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 September 30, 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	**77-0333728**
(State or other jurisdiction of incorporation or organization)	(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 September 30, 2002, there were approximately 5,925,005 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)

	September 30, 2002	December 31, 2001
ASSETS:	(Unaudited)	(Audited)
Current assets:		
Cash and cash equivalents	$ 15,152	$ 10,145
Restricted cash	5,894	3,236
Accounts receivable, net	12,614	2,135
Inventories	53,424	11,886
Marketable debt securities	823	769
Prepaid expenses and other current assets	5,133	4,747
Notes receivable – current	1,244	1,974
Total current assets	**94,284**	**34,892**
Property and equipment, net	10,370	9,715
Intangibles	824	1,013
Other assets	279	16
Total assets	**$ 105,757**	**$ 45,636**
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current liabilities:		
Line of credit	$ 35,562	$ 16,500
Current portion of long term debt	186	172
Accounts payable	36,524	5,876
Accrued liabilities	2,926	3,883
Notes payable	1,816	1,834
Other payable	2,058	1,631
Total current liabilities	**79,072**	**29,896**
Long term liabilities:		
Long term liabilities – long term debt	186	264
Other long term liabilities	1,488	1,488
Total liabilities	**80,746**	**31,648**
Minority interest	14,561	4,877
Stockholders' equity:		
Preferred Stock	—	—
Common Stock	1	1
Additional paid-in capital	72,901	71,350
Accumulated other comprehensive income (loss)	499	(210)
Deferred compensation	(30)	(60)
Accumulated deficit	(62,921)	(61,970)
Total stockholders' equity	**10,450**	**9,111**
Total liabilities and stockholders' equity	**$ 105,757**	**$ 45,636**

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 September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Net revenue	**$ 90,954**	**$ 52,879**	**$ 156,380**	**$ 102,894**
Cost of revenue	86,382	47,500	145,956	90,397
Gross margin	4,572	5,379	10,424	12,497
Operating expenses:				
Research and development	953	923	2,640	2,134
Sales and marketing	879	832	2,001	2,253
General and administrative	1,266	1,577	4,673	4,578
Total operating expenses	**3,098**	**3,332**	**9,314**	**8,965**
Income (loss) from operations	**1,474**	**2,047**	**1,110**	**3,532**
Interest (expense) income	(625)	(677)	(1,389)	(801)
Other income (expense)	1,503	145	(23)	(92)
Income (loss) before minority interest and income taxes	2,352	1,515	(302)	2,639
Income tax (provision) benefit	(280)	(352)	(332)	(444)
Minority interest	(225)	(500)	(317)	(1,137)
Net income (loss)	**$ 1,847**	**$ 663**	**$ (951)**	**$ 1,058**
Basic net income (loss) per share	$ 0.31	$ 0.12	$ (0.16)	$ 0.20
Diluted net income (loss) per share	$ 0.31	$ 0.09	$ (0.16)	$ 0.15

See accompanying notes to condensed consolidated financial statements.

Digital Video Systems, Inc.

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

	Nine Months Ended September 30, 2002	Nine Months Ended September 30, 2001
Cash flows from operating activities:		
Net (loss) income	$ (951)	$ 1,058
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Minority interest	317	1,137
Depreciation and amortization	1,999	1,087
Issuance of common stock for service provided	200	—
Stock options compensation expense	30	54
Write down of notes receivable	730	—
Changes in operating assets and liabilities:		
Accounts receivable	(10,479)	(6,549)
Inventories	(41,538)	(3,728)
Prepaid expenses and other current assets	(621)	(4,349)
Other assets	(28)	1,634
Accounts payable	30,648	9,260
Accrued liabilities	(957)	1,216
Other payable	427	(139)
Other long-term liabilities	—	1,095
Net cash (used in) provided by operating activities	**(20,223)**	**1,776**
Cash flows from investing activities:		
Loans to employees	(1,091)	—
Acquisition of property and equipment	(2,465)	(1,390)
Investment in Shanghai	—	(266)
Investment in marketable debt securities	(54)	—
Net cash used in investing activities	**(3,610)**	**(1,656)**
Cash flows from financing activities:		
Proceeds of common stock	45	2,823
Proceeds from sale of subsidiary stock	11,764	—
Cost of capital raising	—	(215)
Repayment of notes payable and long term liabilities	(18)	(119)
Repayment of line of credit	(64)	—
Proceeds from line of credit borrowings	19,062	2,584
Proceeds from notes receivable	—	320
Net cash provided by financing activities	**30,789**	**5,393**
Effect of exchange rate changes	709	(801)
Net increase in cash and cash equivalents	7,665	4,712
Cash and cash equivalents at beginning of period	**13,381**	**5,186**
Cash and cash equivalents at end of period	$ 21,046	$ 9,898
Supplemental disclosures:		
Interest paid	$ 1,036	$ 829
Offset of notes payable and notes receivable	—	320
Issuance of common stock for service provided or to be provided		437
Taxes paid	466	1,030

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 September 30, 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.

The Company completed its test for goodwill impairment during the second quarter of 2002 and has concluded that a transitional impairment charge from the adoption of SFAS No. 142 is not required. At September 30, 2002 the Company had goodwill of $0.2 million, net of amortization through December 31, 2001.

The following table presents a reconciliation of reported net income and loss and net income and loss per share to adjusted net income and loss and net income and loss per share, as if SFAS No. 142 had been in effect as follows:

(in thousands, except per share amounts)	Three Months Ended September 30, 2002	Three Months Ended September 30, 2001	Nine Months Ended September 30, 2002	Nine Months Ended September 30, 2001
Reported net income (loss)	$ 1,847	$ 663	$ (951)	$ 1,058
Addback: Amortization of goodwill, net of income taxes	—	33	—	98
Adjusted net income (loss)	$ 1,847	$ 696	$ (951)	$ 1,156
Reported income (loss) - basic	$ 0.31	$ 0.12	$ (0.16)	$ 0.20
Addback: Amortization of goodwill, net of income taxes	—	0.01	—	0.02
Adjusted net income (loss) - basic	$ 0.31	$ 0.13	$ (0.16)	$ 0.22
Reported income (loss) - diluted	$ 0.31	$ 0.09	$ (0.16)	$ 0.15
Addback: Amortization of goodwill, net of income taxes	—	—	—	0.01
Adjusted net income (loss) - diluted	$ 0.31	$ 0.09	$ (0.16)	$ 0.16

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 a material impact on our financial position, results of operations or cash flows.

In June 2002, the Financial Accounting Standards Board issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 addresses the timing and amount of costs recognized as a result of restructuring and similar activities. The company will apply SFAS No. 146 to activities initiated after December 31, 2002. The adoption of SFAS No. 146 is not expected to have a material impact on the company's consolidated statements of income or financial position.

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 September 30, 2002	Three Months Ended September 30, 2001	Nine Months Ended September 30, 2002	Nine Months Ended September 30, 2001
Net income (loss)	$ 1,847	$ 663	$ (951)	$ 1,058
Weighted average common shares outstanding (1)	5,882	5,548	5,889	5,218
Dilutive stock options and warrants	—	1,865	—	1,864
Total fully diluted shares	5,882	7,413	5,889	7,082
Basic net income (loss) per share	$ 0.31	$ 0.12	$ (0.16)	$ 0.20
Diluted net income (loss) per share	$ 0.31	$ 0.09	$ (0.16)	$ 0.15

(1) At September 30, 2002 and 2001, 51,000 shares and 1,144,000 shares of common stock in escrow was excluded from the calculation of basic and diluted earnings per share. The common stock in escrow is forfeited and will be excluded from the calculation of earnings per share for future periods.

(2) At September 30, 2002, 1,032,712 shares underlying options and other warrants were excluded from the calculation of the diluted earnings per share because the effect is anti-dilutive.

4. Comprehensive Income (Loss)

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

	Nine Months Ended September 30, 2002	Nine Months Ended September 30, 2001
Net income (loss)	$ (951)	$ 1,058
Cumulative foreign currency translation adjustments	709	(801)
Comprehensive loss	$ (242)	$ 257

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)

	September 30, 2002	December 31, 2001
Inventories:		
Raw materials	$ 29,007	$ 3,772
Work-in-process	16,789	6,464
Finished goods	9,423	1,978
Total inventory	55,219	12,214
Less: inventory reserves	(1,795)	(328)
Net inventory	$ 53,424	$ 11,886

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 September 30, 2002	Nine Months Ended September 30, 2002
Product line:		
DVD products	$ 90,608	$ 154,530
Computer peripherals	343	1,410
Equipment & materials	3	440
Total sales	$ 90,954	$ 156,380

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 and nine months ended September 30, 2002 is as follows:

	Three Months Ended September 30, 2002	Nine Months Ended September 30, 2002
Geographic:		
Domestic	$ 3,027	$ 4,346
Other international countries	87,927	152,034
Total sales	$ 90,954	$ 156,380

During the three months ended September 30, 2002, the Company had no customer which individually accounted for over 10% of sales.

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 December 31, 2001 the OPLI note receivable outstanding was at $2.0 million 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.

At August 4, 2002, the market value of common stock of OPLI shareholders pledged to the Company as security for note receivable, had a market value of $0.8 million resulting in a write down of the note receivable of $0.9 million at May 8, 2002 and an additional $0.3 million at August 4, 2002.

At November 6, 2002, the market value of common stock of OPLI shareholders pledged to the Company as security for note receivable had a market value of $1.25 million resulting in a reduction in the reserve requirement of $0.4 million.

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):

	September 30, 2002	December 31, 2001
Good will	$ 655	$ 655
Intangible assets of acquired businesses	2,400	2,400
Total intangible assets	3,055	3,055
Less: accumulated amortization	(2,231)	(2,042)
	$ 824	$ 1,013

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 September 30, 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 introduction of new products, including anticipated features, functionality and timing thereof, expected impact on our gross margin of such new product introductions, 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 loaders and other Company products, continued availability of working capital as the need to extend credit terms becomes more commonplace, 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

During the three-month period ending September 30, 2002, the Company continued to hold its share of the DVD loader market and has increased revenues by over 70% quarter to quarter and over 50% for the nine-month period year to year. Gross margins for the quarter dropped to 5% of revenues as average unit selling prices for loaders dropped by about 7% from the prior quarter. Margins for the nine-month period were slightly over 6% as average unit selling prices dropped over 25% compared to the comparable period last year. Given this latest round of price reductions the Company can no longer realistically expect double-digit gross margin rates from the DVD loader business. The single chip design is the only significant remaining cost improvement currently contemplated for the existing loader products and should be in production late in the first quarter of next year. Beyond that improvement the Company must continue to obtain component price reductions that are commensurate with declining average selling prices in the loader market if the current rate of gross margin is to be maintained.

Return to double-digit gross margin rates will depend on our timely introduction of new digital video and audio products. As previously announced the Company is currently in development of DVD players for the automotive market and rewriteable DVD drives for the computing and audio markets. The Company currently expects to enter the market for such products in time to participate in the 2003 selling season. The table below summarizes the impact on the Company's financials (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	**2001**	**2002**	**2001**
Revenue	$90,954	$52,879	$156,380	$102,894
Gross profit	4,572	5,379	10,424	12,497
Income (loss) from operations	1,474	2,047	1,110	3,532
Net income (loss)	1,847	663	(951)	1,058

The Company's ownership in DVS Korea in the quarter ending September 30, 2002 remains at 74.6%. In the quarter ending December 31, 2002 it will be reduced to 51.4% reflecting the initial public offering of DVS Korea on the KOSDAQ exchange. Also the Company has a 10% direct ownership in the China Joint Venture (SFDT) and DVS Korea continues to hold its 51% of SFDT.

	Three Months Ended September 30, 2002	Nine Months Ended September 30, 2002
Source of revenue:		
DVSK Korea	$ 58,230	$ 111,260
China Joint Venture (SFDT)	32,381	43,710
US	343	1,410
Total revenue	$ 90,954	$ 156,380

Revenue for the quarter ended September 30, 2002 increased to $91.0 million, up 72% from $52.9 million recorded for the quarter ended September 30, 2001. Gross profit was $4.6 million for the quarter ended September 30, 2002, as compared with $5.3 million in the same quarter last year, reflecting average unit selling price erosion of about 25% in the loader market. Income from operations for the quarter ended September 30, 2002 was $1.5 million, compared with income of $2.0 million in the same quarter of the previous year. Net income in the quarter ending September 30, 2002 was $1.8 million as compared to $0.7 million in the quarter ending September 30, 2001.

Revenues for the nine-month period ended September 30, 2002 increased to $156.4 million, a 52% increase from the $102.9 million recorded for the nine months ending September 30, 2001. Gross profit was $10.4 million for the nine months ended September 30, 2002, as compared to $12.5 million in same period last year due to unit price reductions of approximately 25%. Income from operations for the nine months ended September 30, 2002 was $1.1 million as compared to income from operations of $3.5 million in the like period last year. Net loss of $1.0 million in the nine-month period ending September 30, 2002 as compared to the net income of $1.1 million recorded for the nine-month period ended September 30, 2001.

Working capital at September 30, 2002 was $15.2 million, increased $10.2 million from the December 31, 2001 level of $5 million.

The Three Months Ended September 30, 2002
Compared to the Three Months Ended September 30, 2001

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 September 30, 2002 compared to the like period in 2001. See Condensed Consolidated Statements of Operations.

	Three Months Ended September 30,	
Percent of Revenue	**2002**	**2001**
Revenue	100.0%	100.0%
Gross margin	5.0%	10.2%
Research and development	1.0%	1.7%
Sales and marketing	1.4%	1.6%
General and administration	1.6%	3.0%
Income from operations	1.6%	3.9%
Net income	2.0%	1.3%

	Three Months Ended September 30,		
Consolidated Revenue	**2002**	**2001**	**% Change**
Amount (in thousands)	$ 90,954	$ 52,879	72%

Total revenue increased by $38.0 million, or 72%, for the three months ended September 30, 2002 compared with the three months ended September 30, 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 September 30, 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 September 30, 2002, sales in China were approximately $78.7 million, or 87% of revenue, as compared with $47 million or 89% of revenue for the three months ended September 30, 2001.

Gross Profit	Three Months Ended September 30, 2002	2001	% Change
Amount (in thousands)	$ 4,572	$ 5,379	(15%)
As a percentage of revenue	5.0%	10.2%	

During the three months ended September 30, 2002, gross margin was $4.6 million or 5.0% of revenue, as compared to $5.4 million or 10.2% for the three months ended September 30, 2001. For the quarter ending September 30, 2002, the Company experienced average unit price reductions of 25% in its high volume loader products, as compared to the same period a year ago. Although our cost improvement programs and China Joint Venture have been effective we have not been able to offset the rapid and severe rate of average unit price declines in our DVD loader products. We expect the trend of declining average unit selling prices to continue for the foreseeable future, and if we are unable to obtain corresponding component price reductions for our existing products, or successfully introduce new, higher gross margin products, our results of operations will be harmed.

Research and Development	Three Months Ended September 30, 2002	2001	% Change
Amount (in thousands)	$ 953	$ 923	3%
As a percentage of revenue	1.0%	1.7%	

Research and development expenses consist primarily of personnel and equipment prototype costs required for the Company's product development efforts. We expect to see an increase in R&D spending in absolute dollar terms as we go forward with our new product programs.

Sales and Marketing	Three Months Ended September 30, 2002	2001	% Change
Amount (in thousands)	$ 879	$ 832	6%
As a percentage of revenue	1.0%	1.6%	

Sales and marketing expenses consist primarily of personnel 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 September 30, 2002 increased 6%, as compared with the corresponding quarter of 2001. The spending is expected to increase in absolute dollar terms as we introduce new products utilizing different channels of distribution.

General and Administrative	Three Months Ended September 30, 2002	2001	% Change
Amount (in thousands)	$ 1,266	$ 1,577	(20%)
As a percentage of revenue	1.4%	3.0%	

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 decreased by $0.3 million compared to the comparable quarter last year, which decrease was due primarily to reduction in personnel costs of staff located in the U.S.

Interest Expense	Three Months Ended September 30, 2002	2001	% Change
Amount (in thousands)	$ 625	$ 677	(8%)
As a percentage of revenue	0.7%	1.3%	

Other Income	Three Months Ended September 30, 2002	2001	% Change
Amount (in thousands)	$ 1,503	$ 145	937%
As a percentage of revenue	1.7%	0.3%	

Other income consists principally of exchange rate gains of $1.1 million, a gain of 180% over same period of the prior year. This gain reflects the significant increase in transaction activities from year to year. Also other income of $0.4 million was generated as common stock held by the Company as collateral support of the related party note receivable increased in value during the quarter.

The Nine Months Ended September 30, 2002
Compared with the Nine Months Ended September 30, 2001

The following table sets forth certain income and expense items expressed as a percentage of the Company's total revenue for the nine-month period ended September 30, 2002 compared to the corresponding period in 2001. See Condensed Consolidated Statements of Operations.

Percent of Revenue	Nine Months Ended September 30, 2002	2001
Revenue	100.0%	100.0%
Gross margin	6.7%	12.1%
Research and development	1.7%	2.1%
Sales and marketing	1.3%	2.2%
General and administration	3.0%	4.4%
Income (loss) from operations	0.7%	3.4%
Net income (loss)	(0.6%)	1.0%

In the nine months ended September 30, 2002 we have written down a note receivable from a related party in the amount of $0.7 million and representing 0.5% of revenue. The write down was charged to earnings.

Consolidated Revenue	Nine Months Ended September 30, 2002	2001	% Change
Amount (in thousands)	$ 156,380	$ 102,894	52%

Total revenue increased by $53.5 million, or 52%, for the nine months ended September 30, 2002 compared with the nine months ended September 30, 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 nine months ended September 30, 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 nine months ended September 30, 2002, sales in China were approximately $124.0 million or 79% of revenue.

Gross Profit	Nine Months Ended September 30, 2002	2001	% Change
Amount (in thousands)	$ 10,424	$ 12,497	(17%)
As a percentage of revenue	6.7%	12.1%	

During the nine months ended September 30, 2002, gross margin was $10.4 million or 6.7% of revenue, as compared to $12.5 million, or 12.1% of revenue for the nine months ended September 30, 2001. Despite an effective cost improvement program and the benefits of our China Joint Venture, our gross margin rates have fallen from 12.1 % for the nine-month period ending September 30, 2001 to 6.7 % for the nine-month period ending September 30, 2002. The decline in gross margin rate is due to the severe decline in the average unit selling price of DVD Loaders. For the nine-month period in 2002 compared to the same period in 2001, the average price for DVD loaders have declined by approximately 30%.

Research and Development	Nine Months Ended September 30, 2002	2001	% Change
Amount (in thousands)	$ 2,640	$ 2,134	24%
As a percentage of revenue	1.7%	2.1%	

Research and development expenses consist primarily of personnel and equipment prototype costs required for the Company's product development efforts. Research and development spending during the nine months ended September 30, 2002 increased by $0.5 million, or 24%, over the corresponding period a year ago. This increase of $0.5 million was 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	Nine Months Ended September 30, 2002	2001	% Change
Amount (in thousands)	$ 2,001	$ 2,253	(11%)
As a percentage of revenue	1.3%	2.2%	—

Sales and marketing expenses consist primarily of personnel 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 nine-month period ended September 30, 2002 decreased by $0.3 million, or 11%, as compared with the corresponding period of 2001. As mentioned previously, we expect to increase our Sales & Marketing expenses in absolute dollar terms as we enter new markets in the near future.

General and Administrative	Nine Months Ended September 30, 2002	2001	% Change
Amount (in thousands)	$ 4,673	$ 4,578	2%
As a percentage of revenue	3.0%	4.4%	—

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 during the nine months ended September 30, 2002 increased by $0.1 million or 2% over the corresponding period in 2001 reflecting increased activity in China Joint Venture and DVS Korea.

Interest Expense	Nine Months Ended September 30, 2002	2001	% Change
Amount (in thousands)	$ 1,389	$ 801	73%
As a percentage of revenue	0.9%	0.8%	—

Other Expenses	Nine Months Ended September 30, 2002	2001	% Change
Amount (in thousands)	$ 23	$ 92	(75%)
As a percentage of revenue	0.0%	0.1%	—

Other expenses include the year to date adjustment of the anticipated recovery of the related party note receivable of $0.7 million. Exchange rate gain was $0.7 million in the nine months ended September 30, 2002 as compared to $0.6 million in the nine months ended September 30, 2001. Miscellaneous expenses were $0.4 million this period as compared to $0.9 million in the same period a year ago. Interest income was up $0.2 million over the same period a year ago.

Liquidity and Capital Resources

The Company's Korean subsidiary successfully completed its initial public offering on the KOSDAQ exchange in September 2002 and raised approximately $12 million. The subsidiary management has also been successful in minimizing the previously reported trend to more strenuous credit terms. Given the above coupled with the favorable banking relationships we believe the Company has the necessary funding for future growth of its current products and the development of new proprietary products of the future.

The Company had working capital of $15.2 million at September 30, 2002 as compared to $8.7 million at September 30, 2001.

Net cash used in operating activities was $20.2 million for the nine-month period ended September 30, 2002 as compared with $1.8 million generated in the same period a year ago. Cash was used primarily to fund increased accounts receivable by $10.4 million and build inventories by $41.5 million. The increase in inventory was to meet seasonal demand for the product. Other uses included funding net losses of $1.0 million, decreases in accrued liabilities of $1.0 million, other prepaids and other assets totaling $0.6 million. Cash generated by operating activities was primarily due to the increase in supplier credit totaling $30.6 million and increase in other payable of $0.5 million. Other sources were non-cash charges of $3.2 million which included the write down of a note receivable from related party of $0.7 million, depreciation and amortization of $2.0 million, issuance of common stock for services provided of $0.2 million, and minority interest of $0.3 million.

Net cash used in investing activities was $3.6 million for the nine months ended September 30, 2002 as compared to $1.7 million in the like period a year ago. The monies were used primarily to acquire property and equipment for use in our Asian operations of $2.5 million and loans to employees of $1.1 million.

Net cash provided by financing activities was $30.8 million for the nine months ended September 30, 2002 as compared to $5.4 million for the nine months ended September 30, 2001. The cash provided by financing activities in this period consisted primarily of $11.8 million in proceeds from sale of subsidiary stock and $19.0 million in proceeds from a line of credit.

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 unaudited 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 nine months ended September 30, 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 and future profitability depend 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. The average unit selling price for our DVD loader products has decreased and we expect it to continue to decrease in the foreseeable future. Unless we obtain an equally reduced cost of revenues, our gross margins will continue to decline. Successful development and commercialization of new products is essential to our growth and future profitability. 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 97.2% 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 nine months ended September 30, 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 39 % of our revenues during the nine-month period ended September 30, 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 nine-month period ended September 30, 2002, one customer accounted for 14% 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 revolving loans. We do not use derivative financial instruments in our investment portfolio. Our investments are relatively minor and 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 and market them in 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.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

Our chief executive officer and our chief financial officer, after evaluating our "disclosure controls and procedures" (as defined in Securities Exchange Act of 1934 (the "Exchange Act") Rules 13a-14 (c) and 15-d as of a date (the "Evaluation date") within 90 days before the filing date of this Quarterly Report on Form 10Q have concluded that as of the Evaluation Date, our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

(b) Changes in internal controls.

Subsequent to the Evaluation Date, there were no significant changes in our internal controls or in other factors that could significantly affect our disclosure controls and procedures, nor were there any significant deficiencies or material weaknesses in our internal controls. As a result, no corrective actions were required or undertaken.

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, Pratrap 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. 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. Final settlement is currently being reviewed by all parties and the Company expects no further charges against earnings.

On June 18, 2001, the Company filed a lawsuit in the Santa Clara County Superior Court against Ernst & Young, LLP, the Company's former auditors. The complaint claims professional negligence, breach of contract, breach of fiduciary duty, fraud and deceit. The case was scheduled for mediation in October 2002. Mediation has been postponed pending discussion between all parties. The Company is hopeful it will obtain a favorable outcome to the suit.

On June 24, 2002, the Company filed a lawsuit in the Santa Clara County Superior Court against Mali Kuo, Michael Chen, Meng Tek Ung and Doe's 1 through 50. The complaint claims breach of fiduciary duty, declaratory relief, cancellation of written instruments, rescission and damages. The complaint has been served on Mr. Chen and Ms. Kuo but the Company has not yet been able to serve the other named defendants as they are presently residing outside of the United States. The Company is confident it will obtain a favorable outcome to the suit. As of November 8, 2002, the company has received Mr. Chen's counter claims.

While we have accrued certain amounts for the estimated legal costs associated with 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

99.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(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: November 14, 2002

DIGITAL VIDEO SYSTEMS, INC.

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

/s/ Robert B. Baker
Robert B. Baker
Chief Financial Officer
(PRINCIPAL FINANCIAL OFFICER)

Sarbanes-Oxley Section 302(a) Certification

I, Douglas T. Watson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Digital Video Systems, 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 quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures 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) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

November 14, 2002

____

Douglas T. Watson
Chief Executive Officer

Sarbanes-Oxley Section 302(a) Certification

I, Robert B. Baker, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Digital Video Systems, 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 quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures 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) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

November 14, 2002

Robert B. Baker
Chief Financial Officer

Exhibit 99.1

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

I, Douglas T. Watson, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Digital Video Systems, Inc. on Form 10-Q for the fiscal quarter ended September 30, 2002 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of Digital Video Systems, Inc.

By:________________________________
Name: Douglas T. Watson
Title: Chief Executive Officer

I, Robert B. Baker, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Digital Video Systems, Inc. on Form 10-Q for the fiscal quarter ended September 30, 2002 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of Digital Video Systems, Inc.

By:________________________________
Name: Robert B. Baker
Titles: Chief Financial Officer