Table of Contents

due to changes in interpretations of H.R. 1 and assumptions made by us, as well as guidance that may be issued and actions we may take as a result of H.R. 1. See Note 5, Income Taxes, for further information.

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

Contractual Obligations

The following table describes our contractual obligations as of September 30, 2018:

	Payments due by period				Total
	Up to 1 year	1 - 3 years	3 - 5 years	More than 5 years	
Facilities and equipment leases	\$ 209,000	\$ 505,000	\$ 90,000	\$ —	\$ 804,000
Wafer and test purchase obligations	2,561,000	106,000	—	—	2,667,000
	\$ 2,770,000	\$ 611,000	\$ 90,000	\$ —	\$ 3,471,000

As of September 30, 2018, the current portion of our unrecognized tax benefits was \$0, and the long-term portion was \$619,000.

In connection with the acquisition of MikaMonu on November 23, 2015, we are required to make contingent consideration payments to the former MikaMonu shareholders conditioned upon the retention of MikaMonu's key employee and the achievement of certain product development milestones and revenue targets for products based on the MikaMonu technology. As of September 30, 2018, the accrual for potential contingent consideration was \$4.8 million and is payable at various dates through December 31, 2025.

Critical Accounting Policies and Estimates

Our critical accounting policies and estimates are disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2018.

Please refer to Note 5 to our condensed consolidated financial statements appearing under Part I, Item 1 for a discussion regarding how H.R. 1 may impact the Company's critical accounting policies and estimates.

Off-Balance Sheet Arrangements

At September 30, 2018, we did not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Accordingly, we are not exposed to the type of financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

Recent Accounting Pronouncements

Please refer to Note 1 to our condensed consolidated financial statements appearing under Part I, Item 1 for a discussion of recent accounting pronouncements that may impact the Company.

Table of Contents

Item 3.Quantitative and Qualitative Disclosure About Market Risk

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

Interest Rate Sensitivity. We had cash, cash equivalents, short-term investments and long-term investments totaling \$65.5 million at September 30, 2018. These amounts were invested primarily in money market funds, state and municipal obligations, certificates of deposit, government agency bonds and foreign government obligations. The cash, cash equivalents and short-term marketable securities are held for working capital purposes. We do not enter into investments for trading or speculative purposes. Due to the short-term nature of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. We believe a hypothetical 100 basis point increase or decrease in interest rates would not materially affect the fair value of our interest-sensitive financial instruments. Declines in interest rates, however, will reduce future investment income.

Item 4.Controls and Procedures

Management's Evaluation of Disclosure Controls and Procedures

Based on their evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of September 30, 2018, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report for the purpose of ensuring that the information required to be disclosed by us in this report is made known to them by others on a timely basis, and that the information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, in order to allow timely decisions regarding required disclosure, and that such information is recorded, processed, summarized, and reported by us within the time periods specified in the SEC's rules and instructions for Form 10-Q.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 1A.Risk Factors

Our future performance is subject to a variety of risks. If any of the following risks actually occur, our business, financial condition and results of operations could suffer and the trading price of our common stock could decline. Additional risks that we currently do not know about or that we currently believe to be immaterial may also impair our business operations. You should also refer to other information contained in this report, including our condensed consolidated financial statements and related notes. The risk factors described below do not contain any material changes from those previously disclosed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended March 31, 2018.

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

Our quarterly and annual revenues, expenses and operating results have varied significantly and are likely to vary in the future. For example, in the ten fiscal quarters ended September 30, 2018, we recorded net revenues of as much as \$13.4 million and as little as \$9.6 million and quarterly operating income of as much as \$389,000 and, in seven quarters, operating losses, including our operating loss of \$1.8 million in the quarter ended September 30, 2017. We therefore believe that period-to-period comparisons of our operating results are not a good indication of

Table of Contents

our future performance, and you should not rely on them to predict our future performance or the future performance of our stock price. In future periods, we may not have any revenue growth, or our revenues could decline. Furthermore, if our operating expenses exceed our expectations, our financial performance could be adversely affected. Factors that may affect periodic operating results in the future include:

- changes in our customers' inventory management practices;
- unpredictability of the timing and size of customer orders, since most of our customers purchase our products on a purchase order basis rather than pursuant to a long-term contract;
- our ability to anticipate and conform to new industry standards;
- fluctuations in availability and costs associated with materials needed to satisfy customer requirements;
- manufacturing defects, which could cause us to incur significant warranty, support and repair costs, lose potential sales, harm our relationships with customers and result in write-downs;
- changes in our product pricing policies, including those made in response to new product announcements and pricing changes of our competitors; and
- our ability to address technology issues as they arise, improve our products' functionality and expand our product offerings.

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

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

Nokia, our largest customer, purchases our products directly from us and through contract manufacturers and distributors. Purchases by Nokia represented approximately 47%, 36%, 41% and 32% of our net revenues in the six months ended September 30, 2018 and in fiscal 2018, 2017 and 2016, respectively. We expect that our operating results in any given period will continue to depend significantly on orders from our key OEM customers, particularly Nokia, and our future success is dependent to a large degree on the business success of this customer over which we have no control. We do not have long-term contracts with Nokia or any of our other major OEM customers, distributors or contract manufacturers that obligate them to purchase our products. We expect that future direct and indirect sales to Nokia and our other key OEM customers will continue to fluctuate significantly on a quarterly basis

and that such fluctuations may substantially affect our operating results in future periods. If we fail to continue to sell to our key OEM customers, distributors or contract manufacturers in sufficient quantities, our business could be harmed.

Table of Contents

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

We have incurred significant losses in prior periods. We incurred losses of \$4.5 million, \$115,000 and \$2.2 million during fiscal 2018, 2017 and 2016, respectively. Our operating expenses in fiscal 2016 included substantial expenses related to legal proceedings that resulted in operating losses. Although these proceedings have concluded, there can be no assurance that our Very Fast SRAMs will continue to receive broad market acceptance, that our new product development initiatives will be successful or that we will be able to achieve sustained revenue growth or profitability.

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

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

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

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

- our products may become obsolete upon the introduction of alternative technologies;
- we may incur substantial costs if we need to modify our products to respond to these alternative technologies;
- we may not have sufficient resources to develop or acquire new technologies or to introduce new products capable of competing with future technologies;
- new products that we develop may not successfully integrate with our end-users' products into which they are incorporated;

- we may be unable to develop new products that incorporate emerging industry standards;
- we may be unable to develop or acquire the rights to use the intellectual property necessary to implement new technologies; and

Table of Contents

- when introducing new or enhanced products, we may be unable to manage effectively the transition from older products.

Our future success is substantially dependent on the successful development of new in-place associative computing products which entails significant risks.

Since our acquisition of MikaMonu in November 2015, our principal strategic objective has been the development of a new category of in-place associative computing products based on patented technology that we acquired in the acquisition. We have devoted, and are continuing to devote, substantial efforts and resources to this development effort. This ongoing project involves the commercialization of new, cutting-edge technology, will require a substantial effort during fiscal 2019 and will be subject to significant risks. In addition to the typical risks associated with the development of technologically advanced products (as outlined in the previous paragraph), this project will be subject to enhanced risks of technological problems related to the development of an entirely new category of products, substantial risks of delays or unanticipated costs that may be encountered and risks associated with the establishment of entirely new markets and customer relationships. Our inability to successfully conclude this major development effort and establish a market for the products we hope to develop would have a material adverse effect on our future financial and business success, including our prospects for increased revenues. Additionally, if we are unable to meet the expectations of market analysts and investors with respect to this major development effort, then the price of our common stock could fall.

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

Our products are incorporated into routers, switches, wireless local area network infrastructure equipment, wireless base stations and network access equipment used in the highly cyclical networking and telecommunications markets. We expect that the networking and telecommunications markets will continue to be highly cyclical, characterized by periods of rapid growth and contraction. Our business and our operating results are likely to fluctuate, perhaps quite severely, as a result of this cyclicity.

The market for Very Fast SRAMs is highly competitive.

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

- real or perceived imbalances in supply and demand of Very Fast SRAMs;
- the rate at which OEMs incorporate our products into their systems;
- the success of our customers' products;

- our ability to develop and market new products; and
- the supply and cost of wafers.

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

Table of Contents

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

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

Global economic and market conditions may adversely affect our business, financial condition and results of operations.

We sell our products to end customers both in the United States and internationally. We also rely heavily on our suppliers in Asia. We are therefore susceptible to adverse domestic and international economic and market conditions. In recent years, turmoil in global financial markets and economic conditions has impacted credit availability, consumer spending and capital expenditures, including expenditures for networking and telecommunications equipment. Weakness in global networking and telecommunications markets, particularly in Asia, has continued to adversely impact our revenues in recent quarters. Slowness in economic growth, domestically and in our key markets, uncertainty regarding macroeconomic trends, and volatility in financial markets may continue to adversely affect our business, financial condition and results of operations over coming quarters.

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

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

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

Table of Contents

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

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

- contracts that commit us to purchase specified quantities of wafers over extended periods;
- investments in and joint ventures with the foundries; or
- non-refundable deposits with or prepayments or loans to foundries in exchange for capacity commitments.

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

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

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

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

A significant percentage of our sales are made to distributors and to contract manufacturers who incorporate our products into end products for OEMs. For example, in the six months ended September 30, 2018 and in fiscal 2018, 2017 and 2016, our largest distributor Avnet Logistics accounted for 28.5%, 35.3%, 25.5% and 28.2%, respectively, of our net revenues. Avnet Logistics and our other existing distributors may choose to devote greater resources to marketing and supporting the products of other companies. Since we sell through multiple channels and distribution networks, we may have to resolve potential conflicts between these channels. For example, these conflicts may result from the different discount levels offered by multiple channel distributors to their customers or, potentially, from our direct sales force targeting the same equipment manufacturer accounts as our indirect channel distributors. These conflicts may harm our business or reputation.

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

Our financial results, quarterly product sales, trends and comparisons are affected by fluctuations in the buying patterns of the OEMs that purchase our products from our distributors. While we attempt to assist our distributors in maintaining targeted stocking levels of our products, we may not consistently be accurate or successful. This process involves the exercise of judgment and use of assumptions as to future uncertainties, including end user demand. Inventory levels of our products held by our distributors may exceed or fall below the levels we consider desirable on a going-forward basis. This could result in distributors returning unsold inventory to us, or in us not having sufficient inventory to meet the demand for our products. If we are not able to accurately predict sales through our distributors or effectively manage our relationships with our distributors, our business and financial results will suffer.

Table of Contents

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

At September 30, 2018, four customers accounted for 40%, 21%, 16% and 14% of our accounts receivable, respectively. If any of these customers do not pay us, our financial position and operating results will be harmed. Generally, we do not require collateral from our customers.

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

In November 2015, we acquired all of the outstanding capital stock of privately held MikaMonu Group Ltd., a development-stage, Israel-based company that specializes in in-place associative computing for markets including big data, computer vision and cyber security. We also acquired substantially all of the assets related to the SRAM memory device product line of Sony Corporation in 2009. We intend to supplement our internal development activities by seeking opportunities to make additional acquisitions or investments in companies, assets or technologies that we believe are complementary or strategic. Other than the MikaMonu and Sony acquisitions, we have not made any such acquisitions or investments, and therefore our experience as an organization in making such acquisitions and investments is limited. In connection with the MikaMonu acquisition, we are subject to risks related to potential problems, delays or anticipated costs that may be encountered in the development of products based on the MikaMonu technology and the establishment of new markets and customer relationships for the potential new products. In addition, in connection with any future acquisitions or investments we may make, we face numerous other risks, including:

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

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

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

In recent years, there has been significant litigation in the semiconductor industry involving patents and other intellectual property rights. We have recently been involved in protracted patent infringement litigation, and we could become subject to additional claims or litigation in the future as a result of allegations that we infringe others' intellectual property rights or that our use of intellectual property otherwise violates the law. Claims that our products infringe the proprietary rights of others would force us to defend ourselves and possibly our customers, distributors or manufacturers against the alleged infringement. Any such litigation regarding intellectual property could result in substantial costs and diversion of resources and could have a material adverse effect on our business,

Table of Contents

financial condition and results of operations. Similarly, changing our products or processes to avoid infringing the rights of others may be costly or impractical. If any claims received in the future were to be upheld, the consequences to us could require us to:

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

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

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

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

System security risks, data protection, cyber-attacks and systems integration issues could disrupt our internal operations or the operations of our business partners, and any such disruption could harm our reputation or cause a reduction in our expected revenue, increase our expenses, negatively impact our results of operation or otherwise adversely affect our stock price.

Security breaches, computer malware and cyber-attacks have become more prevalent and sophisticated in recent years. Experienced computer programmers and hackers may be able to penetrate our network security or the network security of our business partners, and misappropriate or compromise our confidential and proprietary information, create system disruptions or cause shutdowns. The costs to us to eliminate or alleviate cyber or other security

problems, bugs, viruses, worms, malicious software programs and security vulnerabilities could be significant, and our efforts to address these problems may not be successful and could result in interruptions and delays that may impede our sales, manufacturing, distribution or other critical functions.

We manage and store various proprietary information and sensitive or confidential data relating to our business on the cloud. Breaches of our security measures or the accidental loss, inadvertent disclosure or unapproved dissemination of proprietary information or confidential data about us, including the potential loss or disclosure of such information or data as a result of fraud, trickery or other forms of deception, could expose us to a risk of loss or misuse of this information, result in litigation and potential liability for us, damage our reputation or otherwise harm our business. In addition, the cost and operational consequences of implementing further data protection measures could be significant.

Table of Contents

Portions of our IT infrastructure also may experience interruptions, delays or cessations of service or produce errors in connection with systems integration or migration work that takes place from time to time. We may not be successful in implementing new systems and transitioning data, which could cause business disruptions and be more expensive, time consuming, disruptive and resource-intensive than originally anticipated. Such disruptions could adversely impact our ability to fulfill orders and interrupt other processes and could adversely affect our financial results, stock price and reputation.

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

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

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

We continuously evaluate the benefits of migrating to smaller geometry process technologies in order to improve performance and reduce costs. Historically, these migrations to new manufacturing processes have resulted in significant initial design and development costs associated with pre-production mask sets for the manufacture of new products with smaller geometry process technologies. For example, in the second quarter of fiscal 2019, we incurred approximately \$1.0 million in research and development expense associated with a pre-production mask set that will not be used in production as part of the transition to our new 28 nanometer SRAM process for our APU product. We will incur similar expenses in the future as we continue to transition our products to smaller geometry processes. The costs inherent in the transition to new manufacturing process technologies will adversely affect our operating results and our gross margin.

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

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

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

the assembly process at one of our suppliers. This write-off adversely affected our operating results for fiscal 2006.

Table of Contents

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

Our products are used as components in our OEM customers' products, including routers, switches and other networking and telecommunications products. Accordingly, demand for our products is subject to factors affecting the ability of our OEM customers to successfully introduce and market their products, including:

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

Our international business exposes us to additional risks.

Products shipped to destinations outside of the United States accounted for 63.4%, 51.5%, 59.1% and 60.3% of our net revenues in the sixmonths ended September 30, 2018 and in fiscal 2018, 2017 and 2016, respectively. Moreover, a substantial portion of our products is manufactured and tested in Taiwan, and the software development for our

associative computing products occurs in Israel. We intend to continue expanding our international business in the future. Conducting business outside of the United States subjects us to additional risks and challenges, including:

heightened price sensitivity from customers in emerging markets;

compliance with a wide variety of foreign laws and regulations and unexpected changes in these laws and regulations;

uncertainties regarding taxes, tariffs, quotas, export controls and license requirements, trade wars, policies that favor domestic companies over nondomestic companies, including government efforts to provide for the development and growth of local competitors, and other trade barriers;

Table of Contents

potential political and economic instability in, or foreign conflicts that involve or affect, the countries in which we, our customers and our suppliers are located;

difficulties in collecting accounts receivable and longer accounts receivable payment cycles;

difficulties and costs of staffing and managing personnel, distributors and representatives across different geographic areas and cultures, including assuring compliance with the U. S. Foreign Corrupt Practices Act and other U. S. and foreign anti-corruption laws;

limited protection for intellectual property rights in some countries; and

fluctuations in freight rates and transportation disruptions.

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

The United States could withdraw from or materially modify certain international trade agreements, or change tax provisions related to the global manufacturing and sales of our products.

A portion of our business activities are conducted in foreign countries, including Taiwan and Israel. Our business benefits from free trade agreements, and we also rely on various U.S. corporate tax provisions related to international commerce as we develop, manufacture, market and sell our products globally. Any action to withdraw from or materially modify international trade agreements, or change corporate tax policy related to international commerce, could adversely affect our business, financial condition and results of operations.

U.S. federal income tax reform could adversely affect us.

On December 22, 2017, the “Tax Cuts and Jobs Act” (“H.R. 1”) was signed into law, significantly impacting several sections of the Internal Revenue Code. Following the enactment of the H.R. 1, the SEC staff issued SAB 118, which provides guidance on accounting for the tax effects of the Tax Act. Staff Accounting Bulletin No. 118 (“SAB 118”) provides a measurement period that should not extend beyond one year from the H.R. 1 enactment date for companies to complete the accounting under ASC 740. In accordance with SAB 118, we must reflect the income tax effects of those aspects of H.R. 1 for which the accounting under ASC 740 is complete. To the extent that our accounting for certain income tax effects of the Tax Act is incomplete but we are able to determine a reasonable estimate, we must record a provisional estimate in the financial statements. If we cannot determine a provisional estimate to be included in the financial statements, we should continue to apply ASC 740 on the basis of the provisions of the tax law that were in effect immediately before the enactment of the H.R. 1.

This new law includes significant changes to the U.S. corporate income tax system, including a permanent reduction in the corporate income tax rate from 35% to 21%, limitations on the deductibility of interest expense and executive compensation and the transition of U.S. international taxation from a worldwide tax system to a territorial tax system. We are continuing to examine the impact that H.R. 1 may have on our business. We re-measured certain

deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future. The re-measurement of our deferred tax balance in fiscal 2018 of \$1.1 million was offset by application of our valuation allowance. We have calculated our best estimate of the impact of H.R. 1 in the fiscal 2018 year-end income tax provision, including the impact of the one-time transition tax, in accordance with our understanding of H.R. 1 and guidance available as of the date of this filing and we recorded a tax expense of \$367,000 related to the transition tax. As we complete the analysis of H.R. 1, collect and prepare necessary data, and interpret any additional guidance, we may make adjustments to our initial assessment. Pursuant to SAB 118, adjustments to the provisional amounts recorded by us as of March 31, 2018 that are identified within a subsequent measurement period of up to one year from the enactment date will be included as an adjustment to tax expense from continuing operations in the period the amounts are determined.

Table of Contents

This original estimate may be materially impacted by a number of additional considerations, including but not limited to the issuance of the final regulations and our ongoing analysis of the new law.

H.R. 1 subjects a U.S. shareholder to tax on global intangible low-taxed income (GILTI) earned by certain foreign subsidiaries. The FASB Staff Q&A, Topic 740, No. 5, Accounting for Global Intangible Low-Taxed Income, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred.

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

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

If there were to be another outbreak of a contagious disease, such as SARS or the H1N1 Flu, that significantly affected the Asia-Pacific region, the operations of our key suppliers could be disrupted. In addition, our business could be harmed if such an outbreak resulted in travel being restricted, or if it adversely affected the operations of our suppliers or our OEM customers or the demand for our products or our OEM customers' products.

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

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

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

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

securities may have rights, preferences or privileges senior to those of our common stock.

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

Some of our products are incorporated into advanced military electronics such as radar and guidance systems. Military expenditures and appropriations for such purchases rose significantly in recent years. However, if

Table of Contents

current U.S. military operations around the world are scaled back, demand for our products for use in military applications may decrease, and our operating results could suffer. Domestic budget considerations may also adversely affect our operating results. For example, if governmental appropriations for military purchases of electronic devices that include our products are reduced, our revenues will likely decline.

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

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

We face increasing complexity in our product design as we adjust to new and future requirements relating to the material composition of our products, including the restrictions on lead and other hazardous substances that apply to specified electronic products put on the market in the European Union, China and California. Other countries, including at the federal and state levels in the United States, are also considering similar laws and regulations. Certain electronic products that we maintain in inventory may be rendered obsolete if they are not in compliance with such laws and regulations, which could negatively impact our ability to generate revenue from those products. Although we cannot predict the ultimate impact of any such new laws and regulations, they will likely result in additional costs, or in the worst case decreased revenue, and could even require that we redesign or change how we manufacture our products. Such redesigns result in additional costs and possible delayed or lost revenue.

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

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

- actual or anticipated declines in operating results;
- changes in financial estimates or recommendations by securities analysts;
- the institution of legal proceedings against us or significant developments in such proceedings;
- announcements by us or our competitors of financial results, new products, significant technological innovations, contracts, acquisitions, strategic relationships, joint ventures, capital commitments or other events;
- changes in industry estimates of demand for Very Fast SRAM products;

- the gain or loss of significant orders or customers;
- recruitment or departure of key personnel; and
- market conditions in our industry, the industries of our customers and the economy as a whole.

In recent years the stock market in general, and the market for technology stocks in particular, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. The market price of our common stock might experience significant fluctuations in the future, including fluctuations unrelated to our performance. These fluctuations could materially adversely affect our business

Table of Contents

relationships, our ability to obtain future financing on favorable terms or otherwise harm our business. In addition, in the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. This risk is especially acute for us because the extreme volatility of market prices of technology companies has resulted in a larger number of securities class action claims against them. Due to the potential volatility of our stock price, we may in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management's attention and resources. This could harm our business and cause the value of our stock to decline.

Use of a portion of our cash reserves to repurchase shares of our common stock presents potential risks and disadvantages to us and our stockholders.

From November 2008 through September 2018, we repurchased and retired an aggregate of 11,983,942 shares of our common stock at a total cost of \$60.6 million, including 3,846,153 shares repurchased at a total cost of \$25 million pursuant to a modified "Dutch auction" self-tender offer that we completed in August 2014 and additional shares repurchased in the open market pursuant to our stock repurchase program. At September 30, 2018, we had outstanding authorization from our Board of Directors to purchase up to an additional \$4.4 million of our common stock from time to time under our repurchase program. Although our Board has determined that these repurchases are in the best interests of our stockholders, they expose us to certain risks including:

- the risks resulting from a reduction in the size of our "public float," which is the number of shares of our common stock that are owned by non-affiliated stockholders and available for trading in the securities markets, which may reduce the volume of trading in our shares and result in reduced liquidity and, potentially, lower trading prices;
- the risk that our stock price could decline and that we would be able to repurchase shares of our common stock in the future at a lower price per share than the prices we have paid in our tender offer and repurchase program; and
- the risk that the use of a portion of our cash reserves for this purpose has reduced, or may reduce, the amount of cash that would otherwise be available to pursue potential cash acquisitions or other strategic business opportunities.

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

As of October 31, 2018, our executive officers, directors and entities affiliated with them beneficially owned approximately 36% of our outstanding common stock. As a result, these stockholders will be able to exercise substantial influence over, and may be able to effectively control, matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, which could have the effect of delaying or preventing a third party from acquiring control over or merging with us.

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

Our Board of Directors has the authority to issue up to 5,000,000 shares of preferred stock. Our Board of Directors can fix the price, rights, preferences, privileges and restrictions of the preferred stock without any further vote or

action by our stockholders. The issuance of shares of preferred stock might delay or prevent a change in control transaction. As a result, the market price of our common stock and the voting and other rights of our stockholders might be adversely affected. The issuance of preferred stock might result in the loss of voting control to other stockholders. We have no current plans to issue any shares of preferred stock. Our charter documents also contain other provisions, which might discourage, delay or prevent a merger or acquisition, including:

- our stockholders have no right to remove directors without cause;
- our stockholders have no right to act by written consent;

Table of Contents

- our stockholders have no right to call a special meeting of stockholders; and
- stockholders must comply with advance notice requirements to nominate directors or submit proposals for consideration at stockholder meetings.

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

Table of Contents

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

Stock Repurchase Program

Our Board of Directors has authorized us to repurchase, at management’s discretion, shares of our common stock. Under the repurchase program, we may repurchase shares from time to time on the open market or in private transactions. The specific timing and amount of the repurchases will be dependent on market conditions, securities law limitations and other factors. The repurchase program may be suspended or terminated at any time without prior notice. During the quarter ended September 30, 2018, we did not repurchase any of our shares under the repurchase program.

(1)

Table of Contents

Item 6.Exhibits

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

Table of Contents

SIGNATURES

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

Date: November 2, 2018

GSI Technology, Inc.

By: /s/ LEE-LEAN SHU

Lee-Lean Shu

President, Chief Executive Officer and Chairman

By: /s/ DOUGLAS M. SCHIRLE

Douglas M. Schirle

Chief Financial Officer