

NETLIST INC
Form 424B5
December 20, 2012
Table of Contents

Filed Pursuant to Rule 424(b)(5)

Registration No. 333-164290

PROSPECTUS SUPPLEMENT

(to the prospectus dated January 20, 2010)

NETLIST, INC.

1,685,394 Shares of Common Stock

Warrants to Purchase 2,275,282 Shares of Common Stock

2,275,282 Shares of Common Stock Underlying the Warrants

We are offering up to 1,685,394 shares of our common stock and warrants to purchase up to 2,275,282 shares of our common stock in this offering (and the shares of common stock issuable from time to time upon exercise of these warrants). Each share of common stock we sell in the offering will be accompanied by a warrant to purchase up to 1.35 shares of common stock at an exercise price of \$0.89 per share. Each share of common stock and accompanying warrant will be sold at a negotiated price of \$0.89. The shares of common stock and warrants will be issued separately but can only be purchased together in this offering.

Our common stock is listed on the NASDAQ Global Market under the symbol NLST. On December 19, 2012, the last reported sales price of our common stock on the NASDAQ Global Market was \$0.89 per share.

Investing in our securities involves a high degree of risk. Before deciding whether to invest in our securities, you should review carefully the risks and uncertainties described under the heading Risk Factors on page S-5 of this prospectus supplement. This prospectus supplement should be read in conjunction with and may not be delivered or utilized without the prospectus dated January 20, 2010.

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We have retained Ascendant Capital Markets, LLC (Ascendant) to act as our exclusive placement agent in connection with the securities offered by this prospectus supplement. The placement agent is not purchasing or selling any of these securities nor is it required to sell any specific number or dollar amount of securities, but has agreed to use its reasonable best efforts to sell the securities offered by this prospectus supplement. We have agreed to pay the placement agent the placement agent fees set forth in the table below.

	Per Share		Total
Offering price	\$	0.89	\$ 1,500,000.66
Placement agent fees(1)	\$	0.0534	\$ 90,000.04
Proceeds, before expenses, to us	\$	0.8366	\$ 1,410,000.62

(1) In addition, we have agreed to reimburse the placement agent for certain of its expenses as described under Plan of Distribution on page S-26 of this prospectus supplement.

We estimate the expenses of this offering, excluding placement agent fees, will be approximately \$85,000. Because there is no minimum offering amount required as a condition to closing this offering, the actual offering amount, the placement agent fees and net proceeds to us, if any, in this offering may be substantially less than the maximum offering amounts set forth above. Delivery of the shares of common stock and warrants is expected to be made on or about December 26, 2012, subject to customary closing conditions.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

ASCENDANT CAPITAL MARKETS, LLC

The date of this prospectus supplement is December 20, 2012.

Table of Contents

TABLE OF CONTENTS

Prospectus Supplement

	Page
<u>ABOUT THIS PROSPECTUS SUPPLEMENT</u>	S-1
<u>SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS</u>	S-2
<u>PROSPECTUS SUMMARY</u>	S-3
<u>THE OFFERING</u>	S-4
<u>RISK FACTORS</u>	S-5
<u>USE OF PROCEEDS</u>	S-24
<u>DILUTION</u>	S-24
<u>DESCRIPTION OF SECURITIES WE ARE OFFERING</u>	S-25
<u>PLAN OF DISTRIBUTION</u>	S-26
<u>LEGAL MATTERS</u>	S-27
<u>EXPERTS</u>	S-27
<u>WHERE YOU CAN FIND MORE INFORMATION</u>	S-27

Prospectus

	Page
<u>ABOUT NETLIST, INC.</u>	1
<u>RISK FACTORS</u>	1
<u>SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS</u>	1
<u>USE OF PROCEEDS</u>	2
<u>DESCRIPTION OF CAPITAL STOCK</u>	2
<u>DESCRIPTION OF WARRANTS</u>	4
<u>DESCRIPTION OF DEPOSITARY SHARES</u>	4
<u>DESCRIPTION OF UNITS</u>	7
<u>PLAN OF DISTRIBUTION</u>	7
<u>LEGAL MATTERS</u>	9
<u>EXPERTS</u>	9
<u>INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE</u>	9
<u>WHERE YOU CAN FIND MORE INFORMATION</u>	10

Table of Contents

No dealer, salesperson or other person is authorized to give any information or to represent anything not contained in this prospectus supplement or the accompanying prospectus. You must not rely on any unauthorized information or representations. This prospectus supplement and the accompanying prospectus are an offer to sell only the securities offered hereby, but only under circumstances and in jurisdictions where it is lawful to do so. The information contained in this prospectus supplement and the accompanying prospectus is current only as of their respective dates.

ABOUT THIS PROSPECTUS SUPPLEMENT

This prospectus supplement and the accompanying base prospectus is part of a registration statement that we filed with the Securities and Exchange Commission, or SEC, utilizing a shelf registration process. Each time we sell securities under the accompanying base prospectus we will provide a prospectus supplement that will contain specific information about the terms of that offering, including the price, the amount of securities being offered and the plan of distribution. The shelf registration statement was filed with the SEC on January 11, 2010, and was declared effective by the SEC on January 20, 2010. This prospectus supplement describes the specific details regarding this offering and may add, update or change information contained in the accompanying prospectus. The accompanying base prospectus provides general information about us, some of which, such as the section entitled Plan of Distribution, may not apply to this offering.

If information in this prospectus supplement is inconsistent with the accompanying base prospectus or the information incorporated by reference, you should rely on this prospectus supplement. This prospectus supplement, together with the base prospectus and the documents incorporated by reference into this prospectus supplement and the base prospectus, includes all material information relating to this offering. We have not authorized anyone to provide you with different or additional information. You should assume that the information appearing in this prospectus supplement, the accompanying prospectus, and the documents incorporated by reference in this prospectus supplement and the accompanying prospectus is accurate only as of the respective dates of those documents. Our business, financial condition, results of operations and prospects may have changed since those dates. **You should carefully read this prospectus supplement, the base prospectus, the information and documents incorporated herein by reference and the additional information under the heading Where You Can Find More Information before making an investment decision.**

We further note that the representations, warranties and covenants made by us in any agreement that is filed as an exhibit to any document that is incorporated by reference into the accompanying prospectus were made solely for the benefit of the parties to such agreement, including, in some cases, for the purpose of allocating risk among the parties to such agreements, and should not be deemed to be a representation, warranty or covenant to you. Moreover, such representations, warranties or covenants were accurate only as of the date when made. Accordingly, such representations, warranties and covenants should not be relied on as accurately representing the current state of our affairs.

Unless otherwise mentioned or unless the context requires otherwise, all references in this prospectus to Netlist, the Company, we, us and our refer to Netlist, Inc., a Delaware corporation, and its subsidiaries on a consolidated basis.

Table of Contents

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus supplement, the accompanying prospectus, the documents we have filed with the SEC that are incorporated herein by reference includes and incorporates by reference forward-looking statements. We intend these forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. Words such as anticipate, estimate, expect, project, intend, may, plan, predict, believe, should and similar words or expressions are intended to identify forward-looking statements. Investors should not place undue reliance on forward-looking statements. All forward-looking statements reflect the present expectation of future events of our management and are subject to known and unknown risks, uncertainties and assumptions that could cause actual results to differ materially from those described in any forward-looking statements. 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; 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; and other important factors that we discuss in greater detail under the heading Risk Factors contained in the applicable prospectus supplement and any related free writing prospectus, and in our most recent annual report on Form 10-K and in our most recent quarterly report on Form 10-Q, as well as any amendments thereto reflected in subsequent filings with the SEC. Given these risks, uncertainties and other important factors, you should not place undue reliance on these forward-looking statements. You should carefully read both this prospectus, the applicable prospectus supplement and any related free writing prospectus, together with the information incorporated herein by reference as described under the heading Where You Can Find More Information, completely and with the understanding that our actual future results may be materially different from what we expect.

These forward-looking statements represent our estimates and assumptions only as of the date made. We undertake no duty to update these forward-looking statements after the date of this prospectus, except as required by law, even though our situation may change in the future. We qualify all of our forward-looking statements by these cautionary statements.

Table of Contents

PROSPECTUS SUMMARY

This summary highlights information contained elsewhere in this prospectus supplement, the accompanying base prospectus and the documents incorporated by reference. This summary does not contain all of the information that you should consider before deciding to invest in our securities. You should read this entire prospectus supplement and the accompanying base prospectus carefully, including the section entitled Risk Factors beginning on page S-5 and our consolidated financial statements and the related notes and the other information incorporated by reference into this prospectus supplement and the accompanying prospectus before making an investment decision.

Our Business

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.

Corporate Information

We commenced operations in September 2000. Our principal executive offices are located at 51 Discovery, Suite 150, Irvine, California 92618 and our telephone number at that address is (949) 435-0025. Our website address is <http://www.netlist.com>. The information contained on our website is not incorporated by reference into, and does not form any part of, this prospectus supplement. We have included our website address as a factual reference and do not intend it to be an active link to our website.

Recent Developments

On December 19, 2012, our Board of Directors adopted Amended and Restated Bylaws. The amendment and restatement of the Bylaws, which is effective as of December 19, 2012, includes provisions regarding communication and disclosure by stockholders to us in connection with our annual meeting, as well as enhanced procedural and forum mechanics and other provisions intended to reflect changes in law and practice in recent years. In addition, the amendment and restatement restricts the ability of our stockholders to call a special meeting of stockholders.

Risk Factors

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Our business is subject to substantial risk. Please carefully consider the Risk Factors beginning on page S-5 of this prospectus supplement and other information included and incorporated by reference in this prospectus supplement, for a discussion of the factors you should consider carefully before deciding to purchase the securities offered by this prospectus supplement. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations. You should be able to bear a complete loss of your investment.

S-3

Table of Contents

THE OFFERING

The following is a brief summary of some of the terms of the offering and is qualified in its entirety by reference to the more detailed information appearing elsewhere in this prospectus supplement and the accompanying prospectus. For a more complete description of the terms of our common stock, see the Description of Securities We Are Offering section in this prospectus supplement.

Securities offered by us in this offering	1,685,394 shares of our common stock, par value \$0.001 per share. Warrants to purchase up to 2,275,282 shares of common stock, with an exercise price equal to \$0.89 per share. 2,275,282 shares of common stock issuable upon exercise of the warrants.
Offering Price	\$0.89 per share of common stock and accompanying warrant.
Common Stock Outstanding Before This Offering	28,672,795 shares.
Common Stock Outstanding After This Offering	30,358,189 shares.
Use of proceeds	For general corporate purposes. See Use of Proceeds on page S-24.
Risk Factors	See Risk Factors and other information included in this prospectus supplement, or incorporated herein by reference, for a discussion of factors you should carefully consider before deciding to invest in our common stock.
NASDAQ Global Market Symbol	NLST

Except as otherwise indicated, the information contained in this prospectus supplement assumes the sale of all of the securities offered hereby.

The number of shares of our common stock outstanding immediately before and after this offering excludes:

- 4,795,429 shares of common stock issuable upon exercise of options outstanding as of December 19, 2012, of which approximately 3,115,991 shares are exercisable; and
- 767,510 shares of common stock available for future grants under our stock option plans as of December 19, 2012.

Table of Contents

RISK FACTORS

Investing in our common stock involves a high degree of risk. Before purchasing our common stock, you should carefully consider the following risk factors as well as all other information contained in this prospectus supplement and the accompanying prospectus and the documents incorporated by reference, including our consolidated financial statements and the related notes. Each of these risk factors, either alone or taken together, could adversely affect our business, operating results and financial condition, as well as adversely affect the value of an investment in our common stock. There may be additional risks that we do not presently know of or that we currently believe are immaterial which could also impair our business and financial position. If any of the events described below were to occur, our financial condition, our ability to access capital resources, our results of operations and/or our future growth prospects could be materially and adversely affected and the market price of our common stock could decline. As a result, you could lose some or all of any investment you may have made or may make in our common stock.

RISKS RELATED TO THIS OFFERING AND OUR COMMON STOCK

You will experience immediate dilution in the book value per share of the common stock you purchase.

Because the price per share of our common stock being offered is substantially higher than the book value per share of our common stock, you will suffer substantial dilution in the net tangible book value of the common stock you purchase in this offering. Based on an assumed offering price to the public of \$0.89 per share, if you purchase shares of common stock in this offering, you will suffer immediate and substantial dilution of \$0.32 per share in the net tangible book value of the common stock. See the section entitled "Dilution" below for a more detailed discussion of the dilution you will incur if you purchase common stock in this offering.

Our management will have broad discretion over the use of the net proceeds from this offering.

We currently anticipate using the net proceeds from this offering for general corporate purposes, including working capital and other general and administrative purposes. We have not reserved or allocated specific amounts for these purposes and we cannot specify with certainty how we will use the net proceeds. Accordingly, our management will have considerable discretion in the application of the net proceeds and you will not have the opportunity, as part of your investment decision, to assess whether the proceeds are being used appropriately. The net proceeds may be used for corporate purposes that do not increase our operating results or market value. Until the net proceeds are used, they may be placed in investments that do not produce income or that lose value.

The warrants are a new issue of securities with no established trading market.

The warrants are a new issue of securities with no established trading market. The warrants will not be listed on any securities exchange and we do not expect them to be quoted on any quotation system. A trading market for the warrants is not expected to develop, and even if a market develops it may not provide meaningful liquidity. The absence of a trading market or liquidity for the warrants may adversely affect their value.

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 December 19, 2012, approximately 18.87% of our outstanding common stock was held by affiliates, including 18.67% 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.

Table of Contents

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:

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- 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 the exercise of warrants issued in connection with this offering, additional sales or the perception that such sales may occur through our Sales Agreement with Ascendant, and our potential issuance of (or perceptions regarding our issuance of) other securities in the future;
- 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 stockholder's ability to sell their shares into the market at the desired time or at the desired price.

Table of Contents

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.

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 Ascendant Capital Markets, LLC (Ascendant), for the offer and sale of up to \$10 million in aggregate amount of our shares from time to time through Ascendant, as our sales agent, pursuant to an effective Registration Statement on Form S-3. Ascendant 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 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 (the Securities Act) 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 Ascendant.

As of September 29, 2012, we have sold 1,755,806 shares pursuant to the Sales Agreement at a weighted average sales price of \$3.26, net of commissions, including 1,058,336 shares in the nine months ended September 29, 2012 at a weighted average sales price of \$3.45 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 effect 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

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

At the present time, we intend to use available funds to finance our operations. Accordingly, while payment of dividends rests within the discretion of our board of directors, no cash dividends on our common shares have been declared or paid by us and we have no intention of paying any such dividends in the foreseeable future. Any return to investors is expected to come, if at all, only from potential increases in the price of our common stock.

RISKS RELATED TO OUR BUSINESS

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

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fluctuations include the following factors, as well as other factors described elsewhere in this prospectus supplement:

- 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;

S-7

Table of Contents

- 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;
- 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 prospectus supplement.

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.

Table of Contents

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 revenues and results of operations are substantially dependent on NVvault .

For the nine months ended September 29, 2012, 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 49% of total revenues. 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, and we recognized no NVvault sales to Dell in the three months ended September 29, 2012. 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.

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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;

S-9

Table of Contents

- 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 September 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. The Company 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.

Table of Contents

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

Our prospective customers generally make a significant commitment of resources to test and evaluate our memory subsystems prior to purchasing our products and integrating them into their systems. This extensive qualification process involves rigorous reliability testing and evaluation of our products, which may continue for six months or longer and is often subject to delays. In addition to qualification of specific products, some of our customers may also require us to undergo a technology qualification if our product designs incorporate innovative technologies that the customer has not previously encountered. Such technology qualifications often take substantially longer than product qualifications and can take over a year to complete. Qualification by a prospective customer does not ensure any sales to that prospective customer. Even after successful qualification and sales of our products to a customer, changes in our products, our manufacturing facilities, our production processes or our component suppliers may require a new qualification process, which may result in additional delays.

In addition, because the qualification process is both product-specific and platform-specific, our existing customers sometimes require us to requalify our products, or to qualify our new products, for use in new platforms or applications. For example, as our OEM customers transition from prior generation 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