LANTRONIX INC
Form 10-Q
February 13, 2009

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

FORM 10-Q

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

For the quarterly period ended December 31, 2008

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.)

15353 Barranca Parkway, Irvine, California
(Address of principal executive offices)

92618
(Zip Code)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (do not check if a smaller reporting company)	Smaller reporting company x

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

As of February 13, 2009, 60,509,876, shares of the Registrant's common stock were outstanding.

LANTRONIX, INC.

FORM 10-Q
FOR THE FISCAL QUARTER ENDED
December 31, 2008

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

LANTRONIX, INC.
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	December 31, 2008	June 30, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 9,151	$ 7,434
Accounts receivable, net	2,146	4,166
Inventories, net	8,127	8,038
Contract manufacturers' receivable	1,132	676
Prepaid expenses and other current assets	608	566
Total current assets	21,164	20,880
Property and equipment, net	2,301	2,271
Goodwill	9,488	9,488
Purchased intangible assets, net	324	382
Other assets	132	144
Total assets	$ 33,409	$ 33,165
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 6,458	$ 7,684
Accrued payroll and related expenses	1,266	2,203
Warranty reserve	266	342
Restructuring reserve	74	744
Short-term debt	667	-
Other current liabilities	4,574	4,221
Total current liabilities	13,305	15,194
Non-current liabilities:		
Long-term liabilities	225	210
Long-term capital lease obligations	428	515
Long-term debt	1,111	-
Total non-current liabilities	1,764	725
Total liabilities	15,069	15,919
Commitments and contingencies		
Stockholders' equity:		
Common stock	6	6
Additional paid-in capital	188,778	187,626
Accumulated deficit	(170,871)	(170,907)
Accumulated other comprehensive income	427	521

Total stockholders' equity		18,340		17,246
Total liabilities and stockholders' equity	$	33,409	$	33,165

See accompanying notes.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2008	2007	2008	2007
Net revenue (1)	$ 12,885	$ 15,277	$ 27,097	$ 28,331
Cost of revenue	5,942	7,414	12,630	14,027
Gross profit	6,943	7,863	14,467	14,304
Operating expenses:				
Selling, general and administrative	5,315	5,331	10,523	11,610
Research and development	1,549	1,758	3,052	3,526
Restructuring charge	128	-	721	-
Amortization of purchased intangible assets	18	18	36	36
Total operating expenses	7,010	7,107	14,332	15,172
Income (loss) from operations	(67)	756	135	(868)
Interest expense, net	(57)	(61)	(83)	(80)
Other income (expense), net	(16)	120	6	131
Income (loss) before income taxes	(140)	815	58	(817)
Provision (benefit) for income taxes	8	(168)	22	(147)
Net income (loss)	$ (148)	$ 983	$ 36	$ (670)
Net income (loss) per share (basic)	$ (0.00)	$ 0.02	$ 0.00	$ (0.01)
Net income (loss) per share (diluted)	$ (0.00)	$ 0.02	$ 0.00	$ (0.01)
Weighted-average shares (basic)	60,502	60,088	60,438	60,015
Weighted-average shares (diluted)	60,502	60,542	60,641	60,015
(1) Includes net revenue from related party	$ 306	$ 211	$ 560	$ 502

See accompanying notes.

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

	Six Months Ended December 31,	
	2008	2007
Operating activities		
Net income (loss)	$ 36	$ (670)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Share-based compensation	1,064	641
Restructuring charge	721	-
Depreciation	366	267
Provision for inventories	101	314
Amortization of purchased intangible assets	58	50
Gain on sale of investment	-	(104)
Provision for officer loan	-	35
Recovery of doubtful accounts	(37)	(3)
Changes in operating assets and liabilities:		
Accounts receivable	2,057	148
Inventories	(190)	704
Contract manufacturers' receivable	(456)	269
Prepaid expenses and other current assets	(121)	135
Other assets	10	(17)
Accounts payable	(1,222)	(2,272)
Accrued payroll and related expenses	(901)	333
Warranty reserve	(76)	(104)
Restructuring reserve	(1,391)	-
Other liabilities	488	(195)
Net cash provided by (used in) operating activities	507	(469)
Investing activities		
Purchases of property and equipment, net	(354)	(252)
Proceeds from the sale of investments	-	104
Net cash used in investing activities	(354)	(148)
Financing activities		
Proceeds from term loan	2,000	-
Payment of term loan	(222)	-
Net proceeds from issuances of common stock	88	220
Payment of capital lease obligations	(179)	(69)
Net cash provided by financing activities	1,687	151
Effect of foreign exchange rate changes on cash	(123)	108
Increase (decrease) in cash and cash equivalents	1,717	(358)
Cash and cash equivalents at beginning of period	7,434	7,582
Cash and cash equivalents at end of period	$ 9,151	$ 7,224

See accompanying notes.

LANTRONIX, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2008

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Lantronix, Inc. (the “Company” or “Lantronix”) have been prepared by the Company in accordance with generally accepted accounting principles (“GAAP”) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2008, included in the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission (“SEC”) on September 19, 2008. They contain all normal recurring accruals and adjustments which, in the opinion of management, are necessary to present fairly the consolidated financial position of the Company at December 31, 2008, and the consolidated results of its operations and cash flows for the three and six months ended December 31, 2008 and 2007. All intercompany accounts and transactions have been eliminated. It should be understood that accounting measurements at interim dates inherently involve greater reliance on estimates than at year-end. The results of operations for the three and six months ended December 31, 2008 are not necessarily indicative of the results to be expected for the full year or any future interim periods.

2. 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 year.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2008	2007	2008	2007
	(In thousands, except per share data)			
Numerator:				
Net income (loss)	$ (148)	$ 983	$ 36	$ (670)
Denominator:				
Weighted-average shares outstanding	63,594	60,088	63,530	60,015
Less: Unvested common shares outstanding	(3,092)	-	(3,092)	-
Denominator for net income (loss) per share (basic)	60,502	60,088	60,438	60,015
Effect of dilutive securities:				
Unvested common shares outstanding	-	-	203	-
Stock options	-	454	-	-
Denominator for net income (loss) per share (diluted)	60,502	60,542	60,641	60,015

Net income (loss) per share (basic)	$	(0.00)	$	0.02	$	0.00	$	(0.01)
Net income (loss) per share (diluted)	$	(0.00)	$	0.02	$	0.00	$	(0.01)

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2008	2007	2008	2007
Common stock equivalents	9,108,631	1,326,975	8,560,047	2,001,466

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3. Inventories

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

	December 31, 2008 (In thousands)	June 30, 2008
Finished goods	$ 6,446	$ 5,707
Raw materials	1,875	1,836
Inventory at distributors	1,742	2,008
Large scale integration chips *	398	809
Inventories, gross	10,461	10,360
Reserve for excess and obsolete inventory	(2,334)	(2,322)
Inventories, net	$ 8,127	$ 8,038

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

4. Warranty

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

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

	Six Months Ended December 31, 2008 (In thousands)	Year Ended June 30, 2008
Beginning balance	$ 342	$ 446
Charged to cost of revenues	48	219
Usage	(124)	(323)
Ending balance	$ 266	$ 342

5. Restructuring Reserve

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

expected to be paid during the third fiscal quarter ended March 31, 2009.

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

	Facilities Termination Costs	Severance Related Costs	Total Restructuring Costs
		(In thousands)	
Restructuring reserve at June 30, 2008	$ -	$ 744	$ 744
Restructuring charge	46	675	721
Cash payments	-	(1,391)	(1,391)
Restructuring reserve at December 31, 2008	$ 46	$ 28	$ 74

6. Bank Line of Credit and Debt

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

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

7. Stockholders' Equity

Share-Based Compensation

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

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

	Number of Shares
Balance of options outstanding at June 30, 2008	8,516,552
Options granted	1,265,730
Options forfeited	(727,478)
Options expired	(542,221)
Options exercised	(12,000)
Balance of options outstanding at December 31, 2008	8,500,583

The following table presents stock option grant date information:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2008	2007	2008	2007
Weighted-average grant date fair value	$ 0.35	$ 0.73	$ 0.37	$ 0.78
Weighted-average grant date exercise price	$ 0.53	$ 0.98	$ 0.55	$ 1.05

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The following table presents a summary of restricted stock activity:

Nonvested Shares	Number of Shares		Weighted-Average Grant - Date Fair Value
Balance of restricted shares at June 30, 2008	100,000	$	0.83
Granted	3,054,032		0.51
Forfeited	(62,007)		0.50
Vested	-		-
Balance of restricted shares at December 31, 2008	3,092,025	$	0.52

During September 2008, the Company granted 2,221,089 restricted shares to certain employees as part of the Company's Long Term Incentive Plan ("LTIP"). During November 2008, the Compensation Committee of the Board of Directors, granted restricted stock under the Company's LTIP plan to Jerry D. Chase, President and Chief Executive Officer and Reagan Y. Sakai, Chief Financial Officer and Secretary. Mr. Chase and Mr. Sakai will receive 432,000 and 250,000 shares of restricted stock, respectively. Each restricted shares grant cliff vests on a pro rata basis over 4 years beginning September 1, 2009, subject to continued employment. The fair value of the restricted shares was based upon the closing trading price of the Company's shares on the grant date.

On November 19, 2008, the Board of Directors approved a grant to the non-management directors of 150,943 and 981,130, restricted shares and stock options, respectively. The grants cliff vest on November 19, 2009, subject to continued service. The fair value of the restricted shares was based upon the closing trading price of the Company's shares on the grant date.

During September 2008 and November 2008, the board of directors approved Performance Plans for the fiscal year ended June 30, 2009, which will be paid in vested common shares if minimum revenue, non-GAAP income and management objectives are met. If all of the objectives are met at 100% attainment per the Performance Plan, the Company estimates that it would take a charge to share-based compensation of approximately $600,000 per quarter over the next two fiscal quarters. As of December 31, 2008, the Company estimated it was at approximately 65% attainment per the Performance Plan which would result in an expense to share-based compensation of approximately $380,000 per quarter during the next two fiscal quarters. During the six months ended December 31, 2008, the Company recorded $357,000 to share-based compensation in connection with this Performance Plan.

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

Vesting Condition		Remaining Unrecognized Compensation Cost (In thousands)	Remaining Years To Vest
Stock Option Awards:			
Service based	$	1,452	
Market and service based		999	

Stock option awards	$	2,451	2.5
Restricted Stock Awards:			
Service based		1,425	
Market and service based		62	
Restricted stock awards	$	1,487	3.5
Performance Plan Awards:			
Performance and service based	$	760	0.5

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2008	2007	2008	2007
	(In thousands)			
Cost of revenues	$ 35	$ 26	$ 47	$ 53
Selling, general and administrative	485	132	714	402
Research and development	221	74	303	186
Total share-based compensation	$ 741	$ 232	$ 1,064	$ 641

Warrants to Purchase Common Stock

During March 2008, the Company distributed warrants to purchase 1,079,615 shares of Lantronix common stock as consideration for settlement of a shareholder lawsuit. The warrants have a contractual life of four years and a strike price of $4.68.

8. Income Taxes

At July 1, 2008, the Company's fiscal 2001 through fiscal 2008 tax years remain open to examination by the Federal and state taxing authorities. The Company has net operating losses ("NOLs") beginning in fiscal 2001 which cause the statute of limitations to remain open for the year in which the NOL was incurred.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2008	2007	2008	2007
Effective tax rate	6%	21%	38%	18%

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

9. Comprehensive Income (Loss)

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2008	2007	2008	2007
	(In thousands)			
Net income (loss)	$ (148)	$ 983	$ 36	$ (670)
Other comprehensive income (loss):				
Change in net unrealized gain on investment, net of taxes of $0	-	8	-	7
	-	(96)	-	(97)

Reclassification adjustment for net realized gain on sale of investment								
Change in translation adjustments, net of taxes of $0		2		29		(94)		100
Total comprehensive income (loss)	$	(146)	$	924	$	(58)	$	(660)

10. Litigation

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

During 2006, the Company concluded multiple securities lawsuits and litigation with a former executive officer. The Company may have an obligation to continue to indemnify the former executive officer and defend him in the litigation regarding the securities violation with which he has been charged. As of December 31, 2008, the Company had $70,000 of reimbursable legal expenses recorded as a liability on its consolidated balance sheet. A receivable for the insurance reimbursement has been recorded for the same amount.

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

Cautionary Statement

You should read the following discussion and analysis in conjunction with our unaudited condensed consolidated financial statements and the related notes thereto contained elsewhere in this Quarterly Report on Form 10-Q. The information contained in this Report is not a complete description of our business. We urge you to carefully review and consider the various disclosures made by us in this Report and in our other reports filed with the Securities and Exchange Commission ("SEC"), including our Annual Report on Form 10-K for the fiscal year ended June 30, 2008 and subsequent reports on our Current Reports on Form 8-K.

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

Overview

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

We have a history of providing devices that enable information technology ("IT") equipment to network using standard protocols for connectivity, including Ethernet and wireless. Our first device was a terminal server that allowed "dumb" terminals to connect to a network. Building on the success of our terminal servers, in 1991 we introduced a complete line of print servers that enabled users to inexpensively share printers over a network. Since then, we have continually refined our core technology and have developed additional innovative networking solutions that expand upon the

business of providing our customers network connectivity. With the expansion of networking and the Internet, our technology focus has been increasingly expanded beyond IT equipment, so that our device solutions provide a product manufacturer with the ability to network its products within the industrial, service and commercial markets referred to as machine-to-machine (“M2M”) networking.

The following describes our M2M device networking product lines:

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

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

The following describes our non-core product line:

- Non-core – Over the years, we have innovated or acquired various product lines that are no longer part of our primary, core markets described above. In general, these non-core businesses represent decreasing markets and we minimize research and development in these product lines. Included in this category are terminal servers, visualization solutions, legacy print servers, software and other miscellaneous products. We have announced the end-of-life for almost all of our non-core products and expect a steep decline in non-core revenues in fiscal 2009 while we complete the exit of this product category.

Financial Highlights and Other Information for the Fiscal Quarter Ended December 31, 2008

The following is a summary of the key factors and significant events that impacted our financial performance during the fiscal quarter ended December 31, 2008:

- Net revenue was $12.9 million for the fiscal quarter ended December 31, 2008, a decrease of $2.4 million or 15.7%, compared to $15.3 million for the fiscal quarter ended December 31, 2007. The decrease was primarily the result of a $1.8 million, or 12.7%, decrease in our device networking product lines and a $588,000, or 52.6%, decrease in our non-core product lines.

- Gross profit margin was 53.9% for the fiscal quarter ended December 31, 2008 compared to 51.5% for the fiscal quarter ended December 31, 2007. The increase in gross profit margin percent was primarily attributable to lower inventory reserve costs and lower personnel costs as a result of our restructuring activities.

- Loss from operations was $67,000 for the fiscal quarter ended December 31, 2008 compared to income from operations of $756,000 for the fiscal quarter ended December 31, 2007. Loss from operations for the fiscal quarter ended December 31, 2008 included a restructuring charge of $128,000.

- Net loss was $148,000, or $0.00 per basic and diluted share, for the fiscal quarter ended December 31, 2008 compared to net income of $983,000, or $0.02 per basic and diluted share, for the fiscal quarter ended December 31, 2007.

- Cash and cash equivalents were $9.2 million as of December 31, 2008, an increase of $1.7 million, compared to $7.4 million as of June 30, 2008.

- Net accounts receivable were $2.1 million as of December 31, 2008, a decrease of $2.0 million, compared to $4.2 million as of June 30, 2008. Annualized days sales outstanding ("DSO") in receivables were 22 days for the fiscal quarter ended December 31, 2008 compared to 24 days for the fiscal quarter ended June 30, 2008. Our accounts receivable and DSO are primarily affected by the timing of shipments within a quarter, our collections performance and the fact that a significant portion of our revenues are recognized on a sell-through basis (upon shipment from distributor inventories rather than as goods are shipped to distributors).

- Net inventories were $8.1 million as of December 31, 2008 compared to $8.0 million as of June 30, 2008. Annualized inventory turns were 2.9 turns for the fiscal quarter ended December 31, 2008 compared to 3.0 turns for the fiscal quarter ended June 30, 2008.

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, goodwill and purchased intangible assets, restructuring reserves and legal settlement costs. These policies are described in further detail in our Annual Report on Form 10-K for the fiscal year ended June 30, 2008. There have been no significant changes in our critical accounting policies and estimates during the fiscal quarter ended December 31, 2008 as compared to what was previously disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2008.

Recent Accounting Pronouncements

Recent accounting pronouncements issued by the Financial Accounting Standards Board (including its Emerging Issues Task Force), the American Institute of Certified Public Accountants, and the SEC did not or are not believed by management to have a material impact on the Company's present or future consolidated financial statements.

Consolidated Results of Operations

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2008	2007	2008	2007
Net revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	46.1%	48.5%	46.6%	49.5%
Gross profit	53.9%	51.5%	53.4%	50.5%
Operating expenses:				
Selling, general and administrative	41.2%	34.9%	38.8%	41.0%
Research and development	12.0%	11.5%	11.3%	12.4%
Restructuring charge	1.0%	0.0%	2.7%	0.0%
Amortization of purchased intangible assets	0.1%	0.1%	0.1%	0.1%
Total operating expenses	54.4%	46.5%	52.9%	53.6%
Income (loss) from operations	(0.5%)	4.9%	0.5%	(3.1%)
Interest expense, net	(0.4%)	(0.4%)	(0.3%)	(0.3%)
Other income (expense), net	(0.1%)	0.8%	0.0%	0.5%
Income (loss) before income taxes	(1.1%)	5.3%	0.2%	(2.9%)
Provision (benefit) for income taxes	0.1%	(1.1%)	0.1%	(0.5%)
Net income (loss)	(1.1%)	6.4%	0.1%	(2.4%)

Comparison of the Fiscal Quarters Ended December 31, 2008 and 2007

Net Revenue by Product Line

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

	Three Months Ended December 31,					
	2008	% of Net Revenue	2007	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Device enablement	$ 10,115	78.5%	$ 11,285	73.9%	$ (1,170)	(10.4%)
Device management	2,241	17.4%	2,875	18.8%	(634)	(22.1%)
Device networking	12,356	95.9%	14,160	92.7%	(1,804)	(12.7%)

Non-core		529	4.1%		1,117	7.3%		(588)	(52.6%)
Net revenue	$	12,885	100.0%	$	15,277	100.0%	$	(2,392)	(15.7%)

The decrease in net revenue for the three months ended December 31, 2008 compared to the fiscal quarter ended December 31, 2007 was the result of a decrease in net revenue across all major product lines and regions. The decrease in our device enablement product line was due to a decrease in our embedded device enablement products, and more specifically, our WiPort, XPort and MatchPort product families and our external device enablement products, more specifically, our MSS and UDS product families. The decrease in our device management product line was the result of a decrease in our SLC, SLS, SCS product families offset by an increase in our SLB product family. We are no longer investing in the development of our non-core product lines and expect net revenue related to these products to continue to decline in the future as we focus our investment on our device networking product lines.

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

	Six Months Ended December 31,				Change	
	2008	% of Net Revenue	2007	% of Net Revenue	$	%
	(In thousands, except percentages)					
Device enablement	$ 21,668	80.0%	$ 21,114	74.5%	$ 554	2.6%
Device management	4,219	15.6%	4,826	17.0%	(607)	(12.6%)
Device networking	25,887	95.5%	25,940	91.5%	(53)	(0.2%)
Non-core	1,210	4.4%	2,391	8.5%	(1,181)	(49.4%)
Net revenue	$ 27,097	100.0%	$ 28,331	100.0%	$ (1,234)	(4.4%)

The decrease in net revenue for the six months ended December 31, 2008 compared to the six months ended December 31, 2007 was primarily the result of a decrease in our non-core and device management product lines, offset by an increase in our device enablement product line. The increase in our device enablement product line was primarily due to an increase in our embedded device enablement products, and more specifically, our XPort and MatchPort product families, offset by a decrease in our external device enablement products, more specifically, our MSS and UDS product families.

Net Revenue by Geographic Region

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

	Three Months Ended December 31,				Change	
	2008	% of Net Revenue	2007	% of Net Revenue	$	%
	(In thousands, except percentages)					
Americas	$ 7,544	58.5%	$ 8,908	58.3%	$ (1,364)	(15.3%)
EMEA	3,668	28.5%	4,125	27.0%	(457)	(11.1%)
Asia Pacific	1,673	13.0%	2,244	14.7%	(571)	(25.4%)
Net revenue	$ 12,885	100.0%	$ 15,277	100.0%	$ (2,392)	(15.7%)

All major geographic regions contributed to the decrease in net revenue for the three months ended December 31, 2008 compared to the fiscal quarter ended December 31, 2007. The decrease in the Americas region was primarily due to the decrease in our non-core product lines in addition to a decrease in our device enablement product lines, and more specifically, the MatchPort, UDS and MSS product families as well as our device management product lines, and more specifically, the SLC, SLS, SCS product families offset by an increase in our SLB product family. The decrease in our EMEA (“Europe, Middle East and Africa”) region was primarily due to a decrease in our device management product lines, and more specifically, the SLC product family as well as our non-core product lines. The decrease in our Asia Pacific region was due to a decrease in our device enablement product lines, and more specifically, the XPort product family and our device management product lines, and more specifically, the SLC product family.

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

	Six Months Ended December 31,					
	2008	% of Net Revenue	2007	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Americas	$ 15,972	58.9%	$ 16,843	59.5%	$ (871)	(5.2%)
EMEA	7,480	27.6%	7,510	26.5%	(30)	(0.4%)
Asia Pacific	3,645	13.5%	3,978	14.0%	(333)	(8.4%)
Net revenue	$ 27,097	100.0%	$ 28,331	100.0%	$ (1,234)	(4.4%)

The decrease in net revenue for the six months ended December 31, 2008 compared to six months ended December 31, 2007 was due to a decrease in our Americas and Asia Pacific regions. The decrease in the Americas region was primarily due to the decrease in our non-core product lines and our device management product lines, and more specifically, the SLS and SCS product families offset by an increase in our SLB product family. The decrease in the Asia Pacific region was primarily due to a decrease in our non-core product lines and our device management product lines, and more specifically, the SLC product family.

Gross Profit

The following table presents fiscal quarter gross profit:

	Three Months Ended December 31,				Change	
	2008	% of Net Revenue	2007	% of Net Revenue	$	%
	(In thousands, except percentages)					
Gross profit	$ 6,943	53.9%	$ 7,863	51.5%	$ (920)	(11.7%)

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

The increase in gross profit margin for the three months ended December 31, 2008 compared to the three months ended December 31, 2007 was primarily attributable to lower inventory reserve costs and lower personnel-related expenses as a result of the restructuring activities.

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

	Six Months Ended December 31,				Change	
	2008	% of Net Revenue	2007	% of Net Revenue	$	%
	(In thousands, except percentages)					
Gross profit	$ 14,467	53.4%	$ 14,304	50.5%	$ 163	1.1%

The increase in gross profit margin for the six months ended December 31, 2008 compared to the six months ended December 31, 2007 was primarily attributable to lower inventory reserve costs, lower unfavorable inventory variances and lower personnel-related expenses as a result of the restructuring activities.

Selling, General and Administrative

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

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

	Three Months Ended December 31,					
	2008	% of Net Revenue	2007	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Personnel-related expenses	$ 2,734		$ 2,922		$ (188)	(6.4%)
Professional fees & outside services	534		768		(234)	(30.5%)
Advertising and marketing	712		663		49	7.4%
Facilities	321		389		(68)	(17.5%)
Share-based compensation	485		132		353	267.4%
Depreciation	139		93		46	49.5%
Other	390		364		26	7.1%
Selling, general and administrative	$ 5,315	41.2%	$ 5,331	34.9%	$ (16)	(0.3%)

In order of significance, the decrease in selling, general and administrative expenses for the three months ended December 31, 2008 compared to the three months ended December 31, 2007 was primarily due to: (i) decreased professional fees and outside services as a result of cost cutting measures and (ii) decreased personnel-related expenses as a result of the restructuring activities; offset by (iii) increased share-based compensation as a result of the new restricted stock grants related to LTIP and Performance Plan.

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

	Six Months Ended December 31,					
	2008	% of Net Revenue	2007	% of Net Revenue	Change $	%
	(In thousands, except percentages)					
Personnel-related expenses	$ 5,540		$ 6,585		$ (1,045)	(15.9%)
Professional fees & outside services	1,333		1,476		(143)	(9.7%)
Advertising and marketing	1,268		1,321		(53)	(4.0%)
Facilities	700		772		(72)	(9.3%)
Share-based compensation	714		402		312	77.6%
Depreciation	269		176		93	52.8%
Other	699		878		(179)	(20.4%)
Selling, general and administrative	$ 10,523	38.8%	$ 11,610	41.0%	$ (1,087)	(9.4%)

In order of significance, the decrease in selling, general and administrative expenses for the six months ended December 31, 2008 compared to the six months ended December 31, 2007 was primarily due to: (i) decreased personnel-related expenses as a result of the restructuring activities and (ii) decreased professional fees and outside services as a result of cost cutting measures; offset by (iii) increased share-based compensation as a result of the new restricted stock grants related to LTIP and Performance Plans.

Research and Development

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

The following table presents fiscal quarter research and development expenses:

	Three Months Ended December 31,				Change	
	2008	% of Net Revenue	2007	% of Net Revenue	$	%
	(In thousands, except percentages)					
Personnel-related expenses	$ 989		$ 1,333		$ (344)	(25.8%)
Facilities	236		216		20	9.3%
Professional fees & outside services	40		53		(13)	(24.5%)
Share-based compensation	221		74		147	198.6%
Depreciation	19		14		5	35.7%
Other	44		68		(24)	(35.3%)
Research and development	$ 1,549	12.0%	$ 1,758	11.5%	$ (209)	(11.9%)

Research and development expenses for the three months ended December 31, 2008 decreased compared to the three months ended December 31, 2007 mainly due to decreased personnel-related expenses as a result of the restructuring activities; offset by increased share-based compensation as a result of the new restricted stock grants related to LTIP and Performance Plans.

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

	Six Months Ended December 31,				Change	
	2008	% of Net Revenue	2007	% of Net Revenue	$	%
	(In thousands, except percentages)					
Personnel-related expenses	$ 2,044		$ 2,588		$ (544)	(21.0%)
Facilities	484		428		56	13.1%
Professional fees & outside services	88		134		(46)	(34.3%)
Share-based compensation	303		186		117	62.9%
Depreciation	37		26		11	42.3%
Other	96		164		(68)	(41.5%)
Research and development	$ 3,052	11.3%	$ 3,526	12.4%	$ (474)	(13.4%)

Research and development expenses for the six months ended December 31, 2008 decreased compared to the six months ended December 31, 2007 primarily due to decreased personnel-related expenses as a result of the restructuring activities; offset by increased share-based compensation as a result of the new restricted stock grants related to LTIP and Performance Plans.

Restructuring Charges

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

The following table presents fiscal quarter restructuring charges:

	Three Months Ended December 31,				Change	
	2008	% of Net Revenue	2007	% of Net Revenue	$	%
	(In thousands, except percentages)					
Restructuring charge	$ 128	1.0%	$ -	0.0%	$ 128	0.0%

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

	Six Months Ended December 31,				Change	
	2008	% of Net Revenue	2007	% of Net Revenue	$	%
	(In thousands, except percentages)					
Restructuring charge	$ 721	2.7%	$ -	0.0%	$ 721	0.0%

Provision for Income Taxes

At July 1, 2008, our fiscal 2001 through fiscal 2008 tax years remain open to examination by the Federal and state taxing authorities. We have net operating losses ("NOLs") beginning in fiscal 2001 which cause the statute of limitations to remain open for the year in which the NOL was incurred.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2008	2007	2008	2007
Effective tax rate	6%	21%	38%	18%

We utilize the liability method of accounting for income taxes as set forth in Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." The federal statutory rate was 34% for all periods. The difference between our effective tax rate and the federal statutory rate resulted primarily from the effect of our domestic losses recorded with a fully reserved tax benefit, as well as the effect of foreign earnings taxed at rates differing from the federal statutory rate. We record net deferred tax assets to the extent we believe these assets will more likely than not be realized. As a result of our cumulative losses, we provided a full valuation allowance against our domestic net deferred tax assets for the fiscal quarters ended December 31, 2008 and 2007.

Liquidity and Capital Resources

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

	December 31, 2008	June 30, 2008	Increase (Decrease)
	(In thousands)		
Working capital	$ 7,859	$ 5,686	$ 2,173
Cash and cash equivalents	$ 9,151	$ 7,434	$ 1,717

In order of significance, our working capital as of December 31, 2008 increased compared to June 30, 2008 primarily due to: (i) an increase in cash and decrease in accounts payable as a result of the proceeds from the term loan and (ii) a decrease in accrued payroll as a result of the timing of pay periods compared to the prior year, offset by (iii) a decrease in accounts receivable as a result of lower shipments compared to the quarter ended June 30, 2008 and (iv) an increase in short term debt as a result of the new term loan. Our cash balance increased compared to the quarter

ended June 30, 2008 as a result of our cash management activities, which included the timing of cash payments to our vendors and the timing of cash receipts from our customers.

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

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

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

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

	December 31, 2008		June 30, 2008	
	(In thousands)			
Available borrowing capacity	$	902	$	3,163
Outstanding letters of credit	$	732	$	732

As of December 31, 2008 and June 30, 2008, approximately $727,000 and $801,000, respectively, of our cash was held in foreign subsidiary bank accounts. Such cash is unrestricted with regard to foreign liquidity needs; however, our ability to utilize a portion of this cash to satisfy liquidity needs outside of such foreign locations is subject to approval by the foreign subsidiary’s board of directors.

Cash Flows for the Three and Six Months Ended

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

	Three Months Ended December 31,				Six Months Ended December 31,			
	2008		2007		2008		2007	
	(In thousands)							
Net cash provided by (used in):								
Net income (loss)	$	(148)	$	983	$	36	$	(670)
Non-cash operating expenses, net		1,185		468		2,273		1,200
Changes in operating assets and liabilities:		-		-				
Accounts receivable		784		(1,286)		2,057		148
Inventories		(123)		328		(190)		704
Contract manufacturers' receivable		(387)		250		(456)		269
Prepaid expenses and other current assets		(10)		59		(121)		135
Other assets		30		(16)		10		(17)
Accounts payable		98		108		(1,222)		(2,272)
Accrued payroll and related expenses		(93)		130		(901)		333
Warranty reserve		(83)		(31)		(76)		(104)
Restructuring reserve		(709)		-		(1,391)		-
Other liabilities		764		(872)		488		(195)
Net cash provided by (used in) operating activities		1,308		121		507		(469)
Net cash used in investing activities		(140)		(22)		(354)		(148)
		(249)		2		1,687		151

Net cash (used in) provided by financing activities								
Effect of foreign exchange rate changes on cash		15		34		(123)		108
Increase (decrease) in cash and cash equivalents	$	934	$	135	$	1,717	$	(358)

Cash Flows for the Three Months Ended

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

Operating activities provided cash during the three months ended December 31, 2007. This was the result of net income and, non-cash operating expenses, which was offset by cash used in operating assets and liabilities. The non-cash items that had a significant impact on net income included share-based compensation, depreciation, provisions for inventories and a gain on the sale of marketable securities. In order of significance, the changes in operating assets and liabilities that had a significant impact on the cash provided by operating activities included (i) an increase in net accounts receivable due to the timing of collections and linearity of sales, and (ii) an increase in other liabilities as a result of an increase in customer prepayments; offset by (iii) a decrease in inventory and contract manufactures' receivable.

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

Investing activities used cash during the three months ended December 31, 2007. This was due to the purchase of property and equipment, which was offset by proceeds from the sale of marketable securities.

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

Financing activities provided cash during the three months ended December 31, 2007. This was due to proceeds from the sale of common shares through employee stock option exercises, which was offset by payments on capital lease obligations.

Cash flows for the Six Months Ended

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

Operating activities used cash during the six months ended December 31, 2007. This was the result of a net loss, cash used by operating assets and liabilities, which was offset by non-cash operating expenses. The non-cash items that had a significant impact on the net loss included share-based compensation, depreciation, provisions for inventories and a gain on the sale of marketable securities. In order of significance, the changes in operating assets and liabilities which had a significant impact on the cash used in operating activities included (i) a decrease in accounts payable due to the timing of payments; offset by (ii) a decrease in inventory due to the timing of shipments and (iii) an decrease in trade and contract manufactures' receivable balances due to the timing of shipment and collections.

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

Investing activities used cash during the six months ended December 31, 2007. This was due to the purchase of property and equipment, which was offset by proceeds from the sale of marketable securities.

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

Financing activities provided cash during the six months ended December 31, 2007. This was due to proceeds from the sale of common shares through the 2000 Employee Stock Purchase Plan (the “ESPP”) offset by payments on capital lease obligations.

Off-Balance Sheet Arrangements

We did not have any off balance sheet arrangements as of December 31, 2008.

Item 3. Controls and Procedures

(a) Evaluation of disclosure controls and procedures

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

(b) Changes in internal controls over financial reporting

There have been no changes in our internal controls over financial reporting identified during the fiscal quarter that ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

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

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

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

- changes in business and economic conditions, including a downturn in the overall economy;
- changes in the mix of net revenues attributable to higher-margin and lower-margin products;
- customers' decisions to defer or accelerate orders;
- variations in the size or timing of orders for our products;
- changes in demand for our products;
- fluctuations in exchange rates;
- defects and other product quality problems;
- loss or gain of significant customers;

- short-term fluctuations in the cost or availability of our critical components;
- announcements or introductions of new products by our competitors;
- effects of terrorist attacks in the U.S. and abroad; and
- changes in demand for devices that incorporate our products.

Our business, financial condition and results of operations may be adversely impacted by the recent worldwide financial crisis.

Recently general worldwide economic conditions have experienced a downturn due to the credit conditions impacted by the sub-prime mortgage turmoil and other factors, slower economic activity, concerns about inflation and deflation, increased energy costs, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns in the markets in which we operate, the ongoing effects of the war in Iraq, recent international conflicts and terrorist and military activity, and the impact of natural disasters and public health emergencies. These conditions make it extremely difficult to accurately forecast and plan future business activities, and they could cause U.S. and foreign businesses to slow spending on our products and services, which would delay and lengthen sales cycles. During challenging economic times our customers may face issues gaining timely access to sufficient credit, which could result in an impairment of their ability to make timely payments to us. If that were to occur, we may be required to increase our allowance for doubtful accounts and our days sales outstanding would be negatively impacted. We cannot predict the timing, strength or duration of any economic slowdown or subsequent economic recovery, worldwide. If the economy or markets in which we operate do not continue at their present levels, our business, financial condition and results of operations will likely be materially and adversely affected. Additionally, the combination of our lengthy sales cycle coupled with challenging macroeconomic conditions could harm our results of operations.

Our common stock may be delisted, which could significantly harm our business.

Our common stock is currently listed on The Nasdaq Capital Market under the symbol “LTRX.” We currently are not in compliance with the $1.00 minimum bid price requirement for inclusion in The Nasdaq Capital Market; however, we have until June 26, 2009, to regain compliance. If our common stock is delisted from The Nasdaq Capital Market, some or all of the following might be impacted, harming our investors:

- the liquidity of our common stock;
- the number of institutional investors that will consider investing in our common stock;
- the number of investors in general that will consider investing in our common stock;
- the number of market makers in our common stock;
- the number of analysts following our stock;
- the availability of information concerning the trading prices;
- the number of broker-dealers willing to execute trades in shares of our common stock; and

- our ability to obtain financing for the continuation of our operations.

In addition, if our common stock were to be delisted from The Nasdaq Capital Market, the price of our common stock and the ability of stockholders to sell such stock may be adversely affected. A return to the Nasdaq would require full compliance with the initial listing requirements of the exchange.

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

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

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

	Six Months Ended December 31,	
	2008	2007
Top five customers (1)	36.4%	37.1%
Ingram Micro	13.2%	8.2%
Tech Data	6.8%	13.8%

(1) Includes Ingram Micro and Tech Data

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

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

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

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

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

We and our contract manufacturers are responsible for procuring raw materials for our products. Our products incorporate components or technologies that are only available from single or limited sources of supply. In particular, some of our integrated circuits are only available from a single source and in some cases are no longer being

manufactured. From time to time, integrated circuits used in our products will be phased out of production. When this happens, we attempt to purchase sufficient inventory to meet our needs until a substitute component can be incorporated into our products. Nonetheless, we might be unable to purchase sufficient components to meet our demands, or we might incorrectly forecast our demands, and purchase too many or too few components. In addition, our products use components that have, in the past, been subject to market shortages and substantial price fluctuations. From time to time, we have been unable to meet our orders because we were unable to purchase necessary components for our products. We do not have long-term supply arrangements with many of our vendors to obtain necessary components or technology for our products. If we are unable to purchase components from these suppliers, product shipments could be prevented or delayed, which could result in a loss of sales. If we are unable to meet existing orders or to enter into new orders because of a shortage in components, we will likely lose net revenues and risk losing customers and harming our reputation in the marketplace, which could adversely affect our business, financial condition or results of operations. We have recently redesigned many of our products to comply with the new environmental regulation such as the Reduction of Hazardous Substances ("RoHS") directive. These regulations are relatively new for our supply chain and interruptions in parts supply due to the additional complexities and limited number of second source supply choices could adversely impact our business.

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

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

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

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

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

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

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

In the past, we have experienced some reduction in the average selling prices and gross margins of products, and we expect that this will continue for our products as they mature. We expect competition to continue to increase, and we anticipate this could result in additional downward pressure on our pricing. Our average selling prices for our products might decline as a result of other reasons, including promotional programs and customers who negotiate price reductions in exchange for longer-term purchase commitments. We also may not be able to increase the price of our products if the prices of components or our overhead costs increase. In addition, we may be unable to adjust our prices in response to currency exchange rate fluctuations resulting in lower gross margins. We also may be unable to adjust

our prices in response to price increases by our suppliers resulting in lower gross margins. Further, as is characteristic of our industry, the average selling prices of our products have historically decreased over the products' life cycles and we expect this pattern to continue. If any of these were to occur, our gross margins could decline and we may not be able to reduce the cost to manufacture our products to keep up with the decline in prices.

Current or future litigation could adversely affect us.

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

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

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

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

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

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

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

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

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

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

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

The following table presents our sales within geographic regions:

	Six Months Ended December 31,				Change	
	2008	% of Net Revenue	2007	% of Net Revenue	$	%
	(In thousands, except percentages)					
Americas	$ 15,972	58.9%	$ 16,843	59.5%	$ (871)	(5.2%)
EMEA	7,480	27.6%	7,510	26.5%	(30)	(0.4%)
Asia Pacific	3,645	13.5%	3,978	14.0%	(333)	(8.4%)
Net revenue	$ 27,097	100.0%	$ 28,331	100.0%	$ (1,234)	(4.4%)

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

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

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

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

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

adversely affect our operating results.

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

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

The following table presents our reserve for excess and obsolete inventory:

	December 31, 2008	June 30, 2008
	(In thousands)	
Finished goods	$ 6,446	$ 5,707
Raw materials	1,875	1,836
Inventory at distributors	1,742	2,008
Large scale integration chips *	398	809
Inventories, gross	10,461	10,360
Reserve for excess and obsolete inventory	(2,334)	(2,322)
Inventories, net	$ 8,127	$ 8,038

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

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

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

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

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

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

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

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

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

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

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

Substantial litigation regarding intellectual property rights exists in our industry. For example, in May 2006 we settled a patent infringement lawsuit with Digi in which we signed an agreement with Digi to cross-license each other's patents. In addition, we paid Digi $600,000 as part of the settlement. The results of litigation are inherently uncertain, and adverse outcomes are possible. Adverse outcomes may have a material adverse effect on our business, financial condition or results of operations.

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

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

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

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

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

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

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

- policing unauthorized use of our products and trademarks is difficult, expensive and time-consuming, and we might be unable to determine the extent of this unauthorized use;
- courts may determine that our software programs use open source software in such a way that deprives the entire programs of intellectual property protection; and
- current federal laws that prohibit software copying provide only limited protection from software pirates.

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

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

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

Business interruptions could adversely affect our business.

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

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

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

Our management does not expect that our internal controls over financial reporting will prevent all errors or frauds. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, involving us have been, or will be, detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by individual acts of a person, or by collusion among two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and we cannot assure you that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies and procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to errors or frauds may occur and not be detected.

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

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

None.

Item 3. Defaults Upon Senior Securities

None.

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

We held our Annual Meeting of Stockholders on November 19, 2008. At the meeting, our stockholders voted on the following proposals and cast their votes as follows:

Proposal 1: To elect the following seven directors to serve until the 2009 Annual Meeting of Stockholders and until their successors are duly elected and qualified:

Nominee	For	Against
Curtis Brown	48,223,897	6,561,579
Bernhard Bruscha	47,614,728	7,170,748
Jerry D. Chase	54,576,880	208,596
Larry Sanders	33,608,363	21,177,113
Howard T. Slayen	53,922,063	863,413
Lewis Solomon	53,892,521	892,955
Thomas M. Wittenschlaeger	54,534,896	250,580

Proposal 2: To ratify the appointment of McGladrey & Pullen, LLP as our independent registered public accountants for the fiscal year ending June 30, 2009:

Nominee	For	Against	Abstain
McGladrey & Pullen, LLP	54,356,048	103,890	325,538

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Description of Document
10.1	Amendment to Letter Agreement effective as of December 26, 2008 between Registrant and Jerry D. Chase.
10.2	Amended and Restated Severance Agreement effective as of December 29, 2008 between Registrant and Reagan Y. Sakai.
10.3	Second Amendment to Letter Agreement effective as of February 12, 2009 between Registrant and Jerry D. Chase.
31.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

* Furnished, not filed.

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SIGNATURES

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

Date: February 13, 2009

LANTRONIX, INC.
(Registrant)

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

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

Exhibit Index

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