LANTRONIX INC
Form 10-K
August 30, 2012

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

S ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended June 30, 2012

£ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________ to ________

Commission File Number 1-16027

LANTRONIX, INC.

(Exact name of registrant as specified in its charter)

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

167 Technology Drive, Irvine, California 92618

(Address of principal executive offices)

(949) 453-3990

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.0001 par value	The Nasdaq Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes £ No S

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes £ No S

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 S No £

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 S No £

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. £

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

Large accelerated filer £ Accelerated filer £ Non-accelerated filer £ Smaller reporting company S

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

The aggregate market value of the registrant's common stock held by non-affiliates based upon the closing sales price of the common stock on December 31, 2011, as reported by the Nasdaq Capital Market, was approximately $10,740,988. Shares of common stock held by each current executive officer and director and by each person who is known by the registrant to own 5% or more of the outstanding common stock have been excluded from this computation in that such persons may be deemed to be affiliates of the registrant. Share ownership information of certain persons known by the registrant to own greater than 5% of the outstanding common stock for purposes of the preceding calculation is based solely on information on Schedule 13G filed with the Securities and Exchange Commission and is as of December 31, 2011. This determination of affiliate status is not a conclusive determination for other purposes.

As of July 31, 2012, there were 14,549,072 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Part III of this Form 10-K incorporate information by reference from portions of the registrant's 2012 Definitive Proxy Statement to be filed not later than 120 days after the close of the 2012 fiscal year.

LANTRONIX, INC.

ANNUAL REPORT ON FORM 10-K

For the Fiscal Year Ended June 30, 2012

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* Not applicable for Smaller Reporting Companies

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K for the year ended June 30, 2012 (the “Report”), including “Management’s Discussion and Analysis of Financial Condition and Results of Operation” in Item 7, contains forward-looking statements within the meaning of the federal securities laws. All statements other than statements of historical fact in this report or referred to or incorporated by referenced into this report are “forward-looking statements” for purposes of these sections. These statements include, among other things, any predictions of earnings, revenues, expenses or other financial items, plans or expectations with respect to development activities, statements concerning industry trends, anticipated demand for our products, our overall business strategy, market acceptance of new products, future customer and sales developments, manufacturing forecasts, including the potential benefits of our contract manufacturers sourcing and supplying raw materials, the significant role of original equipment manufacturers in our business, the future cost and potential benefits of our research and development efforts and liquidity, cash resources forecasts, the impact of pending litigation and any statements of plans, strategies and objectives of management for future operations, any statements concerning the Company’s future operations, financial condition and prospects, and any statements of assumptions underlying any of the foregoing. These statements can sometimes be identified by use of forward-looking words such as “may,” “believe,” “will,” “could,” “project,” “anticipate,” “expect,” “estimate,” “should “potential,” “plan,” “forecasts,” “goal,” “seek” “intend,” other forms of these words or similar words or expressions or negative thereof Investors are cautioned not to unduly rely on such forward-looking statements.

These forward-looking statements are subject to substantial risks and uncertainties that could cause the Company’s results or experiences or future business, financial condition, results of operations or performance to differ materially from the Company’s historical results or those expressed or implied in any forward-looking statement contained in this report. See “Risk Factors” in Item 1A of this Report for a further discussion of these risks, as well as the Company’s subsequent reports on Forms 10-Q and 8-K. These forward-looking statements speak only as of the date on which they are made and the Company does not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of the statement. If the Company does update or correct one or more of these statements, investors and others should not conclude that the Company will make additional updates or corrections.

PART I

ITEM 1. BUSINESS

Overview

Lantronix, Inc. (the “Company,” “Lantronix,” “we” or “us”) designs, develops, markets and sells secure communication technologies that simplify access to and communication with and between almost any electronic device. Our smart machine-to-machine (“M2M”) connectivity solutions enable sharing data between devices and applications to empower better decisions based on real-time information, and gain a competitive advantage by generating new revenue streams, improving productivity and increasing efficiency and profitability. Easy to integrate and deploy, Lantronix products remotely and securely connect devices via networks and the Internet. We have one operating and reportable business segment, device networking, which includes our device enablement and device management product lines. Our device enablement solutions enable digital and analog devices and sensors to be connected to a wired or wireless network for the primary purposes of remote access, control and data acquisition. Our device management solutions primarily serve information technology deployments; offering remote access, control and printing for data center, enterprise, manufacturing, branch office and home applications.

Our innovative networking solutions include fully-integrated hardware and software devices, as well as software tools, to develop related customer applications. We provide technologically agnostic solutions to broad market segments, including industrial and building automation, security, medical, transportation, retail/point-of-sale (“POS”), financial services, governmental, manufacturing, consumer electronics/appliances, information technology (“IT”), data centers and others.

We were initially formed as “Lantronix,” a California corporation, in June 1989. We reincorporated as “Lantronix, Inc.,” a Delaware corporation, in May 2000. Our worldwide headquarters is located in Irvine, California.

Our common stock is currently traded on the Nasdaq Capital Market under the symbol LTRX.

Our Strategy

Our business strategy is based on our proven capability to develop fully-integrated device enablement and device management solutions that increase the value of our customers’ products and services by making them easy to access, control and monitor devices over the Internet or local-area network (“LAN”) using wired, wireless, or mobile solutions. By using our device enablement technology, customers can reduce basic data connection costs, reduce maintenance and repair costs, create differentiation based on better service and create new revenue sources from device-related services.

We have a robust product pipeline and continue to invest in making our products uniquely differentiated and valuable to our customers. Often we provide a complete solution of hardware and integrated software, and have been able to provide turnkey solutions for network-enabling a device, thus eliminating the need for our customers to utilize expensive design and manufacturing expertise in-house. This results in savings to the customer in terms of financial investment, time, and technology risk.

Products and Solutions; Segment Information

We have one operating and reportable business segment, device networking, which includes our device enablement and device management product lines.

Device Enablement Solutions

We provide original equipment manufacturers ("OEMs"), system integrators and end-users with embedded and external device enablement solutions enabling their products to be securely connected, managed and controlled over networks. Our device enablement solutions dramatically shorten a manufacturer's development time to implement network connectivity, provide competitive advantages and greatly reduce engineering and marketing risks.

Our device enablement solutions eliminate the high cost of ownership and support issues associated with networking, which frequently would otherwise require using personal computers ("PCs") or workstations to perform connectivity and remote management functions. Our solutions contain high-performance processors capable of not only controlling the attached device(s), but in many cases are also capable of accumulating data and providing status. The accumulated data can then be formatted by the device enablement solution and presented to users via web pages, e-mail and other network, transport and application level protocols. Many OEMs actually host their application on the enablement device, further reducing their additional hardware and software costs, design cycles and product complexity. Our device enablement solutions have a built-in hypertext transfer protocol ("HTTP") server, making them easy to manage using any standard Web browser. These device enablement solutions include the latest security protocols which support, among others, the stringent security requirements of the healthcare, banking and physical security markets. We are making continual enhancements to our product line to make our products even easier to integrate into enterprise and cloud infrastructures.

Device Management Solutions

These solutions include console servers, remote keyboard, video, mouse ("KVM") servers, print servers, managed power distribution products, software and other miscellaneous products. We offer single and multi-port products (up to 48 ports) that provide IT professionals with the tools they need to remotely connect to the out-of-band management ports on computers and associated equipment.

Our customers use these solutions to monitor and run their systems to ensure the performance and availability of critical business information systems, network infrastructure and telecommunications equipment. The equipment our solutions manage includes routers, switches, servers, phone switches and public branch exchanges that are often located in remote or not easily accessible locations.

Our console servers provide system administrators and network managers an operationally effective way to connect with their remote or not easily accessible equipment through an interface called a console port, helping them work more efficiently, without having to leave their desk or office. Console ports are usually found on servers and special purpose data center equipment such as environmental monitoring/ control systems, communications switches and storage devices. With remote access, system downtime and service calls can be reduced, improving business efficiency. Our console servers provide IT professionals with peace of mind through extensive security features and, in some cases, provisions for dial-in access via modem. These solutions are provided in various configurations and can manage up to 48 devices from one console server.

Our print servers enable wireless printing for iOS devices such as iPads® and iPhones® using their native print menu. Our print servers eliminate the need to print through apps, install software, reconfigure the device, or e-mail documents for printing. Our print servers currently work with USB and network printers and multifunction copy machines for most major brands.

Net Revenue by Product Line

A summary of our net revenue by product line is found in Note 10 to the Notes to our Consolidated Financial Statements in Item 8 of this Report, which is incorporated herein by reference. A discussion of factors potentially affecting our operations is set forth in "Risk Factors" in Item 1A, which is incorporated herein by reference.

Markets

Our principal target markets include the following:

Security

Guarding corporate and customer data, protecting company property and ensuring employee safety are among the most important and challenging responsibilities companies face. As a leader in the physical security space, our solutions enable security solutions providers to build network connectivity into their products (such as security systems, including access control panels, biometric readers, surveillance cameras and fire systems) so they can be remotely accessed and managed over a network or the Internet. With secure data center management products, we are also a major provider in the market for data and computer asset security.

Industrial Automation

In the industrial automation environment – whether it's on the factory floor, semiconductor fabrication clean room, oil platform, weather station, or a warehouse – our customers must depend on their equipment. These customers need the ability to remotely access, manage and control that equipment. With our industrial products, our customers can quickly and reliably connect virtually any piece of factory equipment to a network or the Internet to interactively access, manage, control, evaluate and utilize data from the factory equipment. This powerful, ruggedized, yet simple-to-implement technology provides the ability to perform real-time remote diagnostics and repair, automate data capture and sends notification of a problem.

Building Automation

An intelligent building automation system enables a facilities manager to better manage resources, improve building safety, and reduce energy costs. With our building automation technology, an intelligent building can be created, allowing managers to control virtually every system from a central location. By network-enabling devices quickly and cost-effectively, our building automation products make it possible to integrate building sub-systems (including security, HVAC, lighting, elevators and safety systems) into a single, efficient building management network. For example, the facilities manager at a large corporate campus can control many building elements from electrical and water metering to building access from a single terminal, and can also remotely and quickly diagnose system problems.

Energy

The energy market is increasingly implementing networking technology to more efficiently generate, transmit, distribute and monitor energy. Smart Grid initiatives are driven by adding intelligence to the power grid with networked information regarding the tighter management of power transmission and distribution all the way to the smart meter. With their versatility and protocol independence, our products can bring together a diverse array of devices on the network. In addition, our remote management capability makes our devices dependable tools for monitoring power allocations during critical high-demand periods. Metering, substations, and power-generating equipment are often located in environments where exposure to changing weather conditions is a real factor. Featuring DIN rail mounting and ruggedized housings, our industrial device enablement solutions are frequently the answer for these situations. Our embedded device products are also equipped to handle temperature extremes.

Our products address many facets of power management, including alternate sources such as wind and solar. For most power applications, the key is our ability to remotely control and manage devices in the field. Efficient acquisition of data and control across the network are key requirements for the energy industry. Our products can reduce power management system costs. And with their inherent scalability, they can network-enable existing serial devices and accommodate power system updates for years to come.

Information Technology and Data Centers

Companies can reduce service costs and system downtime while empowering IT managers and staff to securely, remotely and proactively access and troubleshoot equipment around the clock, even if the network is down. Our remote data center management products enable users to access, monitor, troubleshoot and manage IT and data center equipment from anywhere, at any time. Our data center management products also provide the authentication, authorization, encryption and firewall features needed to preserve data security and prevent hackers from disrupting operations. Our data center management products are beneficial to IT departments in virtually every industry sector and are trusted by major telecom companies, financial institutions, and governmental agencies. Our new generation of print servers enable printing to network and USB printers and multifunction copy machines in office and home environments from tablet computers and smartphones.

Healthcare

By network enabling medical devices, our solutions automate and safeguard data collection and dissemination, and facilitate remote patient monitoring, asset tracking and reduced service costs. Our products enable the electronic capture of medical device information for disparate medical devices and provide interfaces to health information technology systems including electronic medical records. Such a level of data collection and collaboration between doctors and healthcare professionals provides shortened diagnosis times, optimized patient care, and ultimately, save lives. Our solutions protect patient privacy with data kept on a highly secured network; eliminate worries about misplaced or overlooked handwritten records; allow less time spent on record keeping; reduce potential for errors like erroneous transcriptions; maximize staff mobility; facilitate collaboration with on and off-site doctors and specialists; and enable on and off-site monitoring.

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Government

We have been a provider of networking and secure remote management technology to government agencies for nearly two decades. We manufacture several products with final assembly in the United States ("U.S.") to meet trade compliance requirements.

Customers

Distributors

Sales to our distributors represent the majority of our revenue. Distributors resell our products to a wide variety of end customers including OEMs, value added resellers ("VARs"), consumers, corporate customers and government entities. We believe our distributor partnerships provide us more opportunities to reach a greater customer market than by solely relying on our own field sales team. We believe that our channel sales approach provides several advantages. We can engage the customers and end users through their channel of choice, making our solutions available from a variety of sources. We can concentrate on developing new relationships at accounts that we believe represent our largest opportunities while our channel partners continue to identify new incremental opportunities and service existing customers.

OEM Manufacturers

To shorten the development cycle and add network connectivity to a product, OEMs can use our external device enablement products to network-enable their installed base of products, while board-level embedded device products are typically used in new product designs. Our capabilities and solutions enable OEMs to focus on their core competencies, resulting in reduced research and development costs, fewer integration problems and faster time-to-market.

End Users

End users require solutions that are simple to install, set up and operate, and can provide immediate results. Generally, these customers need to connect to a diverse range of products and equipment, without modifying existing software and systems.

Customer Concentrations

A discussion concerning sales to our significant customers and related parties, sales within geographic regions as a percentage of net revenue and sales to significant countries as a percentage of net revenue are set forth in Note 10 to the Notes to our Consolidated Financial Statements in Item 8 of this Report, which is incorporated herein by reference. A discussion of factors potentially affecting our customer concentrations and foreign sales is set forth in “Risk Factors” in Item 1A, which is incorporated herein by reference.

Sales and Marketing

We maintain both an inside and a field sales force to provide management and support to our worldwide network of selling partners in an indirect sales model, which include distributors, manufacturers’ representatives, VARs and other resellers throughout the world. We have sales managers and Field Applications Engineers in major regions throughout the world that manage our relationship with our sales partners, identify and develop major new sales opportunities and increase penetration at existing high potential accounts. We implement marketing programs, tools and services specifically geared to drive demand for our products.

Our device enablement solutions are principally sold to manufacturers by our worldwide field sales force and our group of manufacturers’ representatives. We market and sell our device management solutions and select external device enablement solutions through IT resellers, industry-specific system integrators, VARs and directly to end users. Resellers and integrators often obtain our products through distributors. These distributors supply our products to a broad range of VARs, system integrators, direct marketers, government resellers and e-commerce resellers. In turn, these distributors market, sell, install and, in most cases, support our solutions to the end users.

Manufacturing

Our operations strategy is to outsource manufacturing to produce reliable, high quality products at competitive prices and to achieve on-time delivery to our customers. This practice enables us to concentrate our resources on design, engineering, sales and marketing. We manufacture several products with final assembly in the U.S. to meet trade compliance requirements.

We utilize contract manufacturers primarily located in China, Malaysia and Taiwan. Our contract manufacturers source raw materials, components and integrated circuits, in accordance with our pre-determined specifications and forecasts, and perform printed circuit board assembly, final assembly, functional testing and quality control. We believe this arrangement decreases our capital requirements and provides better raw material and component pricing, enhancing our gross margins and operating margins. Please see Part I, Item 1A “Risk Factors” below for a discussion of the risks associated with contract manufacturing.

Research and Development

Our research and development efforts are focused on the development of hardware and software technology and products that will enhance our competitive position in the markets we serve. Products are developed in-house and through outside research and development resources.

	Years Ended June 30,	
	2012	2011
	(In thousands)	
Research and development expenses	$6,910	$7,033

Developer Relations

Recruiting, engaging and participating with third-party developers are integral parts of our ongoing strategy. We encourage, enable and support others in the development of vertical applications using our hardware, firmware and software products. With their help and investment in creating additional applications and markets for our products, we improve our ability to secure a defensible market position and loyal customers.

Competition

The markets in which we compete are dynamic and highly competitive. As these markets grow and develop, we expect competition to intensify.

Our competitors include companies such as Advantech Co., Ltd., Avocent (a business of Emerson Electric Co.), Digi International, Inc., Echelon Corporation, Freescale Semiconductor, Inc., Moxa Technologies, MRV Communications, Inc., Multi-Tech Systems, Inc., Opengear, Perle Systems, Raritan Computer, Inc., Sena Technologies Inc., and Silex Technology, Inc., among others.

The principal competitive factors that affect the market for our products are:

- product quality, technological innovation, compatibility with standards and protocols, reliability, functionality, ease of use and compatibility;
- product pricing;
- potential customers' awareness and perception of our products and of network-enabling technologies; and
- the customer's decision to make versus buy.

Intellectual Property Rights

We have developed proprietary methodologies, tools, processes and software in connection with delivering our products and services. We have not historically relied on patents to protect our proprietary rights, although we continue to build a patent portfolio and currently hold 18 patents, 24 patents pending, and three provisional applications. We have historically relied on a combination of copyright, trademark, trade secret laws and contractual restrictions, such as confidentiality agreements and licenses, to establish and protect our proprietary rights.

United States and Foreign Government Regulation

Many of our products and the industries in which they are used are subject to federal, state or local regulation in the U.S. In addition, our products are exported worldwide. Therefore, we are subject to the regulation of foreign governments. For example, wireless communication is highly regulated in both the U.S. and elsewhere. Some of our products employ encryption technology; the export of some encryption software is restricted. At this time our activities comply with existing laws, but we cannot determine whether future, more restrictive laws, if enacted, would adversely affect us. See "Risk Factors" in Item 1 herein for a discussion of risks associated with foreign operations.

Environmental Matters

Federal, state and local regulations impose various environmental controls on the storage, handling, discharge and disposal of chemicals and gases used in our manufacturing processes. Our company quality manual requires all subcontractors and raw material suppliers to be ISO14001 certified. State agencies require us to report usage of environmentally hazardous materials and we have retained the appropriate personnel to help ensure compliance with all applicable environmental regulations. We actively manage and monitor compliance through our internal auditing program. We believe that our activities conform to present environmental regulations; however, increasing public attention has been focused on the environmental impact of semiconductor operations and these regulations may require us to change the way we source our products, or to fund remedial action regardless of fault.

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In addition, the use and disposal of electronics is under increasing scrutiny and various countries have begun to adopt regulations such as the European Union's Waste Electrical and Electronic Equipment ("WEEE") and the Reduction of the use of certain Hazardous Substances in electrical and electronic equipment ("RoHS") directives, which could require us to both redesign our products to comply with the standards and develop compliance administration systems. We expect additional countries and locations to adopt similar regulations in the future which may be more stringent than the current regulations. Currently however, we believe the majority of our commercial products are compliant with these emerging regulations.

While we have not experienced any materially adverse effects on our operations from environmental regulations, there can be no assurance that changes in such regulations will not impose the need for additional capital equipment or other requirements. We have already invested significant resources into developing compliance tracking systems, and further investments may be required. Any failure by us to adequately restrict the discharge of hazardous substances could subject us to future liabilities or could cause our manufacturing operations to be suspended.

Employees

As of June 30, 2012, we had 114 full- and part-time employees. We have never experienced a work stoppage, none of our employees are currently represented by a labor union and we consider our employee relations to be good.

Backlog

Normally, we manufacture our products in advance of receiving firm product orders from our customers based upon our forecasts of worldwide customer demand. Most customer orders are placed on an as-needed basis and may be canceled or rescheduled by the customer without significant penalty. Accordingly, backlog as of any particular date is not necessarily indicative of our future sales. Because most of our business is on an as-needed basis, we do not believe that backlog information is material to an understanding of our overall business.

Available Information

Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to reports filed or furnished pursuant to Section 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), are available free of charge on our website at www.lantronix.com as soon as reasonably practicable after filing such reports with the SEC. The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling 1-800-SEC-0330. The SEC also maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically. We assume no obligation to update or revise forward looking statements in this Form 10-K, whether as a result of new information, future events or otherwise, unless we are required to do so by law. The Company's audit committee charter; corporate governance and nominating committee charter; and compensation committee charter are also posted on the Company's website at www.lantronix.com under "Investor Relations." The contents of the Company's website are not incorporated by reference into this report.

Executive Officers of the Registrant

The following table presents the names, ages, and positions held by our executive officers. There are no family relationships between any director or executive officer and any other director or executive officer of Lantronix. Executive officers serve at the discretion of the board of directors.

Name	Age	Position
Kurt Busch	41	President and Chief Executive Officer
Jeremy Whitaker	42	Chief Financial Officer and Secretary

KURT BUSCH has served as our President and Chief Executive Officer since August 2011. Mr. Busch served from October 2006 to August 2011 in senior leadership positions at Mindspeed Technologies (Nasdaq: MSPD), a leading supplier of semiconductor solutions for network infrastructure applications ("Mindspeed"). Most recently, he served as Senior Vice President and General Manager for Mindspeed's high performance analog division from November 2007 to August 2011. Mr. Busch also served as Vice President of Marketing and Applications for Mindspeed from October 2006 to November 2007. Under Mr. Busch's leadership, Mindspeed's high performance analog division launched 40 products during his tenure that yielded substantially increased revenues and expanded demand for Mindspeed's products across broad markets including carrier, enterprise data center, surveillance and professional video. Since 1990, Mr. Busch has worked in the networking communications industry. His experience also includes business development roles at Analog Devices (ADI) as well as roles in engineering, sales, marketing and general management at Digital Equipment Corporation (DEC), Intel (INTC), and two start-ups. Mr. Busch earned a bachelor's degree in electrical and computer engineering and a bachelor's degree in biological science from the University of California at Irvine and received his MBA from Santa Clara University in 1998.

JEREMY WHITAKER has served as our Chief Financial Officer and Secretary since September 2011. Mr. Whitaker returned to Lantronix after serving briefly as Vice President, Corporate Controller at Mindspeed from January 2011 to September 2011. Prior to Mindspeed, Mr. Whitaker served as Vice President of Finance and Accounting for Lantronix from September 2010 to January 2011, where he was responsible for managing all worldwide finance and accounting functions. Mr. Whitaker also served as Lantronix' Sr. Director of Finance and Accounting from February 2006 to September 2010 and its Director of Finance and Accounting from August 2005 to February 2006. Prior to August 2005, Mr. Whitaker held vice president and director level finance and accounting positions with two publicly-traded companies. Prior to that, Mr. Whitaker served as an Audit Manager during his six years at Ernst & Young LLP. Mr. Whitaker earned a bachelor's degree in accountancy from California State University Fullerton and a master's degree in accountancy, from University of Notre Dame's Mendoza College of Business.

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, as well as other information contained in this Report and in our other filing with the SEC. 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 Report. Additional risks not presently known to us or that we currently deem immaterial may also adversely affect our business. If any of these risks or uncertainties actually occurs, our business, financial condition, results of operations or prospects could be materially harmed. In that event, the market price for our common stock could decline and you could lose all or part of your investment.

We have a history of losses.

We incurred net losses of approximately $3.0 million and $5.3 million for the fiscal years ended June 30, 2012 and 2011, respectively. There can be no assurance that we will generate net profits in future periods. Further, there can be no assurance that we will be cash flow positive in future periods. In the event we fail to achieve profitability in future periods, the value of our common stock may decline. In addition, if we were unable to maintain positive cash flows, we would be required to seek additional funding, which may not be available on favorable terms, if at all.

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 revenue, 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 forecast of future net revenue. If we were to experience an unexpected reduction in net revenue in a quarter, we would likely be unable to adjust our short-term expenditures significantly. If this were to occur, our operating results for that fiscal quarter would be harmed. In addition, if our operating results in future fiscal quarters were to 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 global economic disruptions;
- changes in our ability to supply customer demand;
- 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;
- natural disasters 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 own platforms.

We may need additional capital and it may not be available on acceptable terms, or at all.

To remain competitive, we must continue to make significant investments to operate our business and continue the development of our products. Our future capital requirements will depend on many factors, including the timing and amount of our net revenue, research and development expenditures, 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. Looking ahead at long-term needs, we may need to raise additional funds for a number of purposes, including:

- to fund working capital requirements;
- to update, enhance or expand the range of products we offer;
- to increase our sales and marketing activities;
- to fund the issuance up to 2.2 million shares of our common stock in connection with outstanding and/or future compensation awards; or
- to respond to competitive pressures or perceived opportunities, such as investment, acquisition and international expansion activities.

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 such 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.

We may issue additional shares of common stock that may dilute the value of our common stock and adversely affect the market price of our common stock.

In April and May of 2012, we issued and sold an aggregate of 3,957,109 shares of our common stock. Our future capital requirements may require us to sell additional shares of our common stock. A large issuance of shares of our common stock may decrease the ownership percentage of current outstanding stockholders and result in a decrease in the market price of our common stock. A large issuance may also result in a change in control of the Company.

The terms of our amended credit facility may restrict our financial and operational flexibility and, in certain cases, our ability to operate.

The terms of our amended credit facility restrict, among other things, our ability to incur additional indebtedness, pay dividends or make certain other restricted payments, consummate certain asset sales, enter into certain transactions with affiliates, merge or consolidate with other persons, or sell, assign, transfer, lease, convey or otherwise dispose of all or substantially all of our assets. Further, we are currently and may in the future be required to maintain specified financial ratios, including a Minimum Tangible Worth ("Minimum TNW") covenant and satisfy certain financial conditions. Our ability to meet those financial ratios and tests can be affected by events beyond our control, and there can be no assurance that we will meet those tests. Pursuant to amended credit agreement and the related loan and security agreement, we have pledged substantially all of our assets to our lender, Silicon Valley Bank ("SVB").

In May and June of 2011, we violated the Minimum TNW covenant and SVB provided a waiver and amended the covenant in August 2011. In January 2012, we entered into another amendment, which further reduced the Minimum TNW covenant. However, the calculated Minimum TNW covenant increased as a result of the completion a private placement and public offering of our common stock during the fourth quarter of the fiscal year ended June 30, 2012, from which we raised total net proceeds of $9.5 million. If we continue to generate net losses, it could result in us not meeting the Minimum TNW covenant. If the three-year $2.0 million term loan with SVB were to be called by SVB, we would be required to repay all amounts owed under such term loan. At that time, we may not have sufficient funds to repay SVB or to satisfy all of our other outstanding obligations. If we cannot satisfy our obligations, SVB may have the right to foreclose on our assets and we would have difficulty continuing as a going concern.

Current conditions in the global economy and the major industry sectors that we serve may materially and adversely affect our business and results of operations.

Currently, about half of our revenue comes from overseas and our business and operating results will continue to be affected by worldwide economic conditions. The prolonged economic crises both in the U.S. and in Europe poses a risk as consumers and businesses postpone spending in response to tighter credit, unemployment, negative news and/or declines in income or asset values, which in turn could have a material adverse effect on demand for our products and services. As a result, existing or potential customers of our products may delay or cancel plans to purchase such products, which would have a material adverse effect on us. Accordingly, if the global economic slowdown continues for a significant period of time or if there is significant further uncertainty or deterioration in the global economy, our business, results of operations, financial position and cash flows could be materially adversely affected.

The current European debt crisis and related European financial restructuring efforts may cause the value of the European currencies, including the Euro, to deteriorate, thus reducing the purchasing power of European customers and reducing the amounts of U.S. dollar revenues. International sales have accounted for a significant percentage of our revenue and we anticipate that they will continue to account for a significant percentage of our revenue. In addition, the European crisis is contributing to instability in global credit markets. If market or economic conditions in Europe, the United States or other key markets such as the Middle East, and Asia remain uncertain, persist, or deteriorate further, customers' purchasing power and demand for our products could decline, which could adversely affect our business, financial condition results of operations and cash flows.

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 some components and 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 and/or components used in our products will be phased out of production by the manufacturer. 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 may be unable to purchase sufficient components to meet our demands, or we may incorrectly forecast our demands, and purchase too many or too few components. We have been experiencing higher component shortages and extended lead-times. 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 most 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 results of operations.

We do not have long-term agreements with most of our contract manufacturers or suppliers. If any of these subcontractors or suppliers were to cease doing business with us, we might 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 from our contract manufacturers or suppliers could damage our customer relationships and materially and adversely affect our business, financial condition or results of operations.

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 five manufacturers in Asia: Esilicon Corp., Universal Scientific Industrial Company, LTD, Hana Microelectronics, Inc. Venture Electronics Services, and Uni Precision Industrial Ltd. 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.

Due to the downturn in the economy, which has put some suppliers out of business, we have been experiencing higher component shortages. 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.

If a major distributor or customer cancels, reduces or delays purchases, our revenue 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 that they buy our products from us, they are also part of our product distribution system. One or more of our distributors could be acquired by a competitor and stop buying product from us.

The loss or deferral of one or more significant customers could significantly harm our operating results. We have in the past, and may 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 and 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 sales 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.

We may experience difficulties associated with utilizing third-party logistics providers.

A majority of our physical inventory management process, as well as the shipping and receiving of our inventory, is performed by third-party logistics providers in Los Angeles, California and Hong Kong. There is a possibility that these third-party logistics providers will not perform as expected and we could experience delays in our ability to ship, receive, and process the related data in a timely manner. This could adversely affect our financial position, results of operations, cash flows and the market price of our common stock.

Relying on third-party logistics providers could increase the risk of the following: failing to receive accurate and timely inventory data, theft or poor physical security of our inventory, inventory damage, ineffective internal controls over inventory processes or other similar business risks out of our immediate control.

If our research and development efforts are not successful, our 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, the net revenue from these products may not be sufficient to justify our investment in the research and development of such products. On the other hand, if we do not invest sufficiently in research and development, we may be unable to maintain our competitive position. The continuing effects of the economic recession could require cost-containment measures, which could force us to reduce our investment in research and development and put us at a competitive disadvantage compared to our competitors.

If we fail to develop or enhance our products to respond to changing market conditions, environmental regulations, 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 evolving 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.

We operate in a market that is subject to frequent changes which could adversely affect our business. For example, we recently introduced the xPrintServer-Network Edition, a print solution for Apple iOS devices. The product's success is dependent upon providing an easy to use print solution for iOS devices in the enterprise and consumer environment. If Apple were to change the iOS technology, or Apple or another competitor were to introduce a new print application or similar product, it could result in the xPrintServer becoming obsolete. If this were to happen, our revenue might not grow at the rate we anticipate, and it could decline.

Changes in governmental regulations have in the past, and may in the future, disrupt our business and cause us to substantially modify our products very quickly. 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.

A number of competitors have greater resources than us and could develop competing technologies based on Internet Protocols, Ethernet Protocols or other protocols that have competitive advantages over our product offerings. If this were to happen, our net revenue might decline or grow at a rate less than we anticipate.

In addition, various countries have begun to require companies selling a broad range of electrical equipment to conform to regulations such as the Waste Electrical and Electronic Equipment ("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, which in turn could have an adverse effect on our gross profit margin. If we cannot develop compliant products in a timely manner or properly administer our compliance programs, our net revenue may also decline due to lower sales, which would adversely affect our operating results.

Certain of our products are sold into mature markets, which could limit our ability to continue to generate revenue from these products.

Certain of our products are sold into mature markets that are characterized by a trend of declining demand. As the overall market for these products decreases due to the adoption of new technologies or declining demand, we expect that our revenues from these products will continue to decline. As a result, our future results and prospects depend in part on our ability to generate revenue from new products that address growth markets.

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

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 also 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 or 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 might not be able to reduce the cost to manufacture our products to keep up with the decline in prices.

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. 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.

New product introductions or 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.