
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2002

OR

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

For the transition period from _____ to _____

Commission file number: 0-28472

DIGITAL VIDEO SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

77-0333728

(I.R.S. Employer
Identification Number)

**1731 Technology Drive, Suite 810
San Jose, CA 95110**

(Address of principal executive offices, including zip code)

(408) 392-0268

(Registrant's telephone number, including area code)

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

As of March 31, 2002, there were approximately 5,909,995 shares of the registrant's common stock outstanding.

DIGITAL VIDEO SYSTEMS, INC.
FORM 10-Q

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Digital Video Systems, Inc.

**Condensed Consolidated Balance Sheet
(In Thousands)**

	<u>March 31, 2002</u>	<u>December 31, 2001</u>
	(Unaudited)	(Audited)
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 14,971	\$ 10,145
Restricted cash	3,586	3,236
Accounts receivable, net	3,847	2,135
Inventories	8,576	11,886
Marketable debt securities	761	769
Prepaid expenses and other current assets	5,769	4,747
Notes receivable – current	<u>1,057</u>	<u>1,974</u>
Total current assets	\$ 38,567	\$ 34,892
Property and equipment, net	9,414	9,715
Intangibles	950	1,013
Other assets	16	16
Deferred tax assets	<u>168</u>	<u>—</u>
Total assets	<u>\$ 49,115</u>	<u>\$ 45,636</u>
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current Liabilities:		
Line of credit	\$ 20,745	\$ 16,500
Current portion of long term debt	170	172
Accounts payable	8,204	5,876
Accrued liabilities	3,099	3,883
Notes payable	3,532	1,834
Other payable	<u>1,941</u>	<u>1,631</u>
Total current liabilities	\$ 37,691	\$ 29,896
Long term liabilities:		
Long term liabilities – long term debt	219	264
Other long term liabilities	<u>1,488</u>	<u>1,488</u>
Total liabilities	\$ 39,398	\$ 31,648
Minority interest	3,876	4,877
Stockholders' equity:		
Preferred Stock	—	—
Common Stock	1	1
Additional paid-in capital	71,550	71,350
Cumulative accumulated other Comprehensive Loss	(167)	(210)
Deferred compensation	(60)	(60)
Accumulated deficit	<u>(65,483)</u>	<u>(61,970)</u>
Total stockholders' equity	\$ 5,841	\$ 9,111
Total liabilities and stockholders' equity	<u>\$ 49,115</u>	<u>\$ 45,636</u>

See accompanying notes to condensed consolidated financial statements.

Digital Video Systems, Inc.

Condensed Consolidated Statements of Operations
(In Thousands, except Per Share Amounts)
(Unaudited)

	Three Months Ended March 31,	
	2002	2001
Net revenue	\$ 22,867	\$ 16,432
Cost of revenue	<u>22,734</u>	<u>14,439</u>
Gross margin	133	1,993
Operating expenses:		
Research and development	903	421
Sales and marketing	633	500
General and administrative	<u>1,746</u>	<u>923</u>
Total operating expenses	<u>3,282</u>	<u>1,844</u>
Income from operations	(3,149)	149
Interest expense	(476)	(172)
Other expense	<u>(529)</u>	<u>(199)</u>
Loss before minority interest and income taxes	(4,154)	(222)
Income tax provision	—	(97)
Minority interest	<u>641</u>	<u>130</u>
Net loss	<u>\$ (3,513)</u>	<u>\$ (189)</u>
Basic net loss per share	<u>\$ (0.60)</u>	<u>\$ (0.04)</u>
Diluted net loss per share	<u>\$ (0.60)</u>	<u>\$ (0.04)</u>

See accompanying notes to condensed consolidated financial statements.

Digital Video Systems, Inc.

Condensed Consolidated Statements of Cash Flows
(In Thousands)
(Unaudited)

	Three Months Ended March 31,	
	2002	2001
Cash flows from operating activities:		
Net loss.....	\$ (3,513)	\$ (189)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Minority interest.....	(1,001)	(130)
Depreciation and amortization.....	545	(199)
Issuance of common stock for service provided.....	200	—
Stock options compensation expense.....	—	18
Changes in operating assets and liabilities:		
Accounts receivable.....	(1,712)	664
Inventories.....	3,310	1,358
Prepaid expenses and other current assets.....	(1,022)	1,045
Other assets.....	—	(128)
Deferred tax asset.....	(168)	
Accounts payable.....	2,328	547
Accrued liabilities.....	(784)	1,086
Other payable.....	310	124
Other long-term liabilities.....	—	(1,109)
Net cash provided by (used in) operating activities.....	(1,507)	3,087
Cash flows from investing activities:		
Acquisition of property and equipment.....	(181)	(32)
Investment in Shanghai.....	—	(267)
Investment in Marketable debt securities.....	8	—
Net cash used in investing activities.....	(173)	(299)
Cash flows from financing activities:		
Proceeds of common stock.....	—	664
Write down of notes receivable.....	917	320
Repayment of line of credit.....	—	(2,476)
Proceeds from notes payable.....	1,698	(97)
Proceeds from line of credit borrowings.....	4,245	—
Payments of notes payable borrowings.....	(47)	—
Net cash provided by (used in) financing activities.....	6,813	(1,589)
Effect of exchange rate changes.....	43	(401)
Net increase in cash and cash equivalents.....	5,176	798
Cash and cash equivalents at beginning of period.....	13,381	5,186
Cash and cash equivalents at end of period.....	<u>\$ 18,557</u>	<u>\$ 5,984</u>
Supplemental disclosures:		
Interest paid.....	51	\$ 45
Taxes paid.....	87	—

See accompanying notes to condensed consolidated financial statements.

Digital Video Systems, Inc.

**Notes to Condensed Consolidated Financial Statements
(Unaudited)**

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of DVS include the accounts of the Company and its subsidiaries. The statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X.

Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements and should be read in conjunction with the audited financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2001.

In the opinion of the management, the accompanying unaudited condensed consolidated financial statements have been prepared on the same basis as the audited financial statements and include all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the interim periods presented. Operating results for the three-month period ended March 31, 2002 are not necessarily indicative of the results that may be expected for any other interim period or the full fiscal year ending December 31, 2002. All significant inter-company balances and transactions have been eliminated.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates include impairment write-downs of fixed assets and intangibles and the level of accounts receivable and inventory reserves. Actual results could differ from those estimates.

2. Accounting Changes

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141, Accounting for Business Combinations (SFAS No. 141) and Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS No. 142). SFAS No. 141 requires the purchase method of accounting be used for all business combinations initiated after June 30, 2001, and establishes specific criteria for the recognition of intangible assets separately from goodwill. The SFAS No. 142 accounting standard addresses financial accounting and reporting for goodwill and other intangible assets and requires that goodwill amortization be discontinued and replaced with periodic tests of impairment. A two-step impairment test is used to first identify potential goodwill impairment and then measure the amount of goodwill impairment loss, if any. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001, and is required to be applied at the beginning of the fiscal year. Impairment losses that arise due to the initial application of this standard will be reported as a cumulative effect of a change in accounting principle. The first step of the goodwill impairment test, which must be completed within six months of the effective date of this standard, will identify potential goodwill impairment. The second step of the goodwill impairment test, which must be completed prior to the issuance of the annual financial statements, will measure the amount of the goodwill impairment loss, if any.

At March 31, 2002, the Company had goodwill of \$655. In accordance with SFAS No. 142, the Company will complete its test for goodwill impairment during the second quarter of 2002 and, if impairment is indicated, record such impairment as a cumulative effect of accounting change effective January 1, 2002. The Company is currently evaluating the effect that the impairment review may have on its consolidated results of operation and financial position.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long Lived Assets," that develops one accounting model for long-lived assets that are to be disposed of by sale and expands the scope of discontinued operations. We adopted SFAS No. 144 on January 1, 2002 and the adoption of this statement did not have an material impact on our financial position, results of operations or cash flows.

3. Net Loss Per Share

Basic net loss per share is computed using the weighted average number of common shares outstanding during the periods. Diluted net income per share is computed using the weighted average number of common and potentially dilutive common shares during the periods, except those that are anti-dilutive. Basic and diluted net loss per share is calculated as follows (in thousands):

	Three Months Ended March 31,	
	2002	2001
Net loss	\$ (3,513)	\$ (189)
Weighted average common shares outstanding (1)	5,869	4,833
Dilutive stock options and warrants	<u>0</u>	<u>0</u>
Total fully diluted shares	<u>5,869</u>	<u>4,833</u>
Basic net loss per share	\$ (0.60)	\$ (0.04)
Diluted net loss per share	<u>\$ (0.60)</u>	<u>\$ (0.04)</u>

(1) At March 31, 2001 and March 31, 2002, 1,144 and 1,167 shares of common stock, respectively, were excluded from the calculation of basic and diluted earnings per share because they represented common stock which have been forfeited pursuant to certain escrow agreements.

4. Comprehensive Income (Loss)

The components of comprehensive income, net of tax, are as follows (in thousands):

	Three Months Ended	
	March 31,	
	2002	2001
Net loss.....	\$ (3,513)	\$ (189)
Cumulative foreign currency translation adjustments	<u>43</u>	<u>(401)</u>
Comprehensive loss.....	<u>\$ (3,470)</u>	<u>\$ (590)</u>

Accumulated other comprehensive income presented on the accompanying consolidated condensed balance sheet consists of the cumulative foreign currency translation adjustments.

5. Inventories

Inventories consisted of the following (in thousands)

	March 31,	December 31,
	2002	2001
Inventories:		
Raw materials	\$ 3,515	\$ 3,772
Work-in-process	4,630	6,464
Finished goods	<u>791</u>	<u>1,978</u>
Total inventory	8,936	12,214
Less inventory reserves.....	<u>(360)</u>	<u>(328)</u>
Net inventory	<u>\$ 8,576</u>	<u>\$ 11,886</u>

6. Segment Information

The Company is organized in a single business segment, its core business of developing, producing and marketing digital video technology related products which include DVD loaders and other DVD products. While its revenue mainly comes from DVD products, the Company also generates revenue, to a lesser extent, from computer peripherals, equipment and materials.

	Three Months Ended March 31, 2002
Product line:	
DVD products	\$ 21,585
Computer peripherals	845
Equipment & materials	437
Total sales	<u>\$ 22,867</u>

A significant portion of the Company's revenue and net income is derived from international sales, particularly from customers based in Asia. Fluctuation of the U.S. dollar against foreign currencies and changes in local regulatory or economic conditions could adversely affect operating results.

Geographic information for revenues for the three months ended March 31, 2002 are as follows:

	Three Months Ended March 31, 2002
Geographic:	
Domestic.....	\$ 1,097
Other international countries	<u>21,770</u>
Total sales	<u>\$ 22,867</u>

During the three months ended March 31, 2002, the Company had two customers which individually accounted for over 10% of sales. The largest customer accounted for sales of approximately \$8 million or approximately 37% of revenue, and the next largest customer accounted for sales of approximately \$4 million or approximately 19% of revenue.

7. Note Receivable-Related Party

On September 30, 1999, the Company entered into an Asset Purchase and Option Agreement ("the Agreement") with OPLI, a related party. Pursuant to the Agreement, the Company sold the assets used in its Digital Video Business, which are comprised of the Ad Insertion Business and the Video on Demand Businesses.

At May 8, 2002, the market value of common stock of OPLI shareholders pledged to the Company as security for note receivable, had a market value of \$1.1 million resulting in a write down of note receivable of \$0.9 million at May 8, 2002.

At December 31, 2001 the OPLI note receivable outstanding was at \$1,974 and was in default. Payment in arrears totaled \$1.0 million. The shares of the Company's common stock purchased in 1998 plus the assets acquired, giving rise to the note receivable, have been pledged and secured. Common stock of OPLI shareholders pledged are in the possession of the Company and at December 31, 2001 had a market value that equals approximately the outstanding balance due on the note receivable.

8. Other

A foreign investment income tax credit is available to offset 75% of income taxes on the Company's foreign subsidiary and net operating loss carryforwards are available to offset current US taxable income.

Intangible assets consisted of the following (in thousands):

	<u>March 31, 2002</u>	<u>December 31, 2001</u>
Good will	\$ 655	\$ 655
Intangible assets of acquired businesses.....	<u>2,400</u>	<u>2,400</u>
Total intangible assets	3,055	3,055
Less: accumulated amortization	<u>(2,105)</u>	<u>(2,042)</u>
	<u>\$ 950</u>	<u>\$ 1,013</u>

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

The following discussion should be read in conjunction with the Consolidated Financial Statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2001 and the condensed consolidated financial statements and notes thereto included herein for the three months ended March 31, 2002.

This document contains forward-looking statements within the meaning of the "safe-harbor" provisions of the Private Securities Litigation Act of 1995 that involve risks and uncertainties, including, without limitation, statements with respect to the Company's strategy, proposed sales of the Company's products, the markets for the Company's products, and the development of the Company's products. The Company's actual results may differ materially from those described in these forward-looking statements due to a number of factors, including, but not limited to, faster than expected declines in the average selling prices of our products, the uncertainty of market acceptance of DVD-ROM drives, DVD loaders and other Company products, planned growth of the Company's operations, dependence on a limited number of suppliers of certain components used in the Company's operations, risks associated with rapid technological change and obsolescence and product development, conducting business in foreign countries, such as China and South Korea, the competitive market for the Company's products and other factors described in the Form 10-K for the year ended December 31, 2001, or in other documents the Company has filed from time to time with the Securities and Exchange Commission. A significant portion of the Company's revenue and net income is derived from international sales, particularly from customers based in Asia. Fluctuation of the U.S. dollar against foreign currencies and changes in local regulatory or economic conditions, among other things, could adversely affect operating results.

Results of Operations

In the quarter ended March 31, 2002, the Company continued to focus on its core products based on its DVD intellectual property portfolio. This has resulted in the Company significantly increasing its sales of DVD loaders in the year just passed and continuing the positive trend through the quarter ended March 31, 2002. However, during this same 15 month period, the loader market has experienced severe pricing pressure resulting in average unit sell prices declining more than 30% over this period. The severity and rapid rate of decline has outpaced the Company's ability to reduce its unit cost structure, resulting in our rate of gross margin in this quarter running at less than 1% as compared to 12.1% in the comparable quarter last year. The table below summarizes the impact on the Company's financials (in thousands):

	<u>Three Months Ended March 31,</u>	
	<u>2002</u>	<u>2001</u>
Revenue.....	\$ 22,867	\$ 16,432
Gross profit	133	1,993
Income (loss) from operations.....	(3,149)	149
Net loss.....	(3,513)	(189)

Revenue for the quarter ended March 31, 2002 increased to \$22.9 million, up 39% from \$16.4 million recorded for the quarter ended March 31, 2001. Gross profit was \$0.1 million for the quarter ended March 31, 2002, as compared

with \$2.0 million in the same quarter last year. Loss from operations for the quarter ended March 31, 2002 was \$3.1 million, compared with income of \$0.1 million in the same quarter of the previous year. Net loss in the quarter ending March 31, 2002 was \$3.5 million as compared to a loss of \$0.2 in the quarter ending March 31, 2001.

Working capital at March 31, 2002 was \$0.9 million, down \$4.1 million from the December 31, 2001 level of \$5 million. We believe it will be necessary for us to raise additional funds through the sale of debt or equity securities in either the U.S. or Korea in order to meet our objectives for worldwide operations for the year 2002. On March 27, 2002, our Korean subsidiary filed a request to file an application for listing its common stock on KOSDAQ (a Korean Stock Exchange).

While we expect revenue for the second quarter of 2002 to be greater than the second quarter of 2001, we also expect continued pricing pressure to result in continued low rates of gross margin. We expect these lower gross margins to continue until such time as we successfully implement our "single board/single chip solutions". Implementation of these "single board/single chip solutions" will result in a significant reduction in costs which should improve the Company's rate of gross profit. The Company presently expects implementation of the "single board/single chip solutions" early in the third quarter of 2002; however, we may not achieve this timetable, which would mean continued deterioration of gross margins.

A more detailed discussion and comparison of these results is presented below.

The following table sets forth for the periods indicated certain income and expense items expressed as a percentage of the Company's total revenue for the three month period ended March 31, 2002 compared with the three month ended March 31, 2001. See Consolidated Statements of Operations for additional details.

Percent of Revenue	Three Months Ended March 31,	
	2002	2001
Revenue.....	100.0%	100.0%
Gross margin	0.6%	12.1%
Research and development.....	3.9%	2.6%
Sales and marketing	2.8%	3.0%
General and administration	7.6%	5.6%
Income (loss) from operations.....	(13.8)%	0.9%
Net loss.....	(15.4)%	(1.1)%

Consolidated Revenue	Three Months Ended March 31,		% Change
	2002	2001	
Amount (in thousands).....	\$ 22,867	\$ 16,432	39%

Total revenue increased by \$6.4 million, or 39%, for the three months ended March 31, 2002 compared with the three months ended March 31, 2001. International revenue, consisting primarily of sales of DVD loaders or CKD (Completely Knocked Down) kits of DVD loaders, represented over 90% of revenue for the quarter ended March 31, 2002. The DVD loaders are sold directly, or indirectly through agents, to DVD player manufacturers in China and certain other countries, for export or local consumption. As the majority of such DVD player manufacturers are located overseas, the Company expects that international sales will continue to constitute a significant portion of its revenue for the foreseeable future.

In the three months ended March 31, 2002, foreign sales in China were approximately \$9.2 million or 40% of revenue as compared with \$6.7 million or 41% of revenue for the three months ended March 31, 2001. No sales were made to our joint venture partner in China.

Gross Profit	Three Months Ended March 31,		% Change
	2002	2001	
Amount (in thousands).....	\$ 133	\$ 1,993	(93%)
As a percentage of revenue.....	0.6%	12.1%	—

During the three months ended March 31, 2002, gross margin was \$0.1 million or 0.6% of revenue, as compared to \$2.0 million or 12.1% for the three months ended March 31, 2001. The Company has, and continues to have in place, a very aggressive cost improvement program. In the past 15 months, our unit manufacturing costs have been reduced by about 20% as a result of these programs and as a result of the procurement efficiency gained as our volumes have increased rapidly. However, these costs reductions have nonetheless lagged behind the over 30% reduction in our average unit sell prices during this period. Our current design and engineering efforts are focused on a single board solution and a single chip solution. We believe that successful completion of either of these programs will improve our rate of gross profit while also providing increased functionality and excellent packaging opportunities. The current schedule is for the initial production of one or both of these programs early in the third quarter. In addition, our rate of gross profit should improve as production shifts to our Joint Venture in China, primarily due to reduced labor costs. Since December, 2001 and continuing through this “off season” period, all of our production needs are being met by the Korean manufacturing facilities. As we enter into the peak season, we expect that the Shanghai facility will be more fully utilized.

Research and Development	Three Months Ended March 31,		% Change
	2002	2001	
Amount (in thousands).....	\$ 903	\$ 421	114%
As a percentage of revenue.....	3.9%	2.6%	—

Research and development expenses consist primarily of personnel and equipment prototype costs required for the Company’s product development efforts. Research and development spending in this quarter was increased to 3.9% of revenue, compared with 2.6% for the corresponding quarter a year ago. This increase in absolute dollar and percentage terms occurred primarily because we increased our staffing in R&D by over 20% in order to pursue the single board/chip solutions and other new product developments.

Sales and Marketing	Three Months Ended March 31,		% Change
	2002	2001	
Amount (in thousands).....	\$ 633	\$ 500	27%
As a percentage of revenue.....	2.8%	3.0%	—

Sales and marketing expenses consist primarily of personnel and consulting costs related to our sales process and the marketing of our products, as well as sales commissions and expenses related to promotional activities. Sales and marketing expenses for the three-month period ended March 31, 2002 increased in dollar terms by \$0.1 million, or 27%, as compared with the corresponding quarter of 2001, although as a percentage of revenue they were at about the same level for both periods. This increase resulted from additional activities necessary to generate the increased revenue.

General and Administrative	Three Months Ended March 31,		% Change
	2002	2001	
Amount (in thousands).....	\$ 1,746	\$ 923	89%
As a percentage of revenue.....	7.6%	5.6%	—

General and administrative expenses consist of administrative salaries, bonuses and benefits, insurance, facility leases, fees for legal and accounting services, investor relations and other related costs. General and administrative expenses in this quarter increased to 7.6% of revenue, from 5.6% for the corresponding quarter in 2001. This increase was consistent with the additional administrative activities associated with the increased revenue and bringing on new plants in Korea and the Joint Venture in China.

Liquidity and Capital Resources

While the Company had cash and equivalents of nearly \$15 million at March 31, 2002, working capital at March 31, 2002 had declined \$4.1 million to \$0.9 million as compared with working capital of \$5.0 million at December 31, 2001. We believe it will be necessary for us to raise additional funds through the sale of debt or equity securities in either the U.S. or Korea, in order to meet our objectives for worldwide operations for the year 2002. On March 27, 2002, our Korean subsidiary filed a request to file an application for listing its common stock on KOSDAQ (a Korean Stock Exchange).

Net cash used by operating activities was \$1.5 million for the three months ended March 31, 2002 as compared with \$3.1 million generated by operating activities in the three months ended March 31, 2001. The use of cash by operating activities was caused by net losses of \$3.5 million, increased accounts receivable of \$1.7 million, increased prepaid and other assets of \$1.2 million, minority interest of \$1.0 million, and reduction in accrued liabilities of \$0.8 million. Cash was provided as inventories declined by \$3.3 million, accounts payable were increased by \$2.3 million, non cash charges for depreciation and amortization of \$0.5 million, increase in other payables of \$0.3 million and common stock issued for services provided of \$0.2 million.

Net cash used in investing activities was \$0.2 million for the three months ended March 31, 2002, primarily consisting of the acquisition of property and equipment. Net cash used in investing activities for the three months ended March 31, 2001 was \$0.3 million primarily used for investment in the Shanghai joint venture.

Net cash provided by financing activities was \$6.8 million for the three months ended March 31, 2002 as compared to \$1.6 million used in the three months ended March 31, 2001. The cash provided by financing activities in this period totaled \$6.8 million, consisting of \$4.2 million in proceeds from a line of credit, \$1.7 million in net proceeds from notes payable and the write down of a note receivable from a related party of \$0.9 million.

The Company has lines of credit with several Korean banks, with a total borrowing limit of approximately \$12 million. The Company also has approximately \$20 million as payment guarantees under letters of credit. The Company believes that it must raise additional capital in the near term if it is to take advantage of the seasonal upswing in the market during the summer and fall of this year.

FACTORS THAT MAY AFFECT FUTURE RESULTS

In addition to the other information contained in this Form 10-Q, we have identified the following risks and uncertainties that may have a material adverse affect on our business, financial condition or results of operation. *This section should be read in conjunction with the audited Consolidated Financial Statements and Notes thereto, and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in this Form 10-Q.*

Our operating results fluctuate significantly, and an unanticipated decline in revenue or earnings may disappoint investors or securities analysts and result in a decline in our stock price.

Our recent growth rate may not be sustainable and you should not use our past financial performance to predict future operating results. In addition to the losses incurred during the quarter ended March 31, 2002, we have incurred substantial net losses in the past, as recently as, among others, fiscal years ended March 31, 1999, 1998 and 1997. Our recent quarterly and annual operating results have fluctuated, and will continue to fluctuate, due to the following factors, all of which are difficult to forecast and many of which are not within our control:

- the availability, timely delivery and cost of components from our suppliers;
- competitive pressures and related changes in selling prices;
- fluctuations in manufacturing yields and significant yield losses which affect our ability to fulfill orders;
- new product announcements and introductions for competing products by us or our competitors;
- the rate at which our products become obsolete;
- unpredictability of changes in demand for, or in the mix of, our products;
- the gain or loss of significant customers;
- market acceptance of products utilizing our technologies;
- changes in the channels through which our products are distributed and the timeliness of receipt of distributor resale information;
- exchange rate fluctuations;
- general economic, political and environmental-related conditions, such as natural disasters;
- difficulties in forecasting, planning and management of inventory levels, which may trigger lower of cost or market inventory adjustments;
- unanticipated research and development expenses associated with new product introductions;
- the timing of significant orders and of license and royalty revenue; and
- the seasonality in our business.

A downturn in the market for consumer products such as personal computers and DVD players that incorporate our products can also harm our operating results. In addition, some of our customers may place orders at or near the end of a quarter. As a result, we may not learn of revenue shortfalls until late in a quarter and may not be able to predict

future revenues with accuracy. Additionally, a large portion of our costs consists of salaries for personnel and materials that must be ordered several months in advance. These costs are based in part on our expectations for future revenues and are relatively fixed in the short term. As a result, any revenue shortfall below expectations could harm our business.

Our capital resources may not be sufficient to meet our capital requirements.

Since our inception, we have periodically experienced negative cash flow from operations and could experience significant negative cash flow from operations in the future. Our current and future capital requirements are substantial and we cannot be certain that cash generated from operations will be sufficient or that financing will be available at favorable terms when required, or at all. If our capital resources are insufficient to meet future capital requirements, we may not meet our financial obligations to our creditors when they become due or we may have to curtail or cease certain operations.

We depend on a limited number of foreign suppliers to manufacture certain key components, and these manufacturers may not be able to satisfy our requirements, which could cause our revenues to decline.

We currently buy certain key components, including optical pick-ups, motors, central processing units and certain other integrated circuits from a limited number of suppliers. We anticipate that these suppliers will manufacture sufficient quantities of these key components to meet our production requirements. If these suppliers fail to satisfy our requirements on a timely basis and at competitive prices, we could suffer manufacturing delays, a possible loss of revenues or higher than anticipated costs of revenues, any of which could seriously harm our operating results. Any constraints on worldwide manufacturing capacity of these key components may affect our ability to obtain adequate supplies from these manufacturers. In certain instances, we have failed to meet the demand for our products or the scheduled shipment dates due to our inability to obtain a sufficient supply of certain key components from our suppliers. The suppliers with which we currently have arrangements, together with any additional supplier at which capacity might be obtained, may not be willing or able to satisfy all of our manufacturing requirements on a timely basis at favorable prices. In addition, we have encountered delays in qualifying new products and in ramping new product production and could experience these delays in the future. We are also subject to the risks of service disruptions, raw material shortages and price increases by the suppliers. Such disruptions, shortages and price increases could seriously harm our operating results.

If we are unable to increase our manufacturing capacity, we may not achieve our planned growth.

Notwithstanding our recent expansion efforts, in order to grow, we need to increase our present manufacturing capacity. Events that we have not foreseen could arise which would limit our capacity. In addition, if we cannot satisfactorily increase our manufacturing capacity, our ability to grow will be severely impaired and this may harm our operating results.

Our financing requirements will increase in order to obtain additional manufacturing capacity in the future.

To obtain additional manufacturing capacity, we may be required to make deposits, equipment purchases, loans, joint ventures, equity investments or technology licenses in or with other companies. These transactions could involve a commitment of substantial amounts of our capital and technology licenses in return for production capacity. We may be required to seek additional debt or equity financing if we need substantial capital in order to secure this capacity and we cannot assure you that we will be able to obtain such financing on terms acceptable to us, if at all.

If we or our suppliers fail to achieve acceptable manufacturing yields, we will experience higher costs of revenues and reduced product availability.

The fabrication of our products requires certain components produced in a highly controlled and clean environment. Companies that supply our components sometimes have experienced problems achieving acceptable manufacturing yields. Low yields may result from marginal design or manufacturing process drift. Yield problems may not be identified until the components are well into the production process, which often makes them difficult, time

consuming and costly to correct. Furthermore, we rely on overseas suppliers of certain key components, which increases the effort and time required to identify, communicate and resolve manufacturing yield problems. If our suppliers fail to achieve acceptable manufacturing yields, we will experience higher costs of revenues and reduced product availability, which would harm our operating results.

If our suppliers discontinue the manufacturing processes or lines needed to meet our demands, or fail to upgrade the technologies needed to manufacture our products, we may face production delays and lower revenues.

Our products' requirements may represent a small portion of the total production of the suppliers that manufacture our components. As a result, we are subject to the risk that a supplier may cease production on an older or lower-volume manufacturing process that it uses to produce our parts. Additionally, we cannot be certain our suppliers will continue to devote resources to advance the production technologies on which the manufacturing of our parts is based. Each of these events could increase our costs and harm our ability to deliver our products on time.

Our dependence on third-party subcontractors to assemble and test our products subjects us to a number of risks, including an inadequate supply of products and higher costs of materials.

We depend on independent subcontractors to assemble and test our components or products. Despite the direct supervision by our staff stationed at our primary production site, our reliance on these subcontractors involves the following significant risks:

- reduced control over delivery schedules and quality;
- the potential lack of adequate capacity during periods of strong demand for such subcontractors' services;
- difficulties selecting and integrating new subcontractors;
- limited warranties on products supplied to us;
- potential increases in prices due to capacity shortages and other factors; and
- potential misappropriation of our intellectual property.

These risks may lead to increased costs, delayed product delivery or loss of competitive advantage, which would harm our profitability and customer relationships.

Our growth depends upon our ability to successfully develop and commercialize new DVD products.

During the last three years, a substantial amount of revenues have been generated by the DVD product line, which is central to our growth strategy. The market for this line of products has experienced intense competition and is highly price sensitive. While we are currently developing and introducing new products in this product line, we cannot assure you that these products will reach the market in a timely manner, satisfactorily address customer needs, be sold in high volume, or be sold at profitable margins.

Our operating expenses are relatively fixed, and we order materials in advance of anticipated customer demand; therefore, we have limited ability to reduce expenses quickly in response to any revenue shortfalls.

Our operating expenses are relatively fixed, and we therefore have limited ability to reduce expenses quickly in response to any revenue shortfalls. Consequently, our operating results will be harmed if our revenues do not meet our revenue projections. We may experience revenue shortfalls for the following reasons:

- significant pricing pressures that occur due to competition, over-supply, or other reasons;

- sudden shortages of raw materials or fabrication, test or assembly capacity constraints that lead our suppliers to allocate available supplies or capacity to other customers which, in turn, harm our ability to meet our sales obligations; and
- the reduction, rescheduling or cancellation of customer orders.

In addition, we typically plan our production and inventory levels based on customers' advance orders, commitments or forecasts, as well as our internal assessment and forecasts of customer demand, which are highly unpredictable and can fluctuate substantially, especially if competition becomes more intense or the demand is reduced due to seasonal or other factors. From time to time, in response to anticipated long lead times to obtain inventory and materials from our suppliers, we may order materials in advance of anticipated customer demand. This advance ordering may result in excess inventory levels or unanticipated inventory write-downs if expected orders fail to materialize.

Because our products typically have lengthy sales cycles, we may experience substantial delays between incurring expenses related to research and development and the generation of revenues.

It usually requires a number of months to realize volume shipments after we first contact a customer. We first work with customers to achieve a design win, which may take months or longer. Our customers then complete the design, testing and evaluation process and begin to ramp up production, over a period which typically lasts months or longer. As a result, a significant period of time may elapse between the time we incur expenses from our research and development efforts and our realization of revenue, if any, from volume purchasing of our products by our customers.

We face intense competition from companies with significantly greater financial, technical and marketing resources that could adversely affect our ability to maintain or increase sales of our products.

We compete with major international electronics companies, many of which have substantially greater financial, technical, marketing, distribution, and other resources than we do. Many of our competitors have their own facilities for the production of semiconductor components and have been active in increasing their market shares and their capacity for the production of competing products. Our DVD products presently account for substantially all of our revenues. Our competitors or potential competitors include Hitachi, Toshiba, Sony, Pioneer, Teac, Sanyo, Samsung, Philips, LG, and many others. Some of the competitors or potential competitors are also suppliers for the key components of some of our models. In these cases, our competitors may have divisions making competing DVD products that have access to some of our proprietary information through the divisions supplying components to us, or exert influence on the parts supplying divisions in ways that may adversely affect our parts supply. These actions would adversely affect our competitiveness and sales. Competition may also come from alternative technologies being developed by these companies.

Our markets are subject to rapid technological change and, therefore, our success depends on our ability to develop and introduce new products.

The markets for our products are characterized by:

- rapidly changing technologies;
- evolving and competing industry standards;
- changing customer needs;
- frequent new product introductions and enhancements;
- increased integration with other functions; and

- rapid product obsolescence.

To develop new products for our target markets, we must develop, gain access to and use leading technologies in a cost-effective and timely manner and continue to expand our technical and design expertise. In addition, we must have our products designed into our customers' future products and maintain close working relationships with key customers in order to develop new products that meet their changing needs. In addition, DVD products involve continually evolving industry standards. Our ability to compete will depend on our ability to identify and ensure compliance with these industry standards. As a result, we could be required to invest significant time and effort and incur significant expense to redesign our products and ensure compliance with relevant standards. We cannot assure you that we will be able to identify new product opportunities successfully, develop and bring to market new products, achieve design wins or respond effectively to new technological changes or product announcements by our competitors. In addition, we may not be successful in developing or using new technologies or in developing new products or product enhancements that achieve market acceptance. Our pursuit of necessary technological advances may require substantial time and expense. Failure in any of these areas could harm our operating results.

Our future success depends in part on the continued service of our key design engineering, sales, marketing and executive personnel and our ability to identify, recruit and retain additional personnel.

We are highly dependent on our principal management and engineering staff. There is intense competition for qualified personnel in our industry, in particular the highly skilled technical personnel involved in the development of DVD technologies and the production of DVD products. Competition is especially intense in Silicon Valley, where our corporate headquarters are located, and in South Korea, where our DVD products have been designed and where most of our manufacturing takes place. We may not be able to continue to attract and retain engineers or other qualified personnel necessary for the development of our business or to replace engineers or other qualified personnel who may leave our employ in the future. Our anticipated growth is expected to place increased demands on our resources and will likely require the addition of new management and engineering personnel and the development of additional expertise by existing management personnel. The failure to recruit and retain key technical and management personnel could harm our business.

Our ability to compete successfully will depend, in part, on our ability to protect our intellectual property rights, and we may be unable to do so.

We rely on a combination of patent, trade secrets, copyright and mask work production laws and rights, nondisclosure agreements and other contractual provisions and technical measures to protect our intellectual property rights. Policing unauthorized use of our products, however, is difficult, especially in foreign countries, such as China and South Korea. Litigation may continue to be necessary in the future to enforce our intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Litigation could result in substantial costs and diversion of resources and could harm our business, operating results and financial condition regardless of the outcome of the litigation. We have acquired ownership or license to a number of patents or patent applications related to our products. However, we cannot assure you that any pending patent application will be granted, or that such patents will provide adequate protection for our intellectual property. Since our competitors may design around our patents or otherwise independently develop competing technology, our operating results would be seriously harmed by the failure to protect our intellectual property.

If we are accused of infringing the intellectual property rights of other parties we may become subject to time-consuming and costly litigation. If we lose such litigation, we could suffer a significant impact on our business and be forced to pay damages.

Third parties may assert that our products infringe their proprietary rights, or may assert claims for indemnification resulting from infringement claims against us. Any such claims may cause us to delay or cancel shipment of our products or pay damages, which could seriously harm our business, financial condition and results of operations. In addition, irrespective of the validity or the successful assertion of such claims, we could incur significant costs in defending against such claims. In addition, we receive from time to time letters or communications from other

companies stating that such companies have patent rights relating to our products. Any legal finding that we infringe the patent of another company would have a significantly negative effect on our operating results. Furthermore, if such a finding were made, there can be no assurance that we could license the other company's technology on commercially reasonable terms or that we could successfully operate without such technology. Moreover, if we are found to infringe, we could be required to pay damages to the owner of the protected technology and could be prohibited from making, using or selling any products that infringe the protected technology. In addition, the management attention consumed by and legal cost associated with any litigation could have a negative effect on our operating results. During the course of lawsuits there may be public announcements of the results of hearings, motions, and other interim proceedings or developments in the litigation. If securities analysts or investors perceive these results to be negative, it could have a substantial negative effect on the trading price of our stock. Whether or not we are successful in any litigation, we expect the litigation to consume substantial amounts of our financial and managerial resources. Further, because of the substantial amount of discovery required in connection with this type of litigation, there is a risk that some of our confidential information could be compromised by disclosure.

General economic conditions may reduce our revenues and harm our business.

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in domestic and global economic conditions. Because of the recent economic slowdown in the United States, many industries are delaying or reducing technology purchases. The impact of this slowdown on us is difficult to predict, but it may result in reductions in purchases of products by our end-user customers, longer sales cycles and increased price competition. As a result, if the current economic slowdown continues or worsens, we may fall short of our revenue expectations for any given quarter in 2002 or for the entire year.

Our business may suffer due to risks associated with international sales and operations.

Sales of products overseas accounted for 90.8%, 99.7%, 99.8% and 96% of our revenues in the fiscal year ended March 31, 2000, the nine-month period ended December 31, 2000, the fiscal year ended December 31, 2001 and the three months ended March 31, 2002, respectively. Our international business activities are subject to a number of risks, each of which could impose unexpected costs on us that would have an adverse effect on our operating results. These risks include:

- difficulties in complying with regulatory requirements and standards;
- tariffs and other trade barriers;
- costs and risks of localizing products for foreign countries;
- reliance on third parties to distribute our products;
- longer accounts receivable payment cycles;
- potentially adverse tax consequences;
- limits on repatriation of earnings; and
- burdens of complying with a wide variety of foreign laws.

We derived most of our product revenue from Asia during the last three years. We expect that this will continue in the remainder of 2002. Additionally, our major suppliers and assembly subcontractors are all located in Asia. Any kind of economic, political or environmental instability in this region of the world can have a severe negative impact on our operating results due to the large concentration of our production and sales activities in this region. For example, during 1997 and 1998, several Asian countries where we currently do business, such as Japan, Taiwan and

South Korea, experienced severe currency fluctuation and economic deflation. If such situations reoccur, it may negatively impact our total revenues and our ability to collect payments from customers in these regions. During such situations, the lack of capital in the financial sectors of these countries can make it difficult for our customers to open letters of credit or other financial instruments that are guaranteed by foreign banks. Finally, the economic situation during such periods may exacerbate a decline in selling prices for our products as our competitors may reduce product prices to generate needed cash.

In addition, we are greatly impacted by the political, economic and military conditions in Taiwan and China, and North Korea and South Korea, which are continuously engaged in political disputes. These countries have recently conducted military exercises in or near the other's territorial waters and airspace. Such disputes may continue and even escalate, resulting in an economic embargo, a disruption in shipping or even military hostilities. This could severely harm our business by interrupting or delaying production or shipment of our products. Any kind of activity of this nature or even rumors of such activity could severely negatively impact our operations, revenues, operating results, and stock price.

Because a small number of customers have accounted for, and are likely to continue to account for, a substantial portion of our revenues, our revenues could decline due to the loss of one of these customers.

Products sold to our top 5 customers accounted for approximately 70 % of our revenues during the three month period ended March 31, 2002. Products sold to our top 10 customers accounted for approximately 80%, 75% and 88% of our revenues during the fiscal year ended March 31, 2000, the nine-month period ended December 31, 2000 and the fiscal year ended December 31, 2001, respectively. In the three month period ended March 31, 2002, one customer accounted for 37% of our revenue. In the fiscal year ended March 31, 2000, one customer accounted for about 36% of our revenue. In the nine-month period ended December 31, 2000, one customer accounted for about 29% of our revenue and another customer accounted for about 14% of our revenue. In the fiscal year ended December 31, 2001, one customer accounted for about 37% of our revenue. No other customers accounted for more than 10% of our revenues during these three periods. If we were to lose any of these customers or experience any substantial reduction in orders from these customers, our revenues and operating results would suffer.

We do not have long-term contracts with our customers and the loss of a major customer could seriously harm our business.

We do not typically enter into long-term contracts with our customers, and we cannot be certain as to future order levels from our customers. When we do enter into a long-term contract, the contract is generally terminable at the convenience of the customer. An early termination by one of our major customers would harm our financial results, as it is unlikely that we would be able to rapidly replace that revenue source.

Our backlog may not result in future revenue, which would seriously harm our business.

Due to possible customer changes in delivery schedules and cancellations of orders, our backlog at any particular date is not necessarily indicative of actual sales for any succeeding period. A reduction of backlog during any particular period, or the failure of our backlog to result in future revenue, could harm our business.

Business interruptions could adversely affect our business.

Our operations are vulnerable to interruptions by fire, earthquake, power loss, telecommunications failure and other events beyond our control. We do not have a detailed disaster recovery plan. Our facilities in Northern California may be subject to electrical blackouts as a consequence of a shortage of available electrical power. In the event these blackouts occur, continue or increase in severity, they could disrupt the operations of our affected facilities. In connection with the shortage of available power, prices for electricity have risen dramatically, and may continue to increase for the foreseeable future. Such price changes will increase our operating costs, which could in turn hurt our profitability. In addition, we do not carry sufficient business interruption insurance to compensate us for losses that may occur, and any losses or damages incurred by us could harm our business.

We may require additional capital in order to bring new products to market, and the issuance of new equity securities will dilute your investment in our common stock.

To permit the growth of our business operations in the future, we need to expand our production capacity and bring new products to market, which will likely require significant working capital. To date we have established credit facilities with certain Korean banks with a total borrowing limit of about \$23 million as of December 31, 2001 and about \$25 million payment guarantees for letters of credit. We have also formed alliances with state-run businesses in China, which have committed to substantial amounts of trade credit and financing for production in China under certain terms. However, there is no assurance that these credit facilities will always be available. We may also need to sell shares of our common stock or seek additional borrowings or outside capital infusions in the future. We cannot assure you that such financing options will be available on terms acceptable to us, if at all, and at the time and place that we need them. In addition, if we issue shares of our common stock, our shareholders will experience dilution with respect to their investment.

We depend on manufacturers' representatives and distributors to generate a substantial amount of our revenues.

We rely on manufacturers' representatives and distributors to sell our products and these entities could discontinue selling our products at any time. One agent accounted for about 49% of our revenues during the fiscal year ended March 31, 2000 and about 46% of our revenues during the nine-month period ended December 31, 2000. Another agent accounted for approximately 37% of our revenues during the fiscal year ended December 31, 2001. The loss of such agent, or any other significant agents could seriously harm our operating results.

Our growth continues to place a significant strain on our management systems and resources and if we fail to manage our growth, our ability to market and sell our products and develop new products may be harmed.

Our business is experiencing rapid growth which has strained our internal systems and will require us to develop or adopt more sophisticated information management systems in order to manage the business effectively. Although we have implemented an ERP system, there is no guarantee that this system and any new systems implemented in the future will be adequate to address our expected growth, or that management will be able to foresee in a timely manner other infrastructure needs before they arise. Our success depends on the ability of our executive officers to effectively manage our growth. If we are unable to manage our growth effectively, our results of operations will be seriously harmed.

RISKS RELATED TO OUR INDUSTRY

The selling prices for our products are very volatile and subject to industry-wide fluctuations. Our success is dependent on the growth and strength of the PC market and the DVD video market.

With a focus on the DVD product line, most of our revenues in the last three years were generated from DVD products. Most of our new products currently being developed are in the DVD product line, particularly DVD-ROM drives and DVD loaders. The sales of DVD-ROM drives are closely related to the strength of the PC market and the popularity of PC's equipped with the DVD-ROM drives, in competition with CD-ROM, CD-RW and other devices. If we experience an unforeseen downturn in the PC market, an unexpected decline in PC's equipped with DVD-ROM drives, or a global over-supply in the production of DVD-ROM drives, our results of operations from our DVD-ROM drive business will be adversely affected. Such a situation occurred in 1999 and more notably in 2001, resulting in weakened product demand, accelerated decline of average selling prices, and accumulation of inventory due to a reduced turnover rate. This condition unfavorably impacted our revenues, gross margins, profitability, and our financial condition. While these conditions improved in later periods, if they were to resume, and if our operations could not properly adjust in time, our growth and operating results would be harmed. Similarly, the sales of our DVD loaders are related to the markets for DVD video discs and DVD video players. If the DVD video market does not grow as expected, the sales of our DVD loaders will also be reduced. Our business could be harmed by such industry-wide fluctuations in the future.

The cyclical nature of the semiconductor industry could create fluctuations in our operating results.

The semiconductor industry has historically been cyclical, characterized by wide fluctuations in product supply and demand. From time to time, there are shortages or over-production of memory or other types of devices. Our business could be harmed by such industry-wide fluctuations in the future because our products incorporate these technologies. When a shortage occurs with one or more key components, it may be difficult for us to produce enough quantities of products to fill customers' orders, and it may require us to pay a higher price for the components in the event of a shortage, adversely affecting our margin and profitability.

There is seasonality in our business.

Sales of our products in the computer peripherals market and consumer electronics market are subject to seasonality. As a result, sales of these products are impacted by seasonal purchasing patterns with higher sales generally occurring in the second half of each calendar year. There may be a sharp decline of sales near the Christmas and New Year holiday. Sales to China and certain other Asian regions may also decline near the lunar New Year's holidays in January or February.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market Risk

The following discusses our exposure to market risk related to changes in interest rates and foreign currency exchange rates. This discussion contains forward-looking statements that are subject to risks and uncertainties. Actual results could vary materially as a result of a number of factors including those set forth in "Factors That May Affect Future Results."

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. The primary objective of our investment activities is to preserve principal while maximizing yields without significantly increasing risk. Our investments consist primarily of commercial paper and certificates of deposits. Due to the nature of our investments, we believe that there is no material risk exposure. All investments are carried at market value, which approximates cost.

Foreign Currency Risk

We develop products in the United States and market our products in North America and the Asia-Pacific region. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. As our sales are primarily in U.S. dollars, a strengthening of the dollar could make our products less competitive in foreign markets.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We may from time to time become a party to various legal proceedings arising in the ordinary course of our business. We do not believe that the outcome of any of such legal matters arising in the ordinary course of business will have a material adverse effect on our business, operating results or financial condition.

On December 4, 2001, a lawsuit was filed in United States District Court, Northern District of California against DVS and certain directors, officers and employees of DVS. The plaintiffs in the foregoing action, Glenbrook Capital Limited Partnership, Oxcal Venture Fund, Limited Partnership, Pratrapp Kondamoori and Bruce C. Bailey, are certain investors that purchased securities from DVS in May 2001 and July 2001 in transactions not involving a public offering. The complaint relating to these transactions purports to allege claims relating to breach of contract, fraud, misrepresentation and violation of the Securities Exchange Act. The plaintiffs seek damages in excess of \$1 million, punitive damages and costs of suit. As of March 31, 2002, DVS and the other defendants have not yet answered any of complaints listed above, and discovery had not yet commenced. Although DVS believes that it has certain meritorious defenses to the complaints and intends to vigorously defend the action, an adverse judgment by a court or jury could have a material and adverse effect on DVS' business, results of operation and financial condition.

DVS Korea is involved in a lawsuit with a former employee who is claiming unfair dismissal. The DVS Korea's legal counsel has not been able to provide an estimate of damages nor have they been able to determine the likelihood of loss. The Company had accrued \$90 at December 31, 2001 and 2000. During the period, in accordance with a Korean court order, DVS Korea deposited \$1,160 with the court until this litigation is resolved. This deposit is included in prepaid expenses in other current assets as of December 31, 2001 and 2000. Management intends to defend this lawsuit vigorously and expects to receive the deposit back during the next year.

While we have accrued certain amounts for the estimated legal costs associated with defending these matters, there can be no assurance that these cases and other third party assertions will be resolved without costly litigation, in a manner that is not adverse to our financial position, results of operations or cash flows or without requiring royalty payments in the future which may adversely impact gross margins. No estimate can be made of the possible loss or possible range of loss associated with the resolution of these contingencies.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

None.

(b) Reports on Form 8-K

None.

Items 2, 3, 4 and 5 are not applicable and have been omitted.

SIGNATURE

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

Date: May 15, 2002

DIGITAL VIDEO SYSTEMS, INC.

By: /s/ Douglas T. Watson
Douglas T. Watson
Chief Executive Officer
(*PRINCIPAL EXECUTIVE OFFICER*)

/s/ Da King Lu
Da King Lu
Vice President, Finance
(*PRINCIPAL FINANCIAL OFFICER*)