LANTRONIX INC
Form 10-Q
October 31, 2014

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, 2014

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.)**

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 x No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

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

As of October 24, 2014, there were 14,787,158 shares of the Registrant’s common stock outstanding.

LANTRONIX, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED

September 30, 2014

INDEX

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2014, or the Report, contains forward-looking statements within the meaning of the federal securities laws. 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. These statements include, among other things, any predictions of earnings, revenues, expenses or other financial items; plans or expectations with respect to our development activities or business strategy; statements concerning industry trends; statements regarding anticipated demand for our products, or the products of our competitors, statements relating to manufacturing forecasts, and the potential impact of our relationship with contract manufacturers and original equipment manufacturers on our business; assumptions regarding the future cost and potential benefits of our research and development efforts; forecasts of our liquidity position or available cash resources ; statements relating to the impact of pending litigation; and statements relating to the assumptions underlying any of the foregoing. 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,” “continu “plan,” “forecasts,” “goal,” “seek,” “intend,” other forms of these words or similar words or expressions or the negativ thereof.

We have based our forward-looking statements on our 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” in Item 1A of this Report, our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or the SEC, on August 22, 2014, or the Form 10-K, as well as in our other 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. For these reasons, investors are cautioned not to place undue reliance on any forward-looking statements.

You should read this Report in its entirety, together with the Form 10-K, 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.

3

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

LANTRONIX, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	September 30, 2014	June 30, 2014
Assets		
Current assets:		
Cash and cash equivalents	$6,283	$6,264
Accounts receivable, net	3,543	3,631
Contract manufacturers' receivable	581	359
Inventories, net	8,545	8,404
Prepaid expenses and other current assets	356	524
Total current assets	19,308	19,182
Property and equipment, net	1,490	1,487
Goodwill	9,488	9,488
Deferred tax assets	400	400
Other assets	104	125
Total assets	$30,790	$30,682
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$4,984	$4,547
Accrued payroll and related expenses	1,823	1,863
Warranty reserve	120	150
Deferred tax liabilities	400	400
Other current liabilities	3,206	3,418
Total current liabilities	10,533	10,378
Long-term capital lease obligations	–	7
Other non-current liabilities	98	131
Total liabilities	10,631	10,516
Commitments and contingencies		
Stockholders' equity:		
Common stock	1	1

Additional paid-in capital	205,268	205,013
Accumulated deficit	(185,481)	(185,219)
Accumulated other comprehensive income	371	371
Total stockholders' equity	20,159	20,166
Total liabilities and stockholders' equity	$30,790	$30,682

See accompanying notes.

4

LANTRONIX, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three Months Ended September 30,	
	2014	2013
Net revenue (1)	$11,536	$10,883
Cost of revenue	5,937	5,493
Gross profit	5,599	5,390
Operating expenses:		
Selling, general and administrative	4,075	3,948
Research and development	1,744	1,681
Total operating expenses	5,819	5,629
Loss from operations	(220)	(239)
Interest expense, net	(5)	(9)
Other expense, net	(21)	(6)
Loss before income taxes	(246)	(254)
Provision for income taxes	16	13
Net loss and comprehensive loss	$(262)	$(267)
Net loss per share (basic and diluted)	$(0.02)	$(0.02)
Weighted-average common shares (basic and diluted)	14,787	14,580
Net revenue from related parties	$79	$193

(1) Includes net revenue from related parties

See accompanying notes.

5

LANTRONIX, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Three Months Ended September 30,	
	2014	2013
Operating activities		
Net loss	$(262)	$(267)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Share-based compensation	255	231
Depreciation	229	229
Provision for excess and obsolete inventories	47	74
Changes in operating assets and liabilities:		
Accounts receivable	88	(179)
Contract manufacturers' receivable	(222)	278
Inventories	(188)	140
Prepaid expenses and other current assets	168	92
Other assets	17	–
Accounts payable	390	240
Accrued payroll and related expenses	(40)	180
Warranty reserve	(30)	(18)
Other liabilities	(240)	(115)
Net cash provided by operating activities	212	885
Investing activities		
Purchases of property and equipment	(181)	(118)
Net cash used in investing activities	(181)	(118)
Financing activities		
Payment of term loan	–	(167)
Payment of capital lease obligations	(12)	(12)
Net cash used in financing activities	(12)	(179)
Increase in cash and cash equivalents	19	588
Cash and cash equivalents at beginning of period	6,264	5,243
Cash and cash equivalents at end of period	$6,283	$5,831

See accompanying notes.

6

LANTRONIX, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2014

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 in accordance with United States generally accepted accounting principles (“U.S. GAAP”) for interim financial information and in accordance with the instructions to Form 10-Q and Article 8 of Securities and Exchange Commission (“SEC”) Regulation S-X. Accordingly, they should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2014, included in our Annual Report on Form 10-K filed with the SEC on August 22, 2014. 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, 2014, the consolidated results of our operations for the three months ended September 30, 2014 and our consolidated cash flows for the three months ended September 30, 2014. 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, 2014 are not necessarily indicative of the results to be expected for the full year or any future interim periods.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued an accounting standard which will supersede existing revenue recognition guidance under current U.S. GAAP. The new standard is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. In doing so, among other things, companies will generally need to use more judgment and make more estimates than under the current guidance. The accounting standard will be effective for Lantronix in the fiscal year beginning July 1, 2017. The standard may be adopted using a full retrospective or a modified retrospective (cumulative effect) method. Early adoption is not permitted. We are currently evaluating this standard and have not yet selected a transition method nor have we determined the effect of the standard on our financial statements and related disclosures.

In August 2014, the FASB issued a new standard that will require management of an entity to assess, for each annual and interim period, if there is substantial doubt about the entity's ability to continue as a going concern within one year of the financial statement issuance date. The definition of substantial doubt within the new standard incorporates a likelihood threshold of "probable" similar to the use of that term under current U.S. GAAP for loss contingencies. Certain disclosures will be required if conditions give rise to substantial doubt. The standard will be effective for Lantronix in the fiscal year beginning July 1, 2016. Early adoption is permitted. We are currently evaluating the impact of this standard on our financial statements and related disclosures.

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, 2014	June 30, 2014
	(In thousands)	
Finished goods	$5,427	$5,162
Raw materials	1,862	1,890
Finished goods held by distributors	1,247	1,242
Large scale integration chips *	9	110
Inventories, net	$8,545	$8,404

* This item is sold individually and embedded into our products.

Other Liabilities

The following table presents details of our other liabilities:

	September 30, 2014	June 30, 2014
	(In thousands)	
Current		
Customer deposits and refunds	$654	$711
Accrued raw materials purchases	1,002	1,138
Deferred revenue	128	128
Capital lease obligations	42	47
Taxes payable	239	235
Accrued operating expenses	1,141	1,159
Total other current liabilities	$3,206	$3,418
Non-current		
Deferred rent	$16	$40
Deferred revenue	82	91
Total other non-current liabilities	$98	$131

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, 2014	2013
	(In thousands, except per share data)	
Numerator:		

Net loss	$(262)	$(267)
Denominator:		
Weighted-average common shares outstanding (basic and diluted)	14,787	14,580
Net loss per share (basic and diluted)	$(0.02)	$(0.02)

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

	Three Months Ended September 30,	
	2014	2013
	(In thousands)	
Common stock equivalents	1,664	2,357

8

Supplemental Cash Flow Information

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

	Three Months Ended September 30, 2014	2013
	(In thousands)	
Accrued property and equipment paid for in the subsequent period	$ 48	$ 52

3. Warranty Reserve

The warranty periods for our products generally 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 additionally, for any known product warranty issues. Although we engage in product quality programs and processes, our warranty obligation is affected by product failure rates, use of materials or service delivery costs that differ from our estimates. As a result, increases or decreases to warranty reserves could be required, which could impact our gross margins.

The following table presents details of our warranty reserve:

	Three Months Ended September 30, 2014	Year Ended June 30, 2014
	(In thousands)	
Beginning balance	$ 150	$ 193
Charged to cost of revenues	(11)	40
Usage	(19)	(83)
Ending balance	$ 120	$ 150

4. Bank Line of Credit

On September 30, 2014, we entered into an amendment (the "Amendment") to our existing Loan and Security Agreement dated May 23, 2006 (the "Loan Agreement") with Silicon Valley Bank ("SVB"). The Amendment provides, among other things, for (i) a renewal of our $4.0 million revolving line of credit with an extended maturity date of September 30, 2016 and (ii) a modification of the revolving credit line borrowing base formula in the Loan Agreement to include a portion of our foreign accounts receivable to the borrowing base and increase the borrowing limit related to domestic accounts receivable.

The Loan Agreement provides for an interest 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 to extinguish or retire our current liabilities immediately. If this ratio is not met, the interest rate will become the greater of the prime rate plus 1.25% or 4.0%. We maintained a monthly quick ratio greater than 1.0 to 1.0 as of and during the three months ended September 30, 2014.

The Loan Agreement includes a covenant requiring us to maintain a certain Minimum Tangible Net Worth ("Minimum TNW"), which is currently required to be at least $6.0 million. This amount is subject to adjustment upward to the extent we raise additional equity or debt financing or achieve net income in future quarters. Our Actual Tangible Net Worth ("Actual TNW") is calculated as total stockholders' equity, less goodwill. If we continue to incur net losses, we may have difficulty satisfying the Minimum TNW financial covenant in the future, in which case we may be unable to borrow funds under the Loan Agreement and any amounts outstanding may need to be repaid immediately.

As of September 30, 2014, there were no borrowings outstanding on the revolving line of credit.

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

	September 30, 2014
	(In thousands)
Minimum TNW	$ 6,000
Actual TNW	$ 10,671

The following table presents the available borrowing capacity on the revolving line of credit and outstanding letters of credit, which were used as security deposits. To date, we have not used any of the borrowing capacity under the revolving line of credit.

	September 30, 2014	June 30, 2014
	(In thousands)	
Available borrowing capacity	$3,232	$1,721
Outstanding letters of credit	$113	$113

5. Stockholders' Equity

Share-Based Plans

Our share-based plans permit the granting of stock options (both incentive and nonqualified stock options), restricted stock units ("RSUs"), stock appreciation rights, non-vested stock, and performance shares to certain employees, directors and consultants. As of September 30, 2014, no stock appreciation rights, non-vested stock, or performance shares were outstanding.

Stock Option Awards

The following table presents a summary of stock option activity under all of our stock option plans during the three months ended September 30, 2014:

	Number of Shares (In thousands)		Weighted Average Exercise Price per Share
Balance of options outstanding at June 30, 2014	2,719		$ 2.35
Granted	799		1.87
Forfeited	(20	)	1.87
Expired	(39	)	3.58
Exercised	–		–
Balance of options outstanding at September 30, 2014	3,459		$ 2.23

Restricted Stock Units

The following table presents a summary of activity with respect to RSUs during the three months ended September 30, 2014:

	Number of Shares (In thousands)	Weighted Average Grant - Date Fair Value per Share
Balance of restricted stock units at June 30, 2014	61	$ 1.40
Granted	25	2.00
Forfeited	–	–
Vested	–	–
Balance of restricted stock units at September 30, 2014	86	$ 1.58

10

Employee Stock Purchase Plan

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

The following table presents a summary of activity under our ESPP during the three months ended September 30, 2014:

	Three Months Ended September 30, 2014 (In thousands)
Shares available for issuance at June 30, 2014	1,126
Reserved for issuance	–
Issued	–
Shares available for issuance at September 30, 2014	1,126

Share-Based Compensation Expense

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

	Three Months Ended September 30,	
	2014	2013
	(In thousands)	
Cost of revenues	$20	$13
Selling, general and administrative	174	158

Research and development	61	60
Total share-based compensation expense	$255	$231

The following table summarizes the remaining unrecognized share-based compensation expense related to our outstanding share-based awards as of September 30, 2014:

	Remaining Unrecognized Compensation Cost	Remaining Weighted Average Years To Recognize
	(In thousands)	
Stock options	$ 1,688	3.0
Restricted stock units	46	0.3
Stock purchase rights under ESPP	134	1.1

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

6. Income Taxes

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

	Three Months Ended September 30,	
	2014	2013
Effective tax rate	7%	5%

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 that we believe these assets will more likely than not be realized. As a result of our cumulative losses and uncertainty of generating future taxable income, we have provided a full valuation allowance against our net deferred tax assets as of September 30, 2014 and June 30, 2014.

7. Litigation and Contingencies

From time to time, we are subject to legal proceedings and claims in the ordinary course of business. We are not currently aware of any such legal proceedings or claims that are expected to have, individually or in the aggregate, a material adverse effect on our business, prospects, financial position, operating results or cash flows.

12

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

You should read the following discussion and analysis in conjunction with our consolidated financial statements and related notes included in Item 1 of this Report, the "Risk Factors" included in Item 1A of this Report and in our Annual Report on Form 10-K for the year ended June 30, 2014, or the Form 10-K, as well as the Cautionary Note Regarding Forward Looking Statements described elsewhere in this Report, before deciding to purchase, hold or sell our common stock.

Overview

Lantronix, Inc. (the "Company," "Lantronix," "we," "our," or "us") designs, develops, markets and sells networking and communications products to make it easier and more cost effective for our customers to participate in the Internet of Things ("IoT") market. We provide solutions and services that enable machines, devices and sensors to be securely accessed, managed and controlled with a focus on the convergence of mobility with machine-to-machine ("M2M") systems.

We provide a broad portfolio of products intended to enhance the value of electronic devices or machines. Our products are typically used by enterprise and commercial businesses, government institutions, telecommunication and utility companies, financial institutions, and individual consumers.

We organize our solutions into two product lines based on how they are marketed, sold and deployed: OEM Modules and Enterprise Solutions. We conduct our business globally and manage our sales teams by geography, according to four regions: the Americas; Europe, Middle East, and Africa ("EMEA"); Asia Pacific; and Japan.

Products and Solutions Overview

OEM Modules

OEM Modules are electronic products that serve as building blocks embedded inside modern electronic systems and equipment. Our OEM Modules product line includes wired and wireless products that are designed to enhance the value and utility of modern electronic systems and equipment by providing secure network connectivity, application hosting, protocol conversion and other functions.

The products are offered with a software suite intended to decrease our customer's time-to-market and increase their value add. Among others, the following product families are included in our OEM Module product line: MatchPort®, PremiereWave® EN, WiPort®, xPico®, xPico® Wi-Fi, and xPort®.

OEM Modules are typically sold to OEMs, original design manufacturers ("ODMs"), contract manufacturers and distributors. OEMs design and sell products under their own brand that are either manufactured by the OEM in-house or by third-party contract manufacturers. ODMs design and manufacture products for third parties, which then sell those products under their own brand. The design cycles using our OEM modules typically range from 12 to 24 months and can generate revenue for the entire life-cycle of an end-user's product.

Enterprise Solutions

Our Enterprise Solutions are electronic products that are typically connected to one or more existing pieces of electronic equipment to provide additional connectivity or functionality. Our Enterprise Solutions are designed to enhance the value and utility of machines and other devices through network connectivity, routing, switching, application hosting, remote management, telemetry, telematics, printing, protocol conversion and other functions. Our Enterprise Solutions include products such as wired and wireless device servers, I/O servers, terminal servers, console servers, print servers, remote keyboard video mouse (KVM), management, power management and software management platforms. Among others, the following product families are included in our Enterprise Solutions product line: EDS, PremierWave® XC, PremierWave® XN, SLB™, SLC™, SLP™, Spider™, UDS, xDirect®, xPress™, xPrintServer®, and xSenso®.

Enterprise Solutions are typically sold through value added resellers ("VARs"), systems integrators, distributors, e-tailers and to a lesser extent to OEMs. Sales are often project based and may result in significant quarterly fluctuations.

Recent Accounting Pronouncements

Please refer to Note 1 of Notes to Unaudited Condensed Consolidated Financial Statements, included in Item 1 of this Report for a discussion of recent accounting pronouncements.

Critical Accounting Policies and Estimates

The accounting policies that have the greatest impact on our financial condition and results of operations and that require the most judgment are those relating to revenue recognition, warranty reserves, allowance for doubtful accounts, inventory valuation, valuation of deferred income taxes, and goodwill. These policies are described in further detail in the Form 10-K. There have been no significant changes in our critical accounting policies and estimates during the three months ended September 30, 2014 as compared to what was previously disclosed in the Form 10-K.

Results of Operations - Summary

In the three months ended September 30, 2014 our net revenues increased by $653,000, or 6%, compared to the three months ended September 30, 2013. Our net loss was $262,000 for the three months ended September 30, 2014 compared to a net loss of $267,000 in the three months ended September 30, 2013. Our net loss for the current quarter improved as a result of our increased revenues, which was partially offset by (i) a decrease in gross margin from 49.5% to 48.5% and (ii) an increase in operating expenses of $190,000, or 3.4%, which primarily resulted from higher personnel-related expenses.

Results of Operations – Three Months Ended September 30, 2014 Compared to the Three Months Ended September 30, 2013

Net Revenue by Product Line and Geographic Region

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

	Three Months Ended September 30,					
		% of Net		% of Net	Change	
	2014	Revenue	2013	Revenue	$	%
	(In thousands, except percentages)					
OEM Modules	$5,628	48.8%	$5,218	47.9%	$410	7.9%
Enterprise Solutions	5,908	51.2%	5,665	52.1%	243	4.3%
Net revenue	$11,536	100.0%	$10,883	100.0%	$653	6.0%

	Three Months Ended September 30,					
	2014			2013		
	(In thousands)					
	OEM Modules	**Enterprise Solutions**	**Total**	**OEM Modules**	**Enterprise Solutions**	**Total**
Americas	$2,409	$ 4,150	$6,559	$1,864	$ 3,686	$5,550
EMEA	2,169	1,125	3,294	2,124	1,206	3,330
Asia Pacific	617	312	929	626	392	1,018
Japan	433	321	754	604	381	985
	$5,628	$ 5,908	$11,536	$5,218	$ 5,665	$10,883

OEM Modules

To date, the revenue contribution from our newer OEM Modules products has been modest. Revenue from our OEM Modules product line grew due to increases in unit sales across substantially all of our product families.

Enterprise Solutions

Net revenue from our Enterprise Solutions product line increased primarily as a result of increased sales of new products in the Americas region. In particular, the SLB2, PremierWaveXN, EDS-MD, and xPort Direct product families contributed to the increased sales. The revenue increase generated by new product sales was partially offset by decreased unit sales in our mature EDS, Xpress and UDS product families.

Gross Profit

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

The following table presents our fiscal quarter gross profit:

	Three Months Ended September 30,				Change	
	2014	% of Net Revenue	2013	% of Net Revenue	$	%
	(In thousands, except percentages)					
Gross profit	$5,599	48.5%	$5,390	49.5%	$209	3.9%

Gross profit as a percent of revenue (referred to as “gross margin”) for the three months ended September 30, 2014 was lower than the prior year period due to higher costs related to manufacturing overhead and freight. As newer products typically have lower margins until they reach production volumes, we may experience downward pressure on gross margins as new product sales grow as a percentage of total net revenue.

Selling, General and Administrative

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

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

Three Months Ended September 30,				Change	
2014	% of Net Revenue	2013	% of Net Revenue	$	%

	(In thousands, except percentages)					
Personnel-related expenses	$2,522		$2,331		$191	8.2%
Professional fees and outside services	364		437		(73)	(16.7%)
Advertising and marketing	419		437		(18)	(4.1%)
Travel	149		157		(8)	(5.1%)
Facilities	300		275		25	9.1%
Share-based compensation	174		158		16	10.1%
Depreciation	65		110		(45)	(40.9%)
Other	82		43		39	90.7%
Selling, general and administrative	$4,075	35.3%	$3,948	36.3%	$127	3.2%

The increase in selling, general and administrative expenses was primarily due to an increase in personnel-related expenses, largely merit increases and sales commissions.

15

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.

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

	Three Months Ended September 30,				Change	
	2014	% of Net Revenue	2013	% of Net Revenue	$	%
	(In thousands, except percentages)					
Personnel-related expenses	$1,154		$1,109		$45	4.1%
Facilities	189		193		(4)	(2.1%)
Outside services	184		223		(39)	(17.5%)
Product certifications	81		43		38	88.4%
Share-based compensation	64		60		4	6.7%
Other	72		53		19	35.8%
Research and development	$1,744	15.1%	$1,681	15.4%	$63	3.7%

Research and development expenses increased slightly due to merit increases. Outside services and product certifications were impacted by the timing of development projects.

Provision for Income Taxes

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

	Three Months Ended September 30,	
	2014	2013
Effective tax rate	7%	5%

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

We record net deferred tax assets to the extent that we believe these assets will more likely than not be realized. As a result of our cumulative losses and uncertainty of generating future taxable income, we have provided a full valuation allowance against our net deferred tax assets as of September 30, 2014 and June 30, 2014.

Liquidity and Capital Resources

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

	September 30, 2014	June 30, 2014	Increase (Decrease)
	(In thousands)		
Working capital	$8,775	$8,804	$ (29)
Cash and cash equivalents	$6,283	$6,264	$ 19

Our principal sources of cash and liquidity include our existing cash and cash equivalents, amounts available under our credit facilities 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 timing and amount of our net revenue, research and development expenses, and expenses associated with any strategic partnerships or acquisitions and 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 future opportunities, (iii) respond to competition or (iv) continue to operate our business. If we issue equity or debt securities to raise additional funds, our existing stockholders may experience dilution, and the new equity or debt securities may have rights, preferences and privileges senior to those of our existing stockholders. There can be no assurance that we will be able to raise any such capital on terms acceptable to us, if at all.

Loan Agreement

On September 30, 2014, we entered into an amendment (the “Amendment”) to our existing Loan and Security Agreement dated May 23, 2006 (the “Loan Agreement”) with Silicon Valley Bank (“SVB”). The Amendment provides, among other things, for (i) a renewal of our $4.0 million revolving line of credit with an extended maturity date of September 30, 2016 and (ii) a modification of the revolving credit line borrowing base formula in the Loan Agreement to include a portion of our foreign accounts receivable to the borrowing base and increase the borrowing limit related to domestic accounts receivable.

The Loan Agreement provides for an interest 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 to extinguish or retire our current liabilities immediately. If this ratio is not met, the interest rate will become the greater of the prime rate plus 1.25% or 4.0%. We maintained a monthly quick ratio greater than 1.0 to 1.0 as of and during the three months ended September 30, 2014.

The Loan Agreement includes a covenant requiring us to maintain a certain Minimum Tangible Net Worth (“Minimum TNW”), which is currently required to be $6.0 million. This amount is subject to adjustment upward to the extent we raise additional equity or debt financing or achieve net income in future quarters. Our Actual Tangible Net Worth (“Actual TNW”) is calculated as total stockholders’ equity, less goodwill. If we continue to incur net losses, we may have difficulty satisfying the Minimum TNW financial covenant in the future, in which case we may be unable to borrow funds under the Loan Agreement and any amounts outstanding may need to be repaid immediately.

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

September
30,

	2014 (In thousands)
Minimum TNW	$ 6,000
Actual TNW	$ 10,671

As of September 30, 2014, there were no borrowings outstanding on the revolving line of credit.

The following table presents the available borrowing capacity on the revolving line of credit and outstanding letters of credit, which were used as security deposits. To date, we have not used any of the borrowing capacity under the revolving line of credit.

	September 30, 2014	June 30, 2014
	(In thousands)	
Available borrowing capacity	$3,232	$1,721
Outstanding letters of credit	$113	$113

Cash Flows

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

	Three Months Ended September 30,		Increase
	2014	2013	(Decrease)
	(In thousands)		
Net cash provided by operating activities	$212	$885	$ (673)
Net cash used in investing activities	(181)	(118)	63
Net cash used in financing activities	(12)	(179)	(167)

17

Operating Activities

Net cash provided by operating activities during the three months ended September 30, 2014 decreased as compared to the prior year period due primarily to (i) increases in inventory and contract manufacturer receivables during the current quarter and (ii) the payment during the current quarter of variable compensation that was accrued as of June 30, 2014.

Investing Activities

Cash used in investing activities was related to capital expenditures for the purchase of property and equipment, primarily related to tooling and test equipment for new product deployment.

Financing Activities

The decrease in net cash used in financing activities was primarily due to the payoff of our term loan in September 2013.

Off-Balance Sheet Arrangements

As part of our ongoing business, we have not participated in transactions that generate material relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities ("SPEs"), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of September 30, 2014, we were not involved in any material unconsolidated SPEs.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures

We maintain disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and proce