SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q/A (Amendment No. 2)

(Mark One)

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

For the quarterly period ended March 31, 2005

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)

357 Castro Street, Suite 5
Mountain View, California 94041
(Address of Principal Executive Offices including Zip Code)

(650) 938-8815
(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 [X] NO [ ]

Indicate by check mark whether the registrant is an accelerated filed (as defined in Rule 12b-2 of the Exchange Act). YES [ ] NO [X]

As of March 31, 2005, there were approximately 1,242,668 shares of the registrant's common stock outstanding.

EXPLANATORY NOTE

This Amendment No. 2 to Form 10-Q for the period ended March 31, 2005 is being filed for the restatement of previously reported quarterly financial information - See: Notes to Condensed Interim Consolidated Financial Statements - Note 16 (Unaudited).

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Digital Video Systems, Inc.
Condensed Consolidated Balance Sheets
(in thousands)

	March 31, 2005 (Restated-Note 16) (Unaudited)	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,393	$ 3,359
Restricted cash	7,667	7,524
Marketable securities	115	166
Accounts receivable, net, less allowance for doubtful accounts of $105 for 2005, and $125 for 2004	2,938	3,168
Accounts receivable - related party, net, less allowance for doubtful accounts of $816 for 2005 and $810 for 2004	642	1,395
Inventories, net	7,862	10,040
Prepaid expenses and other current assets	1,394	1,526
Note receivable - related party	--	341
Total current assets	22,011	27,519
Property and equipment, net	10,252	10,877
Intangibles, net	21	84
Other assets	1,018	803
Total assets	$ 33,302	$ 39,283
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Line of credit	$ 13,479	$ 14,250
Notes payable	3,603	3,604
Accounts payable	8,703	10,467
Accounts payable - related party	--	245
Accrued liabilities (includes $3.4 million settlement with stockholder & current CEO)	7,939	6,124
Total current liabilities	33,724	34,690
Long-term debt	255	238
Total liabilities	33,979	34,928
Minority interest	4,043	4,666
Commitments and contingencies (Note 15)		
Stockholders' equity:		
Preferred stock, $0.0001 par value, 5,000,000 shares authorized; 2,624,012 and 2,738,765 shares issued and outstanding, respectively 3/31/05 and 12/31/04	--	--
Common stock, $0.0001 par value, 30,000,000 shares authorized; 1,242,668 and 1,220,794 shares issued and outstanding, respectively 3/31/05 and 12/31/04	--	--
Additional paid-in capital	83,597	83,427
Accumulated other comprehensive income	2,773	2,668
Accumulated deficit	(91,090)	(86,406)
Total stockholders' equity	(4,720)	(311)
Total liabilities and stockholders' equity	$ 33,302	$ 39,283

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

Digital Video Systems, Inc.
Condensed Consolidated Statements of Operations
(in thousands, except per share amounts)
(Unaudited)

	Three Months Ended March 31,	
	(Restated-Note 16) 2005	2004
Net revenue	$ 11,928	$ 17,522
Cost of revenue	10,749	18,514
Gross profit (loss)	1,179	(992)
Operating expenses:		
Research and development	1,186	1,745
Sales and marketing	794	931
General and administrative	2,221	2,325
Total operating expenses	4,201	5,001
Loss from operations	(3,022)	(5,993)
Interest expense	(207)	(317)
Other income (expense), net	(2,066)	(61)
Loss before minority interest and income taxes	(5,295)	(6,371)
Provision for (benefit from) Income taxes	--	--
Loss before minority interest	(5,295)	(6,371)
Minority interest	716	1,683
Net loss	(4,579)	(4,688)
Dividends on preferred stock	105	--
Net loss available to common shareholders	$ (4,684)	$ (4,688)
Basic and diluted net loss available to common shareholders	$ (3.86)	$ (4.87)
Weighted average common shares and equivalent outstanding	1,212	962

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

Digital Video Systems, Inc.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(Unaudited)

	Three Months Ended March 31, 2005 (Restated-Note 16)	Three Months Ended March 31, 2004
Cash flows from operating activities:		
Net loss	$ (4,579)	$ (4,688)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Gain on disposal of fixed assets	(14)	--
Minority interest	(716)	(1,683)
Depreciation and amortization	789	1,007
Recovery of overestimated bad debt expense	(31)	--
Write down of notes receivable	341	--
Reserve for inventory	(381)	--
Issuance of common stock for services provided	--	129
Amortization of deferred compensation	--	1
Extinguishment of accrued liability in connection with legal settlement	61	--
Stock compensation expense	(38)	--
Noncash interest expense	6	--
Changes in operating assets and liabilities:		
Accounts receivable	250	(2,532)
Accounts receivable - related party	751	255
Inventories	2,560	5,271
Prepaid expenses and other current assets	132	(161)
Other assets	(215)	(356)
Accounts payable	(1,764)	(688)
Accounts payable related party	(245)	(524)
Accrued liabilities	1,750	116
Net cash used in operating activities	(1,343)	(3,853)
Cash flows from investing activities:		
Acquisition of property and equipment	(100)	(885)
Proceeds from the disposal of fixed assets	127	--
Proceeds(purchases) of marketable securities	51	(237)
Decrease (increase) in restricted cash	(143)	441
Net cash used in investing activities	(65)	(681)
Cash flows from financing activities:		
Proceeds from the sale of subsidiary shares	106	2,002
Proceeds from the exercise of options and warrants	--	57
Repayment of line of credit,net	(771)	(2,808)
Proceeds from notes payable	--	3,000
Repayment of notes payable	--	(1,864)
Net cash provided by (used in) financing activities	(665)	387
Effect of exchange rate changes	107	741
Net decrease in cash and cash equivalents	(1,966)	(3,406)
Cash and cash equivalents at beginning of period	3,359	6,444
Cash and cash equivalents at end of period	$ 1,393	$ 3,038
Non-cash financing activity		
Dividends on preferred stock	$ 105	$ --

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

Digital Video Systems, Inc.
Notes to Condensed Interim Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Digital Video Systems, Inc. (the "Company" or "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 consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the interim periods presented. Operating results for the three month period ended March 31, 2005 are not necessarily indicative of the results that may be expected for any other interim period or the full fiscal year ending December 31, 2005. 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, the level of accounts receivable and inventory reserves, and the valuation allowance for deferred tax assets, stock compensation expense, warranty accruals and the valuation of notes receivable. We have identified inventory items which could be surplus to our operational requirements, and believe we have adequately reserved to cover our exposure. However, significant estimation was required in recording inventory at the lower of cost or net realizable value. These estimates could change in the future which could significantly affect the financial statements. Actual results could differ from those estimates.

We have incurred net losses from operations for the last three years and three months ended March 31, 2005, and have an accumulated deficit of $91.1 million and a working capital deficit of $11.7 million at March 31, 2005. Management recognizes the need for an additional infusion of cash within the next quarter. We anticipate that we will acquire additional funding and may sell additional shares of our common or preferred stock through private placements or further public offerings, or we may seek additional credit facilities. The sales of additional equity or convertible securities may result in additional dilution to existing stockholders. If additional funds are raised through the issuance of equity or debt securities, these securities could have rights that are senior to existing stockholders and could contain covenants that would restrict operations. Any additional financing may not be available in amounts or on terms acceptable to the Company, if at all. Additionally, the Company is involved in several outstanding legal matters, and an unfavorable outcome from one or more of these matters could result in a material adverse effect upon the Company's financial position and results of operations. While the Company is aggressively pursuing additional financing, there can be no assurance that the Company will be successful in its efforts to achieve profitable operations, generate sufficient cash from operations or obtain additional funding sources. We have reached an agreement with financing sources to raise capital during the second quarter of 2005 followed by additional tranches through February 2006. There is no assurance, however that the additional capital will be provided in accordance with the amounts, terms and schedule provided by the source. If we do not raise additional capital, we may not be able to meet our financial obligations, and may have to cease or significantly curtail our operations.

Working capital declined from a $7 million deficit at December 31, 2004 to a $11.7million deficit at March 31, 2005. Our total net borrowing with banks in South Korea has been reduced to $13.5, less $7.7 million in restricted cash at March 31, 2005 and further reductions are possible going forward. Moreover, our operations in the United States will require additional funding for 2005 operating requirements. Consequently, an infusion of equity and/or debt subordinate to our existing bank debt will be required to help fund our operations. There is no assurance that we will be able to raise additional capital on acceptable terms or at all.

On April 1, 2005, we were notified by Nasdaq that we had satisfied its listing requirements subject to the condition that the financial statements contained in each of our periodic reports for periods ending on or before March 31, 2006 must evidence shareholders' equity of at least $2.5 million; and that if, during this monitor period, the Company should fail to meet the shareholders' equity requirement, or otherwise fail to satisfy any other requirement for continued listing, the Nasdaq will promptly consider the reasons for such a failure and thereafter render a determination with respect to our continued listing on The Nasdaq SmallCap Stock Market, which could result in the delisting of the Company's securities from The Nasdaq SmallCap Stock Market. As of March 31, 2005 and December 31, 2004, we show a stockholders' deficit of $4.7 million and $0.3 million, respectively and therefore are not in compliance with this shareholders equity requirement.

On July 13, 2005, the Company received a letter stating that the Nasdaq Listing Qualifications Panel had determined to delist the securities of the Company effective as of the open of business on July 15, 2005. The delisting was based on the company's ongoing non-compliance with the Nasdaq's shareholders' equity and filing requirements. The letter stated that the Company had not filed a Form 10Q/A with the required SAS review, nor had it given the Panel any expected filing date, but rather asked the Panel to take no action as the Company completes its review process. The Company requested a review of the Nasdaq's decision and is currently preparing a response to the Nasdaq.

In their report in connection with our 2004 financial statements, our auditors included an explanatory paragraph stating that, because we have incurred significant net losses and as of December 31, 2004 have a net capital deficiency and a working capital deficiency, there is substantial doubt about our ability to continue as a going concern. Our continued existence will depend in large part upon our ability to successfully secure additional financing to fund future operations. In April 2005, we obtained an agreement from a former CEO of the Company to provide up to $25 million of financing in tranches beginning in May 2005 and ending in February 2006. This agreement is still in effect. If this financing is not provided according to the agreement, and if in the future we are not able to achieve positive cash flow from operations or to secure additional financing as needed, we may again experience the risk that we will not be able to continue our operations. If we cannot successfully continue as a going concern, our stockholders may lose their entire investment.

There can be no assurance that we will be able to comply with the quantitative and corporate governance maintenance criteria or any of the other Nasdaq SmallCap Market's rules in the future. If we are delisted, it could have a material adverse effect on the market price of, and the liquidity of the trading market for, our common stock.

2. Recent Accounting Pronouncements

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections" ("SFAS 154") which replaces Accounting Principles Board Opinions No. 20 "Accounting Changes" and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements-An Amendment of APB Opinion No. 28." SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application, or the latest practicable date, as the required method for reporting a change in accounting principle and the reporting of a correction of an error. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005 and is required to be adopted by January 1 in the first quarter ending March 31, 2006.
On March 29, 2005, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the Staff's interpretation of SFAS 123(R). This interpretation expresses the views of the Staff regarding the interaction between SFAS 123(R) and certain SEC rules and regulations and provides the Staff's views regarding the valuation of share-based payment arrangements by public companies. In particular, this SAB provides guidance related to share-based payment transactions with non-employees, the transition from nonpublic to public entity status, valuation methods, the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS 123(R) in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS 123(R), the modification of employee share options prior to adoption of SFAS 123(R) and disclosures in Management's Discussion and Analysis subsequent to adoption of SFAS 123(R). The Company will adopt SAB 107 in connection with its adoption of SFAS 123(R), which could have a material impact on the Company's consolidated financial position, results of operations and cash flows.

In December 2004 the FASB issued SFAS No.123 (revised 2004), "Share-Based Payment". SFAS No. 123(R) will provide investors and other users of financial statements with more complete and neutral financial information by requiring that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. SFAS No.123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans. SFAS No.123(R) replaces FASB SFAS No.123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No.123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, FASB No. 123 permitted entities the option of continuing to apply the guidance in Opinion No. 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. Originally public entities (other than those filing as small business issuers) would have been required to apply SFAS No. 123(R) as of the first interim or annual reporting period that begins after June 15, 2005. On April 14, 2005, the Securities and Exchange Commission (SEC) announced a delay of up to six months in the effective date of the option-expensing requirements set forth in SFAS No. 123(R). For public companies with less than $25 million in revenues, the new effective date for compliance with SFAS No. 123(R) is the first quarter of their first fiscal year beginning after December 15, 2005. We are still evaluating the transition provisions allowed by SFAS No. 123(R) which could have a material impact on the Company's consolidated financial position, results of operations and cash flows.

In April 2004, the Emerging Issues Task Force issued Statement No. 03-06, ("EITF 03-06"), *Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings Per Share*. EITF 03-06 which addresses a number of questions regarding the computation of earnings per share by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the company when, and if, it declares dividends on its common stock. EITF 03-06 also provides further guidance in applying the two-class method of calculating earnings per share, clarifying what constitutes a participating security and how to apply the two-class method of computing earnings per share once it is determined that a security is participating, including how to allocate undistributed earnings to such a security. EITF 03-06 was effective for fiscal periods beginning after March 31, 2004. The adoption of EITF 03-06 did not have a material effect on the Company's results of operations or financial position.

In November 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4". The amendments made by SFAS No. 151 clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current period charges and require the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The guidance is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years beginning after November 23, 2004. We have evaluated the impact of the adoption of SFAS No. 151, and do not believe the impact will be significant to the Company's overall results of operations or financial position.

In December 2004, the FASB issued SFAS No.153, "Exchanges of Non-monetary Assets, an amendment of APB Opinion No. 29, Accounting for Non-monetary Transactions." The amendments made by SFAS No.153 are based on the principle that exchanges of non-monetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for non-monetary exchanges of similar productive assets and replace it with a broader exception for exchanges of non--monetary assets that do not have commercial substance. Previously, APB Opinion 29 required that the accounting for an exchange of a productive asset for a similar productive asset or an equivalent interest in the same or similar productive asset should be based on the recorded amount of the asset relinquished. APB Opinion 29 provided an exception to its basic measurement principle (fair value) for exchanges of similar productive assets. The Board believes that exception required that some non-monetary exchanges, although commercially substantive, be recorded on a carryover basis. By focusing the exception on exchanges that lack commercial substance, the FASB believes the SFAS No. 153 produces financial reporting that more faithfully represents the economics of the transactions. The SFAS No. 153 is effective for non-monetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for non-monetary asset exchanges occurring in fiscal periods beginning after the date of issuance. The provisions of the SFAS No. 153 shall be applied prospectively. We have evaluated the impact of the adoption of SFAS No.153, and do not believe the impact will be significant to the Company's overall results of operations or financial position.

In December 2004 the FASB issued two Staff Positions—FSP FAS 109-1, Application of FASB Statement 109 "Accounting for Income Taxes" to the Tax Deduction of Qualified Production Activities Provided by the American Jobs Creation Act of 2004, and FSP FAS 109-2 "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004." Neither of these affected the Company as it does not participate in the related activities.

3. Accounting for Stock-Based Compensation

We account for stock-based employee compensation using the intrinsic value method under APB Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations and comply with the disclosure provisions of SFAS No. 148, "Accounting for Stock-Based Compensation, Transition and Disclosure - an Amendment of SFAS Statement No. 123".

The following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" to stock based compensation (in thousands, except per share amount).

	Three Months Ended March 31,	
	2005	2004
Net loss available to common shareholders	$ (4,684)	$ (4,688)
Add: Stock-based compensation, as reported	--	1
Deduct: Total stock-based compensation determined under fair value based method for all awards	(91)	(126)
Adjusted net loss, fair value method for all stock-based awards	$ (4,775)	$ (4,813)
Basic and diluted loss per share - as reported	$ (3.86)	$ (4.87)
Basic and diluted loss per share - pro forma	$ (3.94)	$ (5.00)

The fair value for each option granted was estimated at the date of grant using a Black-Scholes option-pricing model, assuming no expected dividends and the following weighted average assumptions:

	Three Months Ended March 31,	
	2005	2004
Weighted average risk-free interest rates	4.03%	1.8%
Average expected life (in years)	3.0	3.0
Volatility	102%	155%

There were no grants of stock awards during the three months ended March 31, 2005. The weighted average grant date fair value of stock awards granted during the three months ended March 31, 2004 was $0.86 per share.

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

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Net loss available to common shareholders	$ (4,684)	$ (4,688)
Weighted average common shares outstanding(1)	1,237	987
Weighted average unvested restricted stock(1)	(25)	(25)
Weighted average common shares outstanding - basic(1)	1,212	962

(1) At March 31, 2005 and 2004, 559,478 and 536,228 shares underlying options and warrants, respectively, were excluded from the calculation of the diluted earnings per share calculation because the effect is anti-dilutive.

5. Comprehensive Loss

The components of comprehensive loss available to common shareholders, net of tax, are as follows (in thousands):

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Net loss available to common shareholders	$ (4,684)	$ (4,688)
Cumulative foreign currency translation adjustments	105	381
Comprehensive loss available to common shareholders	$ (4,579)	$ (4,307)

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

6. Balance Sheet Components

Inventories consisted of the following (in thousands):

	March 31, 2005	December 31, 2004
Inventories:		
Raw materials	$ 6,505	$ 9,200
Work-in-process	2,991	3,114
Finished goods	1,793	1,534
Total inventory	11,289	13,848
Less inventory reserves	(3,427)	(3,808)
Net inventory	$ 7,862	$ 10,040

Intangible assets consisted of the following (in thousands):

	March 31, 2005	December 31, 2004
Intangible assets of acquired businesses	$ 2,400	$ 2,400
Less: accumulated amortization	(2,379)	(2,316)
	$ 21	$ 84

7. Geographic Information

We operate in one business segment, which includes developing, producing and marketing digital video systems and sub-assemblies.

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 is as follows (in thousands):

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Geographic:		
Domestic	$ 540	$ 449
Asia	10,127	14,599
Europe	1,046	1,322
Other international countries	215	1,152
Total sales	$ 11,928	$ 17,522

8. Warranty Accrual

We generally warrant our products for a specific period of time against material defects. We provide for the estimated future costs of warranty obligations in costs of goods sold when the related revenue is recognized. The accrued warranty costs represent the best estimate at the time of sale of the total costs that the Company expects to incur to repair or replace product parts which fail while still under warranty. The amount of accrued estimated warranty costs is primarily based on historical experience as to product failures as well as current information on repair costs. The following table reflects the change in the Company's warranty accrual during the three months ended March 31, 2005 and March 31, 2004, respectively (in thousands):

	March 31, 2005	March 31, 2004
Warranty accrual, beginning of period	$ 28	$ 54
Charged to g & a expense	5	--
Actual warranty expenditures	--	--
Warranty accrual, end of period	$ 33	$ 54

9. Concentration of Certain Risks

We are subject to the risks associated with similar technology companies. These risks include, but are not limited to: history of operating losses, dependence on a limited number of key employees, customers and suppliers, competition from larger and more established companies, the impact of rapid technological changes and changes in customer demand and requirements.

Revenues from significant customers, those representing approximately 10% or more of total revenues, are summarized as follows:

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Customer A	*	22%
Customer B	*	18%
Customer C	*	16%
Customer D	*	11%
Customer E	11%	*
Customer F	10%	*

(* = less than 10%)

Ellion Digital, Inc., a company in which certain of the employees, officers and directors of the Company's subsidiary in Korea have a significant ownership interest, accounted for approximately 8% and 22% of the Company's total revenue for the three months ended March 31, 2005 and 2004, respectively. Ellion

Digital, Inc. comprised 18% of the combined total of accounts receivable and accounts receivable from a related party at March 31, 2005.

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 including Zoran, Mediatech, Philips and Hitachi. We anticipate that these suppliers will manufacture sufficient quantities of these key components to meet our production requirements. If these suppliers fail to satisfy the Company's 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 the Company's operating results. Any constraints on worldwide manufacturing capacity of these key components may affect our ability to obtain adequate supplies from these manufacturers.

10. Equity

Common Stock

In January 2004, we sold 121,212 shares of our common stock to a group of purchasers for $16.50 per share. The gross proceeds were approximately $2.0 million. The proceeds were used for general corporate purposes and the initial funding of DVS Electronics, Pvt. Ltd., ("DVSE"), the Company's subsidiary in India which was formed in 2003.

In April 2004, investors exercised outstanding warrants for 53,186 shares of common stock resulting in net proceeds of approximately $0.6 million. The warrants were originally issued in a July 2003 financing and were temporarily repriced to $12.50 per share from the original exercise price of $28.00 in order to induce the exercise. We used the proceeds from the warrant exercise for general corporate purposes. In connection with the warrant repricing we incurred a warrant modification charge of $0.2 million in the second quarter of 2004.

In July 2004, we reached a settlement concerning legal fees we owed to a law firm by issuing 33,500 shares of our common stock. The stock had a fair market value on the settlement date of $0.3 million, resulting in a $0.3 million gain on the settlement. In September and October 2004, we issued 11,961 shares of common stock to the same law firm as payment of $0.1 million due the law firm. In September 2004, we issued 22,000 shares of common stock to another of the Company's law firms as partial payment of amounts due the law firm. We extinguished $0.1 million of legal fees owed to the law firm based on a fair market value of $6.30 per share on the date of issuance. DVS and the law firm adjusted the number of shares as of the effective date of the registration statement covering the resale of the shares so that the aggregate fair market value of the shares issued as of that date equaled the $0.2 million obligation due the law firm as per the agreement. In November 2004, we issued an aggregate of 35,246 shares of our common stock and warrants to purchase an additional 7,189 shares of our common stock to two former employees of the Company in settlement of all claims relating to litigation for claimed compensation earned in prior years. The aggregate value of this settlement was $0.2 million, and because accrual for this liability had been entered in 2002 there was no effect on our financial statements in 2004 from this transaction.

On February 8, 2005 we amended our Amended and Restated Certificate of Incorporation to affect a 1-for-10 reverse split of the outstanding shares of common stock, effective on February 9, 2005.

In April 2005 we reached a settlement of a $3.4 million judgment awarded to Mali Kuo, our former CEO. In lieu of cash the terms of settlement include the issuance of 8% preferred stock to creditors of Mali Kuo and the issuance of one year warrants for 100,147 shares of common stock exercisable at $4.50 per share. In connection with the settlement we agreed to register with the SEC the 1,001,470 shares of common stock (@ a share price of $3.34) assumable upon the conversion of the 8% preferred stock. The preferred stock automatically converts to 1,001,470 shares of common stock when the SEC declares the registration statement effective.

Preferred Stock

In September 2004, we entered into an agreement with the owner of 550,000 common shares of DVS Korea Co. Ltd., the Company's principal subsidiary ("DVSK"). The 550,000 shares represented a 2.62% ownership interest in DVSK. Under the terms of the agreement, the investor transferred its entire interest in DVSK to the Company in exchange for 396,722 shares of the Company's 8% Series C Convertible Preferred Stock (the "Preferred Stock") and warrants to purchase an additional 19,836 shares of its common stock. Our ownership interest in DVSK would have increased from 51.14% to 53.76% as a result of the exchange. In connection with the purchase, we incurred a loss of $0.1 million. In December 2004, the owner reported to the Company that they were unable to transfer the shares to the Company. Instead, the owner sold the DVSK shares on the Kosdaq market and remitted the $0.2 million of proceeds to the Company. Accordingly, the Company's ownership interest in DVSK reverted back to 51.14%. In December 2004, the 396,722 shares of the Company's 8% series C convertible preferred were converted to 39,672 shares of the company's common stock.

In September 2004, we raised approximately $1.1 million in net proceeds. In connection with this transaction, we issued 2,081,964 shares of 8% Series C Convertible Preferred Stock and 104,098 Class A Warrants ("Class A Warrants") to purchase shares of common stock. In addition, the investors received warrants entitling them to purchase an additional 50% of the number of Preferred Stock and Class A Warrants they had originally purchased, (the "Green Shoe Warrants"). The Class A Warrants are exercisable for five years at an exercise price of $6.10, subject to adjustment. In the event any Preferred Stock remains outstanding on September 20, 2007, the Company will issue a five-year Class B warrant for 50% of the number of shares into which the then-outstanding Preferred Stock is then convertible, also exercisable at $6.10 per share. The Preferred Stock will automatically convert into common stock in the event the Company's common stock trades at or above $12.20 per share for 20 consecutive trading days. We may redeem the Preferred Stock at various prices beginning at $.82 per share and at decreasing prices thereafter. In connection with the warrants issued on this financing, the Company incurred $0.5 million for the beneficial conversion feature which amount will be accreted as a preferred stock dividend using the interest method over the life of the instrument.

In December 2004, six investors exercised the Green Shoe Warrants and acquired 738,768 shares of Preferred Stock and 73,877 Class A Warrants (collectively, the Preferred Stock and Class A Warrants are referred to as the "Units" or the "Securities"). Each Unit consisted of one share of Preferred Stock and 50% warrant coverage. The consideration paid for the Securities was $0.61 per Unit (the "Purchase Price"), for aggregate gross proceeds of $450,648 to DVS. The Class A Warrants are exercisable for five years at an exercise price of $6.10, subject to adjustment. In the event any Preferred Stock remains outstanding on September 20, 2007, we will issue a five-year Class B warrant for 50% of the number of shares of common stock into which the then-outstanding Preferred Stock is then convertible, also exercisable at $0.61 per share. The Preferred Stock will automatically convert into common stock in the event our common stock trades at or above 200% of the $6.10 Purchase Price for 20 consecutive trading days. We may redeem the Preferred Stock at various prices beginning at 135% of the Purchase Price and at decreasing prices thereafter.

On January 31, 2005, two shareholders converted 114,753 shares of the Company's convertible preferred stock to 11,475 shares of its common stock.

11. Legal Matters

From time to time the Company is a party to various legal proceedings arising in the ordinary course of its business. The outcome of any pending legal matters may have a material adverse effect on the Company's business, operating results or financial condition.

Former Officer Litigation

On May 24, 2005, pursuant to the terms of the settlement agreement with Mali Kuo, the Board of Directors elected Ms. Kuo's nominees, Mali Kuo, Jeff Bumb and Bruce Breslow, to the Board. The Board now consists of seven members. On the same date, the Board of Directors elected Mali Kuo to serve as the Company's Chief Executive Officer and Chairman of the Board. Ms. Kuo replaced Thomas A. Spanier, the Company's former Chairman and CEO. Mr. Spanier remains a member of the Board of Directors. During the meeting, the Board also elected Shaun Kang to serve as President of DVS. Shortly thereafter, Dean Clarke Seniff was appointed to serve as our Chief Financial Officer.

On April 29, 2005, we announced that we had reached a settlement of litigation involving our former chief executive officer, Mali Kuo. Under the terms of the settlement agreement with Mali Kuo, we have been directed by Ms. Kuo to issue an aggregate of 100,147 shares of Series D convertible preferred stock (the "Series D Preferred Stock") to 28 persons and a warrant to purchase 100,148 shares of common stock to one holder. We also have entered into a consulting agreement in conjunction with the settlement agreement wherein we have agreed to issue 11,291 shares of Series D Preferred Stock to two persons, as directed by

Ms. Kuo. The Series D Preferred Stock bears an 8% dividend and each share is convertible, at the option of the holder, into ten shares of DVS common stock. Consequently, the 100,147 shares of Series D Preferred Stock will convert into 1,001,470 shares of our common stock. The Series D Preferred Stock will be issued at an effective price of $34.30, or $3.43 per converted share of common stock. The warrants are exercisable for one year at an exercise price of $4.50 per share.

At the time we entered into the settlement agreement with Mali Kuo, we also entered into a separate financing agreement with Ms. Kuo. Under the terms of this financing agreement, Ms. Kuo has agreed to initially raise $3.42 million by the later of June 30, 2005 or the settlement of pending litigation involving OPLI, IDVD and Mr. Kent Yu. As of August 3, 2005, we had received a total of $550,000 from two accredited investors for the issuance of 16,035 shares of Series D Preferred Stock and 16,035 warrants to purchase shares of common stock. The investment was made at a price of $34.30 per share of Series D Preferred Stock, or $3.43 per converted share of common stock. The 16,035 shares of Series D Preferred Stock convert on a ten for one basis into 160,350 shares of our common stock. The warrants are exercisable for one year at an exercise price of $4.50 per share.

The Series D Preferred Stock and warrants to be issued to as part of the settlement and the initial financing are being issued pursuant to the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended. We have agreed to file a registration statement with the SEC to register for resale the shares of common stock issuable upon conversion of the Series D Preferred Stock and the shares of common stock issuable upon exercise of the warrants issued in these transactions. The Series D Preferred Stock shares automatically convert into shares of common stock at the time the SEC declares the registration statement registering such shares effective.

In connection with the April 29, 2005 settlement with Mali Kuo, the Company agreed that it would enter into binding arbitration with Kent Yu, OPLI and IDVD and Ms. Kuo agreed to use her best efforts to cause Kent Yu, OPLI and IDVD to enter into binding arbitration with the Company within 30 days. The parties agree that any award payable by the Company shall be paid with common stock and warrants, net of any offsetting award to the Company.

On February 1, 2005, the jury in the Mali Kuo litigation rendered a verdict against the Company finding that Ms. Kuo had a series of binding agreements with the Company and that she was entitled to approximately $2,670,000. On February 4, 2005, the judge entered the verdict, but stayed its enforcement for 70 days. On March 7 and 8, 2005, the judge heard the Company's motions for a new trial, a judgment notwithstanding the verdict ("JNOV") and equitable estoppel. On April 4, 2005 the judge denied the Company's motions. We filed an appeal on April 5, 2005. On April 8, 2005 the court entered a judgment against DVS totaling $3,420,000 including all fees, costs and interest. The entire liability was reserved in the financial statements for the fiscal year ended December 31, 2004. On April 29, 2005 we announced that we had reached an agreement with Mali Kuo to settle her $3.42 million judgment against the Company (See paragraph 3 of this Note 11).

On June 24, 2002, the Company filed a lawsuit in the Superior Court of California, County of Santa Clara, against Mali Kuo, Michael Chen and Meng Tek Ung, former officers, directors and employees of the Company. Subsequently, former employees D.K. Lu and Jia-Hong Zang were added as defendants. The lawsuit included causes of action for breach of fiduciary duties, negligent performance of employment duties and breach of employment contracts. The defendants filed cross claims against the Company seeking compensation they alleged was due to them under their employment agreements. In 2002, the Company established a reserve of $0.7 million for wages and expenses related to the compensation claims of Mali Kuo and the other former employees. In December 2004 and January 2005, the Company settled all claims with Michael Chen, D.K. Lu and Ming Tek Ung for 47,739 shares of common stock, warrants to acquire 7,189 shares of common stock at $6.10 per share and $58,750 in cash payments. The aggregate value of these settlements was $0.3 million. In April 2005, we settled with Jia-Hong Zang for an aggregate of 30,000 shares of common stock.

OPLI Litigation

In August 2004, the Company filed a lawsuit against Oregon Power Lending Institute ("OPLI") in the Superior Court of California, County of Santa Clara, seeking to collect on a promissory note issued by OPLI (the "OPLI Note") in connection with the purchase of certain assets of the Company. The face amount of the OPLI Note was $3.45 million, and it was secured by a pledge of 86,250 shares of the Company's common stock, some of which was released upon partial payment of the note. After making payments on the OPLI Note, OPLI stopped payments, leaving a balance outstanding of approximately $1,974,000 secured by 54,194 shares of the Company's common stock. In our lawsuit we are seeking collection of the note and accrued interest. The OPLI lawsuit was settled on June 29, 2005, and was approved by the Board of Directors on July 14, 2005. The suit was settled for 33,000 shares of DVSI common stock at $3.43 per share plus 15,000 common shares warrants with a conversion price of $4.50. The agreement specifies that the warrants would expire on the last trading day of 2005. The aggregate value of the settlement was less than $0.1 million. The note is carried on the Company's books at the market value of the collateral which was $123,000 as of March 31, 2005.

IDVD and Kent Yu Litigation

On October 29, 2004, the Company was named in a lawsuit filed by IDVD, Inc. in the Superior Court of California, County of Santa Clara, alleging that the OPLI Note had been assigned by the Company to IDVD as partial consideration for the purchase of a Chinese subsidiary of IDVD by the Company. IDVD is seeking the sum of $2.51 million, which it asserts is owed by the Company in connection with the purchase of the IDVD Chinese subsidiary. On February 17, 2005, Kent Yu filed a lawsuit against the Company and DVS Korea in the Superior Court of California, County of Santa Clara. Mr. Yu alleges that he is the assignee of the equipment which had been allegedly sold by OPLI (who has been sued by the Company for non payment of the note) to DVS Korea in December 2000 for $600,000 and had not received payment. The IDVD and Kent Yu lawsuits were settled on June 29, 2005, and were approved by the Board of Directors on July 14, 2005. The suits were settled jointly for 710,000 shares of DVSI common stock at $3.43 per share plus 200,000 common share warrants with a conversion price of $4.50. The agreement specifies that the warrants would expire on the last trading day of 2005. The aggregate value of the settlement is approximately $2.0 million.

In March 2004, the former CEO of the Company's Korean subsidiary, DVSK, obtained in Korea an ex-parte writ of attachment on approximately $1 million of the stock we own in DVSK. The former CEO sought the writ of attachment based on claims for his salary for the remaining term of his employment agreement with DVSK and severance payments allegedly due to him. We denied any obligation for DVSK or the Company to pay such salaries or severance to the former CEO. In October 2004, we initiated a legal action to cancel the writ of attachment. On March 29, 2005, the Seoul High Court cancelled the attachment. In April the former CEO filed a last appeal to the Supreme Court to overturn the Seoul High Court's decision. We are not aware at this time whether the former CEO will commence any legal action for the claimed severance payments in connection with this writ of attachment.

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While the Company has accrued certain amounts for the estimated settlement 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 the Company's 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 losses associated with the resolution of these contingencies.

12. Notes Payable and Line of Credit

We repaid $1.0 million on our line with our Korean banks in the first quarter, reducing the amount outstanding under the line to $13.5 million. The total borrowing as of March 31, 2005 with these South Korean banks was $13.5 million, less the 7.7 million in restricted cash, though such lines are subject to significant discretion on the part of lenders. As of April 11, 2005, borrowing limits were 18 million and the expiration date has been extended to October 2005. However, unless restricted cash amounts are increased the Company is limited to $13.5 million in borrowings. On April 11, 2005 the Company was notified that the lines had been reduced by $3.0 million. These reductions are due to the adverse effects of changes in the Korean banking environment, coupled with the lenders' concerns over DVSK's losses. During the third quarter of 2004, DVSK pledged its building facility in Korea to one of the Korean banks as additional collateral. In July 2004, SFDT obtained two loans from a Chinese bank for $1.8 million each. The loans are collateralized by the Company's facility in China and have a one-year term with interest at LIBOR plus 0.7%. These loans come due in July 2005; currently there is no alternative source of funding and the company risks foreclosure on the collateralized asset. In September 2004, the Company obtained a $0.3 million loan due in two years at 8% interest from a United States institution. We also issued a warrant for 30,000 shares to this creditor.

13. Amendment to Certificate of Incorporation

On February 8, 2005 we amended our Amended and Restated Certificate of Incorporation to affect a 1-for-10 reverse split of the outstanding shares of common stock, effective on February 9, 2005. All shareholders equity including, number of shares, weighted average shares, per share amount and option activity for all periods presented have been restated to give retroactive recognition to the stock split.

14. Subsequent Events

On April 14, 2005 the Company sold 300,000 shares of the 500,000 shares of Enmedia Inc. Series A Preferred Stock which it owned. The selling price was $.52 per share, which resulted in a loss to the Company of $144,000.

OPLI Litigation

In August 2004, the Company filed a lawsuit against Oregon Power Lending Institute ("OPLI") in the Superior Court of California, County of Santa Clara, seeking to collect on a promissory note issued by OPLI (the "OPLI Note") in connection with the purchase of certain assets of the Company. The face amount of the OPLI Note was $3.45 million, and it was secured by a pledge of 86,250 shares of the Company's common stock, some of which was released upon partial payment of the note. After making payments on the OPLI Note, OPLI stopped payments, leaving a balance outstanding of approximately $1,974,000 secured by 54,194 shares of the Company's common stock. In our lawsuit we are seeking collection of the note and accrued interest. The OPLI lawsuit was settled on June 29, 2005, and was approved by the Board of Directors on July 14, 2005. The suit was settled for 33,000 shares of DVSI common stock at $3.43 per share plus 15,000 common shares warrants with a conversion price of $4.50. The agreement specifies that the warrants would expire on the last trading day of 2005. The aggregate value of the settlement was less than $0.1 million. The note is carried on the Company's books at the market value of the collateral which was $123,000 as of March 31, 2005.

IDVD and Kent Yu Litigation

On October 29, 2004, the Company was named in a lawsuit filed by IDVD, Inc. in the Superior Court of California, County of Santa Clara, alleging that the OPLI Note had been assigned by the Company to IDVD as partial consideration for the purchase of a Chinese subsidiary of IDVD by the Company. IDVD is seeking the sum of $2.51 million, which it asserts is owed by the Company in connection with the purchase of the IDVD Chinese subsidiary. On February 17, 2005, Kent Yu filed a lawsuit against the Company and DVS Korea in the Superior Court of California, County of Santa Clara. Mr. Yu alleges that he is the assignee of the equipment which had been allegedly sold by OPLI (who has been sued by the Company for non payment of the note) to DVS Korea in December 2000 for $600,000 and had not received payment. The IDVD and Kent Yu lawsuits were settled on June 29, 2005, and were approved by the Board of Directors on July 14, 2005. The suits were settled jointly for 710,000 shares of DVSI common stock at $3.43 per share plus 200,000 common share warrants with a conversion price of $4.50. The agreement specifies that the warrants would expire on the last trading day of 2005. The aggregate value of the settlement is approximately $2.0 million.

15. Commitments and Contingencies

The Company leases its facilities and certain office equipment under non-cancelable leases that require the Company to pay operating costs, including property taxes, insurance and maintenance. Future minimum lease payments under these operating leases at March 31, 2005 are as follows (in thousands):

	Amount
2005	$ 488
2006	255
2007	12
2008	--
2009	--
Thereafter	--
	$ 755

Rent expense charged to operations was approximately $0.2 million each for the quarters ended March 31, 2005 and 2004.

16. Restatement of Previously Reported Quarterly Financial Information

The Form 10-Q for the quarter ended March 31, 2005 filed on May 23, 2005 had originally been filed without the completion of review by our auditors. Subsequently, certain errors were discovered and corrected in this amended filing. As a result of these errors certain information previously reported in the Company's Form 10-Q for the quarter ended March 31, 2005 previously filed was restated. The restated financial information is unaudited.

The following table provides a reconciliation of amounts previously reported in the Company's Form 10-Q for the quarter ended March 31, 2005 with amounts adjusted for the restatement. In reviewing the restated Consolidated Statement of Operations for the three months ended March 31, 2005, Consolidated Balance Sheet at March 31, 2005, and the Condensed Consolidated Statements of Cash Flow for the three months ended March 31, 2005; it should be taken into consideration that the restated financial information reflects unaudited adjustments.

Restated Condensed Consolidated Statement of Operations

	For the Three Months Ended March 31, 2005 (Unaudited)					
	Previously Reported (1)	Restatement Adjustment			Restated Total	
Net revenue	$ 11,928	$ --			$ 11,928	
Cost of revenue	10,749				10,749	
Gross profit	1,179	--			1,179	
Operating expenses:						
Research and development	1,186				1,186	
Sales and marketing	794				794	
General and administrative	2,259	(38)	(2)		2,221	
Total operating expenses	4,239	(38)			4,201	
Loss from operations	(3,060)	38			(3,022)	
Interest expense	(207)				(207)	
Other (income) expense, net	(52)	(2,014)	(4)		(2,066)	
Loss before minority interest and income taxes	(3,319)	(1,976)			(5,295)	
Provision for (benefit from) income taxes	--				--	
Loss before minority interest	(3,319)	(1,976)			(5,295)	
Minority interest	716				716	
Net Loss	(2,603)	(1,976)			(4,579)	
Dividends on preferred stock	--	105	(3)		105	
Net loss available to common shareholders	$ (2,603)	$ (2,081)			$ (4,684)	
Basic and diluted net loss available to common shareholders	$ (2.15)	$ (1.71)			$ (3.86)	
Weighted average common shares and equivalent outstanding	1,212				1,212	

(1) As previously reported in the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2005.
(2) Reflects previously unrecorded consultants' stock compensation expense credit of $ 38,148.
(3) Correction of error, preferred dividend previously recorded as expense.
(4) Reflects the OPLI and IDVD and Kent Yu Settlement on June 29, 2005 and approved by the BOD on July 14, 2005.

Restated Condensed Consolidated Balance Sheets

	March 31, 2005 (Unaudited)		
	Previously Reported (1)	Restatement Adjustment	Restated Total
Assets			
Current Assets:			
Cash & cash equivalents	$ 1,393	$ --	$ 1,393
Restricted cash	7,667	--	7,667
Marketable securities	115	--	115
Accounts receivable, net	2,938	--	2,938
Accounts receivable - related party, net	642	--	642
Inventory, net	7,862	--	7,862
Prepaid expenses and other current assets	1,394	--	1,394
Note receivable - related party	123	(123) (4)	--
Total current assets	22,134	(123)	22,011
Property and equipment, net	10,252	--	10,252
Intangible, net	21	--	21
Other assets	1,018	--	1,018
Total assets	$ 33,425	$ (123)	$ 33,302
Liabilities & Stockholders' Equity:			
Current Liabilities:			
Line of credit	$ 13,479	$ --	$ 13,479
Note payable	3,603	--	3,603
Accounts payable	8,703	--	8,703
Accounts payable - related party	--	--	--
Accrued liabilities	6,041	1,898 (2)(4)	7,939
Total current liabilities	31,826	1,898	33,724
Long-term Liabilities:			
Long-term debt	255	--	255
Total liabilities:	32,081	1,898	33,979
Minority interest liability	4,043	--	4,043
Stockholders' Equity:	--	--	--
Preferred stock	--	--	--
Common stock	--	--	--
Additional paid-in capital	83,635	(38) (3)	83,597
Accumlated other comprehensive income	2,773	--	2,773
Accumulated deficit	(89,107)	(1,983)	(91,090)
Total stockholders' equity	(2,699)	(2,021)	(4,720)
Total liabilities and stockholders' equity	$ 33,425	$ (123)	$ 33,302

(1) As previously reported in the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2005.
(2) Reflects an additional preferred stock dividend accrual of $ 7,500.
(3) Reflects previously unrecorded consultant stock compensation expense credit of $ 38,148
(4) Reflects the OPLI and IDVD and Kent Yu Settlement on June 29, 2005 and approved by the BOD on July 14, 2005.

Restated Condensed Consolidated Statement of Cash Flows

	For the Three Months Ended March 31, 2005 (Unaudited)		
	Previously Reported (1)	Restatement Adjustment	Restated Total
Cash flow from operating activities:			
Net loss	$ (2,603)	$ (1,976) (2)	$ (4,579)
Adjustment to reconcile net loss to net cash provided by (used in) operating activities:			
Gain from disposal of fixed assets	(14)	--	(14)
Minority interest	(716)	--	(716)
Depreciation and amortization	789	--	789
Recovery of overestimated bad debt allowance	(31)	--	(31)
Write down of notes receivable	218	123 (5)	341
Reserve for inventory	(382)	1 (3)	(381)
Issuance of common stock for services provided	--	--	--
Amortization of deferred compensation	--	--	--
Extinguishment of accrued expenses in connection with legal settlement	61	--	61
Stock compensation expense	--	(38) (4)	(38)
Non-cash interest expense	5	1 (3)	6
Changes in operating assets and liabilities:			
Accounts receivable	250	--	250
Accounts receivable-related parties	751	--	751
Inventories	2,560	--	2,560
Prepaid expenses and other current assets	132	--	132
Other assets	(215)	--	(215)
Accounts payable	(1,763)	(1) (3)	(1,764)
Accounts payable- related parties	(245)	--	(245)
Accrued liabilities	(140)	1,890 (5)	1,750
Net cash used in operating activities	(1,343)	--	(1,343)
Cash flows from investing activities:			
Acquisition of property and equipment	(100)	--	(100)
Proceeds from the disposal of fixed assets	127	--	127
Proceed from sale of marketable securities	51	--	51
Decrease in restricted cash	(143)	--	(143)
Net cash used in investing activities	(65)	--	(65)
Cash flow from financing activities:			
Proceeds from the sale of subsidiary shares	106	--	106
Repayment of line of credit	(771)	--	(771)
Net cash provided by financing activities	(665)	--	(665)
Effect of exchange rate changes	107	--	107
Net decrease in cash and cash equivalents	(1,966)	--	(1,966)
Cash and cash equivalents at beginning of period	3,359	--	3,359
Cash and cash equivalents at end of period	$ 1,393	$ --	$ 1,393
Non-cash financing activity:			
Dividends on Preferred Stock	$ --	$ 105	$ 105

(1) As previously reported in the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2005.
(2) Refer to adjustments #2 and #4 to Restated Condensed Consolidated Statement of Operations.
(3) Rounding
(4) Refer to adjustment #3 to Restated Condensed Consolidated Balance Sheets
(5) Reflects OPLI and IDVD and Kent Yu Litigation Settlement on June 29, 2005 and approved by the BOD on July 14, 2005.

Additional changes were made to:

Notes to Condensed Interim Consolidated Financial Statements, #12, Notes Payable and Line of Credit were changed. In the second sentence of Note 12, "less $7.7 million in restricted cash" was added to the sentence.

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, 2004 and the condensed consolidated financial statements and notes thereto included herein for the three months ended March 31, 2005. Except for historical information, the following discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, that involve risks and uncertainties, including, without limitation, statements with respect to the Company's strategy, expected operating results, including gross margins, revenues and expected losses, proposed introduction of new products, including anticipated features, functionality and timing thereof, expected impact on our gross margins of such new product introductions, anticipated sales of the Company's products, including levels of sales to specific customers, the markets for the Company's products, the development of the Company's products, expected spending levels for research and development and rates of inventory and receivable turns. 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, failure to raise additional capital to operate and grow our business, failure to maintain existing lines of credit with Korean banks, failure to maintain our listing on the Nasdaq SmallCap Market, the failure to obtain market acceptance of DVD loaders and other Company products, the failure to achieve the 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, timeliness of new product introductions, difficulties in conducting business in foreign countries such as China, South Korea and India, the competitive market for the Company's products and other factors described in this report under "Factors That May Affect Future Results," as well as in the Form 10-K for the year ended December 31, 2004 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. Fluctuations of the U.S. dollar against foreign currencies and changes in local regulatory or economic conditions, among other things, could adversely affect our operating results.

Results of Operations

Overview

We have a 51% ownership interest in a subsidiary in South Korea (DVSK) which generates most of our revenues. DVSK has a majority ownership interest in a manufacturing joint venture in China where a significant portion of our production is performed and additional revenues are generated.

In 2004, the average unit selling price of DVD loaders sold to original equipment manufacturers ("OEM") of DVD players continued to decline to a level at which the Company determined that we would no longer be able to generate acceptable margins from the sale of these products. Accordingly, we have focused on developing products for users who will pay a premium for the increased functionality and reliability of our DVD products, such as automotive and read-write DVD products and DVD loaders for niche markets that continue to provide reasonable profit margins. We believe that our focus on higher margin products and markets should favorably impact our gross margins in future periods to the extent revenues derived from them increase.

During the first quarter of 2005, sales of our read-write and automotive products accounted for 24% and 52% of our revenues, respectively, favorably impacting our gross margins. Our gross margin of 9.9% in the first quarter was also influenced by revenues from our DVD player loaders which have achieved improved gross margins compared to the negative gross margin of (5.7%) incurred during the first quarter of 2004. Negative gross margins in the first quarter of 2004 was also impacted by inventory charges primarily related to the discontinuance of certain DVD products. We anticipate further improvements in gross margins in future quarters to the extent sales of the automotive and read-write DVD products increase.

Working capital declined from a $7 million deficit at December 31, 2004 to a $9.7 million deficit at March 31, 2005. Our total net borrowing with banks in South Korea has been reduced to $13.5, less $7.7 million in restricted cash at March 31, 2005 and further reductions are possible going forward (See Note #12). Moreover, our operations in the United States will require additional funding for 2005 operating requirements. Consequently, an infusion of equity and/or debt subordinate to our existing bank debt will be required to help fund our operations. There is no assurance that we will be able to raise additional capital on acceptable terms or at all.

Results of Operations

The following table summarizes the Company's operating results (in thousands):

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Revenue	$ 11,928	$ 17,522
Gross profit	1,179	(992)
Loss from operations	(3,022)	(5,993)
Net loss available to common shareholders	(4,684)	(4,688)

Revenues declined as the company abandoned unprofitable markets. We anticipate that increased sales of our automotive DVD products will result in improved gross margins in future periods. The availability of parts and working capital, however, may limit any growth in revenues. Further, because of the minority interest in DVSK, the Company will not fully realize all of DVSK's earnings when, and if, DVSK returns to profitability. Consequently, we anticipate that we are likely to incur net losses for at least another quarter.

The Three Months Ended March 31, 2005
Compared to the Three Months Ended March 31, 2004

The following table sets forth certain income and expense items expressed as a percentage of the Company's total revenue for the three month period ended March 31, 2005 compared with the three month period ended March 31, 2004.

Percent of Revenue	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Revenue	100.0 %	100.0 %
Gross margin	9.9 %	(5.7)%
Research and development	9.9 %	10.0 %
Sales and marketing	6.7 %	5.3 %
General and administration	18.6 %	13.3 %
Loss from operations	(25.3)%	(34.2)%
Net loss available to common shareholders	(39.3)%	(26.8)%

Consolidated Revenue	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004	% Change
Amount (in thousands)	$ 11,928	$ 17,522	(32)%

Total revenue decreased by $5.6 million, or 32%, for the three months ended March 31, 2005 as compared with the three months ended March 31, 2004. This decrease is primarily attributable to a significant decrease in sales of our DVD loader products, which was partially offset by the increase in sales of our automotive DVD products, and, to a lesser extent, sales of our read-write products. In the quarter ended March 31, 2005, LG, DM-Tech and Ellion accounted for 11.3%, 10% and 8% of our revenue, respectively. In the quarter ended March 31, 2004, Ellion, Kaixinda, Farimex and Vestel accounted for 22%, 18%, 16% and 11% of our revenue respectively.

Ellion Digital, Inc. is a Korean DVD player manufacturer in which certain officers, directors and employees of DVSK have a significant ownership interest. The revenue generated from Ellion Digital is primarily related to the production of complete DVD systems. Sales to Ellion Digital substantially decreased during the three months ended March 31, 2005. It is anticipated that sales to Ellion will continue to diminish as Ellion unit shipments of DVD systems decline.

Gross Profit (Loss)	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004	% Change
Amount (in thousands)	$ 1,179	$ (992)	(219)%
As a percentage of revenue	9.9 %	(5.7)%	--

The increase in both gross profit and gross margin in the first quarter of 2005 as compared to the first quarter of 2004 is attributable to the sale of our automotive DVD products and the achievement of improved margins on our remaining DVD loader products.

Our products engineering group in South Korea has developed and intends to continue to develop DVD products for the automotive market that we expect will contribute to a higher gross margin in future periods. However, should the prices of our new products experience reductions in prices in the near term similar to our experience in the home consumer electronics market, our total margins will not improve as anticipated and our results of operations and financial position will be significantly weakened.

Research and Development	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004	% Change
Amount (in thousands)	$ 1,186	$ 1,745	(32)%
As a percentage of revenue	9.9 %	10.0 %	--

Our research and development expenses consist primarily of salaries and related costs of employees engaged in ongoing research, design and development activities and providing our OEM customers with custom design and value engineering options to meet their specific requirements. The decrease in expenses in the first quarter of 2005 as compared to the first quarter of 2004 was due to ending R&D activities in the U.S., and the effect of expense reductions at the Company. We expect to continue spending at approximately the same rate in absolute dollar terms during the remainder of 2005.

Sales and Marketing	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004	% Change
Amount (in thousands)	$ 794	$ 931	(15)%
As a percentage of revenue	6.7 %	5.3 %	--

Sales and marketing expenses consist primarily of employee related expenses, export freight and insurance, and advertising/promotional costs. The Company has sales and marketing organizations in Korea, China, India and the United States. The $0.1 million decrease in expenses from the comparable three month period in 2004 is primarily due to the closing of a sales office in Shanghai.

General and Administrative	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004	% Change
Amount (in thousands)	$ 2,221	$ 2,325	(4)%
As a percentage of revenue	18.6 %	13.3 %	--

General and administrative expenses consist of administrative salaries, bonuses, benefits, insurance, facility, legal, accounting services, investor relations and other business support costs. The decrease in general and administrative expenses of $0.1 million in the first quarter of 2005 as compared to the first quarter of 2004 is due primarily to reduced travel, facility and support costs partially offset by higher legal fees.

Other Income / (Expense)		Three Months Ended March 31, 2005		2004	% Change
Amount (in thousands)	$	(2,066)	$	(61)	3,287 %
As a percentage of revenue		(17.3)%		(0.3)%	--

Other expense of $2.1 million in the three months ended March 31, 2005 consisted primarily of a $2.0million of IDVD and Kent Yu Settlement. In the three months ended March 31, 2004 other expense of $0.1 million consisted primarily of an exchange loss of $0.3 million offset by $.02 million of other income.

Interest expense of $0.2 million and $0.3 million in the three months ended March 31, 2005 and 2004, respectively, consisted primarily of costs associated with borrowings outstanding during the quarters.

Liquidity and Capital Resources

At March 31, 2005, the Company had $1.4 million of cash and cash equivalents and $7.7 million of restricted cash as collateral under the terms of our lines of credit.

Net cash used by operating activities was $1.3 million during the first three months of 2005. During the three month period, we experienced a net loss of $4.6 million, adjusted by the non-cash reduction in the minority interest of the investors of our DVSK subsidiary and China joint venture of $0.7 million. Inventories decreased by $2.6 million due to shipments of read-write DVD products, and our ongoing liquidation of our legacy DVD products. Accounts receivable decreased by $1 million, and depreciation and amortization was $0.8 million. These sources of funds were partially offset by a decrease in accounts payable of $2.0 million.

Net cash used in investing activities was $0.07 million for the three months ended March 31, 2005, which consisted of the acquisition of $0.1 million of property and equipment, primarily tooling and equipment in Korea, and an increase of $0.14 million in restricted cash, partially offset by $0.18 million of proceeds from the disposal of fixed assets and marketable securities.

Net cash used in financing activities was $0.67 million for the three months ended March 31, 2005. We repaid $0.8 million on our line of credit with our Korean banks. The cash provided by financing activities in this period was primarily from the $0.1 million in proceeds from the sales of shares of common stock, and $0.1 million from the accrual of dividends on preferred stock

Our borrowing limits in South Korea have been reduced as of April 11, 2005 to $18 million due to the adverse effects resulting from changes in the banking environment, coupled with our current operating levels and concern over our losses (See Note # 12). In the current circumstances, management believes further reductions in our line of credit are possible. We have sought to offset these reductions in our lines of credit by requesting prepayments from our customers on our new products and extended payment terms from our vendors. Because such accommodations are largely at the discretion of our customers and vendors, there is no assurance that we will continue to be successful in these actions. In addition, our operations in the United States will require additional capital in order to meet anticipated operating requirements in 2005. Therefore, we believe that an infusion of equity and/or debt subordinate to our existing bank debt will be required to help fund our operations.

We have reached an agreement with financing sources to raise capital during the second quarter of 2005 followed by additional tranches through February 2006. There is no assurance, however that the additional capital will be provided in accordance with the amounts, terms and schedule provided by the source. If we do not raise additional capital, we may not be able to meet our financial obligations, and may have to cease or significantly curtail our operations.

Contractual Obligations

The following table summarizes our significant contractual obligations at March 31, 2005.

Contractual Obligations	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
	Payments Due by Period (in 000's)				
Operating lease obligations.......	$ 755	$ 651	$ 104	$ --	$ --
Line of credit...........................	13,479	13,479	--	--	--
Notes payable..........................	3,603	3,603	--	--	--
Long-term debt........................	255	--	255	--	--
Total contractual obligations...	$ 18,092	$ 17,733	$ 359	$ --	$ --

Off-Balance Sheet Arrangements

The Company had no "Off-Balance Sheet Arrangements" (as defined by Item 303 of Regulation S-K) at March 31, 2005.

Critical Accounting Policies

Management's discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to product returns, accounts receivable, inventories, investments, intangible assets, income taxes, warranty obligations, restructuring, contingencies and litigation. Actual results may differ from these estimates under different assumptions or conditions. These estimates and judgments are reviewed by senior management and by the Audit Committee on an ongoing basis, at the end of each quarter prior to the public release of our financial results. We believe the following critical accounting policies affect our more significant judgments and estimates used in preparation of our consolidated financial statements.

Revenue Recognition

Net revenue includes product and component sales. We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collection is probable. These criteria are met at the time the product is shipped to the customer. Shipping terms are FOB shipping point. Returns and discounts on sales are deducted from revenue upon knowledge. Returns for products under warranty are repaired and returned to the customer at the Company's cost. The Company provides for an estimate of costs that may be incurred under its warranty at the time product revenue is recognized. We had a warranty reserve of $33,000 at March 31, 2005 and $28,000 at December 31, 2004.

Allowance for Doubtful Accounts

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in the Company's existing accounts receivable; however, changes in circumstances relating to accounts receivable may result in a requirement for additional allowances in the future. We determine the allowance based on historical write-off experience, current market trends and, for larger accounts, the ability to pay outstanding balances. We continually review our allowance for doubtful accounts. Past due balances over 90 days and other higher risk amounts are reviewed individually for collectability. Account balances are charged against the allowance after all collection efforts have been exhausted and the potential for recovery is considered remote.

Excess and Obsolete Inventory

We write down our excess and obsolete inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future product life-cycles, product demand and market conditions. If actual product life cycles, product demand and market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Deferred Taxes

We estimate our actual current tax exposure together with our temporary differences resulting from differing treatment of items for tax and accounting purposes. These temporary differences result in deferred tax assets and liabilities. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. At March 31, 2005 we had provided a valuation allowance for the entire amount of tax assets net of tax liabilities. To the extent that we increase or decrease a valuation allowance in a period, the resulting expense or benefit is included within the tax provision. Significant management judgment is required in determining the provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against net deferred tax assets.

Intangibles

We assess the impairment of identifiable intangibles annually or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Significant under performance relative to projected operating result, changes in the manner of our use of the acquired assets and significant negative industry or economic trends are the more significant indicators that we consider. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations.

Determining Functional Currencies for the Purpose of Consolidation

Our majority owned Korean subsidiary and Chinese joint venture represent the vast majority of our revenues, assets, and liabilities at March 31, 2005. These subsidiaries record gains and losses for transactions they enter into that require settlement in other than their functional currency to their statement of operations. In preparing our consolidated statements, we are required to translate the financial statements of the foreign entity from the currency in which they keep their accounting records, generally the local currency, into United States dollars. This process results in exchange gains and losses which are included as a separate part of our net equity under the caption "cumulative translation adjustment." "On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the RMB to the U.S. dollar. Under the new policy, the RMB is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. This change in policy has resulted in an approximately 2.0% appreciation of the RMB against the U.S. dollar. While the international reaction to the RMB revaluation has generally been positive, there remains significant international pressure on the PRC government to adopt an even more flexible currency policy, which could result in a further and more significant appreciation of the RMB against the U.S. dollar. This change in policy may have a positive or negative impact on future operations.

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 Condensed 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.*

Risks Related to Our Business

We have not recorded an annual operating profit since 2001.

Our last recorded annual profit was for the 2001 fiscal year. Since December 31, 2001, we have incurred cumulative losses of $29.1 million. We cannot assure you that we will achieve profitability in 2005 or thereafter.

We rely upon bank credit facilities which are subject to periodic renewal, at which time they may be maintained, reduced, or withdrawn.

We have credit facilities with five Korean banks that have been reduced from a total borrowing limit of $43.8 million at December 31, 2003 to approximately $20.2 million at March 31, 2005 and to $18 on April 11, 2005. By March 31, 2005, the borrowing was reduced to $13.5 million, less $7.7 million in restricted cash (See Note # 12). These reductions are due to the adverse effects of change in the Korean banking environment, coupled with the lenders' concerns over our losses. These credit lines are subject to significant discretion on the part of the lenders. We also have $3.6 million in loans from a bank in China as of March 31, 2005 that are secured by real estate owned by our joint venture in Shanghai and due in July 2005. There is no assurance that the lenders will continue to extend credit facilities at current or any reduced levels. If the banks were to reduce or terminate these credit facilities, our working capital and our ability to maintain our operations at current or projected levels could be significantly impacted. In particular, the growth of automotive DVD business requires working capital to finance accounts receivable, and our growth in the automotive sector could be severely curtailed without adequate working capital.

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, at present, cash generated from operations is not sufficient to meet these requirements. We cannot be sure in the future that cash generated from operations will be sufficient to meet our requirements or that financing will be available at favorable terms when required, or at all. Currently and in recent years, we have experienced significant shortages in our cash flows and have experienced difficulties in funding our operating expenses and paying our creditors. In April 2005, we obtained an agreement from a former CEO to provide up to $25 million of financing in tranches beginning in May 2005 and ending in February 2006. If we are not successful in raising additional capital through this arrangement or another offering, we may not be able to meet our financial obligations to our creditors when they become due and we may have to curtail or cease certain operations.

Our auditors have a substantial doubt about our ability to continue as a going concern.

In their report in connection with our 2004 financial statements, our auditors included an explanatory paragraph stating that, because we have incurred significant net losses and as of December 31, 2004 have a net capital deficiency and a working capital deficiency, there is substantial doubt about our ability to continue as a going concern. Our continued existence will depend in large part upon our ability to successfully secure additional financing to fund future operations. In April 2005, we obtained an agreement from a former CEO to provide up to $25 million of financing in tranches beginning in May 2005 and ending in February 2006. As of September 19, 2005 $550, 000 has been provided under this agreement. If this financing is not provided according to the agreement, and if in the future we are not able to achieve positive cash flow from operations or to secure additional financing as needed, we will experience the risk that we will not be able to continue our operations. If we cannot successfully continue as a going concern, our stockholders may lose their entire investment.

The DVD player industry is highly competitive with few barriers to entry.

Although DVD players were only first introduced commercially in 1997, the market quickly became "commoditized." Today much of the manufacturing is done in China where products can be manufactured on a large-scale, cost-effective basis. As competition has increased, the market for home DVD players has experienced significant declines in both unit prices and margins. Because most of our DVD products are sold in Asia we have experienced a substantial decline in our revenues and have suffered net losses over the past eight quarters.

In response to the commoditization of the home DVD player market, we have refocused our business to our DVD products, such as automotive DVDs, that are not as susceptible to price erosion. Although we have had some initial success in selling into these markets, there can be no assurance that our new products will not become susceptible to the same commoditization pressures, we faced with DVD players.

Our growth and future profitability depend upon our ability to successfully develop and commercialize new DVD products, as well as market acceptance of such products.

During the last three years, substantially all of our revenues have been generated by our DVD product line, which is central to our growth strategy. Successful development and commercialization of new DVD products, as well as market acceptance of such products, is essential to our achieving positive gross margins as well as growth and future profitability. While we are currently developing and introducing new products (*e.g.,* automotive DVD products), 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 generate acceptable margins. In addition, we expect to continue to invest heavily in research and development and engineering during 2005, which will likely adversely impact achievement of near term profitability.

We are exposed to fluctuations in currency exchange rates.

A large portion of our business is conducted outside the United States. Sales of products outside of the United States, primarily in Asia, represented over 90% of our total revenues for fiscal 2004 as well as for each of our 2002 and 2003 fiscal years. Although some of our revenue and expenses are transacted in U.S. dollars, we are exposed to currency exchange fluctuations since we transact a significant portion of our business in local currencies. Moreover, most of our expenses in Korea, China and India are paid in local currency, which subjects us to the risks of foreign currency fluctuations between the U.S. dollar and such currencies. As a result, an increase in the value of such currencies in comparison to the U.S. dollar could increase our research and development, sales and marketing and general and administrative expenses, and increase the cost of our products, potentially making them less competitive in international markets.

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.

In addition to the losses incurred in during the years ended December 31, 2004 and 2003, we have incurred substantial net losses in the past, as recently as, among others, fiscal years ended December 31, 2002, and fiscal years ended March 31, 1999, 1998 and 1997. We also expect to generate losses as we continue our spending on engineering and other personnel in connection with our research and development efforts related to new product development during 2005 and our expansion into the Indian DVD market. 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:

- market acceptance of our new products, such as automotive DVDs and home DVD recorders;
- timing of our customers' new product development, which incorporates our products;
- continued availability of adequate capital under our bank line of credit in Korea or other financial sources to fund our operations, including the purchase of needed components and manufacturing of our products;
- exchange rate fluctuations;
- adverse results in pending litigation involving former officers of DVS and DVSK;
- difficulties in forecasting, planning and management of inventory levels, particularly given our ongoing implementation of our new enterprise resource planning ("ERP") system in Korea, which may trigger further inventory adjustments;
- the availability, timely delivery and cost of components from our suppliers;

- fluctuations in manufacturing yields and significant yield losses which may affect our ability to fulfill orders;
- new product announcements and introduction of competing products by our competitors;
- pressure to reduce the price at which we sell our products;
- 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;
- changes in the channels through which our products are distributed and the timeliness of receipt of distributor resale information;
- general economic, political and environmental related conditions, such as natural disasters;
- 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 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, large portions of our costs consist 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 would likely harm our operating results.

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

Sales of products overseas accounted for 99.7%, 98.1%, 99.0%, 99.6% and 90.3% of our revenue in the nine-month transition period ended December 31, 2000, the fiscal years ended December 31, 2001, 2002, 2003 and 2004, respectively. Because our automotive DVD sales are principally directed at the American market, we expect the percentage of overseas sales to decline as our automotive DVD sales increase. Prior to the introduction of our automotive DVD products in the third quarter of 2003, substantially all of our sales were outside of the United States. Consequently, even if automotive DVD sales increase to represent a higher percentage of our revenues, we still expect to have very significant overseas sales.

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:

- greater difficulty in ensuring adequacy of our disclosure controls and procedures and internal control over financial reporting with respect to international operations;
- impact of currency fluctuations for which the Company currently has no hedging activity;
- difficulties in complying with foreign regulatory requirements and standards;
- tariffs and other trade barriers relating to cross border transactions;
- costs and risks associated with local business practices and customs in foreign countries;

- longer accounts receivable payment cycles from customers located in foreign countries;
- potentially adverse tax consequences resulting from changes in international tax regulations;
- limits on repatriation of earnings from our foreign operations; and
- limited ability to effect quality-control measures associated with our foreign operations.

We have offices and conduct significant operations in South Korea, China and India. We have derived most of our product revenue from Asia during the last three years. 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 North Korea and South Korea, Taiwan and China, and India and Pakistan, which are frequently engaged in political disputes. In the past, several of these countries have engaged in military hostilities and still continue to conduct military exercises in or near the other's borders, 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.

We may encounter significant difficulties in understanding local business practices that may require additional expenditures.

As a substantial portion of our operations are located in Asia and subject to foreign laws and regulations, our operations in Asia may be adversely affected by changes in local laws and regulations, such as those relating to employment regulations, accounting practices, taxation, import and export tariffs, environmental regulations, land use rights, and other matters. Local governments may impose new, stricter regulations or interpretations of existing regulations, which would require additional expenditures. Asian economies may also differ in terms of structure, government involvement, level of development, growth rate, capital reinvestment, allocation of resources, self-sufficiency and rate of inflation, among others. As a result, we may encounter significant difficulties in understanding and addressing local business practices that may require us to incur additional expenses in connection with our international operations.

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

Products sold to our top five customers accounted for approximately 60% and 56% of our revenue during the years ended December 31, 2003 and 2004, respectively. Products sold to our top 10 customers accounted for approximately 88%, 67%, 78% and 70.3% of our revenue during the fiscal years ended December 31, 2001, 2002, 2003 and 2004, respectively. In the year ended December 31, 2004, Ellion Digital, Kaixinda and Samsung Electronics accounted for 19%, 14% and 7% of our revenue, respectively. In the quarter ended March 31, 2005, LG, DM-Tech, Samsung and Ellion Digital accounted for 11.3%, 10%, 9.4% and 7.9% of our revenue, respectively. We anticipate that our sales may continue to be concentrated in a few major accounts. If we were to lose any of our principal customers or experience any substantial reduction in orders from these customers, our revenues and operating results would suffer.

We may not be able to maintain our listing on the Nasdaq SmallCap Market and if we fail to do so, the price and liquidity of our common stock may decline.

Nasdaq has quantitative and corporate governance maintenance criteria for the continued listing of common stock on the Nasdaq SmallCap Market. The current requirements that may affect our future listing status include (i) having a minimum of $2.5 million in stockholders' equity, and (ii) maintaining a minimum bid price per share of $1.00.

On July 13, 2005, the Company received a letter stating that the Nasdaq Listing Qualifications Panel had determined to delist the securities of the Company effective as of the open of business on July 15, 2005. The delisting was based on the company's ongoing non-compliance with the Nasdaq's shareholders' equity and filing requirements. The letter stated that the Company had not filed a Form 10Q/A with the required SAS review, nor had it given the Panel any expected filing date, but rather asked the Panel to take no action as the Company completes its review process. The Company requested a review of the Nasdaq's decision and is currently preparing a response to the Nasdaq.

On April 1, 2005, we were notified by Nasdaq that we had satisfied its listing requirements subject to the condition that the financial statements contained in each of our periodic reports for periods ending on or before March 31, 2006 must evidence shareholders' equity of at least $2.5 million; and that if, during this monitor period, the Company should fail to meet the shareholders' equity requirement, or otherwise fail to satisfy any other requirement for continued listing, the Panel will promptly consider the reasons for such a failure and thereafter render a determination with respect to our continued listing on The Nasdaq SmallCap Stock Market, which could result in the delisting of the Company's securities from The Nasdaq SmallCap Stock Market. As of March 31, 2005 and December 31, 2004, we show a stockholders' deficit of $4.7 million and $0.3 million, respectively and therefore are not in compliance with this shareholders equity requirement.

On August 19, 2004, we received notification by Nasdaq that because our stockholders' equity at June 30, 2004 was $2.0 million, we did not the meet the requirement of a minimum of $2.5 million in stockholders' equity for continued listing on the Nasdaq SmallCap Market under Marketplace Rule 4310-(c)(2)(B). Subsequently, we raised additional capital to regain compliance with the $2.5 million minimum stockholders' equity requirement. On August 19, 2004, we received notification by Nasdaq that for 30 consecutive trading days, the price of our common stock closed below the minimum $1.00 per share requirement for continued inclusion under Marketplace Rule 4310 (c)(4). In order to regain compliance with Marketplace Rule 4310(c)(8)(D), the bid price of our common stock must close at or above $1.00 per share or more for a minimum of 10 consecutive trading days prior to February 23, 2005 the board and stockholders approved a reverse stock split effective February 9, 2005 under the terms of the reverse stock split each 10 shares of our common stock was combined into one share, and our common stock began trading on a reverse stock split basis on that date.

There can be no assurance that we will be able to comply with the quantitative and corporate governance maintenance criteria or any of the other Nasdaq SmallCap Market's rules in the future. If we are delisted, it could have a material adverse effect on the market price of, and the liquidity of the trading market for, our common stock.

The dynamic nature of our business continues to place a significant strain on our management systems and resources, and if we fail to effectively manage the changes in our products, markets and supply chain, our ability to market and sell our products and develop new products may be harmed.

Our business is experiencing rapid change 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 enterprise resource planning ("ERP") system, there is no guarantee that this system and any new systems implemented in the future will be adequate to address the rapid changes in sales volume, product mix, regional mix and supply chain which we anticipate, or that management will be able to foresee in a timely manner other infrastructure needs before they arise. In addition, we have in the past and may in the future experience problems with the ERP system, which problems may lead to inventory management issues. Our success depends on the ability of our executive officers to effectively manage in this rapidly changing environment. If we are unable to manage our growth effectively, our results of operations will be seriously harmed.

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 will need to bring new products to market, which will likely require significant working capital. We have established credit facilities with certain Korean banks with a total borrowing of about $13.5 million, less $7.7 million in restricted cash (See Note # 12). We have incurred net losses from operations for the last three years and three months ended March 31, 2005, and have an accumulated deficit of $91.1 million and a working capital deficit of $11.7 million at March 31, 2005. 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. An equity offering has been initiated to meet our capital needs for at least the next twelve months, but we cannot assure you that any future equity financing will be available on terms acceptable to us, if at all. The sales of additional equity or convertible securities may result in additional dilution to existing stockholders. If additional funds are raised through the issuance of equity or debt securities, these securities could have rights that are senior to existing stockholders and could contain covenants that would restrict operations. Any additional financing may not be available in amounts or on terms acceptable to the Company, if at all. Additionally, the Company is involved in several outstanding legal matters, and an unfavorable outcome from one or more of these matters could result in a material adverse effect upon the Company's financial position and results of operations. While the Company is aggressively pursuing additional financing, there can be no assurance that the Company will be successful in its efforts to achieve profitable operations, generate sufficient cash from operations or obtain additional funding sources. We have reached an agreement with financing sources to raise capital during the second quarter of 2005 followed by additional tranches through February 2006. There is no assurance, however that the additional capital will be provided in accordance with the amounts, terms and schedule provided by the source. If we do not raise additional capital, we may not be able to meet our financial obligations, and may have to cease or significantly curtail our 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 including Zoran, Mediatech, Philips and Hitachi. 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. Although our on-going relationships with our key suppliers are material in the aggregate, we do not have any specific agreement with any supplier that is material to our business. We purchase materials from suppliers on an as-needed basis through individual purchase orders, none of which is material to our business or results of operations. 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 whom we are currently working, together with any additional suppliers, 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 increasing 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 our suppliers. Such disruptions, shortages and price increases could seriously harm our operating results.

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 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 many reasons, including those listed below:

- significant pricing pressures that occur due to competition, over-supply, or other reasons;
- 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 achieve volume shipments after we first contact a customer. Often, we first work with customers to develop the basic product, 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 our competitors or potential competitors are also suppliers of key components for some of our products. 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 and expectations;
- 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. 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 effectively 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 South Korea, where our DVD products are designed and where much of our initial "pilot" manufacturing takes place and in Silicon Valley, where our corporate headquarters are located. 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 business 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, South Korea and India, where the laws may not protect our proprietary rights as fully as in the United States. 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.

We have become increasingly subject to the risks arising from adverse changes in domestic and global economic conditions. DVD players are to some extent a discretionary item (particularly with respect to automotive DVD players) that consumers may forgo purchasing in difficult economic times. The impact of any 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, we might fall short of our revenue expectations for any given quarter or for the entire year in which a slowdown takes place.

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.

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

In order to grow, we may need to increase our present manufacturing capacity. Events that we have not foreseen could arise which would limit our manufacturing capacity or our ability to outsource manufacturing. 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, purchase, equipment lease or build new facilities, obtain loans, enter into joint ventures, seek equity investments or enter into technology licenses in or with other companies. These transactions could involve a commitment of substantial amounts of our capital and require making available 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.

Risks Related to Investment in Our Securities

The price of our common stock is likely to be volatile.

Our stock price has been extremely volatile in recent years. Since January 1, 2001, our stock has closed at prices ranging from a high of $62.30 on December 11, 2001 to a low of $1.89 on March 31, 2005. If our revenues do not grow or grow more slowly than we anticipate, or if operating or capital expenditures exceed our expectations or cannot be adjusted accordingly, the market price of our common stock could be materially and adversely affected. In addition, the market price of our common stock has been in the past and could in the future be materially and adversely affected for reasons unrelated to our specific business or results of operations. General market price declines or volatility in the future could adversely affect the price of our common stock. In addition, short-term trading strategies of certain investors can also have a significant effect on the price of our stock.

The exercise of warrants or options may depress our stock price.

There are a significant number of warrants and options to purchase our common stock outstanding. Holders may sell the common stock acquired upon exercise of the warrants and options at a market price that exceeds the exercise price of the warrants and options paid by the holders. Sales of a substantial number of shares of common stock in the public market by holders of warrants or options may depress the prevailing market price for our common stock and could impair our ability to raise capital through the future sale of our equity securities.

When we account for employee stock options using the fair value method, it could significantly increase our net loss.

In December 2004, the Financial Accounting Standard Boards (FASB) issued Statement of Financial Accounting Standard No. 123 ("SFAS 123R") *"Share-Based Payment (Revised December 2004)"* which requires a company to recognize, as an expense, the fair value of stock options and other stock-based compensation to employees beginning with interim and annual periods occurring after June 15, 2005 and subsequent reporting periods. We are required to record an expense for our stock-based compensation plans using the fair value method as described in SFAS 123R, which could have significant and ongoing accounting charges and adversely affect our future results.

We do not expect to pay dividends.

We have never paid any cash dividends on our common stock, and we do not anticipate paying any cash dividends in the foreseeable future. We currently intend to retain any future earnings for funding growth and therefore, do not expect to pay any dividends on our common stock in the foreseeable future. Therefore, you may not receive any return on an investment in our common stock in the form of cash dividends.

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 home DVD and automotive DVD markets.

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 loaders. The sales of our DVD loaders are related to the markets for DVD video discs and DVD video players. If we experience an unforeseen downturn in the markets for DVD video discs and DVD video players or a global over-supply in the production of DVD loaders, our results of operations from our DVD loaders business will be adversely affected. 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 used in DVD products. 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. Seasonal purchasing patterns generally lead to higher sales occurring in the second half of each calendar year although there may be a sharp decline of sales near the Christmas and New Year's holidays. 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 Disclosure 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 borrowings and our investment portfolio. Our borrowings consist primarily of amounts outstanding under our lines of credit, which totaled approximately $13.5 million at March 31, 2005 (See Note # 12). While the interest rates under our credit lines are fixed, because the terms of such lines are relatively short, they must frequently be renewed, at which time the interest rates are reset based upon prevailing rates. We do not use derivative financial instruments in our investment portfolio. The primary objective of our investment activities is to preserve principal while maximizing yields without significantly increasing risk. Our investments consist primarily of commercial paper and certificates of deposits. Due to the nature of our investments, we believe that there is no material risk exposure. Cash equivalents and short-term investment are carried at cost, which approximates market value, and investments in marketable debt securities are carried at amortized cost, which approximates market value.

Foreign Currency Risk

We develop products in the United States, Korea, China and India and market our products in the Asia-Pacific region, Europe, North America and India. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. As our sales are primarily in U.S. dollars, a strengthening of the dollar could make our products less competitive in foreign markets. We do not currently engage in any hedging activities to mitigate this risk. "On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the RMB to the U.S. dollar. Under the new policy, the RMB is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. This change in policy has resulted in an approximately 2.0% appreciation of the RMB against the U.S. dollar. While the international reaction to the RMB revaluation has generally been positive, there remains significant international pressure on the PRC government to adopt an even more flexible currency policy, which could result in a further and more significant appreciation of the RMB against the U.S. dollar. This change in policy may have a positive or negative impact on future operations.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

The Chief Executive Officer and the Chief Financial Officer of the Company, with the participation of the Company's management, carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures pursuant to Securities Exchange Act of 1934 Rule 13a-15(e). Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q, were not effective in ensuring that material information relating to the Company, required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

"An internal control material weakness is a significant deficiency, or aggregation of deficiencies, that does not reduce to a relatively low level the risk that material misstatements in the financial statements will be prevented or detected on a timely basis by employees in the normal course of their work. An internal control significant deficiency, or aggregation of deficiencies, is one that could result in a misstatement of the financial statements that is more than inconsequential. Materiality is defined by the FASB as the magnitude of an omission or misstatement in the financial statements that makes it probable that a reasonable person relying on those statements would have been influenced by the information or made a different judgment if the correct information had been known. In assessing the effectiveness of the Company's internal control over financial reporting as of March 31, 2005, management identified the inadequate depth of senior and middle management accounting personnel at its Korea and China subsidiaries as a material weakness in the operating effectiveness of the Company's internal controls.

There is inadequate senior and middle management accounting staff at DVSK and SFDT. Consequently, DVS has needed to make appropriate accounting adjustments for these subsidiaries at each period end. To remediate this weakness, during 2004, DVSK hired additional qualified accounting personnel to facilitate the monitoring as well as the integration of systems and information between DVSK and DVS. Additionally, DVS placed a senior manager in Asia to improve the oversight of its operations in Korea, China and India. DVS also initiated a search for a qualified CFO to be located in Korea.
We continue to evaluate the need for further improvements to internal control over our financial reporting and procedures, including further formalizing of our processes and policies.

(b) Changes in internal control over financial reporting.

During the first quarter of fiscal 2005, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. Although a *key accounting person performing many functions assumed by the Chief Financial Officer quit prior to the end of the first quarter in 2005.*

(c) Limitations on the Effectiveness of Controls

Our management, including the CEO and CFO, do not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all errors and all fraud. Our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance that the control system's objectives will be met and the Company's management, including the CEO and CFO, believe that the Company's disclosure controls and procedures and internal control over financial reporting are effective in providing reasonable assurance that the control system's objectives are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time the Company is a party to various legal proceedings arising in the ordinary course of its business. The outcome of any pending legal matters may have a material adverse effect on the Company's business, operating results or financial condition.

Former Officer Litigation

On May 24, 2005, pursuant to the terms of the settlement agreement with Mali Kuo, the Board of Directors elected Ms. Kuo's nominees, Mali Kuo, Jeff Bumb and Bruce Breslow, to the Board. The Board now consists of seven members. On the same date, the Board of Directors elected Mali Kuo to serve as the Company's Chief Executive Officer and Chairman of the Board. Ms. Kuo replaced Thomas A. Spanier, the Company's former Chairman and CEO. Mr. Spanier remains a member of the Board of Directors. During the meeting, the Board also elected Shaun Kang to serve as President of DVS. Shortly thereafter, Dean Clarke Seniff was appointed to serve as our Chief Financial Officer.

On April 29, 2005, we announced that we had reached a settlement of litigation involving our former chief executive officer, Mali Kuo. Under the terms of the settlement agreement with Mali Kuo, we have been directed by Ms. Kuo to issue an aggregate of 100,147 shares of Series D convertible preferred stock (the "Series D Preferred Stock") to 28 persons and a warrant to purchase 100,148 shares of common stock to one holder. We also have entered into a consulting agreement in conjunction with the settlement agreement wherein we have agreed to issue 11,291 shares of Series D Preferred Stock to two persons, as directed by Ms. Kuo. The Series D Preferred Stock bears an 8% dividend and each share is convertible, at the option of the holder, into ten shares of DVS common stock. Consequently, the 100,147 shares of Series D Preferred Stock will convert into 1,001,470 shares of our common stock. The Series D Preferred Stock will be issued at an effective price of $34.30, or $3.43 per converted share of common stock. The warrants are exercisable for one year at an exercise price of $4.50 per share.

At the time we entered into the settlement agreement with Mali Kuo, we also entered into a separate financing agreement with Ms. Kuo. Under the terms of this financing agreement, Ms. Kuo has agreed to initially raise $3.42 million by the later of June 30, 2005 or the settlement of pending litigation involving OPLI, IDVD and Mr. Kent Yu. As of August 3, 2005, we had received a total of $550,000 from two accredited investors for the issuance of 16,035 shares of Series D Preferred Stock and 16,035 warrants to purchase shares of common stock. The investment was made at a price of $34.30 per share of Series D Preferred Stock, or $3.43 per converted share of common stock. The 16,035 shares of Series D Preferred Stock convert on a ten for one basis into 160,350 shares of our common stock. The warrants are exercisable for one year at an exercise price of $4.50 per share.

The Series D Preferred Stock and warrants to be issued to as part of the settlement and the initial financing are being issued pursuant to the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended. We have agreed to file a registration statement with the SEC to register for resale the shares of common stock issuable upon conversion of the Series D Preferred Stock and the shares of common stock issuable upon exercise of the warrants issued in these transactions. The Series D Preferred Stock shares automatically convert into shares of common stock at the time the SEC declares the registration statement registering such shares effective.

In connection with the April 29, 2005 settlement with Mali Kuo, the Company agreed that it would enter into binding arbitration with Kent Yu, OPLI and IDVD and Ms. Kuo agreed to use her best efforts to cause Kent Yu, OPLI and IDVD to enter into binding arbitration with the Company within 30 days. The parties agree that any award payable by the Company shall be paid with common stock and warrants, net of any offsetting award to the Company.

On February 1, 2005, the jury in the Mali Kuo litigation rendered a verdict against the Company finding that Ms. Kuo had a series of binding agreements with the Company and that she was entitled to approximately $2,670,000. On February 4, 2005, the judge entered the verdict, but stayed its enforcement for 70 days. On March 7 and 8, 2005, the judge heard the Company's motions for a new trial, a judgment notwithstanding the verdict ("JNOV") and equitable estoppel. On April 4, 2005 the judge denied the Company's motions. We filed an appeal on April 5, 2005. On April 8, 2005 the court entered a judgment against DVS totaling $3,420,000 including all fees, costs and interest. The entire liability was reserved in the financial statements for the fiscal year ended December 31, 2004. On April 29, 2005 we announced that we had reached an agreement with Mali Kuo to settle her $3.42 million judgment against the Company (See paragraph 3 of this Note 11).

On June 24, 2002, the Company filed a lawsuit in the Superior Court of California, County of Santa Clara, against Mali Kuo, Michael Chen and Meng Tek Ung, former officers, directors and employees of the Company. Subsequently, former employees D.K. Lu and Jia-Hong Zang were added as defendants. The lawsuit included causes of action for breach of fiduciary duties, negligent performance of employment duties and breach of employment contracts. The defendants filed cross claims against the Company seeking compensation they alleged was due to them under their employment agreements. In 2002, the Company established a reserve of $0.7 million for wages and expenses related to the compensation claims of Mali Kuo and the other former employees. In December 2004 and January 2005, the Company settled all claims with Michael Chen, D.K. Lu and Ming Tek Ung for 47,739 shares of common stock, warrants to acquire 7,189 shares of common stock at $6.10 per share and $58,750 in cash payments. The aggregate value of these settlements was $0.3 million. In April 2005, we settled with Jia-Hong Zang for an aggregate of 30,000 shares of common stock.

OPLI Litigation

In August 2004, the Company filed a lawsuit against Oregon Power Lending Institute ("OPLI") in the Superior Court of California, County of Santa Clara, seeking to collect on a promissory note issued by OPLI (the "OPLI Note") in connection with the purchase of certain assets of the Company. The face amount of the OPLI Note was $3.45 million, and it was secured by a pledge of 86,250 shares of the Company's common stock, some of which was released upon partial payment of the note. After making payments on the OPLI Note, OPLI stopped payments, leaving a balance outstanding of approximately $1,974,000 secured by 54,194 shares of the Company's common stock. In our lawsuit we are seeking collection of the note and accrued interest. The OPLI lawsuit was settled on June 29, 2005, and was approved by the Board of Directors on July 14, 2005. The suit was settled for 33,000 shares of DVSI common stock at $3.43 per share plus 15,000 common shares warrants with a conversion price of $4.50. The agreement specifies that the warrants would expire on the last trading day of 2005. The aggregate value of the settlement was less than $0.1 million. The note is carried on the Company's books at the market value of the collateral which was $123,000 as of March 31, 2005.

IDVD and Kent Yu Litigation

On October 29, 2004, the Company was named in a lawsuit filed by IDVD, Inc. in the Superior Court of California, County of Santa Clara, alleging that the OPLI Note had been assigned by the Company to IDVD as partial consideration for the purchase of a Chinese subsidiary of IDVD by the Company. IDVD is seeking the sum of $2.51 million, which it asserts is owed by the Company in connection with the purchase of the IDVD Chinese subsidiary. On February 17, 2005, Kent Yu filed a lawsuit against the Company and DVS Korea in the Superior Court of California, County of Santa Clara. Mr. Yu alleges that he is the assignee of the equipment which had been allegedly sold by OPLI (who has been sued by the Company for non payment of the note) to DVS Korea in December 2000 for $600,000 and had not received payment. The IDVD and Kent Yu lawsuits were settled on June 29, 2005, and were approved by the Board of Directors on July 14, 2005. The suits were settled jointly for 710,000 shares of DVSI common stock at $3.43 per share plus 200,000 common share warrants with a conversion price of $4.50. The agreement specifies that the warrants would expire on the last trading day of 2005. The aggregate value of the settlement is approximately $2.0 million.

In March 2004, the former CEO of the Company's Korean subsidiary, DVSK, obtained in Korea an exparte writ of attachment on approximately $1 million of the stock we own in DVSK. The former CEO sought the writ of attachment based on claims for his salary for the remaining term of his employment agreement with DVSK and severance payments allegedly due to him. We denied any obligation for DVSK or the Company to pay such salaries or severance to the former CEO. In October 2004, we initiated a legal action to cancel the writ of attachment. On March 29, 2005, the Seoul High Court cancelled the attachment. In April the former CEO filed a last appeal to the Supreme Court to overturn the Seoul High Court's decision. We are not aware at this time whether the former CEO will commence any legal action for the claimed severance payments in connection with this writ of attachment.

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While the Company has accrued certain amounts for the estimated settlement 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 the Company's 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 losses associated with the resolution of these contingencies.

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

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

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

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

(a) Exhibits

31.1 Certification of the President and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 Certifications pursuant to U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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: September 28, 2005

DIGITAL VIDEO SYSTEMS, INC.

By: /s/ MALI KUO
Mali Kuo
Chief Executive Officer
(Principal Executive Officer)

/s/ DEAN CLARKE SENIFF
Dean Clarke Seniff
Chief Financial Officer
(Principal Accounting and Financial Officer)

EXHIBIT INDEX

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