NETLIST INC
Form 10-K
March 29, 2013

Use these links to rapidly review the document
TABLE OF CONTENTS
PART IV
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 29, 2012

or

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

For the transition period from to
Commission file number 001-33170

NETLIST, INC.

(Exact name of registrant as specified in its charter)

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

51 Discovery, Suite 150
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

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

None

(Title of class)

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

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

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 ý No o

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company ý

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

The aggregate market value of the registrant's common stock held by non-affiliates, based on the closing price of the registrant's common stock as reported on The NASDAQ Global Market on June 29, 2012, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $52.2 million. For purposes of this calculation, it has been assumed that all shares of the registrant's common stock held by directors, executive officers and shareholders beneficially owning five percent or more of the registrant's common stock are held by affiliates. The treatment of these persons as affiliates for purposes of this calculation is not conclusive as to whether such persons are, in fact, affiliates of the registrant.

The number of shares outstanding of the registrant's common stock, as of the latest practicable date:

Common Stock, par value $0.001 per share
30,366,553 shares outstanding at March 25, 2013

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the registrant's Annual Meeting of Stockholders for 2013 have been incorporated by reference into Part III of this Annual Report on Form 10-K.

TABLE OF CONTENTS

Unless the context otherwise requires, references to the "Company," "Netlist," "we," "us" or "our" refer to Netlist, Inc. and its subsidiaries.

The registered trademarks of Netlist, Inc. and its subsidiaries include: HyperCloud® and NVvault . Other trademarks used in this Report are the property of their respective owners.

Table of Contents

*This Annual Report on Form 10-K includes "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements relate to expectations concerning matters that are not historical facts, and are generally 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 our actual results could differ materially and adversely from those expressed in any forward-looking statement. These forward-looking statements are all based on currently available market, operating, financial and competitive information and assumptions and are subject to various risks and uncertainties that are difficult to predict. Important information regarding factors that could cause actual results to differ materially from such expectations is disclosed in this Report, including, without limitation, information under the caption "**Risk Factors**". These risks and uncertainties include, but are not limited to risks associated with the launch and commercial success of our products, programs and technologies; the success of product partnerships; continuing development, qualification and volume production of EXPRESSvault , NVvault , HyperCloud® and VLP Planar-X RDIMM; the timing and magnitude of the continued decrease in sales to our key customer; our ability to leverage our NVvault technology in a more diverse customer base; our need to raise additional capital and our ability to obtain financing; the rapidly-changing nature of technology; risks associated with intellectual property, including patent infringement litigation against us as well as the costs and unpredictability of litigation over infringement of our intellectual property and the possibility of our patents being reexamined by the USPTO; volatility in the pricing of DRAM ICs and NAND; changes in and uncertainty of customer acceptance of, and demand for, our existing products and products under development, including uncertainty of and/or delays in product orders and product qualifications; delays in our and our customers' product releases and development; 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 vendors in the supply chain; fluctuations in the market price of critical components; evolving industry standards; and the political and regulatory environment in the People's Republic of China ("PRC"). Except as required by law, we do not undertake any obligation to revise or update any forward-looking statements for any reason.*

PART I

Item 1. Business

Overview

We design, manufacture and sell high-performance, intelligent memory subsystems for datacenter server and high-performance computing and communications markets. Our memory subsystems consist of combinations of dynamic random access memory integrated circuits ("DRAM ICs" or "DRAM"), NAND flash memory ("NAND"), application-specific integrated circuits ("ASICs") and other components assembled on printed circuit boards ("PCBs"). We primarily market and sell our products to leading original equipment manufacturer ("OEM") customers. Our solutions are targeted at applications where memory plays a key role in meeting system performance requirements. 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.

We were incorporated in Delaware in June 2000 and commenced operations in September 2000.

Our Products

HyperCloud®

In November 2009, we introduced HyperCloud® DDR3 memory technology. HyperCloud® utilizes an ASIC chipset that incorporates Netlist patented rank multiplication technology that increases

Table of Contents

memory capacity and load reduction technology that increases memory bandwidth. We expect that these patented technologies will make possible improved levels of performance for memory intensive datacenter applications and workloads, including enterprise virtualization, cloud computing infrastructure, business intelligence real-time data analytics, and high performance computing. HyperCloud® memory has been qualified by two of our OEM customers for use in their server products. HyperCloud® is interoperable with JEDEC standard DDR3 memory modules. Our HyperCloud® products are designed to allow for installation in servers without the need for a BIOS change. As such, their anticipated sales launch is not dependent on the design plans or product cycle of our OEM customers. However, we have experienced longer qualification cycles than anticipated.

In November 2011, we introduced a 32GB two-virtual rank RDIMM integrating HyperCloud® with our proprietary Planar-X technology. The new memory module enables up to 768GB of DRAM memory in next generation two-processor servers. Also in November 2011, we announced collaborative agreements with each of Hewlett-Packard Company ("HP") and International Business Machines ("IBM"), pursuant to which these OEMs have cooperated with us in efforts to qualify HyperCloud® memory products for use with their respective products. In February 2012 and May 2012, we achieved memory qualification of HyperCloud® at IBM and HP, respectively. HP and IBM have engaged and continue to engage with us in joint marketing and further product development efforts. We and each of the OEMs have committed financial and other resources toward the collaboration. However, the efforts undertaken with each of these collaborative agreements may not result in significant product margins for us relative to our investment in developing and marketing these products.

NVvault

Our NVvault product line consists primarily of battery-free and battery-powered flash backed cache memory subsystem targeting Redundant Array of Independent Disks, ("RAID") storage applications. NVvault battery-free provides server and storage OEMs a solution for enhanced datacenter fault recovery. The NVvault products have historically been sold primarily to Dell, for incorporation in its PERC 7 server products. Following Intel's launch of its Romley platform in the first quarter of 2012, we have experienced a rapid decline in NVvault sales to Dell. Sales of NVvault products to Dell totaled $15.7 million for the year ended December 29,2012, compared to $37.7 million for the year ended December 31, 2011. We expect that we will continue to see some demand from Dell through 2013, after which sales of NVvault products for incorporation into PERC 7 servers will be minimal. In order to leverage our NVvault technology into a more diverse customer base, we continue to pursue additional qualifications of NVvault with other customers. We introduced EXPRESSvault in March 2011, and continue to pursue qualifications of next generation DDR3 NVvault with customers. However, our efforts may not result in significant revenues from the sale of NVvault products.

Specialty Memory Modules and Flash-Based Products

The remainder of our revenue is primarily from OEM sales of specialty memory modules and flash-based products, the majority of which were utilized in data center and industrial applications. When developing custom modules for an equipment product launch, we engage with our OEM customers from the earliest stages of new product definition, providing 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 speed, capacity and signal integrity, small form factor, attractive thermal characteristics and low cost per bit. Revenues from our specialty modules and flash-based products are subject to fluctuation as a result of the life cycles of the products into which our modules are incorporated. Our ability to continue to produce revenues from specialty memory modules and flash-based products is dependent on our ability to qualify our products on new platforms as current platforms reach the end of their lifecycles, and on the state of the global economy.

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. Two customers represented approximately 60% and 18% of our net sales for the year ended December 29, 2012 and one customer represented approximately 70% of our net sales for the year ended December 31, 2011.

Technology

We have a portfolio of proprietary technologies and design techniques and have assembled an engineering team with expertise in semiconductors, printed circuit boards, memory subsystem and system design. Our technology competencies include:

IC Design Expertise. We have designed special algorithms that can be implemented in stand-alone integrated circuits or integrated into other functional blocks in ASICs. We utilize these algorithms in the HyperCloud® chipset to incorporate rank multiplication and load reduction functionality. We also incorporate these algorithms in our NVvault™ product line of RDIMMS.

Very Low Profile Designs. We were the first company to create memory subsystems in a form factor of less than one inch in height. We believe our proprietary board design technology is particularly useful in the blade server market, where efficient use of motherboard space is critical. Our technology has allowed us to decrease the system board space required for memory, and improve thermal performance and operating speeds, by enabling our customers to use alternative methods of component layout.

Proprietary PCB Designs. We utilize advanced, proprietary techniques to optimize electronic signal strength and integrity within a PCB. These techniques include the use of 8- or 10-layer boards, matching conductive trace lengths, a minimized number of conductive connectors, or vias, and precise load balancing to, among other things, help reduce noise and crosstalk between adjacent traces. In addition, our proprietary designs for the precise placement of intra-substrate components allow us to assemble memory subsystems with significantly smaller physical size, enabling OEMs to develop products with smaller footprints for their customers.

Planar-X Designs. Our patented Planar-X circuit design provides additional board space for a large number of DRAM components. This enables us to produce higher capacity RDIMM modules, such as our 32GB two-virtual rank HyperCloud® RDIMM, at a lower cost by allowing us to use standard, currently available 4GB DRAM technology.

Thermal Management Designs. We design our memory subsystems to ensure effective heat dissipation. We use thermal cameras to obtain thermal profiles of the memory subsystem during the design phase, allowing us to rearrange components to enhance thermal characteristics and, if necessary, replace components that do not meet specifications. We use thermal simulation and modeling software to create comprehensive heat transfer models of our memory subsystems, which enables our engineers to quickly develop accurate solutions for potential thermal issues. We also develop and use proprietary heat spreaders to enhance the thermal management characteristics of our memory subsystems.

Vault. We were the first to develop and market memory subsystems that incorporate both DRAM and NAND in a single NVvault persistent DIMM solution for backup of volatile data to non-volatile NAND. NVvault is desirable for mission critical backups during power interruption in RAID and main memory for Cloud, Big Data, on-line banking and other real time applications. NVvault is

Table of Contents

incorporated in our EXPRESSvault PCIe solution for both acceleration and backup in storage applications.

Customers

We primarily market and sell our products to leading OEMs in the server, storage and communications markets. 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. Net sales to our two largest customers, Dell and IBM, represented approximately 60% and 18% of our net sales in 2012, respectively. Dell represented approximately 70% of our net sales in 2011. Net sales to some of our OEM customers include memory modules that are qualified by us directly with the OEM customer and sold to electronic manufacturing services providers ("EMSs"), for incorporation into products manufactured exclusively for the OEM customer or, in some instances, to facilitate credit and logistics. These net sales to EMSs have historically fluctuated period to period as a portion of the total net sales to the OEM customers. Net sales to Hon Hai Precision Industry Co. Ltd., an EMS operating under the trade name of Foxconn that purchases memory modules from us for incorporation into products manufactured exclusively for Dell, represented approximately 87% and 96% of net sales to Dell for 2012 and 2011, respectively. Net sales to Kingston Technology, an EMS manufacturer for IBM, represented approximately 62% of net sales to IBM for 2012. For further information regarding our sales to our OEM customer base, please refer to Note 12 of Notes to Consolidated Financial Statements included in Part IV, Item 15 of this Report.

We expect that our key customers or other large OEMs will continue to account for a substantial portion of our net sales in 2013 and in the foreseeable future. The composition of major customers and their respective contributions to our net sales have varied and will likely continue to vary from period to period as our OEMs progress through the life cycle of the products they produce and sell. For example, we have experienced a significant decline in sales of our NVvault sales to Dell following its launch of servers incorporating Intel's Romley platform. Our sales are made primarily pursuant to standard purchase orders that may be rescheduled on relatively short notice. 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. 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.

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 within our expectations and the provisions established, unexpected changes in failure rates could have a material adverse impact on us, requiring additional warranty reserves, and adversely affecting our gross profit and gross margins.

Sales and Marketing

We market and sell our products through a direct sales force and a network of independent sales representatives. Our sales activities focus primarily on developing strong relationships at the technical, marketing and executive management levels within market-leading OEMs. Additionally, our marketing strategy for HyperCloud® includes the creation of demand through end-user evaluation and demonstration activities in vertical computing markets. Our OEM customers design systems for a variety of applications that require a significant number of high performance memory subsystems, representing substantial opportunities for us. We have been successful in developing OEM relationships through our ability to provide high performance memory subsystems. Our direct sales group and field application engineers work closely with our OEM customers at an early stage of their design cycles to solve their design challenges and to design our products into their systems.

We believe in the timely communication and exchange of information with our customers. We utilize well-trained, highly technical program management teams to successfully drive new product development and quickly respond to our customers' needs and expectations. Our program management teams provide quick response times and act as a single point-of-contact for routine issues during the sales process. Additionally, they address the long-term business and technology goals of our customers. We employ a team approach to business development whereby our sales team and independent representatives identify, qualify and prioritize customer prospects through offices in a number of locations worldwide. For additional information regarding our net sales from external customers by geographic area, refer to Note 13 of Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this Report.

Manufacturing

We manufacture substantially all of our products at our facilities in Suzhou in the PRC. Our advanced engineering and design capabilities, combined with our in-house manufacturing processes, allow us to assemble our memory subsystems reliably and in high volume. Our advanced, customized manufacturing facilities are capable of surface mount assembly, subsystem testing, system-level burn-in testing, programming, marking, labeling and packaging. At each stage of the production cycle, including product prototyping, qualification sample production and high-volume manufacturing and delivery, we focus on providing our customers with rapid response and short manufacturing turn-around times. Manufacturing cycle times for our products are typically one week or less, and in some cases as few as two days, from receipt of order.

We acquire components and materials such as ASICs, DRAM ICs and NAND directly from integrated circuit manufacturers and assemble them into finished subsystems. We believe that one of our key strengths is the efficient procurement and management of components for our subsystems, which benefits our customers in the form of lower costs and increased product availability. We have a limited number of suppliers, including SK hynix Semiconductor America and Samsung Semiconductor, Inc, each of which have comprised more than 10% of our total purchases in both of 2012 and 2011. For further information regarding our supplier concentrations, refer to Note 12 of Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this Report. We have developed strong supplier relationships with these and other key DRAM IC and NAND manufacturers, which we believe gives us direct and ready access to the critical components that we need for our production activities. We typically qualify our products with our customers using multiple manufacturers of DRAM ICs and NAND. The flexibility to choose from several DRAM IC and NAND providers allows us to minimize product cost and maximize product availability. Our HyperCloud® RDIMM contains an ASIC chipset component. We intend to procure these ASICs from multiple integrated circuit vendors.

We schedule production based on purchase order commitments and anticipated orders. We release raw materials to the manufacturing floor by means of an on-line shop floor control system, which allows for internal quality analysis, direct access to inventory information and production floor material tracking. We have a flexible manufacturing workforce which allows us to manage unforecasted demand. In addition, in order to mitigate inventory risks, we have the capability to sell excess quantities of certain component inventories of DRAM ICs and NAND to distributors and other users of memory integrated circuits. However, the ASIC and DRAM components used in our HyperCloud® product have limited alternative uses. As such, we may not be able to sell excess quantities of the components,

Table of Contents

should we fail to obtain qualification with major OEMs. Our sales of excess inventory generated less than 1% of our net sales in 2012 and 2011.

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

We perform ongoing reliability testing on our memory subsystems and share the results of that testing with our customers. We believe that this improves the system design process and allows for the elimination of potential problems at the earliest possible stage. In addition, we have implemented procedures which require that all of our memory subsystems undergo functional and system burn-in testing prior to delivery to the customer. We complement our test capabilities with advanced imaging technology to inspect the quality of our assemblies.

We are certified in ISO 9001:2000 Quality Management Systems, ISO 14001:2004 Environmental Management Standards, and OSHAS 18001:2007 Occupational Health and Safety Management Systems.

Competition

Our products are primarily targeted for the server, high performance computing and communications markets. These markets are intensely competitive, as numerous companies vie for business opportunities at a limited number of large OEMs. We face competition from DRAM suppliers, including SK hynix, Samsung and Micron for many of our products, including HyperCloud®. Our primary competitors for the rest of our product lines are mainly memory module providers such as STEC, SMART Modular Technologies, Inc., Agigatech, and Viking Interworks, a division of Sanmina-SCI Corporation. We also face potential direct or indirect competition from logic suppliers such as Inphi and IDT. As we enter new markets and pursue additional applications for our products, we may face competition from a larger number of competitors that produce solutions utilizing similar or competing technologies.

Certain of our competitors have substantially greater financial, technical, marketing, distribution and other resources, broader product lines, lower cost structures, greater brand recognition and longer standing relationships with customers and suppliers. Some of our competitors may also have a greater ability to influence industry standards than we do, as well as more extensive patent portfolios.

Some of our customers and suppliers may have proprietary products or technologies that are competitive with our products, or could develop internal solutions or enter into strategic relationships with, or acquire, existing high-density memory module providers. Any of these actions could reduce our customers' demand for our products. Some of our significant suppliers of memory integrated circuits may be able to manufacture competitive products at lower costs by leveraging internal efficiencies, or could choose to reduce our supply of memory integrated circuits, adversely affecting our ability to manufacture our memory subsystems on a timely basis, if at all.

Our ability to compete in our current target markets and in future markets will depend in large part on our ability to successfully develop, introduce and sell new and enhanced products on a timely and cost-effective basis, and to respond to changing market requirements. We believe that the principal competitive factors in the selection of high performance memory subsystems by potential customers are:

- understanding of OEM system and business requirements;
- timeliness of new value-add product introductions;
- design characteristics and performance;

Table of Contents

- quality and reliability;
- track record of volume delivery;
- credibility with the customer;
- fulfillment capability and flexibility; and
- price.

We believe that we compete favorably with respect to these factors. However, our current and future competitors could develop competing products that could cause a decline in sales or loss of market acceptance of our products.

Research and Development

The market for high performance memory subsystems is constantly changing and therefore continuous development of new technology, processes and product innovation is mandatory to be successful as a leading supplier. We believe that the continued and timely development of new products and improvement of existing products are critical to maintaining our competitive position. Our team of engineers focuses on developing custom semiconductor logic devices and products with innovative thermal solutions, packaging solutions and improved electrical signal integrity that enhances reliability over the life of the system and achieves higher speeds and lowers power consumption. Also, our engineers incorporate various new techniques and methodologies for testing as well as new processes for manufacturing our products.

Our engineering staff closely engages with our OEM partners and their engineering teams at early stages in their system development. This collaboration allows our engineers to understand the customer's system architecture, power budget, operating environment such as air flow and operating temperature and any mechanical constraints. Our engineers use this information to provide guidance and solutions to implement optimum memory subsystems to our OEM partners. An important aspect of our research and development effort is to understand the challenges faced by our OEM partners and provide cost effective solutions that satisfy their requirements by utilizing our industry knowledge, proprietary technologies and technical expertise.

We use advanced design tools in development of our products that allow us to model behavior of a signal trace on our memory modules as well as airflow and thermal profiles of all components in the system. These design tools enable real-time simulation for signal integrity and behavioral modeling of our designs using the Input/Output Buffer Information Specification ("IBIS") of our suppliers' components. These simulation tools help us reduce or eliminate electronic signal reflections, clock skews, signal jitter and noise which can reduce system performance and reliability. Also, our engineers use thermal simulation tools to identify potential thermal problems arising from inadequate airflow necessary to cool the components in the system. These efforts allow our engineers to develop optimum thermal solutions for our customer base.

We believe that to remain competitive we must continue to focus on developing advanced memory technologies. We have invested significant resources in the design of custom semiconductor logic devices. These logic devices are integrated into our next-generation memory subsystems in order to improve their performance. For example, our HyperCloud® logic devices enable our DRAM-based subsystems to achieve higher speeds and address greater memory capacity at a lower price point than currently available products in the market. Logic devices in our NVvault battery-free product enable DRAM and flash memory to be efficiently combined for the purposes of backing up data storage. The development of these semiconductor devices are an important part of our overall effort to maintain a strong competitive position in our industry based on advanced memory technology.

Table of Contents

Our customers typically do not separately compensate us for design and engineering work involved in developing application-specific products for them. Our total expenditures for research and development were approximately $12.8 million and $14.9 million for 2012 and 2011, respectively.

Intellectual Property

Our high performance memory subsystems are developed in part using our proprietary intellectual property, and we believe that the strength of our intellectual property rights will be important to the success of our business. We utilize patent and trade secret protection, confidentiality agreements with customers and partners, disclosure and invention assignment agreements with employees and consultants and other contractual provisions to protect our intellectual property and other proprietary information.

As of December 29, 2012, we had 31 U.S. patents issued and 23 U.S. and 7 foreign patent applications pending. Assuming that they are properly maintained, our patents will expire at various dates between 2022 and 2029. Our issued patents and patent applications relate to the use of custom logic in high performance memory subsystems, PCB design, layout and packaging techniques. We intend to actively pursue the filing of additional patent applications related to our technology advancements. While we believe that our patent and other intellectual property rights are important to our success, our technical expertise and ability to introduce new products in a timely manner also will continue to be important factors in developing and maintaining our competitive position. Accordingly, we believe that our business is not materially dependent upon any one claim in any of our existing patents or pending patent applications.

Despite our precautions, a third party may reverse engineer, copy or otherwise obtain and use our products, services or technology without authorization, develop similar technology independently or design around any patents issued to us. There can be no assurance that our efforts taken to prevent misappropriation or infringement of our intellectual property by third parties have been or will be successful.

Employees

At December 29, 2012, we had approximately 158 employees (including 100 regular employees and 58 temporary employees). Approximately 31 of the regular employees were located in the U.S., and approximately 69 were located in other countries (mainly in the PRC). We had 126 employees in operations, 14 employees in research and development, 12 employees in sales and marketing, and 6 employees engaged in other administrative functions. We are not party to any collective bargaining agreements with any of our employees. We have never experienced a work stoppage, and we believe our employee relations are good.

General Information

We maintain a website at *www.netlist.com* (this uniform resource locator, or URL, is an inactive textual reference only and is not intended to incorporate our website into this Form 10-K). We file reports with the Securities and Exchange Commission ("SEC"), and make available, free of charge, on or through our website, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy and information statements and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Our website also contains copies of our corporate governance policy, code of business conduct and ethics, insider trading policy and whistleblower policy, as well as copies of the charters for our audit committee, compensation committee and nominating and corporate governance committee.

Table of Contents

Item 1A. Risk Factors

You should consider each of the following factors as well as the other information in this Report in evaluating our business and our prospects, including our consolidated financial statements and related notes.

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 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 annual report:

- general economic conditions, including the possibility of a prolonged period of limited economic growth in the U.S. and Europe; disruptions to the credit and financial markets in the U.S., Europe and elsewhere;
- our inability to develop new or enhanced products that achieve customer or market acceptance in a timely manner, including our HyperCloud® memory module and our flash-based memory products;
- our failure to maintain the qualification of our products with our current customers or to qualify current and future products with our current or prospective customers in a timely manner or at all;
- the timing of actual or anticipated introductions of competing products or technologies by us or our competitors, customers or suppliers;
- 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;
- our customers' failure to pay us on a timely basis;
- costs, inefficiencies and supply risks associated with outsourcing portions of the design and the manufacture of integrated circuits;
- our ability to absorb manufacturing overhead if our revenues decline or vary from our projections;
- delays in fulfilling orders for our products or a failure to fulfill orders;
- our ability to procure an adequate supply of key components, particularly DRAM ICs and NAND;

dependence on large suppliers who are also competitors and whose manufacturing priorities may not support our production schedules;

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 and NAND;

our ability to effectively operate our manufacturing facility in the PRC;

manufacturing inefficiencies associated with the start-up of new manufacturing operations, new products and initiation of volume production;

Table of Contents

- our failure to produce products that meet the quality requirements of our customers;
- disputes regarding intellectual property rights and the possibility of our patents being reexamined by the USPTO;
- the costs and management attention diversion associated with litigation;
- the loss of any of our key personnel;
- changes in regulatory policies or accounting principles;
- our ability to adequately manage or finance internal growth or growth through acquisitions;
- the effect of our investments and financing arrangements on our liquidity; and
- the other factors described in this "Risk Factors" section and elsewhere in this annual report.

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. In one or more future periods, our results of operations may fall below the expectations of securities analysts and investors. In that event, the market price of our common stock would likely decline. In addition, the market price of our common stock may fluctuate or decline regardless of our operating performance.

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

Since the inception of our business in 2000, we have only experienced one fiscal year (2006) with profitable results. In order to regain profitability, or to achieve and sustain positive cash flows from operations in the future, we must further reduce operating expenses and/or increase our revenues. Although we have in the past engaged in a series of cost reduction actions, and believe that we could reduce our current level of expenses through elimination or reduction of strategic initiatives, such expense reductions alone may not make us profitable or allow us to sustain profitability if it is achieved. Our ability to achieve profitability will depend on increased revenue growth from, among other things, increased demand for our memory subsystems and related product offerings, as well as our ability to expand into new and emerging markets. We may not be successful in achieving the necessary revenue growth or the expected expense reductions. Moreover, we may be unable to sustain past or expected future expense reductions in subsequent periods. We may not achieve profitability or sustain such profitability, if achieved, on a quarterly or annual basis in the future.

Any failure to achieve profitability could result in increased capital requirements and pressure on our liquidity position. We believe our future capital requirements will depend on many factors, including our levels of net sales, the timing and extent of expenditures to support sales, marketing, research and development activities, the expansion of manufacturing capacity both domestically and internationally and the continued market acceptance of our products. Our capital requirements could result in our having to, or otherwise choosing to, seek additional funding through public or private equity offerings or debt financings. Such funding may not be available on terms acceptable to us, or at all, either of which could result in our inability to meet certain of our financial obligations and other related commitments.

Our future capital needs are uncertain and we may need to raise additional funds, which may not be available on acceptable terms or at all.

We believe our existing cash balances, borrowing availability under our bank credit facility, proceeds available under the sales agreement with Ascendiant 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. However, we will likely need significant additional capital, which we may seek to raise through, among other things, public and private equity offerings and debt financings. Our future capital requirements

Table of Contents

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. Additional funds may not be available on terms acceptable to us, or at all. Furthermore, if we issue equity or convertible debt securities to raise additional funds, our existing stockholders may experience dilution, and the new equity or debt securities may have rights, preferences, and privileges senior to those of our existing stockholders. If we incur additional debt, it may increase our leverage relative to our earnings or to our equity capitalization.

If adequate working capital is not available when needed, we may be required to significantly modify our business model and operations to reduce spending to a sustainable level. It could cause us to be unable to execute our business plan, take advantage of future opportunities, or respond to competitive pressures or customer requirements. It may also cause us to delay, scale back or eliminate some or all of our research and development programs, or to reduce or cease operations.

Our existing indebtedness and any future indebtedness we incur could adversely affect our cash flow and prevent us from fulfilling our financial obligations.

We have incurred debt under our credit facility and term loans with Silicon Valley Bank. Incurring debt could have material consequences, such as:

- requiring us to dedicate a portion of our cash flow from operations and other capital resources to debt service, thereby reducing our ability to fund working capital, capital expenditures, and other cash requirements;

- increasing our vulnerability to adverse economic and industry conditions;

- limiting our flexibility in planning for, or reacting to, changes and opportunities in, our business and industry, which may place us at a competitive disadvantage;

- restricting our ability to guarantee certain obligations, create or assume liens and pay dividends; and

- limiting our ability to incur additional indebtedness on acceptable terms or at all.

As of December 29, 2012, we were in violation of one of the financial covenants contained in our credit agreement with Silicon Valley Bank. We have entered into a forbearance agreement with Silicon Valley Bank, pursuant to which the lender has agreed to forbear from enforcing its rights against us under the credit agreement until April 30, 2013 in exchange for, among other things, an increase in our interest rate to 2.75% above the Prime Rate under the revolving line of credit, an increase in the borrowing base reserve from one million dollars to two million dollars and an increase in the interest rate on the term loan to 3.25% above the Prime Rate. We are currently working with Silicon Valley Bank to obtain a waiver of our non-compliance. If we are unable to obtain a waiver, additional forbearance or a modification to the required net worth levels, the lender could choose to accelerate payment on all outstanding loan balances and we could lose certain vendor credit should the letters of credit issued under the credit agreement become unavailable. If that were to occur, we may be unable to quickly obtain equivalent or suitable replacement financing. If we were not able to secure alternative sources of funding, such acceleration would have a material adverse impact on our financial condition.

Our revenues and results of operations have been substantially dependent on NVvault and we may be unable to replace revenue lost from the rapid decline in NVvault sales.

For the years ended December 29, 2012 and December 31, 2011, our NVvault non-volatile RDIMM used in cache protection and data logging applications, including our NVvault battery-free, the flash-based cache system, accounted for 51% and 66% of total revenues, respectively. Following

Table of Contents

Intel's launch of its Romley platform in the first quarter of 2012, we have experienced a rapid decline in NVvault sales to Dell, and we recognized $15.7 million in NVvault sales to Dell in the year ended December 29, 2012, as compared to $37.7 million in the year ended December 31, 2011. We expect that after product in the supply chain is consumed, we will see some demand from Dell through 2013, after which sales of NVvault products for incorporation into PERC 7 servers will be minimal. In order to leverage our NVvault technology and diversify our customer base, we continue to pursue additional qualifications of NVvault with other OEMs. We also introduced EXPRESSvault in March 2011 and we continue to pursue qualification of next generation DDR3 NVvault with customers. Our future operating results will depend on our ability to commercialize these NVvault product extensions, as well as other new products such as HyperCloud® and other high-density and high-performance solutions. We may not be successful in marketing any new or enhanced products. If we are not successful in generating sales of other products, the decrease or cessation of sales of NVvault products to Dell will significantly reduce our annual revenues and negatively affect our results of operations.

We are subject to risks relating to our focus on developing our HyperCloud® product and lack of market diversification.

We have historically derived a substantial portion 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 a significant portion of our net sales in the near term. Continued market acceptance of these products for use in servers is critical to our success.

In an attempt to set our products apart from those of our competitors, we have invested a significant portion of our research and development budget into the design of ASIC devices, including the HyperCloud® memory subsystem, introduced in November 2009. This design and the products it is incorporated into are subject to increased risks as compared to our other products. For example:

- we may be unable to achieve customer or market acceptance of the HyperCloud® memory subsystem or other new products, or achieve such acceptance in a timely manner;

- the HyperCloud® memory subsystem or other new products may contain currently undiscovered flaws, the correction of which would result in increased costs and time to market;

- we are dependent on a limited number of suppliers for both the DRAM ICs and the ASIC devices that are essential to the functionality of the HyperCloud® memory subsystem, and could experience supply chain disruption as a result of business issues that are specific to our suppliers or the industry as a whole; and

- we are required to demonstrate the quality and reliability of the HyperCloud® memory subsystem or other new products to our customers, and are required to qualify these new products with our customers, both of which have required and will continue to require a significant investment of time and resources prior to the receipt of any revenue from such customers.

We experienced a longer qualification cycle than anticipated with our HyperCloud® memory subsystems, and as of December 29, 2012 we have not generated significant HyperCloud® product revenues relative to our investment in the product. We entered into collaborative agreements with both IBM and HP pursuant to which these OEMs qualified the 16GB version of HyperCloud® for use with their products. The 16GB version of HyperCloud® has been available to order since March 6, 2012 and May 14, 2012 for IBM and HP, respectively. We are working with both OEMs in joint marketing and further product development efforts. We and each of the OEMs have committed financial and other resources toward the collaboration. However, the efforts undertaken pursuant to either of the collaborative agreements may not result in new revenues or gross margins for us that are significant relative to our investment in the products. Failure to maintain qualification of this product with IBM, HP or other potential customers could adversely impact our results of operations.

Additionally, 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 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 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 or retain third party designers, develop the product, identify and eliminate design flaws, and manufacture the product in production quantities either in-house or through third-party manufacturers. 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.

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.

Table of Contents

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 DDR2 DRAM architectures to current generation DDR3 DRAM architectures, we must design and qualify new products for use by those customers. In the past, the 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 from such customer.

Likewise, when our memory component vendors discontinue production of components, it may be necessary for us to design and qualify new products for our customers. Such customers may require of us or we may decide to purchase an estimated quantity of discontinued memory components necessary to ensure a steady supply of existing products until products with new components can be qualified. Purchases of this nature may affect our liquidity. Additionally, our estimation of quantities required during the transition may be incorrect, which could adversely impact our results of operations through lost revenue opportunities or charges related to excess and obsolete inventory.

We must devote substantial resources, including design, engineering, sales, marketing and management efforts, to qualify our products with prospective customers in anticipation of sales. Significant delays in the qualification process, such as those experienced with our HyperCloud® product, could result in an inability to keep up with rapid technology change or new, competitive technologies. If we delay or do not succeed in qualifying a product with an existing or prospective customer, we will not be able to sell that product to that customer, which may result in our holding excess and obsolete inventory and harm our operating results and business.

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 certain of our OEM customers have historically represented a substantial majority of our net sales. Approximately 60% and 18% of our net sales in year ended December 29, 2012 were to two of our customers. Approximately 70% of our net sales in the year ended December 31, 2011 were to one of our customers. We currently expect that sales to major OEM customers will continue to represent a significant percentage of our net sales for the foreseeable future. We do not have long-term agreements with our OEM customers, or with any other customer. Any one of these customers could decide at any time to discontinue, decrease or delay their purchase of our products. In addition, the prices that these customers pay for our products could change at any time. The loss of any of our OEM customers, or a significant reduction in sales to any of them, could 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, net sales to these customers may not continue and the amount of such net sales may not 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. In addition, while we may not be contractually obligated to accept returned products, we may determine that it is in our best interest to accept returns in order to maintain good relations with our customers. As we describe in more detail elsewhere in this Report, we have experienced a significant decline in sales of NVvault   sales to our primary customer. This reduction in sales has had, and is expected to continue to have, a significant impact on our revenues and gross profit.

Table of Contents

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.

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. In a drive to reduce costs and assure supply of their memory module demand, our OEM customers may endeavor to design JEDEC standard DRAM modules into their new products. Although we also manufacture JEDEC modules, this trend could reduce the demand for our higher priced customized memory solutions which in turn would have a negative impact on our financial results. In addition, customers deploying custom memory solutions today may in the future choose to adopt a JEDEC standard, and the adoption of a JEDEC standard module instead of a previously custom module might allow new competitors to participate in a share of our customers' memory module business that previously belonged to us.

If our OEM customers were to adopt JEDEC standard modules, our future business may be limited to identifying the next generation of high performance memory demands of OEM customers and developing solutions that 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.

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 our 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. 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.

In addition to the competition we face from DRAM and logic suppliers such as SK hynix, Samsung, Micron, Inphi and IDT, 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 and 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. Further, some

Table of Contents

of our significant suppliers are also competitors, many of whom have the ability to manufacture competitive products at lower costs as a result of their higher levels of integration.

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.

Our operating results may be adversely impacted by worldwide economic and political uncertainties and specific conditions in the markets we address, including the cyclical nature of and volatility in the memory market and semiconductor industry.

Adverse changes in domestic and global economic and political conditions have made it extremely difficult for our customers, our vendors and us to accurately forecast and plan future business activities, and they have caused and could continue to cause U.S. and foreign businesses to slow spending on our products and services, which would further delay and lengthen sales cycles. In addition, sales of our products are dependent upon demand in the computing, networking, communications, printer, storage and industrial markets. These markets 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.

We may experience substantial period-to-period fluctuations in future operating results due to factors affecting the computing, networking, communications, printers, storage and industrial markets. A decline or significant shortfall in demand in any one of these markets could have a material adverse effect on the demand for our products. As a result, our sales will likely decline during these periods. In addition, because many of our costs and operating expenses are relatively fixed, if we are unable to control our expenses adequately in response to reduced sales, our gross margins, operating income and cash flow would be negatively impacted.

During challenging economic times our customers may face issues gaining timely access to sufficient credit, which could result in an impairment of their ability to make timely payments to us. If that were to occur, we may be required to increase our allowance for doubtful accounts and our days sales outstanding would be negatively impacted. Furthermore, our vendors may face similar issues gaining access to credit, which may limit their ability to supply components or provide trade credit to us. We cannot predict the timing, strength or duration of any economic slowdown or subsequent economic recovery, worldwide, or in the memory market and related semiconductor industry. If the economy or markets in which we operate do not continue to improve or if conditions worsen, our business, financial condition and results of operations will likely be materially and adversely affected. Additionally, the combination of our lengthy sales cycle coupled with challenging macroeconomic conditions could compound the negative impact on the results of our operations.

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, and any failure to optimally calibrate our production capacity and inventory levels to meet customer demand could adversely affect our revenues, gross margins and earnings.

We make significant decisions regarding the levels of business that we will seek and accept, production schedules, component procurement commitments, personnel needs and other resource requirements, based on our estimates of customer requirements. We do not have long-term purchase

Table of Contents

agreements with our customers. Instead, our customers often 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. The short-term nature of commitments by many of our customers, the fact that our customers may cancel or defer purchase orders for any reason, and the possibility of unexpected changes in demand for our customers' products each reduce our ability to accurately estimate future customer requirements for our products. 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. We attempt to forecast the demand for the DRAM ICs, NAND, 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.

Our production expense and component purchase 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. If we overestimate customer demand, we may have excess raw material inventory of DRAM ICs and NAND. If there is a subsequent decline in the prices of DRAM ICs or NAND, the value of our inventory will fall. As a result, we may need to write-down the value of our DRAM IC or NAND inventory, which may result in a significant decrease in our gross margin and financial condition. Also, to the extent that we manufacture products in anticipation of future demand that does not materialize, or in the event a customer cancels or reduces outstanding orders, we could experience an unanticipated increase in our finished goods inventory. In the past, we have had to write-down inventory due to obsolescence, excess quantities and declines in market value below our costs. 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 we underestimate customer demand, we may not have sufficient inventory of DRAM ICs and NAND on hand to manufacture enough product to meet that demand. We also may not have sufficient manufacturing capacity at any given time to meet our customers' demands for rapid increases in production. These shortages of inventory and capacity will lead to delays in the delivery of our products, and we could forego sales opportunities, lose market share and damage our customer relationships.

Declines in our average sales prices, driven by volatile prices for DRAM ICs and NAND, among other factors, may result in declines in our revenues and gross profit.

Our industry is competitive and historically has been characterized by declines in average sales price, based in part on the market price of DRAM ICs and NAND, which have historically constituted a substantial portion of the total cost of our memory subsystems. Our average sales prices may decline due to several factors, including overcapacity in the worldwide supply of DRAM and NAND memory components as a result of worldwide economic conditions, increased manufacturing efficiencies, implementation of new manufacturing processes and expansion of manufacturing capacity by component suppliers.

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 and NAND during that period. If the market prices for DRAM ICs and NAND increase, we generally cannot pass the price increases 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 are declines in the price of DRAM ICs and NAND, we may need to reduce our selling prices for subsequent purchase orders, which may result in a decline in our expected net sales.

Table of Contents

In addition, since a large percentage of our sales are to a small number of customers that are primarily distributors and large OEMs, these customers have exerted, and we expect they will continue to exert, pressure on us to make price concessions. If not offset by increases in volume of sales or the sales of newly-developed products with higher margins, decreases in average sales prices would likely have a material adverse effect on our business and operating results.

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

Our ability to fulfill customer orders or produce qualification samples is dependent on a sufficient supply of DRAM ICs and NAND, which are essential components of our memory subsystems. We are also dependent on a sufficient supply of custom ASIC devices to produce our HyperCloud® memory modules. There are a relatively small number of suppliers of DRAM ICs and NAND, and we purchase from only a subset of these suppliers. We have no long-term DRAM or NAND supply contracts. Additionally, we could face obstacles in moving production of our ASIC components away from our current design and production partners. Our dependence on a small number of suppliers and the lack of any guaranteed sources of ASIC components, DRAM and NAND supply expose us to several risks, including the inability to obtain an adequate supply of these important components, price increases, delivery delays and poor quality.

Historical declines in customer demand and our revenues caused us to reduce our purchases of DRAM ICs and NAND. Such fluctuations could occur in the future. Should we not maintain sufficient purchase levels with some suppliers, our ability to obtain supplies of raw materials may be impaired due to the practice of some suppliers to allocate their products to customers with the highest regular demand.

From time to time, shortages in DRAM ICs and NAND have required some suppliers to limit the supply of their DRAM ICs and NAND. As a result, we may be unable to obtain the DRAM ICs or NAND necessary to fill customers' orders for our products in a timely manner. If we are unable to obtain a sufficient supply of DRAM ICs or NAND 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 ASIC components, DRAM ICs and NAND 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 ASIC components, DRAM ICs and NAND and reduce the number of suppliers available to us, and may require that we qualify a new supplier. If our suppliers are unable to produce qualification samples on a timely basis or at all, we could experience delays in the qualification process, which could have a significant impact on our ability to sell that product.

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

Table of Contents

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 even if we are able to sell these products to another customer, our margin on such products may be reduced.

A prolonged disruption of our manufacturing facility could have a material adverse effect on our business, financial condition and results of operations.

We maintain a manufacturing facility in the PRC for producing most of our products, which allows us to utilize our materials and processes, protect our intellectual property and develop the technology for manufacturing. A prolonged disruption or material malfunction of, interruption in or the loss of operations at our manufacturing facility, or the failure to maintain a sufficient labor force at such facility, would limit our capacity to meet customer demand and delay new product development until a replacement facility and equipment, if necessary, were found. The replacement of the manufacturing facility could take an extended amount of time before manufacturing operations could restart. The potential delays and costs resulting from these steps could have a material adverse effect on our business, financial condition and results of operations.

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, to lower our costs and to otherwise remain competitive. 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. 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.

We depend on third-parties to design and manufacture custom components for some of our products.

Significant customized components, such as ASICs, that are used in some of our products such as HyperCloud® are designed and manufactured by third parties. The ability and willingness of such third parties to perform in accordance with their agreements with us is largely outside of our control. If one or more of our design or manufacturing partners fails to perform its obligations in a timely manner or at satisfactory quality levels, our ability to bring products to market or deliver products to our customers, as well as our reputation, could suffer. In the event of any such failures, we may have no readily available alternative source of supply for such products, since, in our experience, the lead time needed to establish a relationship with a new design and/or manufacturing partner is at least 12 months, and the estimated time for our OEM customers to re-qualify our product with components from a new vendor ranges from four to nine months. We cannot assure you that we can redesign, or cause to have redesigned, our customized components to be manufactured by a new manufacturer in a timely manner, nor can we assure you that we will not infringe on the intellectual property of our current design or manufacture partner when we redesign the custom components, or cause such components to be redesigned by a new manufacturer. A manufacturing disruption experienced by our manufacturing partners, the failure of our manufacturing partners to dedicate adequate resources to the production of our products, the financial instability of our manufacturing or design partners, or any other failure of our design or manufacturing partners to perform according to their agreements with us, would have a material adverse effect on our business, financial condition and results of operations.

Table of Contents

We have many other risks due to our dependence on third-party manufacturers, including: reduced control over delivery schedules, quality, manufacturing yields and cost; the potential lack of adequate capacity during periods of excess demand; limited warranties on products supplied to us; and potential misappropriation of our intellectual property. We are dependent on our manufacturing partners to manufacture products with acceptable quality and manufacturing yields, to deliver those products to us on a timely basis and to allocate a portion of their manufacturing capacity sufficient to meet our needs. Although our products are designed using the process design rules of the particular manufacturers, we cannot assure you that our manufacturing partners will be able to achieve or maintain acceptable yields or deliver sufficient quantities of components on a timely basis or at an acceptable cost. Additionally, we cannot assure you that our manufacturing partners will continue to devote adequate resources to produce our products or continue to advance the process design technologies on which the qualification and manufacturing of our products are based.

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.

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 defective or are used in defective systems, we may be subject to warranty, product recalls or product liability claims.

If our products are defectively manufactured, contain defective components or are used in defective or malfunctioning systems, we could be subject to warranty and 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. Warranty and 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 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 eighteen 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.

Table of Contents

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 have established a manufacturing facility and where the laws may not protect our proprietary rights to the same extent as applicable U.S. laws.

If some or all of the claims in our patent applications are not allowed, 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 are involved in and expect to continue to be involved in costly legal and administrative proceedings to defend against claims that we infringe the intellectual property rights of others or to enforce or protect our intellectual property rights.

As is common to the semiconductor industry, we have experienced substantial litigation regarding patent and other intellectual property rights. Lawsuits claiming that we are infringing others' intellectual property rights have been and may in the future be brought against us, and we are currently defending against claims of invalidity in the USPTO. See Note 9 of Notes to Condensed Consolidated Financial Statements, for a description of our legal contingencies.

The process of obtaining and protecting patents is inherently uncertain. In addition to the patent issuance process established by law and the procedures of the USPTO, we must comply with JEDEC administrative procedures in protecting our intellectual property within its industry standard setting process. These procedures evolve over time, are subject to variability in their application, and may be inconsistent with each other. Failure to comply with JEDEC's administrative procedures could jeopardize our ability to claim that our patents have been infringed.

By making use of new technologies and entering 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 in existing or any future litigation 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 manufacturing and/or selling products, or using certain processes, that are claimed to be infringing a third party's intellectual property;
- pay damages (which in some instances may be three times actual damages), including royalties on past or future sales;

Table of Contents

- 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.

If any adverse ruling in any such matter occurs, any resulting limitations in our ability to market our products, or delays and costs associated with redesigning our products or payments of license fees to third parties, or any failure by us to develop or license a substitute technology on commercially reasonable terms could have a material adverse effect on our business, financial condition and results of operations.

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, 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. We cannot assure you that current or future infringement claims by third parties or claims for indemnification by customers or end users of our products resulting from infringement claims will not be asserted in the future or that such assertions, if proven to be true, will not materially adversely affect our business, financial condition or results of operations.

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

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

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

Table of Contents

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. Similar to our current products, we may use components in these new products that contain the intellectual property of third parties. While we plan to exercise 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.

The flash memory market is constantly evolving and competitive, and we may not have rights to manufacture and sell certain types of products utilizing emerging flash formats, or we may be required to pay a royalty to sell products utilizing these formats.

The flash-based storage market is constantly undergoing rapid technological change and evolving industry standards. Many consumer devices, such as digital cameras, PDAs and smartphones, are transitioning to emerging flash memory formats, such as the Memory Stick, and xD Picture Card formats, which we do not currently manufacture and do not have rights to manufacture. Although we do not currently serve the consumer flash market, it is possible that certain OEMs may choose to adopt these higher-volume, lower-cost formats. This could result in a decline in demand, on a relative basis, for other products that we manufacture such as CompactFlash, SD and embedded USB drives. If we decide to manufacture flash memory products utilizing emerging formats such as those mentioned, we will be required to secure licenses to give us the right to manufacture such products that may not be available at reasonable rates or at all. If we are not able to supply flash card formats at competitive prices or if we were to have product shortages, our net sales could be adversely impacted and our customers would likely cancel orders or seek other suppliers to replace us.

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

As is common in the industry, we currently have in effect a number of agreements in which we have agreed to defend, indemnify and hold harmless our customers and suppliers from damages and costs which may arise from the infringement by our products of third-party patents, trademarks or other proprietary rights. The scope of such indemnity varies, but may, in some instances, include indemnification for damages and expenses, including attorneys' fees. Our insurance does not cover intellectual property infringement. The term of these indemnification agreements is generally perpetual any time after execution of the agreement. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. We may periodically have to respond to claims and litigate these types of indemnification obligations. Although our suppliers may bear responsibility for the intellectual property inherent in the components they sell to us, they may lack the financial ability to stand behind such indemnities. Additionally, it may be costly to enforce any indemnifications that they have granted to us. Accordingly, any indemnification claims by customers could require us to incur significant legal fees and could potentially result in the payment of substantial damages, both of which could result in a material adverse effect on our business and results of operations.

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.

To date, we have been highly dependent on the experience, relationships and technical knowledge of certain key employees. 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 Chun K. Hong, our President, Chief Executive Officer and Chairman of the Board. We maintain "Key Man" life insurance on Chun K. Hong; however, we do not carry "Key Man" life insurance on any of our other key employees.

Our future success also depends on our ability to attract, retain and motivate highly skilled engineering, manufacturing, and other technical and sales personnel. Competition for 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 increase our operating expenses.

Historically, a significant portion of our workforce has 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.

We rely on third-party manufacturers' representatives and the failure of these manufacturers' representatives to perform as expected could reduce our future sales.

We sell some of our products to customers through manufacturers' representatives. We are unable to predict the extent to which our manufacturers' representatives will be successful in marketing and selling our products. Moreover, many of our manufacturers' representatives also market and sell other, potentially competing products. Our representatives may terminate their relationships with us at any time. Our future performance will also depend, in part, on our ability to attract additional manufacturers' representatives that will be able to market and support our products effectively, especially in markets in which we have not previously distributed our products. If we cannot retain our current manufacturers' representatives or recruit additional or replacement manufacturers' representatives, our sales and operating results will be harmed.

The operation of our manufacturing facility in the PRC could expose us to significant risks.

Since 2009, substantially all of our world-wide manufacturing production has been performed at our manufacturing facility in the People's Republic of China, or PRC. Language and cultural differences, as well as the geographic distance from our headquarters in Irvine, California, further compound the difficulties of running a manufacturing operation in the PRC. Our management has limited experience in creating or overseeing foreign operations, and this new facility may divert substantial amounts of their time. We may not be able to maintain control over product quality, delivery schedules, manufacturing yields and costs. Furthermore, the costs related to having excess capacity have in the past and may in the future continue to have an adverse impact on our gross margins and operating results.

We manage a local workforce that may subject us to regulatory uncertainties. Changes in the labor laws of the PRC could increase the cost of employing the local workforce. The increased industrialization of the PRC, as well as general economic and political conditions in the PRC, could also increase the price of local labor. Either of these factors could negatively impact the cost savings we currently enjoy from having our manufacturing facility in the PRC.

The PRC currently provides for favorable tax rates for certain foreign-owned enterprises operating in specified locations in the PRC through 2012. We have established our PRC facility in such a tax-favored location. Should we fail to achieve profitability while favorable tax rates are in effect, or before our loss carryforwards in the PRC expire, it is possible that we would not realize the tax benefits to the extent originally anticipated and this could adversely impact our operating results.

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 have set up a manufacturing facility in the PRC. Selling and manufacturing in foreign countries subjects us to additional risks not present with our domestic operations. We are operating in business and regulatory environments in which we have limited previous experience. We will need to continue to overcome language and cultural barriers to effectively conduct our operations in these 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.

In the future, some of our net sales may be denominated in Chinese Renminbi ("RMB"). The Chinese government controls the procedures by which RMB is converted into other currencies, and conversion of RMB generally requires government consent. As a result, RMB may not be freely convertible into other currencies at all times. If the Chinese government institutes changes in currency conversion procedures, or imposes 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 RMB 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 to make dividends and repatriate funds from our Chinese operations, these dividends would be subject to U.S. corporate income tax.

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 international sales are subject to other risks, including regulatory risks, tariffs and other trade barriers, timing and availability of export licenses, political and economic instability, difficulties in accounts receivable collections, difficulties in managing distributors, lack of a significant local sales presence, difficulties in obtaining governmental approvals, compliance with a wide variety of complex foreign laws and treaties and potentially adverse tax consequences. In addition, the U.S. or foreign countries may implement quotas, duties, taxes or other charges or restrictions upon the importation or exportation of our products, leading to a reduction in sales and profitability in that country.

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

Due to the geographic concentration of our manufacturing operations and the operations of certain of our suppliers, a disruption resulting from equipment failure, power failures, quality control issues, human error, government intervention or natural disasters, including earthquakes and floods like those that have struck Japan and Thailand, respectively, 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 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.

Our internal controls over financial reporting may not be effective, which could have a significant and adverse effect on our business.

Section 404 of the Sarbanes-Oxley Act of 2002 and the rules and regulations of the SEC, which we collectively refer to as Section 404, require us to evaluate our internal controls over financial reporting to allow management to report on those internal controls as of the end of each 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 stock price.

Table of Contents

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

We have in the past expanded 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 future growth effectively, including the expansion of volume in our manufacturing facility in the PRC, we must be able 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 manage future growth or maintain future 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.

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, but not limited to:

- 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.

The issuance of additional sales of our common stock, or the perception that such issuances may occur, including through our "at the market" offering, could cause the market price of our common stock to fall.

We have entered into a Sales Agreement with Ascendiant Capital Markets, LLC ("Ascendiant"), for the offer and sale of up to $10 million in aggregate amount of our shares from time to time through Ascendiant, as our sales agent, pursuant to an effective Registration Statement on Form S-3. Ascendiant is not required to sell any specific number or dollar amount of shares of our common stock but will use its reasonable efforts, as our agent and subject to the terms of the Sales Agreement, to sell

Table of Contents

that number of shares up to $10 million upon our request. Sales of the shares, if any, may be made by any means permitted by law and deemed to be an "at the market" offering as defined in Rule 415 of the Securities Act of 1933, as amended, and will generally be made by means of brokers' transactions on the NASDAQ Global Market or otherwise at market prices prevailing at the time of sale, or as otherwise agreed with Ascendiant.

As of December 29, 2012, we have sold an aggregrate of 2,010,139 shares pursuant to the Sales Agreement at a weighted average sales price of $2.98, net of commissions, including 1,312,669 shares in year ended December 29, 2012 at a weighted average sales price of $2.98 per share. We may terminate the Sales Agreement at any time or it will terminate once proceeds of $10 million have been raised. Whether we choose to affect future sales under the at-the-market program will depend upon a variety of factors, including, among others, market conditions and the trading price of our common stock relative to other sources of capital. The issuance from time to time of these new shares of common stock through our at-the-market program or in any other equity offering, or the perception that such sales may occur, could have the effect of depressing the market price of our common stock.

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 25, 2013 approximately 20.1% of our outstanding common stock was held by affiliates, including 19.9% held by Chun K. Hong, our chief executive officer and chairman of our board of directors. As a result, Mr. Hong has 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 and other corporate transactions. This concentration of control could be disadvantageous to other stockholders with interests different from those of Mr. Hong and our other executive officers and directors. 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 acquirers 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.

The price of and volume in trading of our common stock has and may continue to fluctuate significantly.

Our common stock has been publicly traded since November 2006. The price of our common stock and the trading volume of our shares are volatile and have in the past fluctuated significantly. There can be no assurance as to the prices at which our common stock will trade in the future or that an active trading market in our common stock will be sustained in the future. The market price at which our common stock trades may be influenced by many factors, including but not limited to, the following:

- our operating and financial performance and prospects, including our ability to achieve and sustain profitability in the future;
- investor perception of us and the industry in which we operate;
- the availability and level of research coverage of and market making in our common stock;
- changes in earnings estimates or buy/sell recommendations by analysts;
- sales of our newly issued common stock or other securities in association with our $40 million effective shelf registration on Form S-3, or the perception that such sales may occur
- general financial and other market conditions; and
- changing and recently volatile domestic and international economic conditions.

In addition, shares of our common stock and the public stock markets in general, have experienced, and may continue to experience, extreme price and trading volume volatility. These fluctuations may adversely affect the market price of our common stock and a shareholders ability to sell their shares into the market at the desired time or at the desired price.

In 2007, following a drop in the market price of our common stock, securities litigation was initiated against us. Given the historic volatility of our industry, we may become engaged in this type of litigation in the future. Securities litigation is expensive and time-consuming.

Item 2. Properties

Our corporate headquarters is located in approximately 28,700 square feet of space in Irvine, California, under a lease that expires in July 2013. We also currently lease approximately 42,200 square feet of space for our manufacturing facility in the PRC. This lease expires in March 2017. In addition, we lease approximately 4,500 square feet of space for a design office in San Jose, California, under a lease that expires in May 2014.

We believe that our current facilities are adequate for our current and expected operations for the next twelve months and that additional space can be obtained if needed.

Item 3. Legal Proceedings

The information set forth in the section entitled Litigation and Patent Reexaminations under Note 9 of Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this Report is incorporated herein by reference.

Table of Contents

PART II

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

Our common stock began trading on The NASDAQ Global Market under the trading symbol "NLST" on November 30, 2006, and was not publicly traded prior to that date. The following table sets forth the high and low sale prices for our common stock on the NASDAQ Global Market for the periods indicated:

	High	Low
Year Ended December 29, 2012		
Fourth Quarter	$ 1.32	$ 0.65
Third Quarter	2.32	1.20
Second Quarter	3.55	2.08
First Quarter	4.24	2.41
Year Ended December 31, 2011		
Fourth Quarter	$ 3.96	$ 1.04
Third Quarter	2.10	1.09
Second Quarter	2.81	2.00
First Quarter	3.04	2.09

As of March 25, 2013, there were approximately 37 holders of record of our common shares.

Dividend Policy

We have never declared or paid cash dividends on our capital stock. Our current credit facility prohibits the payment of cash dividends. Accordingly, we do not anticipate declaring or paying cash dividends on our capital stock in the foreseeable future. Any payments of cash dividends will be at the discretion of our board of directors, and will depend upon our results of operations, earnings, capital requirements, legal and contractual restrictions, and other factors deemed relevant by our board of directors.

Securities Authorized for Issuance under Equity Compensation Plans

Our board of directors and stockholders previously approved our Amended and Restated 2000 Equity Incentive Plan and our Amended and Restated 2006 Equity Incentive Plan. Except as listed in the table below, as of December 29, 2012, we do not have any equity based plans, including individual

Table of Contents

compensation arrangements that have not been approved by our stockholders. The following table provides information as of December 29, 2012 with respect to our equity compensation plans:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	4,743,554	$ 3.22	820,635(1)
Equity compensation plans not approved by security holders	8,750(2)	$ 1.92	
Total	4,752,304	$ 3.22	820,635

(1) Subject to certain adjustments, on December 29, 2012, we currently are able to issue a maximum of 5,405,566 shares of common stock pursuant to awards granted under our Amended and Restated 2006 Equity Incentive Plan. That maximum number will automatically increase on the first day of each calendar year by the lesser of (i) 5.0% of the number of shares of common stock that are issued and outstanding as of the first day of the calendar year, and (ii) 1,200,000 shares of common stock, subject to adjustment for certain corporate actions.

(2) Consists of:

(i) 8,750 options to purchase shares of our common stock issued to our former Controller and Director of Financial Reporting in connection with her hiring in April 2010. These options expired on February 28, 2103.

See Note 10 of Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this Report, for additional information on equity compensation plans.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our audited consolidated financial statements and the related notes included elsewhere in this Form 10-K.

This report contains forward-looking statements regarding future events and our future performance. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those expected or projected. These risks and uncertainties include, but are not limited to risks associated with the launch and commercial success of our products, programs and technologies; the success of product partnerships; continuing development, qualification and volume production of EXPRESSvault , NVvault , HyperCloud® and VLP Planar-X RDIMM; the timing and magnitude of the continued decrease in sales to our key customer; our ability to leverage our NVvault technology in a more diverse customer base; our need to raise additional capital and our ability to obtain financing when necessary; the rapidly-changing nature of technology; risks associated with intellectual property, including patent infringement litigation against us as well as the costs and unpredictability of litigation over infringement of our intellectual property and the possibility of our patents being reexamined by the USPTO; volatility in the pricing of DRAM ICs and NAND; changes in and uncertainty of customer acceptance of, and demand for, our existing products and products under development, including uncertainty of and/or delays in product orders and product qualifications; delays in our and our customers' product releases and development; 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 vendors in the supply chain; fluctuations in the market price of critical components; evolving industry *standards; and the political and regulatory environment in the PRC. Other risks and uncertainties are described under the heading "Risk Factors" in Part I, Item IA of this Annual Report on Form 10-K. Except as required by law, we undertake no obligation to revise or update publicly any forward-looking statements for any reason.*

Overview

We design, manufacture and sell high-performance, intelligent memory subsystems for datacenter server and high-performance computing and communications markets. Our memory subsystems consist of combinations of DRAM ICs, NAND, ASICs and other components assembled on PCBs. We primarily market and sell our products to leading OEM customers. Our solutions are targeted at applications where memory plays a key role in meeting system performance requirements. 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.

In November 2009, we introduced HyperCloud® DDR3 memory technology. HyperCloud® utilizes an ASIC chipset that incorporates Netlist patented rank multiplication technology that increases memory capacity and load reduction technology that increases memory bandwidth. We expect that these patented technologies will make possible improved levels of performance for memory intensive datacenter applications and workloads, including enterprise virtualization, cloud computing infrastructure, business intelligence real-time data analytics, and high performance computing. In November 2011, we introduced the world's first 32GB two-virtual rank RDIMM incorporating HyperCloud® technology. The new memory modules enable up to 768GB of DRAM memory in next generation two-processor servers.

Also in November 2011, we announced collaborative agreements with each of Hewlett-Packard Company ("HP") and International Business Machines ("IBM"), pursuant to which these OEMs have cooperated with us in efforts to qualify HyperCloud® memory products for use with their respective products. In February 2012 and May 2012, we achieved memory qualification of HyperCloud® at IBM and HP, respectively. HP and IBM have engaged and continue to engage with us in joint marketing and further product development efforts. We and each of the OEMs have committed financial and other resources toward the collaboration. However, the efforts undertaken under either of the collaborative agreements may not result in significant revenues and product margins for us relative to our investment in developing and marketing this product.

In February 2010, we announced the general availability of the NVvault battery free. The NVvault product line consists primarily of battery-free and battery-powered cache memory subsystem targeting RAID storage applications. NVvault battery-free provides server and storage OEMs a solution for enhanced datacenter fault recovery. The NVvault products have historically been sold primarily to Dell, most recently for incorporation in its PERC 7 server products. Following Intel's launch of its Romley platform in the first quarter of 2012, we have experienced a rapid decline in NVvault sales to Dell. Sales of NVvault products to Dell totaled $15.7 million and $37.7 million for the years ended December 29, 2012 and December 31, 2011, respectively. We expect to see demand from Dell through 2013, after which sales of NVvault products for incorporation into PERC 7 servers will be minimal. In order to leverage our NVvault technology into a more diverse customer base, we continue to pursue additional qualifications of NVvault with other customers. We also introduced EXPRESSvault in March 2011, and continue to pursue qualifications of next generation DDR3 NVvault with customers. However, our efforts may not result in significant revenues from the sale of NVvault products.

Table of Contents

The remainder of our revenues arose primarily from OEM sales of specialty memory modules and flash-based products, the majority of which were utilized in data center and industrial applications. When developing custom modules for an equipment product launch, we engage with our OEM customers from the earliest stages of new product definition, providing 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 speed, capacity and signal integrity, small form factor, attractive thermal characteristics and low cost per bit. Revenues from our specialty modules and flash-based products are subject to fluctuation as a result of the life cycles of the products into which our modules are incorporated. Our ability to continue to produce revenues from specialty memory modules and flash-based products is dependent on our ability to qualify our products on new platforms as current platforms reach the end of their lifecycles, and on the state of the global economy.

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. Two customers represented approximately 60% and 18% of our net sales in 2012 and one customer represented approximately 70% of our net sales in 2011.

Key Business Metrics

The following describes certain line items in our consolidated 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 generally 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 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 and NAND. 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 and NAND to distributors and other users of memory ICs. As compared to previous years, component inventory sales remain a relatively small percentage of net sales as a result of our efforts to diversify both our customer and product line bases. This diversification effort has also allowed us to use components in a wider range of memory subsystems. We expect that component inventory sales will continue to represent a minimal portion of our net sales in future periods.

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 and NAND 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 and NAND. We attempt to pass through such DRAM IC and NAND flash memory cost fluctuations to our customers by frequently renegotiating pricing prior to the placement of their purchase orders. However, the sales prices of our memory subsystems can also fluctuate due to competitive situations unrelated to the pricing of DRAM ICs and NAND, which affects gross margins. The gross margin on our sales of excess component DRAM IC and NAND inventory is much lower than the gross margin on our sales of our memory subsystems. As a result, fluctuations in DRAM IC and NAND inventory sales as a percentage of our overall sales could impact our overall gross margin. We assess the valuation of our inventories on a quarterly basis and record a provision to cost of sales as necessary to reduce inventories to the lower of cost or net realizable value.

Table of Contents

Research and Development. Research and development expense consists primarily of employee and independent contractor compensation and related costs, stock-based compensation, non-recurring engineering fees, computer-aided design software licenses, reference design development costs, patent filing and protection legal 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. We anticipate that research and development expenditures will increase in future periods as we seek to expand new product opportunities, increase our activities related to new and emerging markets and continue to develop additional proprietary technologies.

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 effort is directed at building relationships with OEMs and other customers 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 establish new customers, we anticipate that our sales and marketing expenses will increase.

Critical Accounting Policies

The preparation of our consolidated 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 Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 605. Accordingly, we recognize revenues when there is persuasive evidence that an arrangement exists, product delivery and acceptance have occurred, the sales price is fixed or determinable, and collectability of the resulting receivable is reasonably assured.

We generally use customer purchase orders and/or contracts 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 component 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. 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.

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.

Fair Value of Financial Instruments. Our financial instruments consist principally of cash and cash equivalents, investments in marketable securities, accounts receivable, accounts payable, accrued expenses and debt instruments. The fair value of our cash equivalents and investments in marketable securities is determined based on quoted prices in active markets for identical assets or Level 1 inputs. We recognize transfers between Levels 1 through 3 of the fair value hierarchy at the beginning of the reporting period. We believe that the carrying values of all other financial instruments approximate their current fair values due to their nature and respective durations.

Allowance for Doubtful Accounts. We perform credit evaluations of our customers' financial condition and limit the amount of credit extended to our customers as deemed necessary, but generally require no collateral. We evaluate the collectibility of accounts receivable based on a combination of factors. In cases where we are aware of circumstances that may impair a specific customer's ability to meet its financial obligations subsequent to the original sale, we will record an allowance against amounts due, and thereby reduce the net recognized receivable to the amount that we reasonably believe will be collected. For all other customers, we record allowances for doubtful accounts based primarily on the length of time the receivables are past due based on the terms of the originating transaction, the current business environment and our historical experience. Uncollectible accounts are charged against the allowance for doubtful accounts when all cost effective commercial means of collection have been exhausted. Generally, our credit losses have been within 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 collectability 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 an average cost basis which approximates actual cost on a first-in, first-out basis and includes raw materials, labor and manufacturing overhead. At each balance sheet date, we evaluate ending inventory quantities on hand and record a provision for excess quantities and obsolescence. Among other factors, we consider 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. In addition, we consider changes in the market value of DRAM ICs and NAND in determining the net realizable value of our raw material inventory. Once established, any write downs are considered permanent adjustments to the cost basis of our excess or obsolete 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 or NAND decrease significantly, we may be required to lower our selling prices to reflect the lower current cost of our raw

Table of Contents

materials. If such price decreases reduce the net 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 or NAND could have a material effect on the value of our inventories and our reported operating results.

Impairment of Long-Lived Assets. We evaluate the recoverability of the carrying value of long-lived assets held and used in our operations for impairment on at least an annual basis or whenever events or changes in circumstances indicate that their carrying value may not be recoverable. When such factors and circumstances exist, we compare the projected undiscounted future net cash flows associated with the related asset or group of assets over their estimated useful lives against their respective carrying amount. These projected future cash flows may vary significantly over time as a result of increased competition, changes in technology, fluctuations in demand, consolidation of our customers and reductions in average selling prices. If the carrying value is determined not to be recoverable from future operating cash flows, the asset is deemed impaired and an impairment loss is recognized to the extent the carrying value exceeds the estimated fair value of the asset. The fair value of the asset or asset group is based on market value when available, or when unavailable, on discounted expected cash flows.

Warranty Reserve. We offer product warranties 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 the warranty period at no cost to the customer. Warranties are not offered on sales of excess inventory. 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 consistent between periods and within our expectations and the provisions established, unexpected changes in failure rates could have a material adverse impact on us, requiring additional warranty reserves, and adversely affecting our gross profit and gross margins.

Stock-Based Compensation. We account for equity issuances to non-employees in accordance with ASC Topic 505. 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 ASC Topic 718, employee and director stock-based compensation expense recognized during the period is based on the value of the portion of stock-based payment awards that is ultimately expected to vest during the period. Given that stock-based compensation expense recognized in the consolidated statements of operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. ASC Topic 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Our estimated average forfeiture rates are based on historical forfeiture experience and estimated future forfeitures.

The fair value of common stock option 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, along with assumptions about the risk-free interest rate and expected dividends, all of which affect the estimated fair values of our common stock option awards. The expected term of options granted is calculated as the average of the weighted vesting period and the contractual expiration date of the option. This calculation is based on the safe harbor method permitted by the SEC in instances where the vesting and exercise terms of options granted meet certain conditions and where limited historical exercise data is available. The expected volatility is based on the historical volatility of our common stock. The risk-free rate selected to value any particular grant is based on the U.S. Treasury rate that corresponds to the expected term of the grant effective as of the date of the grant. The expected dividends assumption is based on our history and our expectations regarding dividend payouts. We evaluate the assumptions used to value our common stock option awards on a quarterly basis. If factors change and we employ different assumptions, stock-based compensation expense may differ significantly from what we have recorded in prior periods. Compensation expense for common stock option awards with graded vesting schedules is recognized on a straight-line basis over the requisite service period for the last separately vesting portion of the award, provided that the accumulated cost recognized as of any date at least equals the value of the vested portion of the award.

We recognize the fair value of restricted stock awards issued to employees and outside directors as stock-based compensation expense on a straight-line basis over the vesting period for the last separately vesting portion of the awards. Fair value is determined as the difference between the closing price of our common stock on the grant date and the purchase price of the restricted stock award, if any, reduced by expected forfeitures.

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

Income Taxes. Deferred tax assets and liabilities are recognized to reflect the estimated future tax effects of future deductible or taxable amounts attributable to events that have been recognized on a cumulative basis in the consolidated financial statements, calculated at enacted tax rates for expected periods of realization. We regularly review our deferred tax assets for recoverability and establish a valuation allowance, when determined necessary, based on historical taxable income, projected future taxable income, and the expected timing of the reversals of existing temporary differences. Because we have operated at a loss for an extended period of time, we did not recognize deferred tax assets related to losses incurred in 2012 or 2011. In the future, if we realize a deferred tax asset that currently carries a valuation allowance, we may record an income tax benefit or a reduction to income tax expense in the period of such realization.

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

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

New Accounting Pronouncements. In June 2011, the FASB issued new guidance on the presentation of comprehensive income. The new guidance eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity and requires an entity to present either one continuous statement of net income and other comprehensive income or two separate, but consecutive statements. The guidance relates only to presentation. The Company adopted this guidance in the first quarter of the year ended December 29, 2012. In February 2013, the

Table of Contents

FASB issued new guidance on reporting reclassifications out of accumulated other comprehensive income. This new guidance will be effective for the Company for the first quarter of the fiscal year ended December 28, 2013. Other than requiring additional disclosures, the Company does not expect this new guidance to impact the Company's consolidated financial statements.

Results of Operations

The following table sets forth our consolidated statements of operations as a percentage of net sales for the years indicated:

	Year Ended December 29, 2012	Year Ended December 31, 2011
Net sales	100%	100%
Cost of sales	75	67
Gross profit	25	33
Operating expenses:		
Research and development	35	25
Selling, general and administrative	27	18
Total operating expenses	62	42
Operating loss	(37)	(9)
Other expense, net:		
Interest expense, net	(1)	
Other expense, net		
Total other expense, net	(1)	
Loss before income tax benefit	(38)	(9)
Income tax benefit		
Net loss	(38)%	(9)%

Year Ended December 29, 2012 Compared to the Year Ended December 31, 2011

Net Sales, Cost of Sales and Gross Profit.

The following table presents net sales, cost of sales and gross profit for the years ended December 29, 2012 and December 31, 2011 (in thousands, except percentages):

	Year Ended December 29, 2012	Year Ended December 31, 2011	Change	% Change
Net sales	$ 36,873	$ 60,729	$ (23,856)	(39)%
Cost of sales	27,474	40,468	(12,994)	(32)%
Gross profit	$ 9,399	$ 20,261	$ (10,862)	(54)%
Gross margin	25.5%	33.4%	(7.9)%	

Net Sales. The decrease in net sales for 2012 as compared with 2011 resulted primarily from decreases of approximately (i) $21.5 million in sales of NVvault non-volatile cache systems used in RAID controller subsystems (ii) $5.6 million of specialty memory module sales primarily used in industrial applications as customers slowed production as a result of its product nearing the end of its life and (iii) $2.9 million in flash product sales offset by an increase of $6.1 million in sales resulting

38

Table of Contents

from existing and new customer qualifications of HyperCloud®, VLP, NVvault and ExpressVault product lines.

Approximately 83% of our NVvault sales were made to Dell in 2012. Following Intel's launch of its Romley platform in the first quarter of 2012, we have experienced a rapid decline in DDR2 NVvault sales to Dell. We expect that we will see some demand from Dell through 2013, after which sales of DDR2 NVvault products for incorporation into PERC 7 servers will be minimal. This reduction in sales is expected to continue to have a significant impact on our revenue and gross profit. We expect an increasing percentage of our revenue to come from sales of DDR2 NVvault and ExpressVault to a more diverse customer base, as well as from sales of our HyperCloud® products.

Gross Profit and Gross Margin. The decrease in gross profits for 2012 as compared to 2011 is primarily the result of the change in product mix as the decline in NVvault sales to Dell began to accelerate in the second quarter of 2012. As noted previously, we expect the decline in sales of NVvault to Dell to continue to have a significant impact on our revenue and gross profit.

Research and Development.

The following table presents research and development expenses for the years ended December 29, 2012 and December 31, 2011 (in thousands, except percentages):

	Year Ended December 29, 2012	Year Ended December 31, 2011	Change	% Change
Research and development	$ 12,845	$ 14,924	$ (2,079)	(14)

The decrease in research and development expense for 2012 as compared to 2011 resulted primarily from decreases of (i) $0.6 million in professional and outside services (ii) $1.7 million in internal engineering headcount costs and related overhead and travel expenses, and (iii) $0.6 million in non-recurring engineering charges for supply partners engaged in new product development activities partially offset by an increase of $0.8 million in material expenses related to product builds and testing.

Selling, General and Administrative.

The following table presents selling, general and administrative expenses for the years ended December 29, 2012 and December 31, 2011 (in thousands, except percentages):

	Year Ended December 29, 2012	Year Ended December 31, 2011	Change	% Change
Selling, general and administrative	$ 10,075	$ 10,705	$ (630)	(6)%

Selling, general and administrative expenses decreased by approximately $0.6 million in 2012 as compared to 2011. We incurred decreases of approximately $0.9 million in headcount costs, commissions and related overhead and travel expenses, which were offset by an increase of $0.3 million in advertising and product evaluation expenses, primarily due to product qualification efforts.

Table of Contents

Other Expense, Net

The following table presents other expense, net for the years ended December 29, 2012 and December 31, 2011 (in thousands, except percentages):

	Year Ended December 29, 2012	Year Ended December 31, 2011	Change	% Change
Interest expense, net	$ (338)	$ (228)	$ (110)	48%
Other expense, net	(134)	(56)	(78)	139%
Total other expense, net	$ (472)	$ (284)	$ (188)	66%

The increase in interest expense for 2012 compared with 2011 was the result of new term loans that originated in May 2011 and May 2012.

The decrease in expense, net, for 2012, as compared to 2011 was primarily the result of a realized loss in 2012 of $85,000 from the sale of an auction rate security that was purchased in 2008 and a realized loss in 2011 of $59,000 from the sale of an auction rate security that was purchased in 2008 and a loss on disposal of an asset no longer in use for $52,000 in 2012.

Income Tax Benefit.

The following table presents the benefit for income taxes for the years ended December 29, 2012 and December 31, 2011 (in thousands, except percentages):

	Year Ended December 29, 2012	Year Ended December 31, 2011	Change	% Change
Income tax benefit	$ (12)	$ (53)	$ 41	(77)%

The federal statutory rate was 35% for 2012 and 2011. In both 2012 and 2011, we continued to provide a full valuation allowance against our net deferred tax assets, which consist primarily of net operating loss carry-forwards. In 2012 and 2011, our effective tax rate differed from the 35% statutory rate primarily due to the valuation allowance on newly generated loss carry-forwards. For further discussion see Note 8 to the Consolidated Financial Statements included in Part IV, Item 15 of this Report.

Included in the unrecognized tax benefits at December 31, 2011 was approximately $22,000, of tax positions that, if recognized, would affect our annual effective tax rate. We reduced our unrecognized tax benefits by approximately $22,000 and $55,000 during 2012 and 2011 respectively, as a result of a lapse in a federal statute of limitations, resulting in an income tax benefit.

In 2008, we began operating under tax holidays in the PRC, which are effective from January 2008 through December 2012. Since we operated at a loss in the PRC in 2012 and 2011, we did not realize any benefit attributable to the tax holidays.

Liquidity and Capital Resources

We have historically 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 and term loans under our bank credit facility and capitalized lease obligations.

Table of Contents

Working Capital, Cash and Cash Equivalents, and Marketable Securities.

The following table presents working capital, cash and cash equivalents and investments in marketable securities (in thousands):

	December 29, 2012	December 31, 2011
Working capital	$ 11,116	$ 17,775
Cash and cash equivalents(1)	$ 7,755	$ 10,535
Investments in marketable securities	415	444
	$ 8,170	$ 10,979

(1) Included in working capital

Our working capital decreased in 2012 primarily as a result of decreases in accounts receivable of $8.0 million and cash and cash equivalents of $2.8 million, primarily due to an overall decline in net sales during the year, partially offset by decreases in accounts payable of $2.8 million and accrued payroll and related liabilities of $1.0 million as management cut overhead, headcount, sales commissions and other expenses.

Cash Provided and Used in the Years Ended December 29, 2012 and December 31, 2011.

The following table summarizes our cash flows for the periods indicated:

	Year Ended December 29, 2012	Year Ended December 31, 2011
Net cash provided by (used in):		
Operating activities	$ (6,959)	$ (7,424)
Investing activities	(1,655)	520
Financing activities	5,834	3,229
Net decrease in cash and cash equivalents	$ (2,780)	$ (3,675)

Operating Activities. Net cash used in operating activities for the year ended December 29, 2012 was primarily the result of (i) a net loss of approximately $14.0 million and (ii) approximately $3.0 million in net cash used by changes in operating assets and liabilities, primarily accounts receivable, accounts payable, accrued payroll and related liabilities and inventory. Cash used to fund net losses is reduced by approximately $4.0 million in net non-cash operating expenses, mainly comprised of depreciation and amortization and stock-based compensation.

Accounts receivable decreased approximately $8.0 million at December 29, 2012 compared with December 31, 2011, primarily as a result of a decrease in our net sales of $10.4 million in the fourth quarter of 2012 as compared with the fourth quarter of 2011.

Inventories increased approximately $1.3 million during 2012 as we built inventory to support the sales launch of qualified HyperCloud® products and continued the qualification process for higher density HyperCloud® products and other high-density memory modules. Our inventory also increased as a result of a faster than expected decline in sales of our prior generation NVvault products . We expect that, our inventory levels will continue to be determined by, among other factors, the level of customer orders received and overall demand as well as the stage at which our products are in their respective life cycles and competitive situations in the marketplace. We make efforts to balance such considerations against the risk of obsolescence or potentially excess inventory levels.

Table of Contents

Accounts payable, net of amounts due for property and equipment purchases, decreased approximately $2.9 million during 2012 as a result of decreasing purchases to support a lower level of sales activity.

Net cash used in operating activities for the year ended December 31, 2011 was primarily the result of (i) a net loss of approximately $5.6 million and (ii) approximately $5.8 million in net cash used by changes in operating assets and liabilities, primarily accounts receivable and inventory. Cash used to fund net losses is reduced by approximately $4.0 million in net non-cash operating expenses, mainly comprised of depreciation and amortization and stock-based compensation.

Investing Activities. In 2012 and 2011, we continued to invest remaining net proceeds from our public offerings and debt financing in various money market and marketable securities investments in connection with our efforts to both preserve capital as well as achieve competitive returns on our investments.

Net cash used in investing activities for the year ended December 29, 2012 was the result of the acquisition of $1.7 million in property and equipment. Net cash provided by investing activities for the year ended December 31, 2011 was primarily the result of proceeds from the maturities and sales of marketable securities of approximately $1.3 million. We also used approximately $0.7 million in cash primarily to purchase equipment related to our production facilities in the PRC and our research and development activities in Irvine, California.

Financing Activities. Net cash provided by financing activities for the year ended December 29, 2012 was primarily the result of net proceeds of (i) $3.9 million in net proceeds from the sale of 1,312,669 shares of our common stock through our sales agreement with Ascendiant, described below under the caption *Capital Resources*, (ii)$1.3 million in net proceeds from the sale of 1,685,394 shares of our common stock through a registered public offering, described below under the caption Capital Resources (iii) $1.3 million in net proceeds from the consolidation of and additional credit extended under our bank term loans, and (iv) $0.6 million in proceeds from the exercise of equity awards under our stock option plans, offset by repayment of bank debt, capital leases and other notes payable of $4.5 million. Net cash provided by financing activities for the year ended December 31, 2011 was a result of net proceeds of $2.9 million from a bank term loan obtained from Silicon Valley Bank and $1.9 million in net proceeds from the sale of 697,470 shares of our common stock through our sales agreement with Ascendiant, offset by repayment of bank debt, capital leases and other notes payable of $1.7 million.

In 2012 and 2011, we utilized our lines of credit with Silicon Valley Bank to fund short-term working capital needs and collateralize vendor credit.

Capital Resources.

On October 31, 2009, we entered into a credit agreement with Silicon Valley Bank, which was amended on March 24, 2010, June 30, 2010, September 30, 2010, May 11, 2011, August 10, 2011 and May 14, 2012. Currently, the credit agreement provides for a line of credit pursuant to which we can borrow up to the lesser of (i) 80% of eligible accounts receivable, or (ii) $10.0 million. We have the option to increase credit availability to $15.0 million at any time through the maturity date of September 30, 2014, subject to the conditions of the credit agreement. Prior to the May 14, 2012 amendment the credit agreement contained an overall sublimit of $10.0 million to collateralize our contingent obligations under letters of credit and other financial services. Amounts outstanding under the overall sublimit reduced the amount available under the line. As a result of the May 14, 2012 amendment, letters of credit and other financial services are no longer subject to borrowing base sublimits, and do not reduce the amount available under the line of credit. Instead, we have an additional credit facility for up to $3.0 million in letters of credit through September 30, 2014. All obligations under the credit agreement are secured by a first priority lien on our tangible and intangible

Table of Contents

assets. The only restriction on the use of funds under the revolving line of credit is that we must be in compliance with the covenants of the credit agreement. Interest on the line of credit is payable monthly at either (i) prime plus 1.25%, as long as we maintain $8.5 million in revolving credit availability plus unrestricted cash on deposit with the bank, or (ii) prime plus 2.25%. Additionally, the credit agreement requires payment for an unused line, as well as anniversary and early termination fees, as applicable. At December 29, 2012, letters of credit in the amount of $2.0 million were outstanding.

In connection with the September 30, 2010 amendment to the credit agreement, Silicon Valley Bank extended a $1.5 million term loan under the credit agreement, bearing interest at a rate of prime plus 2.00%. We were required to make equal monthly principal payments over the 36 month term, which totaled $0.5 million annually. In May 2011, Silicon Valley Bank extended an additional $3.0 million term loan, bearing interest at a rate of prime plus 2.75%. We were required to make equal monthly principal payments over the 24 month term of the loan, totaling $1.5 million annually. In May 2012, Silicon Valley Bank consolidated the term loans and extended additional credit, resulting in a combined term loan balance of $3.5 million. We are required to make equal monthly principal payments over a 36 month period, beginning in December 2012, and monthly interest payments from the date of the funding through the final payoff of the loan. The consolidated loan bears interest at a rate of prime plus 2.5%, or 6.5%. At December 29, 2012, $3.4 was outstanding under the term loans.

The credit agreement includes affirmative and negative covenants, including financial covenants with respect to our liquidity and tangible net worth. We are required on a monthly basis to maintain a minimum adjusted quick ratio of 1.0 to 1.0 and a minimum tangible net worth of $15 million plus (i) 50% of new equity and subordinated debt plus (ii) 50% of quarterly net income. As a result of continuing losses, the Company was out of compliance with the tangible net worth debt covenant during the fourth quarter of 2012. We anticipate that it is likely that we will continue to violate one or more financial covenants in the near future. The facility also contains customary events of default, including payment defaults, breaches of representations and warranties, and covenant defaults.

On January 23, 2013, we entered into a forbearance agreement with Silicon Valley Bank (the "Forbearance Agreement"), pursuant to which Silicon Valley Bank agreed to forbear from filing any legal action or instituting or enforcing any rights and remedies it may have against us as a result of our violation of the financial covenants until February 28, 2013. On March 27, 2013, the effectiveness of the Forbearance Agreement was extended until April 30, 2013. The Company is currently working with Silicon Valley Bank to obtain a waiver of our non-compliance with one of the financial covenants contained in the credit agreement. However, we may be unable to obtain such a waiver. If we are unable to obtain a waiver, additional forbearance or a modification to the covenant in violation, the lender could accelerate all of our outstanding obligations under the credit agreement. In addition, we could lose certain vendor credit should the letters of credit issued under the credit agreement become unavailable. If that were to occur, we may be unable to quickly obtain equivalent or suitable replacement financing. If we were not able to secure alternative sources of funding, such acceleration would have a material adverse impact on our financial condition.

Pursuant to the Forbearance Agreement, the principal amount outstanding under the revolving line of credit accrues interest at a per annum rate equal to the following (i) at all times that a Streamline Period is in effect, 1.75% above the Prime Rate; and (ii) at all times that a Streamline Period is not in effect, 2.75% above the Prime Rate; which interest shall be payable monthly. A Streamline Period requires us to maintain $8.5 million in revolving credit availability plus unrestricted cash on deposit with the bank. As of March 27, 2013, the interest rate on the revolving line of credit is 6.75%. In addition, the borrowing base reserve on the revolving line of credit increased from $1 million to $2 million dollars thereby limiting the borrowing availability. Pursuant to the Forbearance Agreement, the principal amount outstanding under the term loan accrues interest at a per annum rate equal to 3.25% above the Prime Rate; which interest shall be payable monthly. As of March 27, 2013, the interest rate on the term loan is 7.25%.

Table of Contents

The following table presents details of outstanding borrowings and availability under our line of credit (in thousands):

	December 29, 2012	December 31, 2011
Availability under the revolving line of credit	$ 1,486	$ 7,797
Outstanding borrowings on the revolving line of credit		
Amounts reserved under credit sublimits		(2,022)
Unutilized borrowing availability under the revolving line of credit	$ 1,486	$ 5,775

On November 21, 2011, we entered into a sales agreement with Ascendiant as sales agent. In accordance with the terms of the sales agreement, we were able to issue and sell shares of our common stock having an aggregate offering price of up to $10.0 million. Since November 2011, we have received net proceeds of approximately $5.8 million, including approximately $3.9 million raised through the sale of approximately 1,312,669 shares during the year ended December 29, 2012. Sales of shares of our common stock may be made in a series of transactions from time to time as we may direct Ascendiant in sales deemed to be an "at the market" offering as defined in Rule 415 under the Securities Act of 1933. Such sales are made pursuant to our effective $40 million shelf registration statement filed with the SEC in September 2011. We may terminate the sales agreement with Ascendiant at any time. In the event of such termination, we would expect to make available any remaining unsold portion of the $10.0 million in aggregate offering price for other sources of financing that are permitted under the effective shelf registration statement. The sales agreement with Ascendiant does not preclude us from pursuing other sources of financing. We may be limited in our ability to benefit from the agreement with Ascendiant if the volume of our shares traded in the market or the market price of our shares is low.

On December 20, 2012, we raised gross proceeds of $1.5 million in a registered public offering of our securities. The offering closed on December 26, 2012, and we received net proceeds of $1.3 million after deducting commissions and offering costs. The offering resulted in the issuance of 1,685,394 shares of common stock and warrants to purchase up to an aggregate of 2,275,282 shares of our common stock, which represents 135% of the number of shares issued and sold in the offering. Each warrant grants the holder the right to purchase one share of our common stock at an exercise price of $0.89 per share and expires in June 2018. These warrants become exercisable 181 days following the December 26, 2012 issuance date.

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

We believe our existing cash balances, borrowing availability under our bank credit facility, proceeds available under the sales agreement with Ascendiant 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. However, should we need additional capital, we may seek to raise capital through, among other things, public and private equity offerings and debt financings. 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. Additional funds may not be available on terms acceptable to us, or at all. If adequate working capital is not available when needed, we may be required to significantly modify our business model and operations to reduce spending to a sustainable level. It could cause us to be unable to execute our business plan, take advantage of future opportunities, or respond to competitive pressures or customer requirements. It may also cause us to delay, scale back or eliminate some or all of our research and development programs, or to reduce or cease operations.

Liquidity

We incurred net losses of approximately $14.0 million and $5.6 million for the year ended December 29, 2012 and December 31, 2011, respectively, and had an accumulated deficit of approximately $86.7 million at December 29, 2012. In addition, we used cash in operating activities of approximately $7.0 million and $7.4 million for the years ended December 29, 2012 and December 31, 2011, respectively. As a result of continuing losses, we are out of compliance with the tangible net worth debt covenant during the fourth quarter of 2012. We have initiated discussions with Silicon Valley Bank to waive the violations and amend the credit agreement.

In addition to renegotiating the credit agreement with Silicon Valley Bank, we are evaluating potential financing opportunities and alliances or other partnership agreements with entities interested in our technologies. We are also planning to reduce expenses, continue efforts to qualify new and enhanced products with our OEM customers, and protect our intellectual property.

If adequate working capital is not available when needed, we may be required to significantly modify our business model and operations to reduce spending to a sustainable level. It could cause us to be unable to execute our business plan, take advantage of future opportunities, or respond to competitive pressures or customer requirements. It may also cause us to delay, scale back or eliminate some or all of our research and development programs, or to reduce or cease operations. While there is no assurance that we can meet our revenue forecasts or successfully negotiate the terms of the credit agreement with Silicon Valley Bank, we anticipate that we can successfully execute our plans and continue operations for at least the next twelve months.

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 8. Financial Statements and Supplementary Data

The financial statements and supplementary data required by this item are included in Part IV, Item 15 of this Report.

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

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Exchange Act, as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in reports we file or

Table of Contents

submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 29, 2012 based on the criteria set forth in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of December 29, 2012.

This Annual Report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our independent registered public accounting firm pursuant to the rules of the Securities and Exchange Commission that permit us to provide only management's report in this Annual Report.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the fourth quarter of 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Internal Control

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of simple errors. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

In addition, projections of any evaluation of effectiveness to future periods are subject to risks that controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

Item 9B. Other Information

None.

Table of Contents

PART III

Certain information required by this Part III is omitted from this Annual Report as we expect to file our definitive Proxy Statement for our Annual Meeting of Stockholders pursuant to Regulation 14A of the Exchange Act not later than 120 days after the end of the fiscal year covered by this Annual Report, and certain information included in the Proxy Statement is incorporated herein by reference.

Item 10. Directors, Executive Officers and Corporate Governance

We incorporate by reference herein the sections entitled "Election Of Directors," "Board Of Directors; Audit Committee Financial Expert" And "Other Information Section 16(a) Beneficial Ownership Reporting Compliance" in our Proxy Statement.

We have adopted a "Code of Business Conduct and Ethics" that applies to all employees, including our executive officers. A copy of the Code of Business Conduct and Ethics is posted on our Internet site at *www.netlist.com*. In the event that we make any amendment to, or grant any waivers of, a provision of the Code of Business Conduct and Ethics that applies to the principal executive officer, principal financial officer, or principal accounting officer that requires disclosure under applicable rules promulgated under the Securities Act or Exchange Act, we intend to disclose such amendment or waiver and the reasons there for on our Internet site.

Item 11. Executive Compensation

The information required by this Item is incorporated herein by reference to the section entitled "Executive Compensation" and "Directors' Compensation" in our Proxy Statement.

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

The information required by this Item is incorporated herein by reference to the section entitled "Security Ownership of Certain Beneficial Owners and Management" and "Equity Compensation Plan Information" in our Proxy Statement.

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

The information required by this Item is incorporated herein by reference to the section entitled "Certain Relationships and Related Transactions" in our Proxy Statement.

Item 14. Principal Accounting Fees and Services

The information required by this Item is incorporated herein by reference to the section entitled "Auditors, Audit Fees and Auditor Independence" in our Proxy Statement.

Table of Contents

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a)(1) All financial statements filed as part of this report.

(a)(2) Exhibits

3.1	Restated Certificate of Incorporation of Netlist, Inc. (incorporated by reference to the exhibit 3.1 of the registration statement on Form S-1 of the registrant (No. 333-136735) filed with the Securities and Exchange Commission (the "SEC") on October 23, 2006)
3.2	Amended and Restated Bylaws of Netlist, Inc. (incorporated by reference to exhibit number 3.1 of the registrant's Current Report on Form 8-K filed with the SEC on December 20, 2012)
10.1#	Amended and Restated 2000 Equity Incentive Plan of Netlist, Inc. (incorporated by reference to exhibit 10.7 of the registration statement on Form S-1 of the registrant (No. 333-136735) filed with the SEC on October 23, 2006)
10.2	Form of Indemnity Agreement for officers and directors (incorporated by reference to exhibit 10.12 of the registration statement on Form S-1 of the registrant (No. 333-136735) filed with the SEC on August 18, 2006)
10.3#	Employment Agreement, dated September 5, 2006, between Netlist, Inc. and Chun K. Hong (incorporated by reference to exhibit 10.13 of the registration statement on Form S-1 of the registrant (No. 333-136735) filed with the SEC on September 27, 2006)
10.4#	Amended and Restated 2006 Equity Incentive Plan of Netlist, Inc. (incorporated by reference to exhibit 10.1 of the registrant's Quarterly Report on Form 10-Q filed with the SEC on August 12, 2010)
10.5#	Form of Restricted Stock Award Agreement issued pursuant to the 2006 Equity Incentive Plan of Netlist, Inc. (incorporated by reference to exhibit 10.2 of the Quarterly Report on Form 10-Q of the registrant filed with the SEC on May 17, 2010)
10.6#	Stock Option Agreement dated June 8, 2010 between the registrant and Lisa Roger (incorporated by reference to exhibit 4.5 of the registration statement on Form S-8 of the registrant (No. 333-168330) filed with the SEC on July 27, 2010)
10.7#	Stock Option Agreement dated as of January 20, 2012 between the registrant and Gerard Yeh (incorporated by reference to exhibit 10.9 of the registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed with the SEC on February 28, 2012)
10.8	Lease (Multi-Tenant; Net), dated April 2, 2007, by and between The Irvine Company LLC and Netlist, Inc. (incorporated by reference to exhibit number 10.1 of the Current Report on Form 8-K of the registrant filed with the SEC on April 6, 2007)

Table of Contents

10.9	First Amendment to Lease, dated May 10, 2011, by and between The Irvine Company LLC and Netlist, Inc. (incorporated by reference to exhibit 10.2 of the Quarterly Report on Form 10-Q of the registrant filed with the SEC on May 12, 2011)
10.10	Loan and Security Agreement, dated as of October 31, 2009, between Silicon Valley Bank and Netlist, Inc. (incorporated by reference to exhibit 10.1 of the registrant's Current Report on Form 8-K filed with the SEC on November 2, 2009)
10.11	Intercompany Subordination Agreement, dated as of October 31, 2009, between Silicon Valley Bank, Netlist, Inc., and Netlist Technology Texas, L.P. (incorporated by reference to exhibit 10.2 of the registrant's Current Report on Form 8-K filed with the SEC on November 2, 2009)
10.12	Guarantor Security Agreement entered into as of October 31, 2009 between Silicon Valley Bank and Netlist Technology Texas LP (incorporated by reference to exhibit 10.3 of the registrant's Current Report on Form 8-K filed with the SEC on November 2, 2009)
10.13	Intellectual Property Security Agreement entered into as of October 31, 2009 by and between Silicon Valley Bank and Netlist, Inc. (incorporated by reference to exhibit 10.4 of the registrant's Current Report on Form 8-K filed with the SEC on November 2, 2009)
10.14	Amendment to Loan Documents entered into as of March 24, 2010, by and between Silicon Valley Bank and Netlist, Inc. (incorporated by reference to exhibit 10.1 of the registrant's Quarterly Report on Form 10-Q filed with the SEC on May 17, 2010)
10.15	Amendment to Loan Documents entered into as of June 30, 2010, by and between Silicon Valley Bank and Netlist, Inc. (incorporated by reference to exhibit 10.2 of the registrant's Quarterly Report on Form 10-Q filed with the SEC on August 12, 2010)
10.16	Amendment to Loan Documents entered into as of September 30, 2010, by and between Silicon Valley Bank and Netlist, Inc. (incorporated by reference to exhibit 10.1 of the registrant's Quarterly Report on Form 10-Q filed with the SEC on November 17, 2010)
10.17	Amendment to Loan Documents entered into as of May 11, 2011, by and between Silicon Valley Bank and Netlist, Inc. (incorporated by reference to exhibit 10.1 of the registrant's Quarterly Report on Form 10-Q filed with the SEC on May 12, 2011)
10.18	Amendment to Loan Documents entered into as of August 10, 2011, by and between Silicon Valley Bank and Netlist, Inc. (incorporated by reference to exhibit 10.1 of the registrant's Quarterly Report on Form 10-Q filed with the SEC on August 15, 2011)
10.19	Amendment to Loan Documents entered into as of May 14, 2012, by and between Silicon Valley Bank and Netlist, Inc. (incorporated by reference to exhibit 10.1 of the registrant's Quarterly Report on Form 10-Q filed with the SEC on May 15, 2012)
10.20*	Design and Production Agreement relating to Register ASIC (the "Production Register Agreement"), dated July 31, 2008, by and between Netlist, Inc. and Toshiba America Electronic Components, Inc. ("Toshiba") (incorporated by reference to exhibit 10.3 of the registrant's Quarterly Report on Form 10-Q/A filed with the SEC on April 1, 2011)
10.21*	Amendment #1 to the Production Register Agreement, dated May 22, 2009, by and between Netlist, Inc. and Toshiba (incorporated by reference to exhibit 10.4 of the registrant's Quarterly Report on Form 10-Q/A filed with the SEC on April 1, 2011)
10.22*	Amendment #1 to the Production Register Agreement, dated January 28, 2010, by and between Netlist, Inc. and Toshiba (incorporated by reference to exhibit 10.5 of the registrant's Quarterly Report on Form 10-Q/A filed with the SEC on April 1, 2011)

Table of Contents

10.23*	Amendment #2 to the Production Register Agreement, dated March 10, 2010, by and between Netlist, Inc. and Toshiba (incorporated by reference to exhibit 10.6 of the registrant's Quarterly Report on Form 10-Q/A filed with the SEC on April 1, 2011)
10.24*	Design and Production Agreement relating to ID ASIC (the "Production ID Agreement"), dated July 31, 2008, by and between Netlist, Inc. and Toshiba (incorporated by reference to exhibit 10.7 of the registrant's Quarterly Report on Form 10-Q/A filed with the SEC on April 1, 2011)
10.25*	Amendment #1 to the Production ID Agreement, dated January 28, 2010, by and between Netlist, Inc. and Toshiba (incorporated by reference to exhibit 10.8 of the registrant's Quarterly Report on Form 10-Q/A filed with the SEC on April 1, 2011)
10.26*	Amendment #2 to the Production ID Agreement, dated March 10, 2010, by and between Netlist, Inc. and Toshiba (incorporated by reference to exhibit 10.9 of the registrant's Quarterly Report on Form 10-Q/A filed with the SEC on April 1, 2011)
10.27*	ASIC Design and Production Agreement, dated August 11, 2010, between Open Silicon, Inc. and Netlist, Inc. (incorporated by reference to exhibit 10.2 of the registrant's Quarterly Report on Form 10-Q/A field with the SEC on August 24, 2011)
10.28	Sales Agreement, dated November 21, 2011, between Netlist, Inc. and Ascendiant Capital Markets, LLC (incorporated by reference to exhibit 10.1 of the registrant's Current Report on Form 8-K filed with the SEC on November 22, 2011)
10.29	Form of Securities Purchase Agreement, dated December 20, 2012 (incorporated by reference to exhibit 10.1 of the registrant's Current Report on Form 8-K filed with the SEC on December 20, 2012)
10.30	Form of Warrant (incorporated by reference to exhibit 4.1 of the registrant's Current Report on Form 8-K filed with the SEC on December 20, 2012)
10.31	Placement Agent Agreement, dated December 20, 2012, by and between Netlist, Inc. and Ascendiant Capital Markets, LLC (incorporated by reference to exhibit 10.2 of the registrant's Current Report on Form 8-K filed with the SEC on December 20, 2012)
10.32+	Forbearance to Loan and Security Agreement, dated March 27, 2013, by and between Netlist, Inc. and Silicon Valley Bank
21.1	Subsidiaries of Netlist, Inc. (incorporated by reference to exhibit 21.1 of the registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed with the SEC on February 28, 2012)
23+	Consent of KMJ Corbin & Company LLP.
24.1+	Power of Attorney (included on the signature page in this Part IV of this report).
31.1+	Certification of Chief Executive Officer of Periodic Report Pursuant to Rule 13a-15(e) or Rule 15d-15(e).
31.2+	Certification of Chief Financial Officer of Periodic Report Pursuant to Rule 13a-15(e) or Rule 15d-15(e).
32+	Certification by Chief Executive Officer and Chief Financial Officer of Periodic Report Pursuant to 18 U.S.C. Section 1350.
101.INS++	XBRL Instance Document
101.SCH++	XBRL Taxonomy Extension Schema Document

101.CAL++	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB++	XBRL Taxonomy Extension Label Linkbase Document
101.PRE++	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF++	XBRL Taxonomy Extension Definition Linkbase Document

+ Filed herewith.

++ Furnished herewith. In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be "filed" for purposes of Section 18 of the Securities and Exchange Act of 1934, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, except as expressly set forth by specific reference in such filing.

Management contract or compensatory plan or arrangement.

* Confidential treatment has been granted or requested with respect to portions of this exhibit pursuant to Rule 24b-2 of the Securities Exchange Act of 1934 and these confidential portions have been redacted from the filing that is incorporated by reference. A complete copy of this exhibit, including the redacted terms, has been separately filed with the SEC.

(b) Exhibits

See subsection (a)(2) above.

Table of Contents

SIGNATURES

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

Date: March 29, 2013

NETLIST, INC.

By: /s/ CHUN K. HONG

Chun K. Hong
President, Chief Executive Officer and
Chairman of the Board

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

Signature	Title	Date
/s/ CHUN K. HONG Chun K. Hong	President, Chief Executive Officer and Chairman of the Board (Principal Executive Officer)	March 29, 2013
/s/ GAIL SASAKI Gail Sasaki	Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	March 29, 2013
/s/ HK DESAI HK Desai	Director	March 29, 2013
/s/ THOMAS F. LAGATTA Thomas F. Lagatta	Director	March 29, 2013
/s/ CLAUDE M. LEGLISE Claude M. Leglise	Director	March 29, 2013
/s/ ALAN H. PORTNOY Alan H. Portnoy	Director	March 29, 2013

Table of Contents

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Netlist, Inc.

We have audited the accompanying consolidated balance sheets of Netlist, Inc. and subsidiaries (the "Company") as of December 29, 2012 and December 31, 2011, and the related consolidated statements of operations, stockholders' equity and comprehensive loss and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit on its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Netlist, Inc. and subsidiaries as of December 29, 2012 and December 31, 2011, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ KMJ CORBIN & COMPANY LLP
Costa Mesa, California
March 29, 2013

NETLIST, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(in thousands, except par value)

	December 29, 2012	December 31, 2011
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 7,755	$ 10,535
Investment in marketable securities	415	
Accounts receivable, net of allowance for doubtful accounts of $47 (2012) and $47 (2011)	3,434	11,399
Inventories	7,380	6,057
Prepaid expenses and other current assets	723	806
Total current assets	19,707	28,797
Property and equipment, net	2,560	2,771
Long-term investments in marketable securities		444
Other assets	130	161
Total assets	$ 22,397	$ 32,173
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 3,367	$ 6,155
Accrued payroll and related liabilities	784	1,813
Accrued expenses and other current liabilities	497	460
Accrued engineering charges	450	450
Current portion of long-term debt	3,493	2,144
Total current liabilities	8,591	11,022
Long-term debt, net of current portion		1,118
Other liabilities	94	94
Total liabilities	8,685	12,234
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.001 par value 10,000 shares authorized; no shares issued and outstanding		
Common stock, $0.001 par value 90,000 shares authorized; 30,348 (2012) and 26,390 (2011) shares issued and outstanding	30	26
Additional paid-in capital	100,403	92,709
Accumulated deficit	(86,721)	(72,740)
Accumulated other comprehensive loss		(56)
Total stockholders' equity	13,712	19,939
Total liabilities and stockholders' equity	$ 22,397	$ 32,173

See accompanying notes to consolidated financial statements.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

(in thousands, except per share amounts)

	Year Ended December 29, 2012	Year Ended December 31, 2011
Net sales	$ 36,873	$ 60,729
Cost of sales(1)	27,474	40,468
Gross profit	9,399	20,261
Operating expenses:		
Research and development(1)	12,845	14,924
Selling, general and administrative(1)	10,075	10,705
Total operating expenses	22,920	25,629
Operating loss	(13,521)	(5,368)
Other expense, net:		
Interest expense, net	(338)	(228)
Other expense, net	(134)	(56)
Total other expense, net	(472)	(284)
Loss before income tax benefit	(13,993)	(5,652)
Income tax benefit	(12)	(53)
Net loss	$ (13,981)	$ (5,599)
Net loss per common share:		
Basic and diluted	$ (0.50)	$ (0.22)
Weighted-average common shares outstanding:		
Basic and diluted	27,853	25,086

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

Cost of sales	$ 114	$ 79
Research and development	667	600
Selling, general and administrative	1,110	941

See accompanying notes to consolidated financial statements.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Loss

(in thousands)

	Year Ended December 29, 2012	Year Ended December 31, 2011
Net loss	$ (13,981)	$ (5,599)
Other comprehensive loss:		
Unrealized loss transferred from other comprehensive loss to earnings	56	59
Net unrealized loss on investments, net of tax		(4)
Total comprehensive loss	$ (13,925)	$ (5,544)

See accompanying notes to consolidated financial statements.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity

(in thousands)

	Series A Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
Balance, January 1, 2011			25,284	$ 25	$ 89,074	$ (67,141)	$ (111)	$ 21,847
Stock-based compensation			11		1,620			1,620
Exercise of stock options			435		203			203
Repurchase of common stock			(37)		(78)			(78)
Issuance of common stock			697	1	1,890			1,891
Components of comprehensive loss:								
Change in net unrealized loss on investments							55	55
Net loss						(5,599)		(5,599)
Balance, December 31, 2011			26,390	26	92,709	(72,740)	(56)	19,939
Stock-based compensation			(48)		1,891			1,891
Exercise of stock options			1,032	1	687			688
Repurchase of common stock			(24)		(64)			(64)
Issuance of common stock			2,998	3	5,180			5,183
Components of comprehensive loss:								
Reversal of unrealized loss due to recognition in current year							56	56
Net loss						(13,981)		(13,981)
Balance, December 29, 2012			30,348	$ 30	$ 100,403	$ (86,721)	$	$ 13,712

See accompanying notes to consolidated financial statements.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(in thousands)

	Year Ended December 29, 2012	Year Ended December 31, 2011
Cash flows from operating activities:		
Net loss	$ (13,981)	$ (5,599)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,987	2,242
Realized loss on sale of investments in marketable securities	85	59
Realized loss on sale of equipment	53	
Provision for bad debts		35
Stock-based compensation	1,891	1,620
Changes in operating assets and liabilities:		
Accounts receivable	7,965	(4,983)
Inventories	(1,323)	(1,548)
Prepaid expenses and other current assets	263	759
Other assets	31	129
Accounts payable	(2,938)	(102)
Accrued payroll and related liabilities	(1,029)	51
Accrued expenses and other current liabilities	37	101
Accrued engineering charges		(188)
Net cash used in operating activities	(6,959)	(7,424)
Cash flows from investing activities:		
Acquisition of property and equipment	(1,698)	(744)
Proceeds from sale of equipment	43	
Proceeds from maturities and sales of investments in marketable securities		1,264
Net cash (used in) provided by investing activities	(1,655)	520
Cash flows from financing activities:		
Borrowings on lines of credit	3,200	500
Payments on lines of credit	(3,200)	(500)
Proceeds of bank term loan	1,319	2,934
Payments on debt	(1,292)	(1,724)
Proceeds from public offering, net	5,183	1,891
Proceeds from exercise of equity awards, net of taxes remitted for restricted stock	624	128
Net cash provided by financing activities	5,834	3,229
Net decrease in cash and cash equivalents	(2,780)	(3,675)
Cash and cash equivalents at beginning of year	10,535	14,210
Cash and cash equivalents at end of year	$ 7,755	$ 10,535

See accompanying notes to consolidated financial statements.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 29, 2012

Note 1 Description of Business

Netlist, Inc. (the "Company" or "Netlist") designs and manufactures a wide variety of high performance, logic-based memory subsystems for the global datacenter and high-performance computing and communications markets. The Company's memory subsystems consist of combinations of dynamic random access memory integrated circuits ("DRAM ICs" or "DRAM"), NAND flash memory ("NAND"), application-specific integrated circuits ("ASICs") and other components assembled on printed circuit boards ("PCBs"). Netlist primarily markets and sells its products to leading original equipment manufacturer ("OEM") customers. The Company's solutions are targeted at applications where memory plays a key role in meeting system performance requirements. The Company leverages 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, reduced power consumption and low cost per bit. Our NVvault product is the first to offer both DRAM and NAND in a standard form factor memory subsystem as a persistent DIMM in mission critical applications.

Netlist was incorporated in June 2000 and is headquartered in Irvine, California. In 2007, the Company established a manufacturing facility in the People's Republic of China (the "PRC"), which became operational in July 2007 upon the successful qualification of certain key customers.

Liquidity

The Company incurred net losses of approximately $14.0 million and $5.6 million for the year ended December 29, 2012 and December 31, 2011, respectively, and had an accumulated deficit of approximately $86.7 million at December 29, 2012. In addition, the Company used cash in operating activities of approximately $7.0 million and $7.4 million for the year ended December 29, 2012 and December 31, 2011, respectively. As a result of continuing losses, the Company was out of compliance with the tangible net worth debt covenant during the fourth quarter of 2012.

On January 23, 2013, we entered into a forbearance agreement with Silicon Valley Bank (the "Forbearance Agreement"), pursuant to which Silicon Valley Bank agreed to forbear from filing any legal action or instituting or enforcing any rights and remedies it may have against us as a result of our violation of the financial covenants until February 28, 2013. On March 27, 2013, the effectiveness of the Forbearance Agreement was extended until April 30, 2013, or an earlier date under certain conditions, such as the occurrence of an event of default or our breach of the Forbearance Agreement. The Company is currently working with Silicon Valley Bank to obtain a waiver of our non-compliance with the financial covenants contained in the credit agreement. However, we may be unable to obtain such a waiver. If we are unable to obtain a waiver, additional forbearance or a modification to the required liquidity levels, the lender could accelerate all of our outstanding obligations under the credit agreement. In addition, we could lose vendor credit should the letters of credit issued under the credit agreement become unavailable. If that were to occur, we may be unable to quickly obtain equivalent or suitable replacement financing. If we were not able to secure alternative sources of funding, such acceleration would have a material adverse impact on our financial condition.

In addition to renegotiating the credit agreement with Silicon Valley Bank, the Company's management is evaluating potential financing opportunities and alliances or other partnership agreements with entities interested in the Company's technologies. The Company is also planning to

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 1 Description of Business (Continued)

reduce its expenses and continue its efforts to qualify new and enhanced products with its OEM customers.

The Company raised net proceeds of approximately $3.9 million in the year ended December 29, 2012 and approximately $1.9 million in the year ended December 31, 2011 under a sales agreement with Ascendiant Capital Markets LLC ("Ascendiant"). In addition, on December 20, 2012, the Company raised net proceeds of approximately $1.3 million in a registered public offering ("Offering") of its securities (see note 10). The Company may raise additional funds through the Company's agreement with Ascendiant or through other sources. The Company may be limited in its ability to benefit from the agreement with Ascendiant if the volume of its shares traded in the market or the market price of its shares is low.

If adequate working capital is not available when needed, the Company may be required to significantly modify its business model and operations to reduce spending to a sustainable level. It could cause the Company to be unable to execute its business plan, take advantage of future opportunities, or respond to competitive pressures or customer requirements. It may also cause the Company to delay, scale back or eliminate some or all of its research and development programs, or to reduce or cease operations. While there is no assurance that the Company can meet its revenue forecasts or successfully negotiate the terms of the credit agreement with Silicon Valley Bank, management anticipates that it can successfully execute its plans and continue operations for at least the next twelve months.

Note 2 Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S.").

Principles of Consolidation

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

Fiscal Year

The Company operates under a 52/53-week fiscal year ending on the Saturday closest to December 31. The 2012 and 2011 fiscal years ended on December 29, 2012 and December 31, 2011, respectively. Fiscal years 2012 and 2011 each consisted of 52 weeks.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure 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.

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 2 Summary of Significant Accounting Policies (Continued)

Significant estimates made by management include, among others, provisions for uncollectible receivables and sales returns, warranty liabilities, valuation of inventories, fair value of financial instruments, impairment of long-lived assets, stock-based compensation expense and realization of deferred tax assets. The Company bases its estimates on historical experience, knowledge of current conditions and the Company's belief of what could occur in the future considering available information. The Company reviews its estimates on an on-going basis. The actual results experienced by the Company may differ materially and adversely from its estimates. To the extent there are material differences between the estimates and the actual results, future results of operations will be affected.

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 integrated circuits ("ICs"), totaling less than 1% of net revenues in 2012 and 2011.

The Company recognizes revenues in accordance with the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 605. Accordingly, the Company recognizes revenues when there is persuasive evidence that an arrangement exists, product delivery and acceptance have occurred, the sales price is fixed or determinable, and collectability of the resulting receivable is reasonably assured.

The Company generally uses customer purchase orders and/or contracts as evidence of an arrangement. Delivery occurs when goods are shipped for customers with shipping point terms and upon receipt for customers with destination terms, at which time title and risk of loss transfer to the customer. Shipping documents are used to verify delivery and customer acceptance. 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 component 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. The Company offers a standard product warranty to our customers and has no other post-shipment obligations. The Company assesses collectability based on the creditworthiness of the customer as determined by credit checks and evaluations, as well as the customer's payment history.

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.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and short-term investments with original maturities of three months or less, other than short-term investments in securities that lack an active market.

Investments in Marketable Securities

The Company accounts for its investments in marketable securities in accordance with ASC Topic 320. The Company determines the appropriate classification of its investments at the time of purchase

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 2 Summary of Significant Accounting Policies (Continued)

and reevaluates such designation at each balance sheet date. The Company's investments in marketable securities have been classified and accounted for as available-for-sale based on management's investment intentions relating to these securities. Available-for-sale securities are stated at fair value, generally based on market quotes, to the extent they are available. Unrealized gains and losses, net of applicable deferred taxes, are recorded as a component of other comprehensive income (loss). Realized gains and losses and declines in value judged to be other than temporary are determined based on the specific identification method and are reported in other income, net in the consolidated statements of operations.

The Company generally invests its excess cash in domestic bank-issued certificates of deposit which carry federal deposit insurance, money market funds and highly liquid debt instruments of U.S. municipalities, corporations and the U.S. government and its agencies. All highly liquid investments with stated maturities of three months or less from the date of purchase are classified as cash equivalents; all investments with stated maturities of greater than three months are classified as investments in marketable securities.

Fair Value of Financial Instruments

The Company's financial instruments consist principally of cash and cash equivalents, investments in marketable securities, accounts receivable, accounts payable, accrued expenses and debt instruments. Other than for certain investments in auction rate securities and short-term corporate bonds (see Note 4), the fair value of the Company's cash equivalents and investments in marketable securities is determined based on quoted prices in active markets for identical assets or Level 1 inputs. Because of their short-term nature, short-term corporate bonds are not frequently traded. Although there are observable quotes for these securities, the markets are not considered active. Accordingly, the fair values of these investments are based on Level 2 inputs. The Company recognizes transfers between Levels 1 through 3 of the fair value hierarchy at the beginning of the reporting period. The Company believes that the carrying values of all other financial instruments approximate their current fair values due to their nature and respective durations.

Allowance for Doubtful Accounts

The Company evaluates the collectability of accounts receivable based on a combination of factors. In cases where the Company is aware of circumstances that may impair a specific customer's ability to meet its financial obligations subsequent to the original sale, the Company will record an allowance against amounts due, and thereby reduce the net recognized receivable to the amount the Company reasonably believes will be collected. For all other customers, the Company records allowances for doubtful accounts based primarily on the length of time the receivables are past due based on the terms of the originating transaction, the current business environment and its historical experience. Uncollectible accounts are charged against the allowance for doubtful accounts when all cost effective commercial means of collection have been exhausted.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 2 Summary of Significant Accounting Policies (Continued)

Concentration of Credit Risk

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

The Company invests its cash equivalents primarily in money market mutual funds. Cash equivalents are maintained with high quality institutions, the composition and maturities of which are regularly monitored by management. The Company had $5.3 million of FDIC insured cash and cash equivalents at December 29, 2012. Investments in marketable securities are generally in high-credit quality debt instruments. Such investments are made only in instruments issued or enhanced by high-quality institutions. The Company has not realized any credit losses related to these investments.

The Company's trade accounts receivable are primarily derived from sales to OEMs in the computer industry (see Note 12). The Company performs credit evaluations of its customers' financial condition and limits the amount of credit extended when deemed necessary, but generally requires no collateral. Credit quality is monitored by evaluation of credit scores and collection history. The Company believes that the concentration of credit risk in its trade receivables is moderated by its credit evaluation process, relatively short collection terms, the high level of credit worthiness of its customers, foreign credit insurance and letters of credit issued on the Company's behalf. Reserves are maintained for potential credit losses, and such losses historically have not been significant and have been within management's expectations. Potential credit losses are limited to the gross value of accounts receivable.

Inventories

Inventories are valued at the lower of actual cost to purchase or manufacture the inventory or the net realizable value of the inventory. Cost is determined on an average cost basis which approximates actual cost on a first-in, first-out basis and includes raw materials, labor and manufacturing overhead. At each balance sheet date, the Company evaluates its ending inventory quantities on hand and on order and records a provision for excess quantities and obsolescence. 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. In addition, the Company considers changes in the market value of components in determining the net realizable value of its inventory. 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.

Property and Equipment

Property and equipment are recorded at cost and depreciated on a straight-line basis over their estimated useful lives, which generally range from three to seven years. Leasehold improvements are recorded at cost and amortized on a straight-line basis over the shorter of their estimated useful lives or the remaining lease term.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 2 Summary of Significant Accounting Policies (Continued)

Impairment of Long-Lived Assets

The Company evaluates the recoverability of the carrying value of long-lived assets held and used by the Company for impairment on at least an annual basis or whenever events or changes in circumstances indicate that their carrying value may not be recoverable. When such factors and circumstances exist, the Company compares the projected undiscounted future net cash flows associated with the related asset or group of assets over their estimated useful lives against their respective carrying amount. If the carrying value is determined not to be recoverable from future operating cash flows, the asset is deemed impaired and an impairment loss is recognized to the extent the carrying value exceeds the estimated fair value of the asset. The fair value of the asset or asset group is based on market value when available, or when unavailable, on discounted expected cash flows. The Company's management believes there is no impairment of long-lived assets as of December 29, 2012. There can be no assurance, however, that market conditions will not change or demand for the Company's products will continue, which could result in future impairment of long-lived assets.

Warranty Reserve

The Company offers product warranties generally ranging from one to three years, depending on the product and negotiated terms of any purchase agreements with customers. 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. Warranties are not offered on sales of excess component inventory. The Company records an estimate for warranty-related costs at the time of sale based on its historical and estimated product return rates and expected repair or replacement costs (see Note 3). Such costs have historically been within management's expectations and the provisions established.

Stock-Based Compensation

The Company accounts for equity issuances to non-employees in accordance with ASC Topic 505. 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 ASC Topic 718, employee and director stock-based compensation expense recognized during the period is based on the value of the portion of stock-based payment awards that is ultimately expected to vest during the period. Given that stock-based compensation expense recognized in the consolidated statements of operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. ASC Topic 718 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 Company's estimated average forfeiture rates are based on historical forfeiture experience and estimated future forfeitures.

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 2 Summary of Significant Accounting Policies (Continued)

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

The Company recognizes the fair value of restricted stock awards issued to employees and outside directors as stock-based compensation expense on a straight-line basis over the vesting period for the last separately vesting portion of the awards. Fair value is determined as the difference between the closing price of our common stock on the grant date and the purchase price of the restricted stock award, if any, reduced by expected forfeitures.

Income Taxes

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

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

Research and Development Expenses

Research and development expenditures are expensed in the period incurred.

Collaborative Agreements

In 2011, the Company entered into two memory technology Collaboration Agreements. The first agreement is a HyperCloud® Technology Collaboration Agreement (the "IBM Agreement") with International Business Machines ("IBM"). Under the IBM Agreement, IBM and the Company have

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 2 Summary of Significant Accounting Policies (Continued)

agreed to cooperate with respect to the qualification of HyperCloud® technology for use with IBM servers and to engage in certain joint marketing efforts if qualification is achieved. IBM and the Company have agreed to commit resources and funds in support of these activities. The IBM Agreement is non-exclusive.

The second agreement is a Collaboration Agreement (the "HP Agreement") with Hewlett-Packard Company ("HP"). Under the HP Agreement, HP and the Company have agreed to cooperate with respect to the qualification of HyperCloud® technology for use with HP servers and to engage in certain joint marketing efforts if qualification is achieved. HP and the Company have agreed to commit resources and funds in support of these activities. The HP Agreement is exclusive for a period of time. HP and the Company agree to collaborate on the future use of HyperCloud® load reduction and rank multiplication technologies for next generation server memory for HP.

In 2011, the Company reimbursed IBM and HP $0.2 million and $0.1 million, respectively, for the cost of certain qualification activities. The Company reimbursed HP an additional $0.9 million in the year ended December 29, 2012. The payments are included in research and development expense in the accompanying consolidated statement of operations. In addition, the Company made $0.8 million of payments to IBM for joint HyperCloud® marketing activities. The Company is amortizing the $0.8 million payments made to IBM based on actual unit shipments compared with estimated total shipments over the term of the Collaboration Agreement. The Company's net sales will be determined after deduction of such customer allowances, in accordance with ASC 605-50.

There can be no assurance that the efforts undertaken under either of the IBM or HP collaboration agreements will result in revenues for the Company that are sufficient to cover the cost of qualification activities, including payments made to HP and IBM under the collaboration agreements.

Through 2011, the Company maintained a collaborative arrangement with a partner in order to develop products using certain of the Company's proprietary technology. Under the arrangement, the development partner was granted a non-exclusive license to specified intellectual property for exclusive use in the development and production of ASIC chipsets for the Company. Both the Company and the development partner provided engineering project management resources at their own expense. The development partner was entitled to non-recurring engineering fees based upon the achievement of development milestones, and to a minimum portion of the Company's purchasing allocations for the component. Expenses incurred and paid to the development partner were insignificant in 2011. As of December 31, 2011, the operational and financial obligations under the agreement have been fulfilled.

Comprehensive Loss

ASC Topic 220 establishes standards for reporting and displaying comprehensive income (loss) and its components in the consolidated financial statements. Accumulated other comprehensive loss includes unrealized gains or losses on investments.

Risks and Uncertainties

The Company is subject to certain risks and uncertainties and management believes that significant changes in their ability to obtain profitable operations due to the history of losses and accumulated deficits, the Company's dependence on a few customers for a significant portion of revenues, risks

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 2 Summary of Significant Accounting Policies (Continued)

related to intellectual property matters, market development of and demand for the Company's products, and the length of the sales cycle could have a material adverse effect on the Company's financial position, results of operations or cash flows.

The Company has invested and expects to continue to invest a significant portion of its research and development budget into the design of ASIC devices, including the HyperCloud® memory subsystem. This new design and the products it is incorporated into are subject to increased risks as compared to the Company's existing products. The Company may be unable to achieve customer or market acceptance of the HyperCloud® memory subsystem or other new products, or achieve such acceptance in a timely manner. The Company has experienced a longer qualification cycle than anticipated with its HyperCloud® memory subsystems, and as of December 29, 2012 the product has not generated significant revenue relative to the Company's investment in the product. The Company has entered into collaborative agreements with both HP and IBM pursuant to which these OEMs have cooperated with the Company to qualify HyperCloud® for use in their respective products. The qualifying OEMs have engaged and continue to engage with the Company in joint marketing and further product development efforts. The Company and each of the OEMs have committed financial and other resources toward the collaboration. There can be no assurance that the efforts undertaken pursuant to either of the collaborative agreements will result in any new revenues for the Company. Further delays or any failure in placing or qualifying this product with HP, IBM or other potential customers would adversely impact the Company's results of operations.

The Company's operations in the PRC are subject to various political, geographical and economic risks and uncertainties inherent to conducting business in the PRC. These include, but are not limited to, (i) potential changes in economic conditions in the region, (ii) managing a local workforce that may subject the Company to uncertainties or certain regulatory policies, (iii) changes in other policies of the Chinese governmental and regulatory agencies, and (iv) changes in the laws and policies of the U.S. government regarding the conduct of business in foreign countries, generally, or in the PRC, in particular. Additionally, the Chinese government controls the procedures by which its local currency, the Chinese Renminbi ("RMB"), is converted into other currencies and by which dividends may be declared or capital distributed for the purpose of repatriation of earnings and investments. If restrictions in the conversion of RMB or in the repatriation of earnings and investments through dividend and capital distribution restrictions are instituted, the Company's operations and operating results may be negatively impacted. Restricted net assets of our subsidiary in the PRC totaled $0.6 million at December 31, 2011. The liabilities of the Company's subsidiaries in the PRC exceeded its assets as of December 29, 2012.

Foreign Currency Remeasurement

The functional currency of the Company's foreign subsidiary is the U.S. dollar. Local currency financial statements are remeasured into U.S. dollars at the exchange rate in effect as of the balance sheet date for monetary assets and liabilities and the historical exchange rate for nonmonetary assets and liabilities. Expenses are remeasured using the average exchange rate for the period, except items related to nonmonetary assets and liabilities, which are remeasured using historical exchange rates. All remeasurement gains and losses are included in determining net loss. Transaction gains and losses were not significant in 2012 and 2011.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 2 Summary of Significant Accounting Policies (Continued)

Net Loss Per Share

Basic net loss per share is calculated by dividing net loss by the weighted-average common shares outstanding during the year, excluding unvested shares issued pursuant to restricted share awards under the Company's share-based compensation plans. Diluted net loss per share is calculated by dividing the net loss by the weighted-average shares and dilutive potential common shares outstanding during the year. Dilutive potential shares consist of dilutive shares issuable upon the exercise or vesting of outstanding stock options and restricted stock awards, respectively, computed using the treasury stock method. In periods of losses, basic and diluted loss per share are the same, as the effect of stock options and unvested restricted share awards on loss per share is anti-dilutive.

New Accounting Pronouncements

In June 2011, the FASB issued new guidance on the presentation of comprehensive income. The new guidance eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity and requires an entity to present either one continuous statement of net income and other comprehensive income or two separate, but consecutive statements. The guidance relates only to presentation. The Company adopted this guidance in the first quarter of the year ended December 29, 2012. In February 2013, the FASB issued new guidance on reporting reclassifications out of accumulated other comprehensive income. This new guidance will be effective for the Company for the first quarter of the fiscal year ended December 28, 2013. Other than requiring additional disclosures, the Company does not expect this new guidance to impact the Company's consolidated financial statements.

Note 3 Supplemental Financial Information

Inventories

Inventories consist of the following (in thousands):

	December 29, 2012	December 31, 2011
Raw materials	$ 4,544	$ 4,312
Work in process	70	237
Finished goods	2,766	1,508
	$ 7,380	$ 6,057

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 3 Supplemental Financial Information (Continued)

Property and Equipment

Property and equipment consist of the following (dollars in thousands):

	Estimated Useful Lives	December 29, 2012	December 31, 2011
Machinery and equipment	3 - 7 yrs.	$ 9,060	$ 8,130
Leasehold improvements	*	1,851	1,817
Furniture and fixtures	5 yrs.	457	457
Computer equipment and software	3 - 7 yrs.	3,903	3,365
		15,271	13,769
Less accumulated depreciation and amortization		(12,711)	(10,998)
		$ 2,560	$ 2,771

---

* Estimated useful life is generally 7 years, or the remaining lease term, whichever is shorter.

Included in property and equipment are assets under capital leases with a cost of approximately $0.5 million and $0.5 million and accumulated amortization of approximately $0.2 million and $0.1 million at December 29, 2012 and December 31, 2011, respectively. Amortization of assets recorded under capital leases is included as a component of depreciation and amortization expense.

Warranty Liability

The following table summarizes the activity related to the warranty liability (in thousands):

	Year Ended	
	December 29, 2012	December 31, 2011
Beginning balance	$ 189	$ 194
Estimated cost of warranty claims charged to cost of sales	164	342
Cost of actual warranty claims	(118)	(347)
Ending balance	235	189
Less current portion	(141)	(95)
Long-term warranty obligations	$ 94	$ 94

The allowance for warranty liabilities expected to be incurred within one year is included as a component of accrued expenses and other current liabilities in the accompanying consolidated balance sheets. The allowance for warranty liabilities expected to be incurred after one year is included as a component of other liabilities in the accompanying consolidated balance sheets.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 3 Supplemental Financial Information (Continued)

Computation of Net Loss Per Share

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

	Year Ended December 29, 2012	Year Ended December 31, 2011
Basic and diluted net loss per share:		
Numerator: Net loss	$ (13,981)	$ (5,599)
Denominator: Weighted-average common shares outstanding, basic and diluted	27,853	25,086
Basic and diluted net loss per share	$ (0.50)	$ (0.22)

The following table sets forth potentially dilutive common share equivalents, consisting of shares issuable upon the exercise or vesting of outstanding stock options and restricted stock awards, respectively, and the exercise of warrants, computed using the treasury stock method. These potential common shares have been excluded from the diluted net loss per share calculations above as their effect would be anti-dilutive for the years then ended (in thousands):

	Year Ended December 29, 2012	Year Ended December 31, 2011
Common share equivalents	622	1,455

The above common share equivalents would have been included in the calculation of diluted earnings per share had the Company reported net income for the years then ended.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 3 Supplemental Financial Information (Continued)

Cash Flow Information

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

	Year Ended December 29, 2012	Year Ended December 31, 2011
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	$ 332	$ 227
Income taxes	$ 4	$ 4
Supplemental disclosure of non-cash investing and financing activities:		
Purchase of equipment through capitalized lease obligations	$	$ 117
Debt financed acquisition of assets	$ 180	$ 169
Purchase of equipment not paid for at the end of the year	$ 150	$ 2
Unrealized losses from investments in marketable securities	$	$ 4
Reversal of unrealized loss charged to other comprehensive income	$ 56	$

Note 4 Fair Value Measurements

The following tables detail the fair value measurements within the fair value hierarchy of the Company's investments in marketable securities (in thousands):

	Fair Value at December 29, 2012	Fair Value Measurements at December 29, 2012 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market mutual funds	$ 2,338	$ 2,338	$	$
Auction and variable floating rate notes	415			415
Total	$ 2,753	$ 2,338	$	$ 415

	Fair Value at December 31, 2011	Fair Value Measurements at December 31, 2011 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

Money market mutual funds	$	5,600	$	5,600	$		$	
Auction and variable floating rate notes		444						444
Total	$	6,044	$	5,600	$		$	444

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 4 Fair Value Measurements (Continued)

The following tables summarize the Company's assets measured at fair value on a recurring basis as presented in the Company's consolidated balance sheets at December 29, 2012 and December 31, 2011:

		Fair Value Measurements at December 29, 2012 Using		
	Fair Value at December 29, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	$ 2,338	$ 2,338	$	$
Marketable securities	415			415
Total assets measured at fair value	$ 2,753	$ 2,338	$	$ 415

		Fair Value Measurements at December 31, 2011 Using		
	Fair Value at December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	$ 5,600	$ 5,600	$	$
Long-term marketable securities	444			444
Total assets measured at fair value	$ 6,044	$ 5,600	$	$ 444

Fair value measurements using Level 3 inputs in the table above relate to the Company's investments in auction rate securities. The disruptions in the credit market continue to adversely affect the liquidity and overall market for auction rate securities. The Company has estimated the fair value of these investments using a discounted cash flow model which included assumptions about the credit quality and expected duration of the investments, along with discount rates affected for the general lack of liquidity. These assumptions reflect the Company's estimates about the reasonable assumptions market participants would likely use in valuing the investments, including assumptions about risk, developed based on the best information available in the circumstances.

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 4 Fair Value Measurements (Continued)

The following table provides a reconciliation of the beginning and ending balances for the Company's assets measured at fair value using Level 3 inputs (in thousands):

	Year Ended December 29, 2012	Year Ended December 31, 2011
Beginning balance	$ 444	$ 890
Sales of available-for-sale marketable securities		(441)
Realized loss included in other expense, net	(85)	(59)
Unrealized loss transferred from other comprehensive loss to earnings	56	59
Unrealized loss included in accumulated other comprehensive loss		(4)
Accrued interest		(1)
Ending balance	$ 415	$ 444

Note 5 Investments in Marketable Securities

Investments in marketable securities consist of the following at December 29, 2012 and December 31, 2011 (in thousands):

	December 29, 2012 Amortized Cost	Net Unrealized Gain (Loss)	Fair Value
Auction and variable floating rate notes	$ 415	$	$ 415

	December 31, 2011 Amortized Cost	Net Unrealized Gain (Loss)	Fair Value
Auction and variable floating rate notes	$ 500	$ (56)	$ 444

At December 29, 2012, the Level 3 fair value of the Company's auction rate securities consists of the par value of $500,000 adjusted for a realized loss of $85,000, recorded as other expense, net in the accompanying consolidated statement of operations for the year ended December 29, 2012.

Realized gains and losses on the sale of investments in marketable securities are determined using the specific identification method. Other than the sale of two of the Company's auction rate securities, described below, there were no sales of available-for-sale securities prior to maturity in 2012 or 2011.

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 5 Investments in Marketable Securities (Continued)

The following table provides the breakdown of investments in marketable securities with unrealized losses at December 31, 2011 (in thousands):

	December 31, 2011			
	Continuous Unrealized Loss			
	Less than 12 months		12 months or greater	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Auction and variable floating rate notes	$	$	$ 444	$ (56)

As of December 31, 2011, the Company held one investment that was in an unrealized loss position.

The following tables present the amortized cost and fair value of the Company's investments in marketable securities classified as available-for-sale at December 29, 2012 and December 31, 2011 by contractual maturity (in thousands):

	December 29, 2012	
	Amortized Cost	Fair Value
Maturity		
Greater than two years*	$ 415	$ 415

	December 31, 2011	
	Amortized Cost	Fair Value
Maturity		
Greater than two years*	$ 500	$ 444

---

* Comprised of auction rate securities which generally have interest rate reset dates of 90 days or less but final contractual maturity dates in excess of 15 years.

Auction Rate Securities

Disruptions in the credit market continue to adversely affect the liquidity and overall market for auction rate securities. As of December 29, 2012 and December 31, 2011, the Company held one investment in a Baa1 rated auction rate debt securities of a municipality with a total purchase cost of $0.5 million. Subsequent to year end, the Company disposed of this auction rate debt security for a realized loss of $85,000 and therefore has recorded the loss at year end as a permanent impairment of this asset. An A3 rated debt obligation backed by pools of student loans guaranteed by the U.S. Department of Education with a total purchase cost of $0.5 million was disposed of in June 2011 for a realized loss of approximately $59,000.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 6 Credit Agreement

On October 31, 2009, the Company entered into a credit agreement with Silicon Valley Bank, which was amended on March 24, 2010, June 30, 2010, September 30, 2010, May 11, 2011 August 10, 2011 and May 14, 2012 (as amended, the "Credit Agreement"). Currently, the Credit Agreement provides that the Company can borrow up to the lesser of (i) 80% of eligible accounts receivable, or (ii) $10.0 million. The Company has the option to increase credit availability to $15.0 million at any time through the maturity date of September 30, 2014, subject to the conditions of the Credit Agreement.

In connection with the September 30, 2010 amendment to the Credit Agreement, Silicon Valley Bank extended a $1.5 million term loan under the Credit Agreement, bearing interest at a rate of prime plus 2.00% ("Term Loan I"). The Company was required to make monthly principal payments of $41,666 over the 36 month term of the loan, or $0.5 million annually. In May 2011, Silicon Valley Bank extended an additional $3.0 million term loan ("Term Loan II"), bearing interest at a rate of prime plus 2.75%. The Company was required to make monthly principal payments of $125,000 over the 24 month term of the loan, or $1.5 million annually. In May 2012, Silicon Valley Bank consolidated both term loans and extended additional credit, resulting in a combined balance of $3.5 million (the "Consolidated Term Loan"). The Consolidated Term Loan is payable in 36 installments of $97,222, beginning December 2012, and bears interest at a rate of prime plus 2.50%. Interest is payable monthly from the date of funding through final payoff of the loan.

Prior to the May 14, 2012 amendment, the Credit Agreement contained an overall sublimit of $10.0 million to collateralize the Company's contingent obligations under letters of credit and other financial services. Amounts outstanding under the overall sublimit reduced the amount available pursuant to the Credit Agreement. As a result of the May 14, 2012 amendment, letters of credit and other financial services are no longer subject to borrowing base sublimits and do not reduce the amount that may be borrowed under the revolving line of credit. Rather the Company has an additional credit facility for up to $3.0 million in letters of credit through September 30, 2014. At December 29, 2012, letters of credit in the amount of $2.0 million were outstanding.

The following table presents details of interest expense related to borrowings on the lines of credit, along with certain other applicable information (in thousands):

	Year Ended	
	December 29, 2012	December 31, 2011
Interest expense	$ 112	$ 35

	December 29, 2012	December 31, 2011
Availability under the revolving line of credit	$ 1,486	$ 7,797
Outstanding borrowings on the revolving line of credit		
Amounts reserved under credit sublimits		(2,022)
Unutilized borrowing availability under the revolving line of credit	$ 1,486	$ 5,775

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 6 Credit Agreement (Continued)

The Company calculates the borrowing availability under the revolving line of credit in arrears, in accordance with the credit agreement and did not over-utilize the revolving line of credit at the time of borrowing. In October 2012, the Company repaid the $2.8 million balance of outstanding borrowings on the revolving line of credit in full.

All obligations under the Credit Agreement are secured by a first priority lien on the Company's tangible and intangible assets. The Credit Agreement subjects the Company to certain affirmative and negative covenants, including financial covenants with respect to the Company's liquidity and tangible net worth and restrictions on the payment of dividends. As of December 29, 2012, the Company was in violation of the tangible net worth covenant but remained in compliance with the quick ratio covenant.

On January 23, 2013, the Company entered into a Forbearance Agreement with Silicon Valley Bank (the "Forbearance Agreement"), pursuant to which Silicon Valley Bank shall forbear from filing any legal action or instituting or enforcing any rights and remedies it may have against the Company as a result of its violation of the financial covenants until February 28. 2013. On March 27, 2013, the effectiveness of the Forbearance Agreement was extended until April 30, 2013, or an earlier date under certain conditions, such as the occurrence of an event of default or a breach of the Forbearance Agreement. As a result of the Company's non-compliance with a loan covenant and in accordance with relevant accounting guidance, the Company reclassified the long-term portion of the Consolidated Term Loan to current portion of long term debt in the accompanying consolidated balance sheet as of December 29, 2012. The Company is currently working with Silicon Valley Bank to obtain a waiver of such non-compliance.

Pursuant to the Forbearance Agreement, the principal amount outstanding under the revolving line shall accrue interest at a per annum rate equal to the following (i) at all times that a Streamline Period (as defined) is an effect, 1.75% above the Prime Rate; and (ii) at all times that a Streamline Period (as defined) is not in effect, 2.75% above the Prime Rate; which interest shall be payable monthly. In addition, the reserve on the revolving line increased from $1 million to$2 million thereby limiting the borrowing availability further. The Credit Agreement requires payment of an unused line fee, as well as anniversary and early termination fees, as applicable.

Pursuant to the Forbearance Agreement, the principal amount outstanding under the term loan shall accrue interest at a per annum rate equal to 3.25% above the Prime Rate; which interest shall be payable monthly.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 7 Long-Term Debt

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

	December 29, 2012	December 31, 2011
Obligations under capital leases (see Note 9)	$ 118	$ 300
Consolidated Term Loan, net of issuance cost of $28	3,375	
Term Loan I (see Note 6)		875
Term Loan II, net of issuance cost of $38 (see Note 6)		2,087
	3,493	3,262
Less current portion	(3,493)	(2,144)
	$	$ 1,118

The Company has purchased manufacturing and computer equipment through the use of various capital leases that mature at various dates through October 2013 (see Note 9). The interest rates on these leases vary between 6.0% and 6.8%.

Interest expense related to the Company's long-term debt is presented in the following table (in thousands):

	Year Ended	
	December 29, 2012	December 31, 2011
Interest expense	$ 234	$ 202

Note 8 Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 8 Income Taxes (Continued)

purposes. Significant components of the Company's deferred tax assets and liabilities are as follows (in thousands):

	December 29, 2012	December 31, 2011
Deferred tax assets:		
Reserves and allowances	$ 1,670	$ 1,995
State taxes, net of federal income tax benefit	2	
Depreciation and amortization	591	682
Other accruals	413	331
Compensatory stock options and rights	1,988	2,150
Other	45	25
Tax credit carryforwards	2,669	1,949
Operating loss carryforward	17,239	12,306
Foreign operating loss carryforward	1,193	1,031
Total deferred tax assets	25,810	20,469
Deferred tax liabilities:		
Prepaid expenses	(205)	(199)
Total deferred tax liabilities	(205)	(199)
Subtotal	25,605	20,270
Valuation allowance	(25,605)	(20,270)
	$	$

The Company evaluates whether a valuation allowance should be established against its deferred tax assets based on the consideration of all available evidence using a "more likely than not" standard. In making such judgments, significant weight is given to evidence that can be objectively verified. As of December 29, 2012 and December 31, 2011, a valuation allowance of $25.6 million and $20.3 million, respectively, has been provided based on the Company's assessment that it is more likely than not, that sufficient taxable income will not be generated to realize the tax benefits of the temporary differences. The valuation allowance increased by approximately $5.3 million and $2.3 million during the years ended December 29, 2012 and December 31, 2011, respectively, primarily related to the increase in the net operating loss carryforward.

At December 29, 2012, the Company has approximately $43.8 million of federal net operating loss ("NOL") carryforwards which begin to expire in year 2029, and approximately $29.3 million of state net operating loss carryforwards which begin to expire in year 2017, and Federal and state tax credit carryforwards of approximately $1.3 million and $1.4 million, respectively at December 29, 2012. Federal tax credit carryforwards begin to expire in 2026 and state tax credits carry forward indefinitely. In addition, the Company has approximately $9.1 million of operating loss carryforwards in the PRC that began to expire in 2012.

The deferred tax asset at December 29, 2012 does not include approximately $1.9 million and $2.0 million of excess tax benefits from employee stock option exercises that are a component of the

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 8 Income Taxes (Continued)

federal and state net operating loss carryover, respectively. The Company's stockholders' equity balance will be increased if and when such excess tax benefits are ultimately realized.

For financial reporting purposes, loss before benefit of income taxes includes the following components (in thousands):

	Year Ended December 29, 2012	Year Ended December 31, 2011
United States	$ (12,640)	$ (4,207)
Foreign	(1,353)	(1,445)
	$ (13,993)	$ (5,652)

The Company's income tax benefit consists of the following (in thousands):

	Year Ended December 29, 2012	Year Ended December 31, 2011
Current:		
Federal	$ (22)	$ (55)
State	10	2
Total current	(12)	(53)
Deferred:		
Federal	(4,335)	(1,516)
State	(764)	(582)
Foreign	(160)	(157)
Change in valuation allowance	5,259	2,255
Total deferred		
Income tax benefit	$ (12)	$ (53)

A reconciliation of income taxes computed by applying the statutory U.S. income tax rate to the Company's loss before income taxes to the income tax benefit is as follows:

	Year Ended December 29, 2012	Year Ended December 31, 2011
U.S. federal statutory tax	35%	35%
Valuation allowance	(32)	(25)
Loss from foreign subsidiary	(3)	(9)
Effective income tax benefit rate	0%	1%

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 8 Income Taxes (Continued)

Unrecognized Tax Benefits

The following table summarizes the activity related to the Company's unrecognized tax benefits (in thousands):

Balance at January 1, 2011	$	77
Reversal of liability for expiration of statute of limitations		(55)
Accrual of potential interest related to unrecognized tax benefits		
Balance at December 31, 2011		22
Reversal of liability for expiration of statute of limitations		(22)
Accrual of potential interest related to unrecognized tax benefits		
Balance at December 29, 2012	$	

Unrecognized tax benefits of tax positions, if recognized, would affect the Company's annual effective tax rate.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits as a component of tax expense. Interest and penalty accruals were insignificant at December 29, 2012 and December 31, 2011.

The Company files tax returns with federal, state and foreign jurisdictions. The Company is no longer subject to IRS or state examinations for periods prior to 2007 although certain carryforward attributes that were generated prior to 2007 may still be adjusted by the IRS.

Tax Holidays

In 2008, the Company began operating under tax holidays in the PRC, which are effective from January 2008 through December 2012. Since the Company operated at a loss in the PRC in 2012 and 2011, it did not realize any benefit to its consolidated results of operations attributable to the tax holidays.

Note 9 Commitments and Contingencies

Leases

The Company leases certain of its facilities and equipment under non-cancelable operating leases that expire at various dates through 2017. Rental expense, net of amortization of deferred gain and sublease income, is presented in the following table (in thousands):

	Year Ended			
	December 29, 2012		December 31, 2011	
Rental expense	$	959	$	1,065

The Company also has acquired certain equipment through the use of various capital leases, some of which contain bargain purchase options.

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 9 Commitments and Contingencies (Continued)

A summary of future minimum payments under both capital and operating lease commitments as of December 29, 2012 is as follows (in thousands):

Fiscal Year	Capital Leases	Operating Leases
2013	121	459
2014		245
2015		230
2016		223
2017		80
Total minimum lease payments	121	$ 1,237
Less amount representing interest	(3)	
Present value of future minimum lease payments (see Note 7)	$ 118	

Litigation and Patent Reexaminations

The Company owns numerous patents and continues to enlarge and strengthen its patent portfolios, which cover different aspects of the Company's technology innovations with various claim scopes. The Company attempts to generate revenue by selling or licensing selected patents or patent portfolios, and intends to vigorously enforce its patent rights against infringers who refuse to license. The Company spends substantial resources in various activities to protect its intellectual property, including activities to defend its patents against challenges made by way of reexamination proceedings at the United States Patent and Trademark Office ("USPTO"). These activities may continue for the foreseeable future, without any guarantee that any ongoing or future patent protection and litigation activities will be successful. The Company is also subject to litigation claims that it has infringed on the intellectual property of others, against which the Company intends to defend vigorously.

Litigation, whether or not eventually decided in the Company's favor or settled, is costly and time-consuming and could divert management's attention and resources. Because of the nature and inherent uncertainties of litigation, should the outcome of any of such actions be unfavorable, the Company's business, financial condition, results of operations or cash flows could be materially and adversely affected. Additionally, the outcome of pending litigation, and the related patent reexaminations, as well as any delay in their resolution, could affect the Company's ability to license its intellectual property in the future or to protect against competition in the current and expected markets for its products.

Google Litigation

In May 2008, the Company initiated discussions with Google, Inc. ("Google") based on information and belief that Google had infringed on a U.S. patent owned by the Company, U.S. Patent No. 7,289,386 ("the '386 patent"), which relates generally to technologies to implement rank multiplication in memory modules. Preemptively, Google filed a declaratory judgment lawsuit against the Company in the U.S. District Court for the Northern District of California (the "Northern District Court"), seeking a declaration that Google did not infringe the '386 patent and that the '386 patent

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 9 Commitments and Contingencies (Continued)

was invalid. The Company filed a counterclaim for infringement of the '386 patent by Google. Claim construction proceedings were held in November 2009, and the Company prevailed on every disputed claim construction issue. In June 2010, the Company filed motions for summary judgment of patent infringement and dismissal of Google's affirmative defenses. In May 2010, Google requested and was later granted an *Inter Partes* Reexamination of the '386 patent by the USPTO. The reexamination proceedings are described below. The Northern District Court granted Google's request to stay the litigation pending result of the reexamination, and therefore has not ruled on the Company's motions for summary judgment.

In December 2009, the Company filed a patent infringement lawsuit against Google in the Northern District Court, seeking damages and injunctive relief based on Google's infringement of U.S. Patent No. 7,619,912 ("the '912 patent"), which is related to the '386 patent and relates generally to technologies to implement rank multiplication. In February 2010, Google answered the Company's complaint and asserted counterclaims against the Company seeking a declaration that the patent is invalid and not infringed, and claiming that the Company committed fraud, negligent misrepresentation and breach of contract based on Netlist's activities in the JEDEC standard-setting organization. The counterclaim seeks unspecified compensatory damages. Accruals have not been recorded for loss contingencies related to Google's counterclaim because it is not probable that a loss has been incurred and the amount of any such loss cannot be reasonably estimated. In October 2010, Google requested and was later granted an *Inter Partes* Reexamination of the '912 patent by the USPTO. The reexamination proceedings are described below. In connection with the reexamination request, the Northern District Court granted the Company and Google's joint request to stay the '912 patent infringement lawsuit against Google until the completion of the reexamination proceedings.

Inphi Litigation

In September 2009, the Company filed a patent infringement lawsuit against Inphi Corporation ("Inphi") in the U.S. District Court for the Central District of California (the "Central District Court"). The complaint, as amended, alleges that Inphi is contributorily infringing and actively inducing the infringement of U.S. patents owned by the Company, including the '912 patent, U.S. Patent No. 7,532,537 ("the '537 patent"), which relates generally to memory modules with load isolation and memory domain translation capabilities, and U.S. Patent No. 7,636,274 ("the '274 patent"), which is related to the '537 patent and relates generally to load isolation and memory domain translation technologies. The Company is seeking damages and injunctive relief based on Inphi's use of the Company's patented technology. Inphi denied infringement and claimed that the three patents are invalid. In April 2010, Inphi requested but was later denied *Inter Partes* Reexaminations of the '912, '537 and '274 patents by the USPTO. In June 2010, Inphi submitted new requests and was later granted *Inter Partes* Reexaminations of the '912, '537 and '274 patents by the USPTO. The reexamination proceedings are described below. In connection with the reexamination requests, Inphi filed a motion to stay the patent infringement lawsuit with the Central District Court, which was granted. The Central District Court has requested that the Company notify it within one week of any action taken by the USPTO in connection with the reexamination proceedings, at which time the Central District Court may decide to maintain or lift the stay.

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 9 Commitments and Contingencies (Continued)

Smart Modular Litigation

On September 10, 2012, Smart Modular, Inc. ("SMOD") filed a patent infringement lawsuit against the Company in the U.S. District Court for the Eastern District of California (the "Eastern District Court"). The complaint alleges that the Company willfully infringes and actively induces the infringement of six claims of a U.S. patent newly issued to SMOD, U.S. Patent No. 8,250,295 ("the '295 patent"), and seeks damages and injunctive relief. SMOD also filed a motion for preliminary injunction and a memorandum in support of the motion on the same day of the complaint. The Company filed a request for reexamination of the '295 patent with the USPTO on September 15, 2012, setting forth six different combinations of prior art that would render the six asserted claims of the '295 patent unpatentable. The Company also filed an answer to SMOD's complaint with the Eastern District Court on October 11, 2012, in which the Company denies infringement of the '295 patent, claims that the '295 patent is invalid and unenforceable, and asserts a set of counterclaims against SMOD. SMOD filed motion to dismiss, motion to strike and motion for partial judgment on the pleadings on November 1, 2012. The Company filed briefs to oppose SMOD's motions on November 29, 2012 and November 30, 2012.

On December 7, 2012, the USPTO granted the Company's request for the reexamination of the '295 patent, and issued an Office Action rejecting all of the six asserted claims over the six different combinations of prior art set forth by the Company in its request. On December 13, 2012, the Company moved to stay litigation pending result of reexamination. The Company's motion to stay and SMOD's motion for preliminary injunction and motion to dismiss has been submitted without oral argument.

On February 7, 2013, Smart Modular filed a response to the Office Action in the reexamination of the '295 patent. Since the response appeared to be defective, Netlist filed a petition to strike the response with the USPTO on February 15, 2013. Smart Modular filed a supplemental response to the same Office Action on February 15, 2013. Netlist filed another petition to strike the supplemental response due to its apparent defects on February 21, 2013. On March 13, 2013, the USPTO issued a Notice of Defective Paper, in which the USPTO found Smart Modular's responses, both the initial filing and the supplemental filing, to be improper, and both responses were expunged from the record. The USPTO gave Smart Modular 15 days to submit another response. Netlist will have 30 days to file comments after Smart Modular's corrected response is filed.

Accruals have not been recorded for loss contingencies related to the SMOD litigation because it is not probable that a loss has been incurred and the amount of any such loss cannot be reasonably estimated.

'386 Patent Reexamination

As noted previously, in May 2010, Google requested and was later granted an *Inter Partes* Reexamination of the '386 patent by the USPTO. In October 2010, SMOD requested and was later granted an *Inter Partes* Reexamination of the '386 patent. The reexaminations requested by Google and SMOD were merged by the USPTO into a single proceeding. In April 2011, a Non-Final Action was issued by the USPTO, rejecting all claims in the patent. In July 2011, the Company responded by amending or canceling some of the claims, adding new claims, and making arguments as to the validity

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 9 Commitments and Contingencies (Continued)

of the rejected claims in view of cited references. Both Google and SMOD filed their comments to the Company's response in October 2011. In October 2012, the USPTO issued an Action Closing Prosecution ("ACP") rejecting all 60 claims. The Company filed a response to the ACP on December 3, 2012. Thus, the reexamination of the '386 patent remains pending and will continue in accordance with established procedures for merged reexamination proceedings.

'912 Patent Reexamination

As noted previously, in April 2010, Inphi requested but was later denied an *Inter Partes* Reexamination of the '912 patent by the USPTO. In June 2010, Inphi submitted a new request and was later granted an *Inter Partes* Reexamination of the '912 patent by the USPTO. In September 2010, the USPTO confirmed the patentability of all fifty-one claims of the '912 patent. In October 2010, Google and SMOD each filed and were later granted requests for reexamination of the '912 patent. In February 2011, the USPTO merged the Inphi, Google and SMOD '912 reexaminations into a single proceeding. In an April 2011 Non-Final Action in the merged reexamination proceeding, the USPTO rejected claims 1-20 and 22-51 and confirmed the patentability of claim 21 of the '912 patent. In July 2011, the Company responded by amending or canceling some of the claims, adding new claims, and making arguments as to the validity of the rejected claims in view of cited references. Inphi, Google, and SMOD filed their comments on the Company's response in August 2011. In October 2011, the USPTO mailed a second Non-Final Action confirming the patentability of twenty claims of the '912 patent, including claims that were added in the reexamination process. In January 2012, the Company responded by amending or canceling some of the claims, adding new claims, and making arguments as to the validity of the rejected claims in view of cited references. Google, Inphi and SMOD filed their comments to the Company's response in February 2012. The USPTO determined that SMOD's comments were defective, and issued a notice to SMOD to rectify and refile the comments within 15 days from the mailing date of the notice. SMOD filed corrected comments and a petition for the USPTO to withdraw the notice in March 2012. The USPTO issued a non-final Office Action on November 13, 2012 maintaining the patentability of many key claims while rejecting some claims that were determined to be patentable previously. The Company filed a response to the Office Action on January 14, 2013. The requesters filed their comments on February 14, 2013. The reexamination of the '912 patent remains pending and will continue in accordance with established procedures for merged reexamination proceedings.

'627 Patent Reexamination

In September 2011, SMOD filed a request for reexamination of U.S. Pat. No. 7,864,627 ("the '627 patent") issued to the Company on January 4, 2011. The '627 patent is related to the '912 patent. In November 2011, the USPTO granted SMOD's request for reexamination of the '627 patent and concurrently issued a Non-Final Action confirming the patentability of three claims. In February 2012, the Company responded by amending or canceling some of the claims, adding new claims, and making arguments as to the validity of the rejected claims in view of cited references. SMOD filed its comments to the Company's response in March 2012. The USPTO determined that SMOD's comments were defective and issued a notice in April 2012 to SMOD to rectify and refile the comments within 15 days from the mailing date of the notice. SMOD filed corrected comments and a petition for the USPTO to withdraw the notice in April 2012. The USPTO posted an Office Action on December 19, 2012, confirming one claim and rejecting the rest of the claims in the '627 patent. The Company filed a response to the Office Action on March 19, 2013. The reexamination of the '627 patent remains pending and will continue in accordance with established *Inter Partes* Reexamination procedures.

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 9 Commitments and Contingencies (Continued)

'537 Patent Reexamination

As noted previously, in April 2010, Inphi requested and was later denied an *Inter Partes* Reexamination of the '537 patent by the USPTO. In June 2010, Inphi submitted a new request and was later granted an *Inter Partes* Reexamination of the '537 patent by the USPTO. In September 2010, the USPTO issued a Non-Final Action confirming the patentability of four claims. In October 2010, the Company responded by amending or canceling some of the claims, adding new claims, and making arguments as to the validity of the rejected claims in view of cited references. Inphi filed its comments on the Company's response in January 2011. In June 2011, the USPTO issued an Action Closing Prosecution ("ACP") which reconfirmed the patentability of the four claims. In August 2010, the Company responded by amending some of the claims and making arguments as to the validity of the rejected claims in view of cited references. Inphi filed its comments on the Company's response in September 2011. The USPTO issued a Right of Appeal Notice ("RAN") in February 2012, in which the claim rejections were withdrawn, thus confirming the patentability of all sixty (60) claims in view of all the previously submitted comments by both Inphi and the Company. Inphi filed a notice of appeal in March 2012, and an appeal brief on May 8, 2012. In response, the USPTO issued a Notice of Defective Appeal Brief. Inphi filed a corrective appeal brief on May 31, 2012, and Netlist filed its reply brief to the corrected Inphi appeal brief on July 2, 2012. The Examiner now has an opportunity to respond to Inphi's corrected appeal brief as well as Netlist's reply brief. If the Examiner maintains his position, the Company and the USPTO examiner will jointly defend the patent in a hearing with the USPTO, in accordance with established procedures for *Inter Partes* Reexamination.

'274 Patent Reexamination

As noted previously, in April 2010, Inphi requested and was later denied an *Inter Partes* Reexamination of the '274 patent by the USPTO. In June 2010, Inphi submitted a new request and was later granted an *Inter Partes* Reexamination of the '274 patent by the USPTO. In September 2011, the USPTO issued a Non-Final Action, confirming the patentability of six claims. The Company has responded by amending or canceling some of the claims, adding new claims, and making arguments as to the validity of the rejected claims in view of cited references. Inphi filed its comments on the Company's response in November 2011. The USPTO issued an ACP in March 2012, which confirmed the patentability of one hundred and four (104) claims in view of all the previously submitted comments by both Inphi and the Company. The PTO subsequently issued a Right of Appeal Notice on June 22, 2012. This Notice triggered Inphi's right as the losing party to file a Notice of Appeal by July 23, 2012 and file an appeal brief by September 23, 2012, and Inphi filed both on their respective due dates. The Company responded to Inphi's appeal brief by filing a reply brief on October 24, 2012. The Examiner now has an opportunity to respond to the appeal brief and the reply brief. If the Examiner maintains his position, the Company and the USPTO examiner will jointly defend the patent in a hearing with the USPTO, in accordance with established procedures for *Inter Partes* Reexamination.

Other Contingent Obligations

During its normal course of business, the Company has made certain indemnities, commitments and guarantees pursuant to which it may be required to make payments in relation to certain

Table of Contents

Note 9 Commitments and Contingencies (Continued)

transactions. These include (i) intellectual property indemnities to the Company's customers and licensees in connection with the use, sales and/or license of Company products; (ii) indemnities to vendors and service providers pertaining to claims based on the Company's negligence or willful misconduct; (iii) indemnities involving the accuracy of representations and warranties in certain contracts; (iv) indemnities to directors and officers of the Company to the maximum extent permitted under the laws of the State of Delaware; and (v) certain real estate leases, under which the Company may be required to indemnify property owners for environmental and other liabilities, and other claims arising from the Company's use of the applicable premises. The duration of these indemnities, commitments and guarantees varies and, in certain cases, may be indefinite. The majority of these indemnities, commitments and guarantees do not provide for any limitation of the maximum potential for future payments the Company could be obligated to make. Historically, the Company has not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these indemnities, commitments and guarantees in the accompanying condensed consolidated balance sheets.

Note 10 Stockholders' Equity

Serial Preferred Stock

The Company's authorized capital includes 10,000,000 shares of Serial Preferred Stock, with a par value of $0.001 per share. No shares were outstanding at December 29, 2012 or December 31, 2011.

Common Stock

In November 2011, the Company entered into a sales agreement with Ascendiant Capital Markets LLC ("Ascendiant"), whereby shares with a total value of up to $10.0 million may be released for sale to the public at the discretion of management at a price equal to the current market price in an "at-the-market" offering as defined in Rule 415 under the Securities Act of 1933. During 2012 and 2011, the Company received net proceeds of approximately $3.9 million and $1.9 million, respectively, raised through the sale of 1,312,669 and 697,470 shares of common stock, respectively. The sales agreement with Ascendiant expires in November 2014.

On December 20, 2012, the Company raised gross proceeds of $1.5 million in a registered public offering ("Offering") of its securities. The Offering closed on December 26, 2012, and the Company received net proceeds of $1.3 million after deducting commissions and offering costs. The Offering resulted in the issuance of 1,685,394 shares of common stock and warrants to purchase up to an aggregate of 2,275,282 shares of the Company's common stock, which represents 135% of the number of shares issued and sold in the Offering. Each warrant grants the holder the right to purchase one share of the Company's common stock at an exercise price of $0.89 per share and expires in June 2018. These warrants become exercisable 181 days following the December 26, 2012 issuance date.

During 2012 and 2011, the Company cancelled 23,631 and 37,422 shares of common stock, respectively, valued at approximately $64,000 and $78,000, respectively, in connection with its obligation to holders of restricted stock to withhold the number of shares required to satisfy the holders' tax liabilities in connection with the vesting of such shares.

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 10 Stockholders' Equity (Continued)

The Company is incorporated in the state of Delaware, and as such, is subject to various state laws which may restrict the payment of dividends or purchase of treasury shares.

Stock-Based Compensation

The Company has stock-based compensation awards outstanding pursuant to the Amended and Restated 2000 Equity Incentive Plan (the "2000 Plan") and the Amended and Restated 2006 Equity Incentive Plan (the "2006 Plan"), under which a variety of option and direct stock-based awards may be granted to employees and nonemployees of the Company. Further grants under the 2000 Plan were suspended upon the adoption of the 2006 Plan. In addition to awards made pursuant to the 2006 Plan, the Company periodically issues inducement grants outside the 2006 Plan to certain new hires.

Subject to certain adjustments, as of December 29, 2012, the Company was authorized to issue a maximum of 5,405,566 shares of common stock pursuant to awards under the 2006 Plan. That maximum number will automatically increase on the first day of each subsequent calendar year by the lesser of (i) 5.0% of the number of shares of common stock that are issued and outstanding as of the first day of the calendar year, and (ii) 1,200,000 shares of common stock, subject to adjustment for certain corporate actions. At December 29, 2012, the Company had 820,635 shares available for grant under the 2006 Plan. At December 29, 2012, an additional 8,750 shares were reserved for issuance upon exercise of inducement grants. Options granted under the 2000 Plan, the 2006 Plan and outside the equity incentive plans primarily vest at a rate of at least 25% per year over four years and expire 10 years from the date of grant. Restricted stock awards vest in eight equal increments at intervals of approximately six months from the date of grant.

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 10 Stockholders' Equity (Continued)

A summary of the Company's common stock option activity is presented below (shares in thousands):

	Options Outstanding			
	Number of Shares (in thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Options outstanding January 1, 2011	4,634	$ 2.57		
Options granted	1,455	2.21		
Options exercised	(435)	0.47		
Options cancelled	(286)	2.89		
Options outstanding December 31, 2011	5,368	2.62		
Options granted	1,667	3.40		
Options exercised	(1,032)	0.67		
Options cancelled	(1,251)	2.83		
Options outstanding December 29, 2012	4,752	$ 3.22	6.3	$ 197
Options exercisable December 29, 2012	3,102	$ 3.42	5.0	$ 175
Options exercisable and expected to vest December 29, 2012	4,532	$ $3.23	6.2	$ 196

The following table summarizes information about stock options outstanding and exercisable at December 29, 2012:

	Options Outstanding			Options Exercisable		
Exercise Price Range	Number of shares (in thousands)	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number of shares (in thousands)	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price
$0.20 - $1.00	524	5.4	$ 0.37	469	5.3	$ 0.37
$1.01 - $3.00	2,208	6.3	$ 2.15	1,464	5.3	$ 2.15
$3.01 - $5.00	1,098	8.8	$ 3.54	247	7.7	$ 3.50
$5.01 - $8.45	922	3.6	$ 6.99	922	3.6	$ 6.99
	4,752	6.3	$ 3.22	3,102	5.0	$ 3.42

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 10 Stockholders' Equity (Continued)

A summary of the Company's restricted stock awards is presented below (shares in thousands):

	Restricted Stock Outstanding	
	Number of Shares	Weighted-Average Grant-Date Fair Value per Share
Balance outstanding at January 1, 2011	426	$ 3.46
Restricted stock granted	24	1.51
Restricted stock vested	(118)	3.47
Restricted stock forfeited	(13)	3.31
Balance outstanding at December 31, 2011	319	$ 3.32
Restricted stock granted		
Restricted stock vested	(113)	3.37
Restricted stock forfeited	(48)	3.22
Balance outstanding at December 29, 2012	158	$ 3.32

The following table presents details of the assumptions used to calculate the weighted-average grant date fair value of common stock options granted by the Company:

	Year Ended	
	December 29, 2012	December 31, 2011
Expected term (in years)	6.4	6.0
Expected volatility	127%	135%
Risk-free interest rate	1.16%	2.12%
Expected dividends		
Weighted-average grant date fair value per share	$ 3.03	$ 2.01
Grant date fair value of options vested	$ 1,482	$ 1,269
Intrinsic value of options exercised (in thousands)	$ 2,610	$ 960

The weighted-average fair value per share of the restricted stock granted in 2012 and 2011 was calculated based on the fair market value of the Company's common stock on the respective grant dates. The grant date fair value of restricted stock vested was $0.3 and $0.2 million in 2012 and 2011, respectively.

At December 29, 2012, the amount of unearned stock-based compensation currently estimated to be expensed from 2013 through 2015 related to unvested common stock options and restricted stock awards is approximately $3.6 million, net of estimated forfeitures. The weighted-average period over which the unearned stock-based compensation is expected to be recognized is approximately 2.6 years. If there are any modifications or cancellations of the underlying unvested awards, the Company may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense or calculate and record additional expense. Future stock-based compensation expense and unearned stock-based compensation will increase to the extent that the Company grants additional common stock options or other stock-based awards.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 10 Stockholders' Equity (Continued)

Warrants

On December 26, 2012 the Company, in association with raising capital through a registered public offering, issued warrants to purchase up to an aggregate of 2,275,282 shares of the Company's common stock, see above. A summary of the warrant activity is presented below:

	Number of Shares (in thousands)	Weighted-Average Exercise Price
Warrants outstanding December 31, 2011		$
Warrant granted	2,275	0.89
Warrants exercised		
Warrants outstanding December 29, 2012	2,275	$ 0.89

There were no warrants exercised or cancelled in the year ended December 29, 2012. Warrants outstanding at December 29, 2012 were classified as equity.

Note 11 401(k) Plan

The Company sponsors a 401(k) defined contribution plan. Employees are eligible to participate in this plan provided they are employed full-time and have reached 21 years of age. Participants may make pre-tax contributions to the plan subject to a statutorily prescribed annual limit. Each participant is fully vested in his or her contributions and investment earnings. The Company may make matching contributions on the contributions of a participant on a discretionary basis. In fiscal 2012, the Company adopted a limited matching contribution policy and made approximately $0.1 million in contributions to participants in this plan in the year ended December 29, 2012. No contributions have been made in the year ended December 31, 2011.

Note 12 Major Customers and Suppliers

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 net sales as follows:

	Year Ended	
	December 29, 2012	December 31, 2011
Customer A	60%	70%
Customer B	18%	*

* less than 10% of net sales

Sales of the Company's NVvault products represented 51% and 66% of net sales in 2012 and 2011.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 12 Major Customers and Suppliers (Continued)

The Company's accounts receivable are concentrated with two customers at December 29, 2012 representing approximately 41% and 24% of aggregate gross receivables. At December 31, 2011, one customer represented approximately 80% of aggregate gross receivables. A significant reduction in sales to, or the inability to collect receivables from, a significant customer could have a material adverse impact on the Company. The Company mitigates risk with foreign receivables by purchasing comprehensive foreign credit insurance.

The Company's purchases have historically been concentrated in a small number of suppliers. The following table sets forth purchases from suppliers comprising 10% or more of the Company's total purchases as follows:

	Year Ended	
	December 29, 2012	December 31, 2011
Supplier A	19%	24%
Supplier B	17%	*

* less than 10% of total purchases

While the Company believes alternative suppliers could be utilized, any inability to obtain components or products in the amounts needed on a timely basis or at commercially reasonable prices could result in delays in product introductions, interruption in product shipments or increases in product costs, which could have a material adverse effect on the Company.

Note 13 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.

To date, a majority of the Company's international sales relate to shipments of products to its U.S. customers' international manufacturing sites or third- party hubs. Net sales derived from shipments to international destinations, primarily to Hong Kong (including foreign subsidiaries of customers that are headquartered in the U.S.), represented approximately 70% and 83% of the Company's net sales in 2012 and 2011, respectively. All of the Company's net sales to date have been denominated in U.S. dollars.

As of December 29, 2012 and December 31, 2011, approximately $1.5 million of the Company's long-lived assets, net of depreciation and amortization, were located outside the U.S., primarily in the PRC. Substantially all other long-lived assets were located in the U.S.

Note 14 Subsequent Events

The Company has evaluated subsequent events through the filing date of this Form 10-K, and determined that no subsequent events that have occurred that would require recognition in the consolidated financial statements or disclosure in the notes thereto other than as discussed in the accompanying notes.

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 15 Quarterly Summary (Unaudited, in thousands except share and per share data)

	Three Months Ended			
	December 29, 2012	September 29, 2012	June 30, 2012	March 31, 2012
Net sales	$ 5,963	$ 6,391	$ 10,552	$ 13,967
Cost of sales	5,126	6,003	7,814	8,531
Gross profit	837	388	2,738	5,436
Operating expenses:				
Research and development	2,618	2,615	3,770	3,842
Selling, general and administrative	2,098	2,497	2,871	2,609
Total operating expenses	4,716	5,112	6,641	6,451
Operating loss	(3,879)	(4,724)	(3,903)	(1,015)
Other income (expense):				
Interest income (expense), net	(90)	(98)	(79)	(71)
Other expense, net	(146)	4	3	5
Total other income (expense), net	(236)	(94)	(76)	(66)
Loss before provision (benefit) for income taxes	(4,115)	(4,818)	(3,979)	(1,081)
Provision (benefit) for income taxes	(17)	4	1	
Net loss	$ (4,098)	$ (4,822)	$ (3,980)	$ (1,081)
Net loss per common share:				
Basic and diluted	$ (0.14)	$ (0.17)	$ (0.14)	$ (0.04)
Weighted-average common shares outstanding:				
Basic and diluted	28,279	28,199	28,111	26,729

Table of Contents

NETLIST, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 29, 2012

Note 15 Quarterly Summary (Unaudited, in thousands except share and per share data) (Continued)

	Three Months Ended			
	December 31, 2011	October 1, 2011	July 2, 2011	April 2, 2011
Net sales	$ 16,381	$ 16,347	$ 16,001	$ 12,000
Cost of sales	10,389	10,819	11,064	8,196
Gross profit	5,992	5,528	4,937	3,804
Operating expenses:				
Research and development	3,502	3,983	3,755	3,684
Selling, general and administrative	2,694	2,511	2,583	2,917
Total operating expenses	6,196	6,494	6,338	6,601
Operating income (loss)	(204)	(966)	(1,401)	(2,797)
Other income (expense):				
Interest income (expense), net	(81)	(72)	(50)	(25)
Other expense, net	2	1	(59)	
Total other income (expense), net	(79)	(71)	(109)	(25)
Loss before provision (benefit) for income taxes	(283)	(1,037)	(1,510)	(2,822)
Provision (benefit) for income taxes	(56)	2	1	
Net loss	$ (227)	$ (1,039)	$ (1,511)	$ (2,822)
Net loss per common share:				
Basic and diluted	$ (0.01)	$ (0.04)	$ (0.06)	$ (0.11)
Weighted-average common shares outstanding:				
Basic and diluted	28,306	25,029	24,988	24,881

Each of the Company's quarters in fiscal 2012 and 2011 is comprised of 13 weeks