

LANTRONIX INC
Form 10-Q
November 01, 2012

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 September 30, 2012

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)

Not Applicable

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

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

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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Accelerated filer

Smaller reporting company

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

As of October 29, 2012, there were 14,576,639 shares of the Registrant's common stock outstanding.

LANTRONIX, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED

September 30, 2012

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PART I. FINANCIAL INFORMATION**Item 1. Financial Statements****LANTRONIX, INC.****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands)**

	September 30, 2012	June 30, 2012
Assets		
Current assets:		
Cash and cash equivalents	\$10,526	\$11,374
Accounts receivable, net	2,237	2,674
Contract manufacturers' receivable	656	622
Inventories, net	7,650	5,955
Prepaid expenses and other current assets	718	549
Deferred tax assets	657	657
Total current assets	22,444	21,831
Property and equipment, net	1,527	1,605
Goodwill	9,488	9,488
Other assets	86	87
Total assets	\$33,545	\$33,011
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$4,809	\$3,563
Accrued payroll and related expenses	1,408	2,100
Warranty reserve	209	232
Short-term debt	667	667
Other current liabilities	3,745	3,342
Total current liabilities	10,838	9,904
Non-current liabilities:		
Long-term liabilities	302	303
Long-term capital lease obligations	41	48
Long-term debt	-	167
Deferred tax liabilities	657	657

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Total non-current liabilities	1,000	1,175
Total liabilities	11,838	11,079

Commitments and contingencies

Stockholders' equity:

Common stock	1	1
Additional paid-in capital	203,254	203,049
Accumulated deficit	(181,947)	(181,517)
Accumulated other comprehensive income	399	399
Total stockholders' equity	21,707	21,932
Total liabilities and stockholders' equity	\$33,545	\$33,011

See accompanying notes.

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

	Three Months Ended September 30, 2012	
	2012	2011
Net revenue (1)	\$11,202	\$11,184
Cost of revenue	5,730	5,882
Gross profit	5,472	5,302
Operating expenses:		
Selling, general and administrative	4,268	4,964
Research and development	1,609	1,695
Amortization of purchased intangible assets	–	18
Total operating expenses	5,877	6,677
Loss from operations	(405)	(1,375)
Interest expense, net	(15)	(27)
Other income (expense), net	5	(29)
Loss before income taxes	(415)	(1,431)
Provision for income taxes	15	13
Net loss and comprehensive loss	\$(430)	\$(1,444)
Net loss per share (basic and diluted)	\$(0.03)	\$(0.14)
Weighted-average common shares (basic and diluted)	14,558	10,560
Net revenue from related parties	\$292	\$237

(1) Includes net revenue from related parties

See accompanying notes.

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

	Three Months Ended September 30,	
	2012	2011
Operating activities		
Net loss	\$(430)	\$(1,444)
Adjustments to reconcile net loss to net cash used in operating activities:		
Share-based compensation	231	160
Depreciation	218	234
Provision for excess and obsolete inventories	(3)	1
Amortization of purchased intangible assets	-	18
Changes in operating assets and liabilities:		
Accounts receivable	437	852
Contract manufacturers' receivable	(34)	314
Inventories	(1,692)	(126)
Prepaid expenses and other current assets	(169)	128
Other assets	1	66
Accounts payable	1,246	(1,487)
Accrued payroll and related expenses	(692)	300
Warranty reserve	(23)	(9)
Other liabilities	418	(370)
Net cash used in operating activities	(492)	(1,363)
Investing activities		
Purchases of property and equipment	(140)	(209)
Net cash used in investing activities	(140)	(209)
Financing activities		
Payment of term loan	(167)	(167)
Minimum tax withholding paid on behalf of employees for restricted shares	(26)	-
Payment of capital lease obligations	(23)	(52)
Net cash used in financing activities	(216)	(219)
Effect of foreign exchange rate changes on cash	-	(10)
Decrease in cash and cash equivalents	(848)	(1,801)
Cash and cash equivalents at beginning of period	11,374	5,836
Cash and cash equivalents at end of period	\$10,526	\$4,035

See accompanying notes.

LANTRONIX, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Lantronix, Inc. (referred to in these unaudited condensed consolidated financial statements as “Lantronix,” “we,” “us,” or “our”) 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 8 of Securities and Exchange Commission (“SEC”) Regulation S-X. Accordingly, they should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2012, included in our Annual Report on Form 10-K filed with the SEC on August 30, 2012. The unaudited condensed consolidated financial statements contain all normal recurring accruals and adjustments that in the opinion of management, are necessary to present fairly the consolidated financial position of Lantronix at September 30, 2012, and the consolidated results of our operations for the three months ended September 30, 2012 and the consolidated cash flows for the three months ended September 30, 2012. All intercompany accounts and transactions have been eliminated. It should be understood that accounting measurements at interim dates inherently involve greater reliance on estimates than at year-end. The results of operations for the three months ended September 30, 2012 are not necessarily indicative of the results to be expected for the full year or any future interim periods.

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (“FASB”) issued guidance regarding the presentation of comprehensive income. The new standard requires the presentation of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The updated guidance is effective on a retrospective basis for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. We adopted this guidance effective July 1, 2012. Such adoption did not have a material impact on our financial statements.

2. Supplemental Financial Information

Inventories

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

	September 30, 2012	June 30, 2012
	(In thousands)	
Finished goods	\$4,872	\$3,162
Raw materials	1,385	1,375
Inventory at distributors *	1,306	1,182
Large scale integration chips **	87	236
Inventories, net	\$7,650	\$5,955

* Balance represents finished goods held by distributors.

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

Computation of Net Loss per Share

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

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

**Three Months
Ended
September 30,
2012 2011
(In thousands,
except per share
data)**

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Numerator:		
Net loss		\$(430) \$(1,444)
Denominator:		
Weighted-average shares	14,561	10,612
Less: Unvested common shares	(3)	(52)
Weighted-average common shares outstanding (basic and diluted)	14,558	10,560
Net loss per share (basic and diluted)		\$(0.03) \$(0.14)

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

**Three
Months
Ended
September
30,
2012 2011
(In
thousands)**

Common stock equivalents	1,404	1,762
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3. Warranty Reserve

Upon shipment to our customers, we provide for the estimated cost to repair or replace products to be returned under warranty. The Company's products typically carry a one- to two-year warranty. Beginning in December 2011 we began offering a 5-year warranty for some of our new products. Our warranty obligation is affected by product failure rates, use of materials and service delivery costs, which may differ from our estimates. As a result, additional warranty reserves could be required, which could reduce gross margins. Additionally, we sell extended warranty services, which extend the warranty period for an additional one to three years, depending upon the product. Warranty net revenue is deferred and recognized ratably over the warranty service period.

The following table presents details of our warranty reserve:

	Three Months Ended September 30, 2012	Year Ended June 30, 2012
	(In thousands)	
Beginning balance	\$232	\$268
Charged to cost of revenues	13	84
Usage	(36)	(120)
Ending balance	\$209	\$232

4. Bank Line of Credit and Debt

We have a Loan and Security Agreement (the "Loan and Security Agreement") with Silicon Valley Bank ("SVB") dated May 23, 2006 which is comprised of a two-year, \$4.0 million revolving line of credit and a three-year, \$2.0 million term loan (the "Term Loan"). We also have (i) a Loan and Security Agreement/(Ex-Im Program) (the "Ex-Im Loan and Security Agreement") dated May 23, 2006 with terms that generally parallel to the Loan and Security Agreement and (ii) an Export-Import Bank of the United States (the "Ex-Im Bank") Working Capital Guarantee Program Borrower Agreement (the "Guarantee Agreement"). The Ex-Im Loan and Security Agreement and the Guaranty Agreement were established primarily as a means to use our assets related to our foreign operations to secure our borrowings.

The Loan and Security Agreement and the Ex-Im Loan and Security Agreement were established in favor of SVB for the purpose of providing us with working capital to finance the manufacture, production or purchase and subsequent export of our finished goods or services and a means to use our assets related to our domestic and foreign operations

to secure our borrowings. SVB and the Ex-Im Bank required that we execute the Guarantee Agreement as a condition precedent to SVB establishing the Loan and Security Agreement and Ex-Im Bank providing the Guarantee Agreement. We collectively refer to the Loan and Security Agreement and the Ex-Im Loan and Security Agreement herein, as each have been amended from time to time, as the "SVB Loan Agreements." The SVB Loan Agreements provide for a revolving line of credit that in the aggregate may not exceed \$4.0 million and the Term Loan. As of September 30, 2012, there were no borrowings outstanding on the revolving line of credit under the SVB Loan Agreements and the Term Loan is being repaid over 36 equal monthly installments with a maturity date of September 30, 2013.

On October 16, 2012, we entered into amendments to the SVB Loan Agreements, effective September 30, 2012 (the "Amended SVB Loan Agreements"), and also re-executed the Guarantee Agreement as of October 16, 2012.

The Amended SVB Loan Agreements extended the maturity date for the revolving line of credit and the Term Loan until September 30, 2014. The Amended SVB Loan Agreements also reduced the interest rate to a rate per annum equal to the greater of the prime rate plus 0.75% or 4.0%, provided that we maintain a monthly quick ratio of 1.0 to 1.0 or greater. The quick ratio measures our ability to use our cash and cash equivalents maintained at SVB (or "quick assets") to extinguish or retire our current liabilities and the longer-term portion of the Term Loan immediately. If this ratio is not met, the interest rate will become the greater of the prime rate plus 1.25% or 4.0%. Additionally, the interest rate on the Term Loan was reduced to the prime rate plus 1.50%, payable monthly. Pursuant to the Amended SVB Loan Agreements, the available borrowing capacity under the revolving line of credit is limited to the lesser of (i) \$4.0 million or (ii) the current portion of the trade accounts receivable balance, less 50% of the balance of deferred revenue, less outstanding borrowings on the revolving line of credit. The Amended SVB Loan Agreements require the payment of a fee of \$5,000 for the Amended Loan and Security Agreement and \$10,000 for the Amended Ex-Im Loan and Security Agreement, upon execution, respectively. We also are required to pay an additional \$5,000 and \$10,000 fee for the Amended Loan and Security Agreement and Amended Ex-Im Loan and Security Agreement, respectively, on September 30, 2013.

The Amended SVB Loan Agreements adjust our Minimum Tangible Net Worth ("Minimum TNW") covenant beginning as of September 30, 2012 from approximately \$7.5 million to \$6.0 million. This amount will adjust upward, as further defined in the agreements, to the extent we raise additional equity or debt financing or achieve net income in future quarters. Our Actual Tangible Net Worth ("Actual TNW") is calculated as total shareholders' equity, less goodwill. If we continue to incur net losses, we may have difficulty satisfying the Minimum TNW financial covenant in the future.

The following table sets forth the Minimum TNW compared to our Actual TNW:

	September 30, 2012 (In thousands)
Minimum TNW	\$ 6,000
Actual TNW	\$ 12,219

The following table presents the balance outstanding on the Term Loan, the available borrowing capacity on the revolving line of credit and outstanding letters of credit, which were used as security deposits:

	September 30, 2012	June 30, 2012
	(In thousands)	
Term Loan	\$667	\$834
Available borrowing capacity under the Revolving Line	\$2,176	\$1,987
Outstanding letters of credit	\$113	\$113

5. Stockholders' Equity

Share-Based Plans and Compensation Expense

We have share-based plans under which non-qualified and incentive stock options have been granted to employees, non-employees and board members. In addition, we have granted restricted stock awards to certain employees and board members under these share-based plans.

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

Three
Months

	Ended	
	September	
	30,	
	2012	2011
	(In	
	thousands)	
Cost of revenues	\$11	\$13
Selling, general and administrative	146	81
Research and development	74	66
Total share-based compensation expense	\$231	\$160

As of September 30, 2012, there was approximately \$1.8 million of unrecognized share-based compensation expense. This expense is currently expected to be recognized over a weighted average period of approximately 3.0 years. If there are any modifications or cancellations of the underlying unvested share-based awards, we may be required to accelerate, increase or cancel remaining unearned share-based compensation expense. Future share-based compensation expense and unearned share-based compensation will increase to the extent that we grant additional share-based awards.

Stock Option Awards

The following table presents a summary of option activity under all of our stock option plans:

	Number of Shares	Weighted Average Exercise Price per Share
	(In thousands)	
Balance of options outstanding at June 30, 2012	2,136	\$ 3.20
Options granted	496	2.03
Options forfeited	(16)	2.62
Options expired	(205)	4.59
Options exercised	—	—
Balance of options outstanding at September 30, 2012	2,411	\$ 2.85

Non-Vested Share Awards

The following table presents a summary of the activity for all of our non-vested shares:

	Number of Shares Unvested	Weighted Average Grant - Date Fair Value per Share
	(in thousands)	
Balance of nonvested shares at June 30, 2012	47	\$ 3.06
Granted	—	—
Forfeited	(1)	—
Vested	(43)	3.00
Balance of nonvested shares at September 30, 2012	3	\$ 4.00