

QUALSTAR CORP
Form DEF 14A
February 11, 2005

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material under Section 240.14a-12

QUALSTAR CORPORATION
(Name of Registrant as Specified in Its Charter)

N/A

(Name of Person(s) Filing Proxy Statement if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

(1) Title of each class of securities to which transaction applies:

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- o Fee paid previously with preliminary materials.
- o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

February 15, 2005

Dear Shareholder:

You are cordially invited to attend the Annual Meeting of Shareholders of Qualstar Corporation to be held on Thursday, March 17, 2005, at the Grand Vista Hotel located at 999 Enchanted Way, Simi Valley, California 93065, beginning at 9:30 a.m. Pacific Time.

At this meeting you will be asked to elect six directors to serve a term of one year. We urge you to read the attached Notice of Annual Meeting and Proxy Statement, which contains detailed information about management's nominees and other matters related to the Annual Meeting. In addition to the formal business to be conducted, management will report on developments of the past year and respond to questions and comments of general interest to shareholders.

It is important that your shares be represented. Therefore, even if you presently plan to attend the Annual Meeting, please complete, sign and date and promptly return the enclosed proxy card in the envelope provided. If you do attend the Annual Meeting and wish to vote in person, you may withdraw your proxy at that time.

I look forward to seeing you at the Annual Meeting.

Sincerely,

William J. Gervais
Chief Executive Officer and President

QUALSTAR CORPORATION
3990-B Heritage Oak Court
Simi Valley, California 93063

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS
To Be Held On March 17, 2005

NOTICE IS HEREBY GIVEN that Qualstar's Annual Meeting of Shareholders (the Annual Meeting) will be held at the Grand Vista Hotel located at 999 Enchanted Way, Simi Valley, California 93065, on Thursday, March 17, 2005, at 9:30 a.m. Pacific Time, for the following purposes:

1. To elect six directors to serve one year terms expiring at the next Annual Meeting of Shareholders, or until their successors have been duly elected and qualified; and

2. To transact any other business as may properly come before the Annual Meeting and any adjournment thereof.

Shareholders of record at the close of business on February 4, 2005, are entitled to notice of, and to vote at, the Annual Meeting and any adjournment thereof. All shareholders are cordially invited to attend the Annual Meeting in person.

By Order of the Board of Directors

Richard A. Nelson
Secretary

Simi Valley, California
February 15, 2005

YOUR VOTE IS IMPORTANT. THEREFORE, WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING YOU SHOULD COMPLETE, SIGN AND DATE THE ENCLOSED PROXY CARD, AND RETURN IT IN THE PREAMDRESSED ENVELOPE PROVIDED. NO POSTAGE IS NECESSARY IF MAILED IN THE UNITED STATES.

QUALSTAR CORPORATION
3990-B Heritage Oak Court
Simi Valley, California 93063

PROXY STATEMENT

ANNUAL MEETING OF SHAREHOLDERS
To Be Held On March 17, 2005

General Information

This Proxy Statement is furnished in connection with the solicitation of proxies by the Board of Directors of Qualstar Corporation, a California corporation, for use at the Annual Meeting of Shareholders of the Company to be held on Thursday, March 17, 2005, at 9:30 a.m. Pacific Time. The Annual Meeting will be held at the Grand Vista Hotel located at 999 Enchanted Way, Simi Valley, California 93065. This Proxy Statement and the accompanying proxy are first being mailed to shareholders on or about February 15, 2005.

Voting and Solicitation of Proxies

On February 4, 2005, the record date with respect to this solicitation, 12,253,117 shares of our common stock were outstanding. No other securities are entitled to vote at the Annual Meeting. Only shareholders of record on such date are entitled to notice of and to vote at the Annual Meeting and at any adjournment thereof. Each shareholder of record is entitled to one vote for each share held as of the record date on all matters to come before the Annual Meeting and at any adjournment thereof.

Quorum. The holders of a majority of the outstanding shares of our common stock, present in person or by proxy and entitled to vote, will constitute a quorum at the Annual Meeting. We count proxies marked *withhold authority* as to any director nominee or *abstain* as to a particular proposal as well as broker non-votes for purposes of determining the presence or absence of a quorum at the Annual Meeting for the transaction of business.

Vote Required. The six director nominees receiving the highest number of affirmative votes of the shares present or represented by proxy and entitled to vote will be elected as directors. Accordingly, proxies marked *withhold authority* and broker non-votes will have no effect in determining which directors receive the highest number of votes. The approval of any other matter that properly comes before the Annual Meeting will require the affirmative votes of a majority of the shares present or represented and entitled to be voted at the Annual Meeting.

The shares represented by all valid proxies received will be voted in accordance with the instructions specified therein. Unless otherwise directed in the proxy, the persons named therein will vote **FOR** the election of each of the director nominees named below. As to any other business that may properly come before the Annual Meeting, the persons named in the enclosed proxy will vote in accordance with their best judgment. We presently do not know of any other business which will be presented for consideration at the Annual Meeting.

Solicitation. Proxies for use at the Annual Meeting are being solicited by our Board of Directors. Proxies will be solicited principally by mail. If desirable, to ensure a quorum at the Annual Meeting, our officers, directors, agents and employees may contact shareholders, banks, brokerage houses and others, by telephone, facsimile or in person to request that proxies be furnished. Qualstar will bear all expenses incurred in connection with this solicitation. These costs include reimbursements to banks, brokerage houses and other custodians, nominees and fiduciaries for their reasonable expenses in forwarding proxy materials to beneficial owners of our common stock. However, officers, directors and employees will not receive additional compensation for these services.

Revocability of Proxies

An executed proxy may be revoked at any time before its exercise by delivering to the Secretary of Qualstar a written notice of revocation or a duly executed proxy bearing a later date. Prior to the date of the Annual Meeting, any notice of revocation or subsequent proxy must be delivered to our Secretary at 3990-B Heritage Oak Court, Simi Valley, California 93063, the principal executive office of Qualstar. On the date of the Annual Meeting, such notice or subsequent proxy should be delivered in person at the Annual Meeting prior to the time of the vote. Accordingly, the execution of the enclosed proxy will not affect a shareholder's right to vote in person should such shareholder find it convenient to attend the Annual Meeting and desire to vote in person, so long as the shareholder has revoked his or her proxy prior to its exercise in accordance with these instructions.

ELECTION OF DIRECTORS

(Proposal 1)

In accordance with Qualstar's bylaws, the number of directors constituting the Board of Directors is currently fixed at six. All six directors are to be elected at the Annual Meeting and will hold office until the next Annual Meeting of Shareholders and until their respective successors are elected and have qualified. It is intended that the persons named in the enclosed proxy will, unless such authority is withheld, vote for the election of the six nominees proposed by the Board. In the event that any of them should become unavailable prior to the Annual Meeting, the proxy will be voted for a substitute nominee or nominees designated by the Board, or the number of directors may be reduced accordingly. All of the nominees named below have consented to being named herein and to serve if elected. The Board has no reason to believe that any of the nominees will be unable to serve.

The following table provides information regarding the nominees, their ages, the year in which each first became a director of Qualstar, their principal occupations or employment during the past five years, directorships held with other public companies, and other biographical data:

Name and Age	Business Experience During Last Five Years and Other Directorships
William J. Gervais(62)	<i>William J. Gervais</i> is a founder of Qualstar, has been our President and a director since our inception in 1984, and was elected Chief Executive Officer in January 2000. From 1984 until January 2000, Mr. Gervais also served as our Chief Financial Officer. From 1981 until 1984, Mr. Gervais was President of Northridge Design Associates, Inc., an engineering consulting firm. Mr. Gervais was a co-founder, and served as Engineering Manager from 1976 until 1981, of Micropolis Corporation, a former manufacturer of hard disk drives. Mr. Gervais earned a B.S. degree in Mechanical Engineering from California State Polytechnic University in 1967.
Richard A. Nelson(61)	<i>Richard A. Nelson</i> is a founder of Qualstar and has been our Vice President of Engineering, Secretary and a director since our inception in 1984. From 1974 to 1984, Mr. Nelson was self employed as an engineering consultant specializing in microprocessor technology. Mr. Nelson earned a B.S. in Electronic Engineering from California State Polytechnic University in 1966.

Name and Age	Business Experience During Last Five Years and Other Directorships
Carl W. Gromada(63)	<i>Carl W. Gromada</i> is being nominated for election as a director of Qualstar for the first time. From 1996 to 2000, Mr. Gromada served as Chief Executive Officer, and a member of the board of directors of Computer Resources Unlimited, Inc., a company involved in the design, manufacture and sale of a broad line of products for the computer storage industry. From 2000 to the present, Mr. Gromada has been a consultant and a private investor. Mr. Gromada received a B.S. degree in Business Administration from Temple University in 1965.
Jose M. Miyar(64)	<i>Jose M. Miyar</i> is being nominated for election as a director of Qualstar for the first time. Mr. Miyar is a Certified Public Accountant and has been engaged in private practice in accounting and tax return preparation from 1978 to the present. Mr. Miyar received a B.S. degree in Finance from California State University at Los Angeles in 1965, and an MBA degree from the University of Southern California in 1972.
Robert E. Rich(54)	<i>Robert E. Rich</i> has served as a director of Qualstar since January 2000. Mr. Rich has been engaged in the private practice of law since 1975 and has been a shareholder of Stradling Yocca Carlson & Rauth, legal counsel to Qualstar, since 1984. Mr. Rich received a B.A. degree in Economics from the University of California, Los Angeles in 1972 and his J.D. degree from the University of California, Los Angeles in 1975.
Robert T. Webber(63)	<i>Robert T. Webber</i> has served as a director of Qualstar since January 2000. Mr. Webber is currently a management and air combat effectiveness consultant. Prior to his retirement in 1999, Mr. Webber was employed for 32 years by Lockheed-Martin Skunk Works and its predecessors, where he served in various positions, most recently as Chief Engineer and Division Manager for the Systems Requirements & Analysis Division. Mr. Webber currently serves on the executive board of the National Defense Industrial Association's Combat Survivability Division, a professional trade association. Mr. Webber received a B.S. degree in Engineering from the University of California, Los Angeles in 1963 and an M.B.A. degree from Pepperdine University in 1971.

INFORMATION REGARDING THE BOARD AND ITS COMMITTEES

Board Committees and Meetings

During the fiscal year ended June 30, 2004, our Board of Directors met five (5) times and the committees of our Board held a total of thirteen (13) meetings. Each incumbent director attended at least 75% of the aggregate of all meetings of the Board of Directors and the committees of the Board, if any, on which he served during fiscal 2004. Although we have no formal policy requiring director attendance at annual meetings of shareholders, we schedule the annual meeting for a date that is convenient for all directors to attend. All incumbent directors attended the 2004 annual meeting of shareholders. Our Board has determined that the following four incumbent directors satisfy the current independent director standards established by rules of The Nasdaq Stock Market, Inc. (Nasdaq): Bruce E. Gladstone, Robert E. Rich, Trude C. Taylor and Robert T. Webber. Messrs. Gladstone and Taylor will not stand for reelection at the 2005 Annual Meeting. Our Board has determined that Carl Gromada and Jose M. Miyar, who have been nominated by our Board for election as directors for the first time, also satisfy the current Nasdaq standards for independence. There are no family relationships among any of the directors, director nominees or executive officers of Qualstar. The

independent directors meet in executive session on a regular basis without any management directors or employees present.

Our Board has two standing committees: the Audit Committee and the Compensation Committee.

The *Audit Committee* is currently comprised of Bruce E. Gladstone, Trude C. Taylor and Robert T. Webber. All members of the Audit Committee are non-employee directors and satisfy current Nasdaq standards with respect to independence, financial expertise and experience. Our Board of Directors has determined that Mr. Taylor meets the Securities and Exchange Commission's definition of audit committee financial expert. The Audit Committee has a written charter that specifies its responsibilities, which include oversight of the financial reporting process and system of internal accounting controls of the Company, and appointment and oversight of the independent registered public accounting firm engaged to audit the Company's financial statements. A copy of our Audit Committee Charter is attached as Exhibit A to this proxy statement. The Audit Committee held nine meetings during fiscal 2004. To ensure independence, the Audit Committee also meets separately with our independent public accountants and members of management.

The *Compensation Committee* is currently comprised of Bruce E. Gladstone, Trude C. Taylor and Robert T. Webber. The Compensation Committee reviews and recommends the salaries and bonuses of our executive officers, establishes compensation and incentive plans for our executive officers, and determines other fringe benefits. The Compensation Committee held four meetings during fiscal 2004.

We do not have a nominating committee. Instead, the Board, as a whole, identifies and screens candidates for membership on the Board. A majority of our Board consists of independent directors. Our Board also includes the two founders of Qualstar, Messrs. Gervais and Nelson, who are still actively involved in the management of the Company and own, in the aggregate, more than 39 percent of the outstanding shares of our common stock. Accordingly, we believe that it is important that the two founders participate in the selection of nominees to the Board and, therefore, we do not have a separate nominating committee. The two new nominees for election as directors, Messrs. Gromada and Miyar, were recommended for nomination by our two founders.

We do not have a formal written charter regarding the nomination process, and no specific minimum qualifications for director nominees have been established. In general, however, persons considered for nomination to the Board must have demonstrated outstanding achievement, integrity and judgment and such other skills and experience as will enhance the Board's ability to serve the long-term interests of the Company and our shareholders, and must be willing and able to devote the necessary time for Board service. To comply with regulatory requirements, a majority of Board members must qualify as independent directors under Nasdaq rules, and at least one Board member must qualify as an audit committee financial expert under SEC rules. The Board considers potential candidates recommended by current directors, company officers, employees and others, although no procedure has been established for shareholders to recommend candidates to be considered as director nominees.

Shareholder Communications with the Board

Shareholders wishing to communicate with the Board of Directors or with an individual Board member concerning the Company may do so by writing to the Board or to the particular Board member, and mailing the correspondence to: Attention: Corporate Secretary, Qualstar Corporation, 3990-B Heritage Oak Court, Simi Valley, California 93063. The envelope should indicate that it contains a shareholder communication. All such shareholder communications will be forwarded to the director or directors to whom the communications are addressed.

Compensation of Directors

Each of our non-employee directors receive \$2,000 per quarter plus \$1,000 for each Board meeting attended as compensation for their service on the Board, and are reimbursed for expenses incurred in connection with attendance at meetings of the Board and any committees on which they serve. Directors who

serve on the Audit Committee of our Board receive an additional fee of \$1,000 per quarter plus an attendance fee of \$500 per meeting if the Audit Committee meeting is held in conjunction with a meeting of the full Board, and \$1,000 per meeting if held on a day when the full Board does not meet. Directors who serve on the Compensation Committee of our Board receive an additional fee of \$500 for attending meetings of that committee that are held on a day when the full Board does not meet. An attendance fee of \$250 per meeting is paid for telephonic meetings of the full Board or of a committee on which a director is a member. No fees are paid for service on the Board to directors who are employees of Qualstar.

Directors are eligible to receive options and rights to purchase restricted stock under our 1998 Stock Incentive Plan. In January 2000, we granted to each of our four non-employee directors the right to purchase 54,000 shares of restricted stock at a price of approximately \$2.78 per share, which each director purchased with a full-recourse promissory note. All of these promissory notes have been repaid in full.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth information with respect to the beneficial ownership of our common stock as of January 31, 2005 for:

each person (or group of affiliated persons) who we know beneficially owns more than 5% of our common stock;

each of our directors and nominees for election to the Board;

each of the named executive officers; and

all of our directors and executive officers as a group.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and includes voting and investment power with respect to shares. Except as indicated by footnote, the persons named in the table have sole voting and sole investment control with respect to all shares beneficially owned, subject to community property laws where applicable. The percentage of shares beneficially owned is based on 12,253,117 shares of common stock outstanding as of January 31, 2005. Shares of common stock subject to options currently exercisable or exercisable within 60 days of January 31, 2005, are deemed outstanding for computing the percentage of the person holding such options, but are not deemed outstanding for computing the percentage of any other person. The address for those individuals for which an address is not otherwise indicated is: c/o Qualstar Corporation, 3990-B Heritage Oak Court, Simi Valley, California 93063.

Name	Common Shares Owned	Options Exercisable Within 60 Days(1)	Beneficial Ownership	
			Number	Percent
William J. Gervais	2,881,350		2,881,350	23.5%
Richard A. Nelson	1,992,250		1,992,250	16.3%
Wells Capital Management Inc. 525 Market Street, 10 th Floor San Francisco, CA 94105	1,657,850(2)		1,657,850	13.5%
Wellington Management 75 State Street Boston, MA 02109	1,247,300(3)		1,247,300	10.2%
Fidelity Management & Research Company 82 Devonshire Street	1,225,703(4)		1,225,703	10.0%

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Carl Gromada	47,271	47,271	*
Jose M. Miyar	12,000	12,000	*
Bruce E. Gladstone	54,000	54,000	*

Name	Common Shares Owned	Options	Beneficial Ownership	
		Exercisable Within 60 Days(1)	Number	Percent
Trude C. Taylor	150,420		150,420	1.2%
Robert E. Rich	131,400		131,400	1.1%
Robert T. Webber	88,000		88,000	*
Frederic T. Boyer		50,000	50,000	*
Robert K. Covey	140,080	15,000	155,080	1.3%
David L. Griffith		60,000	60,000	*
Thomas J. Studebaker		20,000	20,000	*
All directors and officers as a group (13 persons)	5,496,771	175,000	5,671,771	45.6%

* Less than 1.0%

- (1) Represents shares that may be acquired upon exercise of stock options which are either currently vested or will vest within 60 days of January 31, 2005.
- (2) Based on information contained in a Schedule 13G filed with the Securities and Exchange Commission on January 21, 2005, Wells Fargo & Company, as the parent holding company of Wells Capital Management Incorporated, an investment adviser, beneficially owns 1,657,850 shares. It has sole voting power as to 1,600,100 shares and sole dispositive power as to 1,657,850 shares.
- (3) Based on information contained in a Schedule 13G filed with the Securities and Exchange Commission on February 12, 2004, Wellington Management Company, LLP, in its capacity as an investment adviser, beneficially owns 1,247,300 shares. It has shared voting power as to 699,300 shares and shared dispositive power as to 1,247,300 shares.
- (4) Based on information contained in a Schedule 13G filed with the Securities and Exchange Commission on February 17, 2004, FMR Corporation, as the parent holding company of Fidelity Management & Research Company, an investment adviser, beneficially owns 1,225,703 shares and has sole dispositive power over these shares but no voting power. Fidelity Management & Research Company has shared voting power as to 1,225,703 shares.

EXECUTIVE COMPENSATION**Summary Compensation Table**

The following table summarizes all compensation earned by our Chief Executive Officer and the four other most highly compensated executive officers whose total salary and bonus exceeded \$100,000 for services rendered in all capacities to us during the fiscal year ended June 30, 2004. These individuals are referred to as our named executive officers in other parts of this proxy statement. The amounts shown below under "All Other Compensation" represent matching contributions under our 401(k) plan.

Name and Principal Position	Year	Annual Compensation		Long Term Compensation Awards	All Other Compensation (\$)
		Salary (\$)	Bonus (\$)	Securities Underlying Options (#)	
William J. Gervais Chief Executive Officer and President	2004	\$ 185,000			
	2003	\$ 180,600			
	2002	160,300			
Thomas J. Studebaker(1) Vice President of Advanced Development	2004	187,000			\$ 1,100
	2003	187,000		40,000	650
	2002	43,200			
Robert K. Covey Vice President of Marketing	2004	167,000			1,700
	2003	162,600			1,600
	2002	158,300		20,000	1,600
David L. Griffith(2) Vice President of Operations	2004	165,000			
	2003	160,600			
	2002	110,100		80,000	
Frederic T. Boyer(3) Vice President and Chief Financial Officer	2004	175,000			2,600
	2003	111,700	10,000	100,000	
	2002				

(1) Thomas J. Studebaker became our Vice President of Advanced Development in April 2002.

(2) David L. Griffith became our Vice President of Operations in October 2001.

(3) Frederic T. Boyer became our Vice President and Chief Financial Officer in October 2002.

Option Grants in Last Fiscal Year

The following table sets forth certain information concerning grants of options to each of the named executive officers during the year ended June 30, 2004. In addition, in accordance with the rules and regulations of the Securities and Exchange Commission, the following table sets forth the hypothetical gains or option spreads that would exist for the options. Such gains are based on assumed rates of annual compound stock appreciation of 5% and 10% from the date on which the options were granted over the full term of the options. The rates do not represent Qualstar's estimate or projection of future common stock prices, and no assurance can be given that any appreciation will occur or that the rates of annual compound stock appreciation assumed for the purposes of the following table will be achieved.

Name	Options Granted (# of Shares)(1)	Percent of Total Options Granted to Employees in Fiscal Year	Exercise		Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term(2)	
			Price (\$/Share)	Expiration Date	5% (\$)	10% (\$)
William J. Gervais						
Thomas J. Studebaker						
Robert K. Covey						
David L. Griffith						
Frederic T. Boyer						

(1) The per share exercise price of all options granted is the fair market value of Qualstar's common stock on the date of grant. Options have a term of 10 years and become exercisable in four equal annual installments commencing one year after the grant date.

(2) The potential realizable value is calculated from the exercise price per share, assuming the market price of Qualstar's common stock appreciates in value at the stated percentage rate from the date of grant to the expiration date. Actual gains, if any, are dependent on the future market price of the common stock.

Options Exercised and Fiscal Year-End Values

The following table sets forth information regarding options exercised by our named executive officers during the fiscal year ended June 30, 2004, the number of shares covered by both exercisable and unexercisable options as of June 30, 2004, and the value of unexercised in-the-money options held by our named executive officers as of June 30, 2004.

**Aggregated Option Exercises in Last Fiscal Year
and Fiscal Year-End Option Values**

Name	Number of Shares Acquired on Exercise	Value Realized	Number of Securities Underlying Unexercised Options at June 30, 2004		Value of Unexercised In-the-Money Options at June 30, 2004(1)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
William J. Gervais						
Thomas J. Studebaker			20,000	20,000	\$ 7,600	\$ 7,600
Robert K. Covey			10,000	10,000	1,800	1,800
David L. Griffith			40,000	40,000	70,000	70,000
Frederic T. Boyer			25,000	75,000	47,250	141,750

(1) Represents the closing sale price of our common stock on June 30, 2004 (\$6.12), less the exercise price per share, multiplied by the number of shares subject to the options held by the named executive officer.

Compensation Committee Interlocks and Insider Participation in Compensation Decisions

During the fiscal year ended June 30, 2004, the members of the Compensation Committee of our Board of Directors were Bruce E. Gladstone, Trude C. Taylor and Robert T. Webber. No executive officer of Qualstar serves as a member of the board of directors or compensation committee of any entity that has one or more executive officers serving on our Board of Directors. No member of the Compensation Committee is, or ever has been, an employee or officer of Qualstar.

REPORT OF THE COMPENSATION COMMITTEE ON EXECUTIVE COMPENSATION

Introduction

The Compensation Committee of the Board of Directors is composed of three non-employee directors who satisfy the current independence standards established by Nasdaq. The Compensation Committee is responsible for reviewing and establishing proposed levels of executive officer compensation, including base salaries, bonuses and stock option grants. The Committee then submits its specific recommendations to the full Board for its approval. The following report is submitted by the Compensation Committee.

Compensation Philosophy

Qualstar's compensation program is intended to attract, retain, motivate and reward highly qualified executives who are expected to manage both the short-term and long-term success of Qualstar. The level of compensation that is paid to executive officers is based on both the performance of Qualstar and the individual officer. Qualstar's performance is judged primarily upon the operating results and profitability for the immediately preceding fiscal year. Individual performance is measured based on an evaluation of the executive officer's particular responsibilities, his performance in the prior year, and his general management skills.

Compensation Program

Qualstar's compensation program for executive officers consists of cash compensation, both fixed and variable, and, if the situation warrants, equity based compensation. The principal elements of this program are the following:

Salary. The base salary component of an executive officer's compensation is intended to reward the executive for normal levels of performance, as opposed to the bonus component which is intended to compensate for performance exceeding expected levels. When reviewing base salaries, the Committee will consider the following factors:

(1) individual performance, (2) the performance of Qualstar and the extent to which the executive contributed to that performance, and (3) the executive's level of responsibility and prior experience. The Committee will also review published information regarding the compensation of executives at companies comparable to Qualstar to ascertain whether or not Qualstar's compensation rates are both competitive and reasonable. Lastly, the CEO's evaluation of the performance and his recommendation regarding the compensation of other executive officers is also considered.

Bonus Compensation. Bonuses paid to executive officers are based primarily on whether Qualstar achieves targeted levels of revenue and specified percentages of income before taxes, which are established each year by the Board based on recommendations of the Committee. Achievement of specific individual objectives as well each executive officer's performance are also considered by the Committee in determining whether a cash bonus should be awarded to an executive and, if so, also the amount of the bonus to be awarded. The recommendation of the CEO is also considered in determining the amount of any bonus.

Stock Options. In order to align the financial interests of executive officers with those of the shareholders, the Board of Directors grants stock options to its executives on a periodic basis. Options are granted with an exercise price equal to the market value of Qualstar's shares on the date of grant. Since the financial reward provided by stock options will be dependent on appreciation in the market value of Qualstar's shares, stock options effectively reward executives only for performance that results in improved market performance of our common stock, which directly benefits all shareholders. Generally, the number of shares

included in each stock option grant is determined based on an evaluation of the executive's importance to the future performance of Qualstar, as well as his past performance. Options are granted on terms that provide that they will become exercisable (or vest) in annual or other periodic installments (such as, for example, 25% per year over four years), so that if an executive's employment is terminated, whether by Qualstar or by the executive, prior to the full vesting of the options, the unvested portion terminates automatically, thereby creating an incentive for the executive to remain in Qualstar's employ for at least the vesting period.

Members of the Compensation Committee

Bruce E. Gladstone

Trude C. Taylor

Robert T. Webber

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

In January 2000, each of our four non-employee directors purchased 54,000 shares of restricted stock pursuant to our 1998 Stock Incentive Plan at a price of approximately \$2.78 per share, which was the fair market value of our stock on the date of grant as determined by our board of directors. Each director paid for his shares with a full-recourse promissory note in the amount of \$150,000, secured by a pledge of the purchased shares. Payments of principal on the notes were due in four equal annual installments commencing on the second anniversary of the date of the note. Interest on the notes accrued at the rate of 6.21%. All of these promissory notes have been paid in full.

STOCK PRICE PERFORMANCE GRAPH

The following graph compares the total cumulative return to our shareholders on shares of Qualstar's common stock during the period from June 23, 2000 (the date of our initial public offering) through June 30, 2004, with the cumulative total returns of the Nasdaq Stock Market Composite Index and the Nasdaq Computer Manufacturers Index. The graph assumes that the value of the investment in Qualstar's common stock and each index was \$100.00 on June 23, 2000.

	June 23, 2000	June 30, 2000	June 30, 2001	June 30, 2002	June 30, 2003	June 30, 2004
Qualstar Corp	100.00	99.19	84.86	79.68	71.26	79.29
NASDAQ Composite Index(1)	100.00	103.42	56.15	38.25	42.47	53.53
NASDAQ Computer Mfg. Index(2)	100.00	104.44	42.33	27.66	31.76	36.95

(1) Total return calculations for the NASDAQ Composite Index were performed by Standard & Poor's.

(2) Total return calculations for the NASDAQ Computer Manufacturing Index were performed by Standard & Poor's.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires Qualstar's executive officers and directors, and persons who beneficially own more than ten percent of Qualstar's common stock, to file initial reports of ownership and reports of changes in ownership with the SEC and the National Association of Securities Dealers, Inc. Executive officers, directors and persons who beneficially own more than ten percent of Qualstar's common stock are required by SEC regulations to furnish Qualstar with copies of all Section 16(a) forms they file.