
**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 June 30, 2009.

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 000-51560

MathStar, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

41-1881957
(I.R.S. Employer
Identification No.)

**19075 NW Tanasbourne, Suite 200, Hillsboro,
Oregon**
(Address of principal executive offices)

97124
(Zip Code)

(503) 726-5500
(Registrant's telephone number, including area code)

N/A
(Former name, former address, and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

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

Shares outstanding of the Registrant's common stock:

| Class | Outstanding at July 31, 2009 |
|--------------------------------|------------------------------|
| Common stock, \$0.01 par value | 9,181,497 |

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Part I
Financial Information

Item 1. Financial Statements

MathStar, Inc.
Condensed Consolidated Balance Sheets
(Unaudited)
(in thousands, except per share data)

| | <u>December 31,</u> <u>2008</u> | <u>June 30,</u> <u>2009</u> |
|--|------------------------------------|--------------------------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 11,767 | \$ 13,671 |
| Investments in marketable securities – short term | 2,530 | — |
| Accounts receivable | 176 | — |
| Prepaid expenses and other current assets | 222 | 105 |
| Total current assets | <u>14,695</u> | <u>13,776</u> |
| Property and equipment, net | 60 | 56 |
| Investments in marketable securities – long term | 785 | 793 |
| Put option | 26 | 11 |
| Other assets | 23 | 19 |
| Total assets | <u>\$ 15,589</u> | <u>\$ 14,655</u> |
| Liabilities and Stockholders' Equity | | |
| Current liabilities | | |
| Accounts payable | \$ 16 | \$ 48 |
| Accrued expenses | 519 | 621 |
| Total current liabilities | <u>535</u> | <u>669</u> |
| Other long term liabilities | 151 | — |
| Total liabilities | <u>686</u> | <u>669</u> |
| Stockholders' equity | | |
| Preferred stock, \$0.01 par value; 10,000 shares authorized; no shares issued and outstanding | — | — |
| Common stock, \$0.01 par value; 18,000 shares authorized; 9,181 shares issued and outstanding at December 31, 2008 and June 30, 2009 | 92 | 92 |
| Additional paid-in capital | 155,924 | 155,954 |
| Accumulated deficit | (141,113) | (142,060) |
| Total stockholders' equity | <u>14,903</u> | <u>13,986</u> |
| Total liabilities and stockholders' equity | <u>\$ 15,589</u> | <u>\$ 14,655</u> |

The accompanying notes are an integral part of these financial statements.

MathStar, Inc.
Condensed Consolidated Statements of Operations
(Unaudited)
(in thousands, except per share data)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|------------------|------------------------------|------------------|
| | 2008 | 2009 | 2008 | 2009 |
| Revenue | \$ 54 | \$ — | \$ 280 | \$ — |
| Cost of sales | 904 | — | 1,195 | — |
| Gross profit (loss) | (850) | — | (915) | — |
| Operating expenses: | | | | |
| Research and development | 3,542 | — | 7,094 | — |
| Selling, general and administrative | 1,469 | 538 | 3,562 | 996 |
| Restructuring and impairment charges | 2,601 | — | 2,601 | — |
| | <u>7,612</u> | <u>538</u> | <u>13,257</u> | <u>996</u> |
| Operating loss | (8,462) | (538) | (14,172) | (996) |
| Interest income | 210 | 18 | 490 | 53 |
| Other income (loss), net | (11) | — | 26 | (4) |
| Net loss | <u>\$ (8,263)</u> | <u>\$ (520)</u> | <u>\$ (13,656)</u> | <u>\$ (947)</u> |
| Basic and diluted loss per share | <u>\$ (0.90)</u> | <u>\$ (0.06)</u> | <u>\$ (1.49)</u> | <u>\$ (0.10)</u> |
| Weighted average basic and diluted shares outstanding | <u>9,181</u> | <u>9,181</u> | <u>9,181</u> | <u>9,181</u> |

The accompanying notes are an integral part of these financial statements.

MathStar, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(in thousands)

| | Six Months Ended June 30, | |
|--|------------------------------|-----------|
| | 2008 | 2009 |
| Cash flows from operating activities | | |
| Net loss | \$ (13,656) | \$ (947) |
| Adjustments to reconcile net loss to net cash used in operating activities | | |
| Depreciation and amortization | 111 | 4 |
| Loss on asset disposal | 48 | — |
| Asset impairment charges | 1,006 | — |
| Amortization of discount on held-to-maturity securities | 39 | 3 |
| Loss on sale of available-for-sale securities | 7 | — |
| Mark to market, trading securities | — | (8) |
| Mark to market, put option | — | 15 |
| Non-cash changes in inventory reserves | 734 | — |
| Stock-based compensation | (9) | 30 |
| Restructuring charges | 563 | — |
| Gain on sale of marketable securities | (42) | — |
| Foreign currency remeasurement | 7 | 4 |
| Change in operating assets and liabilities | | |
| Accounts receivable | 214 | 176 |
| Inventory | (111) | — |
| Prepaid expenses and other assets | 703 | 121 |
| Accounts payable | (692) | 32 |
| Deferred revenue | (162) | — |
| Accrued expenses | (785) | (53) |
| Net cash used in operating activities | (12,025) | (623) |
| Cash flows from investing activities | | |
| Purchase of property and equipment | (50) | — |
| Proceeds from sale of equipment | 21 | — |
| Proceeds from sale of held-to-maturity securities | 13,058 | 2,527 |
| Proceeds from sale of available-for-sale securities | 4,460 | — |
| Purchase of held-to-maturity securities | (2,931) | — |
| Purchase of available-for-sale securities | (2,685) | — |
| Restricted cash | (2) | — |
| Net cash provided by investing activities | 11,871 | 2,527 |
| Cash flows from financing activities | | |
| Effect of exchange rate changes on cash | (3) | — |
| Net (decrease) increase in cash and cash equivalents | (157) | 1,904 |
| Cash and cash equivalents | | |
| Beginning of period | 4,339 | 11,767 |
| End of period | \$ 4,182 | \$ 13,671 |

The accompanying notes are an integral part of these financial statements.

MathStar, Inc.
Notes to Condensed Consolidated Financial Statements
(in thousands, except per share data)

1. Basis of Presentation and Going Concern

The accompanying interim condensed consolidated financial statements of MathStar, Inc. (“MathStar” or the “Company”) have been prepared in conformity with generally accepted accounting principles in the United States (U.S. GAAP), consistent in all material respects with those applied in the Company’s Annual Report on Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission (“SEC”) on March 31, 2009. The year-end condensed consolidated balance sheet was derived from audited financial statements, but does not include all disclosure required by U.S. GAAP. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. During the quarter ended March 31, 2009, MathStar, Inc. closed its two wholly-owned subsidiaries, MathStar Holdings B.V. and MathStar Limited.

The interim financial information is unaudited, but it reflects all normal adjustments that are, in the opinion of management, necessary to provide a fair statement of results for the interim periods presented. The interim financial results are not necessarily indicative of results to be expected in future interim or annual periods. The interim financial statements should be read in conjunction with the financial statements in the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2009.

During the three months ended March 31, 2008, sales did not materialize as expected, and our development of the next generation of FPOA chips fell even further behind schedule. As a result, on May 20, 2008, the Board of Directors voted to suspend research and development activities and ongoing operations while analyzing strategic alternatives to protect shareholder value. The Board of Directors continues to explore these strategic alternatives, which could include merger, acquisition, increasing operations in another structure or liquidation. MathStar has engaged third party investment banking firms to explore the sale of intellectual property and patents and potential merger and acquisition alternatives.

The accompanying financial statements have been prepared on a basis which assumes that the Company will continue as a going concern and which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. Although the Company has incurred recurring losses and negative cash flows from operations, we have met all financial obligations with vendors, key suppliers, and strategic partners, both prior and subsequent to curtailing operations. We have sufficient cash and investments to meet all known obligations as well as projected expenditures for the next twelve months at current spending levels. However, because we have not definitively committed to any of the strategic alternatives being evaluated, we cannot predict our long-term cash needs or ultimate cash requirements. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Basic earnings per share are computed by dividing the net loss available to common shareholders by the weighted average number of shares outstanding during the period. The diluted earnings per share calculation discloses the impact of all potential dilutive common shares outstanding during the period, including stock options and warrants using the treasury stock method. For the three months and six months ended June 30, 2008 and June 30, 2009, options and warrants totaling 693,903 to purchase shares of common stock were not included in the computation of net loss per share, as their effect was antidilutive.

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2. Restructuring and Impairment Charges

During the three months ended June 30, 2008, the Company announced a curtailment of operations as it evaluated strategic alternatives to preserve shareholder value. This decision resulted in restructuring and impairment charges of \$3,500 in 2008. Management determined that it was highly likely that certain operational assets would not be used and no alternatives existed. In accordance with Statement of Financial Accounting Standards (“SFAS”) No. 144, “*Accounting for the Impairment or Disposal of Long-Lived Assets*” issued by the Financial Accounting Standards Board (“FASB”), these assets were deemed to be impaired and either held-for-sale or abandoned and written down to their fair market value. A plan to locate potential buyers was put in place for their disposal, and no further depreciation expense will be charged to the Company’s operating activity for these assets. In addition, the Company evaluated assets that were not abandoned or held-for-sale and determined that the estimated useful lives of these assets should be shortened. As well, in accordance with SFAS No. 146 issued by the FASB, “*Accounting for Costs Associated with Exit or Disposal Activities*”, certain one-time charges relating to severance to terminated employees, and fees associated with early contract terminations no longer used and giving economic benefit to the Company, were recorded. As the liabilities for these charges were settled, payment was made against the liability, and there will not be any further impact on the Company’s operating results.

| | Twelve Months Ended December 31, 2008 |
|---|--|
| Inventory abandoned | \$ 349 |
| Increase in excess and obsolete reserve | 533 |
| Charged to cost of sales | 882 |
| Severance | 1,506 |
| Fair market adjustment of assets held-for-sale | 328 |
| Contract termination | 57 |
| Assets abandoned | 727 |
| Charged to operating expenses as restructuring and impairment charges | 2,618 |
| Total charges for restructuring and impairment | <u>\$ 3,500</u> |

Below is the detail of restructuring and impairment charges for the six months ended June 30, 2009.

| | Restructuring Liability |
|-----------------------------------|----------------------------|
| Liability as of December 31, 2008 | \$ 4 |
| Additions | — |
| Payments | (4) |
| Liability as of June 30, 2009 | <u>\$ —</u> |

Management believes that no further charges will be incurred for this activity, except for potential termination of non-cancellable lease liabilities for the Hillsboro, Oregon facility, which will depend on the strategic direction chosen by the Company. The amount of the potential lease termination liability will not be known until the strategic direction is identified. Total future lease commitments remaining under this lease are \$725 as of June 30, 2009.

3. New Accounting Pronouncements

In April 2009, the FASB issued Staff Position No. 157-4, “*Determining Fair Value When Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*” (“FSP 157-4”). FSP 157-4 provides guidance on how to determine the fair value of assets and liabilities when the volume and level of activity for the asset/liability has significantly decreased. FSP 157-4 also provides guidance on identifying circumstances that indicate a transaction is not orderly. In addition, FSP 157-4 requires disclosure in interim and annual periods of the inputs and valuation techniques used to measure fair value and a discussion of changes in valuation techniques. FSP 157-4 was effective for the Company beginning in the second quarter of fiscal year 2009. The adoption of FSP 157-4 did not have a material impact on its consolidated financial position, results of operations or cash flows.

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In April 2009, the FASB issued Staff Position No. 115-2 and 124-2, “*Recognition and Presentation of Other-Than-Temporary Impairment*” (“FSP 115-2/124-2”). FSP 115-2/124-2 amends the requirements for the recognition and measurement of other-than-temporary impairments for debt securities by modifying the pre-existing “intent and ability” indicator. Under FSP 115-2/124-2, an other-than-temporary impairment is triggered when there is intent to sell the security, it is more likely than not that the security will be required to be sold before recovery, or the security is not expected to recover the entire amortized cost basis of the security. Additionally, FSP 115-2/124-2 changes the presentation of other-than-temporary impairment in the income statement for those impairments involving credit losses. The credit loss component will be recognized in earnings, and the remainder of the impairment will be recorded in other comprehensive income. FSP 115-2/124-2 was effective for the Company beginning in the second quarter of fiscal year 2009. The adoption of FSP 115-2/124-2 did not have a material impact on its consolidated financial position, results of operations or cash flows.

In April 2009, the FASB issued Staff Position No. 107-1 and APB 28-1, “*Interim Disclosure about Fair Value of Financial Instruments*” (“FSP 107-1/APB 28-1”). FSP 107-1/APB 28-1 requires interim disclosures regarding the fair values of financial instruments that are within the scope of FAS 107, “*Disclosures about the Fair Value of Financial Instruments*.” Additionally, FSP 107-1/APB 28-1 requires disclosure of the methods and significant assumptions used to estimate the fair value of financial instruments on an interim basis as well as changes of the methods and significant assumptions from prior periods. FSP 107-1/APB 28-1 does not change the accounting treatment for these financial instruments and was effective for the Company beginning in the second quarter of fiscal year 2009. For the six months ended June 30, 2009 the change in the fair value of financial instruments was \$8,000.

In May 2009, the FSAB issued Statement No. 165, “*Subsequent Events*” (FAS 165). FAS 165 requires management to evaluate events or transactions that took place after the balance sheet date and prior to release of the financial statements for potential recognition or disclosure in the financial statements. FAS 165 is to be applied to all periods following June 15, 2009. There were no such events or transactions which occurred through August 14, 2009, the date these financial statements were issued.

4. Selected Balance Sheet Information

Investment Securities

| | December 31, 2008 | June 30, 2009 |
|------------------------------|----------------------|------------------|
| Short-term | | |
| Held-to-maturity | | |
| Corporate bonds and notes | \$ 2,530 | \$ — |
| Total short-term investments | <u>2,530</u> | <u>—</u> |
| Long-term | | |
| Trading | | |
| Auction preferred securities | 785 | 793 |
| Total long-term investments | <u>785</u> | <u>793</u> |
| Total investments | <u>\$ 3,315</u> | <u>\$ 793</u> |

| Description | 6/30/09 | Fair Value Measurement at Reporting Date | | |
|--------------------|---------------|--|--|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Using Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Put option | \$ 11 | — | — | \$ 11 |
| Trading securities | 793 | — | — | 793 |
| Total | <u>\$ 804</u> | <u>—</u> | <u>—</u> | <u>\$ 804</u> |

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The Company has auction preferred securities (APS), which are preferred equity instruments in a closed-end mutual fund that provide liquidity through an auction process conducted by an independent auction agent that resets the applicable dividend rate at pre-determined calendar intervals, generally every 28 days. These instruments are senior equity securities that have a liquidation preference of \$25,000 per share plus the amount of accumulated but unpaid dividends. Upon the liquidation, dissolution or winding up of the fund, APS holders are entitled to receive their liquidation preference before any distribution or payment is made to holders of the fund's common shares. Dividends declared and payable on the APS have a priority over dividends on the fund's common shares. Outstanding APS may be redeemed at the option of the fund upon giving notice to APS holders.

The Company generally invested in these securities as part of its overall cash management program. During the first quarter of 2008, the Company's APS failed to auction due to sell orders exceeding buy orders. The funds associated with failed auctions will not be accessible until a successful auction occurs, the fund redeems outstanding APS or an active secondary market is created and a buyer is identified outside of the auction process.

At June 30, 2009, there was insufficient observable APS market information available to determine the fair value of the Company's investments in APS. Therefore, the Company estimated Level 3 fair values for the APS by incorporating assumptions that market participants would use in their estimates of fair value. Despite the failed auctions, the Company's APS continue to be highly rated by the rating agencies. Of the original \$2,680 in APS purchased, \$1,852 was redeemed on May 27, 2008 at face value.

As further required by SFAS No. 157, provided below is a reconciliation of the beginning and ending balances for each type of security valued using a Level 3 valuation at June 30, 2009.

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| | Fair Value Measurement Using Significant Unobservable Inputs (Level 3) | |
|---|--|------------------------------|
| | Put Option | Auction Preferred Securities |
| Beginning balance as of December 31, 2008 | \$ 26 | \$ 785 |
| Total gains (losses) realized/unrealized included in earnings | — | (7) |
| Purchases | — | — |
| Settlements | — | — |
| Issuance of put option | — | — |
| Ending balance as of March 31, 2009 | \$ 26 | \$ 778 |
| Total gains (losses) realized/unrealized included in earnings | (15) | 15 |
| Purchases | — | — |
| Settlements | — | — |
| Issuance of put option | — | — |
| Ending balance as of June 30, 2009 | \$ 11 | \$ 793 |

On November 14, 2008, we accepted an offer from UBS AG (“UBS”), providing us with rights related to our APS (the “Rights”). The Rights permit us to require UBS to purchase our APS at any time during the period from June 30, 2010 until July 2, 2012 at par value, which is defined as the price equal to the liquidation preference of the APS plus accrued but unpaid dividends or interest. Conversely, UBS has the right, in its discretion, to purchase or sell our APS at any time until July 2, 2012 so long as we receive payment at par value upon any sale or disposition. We expect to sell our APS under the Rights. However, if the Rights are not exercised before July 2, 2012, they will expire, and UBS will have no further rights or obligation to buy our APS. So long as we hold our APS, they will continue to accrue interest as determined by the auction process or the terms of the APS if the auction process fails. UBS’s obligations under the Rights are not secured by its assets and do not require UBS to obtain any financing to support its performance obligations under the Rights. UBS has disclaimed any assurance that it will have sufficient financial resources to satisfy its obligations under the Rights.

The Rights represent a firm agreement in accordance with SFAS No. 133, which defines a firm agreement as an agreement with an unrelated party, binding on both parties and usually legally enforceable, with the following characteristics: a) the agreement specifies all significant terms, including the quantity to be exchanged, the fixed price, and the timing of the transaction; and b) the agreement includes a disincentive for nonperformance that is sufficiently large to make performance probable. The enforceability of the Rights results in a put option and should be recognized as a free-standing asset separate from the APS. Upon acceptance of the offer from UBS, we recorded \$26 as the fair value of the put option asset with a corresponding credit to interest income, net. The put option does not meet the definition of a derivative instrument under SFAS No. 133. Therefore, we have elected to measure the put option at fair value under SFAS No. 159, which permits an entity to elect the fair value option for recognized financial assets, in order to match the changes in the fair value of the APS. As a result, gains and losses will be included in earnings in future periods. We expect that future changes in the fair value of the put option will approximate fair value movements in the related APS; during the quarter ended June 30, 2009, the fair value of the put option decreased by \$15. Prior to accepting the UBS offer, we recorded our APS as investments available-for-sale. We recorded unrealized gains and losses on our available-for-sale debt securities, net of a tax benefit, in accumulated other comprehensive income in the shareholders’ equity section of our balance sheets. Such an unrealized loss did not reduce net income for the applicable accounting period.

Inventory

| | December 31, 2008 | June 30, 2009 |
|---|-------------------|---------------|
| Finished goods | \$ 446 | \$ 446 |
| Less: reserve for excess and obsolete inventory | (446) | (446) |
| Total inventory, net | \$ — | \$ — |

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Prepaid and Other Current Assets

| | December 31, 2008 | June 30, 2009 |
|--|----------------------|------------------|
| Prepaid insurance | \$ 105 | \$ 48 |
| Prepaid rent | 26 | 27 |
| Interest receivable | 61 | — |
| Other | 30 | 30 |
| Total prepaid and other current assets | <u>\$ 222</u> | <u>\$ 105</u> |

Property and Equipment

| | December 31, 2008 | June 30, 2009 |
|-----------------------------------|----------------------|------------------|
| Computer equipment | \$ 50 | \$ 50 |
| Purchased software | 91 | 91 |
| Furniture and fixtures | 198 | 198 |
| | <u>\$ 339</u> | <u>\$ 339</u> |
| Less: Accumulated depreciation | (279) | (283) |
| Total property and equipment, net | <u>\$ 60</u> | <u>\$ 56</u> |

Depreciation expense was \$50 and \$2 for the three months ended June 30, 2008 and 2009, respectively, and \$80 and \$4 for the six months ended June 30, 2008 and 2009, respectively.

Under SFAS No. 144, “*Accounting for the Impairment or Disposal of Long-Lived Assets*”, assets that are no longer used in operations and held for sale should be written down to the expected fair market value and depreciation ceased as of the determination date.

Other Assets

| | December 31, 2008 | June 30, 2009 |
|--------------------|----------------------|------------------|
| Deposits | \$ 23 | \$ 19 |
| Total other assets | <u>\$ 23</u> | <u>\$ 19</u> |

Accrued Expenses

| | December 31, 2008 | June 30, 2009 |
|-------------------------------|----------------------|------------------|
| Accrued license contracts | \$ 302 | \$ 302 |
| Accrued severance expense | — | 149 |
| Accrued professional fees | 148 | 110 |
| Accrued rent | 47 | 43 |
| Accrued compensation | 9 | — |
| Accrued restructuring charges | 4 | — |
| Other | 9 | 17 |
| Total accrued expenses | <u>\$ 519</u> | <u>\$ 621</u> |

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Subsequent Event

The subsequent event test in accordance with FAS 165 was performed as of August 14, 2009. There were no transactions or events discovered that required recognition or disclosure.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Quarterly Report on Form 10-Q contains forward-looking statements, which are being provided under the "safe harbor" protection of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are generally written in the future tense and/or are preceded by words such as "will," "may," "should," "could," "expect," "suggest," "believe," "anticipate," "intend," "plan," or other similar words. Forward-looking statements are not guarantees of future performance and involve risks and uncertainties. The forward-looking statements contained in this report are based on information that is currently available to us and expectations and assumptions that we deem reasonable at the time the statements were made. We do not undertake any obligation to update any forward-looking statements in this report or in any of our other communications, except as required by law. All such forward-looking statements should be read as of the time the statements were made and with the recognition that these forward-looking statements may not be complete or accurate at a later date.

Many factors may cause actual results to differ materially from those expressed or implied by the forward-looking statements contained in this report. These factors include, but are not limited to, those risks described in our Annual Report on Form 10-K filed on March 31, 2009.

Business Overview

Until we curtailed operations in the second quarter of 2008, we were a fabless semiconductor company engaged in the development, marketing and selling of our high-performance, programmable platform field programmable object array, or FPOA, chips and design tools required to program our chips. During the three months ended March 31, 2008, sales did not materialize as expected, and our development of the next generation of FPOA chips fell behind schedule. As a result, on May 20, 2008, the Board of Directors voted to suspend research and development activities and curtail ongoing operations while analyzing strategic alternatives. The Board of Directors continues to explore these strategic alternatives, which could include merging with or acquiring another company, increasing operations in another structure or liquidation. We have engaged third party investment banking firms to explore the sale of intellectual property and patents and potential merger and acquisition alternatives.

Recently Issued Accounting Pronouncements

See Note 2 of Notes to Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Critical Accounting Policies

There were no changes in critical accounting policies in the three months ended June 30, 2009.

Results of Operations

Three Months Ended June 30, 2008 and 2009

Revenue. There was no revenue for the three months ended June 30, 2009 compared to \$54,000 for the same period last year. Revenue for the three months ended June 30, 2008 was from the sale of production FPOA chips of \$50,000 and the sale of evaluation products of \$4,000. Future short-term revenue could be generated from sales of production chips we have in inventory. Long-term revenue opportunities will be based on the strategic direction chosen by our Board of Directors and the timing for executing the plan.

Cost of Sales. There was no cost of sales for the three months ended June 30, 2009 compared to \$904,000 for the three months ended June 30, 2008. Costs of sales in the second quarter of 2008 include external chip costs of \$5,000, costs for development products of \$2,000, a non-cash charge of \$533,000 for excess and obsolete inventory comprised primarily of current generation chips held in inventory, \$353,000 for scrapping tool licenses and raw material, and other charges of \$11,000.

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Research and Development. All research and development activity has been suspended, and no expenses were incurred during the three months ended June 30, 2009. For the three months ended June 30, 2008, there were research and development expenses of \$3,542,000. Any future research and development costs will depend on the strategic direction chosen by our Board of Directors and the timing for executing the plan.

Selling, General and Administrative. For the three months ended June 30, 2009, selling, general and administrative expenses were \$538,000 compared to \$1,469,000 for the three months ended June 30, 2008. The \$538,000 consisted of personnel expenses of \$126,000, outside services, legal and accounting fees of \$183,000, facility costs of \$87,000, insurance costs of \$29,000, payments to investment bankers and consultants associated with the sale of the IP and strategic opportunities of \$83,000, and other costs of \$30,000. For the three months ended June 30, 2008, expenses included personnel costs of \$705,000, consulting, professional fees and outside services of \$393,000, travel of \$102,000, facility and depreciation of \$84,000, advertising and promotions of \$71,000, insurance of \$39,000 and other expenses related to operations of \$75,000. Excluding expenses associated with investigating strategic alternatives and IP sales, we believe our expenses are at the lowest sustainable level possible while still meeting the requirements of a public company. Any changes in this level will depend on the strategic direction of the Company chosen by our Board of Directors and the timing for executing the plan.

Restructuring and Impairment Charges. For the three months ended June 30, 2009, we did not record any restructuring and impairment charges. In the three months ended June 30, 2008, we recorded a restructuring and impairment charge of \$2,601,000. See further discussion of these restructuring and impairment charges in Note 2 of the financial statements.

Other Income (Loss). For the three months ended June 30, 2009, other income decreased by \$181,000 or 91% to \$18,000 compared to \$199,000 for the three months ended June 30, 2008. The decrease was the result of \$192,000 less interest income earned on lower investment balances and loss on asset sale of \$11,000.

Six Months Ended June 30, 2008 and 2009

Revenue. There was no revenue reported for the six months ended June 30, 2009 compared to \$280,000 for the same period last year. Revenue for the six months ended June 30, 2008 was from the sale of production FPOA chips of \$276,000 and development products of \$4,000.

Cost of Sales. There was no cost of sales for the six months ended June 30, 2009. For the six months ended June 30, 2008 the cost of sales was \$1,195,000. Cost of sales for the six months ended June 30, 2008 included product costs of \$36,000, a non-cash charge of \$776,000 for excess and obsolete inventory, scrap costs associated with tool licenses and raw material write-offs of \$363,000, and other costs of \$20,000.

Research and Development. For the six months ended June 30, 2009, all research and development activities were curtailed and no expenses were incurred. For the six months ended June 30, 2008, research and development costs were \$7,094,000. The \$7,094,000 included employee related expenses of \$2,698,000, consulting and contractor expense of \$1,550,000, development tool expense of \$614,000, charges for application IP development of \$515,000 because technological feasibility had not been established on the development projects, external development costs associated with the completion of the next generation FPOA of \$1,456,000, and other costs of \$261,000.

Selling, General and Administrative. For the six months ended June 30, 2009, selling, general and administrative expenses were \$996,000 compared to \$3,562,000 for the six months ended June 30, 2008. The \$996,000 in expenses for the six months ended June 30, 2009 included employee related expenses of \$237,000, outside services and professional fees of \$309,000, facility charges of \$167,000, insurance of \$57,000, other operating expenses of \$50,000, and payment related to investment banking activities of \$176,000. The \$3,562,000 in expenses for the six months ended June 30, 2008 included employee related expenses of \$2,161,000, outside services and professional fees of \$633,000, marketing and advertising of \$110,000, travel expenses of \$228,000, facility charges and depreciation of \$164,000, insurance of \$77,000, and other operating expenses of \$189,000. Our selling, general and administrative infrastructure is reduced to key individuals necessary to sustain the corporate structure and activities and plan our strategic direction. Should we choose to increase operations, there will be significant one-time and recurring expenses required to grow our organizational infrastructure.

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Restructuring and Impairment Charges. For the six months ended June 30, 2009, we did not record any restructuring or impairment charges. For the six months ended June 30, 2008, we recorded restructuring and impairment charges of \$2,601,000. See further discussion of these restructuring charges in Note 2 of the financial statements.

Other Income (Loss). For the six months ended June 30, 2009, other income decreased by \$467,000 or 91% to \$49,000 compared to \$516,000 for the six months ended June 30, 2008. The decrease was the result of \$437,000 less interest income and a \$30,000 loss on asset sale.

Liquidity and Capital Resources

In response to the Board of Director's decision to curtail operations and evaluate our strategic alternatives, staff was reduced to two key individuals in the second quarter of 2008, Mr. Douglas M. Pihl, a full-time Chief Executive Officer/Chief Financial Officer, and Mr. John M. Jennings, a part-time Chief Accounting Officer, and support contractors on an as-needed basis to sustain the Company's corporate structure and activities and plan its strategic direction. As set forth in our Current Report on Form 8-K filed on July 15, 2009, Mr. Pihl resigned as Chief Executive Officer, Chief Financial Officer and a Director on July 14, 2009. On August 5, 2009, the Company and Mr. Pihl entered into a Severance and Release Agreement (the "Agreement"), the form of which was included as Exhibit A to Exhibit 10.2 of the Company's Current Report on Form 8-K filed May 8, 2009. Pursuant to the Agreement, the Company has agreed to make a severance payment of \$216,286 to Mr. Pihl. All costs associated with the Agreement were accrued as of June 30, 2009. As set forth in our Current Report on Form 8-K filed on August 14, 2009, effective as of August 1, 2009, the Company engaged Alex H. Danzberger, Jr. to serve as Chief Executive Officer and Chief Financial Officer. We have sufficient cash and investments to satisfy all outstanding obligations and to initiate actions based on the strategic direction when determined by the Board of Directors.

In January 2008, we purchased \$2,680,000 of investments comprised of auction preferred securities (APS). All of our APS are AAA rated by one of the major credit rating agencies. Since mid-February 2008, we have experienced failed auctions for our entire APS portfolio, resulting in our inability to sell these securities. A failed auction results in a lack of liquidity in the securities but does not signify a default by the issuer. Upon an auction failure, the interest rates on the APS do not reset at a market rate but instead reset based on a formula contained in the APS, which generally is higher than the current market rate. The issuer of the APS redeemed \$1,852,000 of the APS on May 27, 2008 and is actively putting a plan in place to redeem the remainder. Our APS were purchased through UBS Financial Services. On August 8, 2008, UBS announced that it reached a settlement with the New York Attorney General, the Massachusetts Securities Division, the Securities and Exchange Commission and other regulatory agencies to restore liquidity to holders of APS. We do not currently need these funds to satisfy outstanding obligations or meet short-term operating requirements.

We classified our APS as trading securities, which has resulted in a \$35,000 cumulative adjustment to the carrying value of our APS to mark them to fair value. If uncertainties in the credit and capital markets continue, if the credit worthiness of the issuer deteriorates, if UBS does not comply with the settlement provisions or if we no longer have the ability to hold these investments, we may be required to recognize additional impairment charges on our APS holdings or a loss on their disposition.

Our future capital requirements will depend on many factors, including the strategic direction the Company chooses, the amount of any sales, the type and structure of any strategic transaction into which we enter, and working capital needs. We believe that our cash on hand and our investment securities will be sufficient to meet our current obligations as well as projected expenditures for the next twelve months at current spending levels. However, our long-term financing requirements will depend significantly on the strategic direction we choose to take and the timing for executing the plan. We cannot quantify our long-term cash requirements until a strategic alternative is decided. Should cash and investments and revenues generated from a strategic alternative not meet our needs, we may need to raise funds through the issue of debt or equity securities. These securities may have rights senior to those currently associated with our common stock and could contain covenants that would restrict our operations. If we are unable to obtain additional financing, we may be unable to continue our operations.

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Net Cash Used in Operating Activities

Net cash used in operating activities was \$623,000 and \$12,025,000 for the six months ended June 30, 2009 and 2008, respectively. Net cash used for operating activities for the six months ended June 30, 2009 was to pay outstanding liabilities and ongoing expenses of the company of \$447,000 and \$176,000 in investment banking fees used in evaluating strategic alternatives. Net cash used for operating activities for the six months ended June 30, 2008 was to fund the completion of the design of our next generation of FPOA chip, pay our selling, general and administrative costs, pay severance payments to employees whose employment was terminated, and fund contract termination expenses.

Net Cash Provided by Investing Activities

Net cash provided by investing activities was \$2,527,000 and \$11,871,000 for the six months ended June 30, 2009 and 2008, respectively. Net cash provided by investing activities for the six months ended June 30, 2009 was from the proceeds from the sale of investments. Net cash provided by investing activities for the six months ended June 30, 2008 was from the proceeds from the sale of investments of \$11,902,000, \$21,000 from the sale of equipment, \$50,000 used to purchase capital equipment and \$2,000 in the increase of restricted cash.

Net Cash Provided by Financing Activities

There were no financing activities for the six months ended June 30, 2009 and 2008.

Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts. As such, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in these relationships.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our exposure to market risk is confined to our cash equivalents and investments. We have invested in high-quality financial instruments, primarily money market funds, federal agency notes and asset-backed securities, which we believe are subject to limited credit risks. Included in our investments are APS. The APS auctions have historically provided a liquid market for these securities, as investors could readily sell their investments at auction. With the liquidity issues experienced in global credit and capital markets, the APS held by us have experienced failed auctions, beginning on February 19, 2008, as the amount of securities submitted for sale exceeded the amount of purchase orders, making the liquidity of the APS questionable. Despite the failed auctions, our APS continue to be highly rated by the rating agencies. We believe we will have full redemption of all APS at par. If all APS are not redeemed, it could have a negative effect on the liquidity of our funds available for strategic alternatives.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

During the fiscal period covered by this report, our management, with the participation of the Chief Executive Officer and Chief Financial Officer, completed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 ("Exchange Act"). Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer has concluded that, as of the end of the fiscal period covered by this report, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the rules and forms of the Securities and Exchange Commission and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

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Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the most recently completed quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II

Other Information

Item 1. Legal Proceedings

We are currently not a party to any legal proceedings.

Item 1A. Risk Factors

There are many factors that may affect our future operating results and financial condition. Some of these risk factors are described in the section entitled "Risk Factors" beginning on page 7 of our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the SEC on March 31, 2009 ("2008 Form 10-K"). Other information included in this Quarterly Report on Form 10-Q also should be carefully considered. The risks and uncertainties described in our 2008 Form 10-K are not the only risks we face. Additional risks and uncertainties not presently known to us or that our management currently deems immaterial also may impair our business operations and financial condition. If any of the risks described were to occur, our business, financial condition, operating results and cash flows could be materially adversely affected.

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

None.

Item 3. Defaults Upon Senior Securities

None.

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

On July 10, 2009, at our Annual Meeting of Stockholders, our stockholders voted on three proposals. The vote on each of those proposals is described below.

Proposal No. 1

The following incumbent directors were re-elected to our Board of Directors by the following votes:

| <u>Nominee</u> | <u>For</u> | <u>Withheld/Against</u> | <u>Broker Non-Votes</u> |
|-------------------------|------------|-------------------------|-------------------------|
| Douglas M. Pihl | 6,703,034 | 1,957,406 | — |
| Benno G. Sand | 6,745,972 | 1,914,468 | — |
| Merrill A. McPeak | 6,738,572 | 1,921,868 | — |
| Richard C. Perkins, Jr. | 6,836,066 | 1,824,374 | — |

As described above, Mr. Pihl resigned as Chief Executive Officer, Chief Financial Officer and a Director on July 14, 2009.

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Proposal No. 2

The stockholders ratified the selection of PricewaterhouseCoopers LLP as our independent registered public accounting firm by the following vote:

| <u>For</u> | <u>Against</u> | <u>Withheld</u> | <u>Broker Non-Votes</u> |
|------------|----------------|-----------------|-------------------------|
| 8,583,073 | 69,139 | 8,228 | — |

Proposal No. 3

The stockholders voted against the stockholder proposal to liquidate MathStar, Inc. and distribute the net proceeds to the stockholders.

| <u>For</u> | <u>Against</u> | <u>Withheld</u> | <u>Broker Non-Votes</u> |
|------------|----------------|-----------------|-------------------------|
| 1,632,210 | 2,782,369 | 71,105 | 4,174,956 |

Item 5. Other Information

None

Item 6. Exhibits

The exhibits are described on the Exhibit Index to this Quarterly Report on Form 10-Q.

SIGNATURES

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

MathStar, Inc.
(Registrant)

Date: August 14, 2009

By: /s/ Alex H. Danzberger, Jr.
Alex H. Danzberger, Jr.
Chief Executive Officer and Chief Financial Officer

EXHIBIT INDEX

| Exhibit No. | Description of Exhibit |
|--------------------|--|
| 3.1 | Certificate of Incorporation of MathStar, Inc. (incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-1 filed by MathStar, Inc. with the Securities and Exchange Commission (“SEC”) on August 3, 2005 (File No. 333-127164) (the “Registration Statement”). |
| 3.2 | By-laws of MathStar, Inc. (incorporated by reference to Exhibit 3.2 to the Registration Statement). |
| 4.1 | Form of common stock certificate of MathStar, Inc. (incorporated by reference to Exhibit 4.1 to the Registration Statement). |
| 31.1 | Certification of Chief Executive Officer pursuant to Rules 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934 (filed herewith electronically). |
| 31.2 | Certification of Chief Financial Officer pursuant to Rules 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934 (filed herewith electronically). |
| 32.1 | Section 1350 Certification of Chief Executive Officer and Chief Financial Officer (filed herewith electronically). |

I, Alex H. Danzberger, Jr., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of MathStar, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2009

By /s/ Alex H. Danzberger, Jr.

Alex H. Danzberger, Jr.
Chief Executive Officer

I, Alex H. Danzberger, Jr., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of MathStar, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2009

By /s/ Alex H. Danzberger, Jr.

Alex H. Danzberger, Jr.
Chief Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of MathStar, Inc. (the "Company") for the quarter ended June 30, 2009 (the "Quarterly Report"), I, Alex H. Danzberger, Jr., Chief Executive Officer and Chief Financial Officer of the Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Quarterly Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and
2. The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 14, 2009

By: /s/ Alex H. Danzberger, Jr.

Alex H. Danzberger, Jr.
Chief Executive Officer and Chief Financial Officer
