LANTRONIX INC
Form 10-Q
October 27, 2017

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**UNITED STATES**

**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 September 30, 2017**

**OR**

**o 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: 1-16027**

**LANTRONIX, INC.**

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Delaware** | **33-0362767** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |

**7535 Irvine Center Drive, Suite 100, Irvine, California**

**(Address of principal executive offices)**

**92618**

**(Zip Code)**

**(949) 453-3990**

**(Registrant's telephone number, including area code)**

**Not Applicable**

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

| | |
|---|---|
| Large accelerated filer o | Accelerated filer o |
| Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company x |

Emerging Growth Company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

As of October 20, 2017, there were 17,973,595 shares of the registrant’s common stock outstanding.

**LANTRONIX, INC.**

**FORM 10-Q**

**FOR THE QUARTERLY PERIOD ENDED**

**SEPTEMBER 30, 2017**

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**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

**This Quarterly Report on Form 10-Q for the three months ended September 30, 2017, or this Report, contains forward-looking statements within the meaning of the federal securities laws, which statements are subject to substantial risks and uncertainties. These forward-looking statements are intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact included in this Report, or incorporated by reference into this Report, are forward-looking statements. Throughout this Report, we have attempted to identify forward-looking statements by using words such as “may,” “believe,” “will,” “could,” “project,” “anticipate,” “expect,” “estimate,” “sho “continue,” “potential,” “plan,” “forecasts,” “goal,” “seek,” “intend,” other forms of these words or similar words or expressions or the negative thereof. In particular, this Report contains forward-looking statements relating to, among other things:**

- **predictions about our earnings, revenues, margins, expenses or other financial matters;**
- **forecasts of our financial condition, results of operations, liquidity position, or working capital requirements;**
- **our ability to comply with certain financial obligations in our loan agreement;**
- **the impact of changes to our share-based awards and any related changes to our share-based compensation expenses;**
- **the impact of future offerings and sales of our debt or equity securities;**
- **the impact of changes in our relationship with our customers;**
- **plans or expectations with respect to our product development activities, business strategies or restructuring and expansion activities;**
- **demand and growth of the market for our products or for the products of our competitors;**
- **the impact of pending litigation, including outcomes of such litigation;**
- **the impact of our response to and implementation of recent accounting pronouncements on our consolidated financial statements and the related disclosures;**

- **sufficiency of our internal controls and procedures;**
- **the success of our plans to realign and reallocate our resources; and**
- **assumptions or estimates underlying any of the foregoing.**

**We have based our forward-looking statements on management's current expectations and projections about trends affecting our business and industry and other future events. Although we do not make forward-looking statements unless we believe we have a reasonable basis for doing so, we cannot guarantee their accuracy. Forward-looking statements are subject to substantial risks and uncertainties that could cause our future business, financial condition, results of operations or performance to differ materially from our historical results or those expressed or implied in any forward-looking statement contained in this Report. Some of the risks and uncertainties that may cause actual results to differ from those expressed or implied in the forward-looking statements are described in "Risk Factors" included in Part II, Item 1A of this Report, in "Risk Factors" included in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended June 30, 2017, filed with the Securities and Exchange Commission, or the SEC, on August 24, 2017, or the Form 10-K, as well as in our other public filings with the SEC. In addition, actual results may differ as a result of additional risks and uncertainties of which we are currently unaware or which we do not currently view as material to our business.**

**You should read this Report in its entirety, together with the documents that we file as exhibits to this Report and the documents that we incorporate by reference into this Report, with the understanding that our future results may be materially different from what we currently expect. The forward-looking statements we make speak only as of the date on which they are made. We expressly disclaim any intent or obligation to update any forward-looking statements after the date hereof to conform such statements to actual results or to changes in our opinions or expectations, except as required by applicable law or the rules of The Nasdaq Stock Market, LLC. If we do update or correct any forward-looking statements, investors should not conclude that we will make additional updates or corrections.**

**We qualify all of our forward-looking statements by these cautionary statements.**

## PART I. FINANCIAL INFORMATION

### Item 1. Financial Statements

**LANTRONIX, INC.**

**UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

**(In thousands)**

| | September 30, 2017 | June 30, 2017 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $8,223 | $8,073 |
| Accounts receivable, net | 2,687 | 3,432 |
| Inventories, net | 7,258 | 6,959 |
| Contract manufacturers' receivable | 344 | 476 |
| Prepaid expenses and other current assets | 320 | 440 |
| Total current assets | 18,832 | 19,380 |
| Property and equipment, net | 1,152 | 1,218 |
| Goodwill | 9,488 | 9,488 |
| Other assets | 46 | 46 |
| Total assets | $29,518 | $30,132 |
| | | |
| Liabilities and stockholders' equity | | |
| Current liabilities: | | |
| Accounts payable | $3,500 | $2,717 |
| Accrued payroll and related expenses | 1,815 | 3,084 |
| Warranty reserve | 129 | 125 |
| Other current liabilities | 3,223 | 3,063 |
| Total current liabilities | 8,667 | 8,989 |
| Long-term capital lease obligations | 44 | 59 |
| Other non-current liabilities | 385 | 396 |
| Total liabilities | 9,096 | 9,444 |
| | | |
| Commitments and contingencies (Note 7) | | |
| | | |
| Stockholders' equity: | | |
| Common stock | 2 | 2 |
| Additional paid-in capital | 210,925 | 210,550 |

| | | |
|---|---|---|
| Accumulated deficit | (190,876) | (190,235) |
| Accumulated other comprehensive income | 371 | 371 |
| Total stockholders' equity | 20,422 | 20,688 |
| Total liabilities and stockholders' equity | $29,518 | $30,132 |

See accompanying notes.

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**LANTRONIX, INC.**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(In thousands, except per share data)**

| | Three Months Ended September 30, | |
|---|---|---|
| | 2017 | 2016 |
| Net revenue | $10,606 | $10,940 |
| Cost of revenue | 5,012 | 5,240 |
| Gross profit | 5,594 | 5,700 |
| Operating expenses: | | |
| Selling, general and administrative | 3,986 | 3,842 |
| Research and development | 2,221 | 1,945 |
| Total operating expenses | 6,207 | 5,787 |
| Loss from operations | (613) | (87) |
| Interest expense, net | (4) | (7) |
| Other income (expense), net | 1 | (3) |
| Loss before income taxes | (616) | (97) |
| Provision for income taxes | 25 | 7 |
| Net loss | $(641) | $(104) |
| Net loss per share (basic and diluted) | $(0.04) | $(0.01) |
| Weighted-average common shares (basic and diluted) | 17,867 | 17,254 |

See accompanying notes.

**LANTRONIX, INC.**

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands)**

| | **Three Months Ended September 30,** | |
|---|---|---|
| | 2017 | 2016 |
| Operating activities | | |
| Net loss | $(641) | $(104) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Share-based compensation | 272 | 201 |
| Depreciation and amortization | 117 | 151 |
| Provision for excess and obsolete inventories | 246 | 13 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 745 | (25) |
| Inventories | (545) | (819) |
| Contract manufacturers' receivable | 132 | 83 |
| Prepaid expenses and other current assets | 120 | 101 |
| Other assets | (1) | 13 |
| Accounts payable | 783 | 104 |
| Accrued payroll and related expenses | (1,269) | 64 |
| Warranty reserve | 4 | 14 |
| Other liabilities | 148 | 427 |
| Net cash provided by operating activities | 111 | 223 |
| | | |
| Investing activities | | |
| Purchases of property and equipment | (50) | (72) |
| Net cash used in investing activities | (50) | (72) |
| | | |
| Financing activities | | |
| Tax withholding paid on behalf of employees for restricted shares | (48) | – |
| Net proceeds from issuances of common stock | 151 | – |
| Payment of capital lease obligations | (14) | (16) |
| Net cash provided by (used in) financing activities | 89 | (16) |
| Increase in cash and cash equivalents | 150 | 135 |
| Cash and cash equivalents at beginning of period | 8,073 | 5,962 |
| Cash and cash equivalents at end of period | $8,223 | $6,097 |

See accompanying notes.

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**LANTRONIX, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2017**

## 1. Summary of Significant Accounting Policies

### The Company

Lantronix, Inc., which we refer to herein as the Company, Lantronix, we, our, or us, is a global provider of secure data access and management solutions for Internet of Things ("IoT") assets. Our mission is to be the leading supplier of IoT solutions that enable companies to dramatically simplify the creation, deployment, and management of IoT projects while providing secure access to data for applications and people.

### Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Lantronix have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP") for interim financial information and in accordance with the instructions to Form 10-Q and Article 8 of Securities and Exchange Commission ("SEC") Regulation S-X. Accordingly, they should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2017, included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2017, which was filed with the SEC on August 24, 2017. The unaudited condensed consolidated financial statements contain all normal recurring accruals and adjustments that in the opinion of management, are necessary to present fairly the consolidated financial position of Lantronix at September 30, 2017, the consolidated results of our operations for the three months ended September 30, 2017 and our consolidated cash flows for the three months ended September 30, 2017. All intercompany accounts and transactions have been eliminated. It should be understood that accounting measurements at interim dates inherently involve greater reliance on estimates than at year-end. The results of operations for the three months ended September 30, 2017 are not necessarily indicative of the results to be expected for the full year or any future interim periods.

### Recent Accounting Pronouncements

*Leases*

In February 2016, the Financial Accounting Standards Board ("FASB") issued an accounting standard that revises lease accounting guidance. Most prominent among the changes in the standard is the recognition of right-of-use ("ROU") assets and lease liabilities by lessees for those leases classified as operating leases under the existing guidance. We will be required to recognize and measure leases existing at, or entered into after, the beginning of the earliest comparative period presented using a modified retrospective approach, with certain practical expedients available. The standard will be effective for Lantronix in the fiscal year beginning July 1, 2019. Early adoption is permitted. While we are continuing to assess the potential impacts of this standard, we currently expect the most significant impact on our financial statements will be the recognition of ROU assets and lease liabilities for our operating leases.

*Revenue from Contracts with Customers*

In May 2014, FASB issued an accounting standard which superseded existing revenue recognition guidance under current U.S. GAAP. The standard is a comprehensive revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. In doing so, among other things, companies will generally need to use more judgment and make more estimates than under the current guidance.

The standard permits two methods of adoption: (i) retrospectively to each prior reporting period presented (the full retrospective method), or (ii) retrospectively with the cumulative effect of initially applying the standard recognized at the date of initial application (the cumulative catch-up transition method). We expect to adopt the standard in the fiscal year beginning July 1, 2018 using the full retrospective method to restate each prior reporting period presented.

We currently anticipate the standard will have a material impact on our financial statements and disclosures. We continue to make progress in assessing all potential impacts of the standard, including any impacts of recently issued amendments. We currently believe the most significant impact of the standard relates to our accounting for sales made to distributors under agreements which contain a limited right to return unsold products and price adjustment provisions. Under the existing revenue guidance, we have historically concluded that the price to these distributors is not fixed and determinable at the time we deliver products to them. Accordingly, revenue from sales to these distributors has not historically been recognized until the distributor resells the product. By contrast, under the new standard, we expect to recognize revenue, including estimates for applicable variable consideration, predominantly at the time of shipment to these distributors.

During the current fiscal year, we also expect to make progress to retrospectively adjust quarterly financial information for our fiscal year ending June 30, 2018. We have not yet determined the quantitative impact on any such quarterly financial information.

**2. Supplemental Financial Information**

**Inventories**

Inventories are stated at the lower of cost (first-in, first-out) or net realizable value and consist of the following:

| | September 30, 2017 | June 30, 2017 |
|---|---|---|
| | **(In thousands)** | |
| Finished goods | $4,300 | $4,191 |
| Raw materials | 1,899 | 1,694 |
| Finished goods held by distributors | 1,059 | 1,074 |
| Inventories, net | $7,258 | $6,959 |

**Other Liabilities**

The following table presents details of our other liabilities:

| | September 30, 2017 | June 30, 2017 |
|---|---|---|
| | **(In thousands)** | |
| Current | | |
| Customer deposits and refunds | $1,068 | $1,119 |
| Accrued raw materials purchases | 578 | 484 |
| Deferred revenue | 200 | 196 |
| Capital lease obligations | 62 | 61 |
| Taxes payable | 273 | 275 |
| Accrued operating expenses | 1,042 | 928 |
| Total other current liabilities | $3,223 | $3,063 |
| | | |
| Non-current | | |
| Deferred rent | $188 | $200 |
| Deferred revenue | 197 | 196 |
| Total other non-current liabilities | $385 | $396 |

**Computation of Net Loss per Share**

Basic and diluted net loss per share is calculated by dividing net loss by the weighted-average number of common shares outstanding during the applicable period.

The following table presents the computation of net loss per share:

| | Three Months Ended September 30, | |
|---|---|---|
| | 2017 | 2016 |
| | (In thousands, except per share data) | |
| Numerator: | | |
| Net loss | $(641) | $(104) |
| Denominator: | | |
| Weighted-average common shares outstanding (basic and diluted) | 17,867 | 17,254 |
| Net loss per share (basic and diluted) | $(0.04) | $(0.01) |

The following table presents the common stock equivalents excluded from the diluted net loss per share calculation, because they were anti-dilutive for the periods presented. These excluded common stock equivalents could be dilutive in the future.

| | Three Months Ended September 30, | |
|---|---|---|
| | 2017 | 2016 |
| | (In thousands) | |
| Common stock equivalents | 1,700 | 3,012 |

**Severance and Related Charges**

During the three months ended September 30, 2017, we realigned certain resources throughout our organization, primarily to optimize our operations and engineering efforts. These activities were substantially completed by September 30, 2017. These activities resulted in total charges of approximately $527,000, which consisted primarily of severance costs, and to a lesser extent, termination costs related to our facility lease in Hong Kong, and are included in the applicable functional line items within the accompanying unaudited condensed consolidated statement of operations for the three months ended September 30, 2017.

The following table presents details of the liability we recorded related to these activities:

| | Three Months Ended September 30, 2017 (In thousands) |
|---|---|
| Beginning balance | $ – |
| Charges | 527 |
| Payments | (241 ) |
| Ending balance | $ 286 |

The remaining liability balance is included in accrued payroll and related expenses in the accompanying unaudited condensed consolidated balance sheet at September 30, 2017.

**3. Warranty Reserve**

The standard warranty periods we provide for our products typically range from one to five years. We establish reserves for estimated product warranty costs at the time revenue is recognized based upon our historical warranty experience, and for any known or anticipated product warranty issues.

The following table presents details of our warranty reserve:

| | Three Months Ended September 30, 2017 | Year Ended June 30, 2017 |
|---|---|---|
| | **(In thousands)** | |
| Beginning balance | $ 125 | $ 138 |
| Charged to cost of revenue | 31 | 65 |
| Usage | (27 ) | (78 ) |
| Ending balance | $ 129 | $ 125 |

**4. Bank Line of Credit**

We are party to a Loan and Security Agreement (as amended, the "Loan Agreement") with Silicon Valley Bank ("SVB"), which provides a $4,000,000 revolving line of credit, based on qualified accounts receivable. The Loan Agreement has a maturity date of September 30, 2018.

The Loan Agreement provides for an interest rate per annum equal to the greater of the prime rate plus 0.75% or 4.25%, provided that we maintain a monthly quick ratio of 1.0 to 1.0 or greater. The quick ratio measures our ability to use our cash and cash equivalents maintained at SVB and our net accounts receivable to extinguish or retire our current liabilities. If this ratio is not met, the interest rate will become the greater of the prime rate plus 1.25% or 4.25%. At September 30, 2017, we met the 1.0 to 1.0 or greater quick ratio requirement.

The Loan Agreement also includes a covenant requiring us to maintain a certain Minimum Tangible Net Worth ("Minimum TNW"), currently required to be approximately $6,021,000. The Minimum TNW is subject to adjustment upward to the extent we raise additional equity or debt financing or achieve net income in future quarters. Our Actual Tangible Net Worth ("Actual TNW") is calculated as total stockholders' equity, less goodwill.

The following table presents the Minimum TNW compared to our Actual TNW:

| | September 30, 2017 |
|---|---|
| | (In thousands) |
| Minimum TNW | $ 6,021 |
| Actual TNW | $ 10,934 |

The following table presents certain information with respect to the Loan Agreement with SVB:

| | September 30, 2017 | June 30, 2017 |
|---|---|---|
| | (In thousands) | |
| Outstanding borrowings on the line of credit | $– | $– |
| Available borrowing capacity | $2,480 | $2,812 |
| Outstanding letters of credit | $51 | $51 |

Our outstanding letters of credit are used as security deposits.

**5. Stockholders' Equity**

**Stock Incentive Plans**

Our stock incentive plans permit the granting of stock options (both incentive and nonqualified stock options), restricted stock units ("RSUs"), stock appreciation rights, non-vested stock, and performance shares to certain employees, directors and consultants. As of September 30, 2017, no stock appreciation rights, non-vested stock, or performance shares were outstanding.

***Stock Options***

The following table presents a summary of activity during the three months ended September 30, 2017 with respect to our stock options:

| | Number of Shares (In thousands) | Weighted-Average Exercise Price per Share |
|---|---|---|
| Balance of options outstanding at June 30, 2017 | 4,184 | $ 1.78 |
| Granted | 783 | 2.16 |
| Forfeited | (91) | 1.49 |
| Expired | (20) | 4.37 |
| Exercised | (85) | 1.78 |
| Balance of options outstanding at September 30, 2017 | 4,771 | $ 1.84 |

***Restricted Stock Units***

The following table presents a summary of activity during the three months ended September 30, 2017 with respect to our RSUs:

| | Number of Shares (In thousands) | Weighted-Average Grant Date Fair Value per Share |
|---|---|---|
| Balance of RSUs outstanding at June 30, 2017 | 300 | $ 1.29 |
| Granted | 10 | 2.15 |
| Vested | (48 ) | 1.16 |
| Balance of RSUs outstanding at September 30, 2017 | 262 | $ 1.35 |

**Employee Stock Purchase Plan**

Our 2013 Employee Stock Purchase Plan (the "ESPP") is intended to provide employees with an opportunity to purchase our common stock through accumulated payroll deductions at the end of a specified purchase period. Each of our employees (including officers) is eligible to participate in the ESPP, subject to certain limitations as set forth in the ESPP.

The following table presents a summary of activity under our ESPP during the three months ended September 30, 2017:

| | Number of Shares (In thousands) |
|---|---|
| Shares available for issuance at June 30, 2017 | 476 |
| Shares issued | – |
| Shares available for issuance at September 30, 2017 | 476 |

**Share-Based Compensation Expense**

The following table presents a summary of share-based compensation expense included in each functional line item on our unaudited condensed consolidated statements of operations:

| | **Three Months Ended September 30,** | |
|---|---|---|
| | 2017 | 2016 |
| | **(In thousands)** | |
| Cost of revenue | $13 | $11 |
| Selling, general and administrative | 212 | 149 |
| Research and development | 47 | 41 |
| Total share-based compensation expense | $272 | $201 |

The following table presents the remaining unrecognized share-based compensation expense related to our outstanding share-based awards as of September 30, 2017:

| | Remaining Unrecognized Compensation Expense | Remaining Weighted-Average Years To Recognize |
|---|---|---|
| | (In thousands) | |
| Stock options | $ 2,071 | 3.1 |
| RSUs | 307 | 1.4 |
| Stock purchase rights under ESPP | 148 | 1.2 |
| | $ 2,526 | |

If there are any modifications or cancellations of the underlying unvested share-based awards, we may be required to accelerate, increase or cancel remaining unearned share-based compensation expense. Future share-based compensation expense and unearned share-based compensation will increase to the extent that we grant additional share-based awards.

**6. Income Taxes**

We utilize the liability method of accounting for income taxes. The following table presents our effective tax rates based upon our provision for income taxes for the periods shown:

| | **Three Months Ended September 30,** | |
|---|---|---|
| | 2017 | 2016 |
| Effective tax rate | 4% | 7% |

The difference between our effective tax rates in the periods presented above and the federal statutory rate is primarily due to a tax benefit from our domestic losses being recorded with a full valuation allowance, as well as the effect of foreign earnings taxed at rates differing from the federal statutory rate.

We record net deferred tax assets to the extent we believe it is more likely than not that these assets will be realized. As a result of our cumulative losses and uncertainty of generating future taxable income, we have provided a full valuation allowance against our net deferred tax assets as of September 30, 2017 and June 30, 2017.

**7. Commitments and Contingencies**

From time to time, we are involved in various legal proceedings and claims arising in the ordinary course of our business. Although the results of legal proceedings and claims cannot be predicted with certainty, we currently believe that the final outcome of these ordinary course matters will not, individually or in the aggregate, have a material adverse effect on our business, operating results, financial condition or cash flows. However, regardless of the outcome, litigation can have an adverse impact on us because of legal costs, diversion of management time and resources, and other factors.

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

*The following discussion and analysis of our financial condition and results of operations should be read together with our unaudited condensed consolidated financial statements and the related notes included in Part I, Item 1 of this Quarterly Report on Form 10-Q for the three months ended September 30, 2017, or this Report. This discussion and analysis contains forward-looking statements that are based on our current expectations and reflect our plans, estimates and anticipated future financial performance. See the section of this Report entitled "Cautionary Note Regarding Forward-Looking Statements" for additional information. These statements involve numerous risks and uncertainties. Our actual results may differ materially from those expressed or implied by these forward-looking statements as a result of many factors, including those set forth in "Risk Factors" in Part II, Item 1A of this Report.*

**Overview**

Lantronix, Inc., which we refer to herein as the Company, Lantronix, we, our, or us, is a global provider of secure data access and management solutions for Internet of Things, or IoT, assets. Our mission is to be the leading supplier of IoT solutions that enable companies to dramatically simplify the creation, deployment, and management of IoT projects while providing secure access to data for applications and people.

We conduct our business globally and manage our sales teams by three geographic regions: the Americas; Europe, Middle East, and Africa, or EMEA; and Asia Pacific Japan, or APJ.

**Products and Solutions Overview**

We organize our products and solutions into three product lines: IoT, IT Management and Other.

*IoT*

Our IoT products typically connect to one or more existing machines, provide network connectivity and are designed to enhance the value and utility of machines by making the data from the machines available to users, systems and processes or by controlling their properties and features over the network.

Our IoT products currently consist of IoT Gateways and IoT Building Blocks. IoT Gateways are designed to provide secure connectivity and the ability to add integrated device management and advanced data access features. IoT Building Blocks provide basic secure machine connectivity and unmanaged data access.

Our IoT products may be embedded into new designs or attached to existing machines. Our IoT products include wired and wireless connections that enhance the value and utility of modern electronic systems and equipment by providing secure network connectivity, application hosting, protocol conversion, secure access for distributed IoT deployments and many other functions. Many of the products are offered with software tools intended to further accelerate our customer's time-to-market and increase their value add.

Most of our IoT products are pre-certified in a number of countries thereby significantly reducing our OEM customers' regulatory certification costs and speeding their time to market.

The following product families are included in our IoT product line: EDS, EDS-MD, PremierWave® EN, PremierWave® XC, PremierWave® XN, UDS, WiPort®, xDirect®, xPico®, xPico® Wi-Fi, xPress™ and XPort®.

*IT Management*

Today, organizations are managing an ever-increasing number of devices and data on enterprise networks where 24/7 reliability is mission critical. Out-of-band management is a technique that uses dedicated network channels to manage critical network devices to ensure management connectivity (including the ability to determine the status of any network component) independent of the status of other in-band network components. Remote out-of-band access allows organizations to effectively manage their enterprise IT resources and at the same time, optimize their IT support resources.

Our IT Management product line includes console management, power management, and keyboard video mouse products that provide remote access to IT and networking infrastructure deployed in test labs, data centers and server rooms.

The following product families are included in our IT Management product line: SLB™, SLC™ 8000, and Spider™. In addition, this product line includes vSLM™, a virtualized central management software solution that simplifies secure administration of our IT Management products and the equipment attached to them through a standard web browser. vSLM is designed to operate with both our IT Management products and certain other manufacturers' IT infrastructure equipment.

*Other*

We categorize products that are non-focus or end-of-life as Other. Our Other product line includes non-focus products such as the xPrintServer®. In addition, this product line includes end-of-life versions of our MatchPort®, SLC™, SLP™, xPress Pro, xSenso®, and WiBox product families.

**Recent Accounting Pronouncements**

Refer to *Note 1* of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Report, which is incorporated herein by reference, for a discussion of recent accounting pronouncements.

**Critical Accounting Policies and Estimates**

The accounting policies that have the greatest impact on our financial condition and results of operations and that require the most judgment are those relating to revenue recognition, warranty reserves, allowance for doubtful accounts, inventory valuation, valuation of deferred income taxes, and goodwill. These policies are described in further detail in the Form 10-K. There have been no significant changes in our critical accounting policies and estimates during the three months ended September 30, 2017 as compared to what was previously disclosed in the Form 10-K.

**Results of Operations – Three Months Ended September 30, 2017 Compared to the Three Months Ended September 30, 2016**

***Summary***

In the three months ended September 30, 2017 our net revenue decreased by $334,000, or 3.1%, compared to the three months ended September 30, 2016. The decreases in net revenue in our IT Management and Other product lines were partially offset by 7.7% growth in our IoT product line. We had a net loss of $641,000 for the three months ended September 30, 2017 compared to a net loss of $104,000 for the three months ended September 30, 2016. Our net loss for the three months ended September 30, 2017 included severance and related charges of $527,000.

***Net Revenue***

The following tables present our fiscal quarter net revenue by product line and by geographic region:

| | Three Months Ended September 30, | | | | Change | |
|---|---|---|---|---|---|---|
| | 2017 | % of Net Revenue | 2016 | % of Net Revenue | $ | % |
| | (In thousands, except percentages) | | | | | |
| IoT | $8,477 | 79.9% | $7,869 | 71.9% | $608 | 7.7% |
| IT Management | 1,789 | 16.9% | 2,437 | 22.3% | (648) | (26.6%) |
| Other | 340 | 3.2% | 634 | 5.8% | (294) | (46.4%) |
| | $10,606 | 100.0% | $10,940 | 100.0% | $(334) | (3.1%) |

| | Three Months Ended September 30, | | | | Change | |
|---|---|---|---|---|---|---|
| | 2017 | % of Net Revenue | 2016 | % of Net Revenue | $ | % |
| | (In thousands, except percentages) | | | | | |
| Americas | $5,697 | 53.7% | $6,166 | 56.4% | $(469) | (7.6%) |
| EMEA | 3,164 | 29.8% | 3,101 | 28.3% | 63 | 2.0% |
| Asia Pacific Japan | 1,745 | 16.5% | 1,673 | 15.3% | 72 | 4.3% |
| | $10,606 | 100.0% | $10,940 | 100.0% | $(334) | (3.1%) |

*IoT*

Net revenue from our IoT product line for the three months ended September 30, 2017 increased compared to the three months ended September 30, 2016 due to growth in unit sales for a variety of our product families in different geographic regions including (i) XPort in all three of our regions, (ii) Micro in EMEA and APJ and (iii) xPico Wi-Fi, mostly in the EMEA region. The overall increase was partially offset by decreases in unit sales of Premierwave XN and some of our other legacy products, including the UDS and xPress product families.

*IT Management*

Net revenue from our IT Management product line for the three months ended September 30, 2017 decreased compared to the three months ended September 30, 2016 primarily due to a decrease in unit sales of our SLC 8000 product family, largely in the Americas region, and to a lesser extent, the EMEA and APJ regions. The decline in the SLC 8000 revenue is primarily due to a fewer number of large customer shipments during the three months ended September 30, 2017 as some of the anticipated orders pushed out of the current quarter.

*Other*

Net revenue from our Other products, which are comprised of non-focus and end-of-life product families, declined year-over-year primarily due to a decline in net revenue from our xPrintServer, as we experienced a large customer deployment in the prior year period.

***Gross Profit***

Gross profit represents net revenue less cost of revenue. Cost of revenue consists primarily of the cost of raw material components, subcontract labor assembly from contract manufacturers, manufacturing overhead, establishing or relieving inventory reserves for excess and obsolete products or raw materials, warranty costs, royalties and share-based compensation.

The following table presents our fiscal quarter gross profit:

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2017 | % of Net Revenue | 2016 | % of Net Revenue | Change $ | % |
| | (In thousands, except percentages) | | | | | |
| Gross profit | $5,594 | 52.7% | $5,700 | 52.1% | $(106) | (1.9%) |

Gross profit as a percent of revenue (referred to as “gross margin”) for the three months ended September 30, 2017 was generally consistent with the three months ended September 30, 2016. Our gross margin for the three months ended September 30, 2017 benefited from our product sales mix as some of our higher margin products, such as XPort, contributed to a larger portion of our revenue. This was largely offset by higher overhead costs and certain reserves we recorded for excess and obsolete inventories during the current quarter. The three months ended September 30, 2017 includes $58,000 of severance and related charges.

***Selling, General and Administrative***

Selling, general and administrative expenses consist of personnel-related expenses, including salaries and commissions, share-based compensation, facility expenses, information technology, trade show expenses, advertising, and legal and accounting fees.

The following table presents our fiscal quarter selling, general and administrative expenses:

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2017 | % of Net Revenue | 2016 | % of Net Revenue | Change $ | Change % |
| | (In thousands, except percentages) | | | | | |
| Personnel-related expenses | $2,736 | | $2,754 | | $(18) | (0.7%) |
| Severance and related charges | 155 | | – | | 155 | 100.0% |
| Professional fees and outside services | 318 | | 339 | | (21) | (6.2%) |
| Advertising and marketing | 178 | | 163 | | 15 | 9.2% |
| Facilities and insurance | 265 | | 233 | | 32 | 13.7% |
| Share-based compensation | 212 | | 149 | | 63 | 42.3% |
| Depreciation | 45 | | 54 | | (9) | (16.7%) |
| Other | 77 | | 150 | | (73) | (48.7%) |
| Selling, general and administrative | $3,986 | 37.6% | $3,842 | 35.1% | $144 | 3.7% |

Selling, general and administrative expenses increased primarily due to (i) the severance and related charges discussed directly below, and (ii) higher share-based compensation expenses, partially attributable to increased participation in our employee stock purchase plan.

During the three months ended September 30, 2017, we realigned certain resources throughout our organization, primarily to optimize our operations and engineering efforts. These activities were substantially completed by September 30, 2017. These activities resulted in total charges of approximately $527,000, which consisted primarily of severance costs, and to a lesser extent, termination costs related to our facility lease in Hong Kong. Of the total charges, approximately $155,000 was classified within selling, general and administrative expenses for the three months ended September 30, 2017.

***Research and Development***

Research and development expenses consist of personnel-related expenses, including share-based compensation, as well as expenditures to third-party vendors for research and development activities and product certification costs. Our quarterly costs related to outside services and product certifications vary from period to period depending on our level of development activities.

The following table presents our fiscal quarter research and development expenses:

| | Three Months Ended September 30, | | | | Change | |
|---|---|---|---|---|---|---|
| | 2017 | % of Net Revenue | 2016 | % of Net Revenue | $ | % |
| | (In thousands, except percentages) | | | | | |
| Personnel-related expenses | $1,449 | | $1,406 | | $43 | 3.1% |
| Severance and related charges | 314 | | – | | 314 | 100.0% |
| Facilities | 202 | | 198 | | 4 | 2.0% |
| Outside services | 65 | | 153 | | (88 ) | (57.5% ) |
| Product certifications | 108 | | 88 | | 20 | 22.7% |
| Share-based compensation | 47 | | 41 | | 6 | 14.6% |
| Other | 36 | | 59 | | (23 ) | (39.0% ) |
| Research and development | $2,221 | 20.9% | $1,945 | 17.8% | $276 | 14.2% |

Research and development expenses increased primarily due to the severance and related charges discussed further directly below.

During the three months ended September 30, 2017, we realigned certain resources throughout our organization, primarily to optimize our operations and engineering efforts. These activities were substantially completed by September 30, 2017. These activities resulted in total charges of approximately $527,000, which consisted primarily of severance costs, and to a lesser extent, termination costs related to our facility lease in Hong Kong. Of the total charges, approximately $314,000 was classified within research and development expenses for the three months ended September 30, 2017.

**Provision for Income Taxes**

The following table presents our effective tax rate based upon our provision for income taxes:

| | Three Months Ended September 30, | |
|---|---|---|
| | 2017 | 2016 |
| Effective tax rate | 4% | 7% |

We utilize the liability method of accounting for income taxes. The difference between our effective tax rates and the federal statutory rate resulted primarily from a tax benefit from our domestic losses being recorded with a full valuation allowance, as well as the effect of foreign earnings taxed at rates differing from the federal statutory rate.

We record net deferred tax assets to the extent that we believe it is more likely than not that these assets will be realized. As a result of our cumulative losses and uncertainty of generating future taxable income, we have provided a full valuation allowance against our net deferred tax assets as of September 30, 2017 and June 30, 2017.

**Liquidity and Capital Resources**

The following table presents details of our working capital and cash and cash equivalents:

| | September 30, 2017 | June 30, 2017 | Change |
|---|---|---|---|
| | (In thousands) | | |
| Working capital | $10,165 | $10,391 | $ (226 ) |
| Cash and cash equivalents | $8,223 | $8,073 | $ 150 |

Our principal sources of cash and liquidity include our existing cash and cash equivalents, borrowings available under our loan agreement, and cash generated from operations. We believe that these sources will be sufficient to fund our current requirements for working capital, capital expenditures and other financial commitments for at least the next 12 months. We anticipate that the primary factors affecting our cash and liquidity are net revenue and working capital requirements.

Management defines cash and cash equivalents as highly liquid deposits with original maturities of 90 days or less when purchased. We maintain cash and cash equivalents balances at certain financial institutions in excess of amounts insured by federal agencies. Management does not believe this concentration subjects us to any unusual financial risk beyond the normal risk associated with commercial banking relationships. We frequently monitor the third-party depository institutions that hold our cash and cash equivalents. Our investment policy primarily emphasizes safety of principal and secondarily emphasizes maximizing yield.

Our future working capital requirements will depend on many factors, including the timing and amount of our net revenue, any future restructuring or cost-cutting measures that we may implement from time to time, research and development expenses, expenses associated with any strategic partnerships or acquisitions, infrastructure investments and fundraising activities.

From time to time, we may seek additional capital from public or private offerings of our capital stock, borrowings under our existing or future credit lines or other sources in order to (i) develop or enhance our products, (ii) take advantage of strategic opportunities, (iii) respond to competition or (iv) continue to operate our business. We currently have an effective Form S-3 shelf registration statement on file with the SEC. If we issue equity securities to raise additional funds, our existing stockholders may experience dilution, and the new equity securities may have rights, preferences and privileges senior to those of our existing stockholders. If we issue debt securities to raise additional funds, we may incur debt service obligations, become subject to additional restrictions that limit or restrict our ability to operate our business, or be required to further encumber our assets. There can be no assurance that we will be able to raise any such capital on terms acceptable to us, if at all.

***Bank Line of Credit***

Refer to *Note 4* of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Report, which is incorporated herein by reference, for a discussion of our loan agreement.

***Cash Flows***

The following table presents the major components of the unaudited condensed consolidated statements of cash flows:

| | **Three Months Ended** September 30 | | |
|---|---|---|---|
| | 2017 | 2016 | Change |
| | (In thousands) | | |
| Net cash provided by operating activities | $ 111 | $ 223 | $ (112 ) |
| Net cash used in investing activities | (50 ) | (72 ) | 22 |
| Net cash provided by (used in) financing activities | 89 | (16 ) | 105 |

*Operating Activities*

Net cash provided by operating activities during the three months ended September 30, 2017 decreased slightly as compared to the prior year period in part due to an increase in our net loss to $641,000 in the three months ended September 30, 2017 as compared to our net loss of $104,000 in the three months ended September 30, 2016. Operating cash flows were also impacted by certain changes in operating assets and liabilities as further described directly below.

Accounts receivable decreased approximately $745,000, or 21.7%, as compared to June 30, 2017 primarily due to the timing and magnitude of our sales in the three months ended September 30, 2017 compared to the three months ended June 30, 2017. Accounts payable increased approximately $783,000, or 28.8%, as compared to June 30, 2017 primarily due to the timing of our payments to vendors, along with a 4.3% increase in inventories at September 30, 2017 compared to June 30, 2017. The impact of these changes in our accounts receivable and accounts payable balances on operating cash flows was largely offset by a decrease in accrued payroll and related expenses of approximately $1,269,000, or 41.1%, as compared to June 30, 2017 resulting from payments of accrued variable compensation made during the three months ended September 30, 2017.

*Investing Activities*

Net cash used in investing activities was related to capital expenditures for the purchase of property and equipment, primarily related to tooling and test equipment.

*Financing Activities*

Net cash provided by financing activities during the three months ended September 30, 2017 resulted primarily from cash we received from the issuance of common stock to employees for stock option exercises. This was partially offset by payments related to (i) withholding taxes in connection with the vesting of restricted stock units and (ii) capital leases. Net cash used in financing activities during the three months ended September 30, 2016 related to payments for capital leases.

**Off-Balance Sheet Arrangements**

As of September 30, 2017, we did not have any relationships with unconsolidated organizations or financial partnerships, including structured finance or special purpose entities, that have been established to facilitate off-balance sheet arrangements or for other purposes.

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

As a smaller reporting company, we are not required to provide the information required by this Item 3.

## Item 4. Controls and Procedures

### (a) Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and (ii) is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

We carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Report. Based upon that evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of September 30, 2017 at the reasonable assurance level.

**(b) Changes in Internal Controls over Financial Reporting**

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(f) and 15d-15(f) of the Exchange Act that occurred during the quarter ended September 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**(c) Inherent Limitation on Effectiveness of Controls**

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. 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. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

From time to time, we are involved in various legal proceedings and claims arising in the ordinary course of our business. Although the results of legal proceedings and claims cannot be predicted with certainty, we currently believe that the final outcome of these ordinary course matters will not, individually or in the aggregate, have a material adverse effect on our business, operating results, financial condition or cash flows. However, regardless of the outcome, litigation can have an adverse impact on us because of legal costs, diversion of management time and resources, and other factors.

### Item 1A. Risk Factors

An investment in our common stock involves risks. Before making an investment decision, you should carefully consider all of the information in this Report, including in the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Part I, Item 2 of this Report, and the unaudited condensed consolidated financial statements and related notes thereto. In addition, you should carefully consider the risks and uncertainties described in the section entitled “Risk Factors” in the Form 10-K, as well as in our other public filings with the SEC. If any of the identified risks are realized, our business, financial condition, operating results and prospects could be materially and adversely affected. In that case, the trading price of our common stock may decline, and you could lose all or part of your investment. In addition, other risks of which we are currently unaware, or which we do not currently view as material, could have a material adverse effect on our business, financial condition, operating results and prospects.

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

None.

### Item 3. Defaults Upon Senior Securities

None.

### Item 4. Mine Safety Disclosures

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

See the "Exhibit Index" immediately following the signature page of this Report, which is incorporated herein by reference.

**SIGNATURES**

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

| | | |
|---|---|---|
| | | **LANTRONIX, INC.** |
| Date: October 27, 2017 | By: | /s/ JEFFREY BENCK<br>**Jeffrey Benck**<br>**President and Chief Executive Officer**<br>**(Principal Executive Officer)** |
| Date: October 27, 2017 | By: | /s/ JEREMY WHITAKER<br>**Jeremy Whitaker**<br>**Chief Financial Officer**<br>**(Principal Financial and Accounting Officer)** |

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**EXHIBIT INDEX**

| Exhibit Number | Description | Provided Herewith | Incorporated by Reference Form | Exhibit | Filing Date |
|---|---|---|---|---|---|
| 31.1 | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | X | | | |
| 31.2 | Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | X | | | |
| 32.1* | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | X | | | |
| 101.INS | XBRL Instance Document | X | | | |
| 101.SCH | XBRL Taxonomy Extension Schema Document | X | | | |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document | X | | | |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document | X | | | |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document | X | | | |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document | X | | | |

* Furnished, not filed.