LANTRONIX INC
Form 10-Q
February 09, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2009

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

167 Technology Drive, Irvine, California
(Address of principal executive offices)

92618
(Zip Code)

(949) 453-3990
(Registrant's telephone number, including area code)

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

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 xNo 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 o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting 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

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 February 2, 2010, 10,315,208, shares of the Registrant's common stock were outstanding.

LANTRONIX, INC.

FORM 10-Q
FOR THE FISCAL QUARTER ENDED
December 31, 2009

INDEX

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

LANTRONIX, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	December 31, 2009	June 30, 2009
Assets		
Current assets:		
Cash and cash equivalents	$9,379	$9,137
Accounts receivable, net	1,762	1,851
Contract manufacturers' receivable	1,026	655
Inventories, net	6,606	6,479
Prepaid expenses and other current assets	847	529
Total current assets	19,620	18,651
Property and equipment, net	2,660	2,230
Goodwill	9,488	9,488
Purchased intangible assets, net	203	265
Other assets	128	122
Total assets	$32,099	$30,756
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$7,583	$5,626
Accrued payroll and related expenses	950	1,414
Warranty reserve	224	224
Restructuring reserve	-	76
Short-term debt	667	667
Other current liabilities	3,062	3,221
Total current liabilities	12,486	11,228
Non-current liabilities:		
Long-term liabilities	662	117
Long-term capital lease obligations	222	309
Long-term debt	444	778
Total non-current liabilities	1,328	1,204
Total liabilities	13,814	12,432
Commitments and contingencies		
Stockholders' equity:		
Common stock	1	1
Additional paid-in capital	190,397	189,584
Accumulated deficit	(172,561)	(171,687)
Accumulated other comprehensive income	448	426
Total stockholders' equity	18,285	18,324
Total liabilities and stockholders' equity	$32,099	$30,756

See accompanying notes.

1

LANTRONIX, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
Net revenue (1)	$11,478	$12,885	$22,432	$27,097
Cost of revenue	5,429	5,942	10,666	12,630
Gross profit	6,049	6,943	11,766	14,467
Operating expenses:				
Selling, general and administrative	4,855	5,315	9,475	10,523
Research and development	1,510	1,549	2,995	3,052
Restructuring charges	-	128	-	721
Amortization of purchased intangible assets	18	18	36	36
Total operating expenses	6,383	7,010	12,506	14,332
Income (loss) from operations	(334)	(67)	(740)	135
Interest expense, net	(42)	(57)	(89)	(83)
Other income (expense), net	11	(16)	(25)	6
Income (loss) before income taxes	(365)	(140)	(854)	58
Provision for income taxes	10	8	20	22
Net income (loss)	$(375)	$(148)	$(874)	$36
Net income (loss) per share (basic)	$(0.04)	$(0.01)	$(0.09)	$0.00
Net income (loss) per share (diluted)	$(0.04)	$(0.01)	$(0.09)	$0.00
Weighted-average shares (basic)	10,301	10,084	10,234	10,073
Weighted-average shares (diluted)	10,301	10,084	10,234	10,107
(1) Includes net revenue from related party	$142	$306	$267	$560

See accompanying notes.

LANTRONIX, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Six Months Ended December 31, 2009	2008
Operating activities		
Net income (loss)	$(874)	$36
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Share-based compensation	1,143	1,064
Depreciation	404	366
(Recovery) provision for inventories	(119)	101
Amortization of purchased intangible assets	62	58
Provision (recovery) of doubtful accounts	12	(37)
Restructuring charge	-	721
Changes in operating assets and liabilities:		
Accounts receivable	77	2,057
Contract manufacturers' receivable	(371)	(456)
Inventories	(8)	(190)
Prepaid expenses and other current assets	(352)	(121)
Other assets	(5)	10
Accounts payable	1,928	(1,222)
Accrued payroll and related expenses	(478)	(901)
Warranty reserve	-	(76)
Restructuring reserve	(76)	(1,391)
Other liabilities	59	488
Net cash provided by operating activities	1,402	507
Investing activities		
Purchases of property and equipment, net	(625)	(354)
Net cash used in investing activities	(625)	(354)
Financing activities		
Minimum tax withholding paid on behalf of employees for restricted shares	(263)	-
Payment of term loan	(333)	(222)
Net proceeds from issuances of common stock	150	88
Payment of capital lease obligations	(138)	(179)
Proceeds from term loan	-	2,000
Net cash (used in) provided by financing activities	(584)	1,687
Effect of foreign exchange rate changes on cash	49	(123)
Increase in cash and cash equivalents	242	1,717
Cash and cash equivalents at beginning of period	9,137	7,434
Cash and cash equivalents at end of period	$9,379	$9,151

See accompanying notes.

LANTRONIX, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Lantronix, Inc. (the “Company” or “Lantronix”) have been prepared by the Company in accordance with generally accepted accounting principles (“GAAP”) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of 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, 2009, included in the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission (“SEC”) on September 28, 2009. They contain all normal recurring accruals and adjustments which, in the opinion of management, are necessary to present fairly the consolidated financial position of the Company at December 31, 2009, and the consolidated results of its operations and cash flows for the three and six months ended December 31, 2009 and 2008. 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 and six months ended December 31, 2009 are not necessarily indicative of the results to be expected for the full year or any future interim periods.

In June 2009, the Financial Accounting Standards Board (“FASB”) established the Accounting Standards Codification, or Codification, as the source of authoritative GAAP recognized by the FASB. The Codification is effective in the first interim and annual periods ending after September 15, 2009 and had no effect on our unaudited condensed consolidated financial statements.

2. Computation of Net Income (Loss) per Share

Basic and diluted net income (loss) per share is calculated by dividing net loss by the weighted-average number of common shares outstanding during the year, adjusted to reflect the December 2009 one-for-six reverse stock split.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
	(In thousands, except per share data)			
Numerator:				
Net income (loss)	$ (375)	$ (148)	$ (874)	$ 36
Denominator:				
Weighted-average shares outstanding	10,620	10,599	10,553	10,588
Less: Unvested common shares outstanding	(319)	(515)	(319)	(515)
Weighted-average shares (basic)	10,301	10,084	10,234	10,073
Effect of dilutive securities:				
Unvested common shares outstanding	-	-	-	34
Stock options	-	-	-	-
	10,301	10,084	10,234	10,107

Denominator for net income (loss) per share (diluted)											
Net income (loss) per share (basic)	$	(0.04	)	$	(0.01	)	$	(0.09	)	$	0.00
Net income (loss) per share (diluted)	$	(0.04	)	$	(0.01	)	$	(0.09	)	$	0.00

The following table presents the common stock equivalents excluded from the diluted net income (loss) per share calculation, because they were anti-dilutive as of such dates. These excluded common stock equivalents that could be dilutive in the future.

4

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
	(In thousands)			
Common stock equivalents	1,201	1,518	1,351	1,427

3. Inventories

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

	December 31, 2009	June 30, 2009
	(In thousands)	
Finished goods	$ 4,445	$ 4,421
Raw materials	1,513	1,537
Inventory at distributors	1,384	1,355
Large scale integration chips *	792	909
Inventories, gross	8,134	8,222
Reserve for excess and obsolete inventory	(1,528)	(1,743)
Inventories, net	$ 6,606	$ 6,479

* This item is sold individually and embedded into the Company's products.

4. Warranty

Upon shipment to its customers, the Company provides for the estimated cost to repair or replace products to be returned under warranty. The Company’s products typically carry a one- or two-year warranty. Although the Company engages in extensive product quality programs and processes, its warranty obligation is affected by product failure rates, use of materials or service delivery costs that differ from the Company’s estimates. As a result, additional warranty reserves could be required, which could reduce gross margins. Additionally, the Company sells extended warranty services, which extend the warranty period for an additional one to three years, depending upon the product.

The following table is a reconciliation of the changes to the product warranty liability for the periods presented:

	Six Months Ended December 31, 2009	Year Ended June 30, 2009
	(In thousands)	
Beginning balance	$ 224	$ 342
Charged to cost of revenues	117	116
Usage	(117)	(234)
Ending balance	$ 224	$ 224

5. Restructuring Reserve

During the fourth fiscal quarter ended June 30, 2008, the Company implemented a restructuring plan to optimize its organization to better leverage existing customer and partner relationships in order to drive revenue growth and profitability. As part of the restructuring plan, 10 employees from the senior-level ranks of the sales, marketing, operations and engineering groups were terminated. During the first fiscal quarter ended September 30, 2008, the

Company implemented a second restructuring plan. As part of the second restructuring plan, an additional 29 employees from all ranks and across all functional groups of the Company were terminated. During the second fiscal quarter ended December 31, 2008, the Company incurred additional restructuring charges related to the termination of a senior-level employee and closure of a sales office in France. During the fourth fiscal quarter ended June 30, 2009, the Company incurred restructuring charges related to the consolidation of its corporate headquarters.

The following table presents a summary of the activity in the Company's restructuring reserve:

	Facilities Termination Costs	Severance Related Costs	Total Restructuring Costs
		(In thousands)	
Restructuring reserve at June 30, 2009	$ 73	$ 3	$ 76
Restructuring charge	-	-	-
Cash payments	(73)	(3)	(76)
Restructuring reserve at December 31, 2009	$ -	$ -	$ -

6. Bank Line of Credit and Debt

In August 2008, the Company entered into an Amendment to Loan and Security Agreement, which provides for a three-year $2.0 million Term Loan and a two-year $3.0 million Revolving Credit Facility (the "Term Loan and Revolving Credit Facility" or "Loan Agreement"). The Term Loan was funded on August 26, 2008 and is payable in 36 equal installments of principal and monthly accrued interest. There are no borrowings outstanding on the Revolving Credit Facility as of the fiscal quarter end.

Borrowings under the Term Loan and Revolving Credit Facility bear interest at the greater of 6.25% or prime rate plus 1.25% per annum. If the Company achieves two consecutive quarters of positive EBITDAS (as defined in the Loan Agreement) greater than $1.00, and only for so long as the Company maintains EBITDAS greater than $1.00 at the end of each subsequent fiscal quarter, then the borrowings under the Term Loan and Revolving Credit Facility will bear interest at the greater of 5.75% or prime rate plus 0.75% per annum. Upon entering into the agreement, the Company paid a fully earned, non-refundable commitment fee of $35,000 and paid an additional $35,000 on the first anniversary of the effective date of the Term Loan.

The Company's obligations under the Term Loan and Revolving Credit Facility are secured by substantially all of the Company's assets, including its intellectual property.

The following table presents our available borrowing capacity and outstanding letters of credit, which were used to secure equipment leases, purchase of materials, deposits for a building lease and security deposits:

	December 31, 2009	June 30, 2009
	(In thousands)	
Available borrowing capacity	$ 948	$ 426
Outstanding letters of credit	$ 651	$ 732

7. Stockholders' Equity

Common Stock

On November 18, 2009, Lantronix stockholders approved a proposal to authorize the Company's board of directors to implement, at its discretion, a reverse stock split of the Company's outstanding shares of common stock within a range of one-third to one-sixth of a share for each outstanding share of common stock, and to file an Amendment to the Company's Certificate of Incorporation (the "Certificate of Amendment") to effect such a reverse stock split. On November 18, 2009, the board of directors authorized a one-for-six reverse stock split of the Company's common stock. On December 18, 2009, the Company filed the Certificate of Amendment. All references to common shares and per-share data for all periods presented in this report have been retrospectively adjusted to give effect to this reverse stock split. As no change was made to the par value of the common shares, $5,000 was reclassified from common stock to additional paid-in capital.

Share-Based Compensation

The Company has one active share-based plan under which non-qualified and incentive stock options have been granted to employees, non-employees and its board of directors. In addition, the Company has granted restricted stock awards to employees and its board of directors under this share-based plan. The compensation committee of the board of directors determines eligibility, vesting schedules and exercise prices for options and restricted stock awards granted under the plans. The Company issues new shares to satisfy stock option exercises, restricted stock grants, and stock purchases under its share-based plans.

On August 18, 2009, eligible employees were granted awards of options to purchase common stock under the Company's Long Term Incentive Plan ("LTIP"). Under the terms of the LTIP, eligible employees were granted a total of 679,038 options to purchase common shares. Twenty-five percent of the options vest on September 1, 2010, and an additional 25% of the options vest each year thereafter, all subject to the recipients' continued employment. The LTIP option awards were made from the Company's 2000 Stock Plan. The exercise price was equal to the fair market value of the Company's common stock on the date of grant as listed on the Nasdaq Capital Market.

On September 15, 2009, Jerry D. Chase, President and Chief Executive Officer and Reagan Y. Sakai, Chief Financial Officer and Secretary were granted 76,724 and 44,400 options, respectively, to purchase common stock under the Company's LTIP plan. Twenty-five percent of the options vest on September 1, 2010, and an additional 25% of the options vest each year thereafter, all subject to the recipients' continued employment. The LTIP option awards were made from the Company's 2000 Stock Plan. The exercise price was equal to the fair market value of the Company's common stock on the date of grant as listed on the Nasdaq Capital Market.

The compensation committee of the board of directors approved a performance plan for the fiscal year ended June 30, 2010 ("Performance Plan"), which will be paid in vested common shares if minimum revenue, non-GAAP income and management objectives are met. As of December 31, 2009, the Company estimated it was at approximately 10% attainment per the Performance Plan which would result in an expense to share-based compensation of approximately $435,000 for the fiscal year ending June 30, 2010. During the six months ended December 31, 2009, the Company recorded $217,000 to share-based compensation in connection with this Performance Plan.

The following table presents a summary of option activity under all of the Company's stock option plans:

	Number of Shares
Balance of options outstanding at June 30, 2009	1,278,505
Options granted	980,219
Options forfeited	(55,919)
Options expired	(83,913)
Options exercised	(50,000)
Balance of options outstanding at December 31, 2009	2,068,892

The following table presents stock option grant date information:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
Weighted-average grant date fair value per share	$ 2.14	$ 2.10	$ 1.88	$ 2.22
Weighted-average grant date exercise price per share	$ 3.06	$ 3.18	$ 2.66	$ 3.30

The following table presents a summary of restricted stock activity:

	Number of Shares	Weighted Average Grant - Date Fair Value
Balance of restricted shares at June 30, 2009	472,065	$ 3.12
Granted	-	-

Forfeited	(22,693)		3.00
Vested	(130,763)		3.09
Balance of restricted shares at December 31, 2009	318,609	$	3.14

7

The following table presents a summary of the total fair value of shares vested for all of the Company's restricted share awards:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
	(In thousands)			
Fair value of shares vested	$ 77	$ -	$ 425	$ -

The following table presents a summary of remaining unrecognized share-based compensation by the vesting condition for the Company's share-based plans:

Vesting Condition	Remaining Unrecognized Compensation Cost	Remaining Years To Vest
	(In thousands)	
Stock Option Awards:		
Service based	$ 2,204	
Market and service based	567	
Stock option awards	$ 2,771	2.9
Restricted Stock Awards:		
Service based	837	
Market and service based	37	
Restricted stock awards	$ 874	2.5

The following table presents a summary of share-based compensation by functional line item:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
	(In thousands)			
Cost of revenues	$ 10	$ 35	$ 19	$ 47
Selling, general and administrative	428	485	851	714
Research and development	146	221	273	303
Total share-basd compensation	$ 584	$ 741	$ 1,143	$ 1,064

Warrants to Purchase Common Stock

During March 2008, the Company distributed warrants to purchase 179,935 shares of Lantronix common stock as consideration for settlement of a shareholder lawsuit. The warrants have a contractual life of four years and a strike price of $28.08.

8. Income Taxes

At July 1, 2009, the Company's fiscal 2002 through fiscal 2009 tax years remain open to examination by the Federal and state taxing authorities. The Company has net operating losses ("NOLs") beginning in fiscal 2002 which cause the statute of limitations to remain open for the year in which the NOL was incurred.

8

The Company utilizes the liability method of accounting for income taxes. The following table presents the Company's effective tax rates based upon the income tax provision for the periods shown:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
Effective tax rate	3%	6%	2%	38%

The federal statutory rate was 34% for all periods. The difference between the Company's effective tax rate and the federal statutory rate resulted primarily from the effect of its domestic losses recorded with a fully reserved tax benefit, as well as the effect of foreign earnings taxed at rates differing from the federal statutory rate.

9. Comprehensive Income (Loss)

The components of comprehensive income (loss) are as follows:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
	(In thousands)			
Net income (loss)	$ (375)	$ (148)	$ (874)	$ 36
Other comprehensive income (loss):				
Change in translation adjustments, net of taxes of $0	(25)	2	22	(94)
Total comprehensive loss	$ (400)	$ (146)	$ (852)	$ (58)

10. Litigation

From time to time, the Company is subject to legal proceedings and claims in the ordinary course of business. Except as discussed below, the Company is currently not aware of any such legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse effect on its business, prospects, financial position, operating results or cash flows.

During 2006, the Company concluded multiple securities lawsuits and litigation with a former executive officer. The Company may have had an obligation to continue to indemnify the former executive officer and defend him in the litigation regarding the securities violation with which he has been charged. As of December 31, 2009, the litigation had been settled and all legal expenses had been reimbursed by insurance.

11. Subsequent Events

The Company has evaluated subsequent events through February 8, 2010, which is the date the Company filed its Quarterly Report on Form 10-Q for the fiscal quarter ending December 31, 2009 with the Securities and Exchange Commission. There are no further subsequent events for disclosure.

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

Cautionary Statement

You should read the following discussion and analysis in conjunction with our unaudited condensed consolidated financial statements and the related notes thereto contained elsewhere in this Quarterly Report on Form

10-Q. The information contained in this Report is not a complete description of our business. We urge you to carefully review and consider the various disclosures made by us in this Report and in our other reports filed with the Securities and Exchange Commission (“SEC”), including our Annual Report on Form 10-K for the fiscal year ended June 30, 2009 and subsequent reports on our Current Reports on Form 8-K.

This Report contains forward-looking statements which include, but are not limited to, statements concerning projected net revenues, expenses, gross profit and net income (loss), the need for additional capital, market acceptance of our products, our ability to achieve further product integration, the status of evolving technologies and their growth potential and our production capacity. Among these forward-looking statements are statements regarding a potential decline in net revenue from non-core product lines, potential variances in quarterly operating expenses, the adequacy of existing resources to meet cash needs, some reduction in the average selling prices and gross margins of products, need to incorporate software from third-party vendors and open source software in our future products and the potential impact of an increase in interest rates or fluctuations in foreign exchange rates on our financial condition or results of operations. These forward-looking statements are based on our current expectations, estimates and projections about our industry, our beliefs and certain assumptions made by us. Words such as “anticipates,” “expects,” “intends,” “plans,” “believes,” “seeks,” “estimates,” “may,” “will” and variations of these words or similar expressions are inte to identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors, including but not limited to those identified under the heading “Risk Factors” set forth in Part II, Item 1A hereto. We undertake no obligation to revise or update publicly any forward-looking statements for any reason.

Overview

We design, develop and market devices that make it possible to access, manage, control and configure electronic products over the Internet or other networks. We are a leader in providing innovative networking solutions. We were initially formed as “Lantronix,” a California corporation, in June 1989. We reincorporated as “Lantronix, Inc.,” a Delaware corporation, in May 2000.

We have a history of providing devices that enable information technology (“IT”) equipment to network using standard protocols for connectivity, including Ethernet and wireless. Our first device was a terminal server that allowed ASCII terminals to connect to a network. Building on the success of our terminal servers, in 1991 we introduced a complete line of print servers that enabled users to inexpensively share printers over a network. Since then, we have continually refined our core technology and have developed additional innovative networking solutions that expand upon the business of providing our customers network connectivity. With the expansion of networking and the Internet, our technology focus has been increasingly expanded beyond IT equipment, so that our device solutions provide a product manufacturer with the ability to network its products within the industrial, service and commercial markets referred to as machine-to-machine (“M2M”) networking.

The following describes our M2M device networking product lines:

- Device Enablement (DeviceLinx) – We offer an array of embedded and external device enablement solutions that enable integrators and manufacturers of electronic and electro-mechanical products to add network connectivity, manageability and control. Our customers’ products emanate from a wide variety of applications within the M2M market, from blood analyzers that relay critical patient information directly to a hospital’s information system, to simple devices such as time clocks, allowing the user to obtain information from these devices and to improve how they are managed and controlled. We also offer products such as multi-port device servers that enable devices outside the data center to effectively share the costs of the network connection and convert various protocols to industry standard interfaces such as Ethernet and the Internet.

- Device Management (SecureLinx and ManageLinx) – We offer off-the-shelf appliances such as console servers, digital remote keyboard, video, mouse extenders, and power control products that enable IT professionals to remotely connect, monitor and control network infrastructure equipment, distributed branch office equipment and large groups of servers using highly secure out-of-band management technology. In addition, our ManageLinx solution provides secure remote Internet access to virtually any piece of IP-enabled equipment, including our DeviceLinx products – even behind remote firewalls or virtual private networks.

The following describes our non-core product line:

- Non-core – Over the years, we have innovated or acquired various product lines that are no longer part of our primary, core markets described above. In general, these non-core product lines represent decreasing markets and we minimize research and development in these product lines. Included in this category are terminal servers, visualization solutions, legacy print servers, software and other miscellaneous products. We have announced the end-of-life for almost all of our non-core products and expect a steep decline in non-core revenues in fiscal 2010 while we complete the exit of this product category.

Financial Highlights and Other Information for the Fiscal Quarter Ended December 31, 2009

The following is a summary of the key factors and significant events that impacted our financial performance during the fiscal quarter ended December 31, 2009:

- Net revenue was $11.5 million for the fiscal quarter ended December 31, 2009, a decrease of $1.4 million or 10.9%, compared to $12.9 million for the fiscal quarter ended December 31, 2008. The decrease was primarily the result of a $1.2 million, or 9.7%, decrease in our device networking product lines and a $205,000, or 38.8%, decrease in our non-core product lines.

- Gross profit margin was 52.7% for the fiscal quarter ended December 31, 2009, compared to 53.9% for the fiscal quarter ended December 31, 2008. The decrease in gross profit margin percent was primarily attributable to product mix, increased freight costs and employee severance during the quarter.

- Loss from operations was $334,000 for the fiscal quarter ended December 31, 2009, compared to $67,000 for the fiscal quarter ended December 31, 2008.

- Net loss was $375,000, or $0.04 per basic and diluted share, for the fiscal quarter ended December 31, 2009, compared to $148,000, or $0.01 per basic and diluted share, for the fiscal quarter ended December 31, 2008.

- Cash and cash equivalents were $9.4 million as of December 31, 2009, an increase of $242,000, compared to $9.1 million as of June 30, 2009.

- Net accounts receivable were $1.8 million as of December 31, 2009, a decrease of $89,000, compared to $1.9 million as of June 30, 2009. Days sales outstanding ("DSO") in receivables were 14 days for the fiscal quarter ended December 31, 2009 compared to 22 days for the fiscal quarter ended June 30, 2009. Our accounts receivable and DSO are primarily affected by the timing of shipments within a quarter, our collections performance and the fact that a significant portion of our revenues are recognized on a sell-through basis (upon shipment from distributor inventories rather than as goods are shipped to distributors).

- Net inventories were $6.6 million as of December 31, 2009, compared to $6.5 million as of June 30, 2009. Inventory turns were 3.3 turns for the fiscal quarter ended December 31, 2009, compared to 3.2 turns for the fiscal quarter ended June 30, 2009.

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 our Annual Report on Form 10-K for the fiscal year ended June 30, 2009. There have been no significant changes in our critical accounting policies and estimates during the fiscal quarter ended December 31, 2009 as compared to what was previously disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2009.

Recent Accounting Pronouncements

In September 2009 the FASB reached a consensus on Accounting Standards Update ("ASU"), 2009-13, Revenue Recognition (Topic 605) – Multiple-Deliverable Revenue Arrangements ("ASU 2009-13") and ASU 2009-14, Software (Topic 985) – Certain Revenue Arrangements That Include Software Elements ("ASU 2009-14"). ASU 2009-13 modifies the requirements that must be met for an entity to recognize revenue from the sale of a delivered item that is part of a multiple-element arrangement when other items have not yet been delivered. ASU 2009-13 eliminates the requirement that all undelivered elements must have either: i) vendor-specific objective evidence ("VSOE") or ii) third-party evidence ("TPE") before an entity can recognize the portion of an overall arrangement consideration that is attributable to items that already have been delivered. In the absence of VSOE or TPE of the standalone selling price for one or more delivered or undelivered elements in a multiple-element arrangement, entities will be required to estimate the selling prices of those elements. Overall arrangement consideration will be allocated to each element (both delivered and undelivered items) based on their relative selling prices, regardless of whether those selling prices are evidenced by VSOE or TPE or are based on the entity's estimated selling price. The residual method of allocating arrangement consideration has been eliminated. ASU 2009-14 modifies the software revenue recognition guidance to exclude from its scope tangible products that contain both software and non-software components that function together to deliver a product's essential functionality. These new updates are effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. We are currently evaluating the impact that the adoption of these ASUs will have on our consolidated financial statements.

Consolidated Results of Operations

The following table presents the percentage of net revenues represented by each item in our condensed consolidated statement of operations:

	Three Months Ended December 31,				Six Months Ended December 31,			
	2009		2008		2009		2008	
Net revenues	100.0	%	100.0	%	100.0	%	100.0	%
Cost of revenues	47.3	%	46.1	%	47.5	%	46.6	%
Gross profit	52.7	%	53.9	%	52.5	%	53.4	%
Operating expenses:								
Selling, general and administrative	42.3	%	41.2	%	42.2	%	38.8	%
Research and development	13.2	%	12.0	%	13.4	%	11.3	%
Restructuring charges	0.0	%	1.0	%	0.0	%	2.7	%
Amortization of purchased intangible assets	0.2	%	0.1	%	0.2	%	0.1	%
Total operating expenses	55.6	%	54.4	%	55.8	%	52.9	%
Income (loss) from operations	(2.9	%)	(0.5	%)	(3.3	%)	0.5	%
Interest expense, net	(0.4	%)	(0.4	%)	(0.4	%)	(0.3	%)
Other income (expense), net	0.1	%	(0.1	%)	(0.1	%)	0.0	%
Income (loss) before income taxes	(3.2	%)	(1.1	%)	(3.8	%)	0.2	%
Provision for income taxes	0.1	%	0.1	%	0.1	%	0.1	%
Net income (loss)	(3.3	%)	(1.1	%)	(3.9	%)	0.1	%

Comparison of the Fiscal Quarters Ended December 31, 2009 and 2008

Net Revenue by Product Line

The following table presents fiscal quarter net revenue by product line:

	Three Months Ended December 31,					
	2009	% of Net Revenue	2008	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Device enablement	$ 9,255	80.6%	$ 10,115	78.5%	$ (860)	(8.5%)
Device management	1,899	16.5%	2,241	17.4%	(342)	(15.3%)
Device networking	11,154	97.1%	12,356	95.9%	(1,202)	(9.7%)
Non-core	324	2.9%	529	4.1%	(205)	(38.8%)
Net revenue	$ 11,478	100.0%	$ 12,885	100.0%	$ (1,407)	(10.9%)

The decrease in net revenue for the three months ended December 31, 2009, compared to the three months ended December 31, 2008 was the result of a decrease in net revenue from our device enablement, device management and non-core product lines. The decrease in our device enablement product line was due to a decrease in our embedded device enablement products, and more specifically, our Micro, ASIC and XPort product families, offset by an increase in our WiPort and MatchPort product families, and a decrease in our external device enablement products, more specifically, our EDS, MSS and WiBox product families. The decrease in our device management product line was due to a decrease in our SLC, SLB and SLP product families. We are no longer investing in the development of our non-core product lines and expect net revenue related to these products to continue to decline in the future as we focus our investment on our device networking product lines.

The following table presents fiscal year-to-date net revenue by product line:

	Six Months Ended December 31,					
	2009	% of Net Revenue	2008	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Device enablement	$ 17,995	80.2%	$ 21,668	80.0%	$ (3,673)	(17.0%)
Device management	3,902	17.4%	4,219	15.6%	(317)	(7.5%)
Device networking	21,897	97.6%	25,887	95.6%	(3,990)	(15.4%)
Non-core	535	2.4%	1,210	4.4%	(675)	(55.8%)
Net revenue	$ 22,432	100.0%	$ 27,097	100.0%	$ (4,665)	(17.2%)

The decrease in net revenue for the six months ended December 31, 2009, compared to the six months ended December 31, 2008 was the result of a decrease in net revenue from our device enablement, device management and non-core product lines. The decrease in our device enablement product line was due to a decrease in our embedded device enablement products, and more specifically, our XPort, ASIC and Micro product families, offset by an increase in our MatchPort product families, and a decrease in our external device enablement products, more specifically, our EDS, UDS, MSS, XPress and WiBridge product families. The decrease in our device management product line was due to a decrease in our SCS, SLB and SLP product families. We are no longer investing in the development of our non-core product lines and expect net revenue related to these products to continue to decline in the future as we focus our investment on our device networking product lines.

Net Revenue by Geographic Region

The following table presents fiscal quarter net revenue by geographic region:

	Three Months Ended December 31,				Change	
	2009	% of Net Revenue	2008	% of Net Revenue	$	%
	(In thousands, except percentages)					
Americas	$ 6,135	53.5%	$ 7,544	58.5%	$ (1,409)	(18.7%)
EMEA	3,548	30.9%	3,668	28.5%	(120)	(3.3%)
Asia Pacific	1,795	15.6%	1,673	13.0%	122	7.3%
Net revenue	$ 11,478	100.0%	$ 12,885	100.0%	$ (1,407)	(10.9%)

The decrease in net revenue for the three months ended December 31, 2009 compared to the three months ended December 31, 2008 was primarily the result of a decrease in the Americas region. The decrease in the Americas region was due to the decrease in our device enablement, device management and non-core product lines. The decrease in America's device enablement net revenue was due to a decrease in the XPort, Micro, EDS, WiBox, and UDS product families. The decrease in the Americas device management net revenue was due to a decrease in our SLC, SLB and SLP product families. We are no longer investing in the development of our non-core product lines.

The following table presents fiscal year-to-date net revenue by geographic region:

	Six Months Ended December 31,					
	2009	% of Net Revenue	2008	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Americas	$ 12,386	55.2%	$ 15,972	58.9%	$ (3,586)	(22.5%)
EMEA	6,457	28.8%	7,480	27.6%	(1,023)	(13.7%)
Asia Pacific	3,589	16.0%	3,645	13.5%	(56)	(1.5%)
Net revenue	$ 22,432	100.0%	$ 27,097	100.0%	$ (4,665)	(17.2%)

The decrease in net revenue for the six months ended December 31, 2009 compared to the six months ended December 31, 2008 was primarily the result of a decrease in the Americas and EMEA ("Europe, Middle East and Africa") regions. The decrease in the Americas region was due to the decrease in our device enablement, device management and non-core product lines. The decrease in America's device enablement net revenue was due to a decrease in the XPort, Micro, EDS, MSS, and UDS product families. The decrease in the Americas device management net revenue was due to a decrease in our SLC, SLB, SCS and SLP product families. We are no longer investing in the development of our non-core product lines. The decrease in our EMEA region was primarily due to a decrease in our device enablement product lines, and more specifically, the ASIC, XPort, UDS, EDS, MSS and XPress product families.

Gross Profit

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

The following table presents fiscal quarter gross profit:

	Three Months Ended December 31,					
	2009	% of Net Revenue	2008	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Gross profit	$ 6,049	52.7%	$ 6,943	53.9%	$ (894)	(12.9%)

The decrease in gross profit margin for the three months ended December 31, 2009, compared to the three months ended December 31, 2008 was primarily attributable to product mix, increased freight costs and employee severance.

The following table presents fiscal year-to-date gross profit:

	Six Months Ended December 31,					
	2009	% of Net Revenue	2008	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Gross profit	$ 11,766	52.5%	$ 14,467	53.4%	$ (2,701)	(18.7%)

The decrease in gross profit margin for the six months ended December 31, 2009, compared to the six months ended December 31, 2008 was primarily attributable to product mix, increased freight costs and employee severance.

Selling, General and Administrative

Selling, general and administrative expenses consisted of personnel-related expenses including salaries and commissions, share-based compensation, facility expenses, information technology, trade show expenses, advertising, and legal and accounting fees offset by reimbursement of legal fees from insurance proceeds.

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

	Three Months Ended December 31,					
	2009	% of Net Revenue	2008	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Personnel-related expenses	$ 2,540		$ 2,734		$ (194)	(7.1%)
Professional fees & outside services	491		534		(43)	(8.1%)
Advertising and marketing	596		712		(116)	(16.3%)
Facilities	306		321		(15)	(4.7%)
Share-based compensation	428		485		(57)	(11.8%)
Depreciation	147		139		8	5.8%
Bad debt expense	17		4		13	325.0%
Other	330		386		(56)	(14.5%)
Selling, general and administrative	$ 4,855	42.3%	$ 5,315	41.2%	$ (460)	(8.7%)

In order of significance, the decrease in selling, general and administrative expenses for the three months ended December 31, 2009, compared to the three months ended December 31, 2008 was primarily due to: (i) decreased personnel-related expenses as a result of the restructuring activities taken during the prior fiscal year and a company-wide furlough program that was taken in response to the economic downturn and (ii) decreased advertising and marketing expenses as a result of cost cutting measures and taking a more focused spending approach.

The following table presents fiscal year-to-date selling, general and administrative expenses:

	Six Months Ended December 31,					
	2009	% of Net Revenue	2008	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Personnel-related expenses	$ 4,938		$ 5,540		$ (602)	(10.9%)
Professional fees & outside services	1,107		1,333		(226)	(17.0%)
Advertising and marketing	1,054		1,268		(214)	(16.9%)
Facilities	634		700		(66)	(9.4%)
Share-based compensation	851		714		137	19.2%
Depreciation	280		269		11	4.1%
Bad debt expense (recovery)	12		(37)		49	(132.4%)
Other	599		736		(137)	(18.6%)
	$ 9,475	42.2%	$ 10,523	38.8%	$ (1,048)	(10.0%)

Selling, general and administrative

In order of significance, the decrease in selling, general and administrative expenses for the six months ended December 31, 2009, compared to the six months ended December 31, 2008 was primarily due to: (i) decreased personnel-related expenses as a result of the restructuring activities taken during the prior fiscal year and a company-wide furlough program that was taken in response to the economic downturn and (ii) decreased professional fees and advertising and marketing expenses as a result of cost cutting measures and taking a more focused spending approach; offset by (iii) increased share-based compensation as a result of new option and share grants related to the fiscal 2010 share-based compensation plans.

Research and Development

Research and development expenses consisted of personnel-related expenses including share-based compensation, as well as expenditures to third-party vendors for research and development activities.

The following table presents fiscal quarter research and development expenses:

	Three Months Ended December 31,					
	2009	% of Net Revenue	2008	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Personnel-related expenses	$ 946		$ 989		$ (43)	(4.3%)
Facilities	278		236		42	17.8%
Professional fees & outside services	95		40		55	137.5%
Share-based compensation	146		221		(75)	(33.9%)
Depreciation	16		19		(3)	(15.8%)
Other	29		44		(15)	(34.1%)
Research and development	$ 1,510	13.2%	$ 1,549	12.0%	$ (39)	(2.5%)

In order of significance, the decrease in research and development expenses for the three months ended December 31, 2009, compared to the three months ended December 31, 2008 was primarily due to: (i) decreased share-based compensation due to the timing of option grants and (ii) decreased personnel-related expenses as a result of the restructuring activities taken during the prior fiscal year and a company-wide furlough program that was taken in response to the economic downturn; offset by (iii) increased professional fees and outside services due specific projects.

The following table presents fiscal year-to-date research and development expenses:

	Six Months Ended December 31,					
	2009	% of Net Revenue	2008	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Personnel-related expenses	$ 1,919		$ 2,044		$ (125)	(6.1%)
Facilities	522		484		38	7.9%
Professional fees & outside services	143		88		55	62.5%
Share-based compensation	273		303		(30)	(9.9%)
Depreciation	32		37		(5)	(13.5%)
Other	106		96		10	10.4%
Research and development	$ 2,995	13.4%	$ 3,052	11.3%	$ (57)	(1.9%)

In order of significance, the decrease in research and development expenses for the six months ended December 31, 2009, compared to the six months ended December 31, 2008 was primarily due to: (i) decreased personnel-related expenses as a result of the restructuring activities taken during the prior fiscal year and a company-wide furlough program that was taken in response to the economic downturn; offset by (ii) increased professional fees and outside services due specific projects.

Restructuring Charges

During the fourth fiscal quarter ended June 30, 2008, we implemented a restructuring plan to optimize our organization to better leverage existing customer and partner relationships to drive revenue growth and profitability. As part of the restructuring plan, 10 employees from the senior-level ranks of the sales, marketing, operations and engineering groups were terminated. During the first fiscal quarter ended September 30, 2008, we implemented a second restructuring plan. As part of the second restructuring plan, an additional 29 employees from all ranks and across all functional groups of the Company were terminated. During the second fiscal quarter ended December 31, 2008, we incurred additional restructuring expenses related to settling with a senior-level employee in France and closing the France sales office.

The following table presents fiscal quarter restructuring charges:

	Three Months Ended December 31,					
	2009	% of Net Revenue	2008	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Restructuring charges	$ -	0.0%	$ 128	1.0%	$ (128)	(100.0%)

The following table presents fiscal year-to-date restructuring charges:

	Six Months Ended December 31,					
	2009	% of Net Revenue	2008	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Restructuring charges	$ -	0.0%	$ 721	2.7%	$ (721)	(100.0%)

Provision for Income Taxes

At July 1, 2009, our fiscal 2002 through fiscal 2009 tax years remain open to examination by the Federal and state taxing authorities. We have net operating losses ("NOLs") beginning in fiscal 2002 which cause the statute of limitations to remain open for the year in which the NOL was incurred.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
Effective tax rate	3%	6%	2%	38%

We utilize the liability method of accounting for income taxes. The federal statutory rate was 34% for all periods. The difference between our effective tax rate and the federal statutory rate resulted primarily from the effect of our domestic losses recorded with a fully reserved tax benefit, 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 these assets will more likely than not be realized. As a result of our cumulative losses, we provided a full valuation allowance against our domestic net deferred tax assets for the fiscal quarters ended December 31, 2009 and 2008.

Liquidity and Capital Resources

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

	December 31, 2009	June 30, 2009	Increase (Decrease)
	(In thousands)		
Working capital	$ 7,134	$ 7,423	$ (289)
Cash and cash equivalents	$ 9,379	$ 9,137	$ 242

In order of significance, our working capital as of December 31, 2009 decreased as compared to June 30, 2009, primarily due to: (i) an increase in accounts payable due to the timing of payments; offset by (ii) a decrease in accrued payroll and related expenses due to the timing of payroll periods and (iii) an increase in receivables from our contract manufacturers' as a result of the timing of shipments and cash collections. Our cash balance increased by $242,000 as of December 31, 2009 compared to the quarter ended June 30, 2009.

We believe that our existing cash and cash equivalents and funds available from our line of credit will be adequate to meet our anticipated cash needs through at least the next 12 months. Our future capital requirements will depend on many factors, including the timing and amount of our net revenue, research and development, expenses associated with any strategic partnerships or acquisitions and infrastructure investments, and expenses related to litigation, which could affect our ability to generate additional cash. If cash generated from operations and financing activities is insufficient to satisfy our working capital requirements, we may need to raise capital by borrowing additional funds through bank loans, the selling of securities or other means. There can be no assurance that we will be able to raise any such capital on terms acceptable to us, if at all. If we are unable to secure additional financing, we may not be able to develop or enhance our products, take advantage of future opportunities, respond to competition or continue to operate our business.

In August 2008, we entered into an amendment to Loan and Security Agreement (the “Amendment to Loan and Security Agreement”), which provides for a three-year $2.0 million Term Loan and a two-year $3.0 million Revolving Credit Facility (the “Term Loan and Revolving Credit Facility” or “Loan Agreement”). The Term Loan was funded on August 26, 2008 and is payable in 36 equal installments of principal and monthly accrued interest. There are no borrowings outstanding on the Revolving Credit Facility as of the fiscal quarter end.

Borrowings under the Term Loan and Revolving Credit Facility bear interest at the greater of 6.25% or prime rate plus 1.25% per annum. If we achieve two consecutive quarters of positive EBITDAS (as defined in the Loan Agreement) greater than $1.00, and only for so long as we maintain EBITDAS greater than $1.00 at the end of each subsequent fiscal quarter, then the borrowings under the Term Loan and Revolving Credit Facility will bear interest at the greater of 5.75% or prime rate plus 0.75% per annum. Upon entering into the agreement, we paid a fully earned, non-refundable commitment fee of $35,000 and paid an additional $35,000 on the first anniversary of the effective date of the Term Loan.

The following table presents our available borrowing capacity and outstanding letters of credit, which were used to secure equipment leases, purchase of materials, deposits for a building lease and security deposits:

	December 31, 2009	June 30, 2009
	(In thousands)	
Available borrowing capacity	$ 948	$ 426
Outstanding letters of credit	$ 651	$ 732

As of December 31, 2009 and June 30, 2009, approximately $387,000 and $666,000, respectively, of our cash was held by our foreign subsidiaries in foreign bank accounts. Such cash may be unrestricted with regard to foreign liquidity needs; however, our ability to utilize a portion of this cash to satisfy liquidity needs outside of such foreign locations may be subject to approval by the foreign subsidiaries’ board of directors.

Cash Flows for the Three and Six Months Ended

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
	(In thousands)			
Net cash provided by (used in):				
Net income (loss)	$ (375)	$ (148)	$ (874)	$ 36
Non-cash operating expenses, net	757	1,185	1,502	2,273
Changes in operating assets and liabilities:				
Accounts receivable	(114)	784	77	2,057
Inventories	(414)	(123)	(8)	(190)
Contract manufacturers' receivable	(343)	(387)	(371)	(456)
Prepaid expenses and other current assets	(363)	(10)	(352)	(121)
Other assets	9	30	(5)	10
Accounts payable	1,756	98	1,928	(1,222)
Accrued payroll and related expenses	(165)	(93)	(478)	(901)
Warranty reserve	-	(83)	-	(76)
Restructuring reserve	(31)	(709)	(76)	(1,391)
Other liabilities	211	764	59	488
Net cash provided by operating activities	928	1,308	1,402	507
Net cash used in investing activities	(420)	(140)	(625)	(354)
	(244)	(249)	(584)	1,687

Net cash (used in) provided by financing activities				
Effect of foreign exchange rate changes on cash	(5)	15	49	(123)
Increase in cash and cash equivalents	$ 259	$ 934	$ 242	$ 1,717

18

Cash Flows for the Three Months Ended

Operating activities provided cash during the three months ended December 31, 2009. This was the result of cash provided by operating assets and liabilities and non-cash operating expenses offset by a net loss. Significant non-cash items included share-based compensation and depreciation. In order of significance, the changes in operating assets and liabilities that had a significant impact on the cash provided by operating activities included (i) an increase in accounts payable due to the timing of payments; offset by (ii) an increase in inventory due to the timing of receipts and (iii) an increase in prepaid expenses and other current assets due to a large receivable from the Company's landlord for reimbursements related to improvements on the new corporate headquarters and (iv) an increase in contract manufacturers' receivables due to the timing of collections and shipments.

Operating activities provided cash during the three months ended December 31, 2008. This was the result of cash provided by operating assets and liabilities and non-cash operating expenses offset by a net loss. Significant non-cash items included share-based compensation, depreciation and a restructuring charge. In order of significance, the changes in operating assets and liabilities that had a significant impact on the cash provided by operating activities included (i) a decrease in accounts receivable due to the timing of collections and linearity of sales and (ii) an increase in other liabilities mainly due to an increase in customer pre-payments; offset by (iii) payments made against the restructuring reserve and (iv) and increase in contract manufactures' receivables due to the timing of collections and linearity of shipments.

Investing activities used cash during the three months ended December 31, 2009 and 2008, due to the purchase of property and equipment.

Financing activities used cash during the three months ended December 31, 2009 and 2008, due to payments on capital lease obligations and the term loan.

Cash Flows for the Six Months Ended

Operating activities provided cash during the six months ended December 31, 2009. This was the result of cash provided by operating assets and liabilities and non-cash operating expenses offset by a net loss. Significant non-cash items included share-based compensation and depreciation. In order of significance, the changes in operating assets and liabilities that had a significant impact on the cash provided by operating activities included (i) an increase in accounts payable due to the timing of payments; offset by (ii) a decrease in accrued payroll and related expenses due to the timing of payroll periods and (iii) an increase in contract manufacturers' receivable due to the timing of collections and shipments and (iv) an increase in prepaid expenses and other current assets due to a large receivable from the Company's landlord for reimbursements related to improvements on the new corporate headquarters.

Operating activities provided cash during the six months ended December 31, 2008. This was the result of net income and non-cash operating expenses offset by cash used in operating assets and liabilities. Significant non-cash items included share-based compensation, a restructuring charge and depreciation. In order of significance, the changes in operating assets and liabilities that had a significant impact on the cash provided by operating activities included (i) payments made against the restructuring reserve and (ii) a decrease in accounts payable due to the pay down of vendors with the proceeds from the term loan, (iii) a decrease in accrued payroll as a result of the timing of payroll cycles at quarter end, and (iv) and increase in contract manufacturers' receivable due to the timing of collections and linearity of shipments; offset by (v) a decrease in accounts receivable due to the timing of collections and linearity of sales and (vi) an increase in other liabilities as a result of an increase in customer prepayments.

Investing activities used cash during the six months ended December 31, 2009 and 2008, due to the purchase of property and equipment.

Financing activities used cash during the six months ended December 31, 2009 due to (i) payments for the minimum tax withholdings on behalf of employees for vested restricted shares and (ii) payments on capital lease obligations and the term loan; offset by (iii) proceeds from the sale of common shares through employee stock option exercises.

Financing activities provided cash during the six months ended December 31, 2008. This was due to proceeds from the new term loan and sale of common shares through the 2000 Employee Stock Purchase Plan (the “ESPP”) offset by payments on capital lease obligations and the term loan.

Off-Balance Sheet Arrangements

We did not have any off balance sheet arrangements as of December 31, 2009.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of our fiscal quarter. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective in ensuring that information required to be disclosed by us in reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer to allow timely decisions regarding required disclosure.

(b) Changes in internal controls over financial reporting

There have been no changes in our internal controls over financial reporting identified during the fiscal quarter that ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information set forth in Note 10 to our notes to the unaudited condensed consolidated financial statements of Part I, Item 1 of this Form 10-Q is hereby incorporated by reference.

Item 1A. Risk Factors

We operate in a rapidly changing environment that involves numerous risks and uncertainties. Before deciding to purchase, hold or sell our common stock, you should carefully consider the risks described in this section. This section should be read in conjunction with the consolidated financial statements and accompanying notes thereto, and Management's Discussion and Analysis of Financial Condition and Results of Operations included in this Quarterly Report on Form 10-Q and in the risks described in our Annual Report on Form 10-K. If any of these risks or uncertainties actually occurs with material adverse effects on Lantronix, our business, financial condition and results of operations could be seriously harmed. In that event, the market price for our common stock could decline and you may lose all or part of your investment.

Our quarterly operating results may fluctuate, which could cause our stock price to decline.

We have experienced, and expect to continue to experience, significant fluctuations in net revenues, expenses and operating results from quarter to quarter. We, therefore, believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance, and you should not rely on them to predict our future performance or the future performance of our stock. A high percentage of our operating expenses are relatively fixed and are based on our expectations of future net revenue. If we were to experience a reduction in revenue in a quarter, we would likely be unable to adjust our short-term expenditures. If this were to occur, our operating results for that fiscal quarter would be harmed. If our operating results in future fiscal quarters fall below the expectations of market analysts and investors, the price of our common stock would likely fall. Other factors that might cause our operating results to fluctuate on a quarterly basis include:

- changes in business and economic conditions, including the recent global economic recession;
- changes in the mix of net revenue attributable to higher-margin and lower-margin products;
- customers' decisions to defer or accelerate orders;
- variations in the size or timing of orders for our products;
- changes in demand for our products;
- fluctuations in exchange rates;
- defects and other product quality problems;
- loss or gain of significant customers;
- short-term fluctuations in the cost or availability of our critical components;
- announcements or introductions of new products by our competitors;
- effects of terrorist attacks in the U.S. and abroad;
- changes in demand for devices that incorporate our products; and
- our customers' decisions to integrate network access and control directly onto their platforms.

If a major distributor or customer cancels, reduces or delays purchases, our net revenues might decline and our business could be adversely affected.

The number and timing of sales to our distributors have been difficult for us to predict. While our distributors are customers in the sense they buy our products, they are also part of our product distribution system. Some of our distributors could be acquired by a competitor and stop buying product from us.

The following table presents sales to our significant customers as a percentage of net revenue:

	Six Months Ended December 31, 2009		2008	
Top five customers (1)	38.6	%	36.4	%
Tech Data	11.4	%	6.8	%
Ingram Micro	7.8	%	13.2	%

(1) Includes Ingram Micro and Tech Data

The loss or deferral of one or more significant customers in a quarter could harm our operating results. We have in the past, and might in the future, lose one or more major customers. If we fail to continue to sell to our major customers in the quantities we anticipate, or if any of these customers terminate our relationship, our reputation, the perception of our products and technology in the marketplace, could be harmed. The demand for our products from our OEM, VAR and systems integrator customers depends primarily on their ability to successfully sell their products that incorporate our device networking solutions technology. Our sales are usually completed on a purchase order basis and we have few long-term purchase commitments from our customers.

Our future success also depends on our ability to attract new customers, which often involves an extended selling process. The sale of our products often involves a significant technical evaluation, and we often face delays because of our customers' internal procedures for evaluating and deploying new technologies. For these and other reasons, the sales cycle associated with our products is typically lengthy, often lasting six to nine months and sometimes longer. Therefore, if we were to lose a major customer, we might not be able to replace the customer in a timely manner, or at all. This would cause our net revenue to decrease and could cause our stock price to decline.

If we fail to develop or enhance our products to respond to changing market conditions and government and industry standards, our competitive position will suffer and our business will be adversely affected.

Our future success depends in large part on our ability to continue to enhance existing products, lower product cost and develop new products that maintain technological competitiveness and meet government and industry standards. The demand for network-enabled products is relatively new and can change as a result of innovations, new technologies or new government and industry standards. For example, a directive in the European Union banned the use of lead and other heavy metals in electrical and electronic equipment after July 1, 2006. As a result, in advance of this deadline, some of our customers selling products in Europe demanded product from component manufacturers that did not contain these banned substances. Any failure by us to develop and introduce new products or enhancements in response to new government and industry standards could harm our business, financial condition or results of operations. These requirements might or might not be compatible with our current or future product offerings. We might not be successful in modifying our products and services to address these requirements and standards. For example, our competitors might develop competing technologies based on Internet Protocols, Ethernet Protocols or other protocols that might have advantages over our products. If this were to happen, our net revenue might not grow at the rate we anticipate, or could decline.

Delays in deliveries or quality problems with our component suppliers could damage our reputation and could cause our net revenue to decline and harm our results of operations.

We and our contract manufacturers are responsible for procuring raw materials for our products. Our products incorporate components or technologies that are only available from single or limited sources of supply. In particular, some of our integrated circuits are only available from a single source and in some cases are no longer being manufactured. From time to time, integrated circuits used in our products will be phased out of production. When this happens, we attempt to purchase sufficient inventory to meet our needs until a substitute component can be incorporated into our products. Nonetheless, we might be unable to purchase sufficient components to meet our demands, or we might incorrectly forecast our demands, and purchase too many or too few components. In addition, our products use components that have, in the past, been subject to market shortages and substantial price fluctuations. From time to time, we have been unable to meet our orders because we were unable to purchase necessary components for our products. We do not have long-term supply arrangements with many of our vendors to obtain necessary components or technology for our products. If we are unable to purchase components from these suppliers, product shipments could be prevented or delayed, which could result in a loss of sales. If we are unable to meet existing orders or to enter into new orders because of a shortage in components, we will likely lose net revenues and risk losing customers and harming our reputation in the marketplace, which could adversely affect our business, financial condition or results of operations.

If we lose the services of any of our contract manufacturers or suppliers, we may not be able to obtain alternate sources in a timely manner, which could harm our customer relations and adversely affect our net revenue and harm our results of operations.

We do not have long-term agreements with our contract manufacturers or suppliers. If any of these subcontractors or suppliers ceased doing business with us, we may not be able to obtain alternative sources in a timely or cost-effective manner. Due to the amount of time that it usually takes us to qualify contract manufacturers and suppliers, we could experience delays in product shipments if we are required to find alternative subcontractors and suppliers. Some of our suppliers have or provide technology or trade secrets, the loss of which could be disruptive to our procurement and supply processes. If a competitor should acquire one of our contract manufacturers or suppliers, we could be subjected to more difficulties in maintaining or developing alternative sources of supply of some components or products. Any problems that we may encounter with the delivery, quality or cost of our products could damage our customer relationships and materially and adversely affect our business, financial condition or results of operations.

Environmental regulations such as the Waste Electrical and Electronic Equipment (“WEEE”) directive may require us to redesign our products and to develop compliance administration systems.

Various countries have begun to require companies selling a broad range of electrical equipment to conform to regulations such as the WEEE directive and we expect additional countries and locations to adopt similar regulations in the future. New environmental standards such as these could require us to redesign our products in order to comply with the standards, and require the development of compliance administration systems. We have already invested significant resources into developing compliance tracking systems, and further investments may be required. Additionally, we may incur significant costs to redesign our products and to develop compliance administration systems; however alternative designs may have an adverse effect on our gross profit margin. If we cannot develop compliant products timely or properly administer our compliance programs, our revenue may also decline due to lower sales, which would adversely affect our operating results.

If our research and development efforts are not successful, our net revenue could decline and our business could be harmed.

If we are unable to develop new products as a result of our research and development efforts, or if the products we develop are not successful, our business could be harmed. Even if we do develop new products that are accepted by our target markets, we do not know whether the net revenue from these products will be sufficient to justify our investment in research and development. In addition, if we do not invest sufficiently in research and development, we may be unable to maintain our competitive position. Our investment in research and development may decrease, which may put us at a competitive disadvantage compared to our competitors and adversely affect our market position.

We expect the average selling prices of our products to decline and material costs to increase, which could reduce our net revenue, gross margins and profitability.

In the past, we have experienced some reduction in the average selling prices and gross margins of products, and we expect that this will continue for our products as they mature. We expect competition to continue to increase, and we anticipate this could result in additional downward pressure on our pricing. Our average selling prices for our products might decline as a result of other reasons, including promotional programs and customers who negotiate price reductions in exchange for longer-term purchase commitments. We also may not be able to increase the price of our products if the prices of components or our overhead costs increase. In addition, we may be unable to adjust our prices in response to currency exchange rate fluctuations resulting in lower gross margins. We also may be unable to adjust our prices in response to price increases by our suppliers resulting in lower gross margins. Further, as is characteristic of our industry, the average selling prices of our products have historically decreased over the products' life cycles and we expect this pattern to continue. If any of these were to occur, our gross margins could decline and we may not be able to reduce the cost to manufacture our products to keep up with the decline in prices.

Current or future litigation could adversely affect us.

We are subject to a wide range of claims and lawsuits in the course of our business. For example, we recently concluded multiple securities lawsuits with our stockholders and litigation with a former executive officer. We may have an obligation to continue to indemnify the former executive officer and defend him in the litigation regarding the securities violation with which he has been charged. There is a risk that our insurance carriers may not reimburse us for such costs. Any lawsuit may involve complex questions of fact and law and may require the expenditure of significant funds and the diversion of other resources. The results of litigation are inherently uncertain, and adverse outcomes are possible.

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

We currently offer warranties ranging from one or two years on each of our products. Our products could contain undetected errors or defects. If there is a product failure, we might have to replace all affected products without being able to book revenue for replacement units, or we may have to refund the purchase price for the units. We do not have a long history with which to assess the risks of unexpected product failures or defects for our device server product line. Regardless of the amount of testing we undertake, some errors might be discovered only after a product has been installed and used by customers. Any errors discovered after commercial release could result in loss of net revenue and claims against us. Significant product warranty claims against us could harm our business, reputation and financial results and cause the price of our stock to decline.

If software that we license or acquire from the open source software community and incorporate into our products were to become unavailable or no longer available on commercially reasonable terms, it could adversely affect sales of our products, which could disrupt our business and harm our financial results.

Certain of our products contain components developed and maintained by third-party software vendors or are available through the “open source” software community. We also expect that we may incorporate software from third-party vendors and open source software in our future products. Our business would be disrupted if this software, or functional equivalents of this software, were either no longer available to us or no longer offered to us on commercially reasonable terms. In either case, we would be required to either redesign our products to function with alternate third-party software or open source software, or develop these components ourselves, which would result in increased costs and could result in delays in our product shipments. Furthermore, we might be forced to limit the features available in our current or future product offerings.

If our contract manufacturers are unable or unwilling to manufacture our products at the quality and quantity we request, our business could be harmed.

We outsource substantially all of our manufacturing to four manufacturers in Asia: Venture Electronics Services, Uni Precision Industrial Ltd., Universal Scientific Industrial Company, LTD and Hana Microelectronics, Inc. In addition, two independent third party foundries located in Asia manufacture substantially all of our large scale integration chips. Our reliance on these third-party manufacturers exposes us to a number of significant risks, including:

- reduced control over delivery schedules, quality assurance, manufacturing yields and production costs;
- lack of guaranteed production capacity or product supply; and
- reliance on these manufacturers to maintain competitive manufacturing technologies.

Our agreements with these manufacturers provide for services on a purchase order basis. If our manufacturers were to become unable or unwilling to continue to manufacture our products at requested quality, quantity, yields and costs, or in a timely manner, our business would be seriously harmed. As a result, we would have to attempt to identify and qualify substitute manufacturers, which could be time consuming and difficult, and might result in unforeseen manufacturing and operations problems. For example, Jabil Circuit, Inc. acquired Varian, Inc. in March 2005 and closed the facility that manufactured our products. We transferred this production to another contract manufacturer. Moreover, as we shift products among third-party manufacturers, we may incur substantial expenses, risk material delays or encounter other unexpected issues.

In addition, a natural disaster could disrupt our manufacturers' facilities and could inhibit our manufacturers' ability to provide us with manufacturing capacity in a timely manner or at all. If this were to occur, we likely would be unable to fill customers' existing orders or accept new orders for our products. The resulting decline in net revenue would harm our business. We also are responsible for forecasting the demand for our individual products. These forecasts are used by our contract manufacturers to procure raw materials and manufacture our finished goods. If we forecast demand too high, we may invest too much cash in inventory, and we may be forced to take a write-down of our inventory balance, which would reduce our earnings. If our forecast is too low for one or more products, we may be required to pay charges that would increase our cost of revenue or we may be unable to fulfill customer orders, thus reducing net revenue and therefore earnings.

Our international activities are subject to uncertainties, which include international economic, regulatory, political and other risks that could harm our business, financial condition or results of operations.

The following table presents our sales within geographic regions:

	Three Months Ended December 31,				Change	
	2009	% of Net Revenue	2008	% of Net Revenue	$	%
	(In thousands, except percentages)					
Americas	$ 6,135	53.5%	$ 7,544	58.5%	$ (1,409)	(18.7%)
EMEA	3,548	30.9%	3,668	28.5%	(120)	(3.3%)
Asia Pacific	1,795	15.6%	1,673	13.0%	122	7.3%
Net revenue	$ 11,478	100.0%	$ 12,885	100.0%	$ (1,407)	(10.9%)

We expect that international revenue will continue to represent a significant portion of our net revenue in the foreseeable future. Doing business internationally involves greater expense and many risks. For example, because the products we sell abroad and the products and services we buy abroad may be priced in foreign currencies, we could be affected by fluctuating exchange rates. In the past, we have lost money because of these fluctuations. We might not successfully protect ourselves against currency rate fluctuations, and our financial performance could be harmed as a result. In addition, we use contract manufacturers based in Asia to manufacture substantially all of our products. International revenue and operations are subject to numerous risks, including:

- unexpected changes in regulatory requirements, taxes, trade laws and tariffs;
- reduced protection for intellectual property rights in some countries;
- differing labor regulations;
- compliance with a wide variety of complex regulatory requirements;
- fluctuations in currency exchange rates;
- changes in a country’s or region’s political or economic conditions;
- effects of terrorist attacks in the U.S. and abroad;
- greater difficulty in staffing and managing foreign operations; and
- increased financial accounting and reporting burdens and complexities.

Our international operations require significant attention from our management and substantial financial resources. We do not know whether our investments in other countries will produce desired levels of net revenues or profitability.

We are exposed to foreign currency exchange risks, which could harm our business and operating results.

We hold a portion of our cash balance in foreign currencies (particularly euros), and as such are exposed to adverse changes in exchange rates associated with foreign currency fluctuations. However, we do not currently engage in any hedging transactions to mitigate these risks. Although from time to time we review our foreign currency exposure and evaluate whether we should enter into hedging transactions, we may not adequately hedge against any future volatility in currency exchange rates and, if we engage in hedging transactions, the transactions will be based on forecasts which later may prove to be inaccurate. Any failure to hedge successfully or anticipate currency risks properly could adversely affect our operating results.

If we are unable to sell our inventory in a timely manner it could become obsolete, which could require us to increase our reserves and harm our operating results.

At any time, competitive products may be introduced with more attractive features or at lower prices than ours. There is a risk that we may be unable to sell our inventory in a timely manner to avoid it becoming obsolete.

The following table presents the components of our inventory, including the reserve for excess and obsolete inventory:

	December 31, 2009	June 30, 2009
	(In thousands)	
Finished goods	$ 4,445	$ 4,421
Raw materials	1,513	1,537
Inventory at distributors	1,384	1,355
Large scale integration chips *	792	909
Inventories, gross	8,134	8,222
Reserve for excess and obsolete inventory	(1,528)	(1,743)
Inventories, net	$ 6,606	$ 6,479

* This item is sold individually and embedded into the Company's products.

In the event we are required to substantially discount our inventory or are unable to sell our inventory in a timely manner, we would be required to increase our reserves and our operating results could be substantially harmed.

We are subject to export control regulations that could restrict our ability to increase our international revenue and may adversely affect our business.

Our products and technologies are subject to U.S. export control laws, including the Export Administration Regulations, administered by the Department of Commerce and the Bureau of Industry Security, and their foreign counterpart laws and regulations, which may require that we obtain an export license before we can export certain products or technology to specified countries. These export control laws, and possible changes to current laws, regulations and policies, could restrict our ability to sell products to customers in certain countries or give rise to delays or expenses in obtaining appropriate export licenses. Failure to comply with these laws and regulations could result in government sanctions, including substantial monetary penalties, denial of export privileges, and debarment from government contracts. Any of these could adversely affect our operations and, as a result, our financial results could suffer.

If we are unable to attract, retain or motivate key senior management and technical personnel, it could seriously harm our business.

Our financial performance depends substantially on the performance of our executive officers, key technical, marketing and sales employees. We are also dependent upon our technical personnel, due to the specialized technical nature of our business. If we were to lose the services of our executive officers or any of our key personnel and were not able to find replacements in a timely manner, our business could be disrupted, other key personnel might decide to leave, and we might incur increased operating expenses associated with finding and compensating replacements.

If our OEM customers develop their own expertise in network-enabling products, it could result in reduced sales of our products and harm our operating results.

We sell to both resellers and OEMs. Selling products to OEMs involves unique risks, including the risk that OEMs will develop internal expertise in network-enabling products or will otherwise incorporate network functionality in their products without using our device networking solutions. If this were to occur, our sales to OEMs would likely decline, which could reduce our net revenue and harm our operating results.

New product introductions and pricing strategies by our competitors could reduce our market share or cause us to reduce the prices of our products, which would reduce our net revenue and gross margins.

The market for our products is intensely competitive, subject to rapid change and is significantly affected by new product introductions and pricing strategies of our competitors. We face competition primarily from companies that network-enable devices, semiconductor companies, companies in the automation industry and companies with significant networking expertise and research and development resources. Our competitors might offer new products with features or functionality that are equal to or better than our products. In addition, since we work with open standards, our customers could develop products based on our technology that compete with our offerings. We might not have sufficient engineering staff or other required resources to modify our products to match our competitors. Similarly, competitive pressure could force us to reduce the price of our products. In each case, we could lose new and existing customers to our competition. If this were to occur, our net revenue could decline and our business could be harmed.

Current or future litigation over intellectual property rights could adversely affect us.

Substantial litigation regarding intellectual property rights exists in our industry. For example, in May 2006 we settled a patent infringement lawsuit with Digi in which we signed an agreement with Digi to cross-license each other's patents for six years. There is a risk that we will not be able to negotiate a new cross-license agreement when the current cross-license expires in May 2012. The results of litigation are inherently uncertain, and adverse outcomes are possible. Adverse outcomes may have a material adverse effect on our business, financial condition or results of operations.

There is a risk that other third parties could claim that our products, or our customers' products, infringe on their intellectual property rights or that we have misappropriated their intellectual property. In addition, software, business processes and other property rights in our industry might be increasingly subject to third party infringement claims as the number of competitors grows and the functionality of products in different industry segments overlaps. Other parties might currently have, or might eventually be issued, patents that pertain to the proprietary rights we use. Any of these third parties might make a claim of infringement against us. The results of litigation are inherently uncertain, and adverse outcomes are possible.

Responding to any infringement claim, regardless of its validity, could:

- be time-consuming, costly and/or result in litigation;
- divert management's time and attention from developing our business;
- require us to pay monetary damages, including treble damages if we are held to have willfully infringed;
- require us to enter into royalty and licensing agreements that we would not normally find acceptable;
- require us to stop selling or to redesign certain of our products; or
- require us to satisfy indemnification obligations to our customers.

If any of these occur, our business, financial condition or results of operations could be adversely affected.

We may not be able to adequately protect or enforce our intellectual property rights, which could harm our competitive position or require us to incur significant expenses to enforce our rights.

We have not historically relied on patents to protect our proprietary rights, although we are now building a patent portfolio. In May 2006, we entered into a six-year patent cross-license agreement with Digi in which the parties agreed to cross-license each other's patents, which could reduce the value of our existing patent portfolio. We rely primarily on a combination of laws, such as copyright, trademark and trade secret laws, and contractual restrictions, such as confidentiality agreements and licenses, to establish and protect our proprietary rights. Despite any precautions that we have taken:

- laws and contractual restrictions might not be sufficient to prevent misappropriation of our technology or deter others from developing similar technologies;
- other companies might claim common law trademark rights based upon use that precedes the registration of our marks;
- other companies might assert other rights to market products using our trademarks;

- policing unauthorized use of our products and trademarks is difficult, expensive and time-consuming, and we might be unable to determine the extent of this unauthorized use;

- courts may determine that our software programs use open source software in such a way that deprives the entire programs of intellectual property protection; and

- current federal laws that prohibit software copying provide only limited protection from software pirates.

Also, the laws of some of the countries in which we market and manufacture our products offer little or no effective protection of our proprietary technology. Reverse engineering, unauthorized copying or other misappropriation of our proprietary technology could enable third-parties to benefit from our technology without paying us for it. Consequently, we may be unable to prevent our proprietary technology from being exploited by others in the U.S. or abroad, which could require costly efforts to protect our technology. Policing the unauthorized use of our products, trademarks and other proprietary rights is expensive, difficult and, in some cases, impracticable. Litigation may be necessary in the future to enforce or defend our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Such litigation could result in substantial costs and diversion of management resources, either of which could harm our business. Accordingly, despite our efforts, we may not be able to prevent third parties from infringing upon or misappropriating our intellectual property, which may harm our business, financial condition and results of operations.

Acquisitions, strategic partnerships, joint ventures or investments may impair our capital and equity resources, divert our management's attention or otherwise negatively impact our operating results.

We may pursue acquisitions, strategic partnerships and joint ventures that we believe would allow us to complement our growth strategy, increase market share in our current markets and expand into adjacent markets, broaden our technology and intellectual property and strengthen our relationships with distributors and OEMs. Any future acquisition, partnership, joint venture or investment may require that we pay significant cash, issue stock or incur substantial debt. Acquisitions, partnerships or joint ventures may also result in the loss of key personnel and the dilution of existing stockholders as a result of issuing equity securities. In addition, acquisitions, partnerships or joint ventures require significant managerial attention, which may be diverted from our other operations. These capital, equity and managerial commitments may impair the operation of our business. Furthermore, acquired businesses may not be effectively integrated, may be unable to maintain key pre-acquisition business relationships, may contribute to increased fixed costs and may expose us to unanticipated liabilities and otherwise harm our operating results.

Business interruptions could adversely affect our business.

Our operations and those of our suppliers are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure, terrorist attacks and other events beyond our control. A substantial portion of our facilities, including our corporate headquarters and other critical business operations, are located near major earthquake faults and, therefore, may be more susceptible to damage if an earthquake occurs. We do not carry earthquake insurance for direct earthquake-related losses. If a business interruption occurs, our business could be materially and adversely affected.

If we fail to maintain an effective system of disclosure controls or internal controls over financial reporting, our business and stock price could be adversely affected.

Section 404 of the Sarbanes-Oxley Act of 2002 requires companies to evaluate periodically the effectiveness of their internal controls over financial reporting, and to include a management report assessing the effectiveness of their internal controls as of the end of each fiscal year. Beginning with our annual report on Form 10-K for our fiscal year ended June 30, 2008, we are required to comply with the requirement of Section 404 of the Sarbanes-Oxley Act of 2002 to include in each of our annual reports an assessment by our management of the effectiveness of our internal controls over financial reporting. Beginning with our annual report on Form 10-K for our fiscal year ending June 30, 2010, our independent registered public accounting firm will issue a report assessing the effectiveness of our internal controls.

Our management does not expect that our internal controls over financial reporting will prevent all errors or frauds. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be 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, involving us have been, or will be, detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by individual acts of a person, or by collusion among two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and we cannot assure you 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 deterioration in the degree of compliance with policies and procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to errors or frauds may occur and not be detected.

We cannot assure you that we or our independent registered public accounting firm will not identify a material weakness in our disclosure controls and internal controls over financial reporting in the future. If our internal controls over financial reporting are not considered adequate, we may experience a loss of public confidence, which could have an adverse effect on our business and our stock price.

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

None.

Item 3.Defaults Upon Senior Securities

None.

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

On November 18, 2009, 9,427,039 shares were represented in person or by proxy at the meeting, which constituted a quorum. The results of the three proposals, adjusted to reflect the December 2009 one-for-six reverse stock split, were as follows:

1. The following seven directors were elected to the Company's Board:

Nominee	For	Against
Curtis Brown	9,288,825	138,047
Bernhard Bruscha	6,523,726	2,903,146
Jerry D. Chase	9,366,009	60,863
Larry Sanders	9,361,530	65,342
Howard T. Slayen	9,369,995	56,877
Lewis Solomon	9,359,737	67,135
Thomas M. Wittenschlaeger	7,816,980	1,609,892

2. To authorize the Board to implement, in its discretion, a reverse stock split of our outstanding shares of common stock with a range of one-third to one-sixth of a share for each outstanding share of common stock, and to file an amendment to our Certificate of Incorporation to effect such a reverse stock split:

Proposal	For	Against	Abstain
Reverse stock split	9,258,932	155,783	12,158

Upon receiving stockholder approval, the Board was granted the discretion to determine the reverse split ratio of the number of shares of common stock between and including three and six, which will be combined, converted and exchanged into one share of common stock and to direct our officers to execute and file the amendment to our Certificate of Incorporation, which shall so specify such ratio, at any time before the first anniversary date of the 2009 Annual Meeting. Furthermore, pursuant to Section 242(c) of the Delaware General Corporation Law, the Board may elect to abandon such proposed amendment without further action by the stockholders.

The reverse stock split would become effective as of 5:00 p.m. Eastern time on the date of filing of the amendment to our Certificate of Incorporation with the office of the Secretary of State of the State of Delaware. Except as with respect to fractional shares, on the effective date of the reverse stock split, not less than three and not more than six shares, as applicable, of common stock issued and outstanding immediately prior that effective date will be, automatically and without any action on the part of the stockholders, combined, converted and changed into one share of common stock in accordance with the ratio of the reverse stock split determined by the Board within the limits set forth above.

3. To ratify the appointment of McGladrey & Pullen, LLP as our independent registered public accountants for the fiscal year ending June 30, 2010:

Nominee	For	Against	Abstain
McGladrey & Pullen, LLP	9,360,542	32,769	33,562

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Description of Document
3.1	Amended and Restated Bylaws
31.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

* Furnished, not filed.

SIGNATURES

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

Date: February 8, 2010

LANTRONIX, INC.
(Registrant)

By: /s/ Jerry D. Chase
Jerry D. Chase
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ Reagan Y. Sakai
Reagan Y. Sakai
Chief Financial Officer and Secretary
(Principal Financial Officer)

Exhibit Index

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