LANTRONIX INC
Form 10-Q
January 25, 2019

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2018

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________ to ___________.

Commission file number: 1-16027

LANTRONIX, INC.

(Exact name of registrant as specified in its charter)

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

7535 Irvine Center Drive, Suite 100, Irvine, California

(Address of principal executive offices)

92618

(Zip Code)

(949) 453-3990

(Registrant's telephone number, including area code)

Not Applicable

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes x No o

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o	Smaller reporting company x
Emerging Growth Company o	

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

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

As of January 18, 2019, there were 22,213,219 shares of the registrant’s common stock outstanding.

LANTRONIX, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED

DECEMBER 31, 2018

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q for the three months ended December 31, 2018, or this Report, contains forward-looking statements within the meaning of the federal securities laws, which statements are subject to substantial risks and uncertainties. These forward-looking statements are intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact included in this Report, or incorporated by reference into this Report, are forward-looking statements. Throughout this Report, we have attempted to identify forward-looking statements by using words such as “may,” “believe,” “will,” “could,” “project,” “anticipate,” “expect,” “estimate,” “should,” “continue,” “potential,” “plan,” “forecasts,” other forms of these words or similar words or expressions or the negative thereof. These forward-looking statements relate to, among other things:

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

- sufficiency of our internal controls and procedures;
- our ability to comply with certain financial obligations in our loan agreement;
- the success of our plans to realign and reallocate our resources; and
- assumptions or estimates underlying any of the foregoing.

We have based our forward-looking statements on management’s current expectations and projections about trends affecting our business and industry and other future events. Although we do not make forward-looking statements unless we believe we have a reasonable basis for doing so, we cannot guarantee their accuracy. Forward-looking statements are subject to substantial risks and uncertainties that could cause our future business, financial condition, results of operations or performance to differ materially from our historical results or those expressed or implied in any forward-looking statement contained in this Report. Some of the risks and uncertainties that may cause actual results to differ from those expressed or implied in the forward-looking statements are described in “Risk Factors” included in Part II, Item 1A of this Report, in “Risk Factors” included in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended June 30, 2018, filed with the Securities and Exchange Commission, or the SEC, on August 23, 2018, or the Form 10-K, as well as in our other public filings with the SEC. In addition, actual results may differ as a result of additional risks and uncertainties of which we are currently unaware or which we do not currently view as material to our business.

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

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

LANTRONIX, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	December 31, 2018	June 30, 2018
Assets		
Current assets:		
Cash and cash equivalents	$19,367	$9,568
Accounts receivable, net	6,134	4,244
Inventories, net	9,352	8,439
Contract manufacturers' receivable	419	649
Prepaid expenses and other current assets	752	370
Total current assets	36,024	23,270
Property and equipment, net	1,184	1,036
Goodwill	9,488	9,488
Other assets	55	61
Total assets	$46,751	$33,855
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$4,317	$3,942
Accrued payroll and related expenses	2,731	2,808
Warranty reserve	106	99
Other current liabilities	3,325	2,877
Total current liabilities	10,479	9,726
Other non-current liabilities	256	316
Total liabilities	10,735	10,042
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Common stock	2	2

Additional paid-in capital	224,422	212,995
Accumulated deficit	(188,779)	(189,555)
Accumulated other comprehensive income	371	371
Total stockholders' equity	36,016	23,813
Total liabilities and stockholders' equity	$46,751	$33,855

See accompanying notes.

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LANTRONIX, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three Months Ended December 31,		**Six Months Ended December 31,**	
	2018	2017	2018	2017
Net revenue	$12,114	$11,336	$24,393	$21,942
Cost of revenue	5,453	5,022	10,991	10,034
Gross profit	6,661	6,314	13,402	11,908
Operating expenses:				
Selling, general and administrative	4,159	4,173	8,631	8,159
Research and development	2,279	1,874	4,577	4,095
Total operating expenses	6,438	6,047	13,208	12,254
Income (loss) from operations	223	267	194	(346)
Interest income (expense), net	60	(5)	56	(9)
Other income (expense), net	8	1	(2)	2
Income (loss) before income taxes	291	263	248	(353)
Provision for income taxes	14	38	54	63
Net income (loss)	$277	$225	$194	$(416)
Net income (loss) per share - basic	$0.01	$0.01	$0.01	$(0.02)
Net income (loss) per share - diluted	$0.01	$0.01	$0.01	$(0.02)
Weighted-average common shares - basic	22,091	18,073	20,721	17,970
Weighted-average common shares - diluted	23,442	18,739	22,263	17,970

See accompanying notes.

LANTRONIX, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Six Months Ended December 31,	
	2018	2017
Operating activities		
Net income (loss)	$194	$(416)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Share-based compensation	929	582
Depreciation and amortization	219	226
Changes in operating assets and liabilities:		
Accounts receivable	(713)	(530)
Inventories	(1,375)	(102)
Contract manufacturers' receivable	230	(63)
Prepaid expenses and other current assets	(289)	(38)
Accounts payable	369	1,252
Accrued payroll and related expenses	(77)	(420)
Warranty reserve	7	(4)
Other liabilities	193	(398)
Net cash (used in) provided by operating activities	(313)	89
Investing activities		
Purchases of property and equipment	(355)	(76)
Net cash used in investing activities	(355)	(76)
Financing activities		
Net proceeds from issuances of common stock	10,667	454
Tax withholding paid on behalf of employees for restricted shares	(169)	(88)
Payment of capital lease obligations	(31)	(29)
Net cash provided by financing activities	10,467	337
Increase in cash and cash equivalents	9,799	350
Cash and cash equivalents at beginning of period	9,568	8,073
Cash and cash equivalents at end of period	$19,367	$8,423

See accompanying notes.

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LANTRONIX, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2018

1. Summary of Significant Accounting Policies

The Company

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

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Lantronix have been prepared in accordance with United States generally accepted accounting principles 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, 2018, included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2018, which was filed with the SEC on August 23, 2018. 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 December 31, 2018, the consolidated results of our operations for the three and six months ended December 31, 2018 and our consolidated cash flows for the six months ended December 31, 2018. All intercompany accounts and transactions have been eliminated. 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, 2018 are not necessarily indicative of the results to be expected for the full year or any future interim periods.

Reclassifications

Certain reclassifications have been made to the prior fiscal year financial information to conform with the current fiscal year presentation. Reclassification had no impact on net income or cash flows.

Recent Accounting Pronouncements

Shared-Based Compensation

In June 2018, the Financial Accounting Standards Board ("FASB") issued an accounting standard that expands the scope of existing share-based compensation guidance for employees. The new standard will include share-based payment transactions for acquiring goods and services from nonemployees, whereby share-based payments to nonemployees will be measured and recorded at the fair value of the equity instruments that an entity is obligated to issue on the grant date. Entities are required to adopt the standard using a modified retrospective approach with a cumulative adjustment to opening retained earnings in the year of adoption for the remeasurement of liability-classified awards that have not been settled by the date of adoption and equity-classified awards for which a measurement date has not been established. The standard will be effective for Lantronix in the fiscal year beginning July 1, 2019, with early adoption permitted. We are currently evaluating this guidance and do not anticipate that adoption will have a material impact on our consolidated financial statements.

Leases

In February 2016, FASB issued an accounting standard that revises lease accounting guidance. The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. A lessee is also required to record a right-of-use ("ROU") asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for in a manner similar to that called for by guidance for operating leases prior to the adoption of the new standard. The standard requires entities to recognize and measure leases existing at, or entered into after, the beginning of the earliest comparative period presented using a modified retrospective approach, with certain practical expedients available. In July 2018, FASB issued guidance ("ASU 2018-11"), which offers a practical expedient that allows entities the option to apply the provisions of the new lease standard by recognizing a cumulative effect adjustment at the effective date of adoption without adjusting the prior comparative periods presented.

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For public companies, adoption of the standard is required for annual periods beginning after December 15, 2018. Lantronix will adopt the standard in the fiscal year beginning July 1, 2019. We currently expect the most significant impact of adopting this standard on our financial statements will be the recognition of ROU assets and lease liabilities for our operating leases. We anticipate the valuation of our ROU assets and lease liabilities will be based on the estimated present value of the applicable future lease commitments. We also continue to assess the appropriate discount rate that will be applied to our valuation estimates. We expect to elect certain practical expedients, including the transition option provided in ASU 2018-11, in connection with adopting the new standard. We have not yet determined any quantitative impacts of adoption of this standard on our consolidated financial statements. Through the adoption date, we will continue our assessments, which may cause us to identify additional impacts that this standard will have on our consolidated financial statements.

Revenue from Contracts with Customers

Refer to Note 2 below regarding our adoption of the new revenue standard under FASB's Accounting Standards Codification 606: Revenue from Contracts with Customers ("ASC 606").

2. Revenue Recognition

Nature of Net Revenue

Most of our net revenue is currently derived from sales of hardware products. We also derive a small portion of our net revenue from professional engineering services, extended warranty services, and software licenses. Extended warranty services generally extend the warranty period on our hardware products for an additional one to three years, depending upon the product.

In addition to the products and services described directly above, during the past year we have introduced a number of ready-to-use applications as well as software-as-a-service ("SaaS") offerings for our IoT and IT Management product lines, including Lantronix Gateway Central, MACH10® Global Device Manager, and ConsoleFlow™. These software offerings are in the early stages of evaluation and have not yet generated net revenue.

Net Revenue by Product Line and Geographic Region

We organize our products and solutions into three product lines: IoT, IT Management and Other. Our IoT products typically connect to one or more existing machines or are built into new industrial devices to provide network connectivity. Our IT Management product line includes console management, power management, and keyboard-video-mouse (commonly referred to as KVM) products that provide remote access to IT and networking infrastructure deployed in test labs, data centers, branch offices and server rooms. We categorize products that are non-focus or end-of-life as Other.

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

The following tables present our net revenue by product line and by geographic region. Net revenues by geographic region are based on the "bill-to" location of our customers:

	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2018	2017	2018	2017
	(In thousands)			
IoT	$9,070	$7,961	$18,037	$16,419
IT Management	2,888	3,218	5,989	5,007
Other	156	157	367	516
	$12,114	$11,336	$24,393	$21,942

	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2018	2017	2018	2017
	(In thousands)			
Americas	$6,182	$6,292	$13,096	$11,989
EMEA	4,080	3,172	7,600	6,336
Asia Pacific Japan	1,852	1,872	3,697	3,617
	$12,114	$11,336	$24,393	$21,942

Revenue Recognition Policy and Significant Judgments

Revenue is recognized upon the transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. In accordance with ASC 606, we apply the following five-step approach in determining the amount and timing of revenue to be recognized: (i) identifying the contract with a customer, (ii) identifying the performance obligations in the contract, (iii) determining the transaction price, (iv) allocating the transaction price to the performance obligations in the contract and (v) recognizing revenue when the performance obligation is satisfied.

On occasion, we enter into contracts that can include various combinations of products and services, which are generally capable of being distinct and accounted for as separate performance obligations. Revenue is recognized net of (i) any taxes collected from customers, which are subsequently remitted to governmental authorities and (ii) shipping and handling costs collected from customers.

Product Shipments

Most of our product revenue is recognized as a distinct single performance obligation when products are tendered to a carrier for delivery, which represents the point in time that our customer obtains control of the promised products. A smaller portion of our product revenue is recognized when our customer receives delivery of the promised products.

A significant portion of our products are sold to distributors under agreements which contain (i) limited rights to return unsold products and (ii) price adjustment provisions, both of which are accounted for as variable consideration when estimating the amount of revenue to recognize. We base our estimates for returns and price adjustments primarily on historical experience; however, we also consider contractual allowances, approved pricing adjustments and other known or anticipated returns and price adjustments in a given period. Such estimates are generally made at the time of shipment to the customer and updated at the end of each reporting period as additional information becomes available and only to the extent that it is probable that a significant reversal of any incremental revenue will not occur. Our estimates of accrued variable consideration are included in other current liabilities in the accompanying unaudited condensed consolidated balance sheet at December 31, 2018.

Services and Multiple Performance Obligations

Revenues from our extended warranty and services are generally recognized ratably over the applicable service period. We expect revenues from future sales of our SaaS products to be recognized ratably over the applicable service period as well. Revenues from professional engineering services are generally recognized as services are performed.

From time to time, we may enter into contracts with customers that include promises to transfer multiple deliverables that may include sales of products, professional engineering services and other product qualification or certification services. Determining whether the deliverables in such arrangements are considered distinct performance obligations that should be accounted for separately versus together often requires judgment. We consider performance obligations to be distinct when the customer can benefit from the promised good or service on its own or by combining it with other resources readily available and when the promised good or service is separately identifiable from other promised goods or services in the contract. In such arrangements, we allocate revenue on a relative standalone selling price basis by maximizing the use of observable inputs to determine the standalone selling price for each performance obligation.

Contract Balances

In certain instances, the timing of revenue recognition may differ from the timing of invoicing to our customers. We record a contract asset receivable when revenue is recognized prior to invoicing, and a contract or deferred revenue liability when revenue is recognized subsequent to invoicing. With respect to product shipments, we expect to fulfill contract obligations within one year and so we have elected not to separately disclose the amount nor the timing of recognition of these remaining performance obligations. For contract balances related to contracts that include services and multiple performance obligations, refer to the deferred revenue discussion below. There were no unbilled contract asset receivable balances as of July 1, 2018, the transition date for ASC 606.

Payment terms and conditions vary by customer, but generally include a requirement of payment within 30 to 60 days from the invoice date. We do not consider this a significant period of time and have elected not to determine whether contracts with customers contain significant financing components. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, not to provide financing to them.

Deferred Revenue

Deferred revenue is currently comprised primarily of unearned revenue related to our extended warranty services. These services are generally invoiced at the beginning of the contract period and revenue is recognized ratably over the service period. Current and non-current deferred revenue balances represent revenue allocated to the remaining unsatisfied performance obligations at the end of a reporting period and are included in other current liabilities and other non-current liabilities, respectively, in the accompanying unaudited condensed consolidated balance sheets.

The following table presents the changes in our deferred revenue balance for the six months ended December 31, 2018 (in thousands):

Balance, July 1, 2018	$480
New performance obligations	96
Recognition of revenue as a result of satisfying performance obligations	(179)
Balance, December 31, 2018	$397
Less: non-current portion of deferred revenue	(163)
Current portion, December 31, 2018	$234

We expect to recognize substantially all of the non-current portion of deferred revenue over the next two to three years.

Costs to Obtain or Fulfill a Contract with a Customer

In accordance with applicable accounting guidance, we recognize an asset for the incremental costs of obtaining or fulfilling a contract with a customer if we expect the benefit of those costs to be longer than one year. We apply a practical expedient to expense costs as incurred for costs to obtain a contract when the amortization period would have been one year or less. These costs primarily relate to commissions earned and paid to our internal sales team and to certain external sales representatives, and are recorded in selling, general and administrative expenses in the accompanying unaudited condensed consolidated statements of operations. As of December 31, 2018, we do not have any assets recorded pertaining to incremental costs to obtain or fulfill a contract with a customer.

Adoption of New Revenue Standard and Change in Accounting Policy

On July 1, 2018, we adopted ASC 606 using the modified retrospective method and applied it to contracts that were not completed as of that date. Upon adoption, we recorded a non-cash cumulative effect adjustment of $582,000 to our accumulated deficit as of July 1, 2018. The prior year comparative financial information has not been restated and continues to be presented under the accounting standards in effect for the respective periods.

The primary impact to Lantronix of adopting ASC 606 relates to a shift in the timing of when revenue is recognized for sales made to distributors under agreements which contain limited rights to return unsold products and price adjustment provisions. Under the revenue standards that we followed prior to adopting ASC 606, we concluded that the prices to these distributors were not fixed and determinable at the time we deliver products to them and accordingly, revenues from sales to these distributors, and the related inventory costs, were not recognized until the distributors resold the products. By contrast, upon adopting ASC 606, we now recognize revenue, including estimates for variable consideration, when we transfer control of the products to the distributor rather than deferring recognition until the distributor resells the products.

The following table summarizes the significant changes to our accompanying unaudited condensed consolidated balance sheet in connection with adopting ASC 606:

	Balance at June 30, 2018	ASC 606 Adoption Adjustments	Balance at July 1, 2018
	(In thousands)		
Assets:			
Accounts receivable, net	$4,244	$ 1,177	$5,421
Inventories, net	8,439	(462)	7,977
Prepaid expenses and other current assets	370	93	463
Liabilities and Shareholders' Equity:			
Other current liabilities	$2,877	$ 226	$3,103
Accumulated deficit	(189,555)	582	(188,973)

The following tables summarize the significant impacts of adopting ASC 606 on our financial statements as of December 31, 2018 and for the three and six months ended December 31, 2018:

Condensed Consolidated Balance Sheet

	December 31, 2018		
	As Reported	Impact of Adoption	Balances Without Adoption of ASC 606
	(In thousands)		
Assets:			
Accounts receivable, net	$6,134	$ (3,600)	$2,534
Inventories, net	9,352	1,446	10,798
Prepaid expenses and other current assets	752	(156)	596
Liabilities and Shareholders' Equity:			
Other current liabilities	$3,325	14	3,339
Accumulated deficit	(188,779)	(2,324)	$(191,103)

Accounts receivable, net and inventories, net, as reported at December 31, 2018, differ from the balances that would have been recorded without the adoption of ASC 606 since we no longer record deferred revenue and inventory balances for products held at certain distributor customers awaiting sell-through. Additionally, under ASC 606 we record contract assets and contract liabilities as estimates for variable consideration, which are recorded to prepaid expenses and other current assets and other current liabilities, respectively. The accumulated deficit balance, as reported, differs from the balance without the adoption of ASC 606 as a result of the adjustments discussed above.

Condensed Consolidated Statement of Operations

	Three Months Ended December 31, 2018		
	As Reported	Impact of Adoption	Amounts Without Adoption of ASC 606
	(In thousands, except per share amounts)		
Net revenue	$12,114	$ (1,038)	$ 11,076
Cost of revenue	5,453	(201)	5,252
Net income (loss)	277	(836)	(559)
Net income (loss) per share - basic	$0.01	$ (0.04)	$ (0.03)
Net income (loss) per share - diluted	$0.01	$ (0.04)	$ (0.03)

	Six Months Ended December 31, 2018		
	As Reported	Impact of Adoption	Amounts Without Adoption of ASC 606
	(In thousands, except per share amounts)		
Net revenue	$24,393	$ (2,666)	$ 21,727
Cost of revenue	10,991	(922)	10,069
Net income (loss)	194	(1,742)	(1,548)
Net income (loss) per share - basic	$0.01	$ (0.08)	$ (0.07)
Net income (loss) per share - diluted	$0.01	$ (0.08)	$ (0.07)

Net revenue, as reported, for the three and six months ended December 31, 2018 differs from the recalculated net revenue without the adoption of ASC 606 due to the difference in timing of when we recognize revenue for sales to certain distributor customers, as further described above. More specifically, as of June 30, 2018, inventories held by our distributor customers were at historically low levels. During the three and six months ended December 31, 2018, our distributor customers increased their purchases and brought their inventories up to levels that were more consistent with what they have held historically. This had the impact of lower sell-through net revenues as recalculated without the effect of adopting ASC 606. Likewise, the differences in cost of revenue, net income (loss) and net income (loss) per share in the tables directly above are primarily attributable to the difference in net revenue.

3. Supplemental Financial Information

Inventories

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

	December 31, 2018	June 30, 2018
	(In thousands)	
Finished goods	$6,246	$5,892
Raw materials	3,106	2,547
Inventories, net	$9,352	$8,439

Other Liabilities

The following table presents details of our other liabilities:

	December 31, 2018	June 30, 2018
	(In thousands)	
Current		
Accrued variable consideration	$1,087	$–
Customer deposits and refunds	191	916
Accrued raw materials purchases	631	460
Deferred revenue	234	305
Capital lease obligations	28	55
Taxes payable	312	296
Accrued operating expenses	842	845
Total other current liabilities	$3,325	$2,877
Non-current		
Deferred rent	$93	$137
Deferred revenue	163	175
Capital lease obligations	–	4
Total other non-current liabilities	$256	$316

Computation of Net Income (Loss) per Share

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

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

	Three Months Ended December 31,		**Six Months Ended December 31,**	
	2018	2017	2018	2017
	(In thousands, except per share data)			
Numerator:				
Net income (loss)	$277	$225	$194	$(416)
Denominator:				
Weighted-average common shares outstanding - basic	22,091	18,073	20,721	17,970
Effect of dilutive securities:	1,351	666	1,542	–
Denominator for net income (loss) per share - diluted	23,442	18,739	22,263	17,970
Net income (loss) per share - basic	$0.01	$0.01	$0.01	$(0.02)
Net income (loss) per share - diluted	$0.01	$0.01	$0.01	$(0.02)

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

	Three Months Ended December 31,		**Six Months Ended December 31,**	
	2018	2017	2018	2017
	(In thousands)			
Common stock equivalents	70	1,647	4	2,056

Severance and Related Charges

Current Fiscal Year

During the six months ended December 31, 2018, we initiated a plan to realign certain personnel resources to better fit our current business needs. These activities were substantially completed by September 30, 2018 and resulted in a total charge of approximately $460,000, which included $323,000 in severance-related costs and $137,000 in share-based compensation expense. These costs are included in the applicable functional line items within the accompanying unaudited condensed consolidated statements of operations for the six months ended December 31, 2018.

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

	Six Months Ended December 31, 2018 (In thousands)
Beginning balance	$ –
Charges	323
Payments	(251)
Ending balance	$ 72

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The ending balance is recorded in accrued payroll and related expenses on the accompanying unaudited condensed consolidated balance sheet at December 31, 2018.

Prior Fiscal Year

During the six months ended December 31, 2017, we realigned certain personnel resources throughout our organization, primarily to optimize our operations and engineering efforts. These activities resulted in total charges of approximately $527,000 and consisted primarily of severance costs, and to a lesser extent, termination costs related to our facility lease in Hong Kong. These charges are included in the applicable functional line items within the accompanying unaudited condensed consolidated statement of operations for the six months ended December 31, 2017.

Supplemental Cash Flow Information

The following table presents non-cash investing transactions excluded from the accompanying unaudited condensed consolidated statements of cash flows:

	Six Months Ended December 31,	
	2018	2017
	(In thousands)	
Accrued property and equipment paid for in the subsequent period	$ 6	$ 44

4. Warranty Reserve

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

The following table presents details of our warranty reserve:

	Six Months Ended December 31, 2018	Year Ended June 30, 2018
	(In thousands)	
Beginning balance	$ 99	$ 125
Charged to cost of revenue	29	168
Usage	(22)	(194)
Ending balance	$ 106	$ 99

5. Bank Line of Credit

In October 2018, we entered into a new Loan and Security Agreement (the “Loan Agreement”) with Silicon Valley Bank (“SVB”), as our previous agreement expired at the end of September 2018. The Loan Agreement provides us with a $4.0 million revolving line of credit based on qualified accounts receivable and has a maturity date of September 30, 2020. There were no outstanding borrowings as of December 31, 2018 or June 30, 2018.

The Loan Agreement provides for an interest rate per annum equal to the greater of (i) the prime rate plus 0.50% or (ii) 5.00%, 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 to extinguish or retire our current liabilities immediately. If this ratio is not met, the interest rate will become the greater of (i) the prime rate plus 1.00% or (ii) 5.00%. At December 31, 2018, we met the quick ratio requirement.

The Loan Agreement also includes a covenant requiring us to maintain a certain Minimum Tangible Net Worth ("Minimum TNW"), currently required to be $7,321,000. The Minimum TNW is subject to upward adjustment to the extent we raise additional equity or debt financing or achieve net income in future periods. Our Actual Tangible Net Worth ("Actual TNW") is calculated as total stockholders' equity, less goodwill. At December 31, 2018, our Actual TNW was $26,528,000.

6. Stockholders' Equity

Public Offering

On September 18, 2018, we entered into an underwriting agreement with Needham & Company, LLC and Lake Street Capital Markets, LLC (the "Underwriters") relating to the offer and sale of 2,500,000 shares of our common stock, par value $0.0001 per share, to the public at a price of $4.00 per share. We also granted the Underwriters a 30-day option to purchase up to 375,000 additional shares of our common stock to cover over-allotments, if any (the "Option Shares"). Pursuant to the underwriting agreement, we sold an aggregate of 2,700,000 shares, including 200,000 Option Shares, to the Underwriters and received proceeds net of underwriting discounts and expenses of approximately $9,775,000.

Stock Incentive Plans

Our stock incentive plans permit the granting of stock options (both incentive and nonqualified stock options), restricted stock units ("RSUs"), stock appreciation rights, non-vested stock, and performance shares to certain employees, directors and consultants. As of December 31, 2018, no stock appreciation rights, non-vested stock, or performance shares were outstanding.

Stock Options

The following table presents a summary of activity during the six months ended December 31, 2018 with respect to our stock options:

	Number of	Weighted-Average

	Shares	Exercise Price per Share
	(In thousands)	
Balance of options outstanding at June 30, 2018	3,931	$ 1.73
Granted	72	3.58
Forfeited	(114)	1.88
Expired	(4)	1.98
Exercised	(533)	1.77
Balance of options outstanding at December 31, 2018	3,352	$ 1.76

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Restricted Stock Units

The following table presents a summary of activity during the six months ended December 31, 2018 with respect to our RSUs:

	Number of Shares (In thousands)	Weighted-Average Grant Date Fair Value per Share
Balance of RSUs outstanding at June 30, 2018	140	$ 1.51
Granted	666	5.04
Vested	(93)	1.25
Forfeited	(14)	2.20
Balance of RSUs outstanding at December 31, 2018	699	$ 4.89

Employee Stock Purchase Plan

Our 2013 Employee Stock Purchase Plan (“ESPP”) is intended to provide employees with an opportunity to purchase our common stock through accumulated payroll deductions at the end of a specified purchase period. Each of our employees (including officers) is eligible to participate in our ESPP, subject to certain limitations as set forth in our ESPP. In November 2018, our stockholders approved an amendment to the ESPP to increase the number of shares of common stock reserved for issuance under the ESPP by 500,000 shares.

The following table presents a summary of activity under our ESPP during the six months ended December 31, 2018:

	Number of Shares (In thousands)
Shares available for issuance at June 30, 2018	148
Reserved for issuance	500
Shares issued	(69)

Shares available for issuance at December 31, 2018	579

Share-Based Compensation Expense

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

	Three Months Ended December 31,		**Six Months Ended December 31,**	
	2018	2017	2018	2017
		(In thousands)		
Cost of revenue	$23	$13	$40	$26
Selling, general and administrative	337	239	737	451
Research and development	91	58	152	105
Total share-based compensation expense	$451	$310	$929	$582

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The following table presents the remaining unrecognized share-based compensation expense related to our outstanding share-based awards as of December 31, 2018:

	Remaining Unrecognized Compensation Expense	Remaining Weighted-Average Years To Recognize
	(In thousands)	
Stock options	$1,246	2.1
RSUs	3,099	3.5
Stock purchase rights under ESPP	60	0.4
	$4,405	

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.

7. Income Taxes

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

	Three Months Ended December 31,		**Six Months Ended December 31,**	
	2018	2017	2018	2017
Effective tax rate	5%	14%	22%	18%

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

We record net deferred tax assets to the extent we believe it is more likely than not that these assets will be realized. Due to our cumulative losses and uncertainty of generating future taxable income, we have provided a full valuation allowance against our net deferred tax assets as of December 31, 2018 and June 30, 2018.

8. Commitments and Contingencies

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

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

The following discussion and analysis of our financial condition and results of operations should be read together with our unaudited condensed consolidated financial statements and the related notes included in Part I, Item 1 of this Quarterly Report on Form 10-Q for the three months ended December 31, 2018, or this Report. This discussion and analysis contains forward-looking statements that are based on our current expectations and reflect our plans, estimates and anticipated future financial performance. See the section of this Report entitled "Cautionary Note Regarding Forward-Looking Statements" for additional information. These statements involve numerous risks and uncertainties. Our actual results may differ materially from those expressed or implied by these forward-looking statements as a result of many factors, including those set forth in "Risk Factors" in Part II, Item 1A of this Report.

Overview

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

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

Products and Solutions Overview

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

IoT

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

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

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

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

The following product families are included in our IoT product line: EDS, EDS-MD, PremierWave® EN, PremierWave® XC, SGX™, UDS, WiPort®, xDirect®, xPico®, xPico® Wi-Fi, xPress™, XPort®, XPort® Pro, MACH10® Global Device Manager and Lantronix Gateway Central.

IT Management

Today, organizations are managing an ever-increasing number of devices and data on enterprise networks where 24/7 reliability is mission critical. Out-of-band management is a technique that uses a dedicated management network to access critical network devices to ensure management connectivity (including the ability to determine the status of any network component) independent of the status of other in-band network components. Remote out-of-band access allows organizations to effectively manage their enterprise IT resources and at the same time, optimize their IT support resources. Our vSLM™, a virtualized central management software solution, simplifies secure administration of our IT Management products and the equipment attached to them through a standard web browser.

Our IT Management product line includes console management, power management, and keyboard-video-mouse (commonly referred to as KVM) products that provide remote access to IT and networking infrastructure deployed in test labs, data centers, branch offices and server rooms.

The following product families are included in our IT Management product line: SLB™, SLC™ 8000, Spider™, ConsoleFlow and vSLM™.

Other

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

Recent Accounting Pronouncements

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

Critical Accounting Policies and Estimates

The accounting policies that have the greatest impact on our financial condition and results of operations and that require the most judgment are those relating to revenue recognition, allowance for doubtful accounts, inventory valuation, warranty reserves, valuation of deferred income taxes, and goodwill. These policies are described in further detail in the Form 10-K. The following discussion of our critical accounting policy over revenue recognition has been updated as a result of our adoption of the new revenue standard effective July 1, 2018 (refer to Note 2 in Part I, Item 1 of this Report for further discussion). The prior year comparative financial information has not been restated and continues to be presented under the accounting standards in effect for the respective periods. There have been no other significant changes in our critical accounting policies and estimates during the three and six months ended December 31, 2018 as compared to what was previously disclosed in the Form 10-K.

Revenue Recognition

Revenue is recognized upon the transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We apply the following five-step approach in determining the amount and timing of revenue to be recognized: (i) identifying the contract with a customer, (ii) identifying the performance obligations in the contract, (iii) determining the transaction price, (iv) allocating the transaction price to the performance obligations in the contract and (v) recognizing revenue when the performance obligation is satisfied.

A significant portion of our products are sold to distributors under agreements which contain (i) limited rights to return unsold products and (ii) price adjustment provisions, both of which are accounted for as variable consideration when estimating the amount of revenue to recognize. Establishing accruals for product returns and pricing adjustments requires the use of judgment and estimates that impact the amount and timing of revenue recognition. When product revenue is recognized, we establish an estimated allowance for future product returns based primarily on historical returns experience and other known or anticipated returns. We also record reductions of revenue for pricing adjustments, such as competitive pricing programs and rebates, in the same period that the related revenue is recognized, based primarily on approved pricing adjustments and our historical experience. Actual product returns or pricing adjustments that differ from our estimates could result in increases or decreases to our net revenue.

From time to time, we may enter into contracts with customers that include promises to transfer multiple deliverables that may include sales of products, professional engineering services and other product qualification or certification services. Determining whether the deliverables in such arrangements are considered distinct performance obligations that should be accounted for separately versus together often requires judgment. We consider performance obligations to be distinct when the customer can benefit from the promised good or service on its own or by combining it with other resources readily available and when the promised good or service is separately identifiable from other promised goods or services in the contract. In such arrangements, we allocate revenue on a relative standalone selling price basis by maximizing the use of observable inputs to determine the standalone selling price for each performance obligation. Additionally, estimating standalone selling prices for separate performance obligations within a contract may require significant judgment and consideration of various factors including market conditions, items contemplated during negotiation of customer arrangements and internally-developed pricing models. Changes to performance obligations that we identify, or the estimated selling prices pertaining to a contract, could materially impact the amounts of earned and unearned revenue that we record.

Results of Operations – Three Months Ended December 31, 2018 Compared to the Three Months Ended December 31, 2017

Summary

In the three months ended December 31, 2018 our net revenue increased by $778,000, or 6.9%, compared to the three months ended December 31, 2017. The increase in net revenue was driven by a 13.9% increase in net revenue in our IoT product line, which was partially offset by a decline in our IT Management product line. We had net income of $277,000 for the three months ended December 31, 2018 compared to net income of $225,000 for the three months ended December 31, 2017. The increase in net income was primarily due to the increase in net revenue combined with an increase in interest income.

Net Revenue

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

	Three Months Ended December 31,				Change	
	2018	% of Net Revenue	2017	% of Net Revenue	$	%
	(In thousands, except percentages)					
IoT	$9,070	74.9%	$7,961	70.2%	$1,109	13.9%
IT Management	2,888	23.8%	3,218	28.4%	(330)	(10.3%)
Other	156	1.3%	157	1.4%	(1)	(0.6%)
	$12,114	100.0%	$11,336	100.0%	$778	6.9%

	Three Months Ended December 31,				Change	
	2018	% of Net Revenue	2017	% of Net Revenue	$	%
	(In thousands, except percentages)					
Americas	$6,182	51.0%	$6,292	55.5%	$(110)	(1.7%)
EMEA	4,080	33.7%	3,172	28.0%	908	28.6%
Asia Pacific Japan	1,852	15.3%	1,872	16.5%	(20)	(1.1%)
	$12,114	100.0%	$11,336	100.0%	$778	6.9%

IoT

Net revenue from our IoT product line for the three months ended December 31, 2018 increased compared to the three months ended December 31, 2017 due to increases in unit sales in a variety of our product families including (i) XPort, XPort Pro, and EDS in our Americas region and (ii) our large-scale integration chips in our EMEA region. The overall increase was partially offset by decreases in unit sales of certain product families including (i) xPico Wi-Fi in the EMEA and Americas regions and (ii) UDS in the EMEA and APJ regions.

IT Management

Net revenue from our IT Management product line for the three months ended December 31, 2018 decreased compared to the three months ended December 31, 2017 due to decreased unit sales of our SLB product family in the Americas region. In the prior year quarter we experienced larger sales in this product family driven by deployments to two large customers. The overall decrease in IT Management was partially offset by an increase in unit sales of our SLC8000 product family in our EMEA region.

Other

Net revenue from our Other products, which are comprised of non-focus and end-of-life product families, was generally unchanged from the prior year period.

Gross Profit

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

The following table presents our fiscal quarter gross profit:

	Three Months Ended December 31,				Change	
	2018	% of Net Revenue	2017	% of Net Revenue	$	%
	(In thousands, except percentages)					
Gross profit	$6,661	55.0%	$6,314	55.7%	$347	5.5%

Gross profit as a percent of revenue (referred to as "gross margin") for the three months ended December 31, 2018 declined slightly compared to the three months ended December 31, 2017, primarily due to tariff charges of approximately $150,000 that we incurred for certain products during the quarter. In September 2018, the U.S. government expanded the list of products with tariffs relating to Chinese goods imported into the U.S., which effectively covers the type of products that we sell. We continue to execute on our plan to mitigate our financial exposure to these tariffs in future periods. Our gross margin in the prior year quarter also benefited by approximately $125,000 from improved demand and related sales of various products to which we had applied excess and obsolete reserve estimates in previous periods. The overall decline in our gross margin in the current quarter compared to the prior year quarter was partially offset by improved product sales mix.

Selling, General and Administrative

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

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

	Three Months Ended December 31,				Change	
	2018	% of Net Revenue	2017	% of Net Revenue	$	%
	(In thousands, except percentages)					
Personnel-related expenses	$2,972		$3,097		$(125)	(4.0%)
Professional fees and outside services	311		296		15	5.1%
Advertising and marketing	173		181		(8)	(4.4%)
Facilities and insurance	205		203		2	1.0%
Share-based compensation	337		239		98	41.0%
Depreciation	48		46		2	4.3%
Other	113		111		2	1.8%
Selling, general and administrative	$4,159	34.3%	$4,173	36.8%	$(14)	(0.3%)

Selling, general and administrative expenses have generally remained consistent during the periods presented. We saw an increase in share-based compensation expenses attributable to stock awards being granted with a higher estimated fair value. This was largely offset by a decrease in variable compensation expense for the three months ended December 31, 2018 compared to the prior year period.

Research and Development

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

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

	Three Months Ended December 31,				Change	
	2018	% of Net Revenue	2017	% of Net Revenue	$	%
	(In thousands, except percentages)					
Personnel-related expenses	$1,667		$1,513		$154	10.2%
Facilities	246		194		52	26.8%
Outside services	130		32		98	306.3%
Product certifications	38		26		12	46.2%
Share-based compensation	91		58		33	56.9%
Other	107		51		56	109.8%
Research and development	$2,279	18.8%	$1,874	16.5%	$405	21.6%

Research and development expenses increased primarily due to higher (i) headcount-related expenses, as we have continued to add engineering personnel over the past year, both domestically and in India, and (ii) outside service costs related to various new product development projects.

Results of Operations – Six Months Ended December 31, 2018 Compared to the Six Months Ended December 31, 2017

Summary

In the six months ended December 31, 2018 our net revenue increased by $2,451,000, or 11.2%, compared to the six months ended December 31, 2017. The overall increase in net revenue was primarily due to improvements in our IoT and IT Management product lines. We had net income of $194,000 for the six months ended December 31, 2018 compared to a net loss of $416,000 for the six months ended December 31, 2017. The improvement was principally driven by the increase in net revenue combined with improved margins, which were somewhat offset by increased investment in research and development and share-based compensation.

Net Revenue

The following tables present our fiscal year-to-date net revenue by product line and geographic region:

	Six Months Ended December 31,					
	2018	% of Net Revenue	2017	% of Net Revenue	Change $	Change %
	(In thousands, except percentages)					
IoT	$18,037	73.9%	$16,419	74.8%	$1,618	9.9%
IT Management	5,989	24.6%	5,007	22.8%	982	19.6%
Other	367	1.5%	516	2.4%	(149)	(28.9%)
	$24,393	100.0%	$21,942	100.0%	$2,451	11.2%

	Six Months Ended December 31,					
	2018	% of Net Revenue	2017	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Americas	$13,096	53.7%	$11,989	54.6%	$1,107	9.2%
EMEA	7,600	31.2%	6,336	28.9%	1,264	19.9%
Asia Pacific Japan	3,697	15.1%	3,617	16.5%	80	2.2%
	$24,393	100.0%	$21,942	100.0%	$2,451	11.2%

IoT

Net revenue from our IoT product line for the six months ended December 31, 2018 increased compared to the six months ended December 31, 2017 due to growth in unit sales in a variety of our product families across different geographic regions including (i) XPort in the Americas and APJ regions, (ii) XPort Pro mostly in the Americas region and (iii) our large-scale integration chips in our EMEA region. The overall increase was partially offset by decreases in unit sales of certain product families including (i) UDS in the Americas and EMEA regions and (ii) EDS-MD in the EMEA region.

IT Management

Net revenue from our IT Management product line for the six months ended December 31, 2018 increased compared to the six months ended December 31, 2017, primarily due to growth in unit sales of our SLC8000 product family in the EMEA region and, to a lesser extent, the Americas and APJ regions. This was partially offset by a decrease in unit sales of our SLB product family in the Americas region, as we experienced two large customer deployments in the prior year.

Other

Net revenue from our Other products, which are comprised of non-focus and end-of-life product families, continues to decline as expected.

Gross Profit

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

	Six Months Ended December 31,					
	2018	% of Net Revenue	2017	% of Net Revenue	Change $	Change %
	(In thousands, except percentages)					
Gross profit	$13,402	54.9%	$11,908	54.3%	$1,494	12.5%

Gross margin for the six months ended December 31, 2018 was slightly higher than for the six months ended December 31, 2017, primarily due to improved product sales mix. This was partially offset by tariff charges of approximately $150,000 in the current year period.

Included in our cost of revenue for the six months ended December 31, 2018 and 2017 are $39,000 and $58,000, respectively, in severance and related charges.

Selling, General and Administrative

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

	Six Months Ended December 31,					
		% of Net		% of Net	Change	
	2018	Revenue	2017	Revenue	$	%
	(In thousands, except percentages)					
Personnel-related expenses	$5,906		$5,833		$73	1.3%
Severance and related charges	201		155		46	29.7%
Professional fees and outside services	682		614		68	11.1%
Advertising and marketing	318		359		(41)	(11.4%)
Facilities and insurance	461		468		(7)	(1.5%)
Share-based compensation	737		451		286	63.4%
Depreciation	94		91		3	3.3%
Other	232		188		44	23.4%
Selling, general and administrative	$8,631	35.4%	$8,159	37.2%	$472	5.8%

Selling, general and administrative expenses increased primarily due to (i) higher share-based compensation expenses, primarily attributable to stock awards being granted with a higher estimated fair value, (ii) slightly higher headcount-related expenses, as we have added personnel to our sales teams and (iii) the severance and related charges discussed below. The overall increase to personnel-related expenses above was partially offset by lower variable compensation in the current year period.

During the six months ended December 31, 2018, we realigned certain personnel resources to better fit our current business needs. These activities resulted in total charges of approximately (i) $323,000 in severance-related costs and (ii) $137,000 in share-based compensation expense. Of the total charges of $460,000, approximately, $201,000 of severance-related costs and $137,000 of share-based compensation were classified within selling, general and administrative expenses.

During the six months ended December 31, 2017, we realigned certain personnel resources throughout our organization, primarily to optimize our operations and engineering efforts. These activities resulted in total net charges of approximately $527,000, which consisted primarily of severance costs, and to a lesser extent, termination costs related to our facility lease in Hong Kong. Of the total charges, approximately $155,000 was classified within selling, general and administrative expenses.

Research and Development

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

	Six Months Ended December 31,				Change	
	2018	% of Net Revenue	2017	% of Net Revenue	$	%
	(In thousands, except percentages)					
Personnel-related expenses	$3,333		$2,962		$371	12.5%
Severance and related charges	83		314		(231)	(73.6%)
Facilities	465		396		69	17.4%
Outside services	272		97		175	180.4%
Product certifications	92		134		(42)	(31.3%)
Share-based compensation	152		105		47	44.8%
Other	180		87		93	106.9%
Research and development	$4,577	18.8%	$4,095	18.7%	$482	11.8%

Research and development expenses increased primarily due to higher (i) headcount-related expenses, as we have continued to add engineering personnel over the past year, both domestically and in India, and (ii) outside service costs related to various new product development projects. These increases were partially offset by a decrease in the severance-related charges discussed above.

Interest Income (Expense), Net

During the six months ended December 31, 2018, we began earning interest on our domestic cash balance, which significantly increased as a result of our public offering in September 2018, described further below. Our interest income was partially offset by interest expenses related to our bank line of credit.

Provision for Income Taxes

Refer to *Note 7* of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Report, which is incorporated herein by reference, for a discussion regarding our provision for income taxes.

Liquidity and Capital Resources

Liquidity

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

	December 31, 2018	June 30, 2018	Change
	(In thousands)		
Working capital	$25,545	$13,544	$12,001
Cash and cash equivalents	$19,367	$9,568	$9,799

In September and October 2018, we sold 2,700,000 shares of our common stock in a public offering. We received net cash proceeds from the offering of approximately $9,775,000.

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

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

Our future working capital requirements will depend on many factors, including the following: timing and amount of our net revenue; our product sales mix and the resulting gross margins; research and development expenses; selling, general and administrative expenses; and expenses associated with any strategic partnerships, acquisitions or infrastructure investments.

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

Bank Line of Credit

Refer to *Note 5* of Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Report, which is incorporated herein by reference, for a discussion of our loan agreement.

Cash Flows

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

	Six Months Ended December 31,		
	2018	2017	Change
	(In thousands)		
Net cash (used in) provided by operating activities	$(313)	$89	$(402)
Net cash used in investing activities	(355)	(76)	(279)
Net cash provided by financing activities	10,467	337	10,130

Operating Activities

We used net cash from operating activities during the six months ended December 31, 2018, compared to the prior year period during which we received net cash provided by operating activities. Our use of net cash from operating activities was largely due to an increase in inventory of approximately $913,000 during the six months ended

December 31, 2018, as we have built up our inventory levels as part of our plans to transition between overseas contract manufacturer locations and to mitigate the effects of certain tariffs recently implemented by the U.S. government. The impact of this increase in inventory was partially offset by our net income for the period.

Investing Activities

Net cash used in investing activities during the six months ended December 31, 2018 relates to capital expenditures for the purchase of property and equipment, primarily related to tooling, test equipment, and production software investments.

Financing Activities

Net cash provided by financing activities during the six months ended December 31, 2018 resulted primarily from the public offering of common stock described above. Additionally, for the periods ended December 31, 2018 and 2017 financing activities provided cash from employee stock option exercises and ESPP purchases. This was partially offset by payments for (i) withholding taxes related to the vesting of restricted stock units and (ii) capital leases.

Off-Balance Sheet Arrangements

As of December 31, 2018, we did not have any relationships with unconsolidated organizations or financial partnerships, including structured finance or special purpose entities, that have been established to facilitate off-balance sheet arrangements or for other purposes.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act) that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and (ii) is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

We carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Report. Based upon that evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of December 31, 2018 at the reasonable assurance level.

(b) Changes in Internal Controls over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(f) and 15d-15(f) of the Exchange Act that occurred during the quarter ended December 31, 2018, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

(c) Inherent Limitation on Effectiveness of Controls

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

An investment in our common stock involves risks. Before making an investment decision, you should carefully consider all of the information in this Report, including in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part I, Item 2 of this Report, and the unaudited condensed consolidated financial statements and related notes thereto in Part I, Item 1 of this Report. In addition, you should carefully consider the risks and uncertainties described in the section entitled "Risk Factors" in the Form 10-K, as well as in our other public filings with the SEC. If any of the identified risks are realized, our business, financial condition, operating results and prospects could be materially and adversely affected. In that case, the trading price of our common stock may decline, and you could lose all or part of your investment. In addition, other risks of which we are currently unaware, or which we do not currently view as material, could have a material adverse effect on our business, financial condition, operating results and prospects.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

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

SIGNATURES

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

LANTRONIX, INC.

Date: January 25, 2019 By: /s/ JEFFREY BENCK
Jeffrey Benck
President and Chief Executive Officer
(Principal Executive Officer)

Date: January 25, 2019 By: /s/ JEREMY WHITAKER
Jeremy Whitaker
Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

Exhibit Number	Description	Provided Herewith	Incorporated by Reference Form	Exhibit	Filing Date
10.1	Amended and Restated Loan and Security Agreement dated October 15, 2018 among Lantronix, Inc., Lantronix Holding Company, and Silicon Valley Bank		8-K	99.1	10/16/2018
10.2	Lantronix, Inc. 2013 Employee Stock Purchase Plan, as amended on November 13, 2018		8-K	99.1	11/15/2018
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X			
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X			
32.1*	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X			
101.INS	XBRL Instance Document	X			
101.SCH	XBRL Taxonomy Extension Schema Document	X			
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	X			
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	X			
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	X			
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	X			

*Furnished, not filed.