NETLIST INC
Form 10-Q
May 15, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

or

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

For the transition period from to

Commission file number 001-33170

NETLIST, INC.

(Exact name of registrant as specified in its charter)

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

475 Goddard, Irvine, CA 92618
(Address of principal executive offices) (Zip Code)

(949) 435-0025

(Registrant s telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.001 per share	The NASDAQ Global Market

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 o No x

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

Large Accelerated Filer o Accelerated Filer o Non-accelerated filer x

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

The number of shares outstanding of each of the registrant s classes of common stock as of the latest practicable date:

Common Stock, par value $0.001 per share

19,644,487 shares outstanding at April 30, 2007

NETLIST, INC. AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

FOR THE THREE MONTHS ENDED MARCH 31, 2007

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NETLIST, INC. AND SUBSIDIARIES

Unaudited Condensed Consolidated Balance Sheets
(in thousands)

	March 31, 2007	December 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,694	$ 30,975
Investments in marketable securities	16,149	5,267
Accounts receivable, net	18,033	23,703
Inventories	13,380	19,473
Deferred taxes	1,100	1,054
Prepaid expenses and other current assets	897	988
Total current assets	61,253	81,460
Property and equipment, net	3,894	3,830
Deferred taxes	932	576
Long-term investments in marketable securities	6,842	1,502
Other assets	636	326
Total assets	$ 73,557	$ 87,694
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 5,491	$ 11,680
Revolving line of credit	12,026	19,238
Current portion of long-term debt	865	1,033
Current portion of deferred gain on sale and leaseback transaction	118	118
Income taxes payable	108	552
Accrued expenses and other current liabilities	2,459	3,255
Total current liabilities	21,067	35,876
Long-term debt, net of current portion	1,010	1,230
Deferred gain on sale and leaseback transaction, net of current portion	314	344
Total liabilities	22,391	37,450
Commitments and contingencies		
Stockholders equity:		
Common stock	20	20
Additional paid-in capital	66,998	66,557
Note receivable from stockholder	(1)	(1)
Accumulated deficit	(15,855)	(16,332)
Accumulated other comprehensive income	4	
Total stockholders equity	51,166	50,244
Total liabilities and stockholders equity	$ 73,557	$ 87,694

See accompanying notes.

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NETLIST, INC. AND SUBSIDIARIES

Unaudited Condensed Consolidated Statements of Operations
(in thousands, except per share amounts)

	Three Months Ended March 31, 2007	April 1, 2006
Net sales	$ 37,538	$ 26,020
Cost of sales(1)	32,089	23,466
Gross profit	5,449	2,554
Operating expenses:		
Research and development(1)	1,067	666
Selling, general and administrative(1)	3,704	1,803
Total operating expenses	4,771	2,469
Operating income	678	85
Other expense:		
Interest expense, net of interest income	(48)	(400)
Other income (expense), net	1	(10)
Total other expense, net	(47)	(410)
Income (loss) before provision (benefit) for income taxes	631	(325)
Provision (benefit) for income taxes		(83)
Net income (loss)	$ 631	$ (242)
Net income (loss) per common share:		
Basic	$ 0.03	$ (0.02)
Diluted	$ 0.03	$ (0.02)
Weighted-average common shares outstanding:		
Basic	19,624	10,753
Diluted	21,425	10,753

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

Cost of sales	$ 64	$ 7
Research and development	46	11
Selling, general and administrative	218	55

See accompanying notes.

NETLIST, INC. AND SUBSIDIARIES

Unaudited Condensed Consolidated Statements of Cash Flows
(in thousands)

	Three Months Ended March 31, 2007	April 1, 2006
Cash flows from operating activities:		
Net income (loss)	$ 631	$ (242)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	254	249
Amortization of deferred gain on sale and leaseback transaction	(30)	(30)
Deferred income taxes	(402)	
Impairment of long-lived asset	114	
Loss on disposal of assets		15
Stock-based compensation	328	73
Changes in operating assets and liabilities:		
Accounts receivable	5,670	137
Inventories	6,093	315
Income taxes receivable		(83)
Prepaid expenses and other current assets	91	166
Other assets	(310)	3
Accounts payable	(6,172)	1,987
Income taxes payable	(598)	
Accrued expenses and other current liabilities	(796)	(12)
Net cash provided by operating activities	4,873	2,578
Cash flows from investing activities:		
Acquisition of property and equipment	(449)	(67)
Proceeds from sale of equipment		45
Purchases of investments in marketable securities	(30,618)	
Proceeds from maturities of investments in marketable securities	14,400	
Net cash used in investing activities	(16,667)	(22)
Cash flows from financing activities:		
Borrowings on lines of credit	40,174	22,542
Payments on lines of credit	(47,386)	(25,933)
Payments on debt	(388)	(200)
Proceeds from exercise of stock options and warrants	113	104
Net cash used in financing activities	(7,487)	(3,487)
Net decrease in cash and cash equivalents	(19,281)	(931)
Cash and cash equivalents, beginning of period	30,975	953
Cash and cash equivalents, end of period	$ 11,694	$ 22

See accompanying notes.

NETLIST, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2007

NOTE 1 DESCRIPTION OF BUSINESS

Netlist, Inc. (the Company or Netlist) was incorporated on June 12, 2000 in Delaware. Netlist designs and manufactures high performance memory subsystems for the server, high performance computing and communications markets. The Company s solutions are targeted at applications where memory plays a key role in meeting system performance requirements.

In December 2006, the Company sold 6,250,000 of its common shares in its initial public offering at an offering price of $7.00 per share, resulting in proceeds of $39.5 million, net of underwriters discounts and offering expenses of approximately $4.2 million.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The interim unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Securities and Exchange Commission (SEC) Form 10-Q and Article 10 of SEC Regulation S-X. These financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Therefore, these interim unaudited condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and notes thereto for the year ended December 30, 2006, included in the Company s Annual Report on Form 10-K filed with the SEC on February 28, 2007.

The condensed consolidated financial statements included herein are unaudited; however, they contain all normal recurring accruals and adjustments that, in the opinion of the Company s management, are necessary to present fairly the consolidated financial position of the Company and its wholly owned subsidiaries as of March 31, 2007 and December 30, 2006, and the consolidated results of its operations and cash flows for the three months ended March 31, 2007 and April 1, 2006. All intercompany balances and transactions have been eliminated in consolidation. The results of operations for the three months ended March 31, 2007 are not necessarily indicative of the results to be expected for the full year or any future interim periods.

Fiscal Year

Effective January 1, 2003, the Company changed its fiscal year from a calendar year to a 52/53-week fiscal year ending on the Saturday closest to December 31. Each of the Company s first three quarters in a fiscal year end on the Saturday closest to March 31, June 30 and September 30, respectively.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant estimates made by management include, among others, provisions for uncollectible receivables and sales returns, valuation of inventories, recoverability of long-lived assets and realization of deferred tax assets. Actual results could differ from these estimates.

Inventories

Inventories are valued at the lower of cost or net realizable value. Cost is determined on a first-in, first-out basis and includes raw materials, labor and manufacturing overhead. At each balance sheet date, the Company evaluates its ending inventories for excess quantities and obsolescence. This evaluation includes an analysis of sales levels by product type. Among other factors, the Company considers historical demand and forecasted demand in relation to the inventory on hand, competitiveness of product offerings, market conditions and product life cycles when determining obsolescence and net realizable value. Provisions are made to reduce excess or obsolete inventories to their estimated net realizable values. Once established, write-downs are considered permanent adjustments to the cost basis of the excess or obsolete inventories.

Revenue Recognition

The Company s revenues primarily consist of product sales of high performance memory subsystems to original equipment manufacturers (OEMs). Revenues also include sales of excess inventories to distributors and other users of memory intergrated circuits (ICs) totaling approximately $1.0 million and $5.1 million, during the three months ended March 31, 2007 and April 1, 2006, respectively.

The Company recognizes revenues in accordance with the SEC s Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition* (SAB No. 104). In accordance with the provisions of SAB No. 104, the Company recognizes revenues when there is persuasive evidence of an arrangement, product delivery and acceptance have occurred, the sales price is fixed or determinable, and collectibility of the resulting receivable is reasonably assured.

For all sales, the Company uses a binding purchase order as evidence of an arrangement. Delivery occurs when goods are shipped for customers with FOB Shipping Point terms and upon receipt for customers with FOB Destination terms, at which time title and risk of loss transfer to the customer. The Company assesses whether the sales price is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund. Customers are generally allowed limited rights of return for up to 30 days, except for sales of excess inventories, which contain no right-of-return privileges. Estimated returns are provided for at the time of sale based on historical experience or specific identification of an event necessitating a reserve. Returns from customers have not been material in any period as the Company s principal customers have adopted build-to-order manufacturing models or just-in-time management processes. The Company offers a standard product warranty to its customers and has no other post-shipment obligations. The Company assesses collectibility based on the creditworthiness of the customer as determined by credit checks and evaluations, as well as the customer s payment history.

Most of the Company s international shipments are made to third-party inventory warehouses, or hubs, and the Company recognizes revenue when the inventory is pulled from the hub for use in production by the customer.

All amounts billed to customers related to shipping and handling are classified as revenues, while all costs incurred by the Company for shipping and handling are classified as cost of sales.

Warranties

The Company offers warranties generally ranging from one to three years to its customers, other than on sales of excess inventory, depending on the product and negotiated terms of purchase agreements. Such warranties require the Company to repair or replace defective product returned to the Company during such warranty period at no cost to the customer. An estimate by the Company for warranty related costs is recorded by the Company at the time of sale based on its historical and estimated product return rates and expected repair or replacement costs. Such costs have historically been consistent between periods and insignificant. The Company s estimated warranty liability at March 31, 2007 was approximately $0.3 million, and is included as a component of accrued expenses and other current liabilities in the accompanying unaudited condensed consolidated balance sheet.

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Stock-Based Compensation

The Company accounts for equity issuances to non-employees in accordance with Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123), and Emerging Issues Task Force (EITF) No. 96-18, *Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods and Services*. All transactions in which goods or services are the consideration received for the issuance of equity instruments are accounted for based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more reliably measurable. The measurement date used to determine the fair value of the equity instrument issued is the earlier of the date on which the third-party performance is complete or the date on which it is probable that performance will occur.

In accordance with SFAS No. 123(R), *Share-Based Payment* (SFAS No. 123(R)), employee and director stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in the accompanying unaudited condensed consolidated statements of operations includes compensation expense for share-based payment awards granted prior to, but not yet vested as of December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS No. 123 and compensation expense for the share-based payment awards granted subsequent to December 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R). Given that stock-based compensation expense recognized in the unaudited condensed consolidated statements of operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The fair value of stock-based awards to employees and directors is calculated using the Black-Scholes option pricing model. The Black-Scholes model requires subjective assumptions regarding future stock price volatility and expected time to exercise, which greatly affect the calculated fair values of the Company s stock-based awards. The expected term of options granted is derived from historical data on employee exercises and post-vesting employment termination behavior. The risk-free rate selected to value any particular grant is based on the U.S. Treasury rate that corresponds to the expected term of the grant effective as of the date of the grant. The expected volatility is based on the historical volatilities of the common stock of comparable publicly traded companies based on the Company s belief that it currently has limited historical data regarding the volatility of its stock price on which to base a meaningful estimate of expected volatility. These factors could change in the future, affecting the determination of stock-based compensation expense in future periods.

Net Income (Loss) Per Share

Basic net income (loss) per share is calculated by dividing net income (loss) by the weighted-average common shares outstanding during the period. Diluted net income (loss) per share is calculated by dividing the net income (loss) by the weighted-average common shares and dilutive potential common shares outstanding during the period. Dilutive potential common shares consist of dilutive shares issuable upon the exercise of outstanding stock options and warrants computed using the treasury stock method. During fiscal 2006 and prior years, in addition to outstanding stock options and warrants, dilutive potential common shares also consisted of shares issuable upon the conversion of notes payable and convertible preferred stock using the if converted method.

New Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparison between entities that choose different measurement attributes for similar types of assets and liabilities. The Company will adopt SFAS No. 159 in the first quarter of 2008, is still evaluating the effect, if any, on its consolidated financial position and consolidated results of operations and has not yet determined its impact.

NOTE 3 SUPPLEMENTAL FINANCIAL INFORMATION

Inventories

Inventories consist of the following (in thousands):

	March 31, 2007	December 30, 2006
Raw materials	$ 4,279	$ 10,513
Work in process	1,984	3,343
Finished goods	7,117	5,617
	$ 13,380	$ 19,473

Comprehensive Income (Loss)

The components of comprehensive income (loss), net of taxes, consist of the following (in thousands):

	Three Months Ended March 31, 2007	April 1, 2006
Net income (loss)	$ 631	$ (242)
Other comprehensive income (loss):		
Change in net unrealized gain on investments	4	
Comprehensive income (loss)	$ 635	$ (242)

Computation of Net Income (Loss) Per Share

The following table sets forth the computation of basic and diluted net income (loss) per share, including the reconciliation of the numerator and denominator used in the calculation of basic and diluted net income (loss) per share (in thousands, except per share data):

	Three Months Ended March 31, 2007	April 1, 2006
Basic net income (loss) per share:		
Numerator: Net income (loss)	$ 631	$ (242)
Denominator: Weighted-average common shares outstanding, basic	19,624	10,753
Basic net income (loss) per share	$ 0.03	$ (0.02)
Diluted net income (loss) per share:		
Numerator: Net income (loss)	$ 631	$ (242)
Weighted-average common shares outstanding, basic	19,624	10,753
Effect of dilutive securities:		
Stock options and warrants	1,801	
Denominator: Weighted-average common shares outstanding, diluted	21,425	10,753
Diluted net income (loss) per share	$ 0.03	$ (0.02)

All potentially dilutive common share equivalents of approximately 3.6 million shares have been excluded from the diluted net loss per share calculation for the three months ended April 1, 2006 as their effect would be anti-dilutive for the period then ended.

Major Customers

The Company s product sales have historically been concentrated in a small number of customers. The following table sets forth sales to customers comprising 10% or more of the Company s total revenues:

	Three Months Ended March 31, 2007	April 1, 2006
Customer:		
A	38 %	16 %
B	11 %	33 %
C	31 %	

The Company s accounts receivable are concentrated with four customers at March 31, 2007, representing 38%, 21%, 11% and 11% of aggregate gross receivables. At December 30, 2006, accounts receivable are concentrated with four customers representing 32%, 19%, 14% and 13% of aggregate gross receivables. A significant reduction in sales to, or the ability to collect receivables from, a significant customer could have a material adverse impact on the Company.

NOTE 4 CREDIT AGREEMENT

In April 2007, the Company executed the Seventh Amendment to the Amended and Restated Credit and Security Agreement (the Seventh Amendment). The Seventh Amendment, which is effective as of March 21, 2007, allows the Company to, at its election, increase its line of credit from $25 million, in $2.5 million increments, up to a total of $40 million at the prime rate of interest, which was 8.25% at March 31, 2007 and December 30, 2006. In addition, the amendment (i) extends the maturity date of the line of credit to July 31, 2009, (ii) establishes an equipment advance line of $3 million, (iii) increases the sublimit for letters of credit to $5 million, (iv) sets an inventory sublimit of $7 million, with the ability to increase to $10 million if certain financial targets are met, (v) provides for the reduction in interest rates on borrowings if certain borrowing amounts and financial performance targets are met, (vi) resets the minimum book net worth, capital expenditures, and minimum debt service coverage ratio financial covenants and (vii) eliminates the minimum net income and stop loss financial covenants. As of March 31, 2007, the Company was in compliance with all financial covenants.

The $40 million credit facility was preceded by a line of credit facility up to $25 million ($3 million of which was in the form of letters of credit), limited to 85% of eligible accounts receivable, plus the least of (i) a percentage of eligible inventory determined from time to time by the Company s bank, (ii) 80% of the orderly liquidation value, as defined, of eligible inventories, and (iii) $7 million. Interest is payable monthly, at the Company s option, either at prime rate plus 0.50% or LIBOR plus 3%. The interest rate was reduced to the prime rate or LIBOR plus 2.50% in December 2006 concurrent with the Company s raise of capital through an initial public offering.

Interest on the equipment advances is payable monthly, at the Company s option, either at the prime rate or LIBOR plus 2.50%. Interest only payments were required on the equipment advances through January 31, 2007. Commencing February 1, 2007, the Company was required to repay the equipment advances in 42 equal monthly installments. The outstanding balance on this loan was approximately $1.0 million and $1.1 million at March 31, 2007 and December 30, 2006, respectively. (see Note 5).

Interest expense related to borrowings on the line of credit was approximately $0.4 million and $0.3 million for the three months ended March 31, 2007 and April 1, 2006, respectively. Outstanding borrowings on the line of credit were approximately $12.0 million and $19.2 million at March 31, 2007 and December 30, 2006, respectively. Borrowing availability under the line of credit was approximately $2.9 million at March 31, 2007.

NOTE 5 LONG-TERM DEBT

Long-term debt consists of the following (in thousands):

	March 31, 2007	December 30, 2006
Obligations under capital leases	$ 696	$ 802
Equipment note payable to bank (see Note 4)	996	1,072
Notes payable to others	183	389
	1,875	2,263
Less current portion	(865)	(1,033)
	$ 1,010	$ 1,230

Notes Payable to Others

In November 2002, the Company entered into a $100,000 unsecured loan agreement with an individual, bearing interest at 7% payable annually, principal due, as amended, in June 2006. In January 2004, $4,000 of the principal amount was used to exercise certain stock options. The balance of this note was $96,000 at December 30, 2006, which, along with accrued interest, was repaid in full in January 2007.

In January 2003, the Company entered into a $300,000 loan agreement with a financing company, collateralized by assets owned by an employee related to the majority stockholder. This note bears interest at 14% per annum and matures in January 2009. Principal and interest payments of approximately $6,000 are due and payable monthly. The balance of this note was approximately $119,000 and $133,000 at March 31, 2007 and December 30, 2006, respectively.

In August 2005, the Company entered into an agreement with a financing company in connection with financing certain insurance policies. The financing agreement required monthly principal and interest payments of approximately $25,000 through maturity on June 30, 2006. Interest was payable at 8.55% per annum. The outstanding principal balance on this financing was $142,000 at December 31, 2005. During the year ended December 30, 2006, the balance was repaid in full. In August 2006, the Company entered into a new agreement with the financing company to finance its insurance policies. The financing agreement requires monthly principal and interest payments of approximately $32,000 through maturity on June 30, 2007. Interest is payable at 9.45% per annum. The outstanding principal balance on this financing was approximately $64,000 and $160,000 at March 31, 2007 and December 30, 2006, respectively.

Capital Leases

The Company has purchased manufacturing and computer equipment through the use of various capital leases. These leases require aggregate monthly payments of approximately $34,000 and mature at various dates through May 2011. The interest rates on these leases vary between 4.3% and 9.4%.

Interest expense related to long-term debt was approximately $57,000, and $46,000 for the three months ended March 31, 2007 and April 1, 2006, respectively.

NOTE 6 INCOME TAXES

The Company recorded a tax provision of $0 and $83,000 for the three months ended March 31, 2007 and April 1, 2006, respectively. The effective tax rates for the Company were 0% and 26% for the three months ended March 31, 2007 and April 1, 2006, respectively.

The Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), on December 31, 2006, the first day of fiscal 2007. As a result of the implementation of FIN 48, the Company recorded an increase in the net liability for unrecognized tax positions of approximately $0.2 million, which was recorded as an adjustment to the beginning balance of accumulated deficit as of December 31, 2006. Including the increase in the net liability, at December 31, 2006 the Company had approximately $0.5 million of total unrecognized tax benefits. Included in this balance were $0.5 million of tax positions that, if recognized, would affect the effective tax rate.

The Company s continuing practice is to recognize accrued interest and penalties related to unrecognized tax benefits as a component of tax expense. This policy did not change as a result of the adoption of FIN 48. The Company had approximately $30,000 accrued for interest and $0 accrued for penalties at December 31, 2006.

The Company files tax returns with federal and state jurisdictions. The Company is no longer subject to IRS or state examinations prior to fiscal 2003, although certain carryforward attributes that were generated prior to fiscal 2003 may still be adjusted by the IRS if they either have been or will be used in a future period.

NOTE 7 COMMITMENTS AND CONTINGENCIES

Litigation

From time to time, the Company may be involved in litigation relating to claims arising out of its operations in the normal course of business.

In May 2007, the Company and certain of its officers and directors were named as defendants in a securities class action filed in federal court in New York (Tran v. Netlist, et al., No. 07 CV 3754). The complaint is filed on behalf of purchasers of the Company s common stock in or traceable to the Company s initial public offering and asserts claims under Sections 11 and 15 of the Securities Act of 1933. The Company has not been served with the complaint.

Other Obligations

In March 2007, the Company entered into a five year lease commitment agreement on a facility in Suzhou in the People s Republic of China for which the total base rent for the term of the lease is expected to approximate $800,000. In March 2007, the Company began its occupation of the facility and commenced recording monthly rent expense of approximately $13,000.

In April 2007, the Company entered into a four year facility lease agreement of approximately 28,700 rentable square feet in Irvine, California. The Company plans to occupy the new facility in July 2007, which will allow for the consolidation of its headquarters and manufacturing operations into a single location. The total base rent for the term of the lease will be approximately $1.7 million, with monthly rent payments ranging from approximately $33,000 to $37,000 during the term of the lease.

NOTE 8 RELATED PARTY TRANSACTIONS

In February 2003, the Company loaned an employee $19,900 to exercise a portion of his then-vested common stock options. This full recourse note bears interest at a rate of 7% payable annually, and is due on February 17, 2008. In December 2006, the employee repaid $23,000 of the note. As of March 31, 2007 and December 30, 2006, the remaining amount outstanding was approximately $1,000 and has been recorded as a reduction of stockholders equity in the consolidated balance sheets.

NOTE 9 IMPAIRMENT OF LONG-LIVED ASSET

During fiscal 2006, the Company acquired certain laser soldering equipment (the Equipment) primarily intended for use in connection with a new product technology to be developed for a customer. In the first quarter of 2007, management determined that certain alternative equipment and related design processes were a more appropriate complement to the development of this technology. As a result, the Company determined the extent to which it expects to utilize the Equipment in the future had decreased from its original estimates. Accordingly, the Company concluded that the carrying value of the Equipment of approximately $0.3 million was no longer recoverable and was in fact impaired. In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company estimated the current fair value of the Equipment primarily using market prices for comparable machinery and equipment. As a result of its analysis, the Company recorded an impairment charge of approximately $0.1 million to write down the carrying value of the Equipment to its estimated fair value. This charge is included as a component of research and development expense for the three months ended March 31, 2007 in the accompanying unaudited condensed consolidated statement of operations.

The Company is still evaluating the extent of possible alternative uses for the Equipment, which may include ultimately disposing of the Equipment through a sale.

NOTE 10 STOCK OPTIONS AND WARRANTS

Common Stock Options

In November 2000, the Company adopted the 2000 Equity Incentive Plan (the 2000 Plan) and in October 2006, the Company adopted the 2006 Equity Incentive Plan (the 2006 Plan), under which direct stock awards or options to acquire shares of the Company s common stock may be granted to employees and nonemployees of the Company. The 2000 Plan is administered by the Board of Directors or a committee thereof, and the 2006 Plan is administered by the Compensation Committee of the Board of Directors. The 2000 Plan permitted the issuance of up to 5,750,000 shares of the Company s common stock. Effective as of the Company s initial public offering on December 5, 2006, no further grants may be

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made under the 2000 Plan. The 2006 Plan permits the issuance of a maximum of 500,000 shares of common stock, automatically increasing on the first day of each calendar year beginning on or after January 1, 2007 by the lesser of (i) 500,000 shares and (ii) such smaller number of shares as may be determined by our Board of Directors prior to that date. Options granted under the 2000 Plan and 2006 Plan primarily vest over a rate of 25% per year over four years and expire 10 years from the date of grant.

In March 2007, the Company granted options to purchase 3,000 shares of the Company s common stock to a non-employee consultant, which were immediately vested as of the grant date and carry an exercise price of $2.55 per share. The total grant date fair value of these options was approximately $20,000, which was recorded as stock-based compensation expense for the three months ended March 31, 2007.

A summary of common stock option activity as of and for the three months ended March 31, 2007 is presented below (shares in thousands):

	Shares	**Weighted-Average Exercise Price per Share**
Options outstanding at December 31, 2006	3,318	$ 3.34
Options granted	91	8.56
Options exercised	(101)	1.12
Options cancelled	(27)	2.55
Options outstanding at March 31, 2007	3,281	$ 3.56

The weighted-average grant date fair value per share of stock options granted during the three months ended March 31, 2007 and April 1, 2006 was $6.07 and $0.52, respectively. These values were estimated using the following assumptions:

	Three Months Ended March 31, 2007	**Three Months Ended April 1, 2006**
Expected term (in years)	5.4	6
Expected volatility	80%	40%
Risk-free interest rate	4.65%	4.55%
Expected dividends		

At March 31, 2007, the amount of unearned stock-based compensation currently estimated to be expensed from fiscal 2007 through fiscal 2011 related to unvested common stock options is approximately $3.5 million. The weighted-average period over which the unearned stock-based compensation is expected to be recognized is approximately 3.2 years. If there are any modifications or cancellations of the underlying unvested common stock options, the Company may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense. Future stock-based compensation expense and unearned stock-based compensation will increase to the extent that the Company grants additional equity awards.

Warrants

From time to time, the Company issues warrants to non-employees for services rendered or to be rendered in the future. Such warrants are issued outside of the 2000 Plan and 2006 Plan. As of March 31, 2007 and December 30, 2006, there were warrants outstanding to purchase 397,500 shares of common stock. As of March 31, 2007, approximately 368,000 warrants to purchase shares of common stock were fully vested and exercisable, while the remaining warrants to purchase 29,500 shares of common stock vest over approximately the next 3.5 years. The weighted-average exercise price of the warrants outstanding at March 31, 2007 was $1.35 per share.

NOTE 11 SEGMENT AND GEOGRAPHIC INFORMATION

The Company operates in one reportable segment: the design and manufacture of high-performance memory subsystems for the server, high-performance computing and communications markets. The Company evaluates financial performance on a Company-wide basis. All the Company s international sales relate to shipments of products to its U.S. customers international manufacturing sites or third-party hubs and are denominated in U.S. dollars.

NOTE 12 SUBSEQUENT EVENT

In May 2007, the Company and certain of its officers and directors were named as defendants in a securities class action filed in federal court in New York (Tran v. Netlist, et al., No. 07 CV 3754). The complaint is filed on behalf of purchasers of the Company s common stock in or traceable to the Company s initial public offering and assets claims under Sections 11 and 15 of the Securities Act of 1933. The Company has not been served with the complaint.

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

Cautionary Statement

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our Unaudited Condensed Consolidated Financial Statements and the related notes thereto contained in Part I, Item 1 of this Report. The information contained in this Quarterly Report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this Report and in our other reports filed with the Securities and Exchange Commission (SEC), including our Annual Report on Form 10-K for the fiscal year ended December 30, 2006 and subsequent reports on Form 8-K, which discuss our business in greater detail.

The section entitled Risk Factors set forth in Part II, Item 1A, and similar discussions in our other SEC filings, describe some of the important risk factors that may affect our business, results of operations and financial condition. You should carefully consider those risks, in addition to the other information in this Quarterly Report on Form 10-Q and in our other filings with the SEC, before deciding to purchase, hold or sell our common stock.

This report contains forward-looking statements that involve risks, uncertainties, estimates and assumptions. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors, including but not limited to those identified under the heading Risk Factors set forth in Part II, Item 1A. We undertake no obligation to revise or update publicly any forward-looking statements for any reason.

Overview

We design, manufacture and sell high performance memory subsystems for the server, high performance computing and communications markets. Our memory subsystems consist of dynamic random access memory integrated circuits, or DRAM ICs, and other components assembled on a printed circuit board, or PCB. We engage with our original equipment manufacturer, or OEM, customers from the earliest stages of new product definition, which provides us unique insight into their full range of system architecture and performance requirements. This close collaboration has also allowed us to develop a significant level of systems expertise. We leverage a portfolio of proprietary technologies and design techniques, including efficient planar design, alternative packaging techniques and custom semiconductor logic, to deliver memory subsystems with high memory density, small form factor, high signal integrity, attractive thermal characteristics and low cost per bit.

Due to their importance to overall system architecture and performance, our products must undergo lengthy qualification reviews by our OEM customers, which may last up to six months. In addition, in order to penetrate large OEMs, we have typically been required to demonstrate our ability to meet strict standards for quality, customer service and turnaround time by first supplying less complex products into a limited range of high volume applications. For example, the initial products we sold to IBM were used in mobile computing applications. The majority of our sales of subsequent products to IBM have been for high-end server applications, our primary market focus. Consistent with the concentrated nature of the

OEM customer base in our target markets, a small number of large customers have historically accounted for a significant portion of our net sales. Dell and IBM represented 38% and 11%, respectively, of our net sales in the three months ended March 31, 2007, and 16% and 33%, respectively, of our net sales in the three months ended April 1, 2006. Additionally, Hewlett Packard represented 31% of our net sales in the three months ended March 31, 2007. We expect that Dell, IBM and Hewlett Packard will continue to represent a significant percentage of our net sales for at least the next 12 months.

During the three months ended March 31, 2007, the market price of DRAM ICs decreased over 50%. This decline has adversely affected the selling prices of many of our products and resulted in lower revenues, lower gross margin and reduced inventory value during this period. Should the decline in the DRAM IC market continue, it would result in lower net sales, lower gross margin and reduced inventory value in subsequent periods. We expect that the continued softness in the DRAM market will have a significant impact on our overall results of operations in subsequent periods.

Key Business Metrics

The following describes certain line items in our statements of operations that are important to management s assessment of our financial performance:

Net Sales. Net sales consist primarily of sales of our high performance memory subsystems, net of a provision for estimated returns under our right of return policies, which range up to 30 days. We generally do not have long-term sales agreements with our customers. Although OEM customers typically provide us with non-binding forecasts of future product demand over specific periods of time, they generally place purchase orders with us approximately two weeks in advance of scheduled delivery. Selling prices are typically negotiated monthly, based on competitive market conditions and the current price of DRAM ICs. Purchase orders generally have no cancellation or rescheduling penalty provisions. We often ship our products to our customers international manufacturing sites. All of our sales to date, however, are denominated in U.S. dollars. We also sell excess component inventory of DRAM ICs to distributors and other users of memory ICs. These sales accounted for approximately 3% and 19% of our net sales in the three months ended March 31, 2007 and April 1, 2006, respectively. We expect that component inventory sales will continue to decrease as a percentage of net sales in future periods as we diversify our customer base and therefore are able to use components in a wider range of memory subsystems.

Cost of Sales. Our cost of sales includes the cost of materials, manufacturing costs, depreciation and amortization of equipment, inventory valuation provisions, stock-based compensation and occupancy costs and other allocated fixed costs. The DRAM ICs incorporated into our products constitute a significant portion of our cost of sales, and thus our cost of sales will fluctuate based on the current price of DRAM ICs. We attempt to pass through such DRAM IC cost fluctuations to our customers by frequently renegotiating pricing prior to the placement of their purchase orders. To the extent we are successful, a large majority of our product cost is variable, and thus our cost of sales and gross margin percentages may not be significantly impacted by changes in sales volume. However, the sales prices of our memory subsystems can also fluctuate due to competitive situations unrelated to the pricing of DRAM ICs, which will affect gross margins. The gross margin on our sales of excess component DRAM IC inventory is much lower than the gross margin on our sales of our memory subsystems. As a result, a decrease in DRAM IC inventory sales as a percentage of our overall sales would result in an improved overall gross margin. We assess the valuation of our inventories on a monthly basis and record a provision to cost of sales as necessary to reduce inventories to the lower of cost or market value.

Research and Development. Research and development expense consists primarily of employee and independent contractor compensation and related costs, stock-based compensation, computer-aided design software licenses, reference design development costs, patent-related fees, depreciation or rental of evaluation equipment, and occupancy and other allocated overhead costs. Also included in research and development expense are the costs of material and overhead related to the production of engineering samples of new products under development or products used solely in the research and development process. Our customers typically do not separately compensate us for design and engineering work involved in developing application-specific products for them. All research and development costs are expensed as incurred. As we continue to develop additional proprietary technologies, we anticipate that research and development expenditures will increase.

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Selling, General and Administrative. Selling, general and administrative expenses consist primarily of employee salaries and related costs, stock-based compensation, independent sales representative commissions, professional services, promotional and other selling and marketing expenses, and occupancy and other allocated overhead costs. A significant portion of our selling efforts is directed at building relationships with OEMs and working through the product approval and qualification process with them. Therefore, the cost of material and overhead related to products manufactured for qualification is included in selling expenses. As we continue to service existing and penetrate new OEM customers, we anticipate that our sales and marketing expenses will increase. We also anticipate that our general and administrative expenses will increase as a percentage of net sales as we incur accounting and legal expenses associated with our ongoing public reporting obligations and compliance with the requirements of the Sarbanes-Oxley Act of 2002.

Provision (Benefit) for Income Taxes. Our income tax provision (benefit) is based on the statutory federal tax rate of 35% and is typically impacted by state taxes and permanent book-tax differences.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of net sales and expenses during the reporting period. By their nature, these estimates and assumptions are subject to an inherent degree of uncertainty. We base our estimates on our historical experience, knowledge of current conditions and our beliefs of what could occur in the future considering available information. We review our estimates on an on-going basis. Actual results may differ from these estimates, which may result in material adverse effects on our operating results and financial position. We believe the following critical accounting policies involve our more significant assumptions and estimates used in the preparation of our consolidated financial statements:

Revenue Recognition. We recognize revenues in accordance with the Securities and Exchange Commission s Staff Accounting Bulletin No. 104, *Revenue Recognition*, or SAB No. 104. Under the provisions of SAB No. 104, we recognize revenues when there is persuasive evidence of an arrangement, product delivery and acceptance have occurred, the sales price is fixed or determinable, and collectibility of the resulting receivable is reasonably assured.

For all sales, we use a binding purchase order as evidence of an arrangement. Delivery occurs when goods are shipped for customers with FOB Shipping Point terms and upon receipt for customers with FOB Destination terms, at which time title and risk of loss transfer to the customer. Shipping documents are used to verify delivery and customer acceptance. We assess whether the sales price is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund. Customers are generally allowed limited rights of return for up to 30 days, except for sales of excess inventories, which contain no right-of-return privileges. Estimated returns are provided for at the time of sale based on historical experience or specific identification of an event necessitating a reserve. Returns from customers have not been material in any period as our principal customers have adopted build-to-order manufacturing models or just-in-time management processes. We offer a standard product warranty to our customers and have no other post-shipment obligations. We assess collectibility based on the creditworthiness of the customer as determined by credit checks and evaluations, as well as the customer s payment history. Most of our international shipments are made to third- party inventory warehouses, or hubs, and we recognize revenue when the inventory is pulled from the hub for use in production by the customer. We receive a report from the customer on a daily basis indicating the inventories pulled from a hub for use by the customer, and perform a daily reconciliation of inventories shipped to and pulled by the customer to those inventories reflected on the customer s reports to ensure that sales are recognized in the appropriate periods.

Customers are generally allowed limited rights of return for up to 30 days. Estimated returns are provided for at the time of sale based on historical experience or specific identification of an event necessitating a reserve. While these returns have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience similar return rates in the future. Any significant increase in product failure rates and the resulting product returns could have a material adverse effect on our operating results for the period or periods in which such returns materialize.

All amounts billed to customers related to shipping and handling are classified as net sales, while all costs incurred by us for shipping and handling are classified as cost of sales.

Warranty Reserve. We offer warranties on our memory subsystems generally ranging from one to three years, depending on the product and negotiated terms of purchase agreements with our customers. Such warranties require us to repair or replace defective product returned to us during such warranty period at no cost to the customer. Our estimates for warranty related costs are recorded at the time of sale based on historical and estimated future product return rates and expected repair or replacement costs. While such costs have historically been insignificant, unexpected changes in failure rates could have a material adverse impact on us.

Accounts Receivable. We perform credit evaluations of our customers financial condition and limit the amount of credit extended to our customers as deemed necessary, but generally require no collateral. We continuously monitor collections and payments from our customers and maintain a provision for estimated credit losses based upon our historical experience and any specific customer collection issues that we have identified. Generally, these credit losses have been within our expectations and the provisions established. However, we cannot guarantee that we will continue to experience credit loss rates similar to those we have experienced in the past.

Our accounts receivable are highly concentrated among a small number of customers, and a significant change in the liquidity or financial position of one of these customers could have a material adverse effect on the collectibility of our accounts receivable, our liquidity and our future operating results.

Inventories. We value our inventories at the lower of the actual cost to purchase or manufacture the inventory or the net realizable value of the inventory. Cost is determined on a first-in, first-out basis and includes raw materials, labor and manufacturing overhead. We regularly review inventory quantities on hand and on order and record a provision for excess and obsolete inventories based primarily on our estimated forecast of product demand and production requirements for the next three to six months. In addition, we consider changes in the market value of DRAM ICs in determining the realizable value of our raw material inventory. Once established, any write-downs are considered permanent adjustments to the cost basis of our inventories. A significant decrease in demand for our products could result in an increase in the amount of excess inventory quantities on hand. In addition, our estimates of future product demand may prove to be inaccurate, in which case we may have understated or overstated the provision required for excess and obsolete inventory. In the future, if our inventories are determined to be overvalued, we would be required to recognize additional expense in our cost of sales at the time of such determination. Likewise, if our inventories are determined to be undervalued, we may have over-reported our costs of sales in previous periods and would be required to recognize additional gross profit at the time such inventories are sold. In addition, should the market value of DRAM ICs decrease significantly, we may be required to lower our selling prices to reflect the lower cost of our raw materials. If such price decreases reduce the realizable value of our inventories to less than our cost, we would be required to recognize additional expense in our cost of sales in the same period. Although we make every reasonable effort to ensure the accuracy of our forecasts of future product demand, any significant unanticipated changes in demand, technological developments or the market value of DRAM ICs could have a material effect on the value of our inventories and our reported operating results.

Long-Lived Assets. We review the recoverability of the carrying value of long-lived assets on an annual basis or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of these assets is determined based upon the forecasted undiscounted future net cash flows from the operations to which the assets relate, utilizing our best estimates, appropriate assumptions and projections at the time. These projected future cash flows may vary significantly over time as a result of increased competition, changes in technology, fluctuations in demand, consolidation of our customers and reductions in average selling prices. If the carrying value is determined not to be recoverable from future operating cash flows, the asset is deemed impaired and an impairment loss is recognized to the extent the carrying value exceeds the estimated fair market value of the asset.

Stock-Based Compensation. We account for equity issuances to non-employees in accordance with Statement of Financial Accounting Standards, or SFAS, No. 123, *Accounting for Stock Based Compensation*, and Emerging Issues Task Force, or EITF Issue No. 96-18, *Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods and Services*. All transactions in which goods or services are the consideration received for the issuance of equity instruments are accounted for based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more reliably measurable. The measurement date used to determine the fair value of the equity instrument issued is the earlier of the date on which the third-party performance is complete or the date on which it is probable that performance will occur.

Prior to January 1, 2006, we accounted for stock-based compensation issued to employees using the intrinsic value method of accounting prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* and related pronouncements. Under this method, compensation expense was recognized over the respective vesting period based on the excess, on the date of grant, of the fair value of our common stock over the grant price, net of forfeitures. Deferred stock-based compensation was amortized on a straight-line basis over the vesting period of each grant.

On January 1, 2006, we adopted SFAS No. 123(R), *Share-Based Payment*, or SFAS No. 123(R), which requires the measurement and recognition of compensation expense for all share-based payment awards made to our employees and directors related to our Amended and Restated 2000 Equity Incentive Plan based on estimated fair values. We adopted SFAS No. 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of our fiscal year 2006. Our consolidated financial statements as of and for the year ended December 30, 2006 reflect the impact of adopting SFAS No. 123(R). In accordance with the modified prospective transition method, our consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R). The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our consolidated statement of operations. As stock-based compensation expense recognized in the consolidated statement of operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Income Taxes. We recognize deferred tax assets and liabilities based on the differences between the financial statement carrying values and the tax bases of assets and liabilities. We regularly review our deferred tax assets for recoverability and establish a valuation allowance based on historical taxable income, projected future taxable income, and the expected timing of the reversals of existing temporary differences. If we operate at a loss for an extended period of time or are unable to generate sufficient future taxable income, or if there is a material change in the actual effective tax rates or time period within which the underlying temporary differences become taxable or deductible, we could be required to record a valuation allowance against all or a significant portion of our deferred tax assets which could substantially increase our effective tax rate for such period. Any significant changes in statutory tax rates or the amount of our valuation allowance could have a material effect on the value of our deferred tax assets and liabilities, and our reported financial results. Additionally, the Company adopted Financial Accounting Standards Board, or FASB, Interpretation No. 48, *Accounting for Uncertainty in Income Taxe*s, or FIN 48, on December 31, 2006, the first day of fiscal 2007. FIN 48 is an interpretation of SFAS No. 109, *Accounting for Income Taxes*, and seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. FIN 48 prescribes a recognition threshold and measurement requirement for the financial statement recognition of a tax position that has been taken or is expected to be taken on a tax return. FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Under FIN 48 the Company may only recognize or continue to recognize tax positions that meet a more likely than not threshold. Refer to Note. 6, Income Taxes, for additional information.

Results of Operations

The following table sets forth certain consolidated statements of operations data as a percentage of net sales for the periods indicated:

	Three Months Ended March 31, 2007		April 1, 2006	
Net sales	100.0	%	100.0	%
Cost of sales	85.5		90.2	
Gross profit	14.5		9.8	
Operating expenses:				
Research and development	2.8		2.6	
Selling, general and administrative	9.9		6.9	
Total operating expenses	12.7		9.5	
Operating income	1.8		0.3	
Interest expense, net	(0.1	)	(1.6	)
Other income (expense), net				
Income (loss) before provision (benefit) for income taxes	1.7		(1.2	)
Provision (benefit) for income taxes			(0.3	)
Net income (loss)	1.7	%	(0.9	)%

Three Months Ended March 31, 2007 Compared to Three Months Ended April 1, 2006

Net Sales. Net sales for the three months ended March 31, 2007 were $37.5 million, a net increase of $11.5 million, or 44%, over the three months ended April 1, 2006. Sales of laptop personal computer, or PC, memory subsystems increased approximately $11.0 million over the three months ended April 1, 2006 primarily as a result of certain opportunities that arose in the market to sell such additional units during the current period. This was offset by a decrease in sales of our very low profile memory subsystems of approximately $8.3 million. In addition, DDR2 server memory subsystem sales increased by approximately $2.8 million while DDR subsystem sales decreased by approximately $0.3 million as customers continue transitioning to DDR2 architectures. Finally, sales of memory subsystems used to control redundant arrays of independent disks (RAIDs), which commenced late in the second quarter of fiscal 2006, contributed to approximately $11.3 of our revenues for the three months ended March 31, 2007.

Although sales of laptop PC memory increased significantly during the three months ended March 31, 2007 compared to the comparable quarter of 2006, such sales were adversely impacted by the significant decrease in DRAM IC market prices during the quarter. Such market price decreases cause us to decrease pricing on many of our products, including laptop PC memory subsystems. Should such market price declines continue, our overall revenues could be adversely impacted as we lower prices on some products to meet market conditions.

Sales of our component inventory to distributors and other users of memory ICs represented 3% and 19% of net sales for the three months ended March 31, 2007 and April 1, 2006, respectively. We expect that component inventory sales will continue to represent a relatively small percentage of net sales in future periods as we diversify our customer base and therefore are able to use components in a wider range of memory subsystems.

Gross Profit and Gross Margin. Gross profit for the three months ended March 31, 2007 was $5.5 million, an increase of $2.9 million, or 113%, over the three months ended April 1, 2006. Gross margin increased to 14.5% from 9.8% for the same period. The increase in both gross profit and gross margin is primarily attributable to increased sales of DDR2 server memory subsystems and memory subsystems to control RAIDs, which generate higher margins due to their innovative design. These increases were partially offset by the comparatively low gross margins realized on sales of laptop memory to one OEM customer during the three months ended March 31, 2007. The gross margin on sales of laptop PC memory was adversely impacted by the significant decrease in the market price of DRAM ICs during the first quarter of fiscal 2007. To the extent that such market price declines continue and should our product sales mix shift more toward lower margin products such as laptop memory, our gross profit, gross margin and overall operating results could be adversely affected.

Research and Development. Research and development expenses for the three months ended March 31, 2007 were $1.1 million, an increase of $0.4 million compared to the three months ended April 1, 2006. The increase was primarily attributable to (i) an increase of $0.1 million related to additional personnel engaged in research and development activities since April 1, 2006, (ii) $0.1 million related to the impairment write-down of certain long-lived assets used in the product development process and (iii) an increase of $0.1 million related to equipment, testing and certain other professional services incurred.

Selling, General and Administrative. Selling, general and administrative expenses for the three months ended March 31, 2007 were $3.7 million, an increase of $1.9 million compared to the three months ended April 1, 2006. The increase was primarily attributable to (i) an increase of $0.6 million related to additional personnel engaged in selling, general and administrative activities since April 1, 2006, (ii) an increase of $0.7 million in legal and professional services, primarily related to reporting and other obligations as a result of becoming a publicly traded company, along with costs incurred to set up our operation in China, (iii) an increase of $0.4 million related to certain selling and promotional expenses and (iv) an increase of $0.2 million in stock-based compensation.

Other Expense, Net. Other expense, net, for the three months ended March 31, 2007 was $47,000, a decrease of $0.4 million compared to the three months ended April 1, 2006. The decrease was due primarily to interest income of approximately $0.4 million earned during the current period on our investments in marketable securities, which significantly offset our interest expense of approximately $0.5 million for the three months ended March 31, 2007.

Provision (Benefit) for Income Taxes. We did not record a provision for income taxes for the three months ended March 31, 2007 which is compared to an income tax benefit of $83,000 recorded for the three months ended April 1, 2006. As of March 31, 2007, we have estimated our annual effective tax rate to be zero for fiscal 2007, which is based on our projected annualized income and the effect of research and development credits.

New Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*, or SFAS No.159. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparison between entities that choose different measurement attributes for similar types of assets and liabilities. We will adopt SFAS No. 159 in the first quarter of 2008 and are still evaluating the effect, if any, on our consolidated financial position and consolidated results of operations and have not yet determined its impact.

Liquidity and Capital Resources

Since our inception, we have financed our operations primarily through issuances of equity and debt securities and cash generated from operations. We have also funded our operations with a revolving line of credit under our bank credit facility, from capitalized lease obligations, financing of receivables and from the sale and leaseback of our manufacturing facility.

Working Capital and Cash and Marketable Securities. The following table presents working capital, cash and cash equivalents and investments in marketable securities (in thousands):

	March 31, 2007	December 30, 2006
Working Capital	$ 40,186	$ 45,584
Cash and cash equivalents(1)	$ 11,694	$ 30,975
Short-term marketable securities(1)	16,149	5,267
Long-term marketable securities	6,842	1,502
	$ 34,685	$ 37,744

(1) Included in working capital

Our working capital decreased in the three months ended March 31, 2007 primarily as a result of additional purchases of long-term investments in marketable securities and property and equipment during the period.

Cash Provided and Used in the Three Months Ended March 31, 2007 and April 1, 2006

Operating Activities. Net cash provided by operating activities for the three months ended March 31, 2007 was $4.9 million primarily as a result of $0.6 million in net income for the three months ended March 31, 2007 and (i) $0.3 million in net non-cash operating expenses, primarily comprising depreciation and amortization, deferred income taxes, stock-based compensation and impairment of long-lived assets and (ii) $4.0 million in net cash provided by changes in operating assets and liabilities. Net cash provided by operating activities for the three months ended April 1, 2006 was $2.6 million. This was primarily the result of the net loss for the three months ended April 1, 2006 offset by (i) $0.3 million in net non-cash operating expenses, primarily comprising depreciation and amortization and stock-based compensation expense, and (ii) $2.5 million in net cash provided by changes in operating assets and liabilities.

Investing Activities. Net cash used in investing activities for the three months ended March 31, 2007 was $16.7 million primarily as a result of purchases of additional investments in marketable securities during the period of approximately $30.6 million, partially offset by proceeds received from maturities of certain investments in marketable securities of approximately $14.4 million. Net cash used in investing activities for the three months ended April 1, 2006 was $22,000 resulting from the purchase of $67,000 of capital equipment to support operations, partially offset by the receipt of $45,000 in proceeds from the sale of certain other capital equipment.

Financing Activities. Net cash used in financing activities for the three months ended March 31, 2007 was $7.5 million primarily as a result of net repayments on our outstanding revolving line of credit of approximately $7.2 million. Net cash used in financing activities for the three months ended April 1, 2006 was $3.5 million resulting primarily from net repayments on our outstanding revolving line of credit of approximately $3.4 million.

Capital Resources

In April 2007, we executed a seventh amendment (the Seventh Amendment) to our credit agreement with our bank, which is effective March 21, 2007. The Seventh Amendment allows us, at our election, to increase our maximum borrowings on the line of credit from $25 million, in $2.5 million increments, up to a total of $40 million. In addition, among other terms, the Seventh Amendment (i) extends the maturity date of the line of credit to July 31, 2009, (ii) establishes an equipment advance line of $3 million, (iii) increases the sublimit for letters of credit to $5 million, (iv) sets an inventory sublimit of $7 million, subject to increase to $10 million if certain targets are met and (v) provides for the reduction in interest rates on borrowings if certain borrowing amounts and financial performance targets are met.

Under the revolving line of credit, we may borrow up to the greater of 85% of eligible accounts receivable plus the least of (i) a percentage of eligible inventory determined from time to time by the Company s bank, (ii) 80% of the orderly liquidation value, as defined, of eligible inventories, and (iii) $7 million. Interest is payable monthly at the prime rate of 8.25% as of March 31, 2007. Outstanding borrowings under the revolving line of credit were $12.0 million and $19.2 million as of March 31, 2007 and December 30, 2006, respectively. Borrowing availability as of March 31, 2007 was $2.9 million.

Under the equipment financing line of credit, we may borrow up to 80% of the cost of equipment purchases up to the maximum of $3 million. Interest on equipment line of credit advances was payable at the prime rate plus 0.5% prior to the Company s initial public offering in December 2006 and was reduced to the prime rate thereafter. Principal is due monthly through the maturity date of the credit agreement in July 2009, when all unpaid principal and interest is due. Outstanding borrowings under the new equipment line of credit were $996,000 and $1.1 million at March 31, 2007 and December 30, 2006, respectively.

Under the terms of the credit agreement, as stipulated within the Seventh Amendment, we are required to comply with certain financial and other covenants. The financial covenants require us to (i) achieve minimum book net worth on a monthly basis, (ii) limit annual capital expenditures under a defined annual cap and (iii) achieve a minimum quarterly debt service coverage ratio. While we are currently in compliance with all financial covenants and expect to maintain compliance for the foreseeable future, we have in the past been in violation of one or more covenants. We cannot assure you that we will not violate one or more covenants in the future. If we were to be in violation of covenants under our credit agreement, our lender could choose to accelerate payment on all outstanding loan balances. There can be no assurance that we would be able to quickly obtain equivalent or suitable replacement financing in this event. If we were not able to secure alternative sources of funding, such acceleration would have a material adverse impact on our financial condition.

We have in the past utilized equipment leasing arrangements to finance capital expenditures. Equipment leases will continue to be a financing alternative that we may pursue in the future.

We believe our existing cash balances, borrowing availability under our bank credit facility, and the cash expected to be generated from operations, will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our future capital requirements will depend on many factors, including our levels of net sales, the timing and extent of expenditures to support research and development activities, the expansion of manufacturing capacity both domestically and internationally and the continued market acceptance of our products. We could be required, or may choose, to seek additional funding through public or private equity or debt financings. In addition, in connection with any future acquisitions, we may require additional funding which may be provided in the form of additional debt or equity financing or a combination thereof. These additional funds may not be available on terms acceptable to us, or at all.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our bank credit facility because borrowings under the facility are variable rate borrowings, generally at prime. Assuming that all lines under the facility are fully drawn and holding other variables constant, each 1.0% increase in interest rates on our variable rate borrowings will result in an increase in annual interest expense and a decrease in our cash flows and income before taxes of approximately $0.4 million per year. We do not use derivative instruments to hedge the interest rate risk related to our credit facility.

We have invested most of the proceeds of our initial public offering in securities which may be subject to market risk for changes in interest rates. To mitigate this risk, we maintain a portfolio of cash equivalents and investments in a variety of marketable securities, which include commercial paper, money market funds, government and non-government debt securities. We currently do not use derivative financial instruments.

Our cash equivalents and investments in marketable securities are classified as available-for-sale in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and are therefore stated at fair value. Differences between fair value and amortized cost are recorded as unrealized gains and losses and are reported, net of taxes, as a component of accumulated other comprehensive income (loss). The fair value of our investments in marketable securities fluctuates based on changes in market conditions and interest rates; however, given the general short-term maturities of our investments, we do not believe these instruments are subject to significant market or interest rate risk.

The carrying value, maturity and estimated fair value of our cash equivalents and investments in marketable securities as of March 31, 2007 were as follows:

	Carrying Value March 31, 2007	Maturity Within One Year after March 31, 2007	Greater Than One Year After March 31, 2007	Fair Value March 31, 2007
	(In thousands, except interest rates)			
Investments				
Cash equivalents	$ 11,163	$ 11,163	$	$ 11,163
Weighted average interest rate	5.29 %	5.29 %	%	
Marketable securities	$ 22,991	$ 16,149	$ 6,842	$ 22,991
Weighted average interest rate	5.32 %	5.27 %	5.40 %	

Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not have any undisclosed borrowings or debt, and we have not entered into any synthetic leases. We are, therefore, not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. We carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principle financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, (Exchange Act)) as of the end of our fiscal quarter ended March 31, 2007. Based upon that evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective in ensuring that information required to be disclosed by us in reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and (ii) is accumulated and communicated to our management, including our principal executive officer and principal financial officer to allow timely decisions regarding required disclosure.

(b) Change in internal controls over financial reporting. During the fiscal quarter that ended March 31, 2007, there have not been any changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information set forth under Note 7 of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item I of this Report, is incorporated herein by reference.

Item 1A. Risk Factors

This Report includes forward-looking statements. These forward-looking statements generally are identified by words such as believe , expect , anticipate , estimate , intend , strategy , may , will likely and similar words or phrases. A forward-looking statement is neither a prediction nor a guarantee of future events or circumstances, and those future events or circumstances may not occur. Investors should not place undue reliance on the forward-looking statements, which speak only as of the date of this Report. We are under no obligation to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise. These forward-looking statements are all based on currently available operating, financial and competitive information and are subject to various risks and uncertainties, including but not limited to the rapidly-changing nature of technology; evolving industry standards; introductions of new products by competitors; changes in end-user demand for technology solutions; our ability to attract and retain skilled personnel; our reliance on suppliers of critical components; and the political and regulatory environment in the People s Republic of China (PRC). Our actual future results and trends may differ materially depending on a variety of factors including, but not limited to, the risks and uncertainties discussed below. The risks below are not the only ones we face. Additional risks and risks that management currently considers immaterial may also have an adverse effect on us.

We have a limited operating history, and we expect a number of factors to cause our operating results to fluctuate on a quarterly and annual basis, which may make it difficult to predict our future performance.

Our limited operating history makes it difficult to predict our future performance. Our operating results have varied significantly in the past and will continue to fluctuate from quarter-to-quarter or year-to-year in the future due to a variety of factors, many of which are beyond our control. Factors relating to our business that may contribute to these quarterly and annual fluctuations include the following factors, as well as other factors described elsewhere in this report:

- the loss of, or a significant reduction in sales to, a key customer;
- the cyclical nature of the industry in which we operate;
- a reduction in the demand for our high performance memory subsystems or the systems into which they are incorporated;
- changes in the prices of our products or in the cost of the materials that we use to build our products, including fluctuations in the market price of DRAM ICs;
- our inability to develop new or enhanced products that achieve customer or market acceptance in a timely manner;
- the timing of introductions of competing products or technologies;
- our ability to adequately finance future growth;
- our ability to procure an adequate supply of key components, particularly DRAM ICs;
- our failure to maintain the qualification of our products with our current customers or to qualify future products with our current or prospective customers;
- our failure to produce products that meet the quality requirements of our customers;
- our establishment and ongoing operation of a new manufacturing facility in the PRC;

- the loss of any of our key personnel;
- delays in fulfilling orders for our products or a failure to fulfill orders;
- disputes regarding intellectual property rights;
- litigation involving our products;
- our customers   failure to pay us on a timely basis; and;
- changes in accounting principles or policies.

Due to the various factors mentioned above, and others, the results of any prior quarterly or annual periods should not be relied upon as an indication of our future operating performance.

Sales to a limited number of customers represent a significant portion of our net sales and the loss of, or a significant reduction in sales to, any one of these customers could materially harm our business.

Sales to Dell, IBM and Hewlett Packard represented 38%, 11% and 31%, respectively, of our net sales in the three months ended March 31, 2007. Sales to Dell and IBM represented 16% and 33%, respectively, of our net sales in the three months ended April 1, 2006. We expect that sales to Dell, IBM and Hewlett Packard will continue to represent a significant percentage of our net sales for at least the next 12 months. We do not have long-term agreements with these customers, or with any other customer. Any one of these three customers could decide at any time to discontinue, decrease or delay their purchase of our products. In addition, the prices that these two customers pay for our products could change at any time. The loss of Dell, IBM or Hewlett Packard as a customer, or a significant reduction in sales to any of them, would significantly reduce our net sales and adversely affect our operating results.

Our ability to maintain or increase our net sales to our key customers depends on a variety of factors, many of which are beyond our control. These factors include our customers continued sales of servers and other computing systems that incorporate our memory subsystems and our customers continued incorporation of our products into their systems.

Because of these and other factors, we cannot assure you that net sales to these customers will continue or that the amount of such net sales will reach or exceed historical levels in any future period. Because these customers account for a substantial portion of our net sales, the failure of any one of these customers to pay on a timely basis would negatively impact our cash flow.

A limited number of relatively large potential customers dominate the markets for our products.

Our target markets are characterized by a limited number of large companies. Consolidation in one or more of our target markets may further increase this industry concentration. As a result, we anticipate that sales of our products will continue to be concentrated among a limited number of large customers in the foreseeable future. We believe that our financial results will depend in significant part on our success in establishing and maintaining relationships with, and effecting substantial sales to, these potential customers. Even if we establish these relationships, our financial results will be largely dependent on these customers sales and business results.

The markets in which we compete are cyclical in nature, and any future downturn could adversely affect our business.

The markets in which we compete and in which our customers operate have been cyclical and are characterized by wide fluctuations in product supply and demand. These markets have experienced significant downturns, often connected with, or in anticipation of, maturing product cycles, reductions in technology spending and declines in general economic conditions. These downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and the erosion of average selling prices. As a result, our sales will likely decline during these periods. In addition, if we are unable to control our expenses adequately in response to reduced net sales, our results of operations would be negatively impacted.

We are subject to risks relating to product concentration and lack of market diversification.

In the three months ended March 31, 2007 and April 1, 2006, we derived 60% and 75%, respectively, of our net sales from sales of our high performance memory subsystems for use in the server market. We expect these memory subsystems to continue to account for most of our net sales in the near term. Continued market acceptance of these products for use in servers is critical to our success. If the demand for servers deteriorates or if the demand for our products to be incorporated in servers declines, our operating results would be adversely affected, and we would be forced to diversify our product portfolio and our target markets. We may not be able to achieve this diversification, and our inability to do so may adversely affect our business.

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

We incurred net losses each year from the inception of our business through fiscal 2005. Our cumulative net losses were $15.9 million and $16.3 million as of March 31, 2007 and December 30, 2006, respectively. We may not be able to maintain profitability on a quarterly or annual basis in the future.

The price of DRAM ICs is volatile, and excess inventory of DRAM ICs, other components, and finished products could adversely affect our gross margin.

The prices of our products are adjusted periodically based in part on the market price of DRAM ICs, which have historically constituted approximately 75% - 90% of the total cost of our memory subsystems. Once our prices with a customer are negotiated, we are generally unable to revise pricing with that customer until our next regularly scheduled price adjustment. Consequently, we are exposed to the risks associated with the volatility of the price of DRAM ICs during that period. If the market price for DRAM ICs increases, we generally cannot pass this price increase on to our customers for products purchased under an existing purchase order. As a result, our cost of sales could increase and our gross margins could decrease. Alternatively, if there is a decline in the price of DRAM ICs, we may need to reduce our selling prices for subsequent purchase orders, which may result in a decline in our expected net sales.

Customer demand for our products, and thus DRAM ICs, can be difficult to estimate because we do not have long-term commitments from our customers, and our customers may cancel or defer purchase orders for any reason. If we overestimate customer demand, we may have excess inventory of DRAM ICs. If there is a subsequent decline in the price of DRAM ICs, the value of our inventory will fall. As a result, we may need to write-down the value of our DRAM IC inventory, which may result in a significant decrease in our gross margin and financial condition. If we underestimate customer demand, we may not have sufficient inventory of DRAM ICs to manufacture our products. This will lead to delays in the delivery of our products, which could cause order cancellations, the loss of customers and a decrease in our net sales.

We use a small number of DRAM IC suppliers and are subject to risks of disruption in the supply of DRAM ICs.

Our ability to fulfill customer orders is dependent on a sufficient supply of DRAM ICs, which are an essential component of our memory subsystems. There is a relatively small number of suppliers of DRAM ICs, and we purchase from only a subset of these suppliers. We have no long-term DRAM supply contracts. Our dependence on a small number of suppliers and the lack of any guaranteed sources of DRAM supply expose us to several risks, including the inability to obtain an adequate supply of DRAM ICs, price increases, delivery delays and poor quality.

From time to time, shortages in DRAM ICs have required some suppliers to limit the supply of their DRAM ICs. As a result, we may be unable to obtain the DRAM ICs necessary to fill customers orders for our products in a timely manner. If we are unable to obtain a sufficient supply of DRAM ICs to meet our customers requirements, these customers may reduce future orders for our products or not purchase our products at all, which would cause our net sales to decline and harm our operating results. In addition, our reputation could be harmed, we may not be able to replace any lost business with new customers, and we may lose market share to our competitors.

Our customers qualify the DRAM ICs of our suppliers for use in their systems. If one of our suppliers should experience quality control problems, it may be disqualified by one or more of our customers. This would disrupt our supplies of DRAM ICs and reduce the number of suppliers available to us, and may require that we qualify a new supplier.

If the supply of other component materials used to manufacture our products is interrupted, or if our inventory becomes obsolete, our results of operations and financial condition could be adversely affected.

We use consumables and other components, including PCBs, to manufacture our memory subsystems. We sometimes procure PCBs and other components from single or limited sources to take advantage of volume pricing discounts. Material shortages or transportation problems could interrupt the manufacture of our products from time to time in the future. These delays in manufacturing could adversely affect our results of operations.

Frequent technology changes and the introduction of next-generation products also may result in the obsolescence of other items of inventory, such as our custom-built PCBs, which could reduce our gross margin and adversely affect our operating performance and financial condition. We may not be able to sell some products developed for one customer to another customer because our products are often designed to address specific customer requirements, and if we are able to sell these products our margin on such products may be reduced.

We may lose our competitive position if we are unable to timely and cost-effectively develop new or enhanced products that meet our customers requirements and achieve market acceptance.

Our industry is characterized by intense competition, rapid technological change, evolving industry standards and rapid product obsolescence. Evolving industry standards and technological change or new, competitive technologies could render our existing products obsolete. Accordingly, our ability to compete in the future will depend in a large part on our ability to identify and develop new or enhanced products on a timely and cost-effective basis, and to respond to changing customer requirements. In order to develop and introduce new or enhanced products, we need to:

- identify and adjust to the changing requirements of our current and potential customers;
- identify and adapt to emerging technological trends and evolving industry standards in our markets;
- design and introduce cost-effective, innovative and performance-enhancing features that differentiate our products from those of our competitors;
- develop relationships with potential suppliers of components required for these new or enhanced products;
- qualify these products for use in our customers products; and
- develop and maintain effective marketing strategies.

Our product development efforts are costly and inherently risky. It is difficult to foresee changes or developments in technology or anticipate the adoption of new standards. Moreover, once these things are identified, if at all, we will need to hire the appropriate technical personnel, develop the product and identify and eliminate design flaws. As a result, we may not be able to successfully develop new or enhanced products, or we may experience delays in the development and introduction of new or enhanced products. Delays in product development and introduction could result in the loss of, or delays in generating, net sales and the loss of market share, as well as damage to our reputation. Even if we develop new or enhanced products, they may not meet our customers requirements or gain market acceptance. Accordingly, we cannot assure you that our future product development efforts will result in the development of new or enhanced products or that such products will achieve market acceptance.

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

Our prospective customers generally make a significant commitment of resources to test and evaluate our memory subsystems prior to purchasing our products and integrating them into their systems. This extensive qualification process involves rigorous reliability testing and evaluation of our products, which may continue for six months or longer and is often subject to delays. In addition to qualification of specific products, some of our customers may also require us to undergo a technology qualification if our product designs incorporate innovative technologies that the customer has not previously encountered. Such technology qualifications often take substantially longer than product qualifications and can take over a year to complete. Qualification by a prospective customer does not ensure any sales to that prospective customer. Even after successful qualification and sales of our products to a customer, changes in our products, our manufacturing facilities, our production processes or our component suppliers may require a new qualification process, which may result in additional delays. In addition, because the qualification process is both product-specific and platform-specific, our existing customers sometimes require us to requalify our products, or to qualify our new products, for use in new platforms or applications. For example, as our OEM customers transition from prior generation DDR DRAM architectures to current generation DDR2 DRAM architectures, we must design and qualify new products for use by those customers. In the past, this process of design and qualification has taken up to six months to complete, during which time our net sales to those customers declined significantly. After our products are qualified, it can take several months before the customer begins production and we begin to generate net sales. We must devote substantial resources, including design, engineering, sales, marketing and management efforts, to qualify our products with prospective customers in anticipation of sales. If we delay or do not succeed in qualifying a product with a prospective customer, we will not be able to sell that product to that prospect, which would harm our operating results and business.

We may not be able to maintain our competitive position because of the intense competition in our targeted markets.

We participate in a highly competitive market, and we expect competition to intensify. Many of these competitors have longer operating histories, significantly greater resources and name recognition, a larger base of customers and longer-standing relationships with customers and suppliers than we have. As a result, some of these competitors are able to devote greater resources to the development, promotion and sale of products and are better positioned than we are to influence customer acceptance of their products over our products. These competitors also may be able to respond better to new or emerging technologies or standards and may be able to deliver products with comparable or superior performance at a lower price. For these reasons, we may not be able to compete successfully against these competitors.

In addition to the competitors described above, some of our OEM customers have their own internal design groups that may develop solutions that compete with ours. These design groups have some advantages over us, including direct access to their respective companies technical information and technology roadmaps. Our OEM customers also have substantially greater resources, financial or otherwise, than we do, and may have lower cost structures than ours. As a result, they may be able to design and manufacture competitive products more efficiently or inexpensively. If any of these OEM customers are successful in competing against us, our sales could decline, our margins could be negatively impacted and we could lose market share, any or all of which could harm our business and results of operations.

We expect our competitors to continue to improve the performance of their current products, reduce their prices and introduce new or enhanced technologies that may offer greater performance and improved pricing. If we are unable to match or exceed the improvements made by our competitors, our market position would deteriorate and our net sales would decline. In addition, our competitors may develop future generations and enhancements of competitive products that may render our technologies obsolete or uncompetitive.

We also expect to face competition from new and emerging companies that may enter our existing or future markets. These potential competitors may have similar or alternative products which may be less costly or provide additional features.

The establishment and ongoing operation of our planned manufacturing facility in the People s Republic of China, or the PRC, could expose us to new and significant risks.

We are in the process of establishing a new manufacturing facility in the PRC. To prepare this facility for operation, we will need to purchase new equipment, replicate our current manufacturing processes and hire additional technical personnel. The difficulties normally associated with this complicated process will be compounded by language and cultural differences, as well as the geographic distance from our current facility. Our management has limited experience in creating or overseeing foreign operations, and this new facility may divert substantial amounts of their time. Further, this new facility will be subject to factory audits by our customers. We may not be able to begin operations at this new facility on a timely basis, or at all. Even if this facility becomes operational and is qualified by our customers, we cannot assure you that we will be able to maintain control over product quality, delivery schedules, manufacturing yields and costs as we increase our output. We will also have to manage a local workforce that may subject us to uncertainties or regulatory policies. Any difficulties in operating this new facility could cause product delivery delays and reduce our operating results.

We currently anticipate that our new manufacturing facility in the PRC will become operational in the second half of 2007. Once this facility is established and becomes operational, some of our net sales will be denominated in Chinese Renminbi, or Yuan. The Chinese government controls the procedures by which Yuan is converted into other currencies, and conversion of Yuan generally requires government consent. As a result, Yuan may not be freely convertible into other currencies at all times. If the Chinese government institutes changes in currency conversion procedures, or imposes restrictions on currency conversion, those actions may negatively impact our operations and could reduce our operating results. In addition, fluctuations in the exchange rate between Yuan and U.S. dollars may adversely affect our expenses and results of operations as well as the value of our assets and liabilities. These fluctuations may also adversely affect the comparability of our period-to-period results. If we decide to declare dividends and repatriate funds from our Chinese operations, we will be required to comply with the procedures and regulations of applicable Chinese law. Any changes to these procedures and regulations, or our failure to comply with those procedures and regulations, could prevent us from making dividends and repatriating funds from our Chinese operations, which could adversely affect our financial condition. If we are able make dividends and repatriate funds from our Chinese operations, these dividends would be subject to U.S. corporate income tax.

The PRC currently provides for favorable tax rates for certain foreign-owned enterprises operating in specified locations in the PRC. We are establishing our China facility in such a tax-favored location. Should the PRC government enact a revised income tax structure, it is possible that we would not realize the tax benefits that we currently anticipate and this could adversely impact our operating results.

We depend on a few key employees, and if we lose the services of any of those employees or are unable to hire additional personnel, our business could be harmed.

Our success to date has been highly dependent on the experience, relationships and technical knowledge of Chun K. Hong, our President, Chief Executive Officer and Chairman of the Board, Jayesh Bhakta, our Chief Technology Officer, and Christopher Lopes, our Vice President of Sales. We believe that our future success will be dependent on our ability to retain the services of these key employees, develop their successors, reduce our reliance on them, and properly manage the transition of their roles should departures occur.

The loss of these key employees could delay the development and introduction of, and negatively impact our ability to sell our products and otherwise harm our business. We do not have employment agreements with any of these key employees other than Mr. Hong. We do not carry Key Man life insurance on any of our key employees.

Our future success also depends on our ability to attract, retain and motivate highly skilled engineering, manufacturing, other technical and sales personnel. Competition for experienced personnel is intense. We may not be successful in attracting new engineers or other technical personnel, or in retaining or motivating our existing personnel. If we are unable to hire and retain engineers with the skills necessary to keep pace with the evolving technologies in our markets, our ability to continue to provide our current products and to develop new or enhanced products will be negatively impacted, which would harm our business. In addition, the shortage of experienced engineers, and other factors, may lead to increased recruiting, relocation and compensation costs for such engineers, which may exceed our expectations and resources. These increased costs may make hiring new engineers difficult, or may reduce our margins.

As of March 31, 2007, approximately 21% of our workforce consisted of contract personnel. We invest considerable time and expense in training these contract employees. We may experience high turnover rates in our contract employee workforce, which may require us to expend additional resources in the future. If we convert any of these contract employees into permanent employees, we may have to pay finder s fees to the contract agency.

Our lack of a significant backlog of unfilled orders, and the difficulty inherent in forecasting customer demand, makes it difficult to forecast our short-term production requirements to meet that demand.

We do not have long-term purchase agreements with our customers. Instead, our customers generally place purchase orders no more than two weeks in advance of their desired delivery date, and these purchase orders generally have no cancellation or rescheduling penalty provisions. This fact, combined with the quick turn-around times that apply to each order, makes it difficult to forecast our production needs and allocate production capacity efficiently. Our production expense levels are based in part on our forecasts of our customers future product requirements and to a large extent are fixed in the short term. As a result, we likely will be unable to adjust spending on a timely basis to compensate for any unexpected shortfall in those orders. Any significant shortfall of customer orders in relation to our expectations could hurt our operating results, cash flows and financial condition. Also, any rapid increases in production required by our customers could strain our resources and reduce our margins. If such a rapid increase were to occur at any given time, we may not have sufficient short-term manufacturing capacity to meet our customers immediate demands.

We attempt to forecast the demand for the DRAM ICs and other components needed to manufacture our products. Lead times for components vary significantly and depend on various factors, such as the specific supplier and the demand and supply for a component at a given time. If we underestimate customer demand or if we have not provided for sufficient manufacturing capacity, we would not be able to manufacture a sufficient quantity of our products and could forego sales opportunities, lose market share and damage our customer relationships.

If we are unable to manufacture our products efficiently, our operating results could suffer.

We must continuously review and improve our manufacturing processes in an effort to maintain satisfactory manufacturing yields and product performance, lower our costs and otherwise remain competitive. For example, we began implementing lead-free soldering technologies in our manufacturing processes in the second quarter of 2005, and Reduction of Hazardous Substances manufacturing processes in the fourth quarter of 2005, both of which have been fully implemented. Implementing process improvements in the future could negatively impact our manufacturing yields, which would in turn adversely affect our results of operations.

As we manufacture more complex products, the risk of encountering delays or difficulties increases. The start-up costs associated with implementing new manufacturing technologies, methods and processes, including the purchase of new equipment, and any resulting manufacturing delays and inefficiencies, could negatively impact our results of operations.

If we need to add manufacturing capacity, an expansion of our existing manufacturing facility or establishment of a new facility could be subject to factory audits by our customers. For example, our new manufacturing facility in the PRC will need to be audited and approved by our key customers. Any delays or unexpected costs resulting from this audit process could adversely affect our net sales and results of operations. In addition, we cannot be certain that we will be able to increase our manufacturing capacity on a timely basis or meet the standards of any applicable factory audits.

If we fail to protect our proprietary rights, our customers or our competitors might gain access to our proprietary designs, processes and technologies, which could adversely affect our operating results.

We rely on a combination of patent protection, trade secret laws and restrictions on disclosure to protect our intellectual property rights. We have submitted a number of patent applications regarding our proprietary processes and technology. It is not certain when or if any of the claims in the remaining applications will be allowed. To date we have had only four patents issued. We intend to continue filing patent applications with respect to most of the new processes and technologies that we develop. However, patent protection may not be available for some of these processes or technologies.

It is possible that our efforts to protect our intellectual property rights may not:

- prevent challenges to, or the invalidation or circumvention of, our existing intellectual property rights;
- prevent our competitors from independently developing similar products, duplicating our products or designing around any patents that may be issued to us;
- prevent disputes with third parties regarding ownership of our intellectual property rights;
- prevent disclosure of our trade secrets and know-how to third parties or into the public domain;
- result in valid patents, including international patents, from any of our pending or future applications; or
- otherwise adequately protect our intellectual property rights.

Others may attempt to reverse engineer, copy or otherwise obtain and use our proprietary technologies without our consent. Monitoring the unauthorized use of our technologies is difficult. We cannot be certain that the steps we have taken will prevent the unauthorized use of our technologies. This is particularly true in foreign countries, such as the PRC, where we are in the process of establishing a new manufacturing facility and where the laws may not protect our proprietary rights to the same extent as applicable U.S. laws.

If some or all of the claims in our patent applications are not allowed, or if any of our intellectual property protections are limited in scope by a court or circumvented by others, we could face increased competition with regard to our products. Increased competition could significantly harm our business and our operating results.

We may be involved in costly legal proceedings to defend against claims that we infringe the intellectual property rights of others or to enforce or protect our intellectual property rights.

Lawsuits claiming that we are infringing others intellectual property rights may be brought against us, and we may have to defend against claims of infringement or invalidity. We currently plan to explore new technologies such as flash memory and to develop new products for our existing markets, such as communications, and for new markets, such as networking. By making use of these new technologies and entering these new markets there is an increased likelihood that others might allege that our products infringe on their intellectual property rights. Litigation is inherently uncertain, and an adverse outcome could subject us to significant liability for damages or invalidate our proprietary rights. An adverse outcome also could force us to take specific actions, including causing us to:

- cease selling products that are claimed to be infringing a third party s intellectual property;
- pay royalties on past or future sales;
- seek a license from the third party intellectual property owner to use their technology in our products, which license may not be available on reasonable terms, or at all; or
- redesign those products that are claimed to be infringing a third party s intellectual property.

There is a limited pool of experienced technical personnel that we can draw upon to meet our hiring needs. As a result, a number of our existing employees have worked for our existing or potential competitors at some point during their careers, and we anticipate that a number of our future employees will have similar work histories. In the past, some of these competitors have claimed that our employees misappropriated their trade secrets or violated non-competition or non-solicitation agreements. Some of our competitors may threaten or bring legal action involving similar claims against us or our existing employees or make such claims in the future to prevent us from hiring qualified candidates. Lawsuits of this type may be brought, even if there is no merit to the claim, simply as a strategy to drain our financial resources and divert management s attention away from our business.

We also may find it necessary to litigate against others, including our competitors, customers and former employees, to enforce our intellectual property and contractual and commercial rights including, in particular, our trade secrets, as well as to challenge the validity and scope of the proprietary rights of others. We could become subject to counterclaims or countersuits against us as a result of this litigation. Moreover, any legal disputes with customers could cause them to cease buying or using our products or delay their purchase of our products and could substantially damage our relationship with them.

Any litigation, regardless of its outcome, would be time consuming and costly to resolve, divert our management s time and attention and negatively impact our results of operations.

If we are required to obtain licenses to use third party intellectual property and we fail to do so, our business could be harmed.

Although some of the components used in our final products contain the intellectual property of third parties, we believe that our suppliers bear the sole responsibility to obtain any rights and licenses to such third party intellectual property. While we have no knowledge that any third party licensor disputes our belief, we cannot assure you that disputes will not arise in the future. The operation of our business and our ability to compete successfully depends significantly on our continued operation without claims of infringement or demands resulting from such claims, including demands for payments of money in the form of, for example, ongoing licensing fees.

We are also developing products to enter new markets, such as the industrial flash market. Similar to our current products, we may use components in these new products that contain the intellectual property of third parties. While we will exercise necessary precautions to avoid infringing on the intellectual property rights of third parties, we cannot assure you that disputes will not arise.

If it is determined that we are required to obtain inbound licenses and we fail to obtain licenses, or if such licenses are not available on economically feasible terms, our business, operating results and financial condition could be significantly harmed.

If our products do not meet the quality standards of our customers, we may be forced to stop shipments of products until the quality issues are resolved. If our products are defective or are used in defective systems, we may be subject to product recalls or product liability claims.

Our customers require our products to meet strict quality standards. Should our products not meet such standards, our customers may discontinue purchases from us until we are able to resolve the quality issues that are causing us to not meet the standards, Such quality holds could have a significant adverse impact on our revenues and operating results.

If our products are defectively manufactured, contain defective components or are used in defective or malfunctioning systems, we could be subject to product liability claims and product recalls, safety alerts or advisory notices. While we have product liability insurance coverage, it may not be adequate to satisfy claims made against us. We also may be unable to obtain insurance in the future at satisfactory rates or in adequate amounts. Product liability claims or product recalls, regardless of their ultimate outcome, could have an adverse effect on our business, financial condition and reputation, and on our ability to attract and retain customers. In addition, we may determine that it is in our best interest to accept product returns in circumstances where we are not contractually obligated to do so in order to maintain good relations with our customers. Accepting product returns may negatively impact our operating results.

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

We will evaluate opportunities to acquire businesses or technologies that might complement our current product offerings or enhance our technical capabilities. We have no experience in acquiring other businesses or technologies. Acquisitions entail a number of risks that could adversely affect our business and operating results, including:

- difficulties in integrating the operations, technologies or products of the acquired companies;
- the diversion of management s time and attention from the normal daily operations of the business;
- insufficient increases in net sales to offset increased expenses associated with acquisitions or acquired companies;
- difficulties in retaining business relationships with suppliers and customers of the acquired companies;
- the overestimation of potential synergies or a delay in realizing those synergies;
- entering markets in which we have no or limited experience and in which competitors have stronger market positions; and
- the potential loss of key employees of the acquired companies.

Future acquisitions also could cause us to incur debt or be subject to contingent liabilities. In addition, acquisitions could cause us to issue equity securities that could dilute the ownership percentages of our existing stockholders. Furthermore, acquisitions may result in material charges or adverse tax consequences, substantial depreciation, deferred compensation charges, in-process research and development charges, the amortization of amounts related to deferred stock-based compensation expense and identifiable purchased intangible assets or impairment of goodwill, any or all of which could negatively affect our results of operations.

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

We have expanded, and plan to continue to expand, our operations, both domestically and internationally. Any future growth may strain our resources, management information and telecommunication systems, and operational and financial controls. To manage our growth effectively, including the development of our new manufacturing facility in the PRC, we must continue to improve and expand our systems and controls. We may not be able to do this in a timely or cost-effective manner, and our current systems and controls may not be adequate to support our future operations. In addition, our officers have relatively limited experience in managing a rapidly growing business or a public company. As a result, they may not be able to provide the guidance necessary to continue our growth or maintain our market position. Any failure to manage our growth or improve or expand our existing systems and controls, or unexpected difficulties in doing so, could harm our business.

Our internal controls over financial reporting may not be effective, and our independent auditors may not be able to certify as to their effectiveness, which could have a significant and adverse effect on our business.

We plan to evaluate our internal controls over financial reporting to allow management to report on, and our registered public accounting firm to attest to, those internal controls as will be required by Section 404 of the Sarbanes-Oxley Act of 2002 and the rules and regulations of the Securities and Exchange Commission, which we collectively refer to as Section 404. This will involve system and process evaluations and testing to comply with the management assessment and independent registered public accounting firm attestation requirements of Section 404, which will initially have to be made in our annual report on Form 10-K for our 2007 fiscal year. Effective internal controls are necessary for us to produce reliable financial reports and are important in our effort to prevent financial fraud. In the course of our Section 404 evaluations, we may identify conditions that may result in significant deficiencies or material weaknesses and we may conclude that enhancements, modifications or changes to our internal controls are necessary or desirable. Implementing any such matters would divert the attention of our management, could involve significant costs, and may negatively impact our results of operations.

We note that there are inherent limitations on the effectiveness of internal controls, as they cannot prevent collusion, management override or failure of human judgment. If we fail to maintain an effective system of internal controls or if management or our independent registered public accounting firm were to discover material weaknesses in our internal controls, we may be unable to produce reliable financial reports or prevent fraud, and it could harm our financial condition and results of operations, result in a loss of investor confidence and negatively impact our share price.

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

Many of our memory subsystems are specifically designed for our OEM customers high performance systems. Our business would be harmed if these high performance systems were to become standardized so that DRAM IC manufacturers or other companies could develop and manufacture a commodity memory module addressing the demands of some or all of these high performance applications. If DRAM IC manufacturers or other companies are able to develop a standardized solution, our future business may be limited to identifying the next generation of high performance memory demands of OEM customers and developing a solution that addresses such demands. Until fully implemented, this next generation of products may constitute a much smaller market, which may reduce our net sales and market share.

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

We are subject to various and frequently changing U.S. federal, state and local and foreign governmental laws and regulations relating to the protection of the environment, including those governing the discharge of pollutants into the air and water, the management and disposal of hazardous substances and wastes, the cleanup of contaminated sites and the maintenance of a safe workplace. In particular, some of our manufacturing processes may require us to handle and dispose of hazardous materials from time to time. For example, in the past our manufacturing operations have used lead-based solder in the assembly of our products. Today, we use lead-free soldering technologies in our manufacturing processes, as this is required for products entering the European Union. We could incur substantial costs, including clean-up costs, civil or criminal fines or sanctions and third-party claims for property damage or personal injury, as a result of violations of, or noncompliance with, environmental laws and regulations. These laws and regulations also could require us to incur significant costs to remain in compliance.

Economic, political and other risks associated with international sales and operations could adversely affect our net sales.

Part of our growth strategy involves making sales to foreign corporations and delivering our products to facilities located in foreign countries. To facilitate this process and to meet the long-term projected demand for our products, we are planning to set up a new manufacturing facility in the PRC. Selling and manufacturing in foreign countries subjects us to additional risks not present with our domestic operations. We will begin operating in business and regulatory environments in which we have little or no previous experience. We will need to overcome language and cultural barriers to effectively conduct our operations in these new environments. In addition, the economies of the PRC and other countries have been highly volatile in the past, resulting in significant fluctuations in local currencies and other instabilities. These instabilities affect a number of our customers and suppliers in addition to our foreign operations and continue to exist or may occur again in the future. International turmoil and the threat of future terrorist attacks, both domestically and internationally, have contributed to an uncertain political and economic climate, both in the U.S. and globally, and have negatively impacted the worldwide economy. The occurrence of one or more of these instabilities could adversely affect our foreign operations and some of our customers or suppliers, each of which could adversely affect our net sales. In addition, our failure to meet applicable regulatory requirements or overcome cultural barriers could result in production delays and increased turn-around times, which would adversely affect our business.

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

Our current manufacturing facility is located in Irvine, California. Due to this geographic concentration, a disruption of our manufacturing operations, resulting from equipment failure, power failures, quality control issues, human error, government intervention or natural disasters, including earthquakes, fires or floods, could interrupt or interfere with our manufacturing operations and consequently harm our business, financial condition and results of operations. Such disruptions would cause significant delays in shipments of our products and adversely affect our operating results.

Our principal stockholders have significant voting power and may take actions that may not be in the best interest of our other stockholders.

As of March 31, 2007, our executive officers, directors and 5% stockholders beneficially own, in total, approximately 50% of our outstanding common stock. As a result, these stockholders, acting together, have the ability to exert substantial influence over all matters requiring approval by our stockholders, including the election and removal of directors and any proposed merger, consolidation or sale of all or substantially all of our assets

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and other corporate transactions. This concentration of control could be disadvantageous to other stockholders with interests different from those of our executive officers, directors and principal stockholders. For example, our executive officers, directors and principal stockholders could delay or prevent an acquisition or merger even if the transaction would benefit other stockholders. In addition, this significant concentration of share ownership may adversely affect the trading price for our common stock because investors may perceive disadvantages in owning stock in companies with stockholders that have the ability to exercise significant control.

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

Our certificate of incorporation and bylaws contain provisions that could delay or prevent a change of control of our company or changes in our board of directors that our stockholders might consider favorable. In addition, these provisions could limit the price that investors would be willing to pay in the future for shares of our common stock. The following are examples of provisions which are included in our certificate of incorporation and bylaws, each as amended:

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

In addition, we are governed by the provisions of Section 203 of the Delaware General Corporate Law, which may prohibit certain business combinations with stockholders owning 15% or more of our outstanding voting stock. These and other provisions in our certificate of incorporation and bylaws, and of Delaware law could make it more difficult for stockholders or potential acquirors to obtain control of our board of directors or initiate actions that are opposed by the then-current board of directors, including delaying or impeding a merger, tender offer, or proxy contest or other change of control transaction involving our company. Any delay or prevention of a change of control transaction or changes in our board of directors could prevent the consummation of a transaction in which our stockholders could receive a substantial premium over the then-current market price for their shares.

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

On December 5, 2006 we completed our initial public offering of our common stock pursuant to our Registration Statement on Form S-1 (File No. 333-136735) that was declared effective by the SEC on November 29, 2006. There has been no material change with respect to our use of the net proceeds from our initial public offering to the information discussed in our Annual Report on Form 10-K for the year ended December 30, 2006.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Securities Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Description of Document
3.1(1)	Restated Certificate of Incorporation of Netlist, Inc.
3.2(1)	Amended and Restated Bylaws of Netlist, Inc.
10.1(2)	Lease (Multi-Tenant; Net), dated April 2, 2007, by and between The Irvine Company LLC, a Delaware limited liability company, and Netlist, Inc., a Delaware corporation.
10.2(2)	Seventh Amendment to Amended and Restated Credit and Security Agreement, dated effective as of March 21, 2007, by and among Netlist, Inc., a Delaware corporation, Netlist Technology Texas, L.P., a Texas limited partnership, and Wells Fargo Bank, National Association.
31.1	Certification of Principal Executive Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer, as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32(3)	Certification of Chief Executive Officer and Chief Financial Officer, as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and furnished herewith pursuant to SEC Release No. 33-8238.

(1) Incorporated by reference to the corresponding exhibit number of the registration statement on Form S-1 of the registrant (No. 333-136735) filed with the Securities and Exchange Commission on October 23, 2006.

(2) Incorporated by reference to the corresponding exhibit number of the current report on Form 8-K of the registrant filed with the Securities and Exchange Commission on April 6, 2007.

(3) The information in Exhibit 32 shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, (the Exchange Act), or otherwise subject to the liabilities of that section, nor shall they be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act (including this Report), unless Netlist, Inc. specifically incorporates the foregoing information into those documents by reference.

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: May 15, 2007		NETLIST, INC. a Delware corporation (Registrant)
	By:	/s/ Chun K. Hong **Chun K. Hong** **President, Chief Executive Officer and Chairman of the Board** **(Principal Executive Officer)**
	By:	/s/ Lee Kim **Lee Kim** **Vice President and Chief Financial Officer** **(Principal Financial Officer)**

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