FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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JNI CORP

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Mailing Address
9775 TOWNE CENTRE DRIVE
SAN DIEGO CA 92121

Business Address
9775 TOWNE CENTRE DRIVE
SAN DIEGO CA 92121
8585353121

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2001

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 0-27755

JNI CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**33-0740004**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

10945 Vista Sorrento Parkway
San Diego, CA 92130
(Address of principal executive offices, including zip code)
(858) 523-7000
(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 such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes /x/ No / /

As of July 31, 2001, there were 27,244,881 shares of the registrant's common stock, $0.001 par value, outstanding.

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PART I–FINANCIAL INFORMATION

Item 1. ***Financial Statements***

JNI Corporation
BALANCE SHEETS
(In thousands, except share and per share data)

	June 30, 2001	December 31, 2000
	(unaudited)	
ASSETS		
Current assets:		

Cash and cash equivalents	$ 9,220	$ 4,095
Marketable securities available for sale	111,030	112,350
Accounts receivable, net	11,513	21,635
Inventories	11,631	19,262
Other current assets	5,168	6,509
Total current assets	148,562	163,851
Property and equipment, net	13,653	8,995
Intangible assets, net	2,009	4,688
Other assets	806	560
	$ 165,030	$ 178,094
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 6,076	$ 9,126
Accrued liabilities	6,149	7,575
Deferred revenue	2,350	4,704
Total current liabilities	14,575	21,405
Contingencies (Note 6)		
Stockholders' equity:		
Preferred stock, undesignated series, 5,000,000 shares authorized; none issued	–	–
Common stock, par value $.001 per share; 100,000,000 shares authorized; 27,243,444 and 25,551,749 shares issued and Outstanding	27	26
Additional paid-in capital	144,667	143,610
Unearned stock-based compensation	(437)	(665)
Accumulated other comprehensive income	39	6
Retained earnings	6,159	13,712
Total stockholders' equity	150,455	156,689
	$ 165,030	$ 178,094

See accompanying notes to financial statements.

JNI Corporation
STATEMENTS OF OPERATIONS
(In thousands, except share and per share data)
(unaudited)

	Three Months Ended June 30,	Six Months Ended June 30,

	2001	2000	2001	2000
Net revenues	$ 23,057	$ 24,024	$ 44,199	$ 42,501
Cost of revenues	17,071	9,888	25,659	17,235
Gross margin	5,986	14,136	18,540	25,266
Operating expenses:				
Research and development	6,769	4,798	12,616	8,820
Selling and marketing	4,503	2,934	8,493	5,255
General and administrative	2,604	1,743	4,833	3,396
Amortization of intangible assets	1,339	1,339	2,679	2,679
Amortization of stock-based compensation	107	167	228	341
Total operating expenses	15,322	10,981	28,849	20,491
Operating income (loss)	(9,336)	3,155	(10,309)	4,775
Interest income	1,320	542	2,756	1,058
Income (loss) before income taxes	(8,016)	3,697	(7,553)	5,833
Income tax provision (benefit)	(162)	1,405	–	2,217
Net income (loss)	$ (7,854)	$ 2,292	$ (7,553)	$ 3,616
Earnings (loss) per share:				
Basic	$ (0.29)	$ 0.10	$ (0.28)	$ 0.16
Diluted	$ (0.29)	$ 0.09	$ (0.28)	$ 0.13
Number of shares used in per share computations:				
Basic	27,177,000	22,995,000	27,057,000	22,499,000
Diluted	27,177,000	26,754,000	27,057,000	26,915,000

See accompanying notes to financial statements.

JNI Corporation
STATEMENTS OF CASH FLOWS
(In thousands)
(unaudited)

	Six Months Ended June 30,	
	2001	2000
Cash flows from operating activities:		
Net income (loss)	$ (7,553)	$ 3,616
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Deferred income taxes	–	(720)
Depreciation and amortization	2,263	923

Amortization of intangible assets	2,679	2,679
Amortization of stock-based compensation	228	334
Changes in assets and liabilities:		
Accounts receivable, net	10,122	(6,174)
Inventories	7,631	(3,322)
Other assets	1,095	(325)
Accounts payable	(3,050)	1,516
Accrued liabilities	(1,426)	1,473
Deferred revenue	(2,354)	1,702
Other liabilities	−	(11)
Net cash provided by operating activities	9,635	1,691
Cash flows from investing activities:		
Purchases of marketable securities available for sale	(2,647)	(923)
Proceeds from sale of marketable securities available for sale	4,000	−
Capital expenditures	(6,921)	(2,252)
Net cash used in investing activities	(5,568)	(3,175)
Cash flows from financing activities:		
Net proceeds from issuance of common stock	1,058	546
Net cash provided by financing activities	1,058	546
Net change in cash and cash equivalents	5,125	(938)
Cash and cash equivalents, beginning of period	4,095	5,062
Cash and cash equivalents, end of period	$ 9,220	$ 4,124

See accompanying notes to financial statements.

JNI Corporation

NOTES TO FINANCIAL STATEMENTS
(In thousands, except share data)

Note 1−General

The accompanying unaudited financial statements of JNI Corporation (the "Company") for the three and six month periods ended June 30, 2001 and 2000 have been prepared on the same basis as the audited financial statements for the year ended December 31, 2000 and, in the opinion of management, include all adjustments (consisting only of normal recurring items) that the Company considers necessary for a fair presentation of its financial position, results of operations, and cash flows for such periods. However, the accompanying financial statements do not contain all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The interim financial statements and notes are presented as permitted by the requirements of Form 10-Q and do not contain certain information included in the Company's annual financial statements and notes thereto. These financial statements should be read in conjunction with the Company's audited financial statements and notes thereto presented in its Annual Report on Form 10-K for the fiscal year ended December 31, 2000 (the "2000 Annual Report"), as filed with the Securities and Exchange Commission. The interim financial information contained in this Quarterly Report is not necessarily indicative of the results to be expected for any other interim period or for the entire year.

Note 2−Inventory

Components of inventories are as follows:

	As of	
	June 30 2001	December 31 2000
Inventories:		
Raw materials	$ 8,615	$ 14,149
Work in process	1,333	2,260
Finished goods	1,683	2,853
Total	$ 11,631	$ 19,262

During the second quarter ended June 30, 2001, the Company recorded a charge of $7,700 to write down excess inventories.

Note 3−Reconciliation of Net Income and Shares Used in Per Share Computations

Earnings (loss) per share is computed using the weighted average number of shares of common stock outstanding and is presented for basic and diluted earnings (loss) per share. Basic earnings (loss) per share is computed by dividing income (loss) available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per share is computed by dividing income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period increased to include, if dilutive, the number of additional common shares that would have been outstanding if the potential common shares had been issued. The dilutive effect of outstanding stock options is reflected in diluted earnings (loss) per share by application of the treasury stock method. The Company has excluded all outstanding stock options from the calculation of diluted loss per share for the three and six months ended June 30, 2001 because such securities are antidilutive for these periods. The total number of potential common shares

excluded from the calculations of diluted loss per common share for the three and six months ended June 30, 2001 was 295,000 and 489,000, respectively.

The following table sets forth the computation of basic and diluted shares outstanding:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
Numerator:				
Net income (loss)	$ (7,854)	$ 2,292	$ (7,553)	$ 3,616
Denominator:				
Denominator for basic earnings (loss) per share				
Weighted average shares outstanding	27,177,000	22,995,000	27,057,000	22,499,000
Effect of dilutive securities:				
Dilutive warrants outstanding	−	−	−	406,000
Dilutive options outstanding	−	3,753,000	−	3,989,000
Employee stock purchase plan shares	−	6,000	−	21,000

Denominator for diluted earnings (loss) per share−adjusted weighted average shares	27,177,000	26,754,000	27,057,000	26,915,000

Note 4−Comprehensive Income

The Company presents unrealized gains and losses on the Company's available-for-sale securities in its statement of stockholders' equity and comprehensive income on an annual basis and in a footnote in its quarterly reports. During the three months ended June 30, 2001 and 2000, total comprehensive income (loss) was $(7,839) and $2,294, respectively. During the six months ended June 30, 2001 and 2000, total comprehensive income (loss) was $(7,520) and $3,596, respectively. Other comprehensive income or loss consists of unrealized gains or losses on the Company's marketable securities available for sale and included an unrealized gain of $15 and $2 during the three months ended June 30, 2001 and 2000, respectively. Other comprehensive income or loss included an unrealized gain of $33 and an unrealized loss of $20 during the six months ended June 30, 2001 and 2000, respectively.

Note 5−Related Party Loans

In April 2001, the Company's chief technology officer and chief operating officer received loans from the Company in the amount of $1,200 and $550, respectively, payable in full on or before April 5, 2002, at an interest rate of 5%. The loans are collateralized by Company stock owned by these individuals.

Note 6−Contingency

In April 2001, an alleged stockholder of the Company filed an alleged class action complaint against the Company and certain of its officers and directors in the United States District Court for the Southern District of California on behalf of purchasers of the Company's common stock during the period between October 16, 2000 and January 24, 2001. Thereafter, five additional and virtually identical lawsuits have been filed. The most recent of these lawsuits allege claims on behalf of purchasers of the Company's common stock during the period between October 16, 2000 and March 28, 2001 (the "Class Period"). The cases allege that during the Class Period, the Company made false statements about its business and results causing its stock to trade at artificially inflated levels. Based on these allegations, the cases allege that the Company and the others named in the cases violated the Securities Exchange Act of 1934. The Company has retained counsel to defend these cases.

The Company anticipates that the cases will be consolidated. The Company believes that these cases are without merit and intends to defend the cases vigorously.

Note 7−New Accounting Pronouncements

In June 2001 the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, *Business Combinations.* SFAS No. 141 addresses financial accounting and reporting for business combinations and supersedes APB Opinion No. 16, *Business Combinations,* and FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises*. All business combinations in the scope of this Statement are to be accounted for using one method, the purchase method. This accounting pronouncement is not expected to have a material impact on the Company's financial position or results of operations.

In June 2001 the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets.* SFAS No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, *Intangible Assets.* It addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This Statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. This accounting pronouncement is not expected to have a material impact on the Company's financial position or results of operations.

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

Forward Looking Statements: No Assurances Intended

This Report (including the following section regarding Management's Discussion and Analysis of Financial Condition and Results of Operations) contains forward-looking statements regarding the Company and its business, financial condition, results of operations and prospects. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates" and similar expressions or variations of such words are intended to identify forward-looking statements, but are not the exclusive means of identifying forward-looking statements in this Report. Additionally, statements concerning future matters such as the development of new products, enhancements or technologies, sales levels, expense levels and other statements regarding matters that are not historical are forward-looking statements.

Although forward-looking statements in this Report reflect the good faith judgment of the Company's management, such statements can only be based on facts and factors currently known by the Company. Consequently, forward-looking statements are inherently subject to risks and uncertainties and actual results and outcomes may differ materially from the results and outcomes discussed in or anticipated by the forward-looking statements. Factors that could cause or contribute to such differences in results and outcomes include without limitation those discussed under the heading "Other Information" in Item 5 below, as well as those discussed elsewhere in this Report and those discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2000. Readers are urged not to place undue reliance on these forward-looking statements, which speak only as of the date of this Report. The Company undertakes no obligation to revise or update any forward-looking statements in order to reflect any event or circumstance that may arise after the date of this Report. Readers are urged to carefully review and consider the various disclosures made by the Company in this Report, which attempt to advise interested parties of the risks and factors that may affect the Company's business, financial condition, results of operations and prospects.

Overview

We are a leading designer and supplier of Fibre Channel hardware and software products that connect servers and data storage devices across storage area networks, or SANs. SANs were made possible by the emergence of Fibre Channel technology, a new generation of server-to-storage communications technology that improves data communication speeds, connectivity, distance between connections, reliability and accessibility. We currently market a broad range of Fibre Channel host bus adapters and software that connect servers and storage subsystems to facilitate the integration and management of SAN devices. We also design and market high-performance application specific integrated circuits, or ASICs, based on our proprietary technology. Throughout our history, we have designed Fibre Channel products for the most demanding enterprise-level systems running mission critical SAN applications that are integral to our customers' businesses. We were the first in the industry to demonstrate products capable of sustained two gigabit per second Fibre Channel transmissions.

We design our products to operate with all major server operating systems and network configurations used in SANs. Our Fibre Channel host bus adapters, many of which incorporate our proprietary ASIC technology, can be used both with UNIX and PC-based server platforms and their associated interfaces. We have designed our proprietary driver software on a common code base to facilitate rapid certification by original equipment manufacturers, or OEMs, and to enhance our ability to bring new products and features to market rapidly in a variety of operating system environments. Our software drivers significantly reduce the need for a variety of adapters in heterogeneous environments and ensure interoperability between different sets of platforms and servers. Our EZ Fibre

configuration and management software simplifies the installation of our adapters in supported operating system environments.

We sell our products domestically and internationally primarily through OEM and distribution channel customers including distributors, system integrators and value added resellers who sell directly to end-users. Our significant customers include leading storage solution providers, server OEMs and storage OEMs.

We recognize revenue from product sales upon shipment except for sales to distributor customers that have contractual rights of return. Revenue from sales to distributors that have contractual rights of return is recognized when these distributors ship our products to their end-user customers. Allowances for estimated sales returns are provided at the time revenue is recognized. We reserve for uncollectable accounts and warranty claims based on past history and expected future returns related to products shipped.

Cost of revenues is comprised principally of payments to our contract manufacturers, costs of components, material expediting charges, final assembly costs, manufacturing and quality-related costs, inventory management costs and support costs. We expect our gross margin to be affected by many factors, including changes in average unit selling price, fluctuations in demand for our products, the mix of products sold, the mix of sales channels through which our products are sold, the timing and size of customer orders, fluctuations in manufacturing volumes, changes in costs of components, and new product introductions both by us and our competitors.

Research and development expenses consist primarily of salaries and related expenses for engineering personnel, fees paid to consultants and outside service providers, depreciation of development and test equipment, prototyping expenses related to the design, development, testing and enhancements of our products and the cost of computer support services. We expense all research and development costs as incurred.

Selling and marketing expenses consist primarily of salaries, commissions and related expenses for personnel engaged in marketing, sales and customer support functions, public relations, advertising, promotional and trade show costs and travel expenses.

General and administrative expenses include salaries and related expenses for personnel engaged in finance, human resources, information technology, administrative activities and legal and accounting fees.

Amortization of intangible assets arises from the amortization of intangible assets acquired in connection with the purchase of products and technology from Adaptec in November 1998 for 1,132,895 shares of common stock and a warrant to purchase 840,000 shares of common stock. As a result of the consideration paid to Adaptec, we recorded $11.6 million in intangible assets related to the core technology acquired which is being amortized over an estimated useful life of three years.

Amortization of stock-based compensation relates to deferred compensation recorded in connection with the grant of stock options to employees in all operating expense categories where the option exercise price was less than the fair value of the underlying shares of common stock as determined for financial reporting purposes. We have recorded deferred compensation within stockholders' equity which is being amortized over the vesting period of the related stock options, generally four years.

Comparison of Three Months Ended June 30, 2001 and 2000

Net revenues. Net revenues decreased $967,000, or 4%, to $23.1 million in the three months ended June 30, 2001 from $24.0 million in the three months ended June 30, 2000. The decrease was due to a $1.7 million decrease in sales of our SBus host bus adapter products partially offset by a

$245,000 increase in sales of our PCI host bus adapter products and a $489,000 increase in sales of our ASICs and ASICs development agreements. The decrease in revenues is primarily a result of the continued slowdown in information technology spending coupled with our dominance in the Solaris market and the weakness experienced in this market.

Gross margin. Gross margin decreased $8.2 million, or 58%, to $6.0 million in the three months ended June 30, 2001 from $14.1 million in the three months ended June 30, 2000. Gross margin as a percentage of net revenues decreased to 26.0% during the three months ended June 30, 2001 from 58.8% during the three months ended June 30, 2000. The decrease is primarily attributed to a $7.7 million charge recorded for excess inventory. In the second quarter of 2001, we recorded an excess inventory charge of $7.7 million against cost of revenues based on the determination that current inventory levels were in excess of projected future demand. Excluding the $7.7 million excess inventory charge, gross margin as a percentage of net revenues increased to 59.5% during the three months ended June 30, 2001 from 58.8% during the three months ended June 30, 2000.

Research and development. Research and development expenses increased $2.0 million, or 41%, to $6.8 million for the three months ended June 30, 2001 from $4.8 million for the three months ended June 30, 2000. The increase was due primarily to higher personnel costs, resulting from an increase in the number of personnel needed in order to staff a higher level of research and development, and higher depreciation expense, resulting from an increase in capital expenditures necessary to expand our research and development efforts and continued investments in our system integration lab. The increase in office and lab space for our research and development team resulted in higher rent and occupancy related expenses. As a percentage of net revenues, research and development expenses increased to 29.4% for the three months ended June 30, 2001 from 20.0% for the three months ended June 30, 2000.

Selling and marketing. Selling and marketing expenses increased $1.6 million, or 53%, to $4.5 million for the three months ended June 30, 2001 from $2.9 million for the three months ended June 30, 2000. The increase in selling and marketing expenses was due primarily to an increase in personnel costs resulting from the expansion of our sales and marketing staff including the costs associated with hiring a new Vice President of Worldwide Sales and a new Vice President of Business Development in the second quarter, increased travel expenses by our sales people, an increase in public relations expenses and reproduction and printing costs as we continue our efforts to increase our brand awareness and increased costs associated with opening new sales offices in the United States and Europe. Selling and marketing expenses as a percentage of net revenues increased to 19.5% for the three months ended June 30, 2001 from 12.2% for the three months ended June 30, 2000.

General and administrative. General and administrative expenses increased $861,000, or 49%, to $2.6 million for the three months ended June 30, 2001 from $1.7 million for the three months ended June 30, 2000. The increase was primarily due to higher personnel costs arising from the addition of new employees, an increase in legal fees mainly as a result of the class action lawsuit filed in April 2001, an increase in costs associated with the printing of the Company's annual report and an increase in insurance expenses due to the Company's continued expansion. General and administrative expenses as a percentage of net revenues increased to 11.3% for the three months ended June 30, 2001 from 7.3% for the three months ended June 30, 2000.

Amortization of intangible assets. We amortized $1.3 million of intangible assets during the three months ended June 30, 2001 and 2000.

Amortization of stock-based compensation. In connection with the grant of stock options to employees, we amortized stock-based compensation of $107,000 and $167,000 during the three months ended June 30, 2001 and 2000, respectively.

Interest income. Interest income of $1.3 million primarily represents interest earned on our investments in marketable securities during the three months ended June 30, 2001, primarily resulting from the proceeds from our public offering completed in October 2000. Interest income of $542,000 primarily represents interest earned on our investments in marketable securities during the three months ended June 30, 2000, resulting from the proceeds from our initial public offering completed in October 1999.

Income tax provision. As a result of our tax projections for fiscal year 2001, our estimated effective tax rate for fiscal year 2001 is 0%. Accordingly, we recorded a tax benefit in the second quarter of 2001, representing a reversal of the $162,000 tax provision recorded in the first quarter. We recognized an income tax provision of $1.4 million, with an effective tax rate of 38.0%, during the three months ended June 30, 2000 as a result of the taxable income generated in the three months ended June 30, 2000.

Comparison of Six Months Ended June 30, 2001 and 2000

Net revenues. Net revenues increased $1.7 million, or 4%, to $44.2 million in the six months ended June 30, 2001 from $42.5 million in the six months ended June 30, 2000. The increase was due to a $3.4 million increase in sales of our PCI host bus adapter products partially offset by a $1.8 million decrease in sales of our SBus host bus adapter products. Although our net revenues increased from the six months ended June 30, 2000 to the six months ended June 30, 2001, we experienced a slow down in revenue growth primarily as a result of the slowdown in information technology spending experienced in 2001 coupled with our dominance in the Solaris market and the weakness experienced in this market.

Gross margin. Gross margin decreased $6.7 million, or 27%, to $18.5 million in the six months ended June 30, 2001 from $25.3 million in the six months ended June 30, 2000. Gross margin as a percentage of net revenues decreased to 41.9% during the six months ended June 30, 2001 from 59.4% during the six months ended June 30, 2000. The decrease is attributed to a $7.7 million charge recorded for excess inventory. In the second quarter of 2001, we recorded an excess inventory charge of $7.7 million against cost of revenues based on the determination that current inventory levels were in excess of projected future demand. Excluding the $7.7 million excess inventory charge, gross margin as a percentage of net revenues remained flat at 59.4% during the six months ended June 30, 2001 and 2000.

Research and development. Research and development expenses increased $3.8 million, or 43%, to $12.6 million for the six months ended June 30, 2001 from $8.8 million for the six months ended June 30, 2000. The increase was due primarily to higher personnel costs, resulting from an increase in the number of personnel needed in order to staff a higher level of research and development, and higher depreciation expense, resulting from an increase in capital expenditures necessary to expand our research and development efforts and continued investments in our system integration lab. The increase in office and lab space for our research and development team resulted in higher rent and occupancy related expenses. Additionally, we opened up an office for a research and development team in Singapore in January of 2001 to assist in the design and development of our ASICs which also contributed to the increase in research and development expenses. As a percentage of net revenues, research and development expenses increased to 28.5% for the six months ended June 30, 2001 from 20.8% for the six months ended June 30, 2000.

Selling and marketing. Selling and marketing expenses increased $3.2 million, or 62%, to $8.5 million for the six months ended June 30, 2001 from $5.3 million for the six months ended June 30, 2000. The increase in selling and marketing expenses was due primarily to an increase in personnel costs resulting from the expansion of our sales and marketing staff, increased travel expenses by our sales people, an increase in public relations expenses and reproduction and printing costs as we

continue our efforts to increase our brand awareness and increased costs associated with opening new sales offices in the United States and Europe. Selling and marketing expenses as a percentage of net revenues increased to 19.2% for the six months ended June 30, 2001 from 12.4% for the six months ended June 30, 2000.

General and administrative. General and administrative expenses increased $1.4 million, or 42%, to $4.8 million for the six months ended June 30, 2001 from $3.4 million for the six months ended June 30, 2000. The increase was primarily due to higher personnel costs arising from the addition of new employees, including senior management, and an increase in consulting and legal expenses and insurance costs. General and administrative expenses as a percentage of net revenues increased to 10.9% for the six months ended June 30, 2001 from 8.0% for the six months ended June 30, 2000.

Amortization of intangible assets. We amortized $2.7 million of intangible assets during the six months ended June 30, 2001 and 2000.

Amortization of stock-based compensation. In connection with the grant of stock options to employees, we amortized stock-based compensation of $228,000 and $341,000 during the six months ended June 30, 2001 and 2000, respectively.

Interest income. Interest income of $2.8 million primarily represents interest earned on our investments in marketable securities during the six months ended June 30, 2001, primarily resulting from the proceeds from our public offering completed in October 2000. Interest income of $1.1 million primarily represents interest earned on our investments in marketable securities during the six months ended June 30, 2000, resulting from the proceeds from our initial public offering completed in October 1999.

Income tax provision. As a result of our tax projections for fiscal year 2001, the Company's estimated effective tax rate for fiscal year 2001 is 0%. Accordingly, we recognized an income tax provision of $0 during the six months ended June 30, 2001. We recognized an income tax provision of $2.2 million, with an effective tax rate of 38.0%, during the six months ended June 30, 2000 as a result of the taxable income generated in the six months ended June 30, 2000.

Liquidity and Capital Resources

During the six months ended June 30, 2001, cash provided by operating activities was $9.6 million, compared to $1.7 million of cash provided by operating activities during the six months ended June 30, 2000. The cash provided by operations during the six months ended June 30, 2001 reflects a $10.1 million decrease in accounts receivable and a $7.6 million decrease in inventory, which includes the $7.7 million charge recorded for excess inventory, partially offset by a net loss before depreciation and amortization of approximately $2.4 million and $5.7 million of cash used for other working capital items such as other assets, accounts payable, accrued liabilities and deferred revenue.

Net cash used in investing activities was $5.6 million in the six months ended June 30, 2001 and consisted of capital expenditures and purchases of marketable securities available for sale partially offset by the proceeds from the sale of marketable securities. Net cash used in investing activities was $3.2 million in the six months ended June 30, 2000 and consisted of capital expenditures and purchases of marketable securities available for sale. The capital expenditures primarily reflect our investment in computer and lab equipment to build out our system integration lab as well as investment in software development tools and equipment for our engineering operations.

Net cash provided by financing activities was $1.1 million in the six months ended June 30, 2001, which resulted from net proceeds from the issuance of common stock, consisting of proceeds from the exercise of stock options and purchases of shares under our employee stock purchase plan. Net cash provided by financing activities was $546,000 in the six months ended June 30, 2000, which resulted

from net proceeds from the issuance of common stock, primarily consisting of proceeds from the exercise of stock options and purchases of shares under our employee stock purchase plan.

We had $120.3 million of cash and cash equivalents and investments and $134.0 million of working capital at June 30, 2001. We believe that our cash and investments position will be sufficient to meet working capital needs at least through the next 12 months. Our future capital requirements will depend on many factors, including the rate of revenue growth, the timing and extent of spending to support product development efforts and expansion of sales and marketing, the timing of introductions of new products and enhancements to existing products, and market acceptance of our products. There can be no assurance that additional equity or debt financing, if required, will be available on acceptable terms, or at all.

New Accounting Pronouncements

In June 2001 the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, *Business Combinations.* SFAS No. 141 addresses financial accounting and reporting for business combinations and supersedes APB Opinion No. 16, *Business Combinations,* and FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises*. All business combinations in the scope of this Statement are to be accounted for using one method, the purchase method. This accounting pronouncement is not expected to have a material impact on our financial position or results of operations.

In June 2001 the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets.* SFAS No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, *Intangible Assets.* It addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This Statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. This accounting pronouncement is not expected to have a material impact on our financial position or results of operations.

Item 3. *Quantitative and Qualitative Disclosures about Market Risk*

Our exposure to market risk for changes in interest rates relates primarily to changes in the fair market value of our investments and the amount of interest income earned on our investment portfolio. In the normal course of business, we employ established policies and procedures to manage our exposure to changes in the fair market value of our investments.

Under our current policies, we do not use interest rate derivative instruments to manage exposure to interest rate changes. We ensure the safety and preservation of our invested principal funds by limiting default risks, market risk and reinvestment risk. We mitigate default risk by investing in investment grade securities. A hypothetical 100 basis point adverse move in interest rates along the entire interest rate yield curve would not materially affect the fair value of our interest sensitive financial instruments at June 30, 2001.

Currently, all of our sales are denominated in U.S. dollars, so we are not exposed to foreign currency related risks.

PART II–OTHER INFORMATION

Item 1. *Legal Proceedings*

In April 2001, an alleged stockholder of the Company filed an alleged class action complaint against the Company and certain of its officers and directors in the United States District Court for the Southern District of California on behalf of purchasers of the Company's common stock during the period between October 16, 2000 and January 24, 2001. Thereafter, five additional and virtually identical lawsuits have been filed. The most recent of these lawsuits allege claims on behalf of purchasers of the Company's common stock during the period between October 16, 2000 and March 28, 2001 (the "Class Period"). The cases allege that during the Class Period, the Company made false statements about its business and results causing its stock to trade at artificially inflated levels. Based on these allegations, the cases allege that the Company and the others named in the cases violated the Securities Exchange Act of 1934. The Company has retained counsel to defend these cases. The Company anticipates that the cases will be consolidated. The Company believes that these cases are without merit and intends to defend the cases vigorously.

Item 2. *Changes in Securities and Use of Proceeds*

None.

Item 3. *Defaults upon Senior Securities*

None.

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

On May 22, 2001, JNI held an Annual Meeting of Stockholders at which the following proposals were voted on by the stockholders:

1. To elect five directors for a one-year term to expire at the 2002 Annual Meeting of Stockholders:

Nominee	For	Withheld
John Bolger	22,346,854	291,840

Neal Waddington	22,296,848	341,846
John C. Stiska	20,541,352	2,097,342
Lawrence E. Fox	22,346,454	292,240
Eric P. Wenaas	20,542,740	2,095,954

2.

To consider the adoption of an increase in the maximum number of shares that may be issued under the Company's 1999 Stock Option Plan by 1,500,000 shares, from 2,312,800 to 3,812,800 shares and to establish a share grant limitation.

For approval	11,829,479
Against approval	3,866,105
Abstained	322,306
Broker Non-Votes	6,620,804

Item 5. ***Other Information***

Factors That May Affect Future Performance

Risks relating to our business

We have a limited history of profitability which may be difficult to maintain.

We shipped our first commercially available Fibre Channel products in 1995, but we did not achieve operating income until the quarter ended September 30, 1998. You should consider the risks and difficulties frequently encountered by companies such as ours in new and rapidly evolving markets. We may not realize sufficient net revenues in future periods to attain and maintain profitability. In addition, because of the competition in the Fibre Channel and SAN markets and the evolving nature of these markets, sustaining profitability may be extremely challenging.

Our quarterly operating results are volatile and may cause our stock price to fluctuate.

Our future revenues and operating results are likely to vary significantly from quarter to quarter due to a number of factors, many of which are outside of our control. Accordingly, you should not rely on quarter-to-quarter comparisons of our operating results as an indication of future performance. It is possible that in some future periods our operating results will be below the expectations of public market analysts and investors. In this event, the price of our common stock will likely decline. Factors that may cause our revenues, gross margins and operating results to fluctuate include the following:

the size, timing, terms and fluctuations of customer orders, particularly large orders from our significant OEM or reseller customers;

- changes in customer buying patterns;
- declining average selling prices of our products;
- fluctuations in sales levels of Sun servers;
- the timing of the introduction or enhancement of products by us, our significant OEM or reseller customers or our competitors;
- delays in obtaining OEM certifications for our products;
- our ability to obtain sufficient supplies of single- or limited-source components of our products;
- fluctuations in costs of goods sold and potential write-offs of obsolete inventory as we transition to new products;
- operating expenses, particularly in connection with our strategies to increase brand awareness or to invest in accelerated research and development; and
- general economic conditions.

Because our revenues in a given quarter depend substantially on orders booked in that quarter, a decrease in the number of orders we receive is likely to adversely and disproportionately affect our quarterly operating results. This is because our expense levels are partially based on our expectations of future sales and we may be unable to adjust spending in a timely manner to compensate for any unexpected revenue shortfall. As a result, our expenses may be disproportionately large as compared to sales in a quarter with reduced orders. Any shortfall in sales in relation to our quarterly expectations or any delay of customer orders would likely have an immediate and adverse impact on our business, quarterly operating results and financial condition.

Delays in product development could adversely affect our market position or customer relationships.

We have experienced delays in product development in the past and may experience similar delays in the future. Given the short product life cycles in the markets for our products, any delay or unanticipated difficulty associated with new product introductions or product enhancements could cause us to lose customers and damage our competitive position. Prior delays have resulted from numerous factors, such as:

changing OEM product specifications;

undetected errors or failures in software and hardware;

changing market or competitive product requirements;

difficulties in hiring and retaining necessary personnel;

difficulties in reallocating engineering resources and other resource limitations;

difficulties with independent contractors;

unanticipated engineering complexity; and

delays in the acceptance or shipment of products by OEM customers.

Because we depend on a small number of OEM and distribution channel customers for a significant portion of our revenues in each period, the loss of any of these customers, the failure to obtain certifications or any cancellation or delay of a large purchase by any of these customers could significantly reduce our net revenues.

Historically, a limited number of OEMs and distribution channel customers has accounted for a significant majority of our total net revenues. The loss of any of our key customers, or a significant reduction in sales to those customers, could significantly reduce our net revenues. For the six months ended June 30, 2001, Info X, Inc. accounted for 23% of our net revenues and Acal Electronics accounted for 14% of our net revenues. We anticipate that our operating results in any given period will continue to depend to a significant extent upon revenues from a small number of customers.

Before we can sell our products to an OEM or its associated distribution channel, that OEM must certify our products. The certification process can take up to 12 months. This process requires the commitment of OEM personnel and test equipment, and we compete with our competitors for these resources. Any delays in obtaining these certifications or any failure to obtain these certifications would adversely affect our ability to sell our products. In addition, because none of our customers is contractually obligated to purchase any fixed amount of products from us in the future, they may stop placing orders with us at any time, regardless of any forecast they may have previously provided. If any of our large customers stops or delays purchases, our revenues and profitability would be adversely affected, which could cause our stock price to decline. We cannot be certain that we will retain our current OEM or distribution channel customers or that we will be able to recruit additional or replacement customers. As is common in an emerging technology industry, our agreements with OEMs and distribution channel customers typically are non-exclusive and often may be terminated by either party without cause. Moreover, many of our OEM and distribution channel customers utilize or carry competing product lines. If we were to suddenly lose one or more important OEM or distribution channel customers to a competitor, our business, operating results or financial condition could be materially adversely affected.

Furthermore, some of our OEM customers could develop products internally that would replace our products. The resulting reduction in sales of our products to any such OEM customers, in addition to the increased competition presented by these customers, could have a material adverse effect on our business, operating results or financial condition.

Because a significant portion of our products is designed to work with servers from Sun Microsystems, Inc. and storage arrays from EMC Corporation, our business could suffer if demand for such Sun or EMC equipment declines or if we fail to adapt quickly to changes in the market for such equipment.

Our host bus adapters have achieved their greatest market acceptance in computing environments built with high-end servers from Sun Microsystems due to our products' interoperability with the Sun Solaris operating system. Further, a significant portion of our products is currently used to connect high-end Sun servers that incorporate SBus interfaces to SANs, and these products have accounted for the substantial majority of our historical revenues. In addition, we believe that more than half of our host bus adapters are used to form connections to storage arrays manufactured by EMC. Accordingly, we depend to a certain extent upon the increased market penetration of Sun and EMC systems, and if the demand for these systems does not expand, our revenue growth may suffer.

To maintain our position in the market for Sun Solaris SAN connectivity products we must continue to develop, market and sell host bus adapters that interoperate effectively in evolving Sun and EMC environments. Sun has released new midrange server products that do not include the SBus interface. Additionally, it is our expectation that Sun will in the future release additional midrange and new high-end server products that do not include the SBus interface. In order to maintain our leading share in this market, we must effectively market and sell host bus adapters that build on our Solaris expertise but that utilize our proprietary Emerald ASICs and the PCI bus architecture. Because our SBus host bus adapters have a higher average selling price than our PCI host bus adapters, a rapid decline in SBus shipments could adversely affect our revenue levels even if we maintained our market share through increased shipments of PCI host bus adapters.

If we do not develop, market and sell host bus adapters that interoperate with operating systems other than the Sun Solaris operating system our business will suffer.

We have derived a substantial majority of our historical revenues from sales of host bus adapters that include software designed to work with the Sun Microsystems Solaris operating system, and we have only recently begun to ship products that interoperate with operating systems other than the Sun Solaris operating system and incorporate our proprietary Emerald ASICs. Our success depends on our ability to continue to develop, market and sell products with these features. These new products remain in the early stage of market introduction and are subject to the risks inherent in the commercialization of new products. We may not be successful in developing solutions for all major operating systems or in marketing the new products we develop, and we cannot assure you that our intended customers will purchase our products instead of competing products. Our failure to obtain a significant share of the market for host bus adapters compatible with operating systems other than the Sun Solaris operating system would impair our growth and harm our results of operations.

Our future success depends in part upon our ability to market and sell products that incorporate our proprietary Emerald ASICs.

In 2000, we made our first commercial shipments of host bus adapters that incorporate our proprietary Emerald family of ASICs rather than the third-party ASICs we historically have used. We are seeking additional OEM certifications of our host bus adapters that incorporate our Emerald ASICs, but we may not obtain these certifications on a timely basis or at all. In addition, we must continue to develop and release new and enhanced versions of our ASICs to remain competitive, which will require further certifications by our OEM customers. Accordingly, we may not be successful in marketing products using our proprietary ASICs, and we cannot assure you that our intended customers will purchase these products instead of competing products.

Because we depend on sole source and limited source suppliers for key components, we are susceptible to supply shortages that could adversely affect our operating results.

We rely on third-party suppliers for components that are used in our products, and we have experienced delays and difficulty in securing components in the past. In times of shortage, we have been required to pay, and may in the future be required to pay, substantial premiums for components, which could adversely affect our gross margins. Key components that we use in our products may, from time to time, only be available from single sources with which we do not have long-term contracts. The components we use for our products are based on an emerging technology and may not be available with the performance characteristics or in the quantities that we require. Any inability to supply products due to a lack of components or to redesign products to incorporate alternative components in a timely manner could materially adversely affect our business, operating results or financial condition.

Our operating results may suffer because of increasing competition in the Fibre Channel market, as well as additional competition from alternative data storage solutions.

The market in which we compete is intensely competitive. As a result, we will face a variety of significant challenges, including rapid technological advances, price erosion, changing customer preferences and evolving industry standards. Our competitors continue to introduce products with improved price/performance characteristics, and we will have to do the same to remain competitive. Increased competition could result in significant price competition, reduced revenues, lower profit margins or loss of market share, any of which would have a material adverse effect on our business, operating results and financial condition. We cannot be certain that we will be able to compete successfully against either current or potential competitors in the future.

Many of our current and potential competitors, including Emulex Corporation, Qlogic Corporation, Interphase Corporation, Agilent Technologies, Inc., Troika Software, Inc. and Adaptec, Inc., have substantially greater financial, technical, marketing and distribution resources than we have. We face the threat of potential competition from new entrants into the Fibre Channel market and the Sun Solaris segment of that market, which continues to represent the substantial majority of our revenues. These potential new entrants include large technology companies that may develop or acquire differentiating technology and then apply their resources, including established distribution channels and brand recognition, to obtain significant market share. Emerging companies attempting to obtain a share of the existing market also may compete with us. Our products may also compete at the end-user level with other current or future technology alternatives, such as SCSI, InfiniBand and Gigabit Ethernet. Further, businesses that implement SANs may select fully-integrated SAN systems that are offered by large product solution companies. Because such systems do not interoperate with products from independent open system suppliers, like us, customers that invest in these systems will be less likely to purchase our products. Other technologies designed to address the applications served by Fibre Channel today are under development, and because we exclusively sell Fibre Channel products for SAN connectivity, our business could suffer if the market for Fibre Channel products grows more slowly than we anticipate as a result of competition from such technologies.

Consolidation of our competitors may cause us to lose customers and hurt our sales.

Consolidation in the data storage industry may strengthen our competitors' positions in our market, cause us to lose customers and hurt our sales. In addition, acquisitions may strengthen our competitors' financial, technical and marketing resources and provide them with access to potential customers, which may harm our business.

Our failure to attract and retain key managerial, technical, selling and marketing personnel could adversely affect our business.

Our success depends upon our retention of key managerial technical, selling and marketing personnel. The loss of the services of key personnel might significantly delay or prevent the

achievement of our development and strategic objectives. We do not maintain key person life insurance on any of our employees, and none of our employees is under any obligation to continue providing services to JNI.

We must continue to attract, train and retain managerial, technical, selling and marketing personnel. In particular, we are currently seeking to hire additional skilled development engineers who are currently in short supply. Competition for such highly skilled employees in our industry is intense, and we cannot be certain that we will be successful in recruiting or retaining such personnel. We also believe that our success depends to a significant extent on the ability of our key personnel to operate effectively, both individually and as a group. Many of our employees have only recently joined us. If we are unable to identify, hire and integrate new employees in a timely and cost-effective manner, our operating results may suffer.

Because we exclusively sell Fibre Channel products, our revenues will be limited if the Fibre Channel market does not continue to expand.

The growth of the market for our current products depends upon the continued acceptance of Fibre Channel technology as an alternative to other technologies utilized for network and storage communications. If the Fibre Channel market develops more slowly than anticipated or attracts more competitors than we expect, our business, operating results and financial condition would be materially adversely affected. We cannot be certain that Fibre Channel products will gain broader market acceptance or that customers will choose our technology and products.

To achieve widespread market acceptance, Fibre Channel must supplant current widely accepted alternative technologies such as Small Computer Systems Interface, or SCSI. It may be difficult to convince new customers to adopt Fibre Channel technology because many technology companies with SCSI-based product portfolios already have:

- well-established relationships with our current and potential customers;
- extensive knowledge of the markets we serve;
- better name recognition; and
- extensive development, selling and marketing resources.

If Fibre Channel does not replace existing technologies such as SCSI in emerging applications such as SANs or otherwise achieve broad market acceptance, our growth will be limited. Additionally, new technologies are currently in development that may compete for market share with Fibre Channel if they are successfully developed and commercialized. Because these competing new technologies are likely to have support from technology companies with more significant resources than we and other Fibre Channel companies have, they may limit the growth of the Fibre Channel market and therefore our growth.

In our industry, technology and other standards change rapidly, and we must keep pace with the changes to compete successfully.

The market for our products is characterized by rapidly changing technology, evolving industry standards and the frequent introduction of new products and enhancements. Our future success depends in a large part on our ability to enhance our existing products and to introduce new products on a timely basis to meet changes in customer preferences and evolving industry standards. Additionally, changes in technology and customer preferences could potentially render our current products uncompetitive or obsolete. We cannot be certain that we will be successful in designing, supplying and marketing new products or product enhancements that respond to such changes in a timely manner and achieve market acceptance. We also cannot be certain that we will be able to develop the underlying core technologies necessary to create new products and enhancements, or that

we will be able to license the core technologies from third parties. In addition, because our products are designed to work with software produced by third parties, our operating results could be adversely affected if such third parties delay introduction of new versions of their software for which we have designed new products or if they make unanticipated modifications to such software. If we are unable, for technological or other reasons, to develop new products or enhance existing products in a timely manner in response to technological and market changes, our business, operating results and financial condition would be materially adversely affected.

The SAN market in which we compete is new and unpredictable, and if this market does not develop and expand as we anticipate, our business will suffer.

Our products are principally purchased for use in SANs. Accordingly, widespread adoption of SANs as an integral part of data-intensive enterprise computing environments is crucial to our future success. The market for SANs and the related equipment, including the host bus adapters, ASICs and management software we offer, has only recently begun to develop and is rapidly evolving. Because this market is new, it is difficult to predict its potential size or future growth rate. Potential end-users who have invested substantial resources in their existing data storage and management systems may be reluctant or slow to adopt a new approach like a SAN. If this market does not develop as rapidly as we anticipate, our operating results may be below the expectations of public market analysts and investors, which would likely cause our stock price to decline. Furthermore, the evolution of the SAN architecture is uncertain. If products are developed that incorporate the host bus adapter or do not require separate adapters, our adapter products may be rendered obsolete or unnecessary.

If we fail to expand our distribution channels and manage our distribution relationships, our results of operations could be harmed significantly.

Our success will depend on our continuing ability to develop and manage relationships with significant OEMs, resellers and systems integrators, as well as on the sales efforts and success of these customers. We may not be able to expand our distribution channels or manage our distribution relationships successfully, and our customers may not market our products effectively. Our failure to expand our distribution channels or successfully manage our distribution relationships or the failure of our customers to sell our products could harm our results of operations.

If we are unable to perform additional testing of our products required by certain customers on a timely basis, our revenues may suffer.

Although we test substantially all of our products prior to shipment, some of our customers require additional testing of the products we sell to them. During the six months ended June 30, 2001, approximately half of the units we shipped were subject to such additional tests. If our capacity to conduct this testing does not expand concurrently with the anticipated growth of our business, product shipments could be delayed, which could result in delayed or lost revenues and customer dissatisfaction.

The sales cycle for our products is long, and we may incur substantial, non- recoverable expenses or devote significant resources to sales that do not occur when anticipated or at all.

Our sales cycle, particularly to OEMs, typically involves a lengthy certification process during which we generally invest significant resources in addressing customer specifications. The purchase of our products or solutions that incorporate our products typically involves significant internal procedures associated with the evaluation, testing, implementation and acceptance of new technologies. This evaluation process frequently results in a lengthy sales process, typically ranging from three months to longer than a year, and is subject to a number of significant risks, including budgetary constraints and internal acceptance reviews. The length of our sales cycle also varies substantially from customer to customer. Because of the length of the sales cycle, we may experience a delay between increasing expenses for research and development and selling and marketing efforts and the generation of higher revenues, if any, from such expenditures.

The failure of our OEM customers to keep pace with rapid technological change and to successfully develop and introduce new products could adversely affect our net revenues.

Our ability to generate increased revenues depends significantly upon the ability and willingness of our OEM customers to develop and promote products on a timely basis that incorporate our technology. OEMs must commit significant resources each time they develop a product that incorporates one of our new products. If our OEM customers do not invest in the development and marketing of solutions that incorporate our products and successfully market these solutions, then sales of our products to the OEM customers will be adversely affected. The ability and willingness of OEM customers to develop and promote such products is based upon a number of factors beyond our control.

We expect that the average selling prices of each of our products may decrease over time following release, which may reduce gross margins or revenues.

We expect that we will experience downward pricing pressure on our products. We anticipate that, in the future, the average selling prices of each of our products will decrease over time following its release in response to competitive pricing pressures, increased sales discounts, new product introductions by us or our competitors or other factors. Therefore, to maintain our gross margins, we must develop and introduce on a timely basis new products and product enhancements and continually reduce our product costs. Our failure to do so would cause our revenue and gross margins to decline, which could materially adversely affect our operating results and cause the price of our common stock to decline.

Our product cycles may be short, and from time to time we may need to write off excess and obsolete inventory.

In the rapidly changing technology environment in which we operate, product cycles tend to be short. However, we must have sufficient quantities of our products available to satisfy our customers' demands. Accordingly, we order significant quantities of our products from our manufacturers prior to receiving customer orders. Although we expect to sell the inventory within a short period of time, products may remain in inventory for extended periods and may become obsolete because of the passage of time and the introduction of new products. For example, as we introduce successive generations of ASICs, we may experience excess inventory of host bus adapters that incorporate the prior generation of ASICs. In these situations, we would be required to write off obsolete inventory, which could have a material adverse effect on our business, financial condition and results of operations.

Because we rely on third parties, and in some cases, a sole manufacturer, for substantially all of our manufacturing and assembly, failures by these third parties to provide products of sufficient quality and quantity could cause us to delay product shipments, which could result in delayed or lost revenues or customer dissatisfaction.

Taiwan Semiconductor Manufacturing Company, or TSMC, is currently our sole manufacturer for all of our Emerald ASIC wafers, and various subcontractors, such as Amkor Technology, Inc., Caesar International Inc. and Siliconware USA Inc., perform assembly, packaging and testing of our ASICs so that we purchase and receive only finished product. SCI Systems, Inc. in Rapid City, South Dakota, and SMS Technologies, Inc. in San Diego, California perform substantially all assembly operations for our host bus adapters. We have no firm long-term commitments from TSMC, SCI or SMS to supply products to us for any specific period, or in any specific quantity, except as may be provided in a particular purchase order.

Our reliance on TSMC for fabrication of our Emerald ASIC wafers involves particular risks. The semiconductor industry is highly cyclical and, in the past, foundry capacity has been very limited at times and may become limited in the future. Our dependence on TSMC increases our exposure to this

cyclicality and to possible shortages of key components, product performance shortfalls and reduced controls over delivery schedules, manufacturing capability, quality assurance, quantity and costs. If TSMC or any of our other third-party manufacturers experiences delays, disruptions, earthquakes, capacity constraints or quality control problems in its manufacturing operations, then product shipments to our customers could be delayed, which would negatively impact our net revenues, competitive position and reputation.

Further, our business would be harmed if we fail to effectively manage the manufacture of our products. Because we place orders with our manufacturers based on our forecasts of expected demand for our products, if we inaccurately forecast demand, we may be unable to obtain adequate manufacturing capacity or adequate quantities of components to meet our customers' delivery requirements, or we may accumulate excess inventories.

We may in the future need to find new contract manufacturers in order to increase our volumes or to reduce our costs. We may not be able to find contract manufacturers that meet our needs, and even if we do, qualifying a new contract manufacturer and commencing volume production is expensive and time consuming. If we are required or elect to change contract manufacturers, we may lose revenues, and our customer relationships may suffer.

Our reliance on manufacturers in other countries outside the U.S. subjects us to risks inherent in doing business on an international level that could harm our operating results.

Currently, our ASIC products are manufactured by a third party located in Asia, and we may expand our manufacturing, assembly and testing activities abroad. Accordingly, we are subject to risks inherent in international operations, which include:

- political, social and economic instability;
- trade restrictions and tariffs;
- the imposition of governmental controls;
- exposure to different legal standards, particularly with respect to intellectual property;
- import and export license requirements;
- unexpected changes in regulatory requirements; and
- potentially adverse tax consequences.

In particular, many Asian countries have in recent years experienced significant economic difficulties, including currency devaluation and instability, business failures and a generally depressed business climate, particularly in the semiconductor industry. In view of our reliance on Asian manufacturers, and our expanded international operations, any future economic downturns in the Asian economy may seriously harm our business.

Because our intellectual property is critical to the success of our business, our operating results would suffer if we were unable to adequately protect our intellectual property.

Our proprietary technologies are crucial to our success and ability to compete. We rely primarily on a combination of copyrights, trademarks, trade secret laws and contractual provisions to establish and protect our intellectual property rights in our proprietary technologies, including the source code for our software and the reference designs for our ASICs. We presently have no patents. We generally enter into confidentiality or license agreements with employees, consultants and customers and seek to control access to and distribution of our source code, documentation and other proprietary information. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. Policing unauthorized use of our proprietary information is difficult. Other parties also may independently develop or

otherwise acquire equivalent or superior technology. In addition, the laws of some of the countries in which our products are or may be developed, manufactured or sold may not protect our products and intellectual property rights to the same extent as the laws of the United States, or at all. Our failure to protect our intellectual property rights could have a material adverse effect on our business, operating results or financial condition.

We may become involved in costly and lengthy patent infringement or intellectual property litigation which could seriously harm our business.

In recent years, there has been significant litigation in the United States and in foreign countries involving patents and other intellectual property rights. We may become party to litigation in the future as a result of an alleged infringement of others' intellectual property. From time to time, we receive inquiries from other companies concerning whether we used their proprietary information to develop driver software compatible with their operating systems. Any claims that we improperly use another party's proprietary information or that we infringe another party's intellectual property, with or without merit, could adversely affect or delay sales of our products that use the technology in question, result in costly and time-consuming litigation, divert our technical and management personnel, or require us to develop non-infringing technology or enter into royalty or licensing arrangements, any of which would adversely affect our business, financial condition or operating results. It also is possible that patent holders will assert patent rights which apply broadly to our industry, and that such patent rights, if valid, may apply to our products or technology. These or other claims may require us to stop using the challenged intellectual property or to enter into royalty or licensing agreements. We cannot be certain that the necessary licenses will be available or that they can be obtained on commercially reasonable terms. If we were to fail to obtain such royalty or licensing agreements in a timely manner or on reasonable terms, our business, operating results or financial condition could be materially adversely affected.

Our export sales subject us to risks that could adversely affect our business.

Export sales accounted for 31% of our net revenues during the six months ended June 30, 2001, 23% of our net revenues in 2000, 17% of our net revenues in 1999 and 14% of net revenues in 1998. Accordingly, we encounter risks inherent in international operations. Because all of our sales are currently denominated in U.S. dollars, if the value of the U.S. dollar increases relative to foreign currencies, our products could become less competitive in international markets. Our export sales could also be limited or disrupted by any of the following factors:

- restrictions on the export of technology;
- longer accounts receivable payment cycles;
- reduced and limited protections of intellectual property rights;
- trade restrictions; and
- changes in tariffs.

Failure to comply with governmental regulations by us or our OEM customers could reduce our sales or require design modifications.

Our products are subject to U.S. Department of Commerce and Federal Communications Commission regulations as well as various standards established by authorities in other countries. Failure to comply with existing or evolving U.S. or foreign governmental regulation or to obtain timely domestic or foreign regulatory approvals or certificates could materially harm our business by reducing our sales or requiring design modifications to our products or the products of our OEM customers. Neither we nor our customers may export such products without obtaining an export license. United States export laws also prohibit the export of our products to a number of countries deemed by the

U.S. to be hostile. These restrictions may make foreign competitors facing less stringent controls on their products more competitive in the global market than we or our customers are. The U.S. government may not approve any pending or future export license requests. In addition, the list of products and countries for which export approval is required, and the regulatory policies with respect thereto, could be revised.

Our products are complex and may contain undetected software or hardware errors that could lead to an increase in our costs, reduce our net revenues or damage our reputation.

Products as complex as ours frequently contain undetected software or hardware errors when first introduced or as new versions are released. We have from time to time found errors in existing products, and we may from time to time find errors in our existing, new or enhanced products. The occurrence of hardware or software errors could adversely affect sales of our products, cause us to incur significant warranty and repair costs, divert the attention of our engineering personnel from our product development efforts and cause us to lose credibility with current or prospective customers.

We may need additional capital in the future to fund the growth of our business, and financing may not be available.

We currently anticipate that our available capital resources, combined with cash flows from operations and expected interest income, will be sufficient to meet our expected working capital and capital expenditure requirements for at least the next 12 months. However, we cannot assure you that such resources will be sufficient to fund the growth of our business.

We may also raise additional funds through public or private debt or equity financings if such financings become available on favorable terms, but such financings would likely dilute our stockholders. We cannot assure you that any additional financing we may need will be available on terms favorable to us, or at all. If adequate funds are not available or are not available on acceptable terms, we may not be able to take advantage of unanticipated opportunities, develop new products or otherwise respond to competitive pressures. In any such case, our business, operating results or financial condition could be materially adversely affected.

We may engage in future acquisitions that dilute our stockholders' equity and cause us to incur debt or assume contingent liabilities.

We may pursue acquisitions that could provide new technologies or products. Future acquisitions may involve the use of significant amounts of cash, potentially dilutive issuances of equity or equity-linked securities, the incurrence of debt, or amortization expenses related to goodwill and other intangible assets.

In addition, acquisitions involve numerous risks, including:

- difficulties in the assimilation of the operations, technologies, products and personnel of the acquired company;

- the diversion of management's attention from other business concerns;

risks of entering markets in which we have no or limited prior experience; and

the potential loss of key employees of the acquired company.

We currently have no commitments or agreements with respect to any such acquisition. In the event that such an acquisition does occur and we are unable to successfully integrate businesses, products, technologies or personnel that we acquire, our business, operating results or financial condition could be materially adversely affected.

Our stock price is volatile, which has and may result in lawsuits against us and our officers and directors.

The stock market in general, and the stock prices in technology-based companies in particular, have experienced extreme volatility that often has been unrelated to the operating performance of any specific public company. The market price of our common stock has fluctuated in the past and is likely to fluctuate in the future as well. Factors which could have a significant impact on the market price of our common stock include, but are not limited to, the following:

Quarterly variations in operating results;

Announcements of new products by us or our competitors;

The gain or loss of significant customers;

Changes in analysts' earnings estimates;

Rumors or dissemination of false information;

Pricing pressures;

Short selling of our common stock;

General conditions in the computer, storage or communications markets; or

Events affecting other companies that investors deem to be comparable to us.

In the past, companies that have experienced volatility in the market price of their stock have been the object of securities class action litigation. In this regard, we and certain of our officers and directors have been named as defendants in securities class action lawsuits filed in the United States District Court, Central District of California. Such lawsuits allege that we and certain of our officers and directors made misrepresentations and omissions in violation of sections 10(b) and 20(a) of the Securities Exchange Act of 1934. As a result of these lawsuits, a number of derivitive cases have been filed in California and Delaware alleging that certain of officers and directors breached their fiduciary duties to the Company in connection with the events alleged in the class action lawsuits. The complaints generally seek compensatory damages, costs and attorney's fees in an unspecified amount. Such litigation could result in substantial costs to us and a diversion of our management's attention and resources. While we believe that the lawsuits are without legal merit and intend to defend them vigorously, because the lawsuits are at an early stage, it is not possible to predict whether we will incur any material liability in connection with such lawsuits.

Item 6. ***Exhibits and Reports on Form 8-K***

(a)

Exhibits

3.1(1) Fourth Amended and Restated Certificate of Incorporation of the Company

3.2(2) Certificate of Designation, Rights and Preferences

3.4(1) Bylaws of the Company

(1)

Incorporated by reference to the Registration Statement on Form S-1 filed by JNI Corporation (File No. 333-86501).

(2)

Incorporated by reference to the current report on Form 8-K filed by JNI Corporation on February 9, 2001 (File No. 000-27755).

(b)

Reports on Form 8-K

None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report on Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

JNI CORPORATION

Date: August 3, 2001 By: /s/ NEAL WADDINGTON

Neal Waddington
President, Chief Executive Officer and Director

Date: August 3, 2001

/s/ GLORIA PURDY

Gloria Purdy
Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: August 3, 2001

/s/ PAUL KIM

Paul Kim
Vice President–Finance and Corporate Controller

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