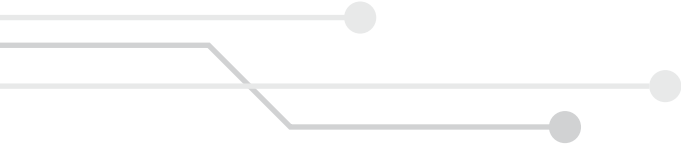
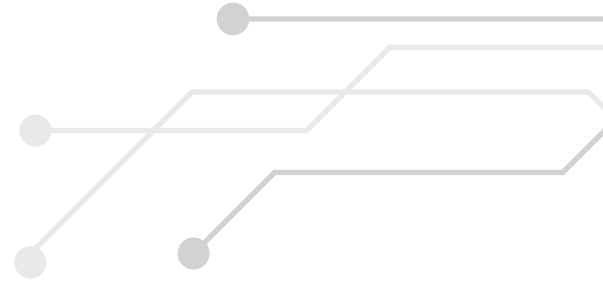


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Annual Report





Lantronix, Inc.

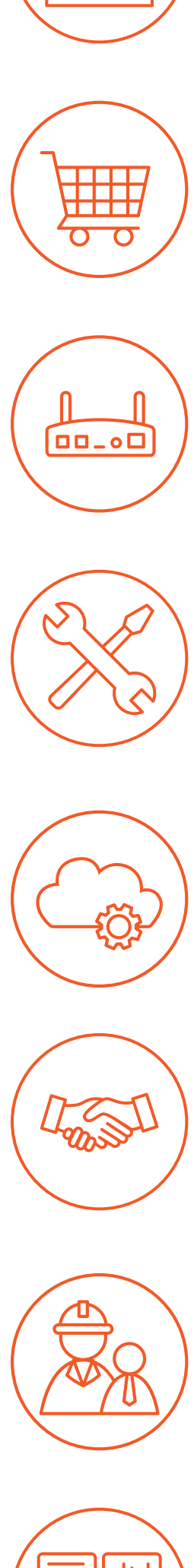
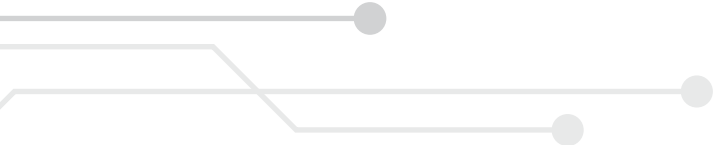
is a global provider of Engineering Services and turnkey solutions for the Internet of Things ("IoT") and Remote Environment Management ("REM").

Our Mission

is to be the leader in providing reliable and secure turnkey customer solutions which streamline deployments, accelerate time to market, and drive operational efficiencies.

Our Solutions

elegantly combine software as a service ("SaaS"), connectivity services, and intelligent hardware to dramatically simplify the architecture, deployment, and operation of IoT and REM projects.



Dear Fellow Shareholders,

We made significant progress in transforming Lantronix in fiscal 2020, even in the face of the Covid-19 pandemic and a subsequent global recession.

We added substantial scale to our model during the year, driving revenues of \$59.9 million, up 28% year over year. This increase was largely due to the acquisitions of Maestro in Q4 of fiscal 2019 and Intrinsyc in Q3 of fiscal 2020. Together, these acquisitions broadened our product portfolio, drove revenue growth, and compensated for the relatively sluggish performance of our legacy product offering. As we integrated these acquisitions and realized synergies, we also realized the benefits of scale and we were able to bring down GAAP operating expenses from 71.5% of revenues exiting fiscal 2019, to 46.8% of revenues exiting fiscal 2020. As we execute on our growth plan in fiscal 2021, we believe these efficiencies will translate into more profit on the bottom line for the benefit of our shareholders.

Looking ahead to fiscal 2021, we are forecasting strong financial performance. On our Q4 conference call on September 10th, we guided for revenue growth of 20%-25% in fiscal 2021, with earnings growth on the order of 120%-160% year over year, owing to improving profitability as we continue to extract the benefits of our growing revenue scale.

Against the backdrop of our financial performance in fiscal 2020 and our strong year over year guidance for fiscal 2021, fellow shareholders of Lantronix have benefitted from solid shareholder returns. In fiscal 2020, shareholders of Lantronix saw their share value increase 11.8% year over year, and shareholder returns from the start of fiscal 2020 through today total almost 40%. We are pleased to see our efforts rewarded with such strong shareholder returns, but there remains much more for us to do.

Looking back, in my letter to shareholders one year ago I relayed that I came to Lantronix because I believed that we had an incredible opportunity to grow and build a world-class franchise. To realize this potential, we planned to expand our product offering and therefore our revenue opportunities within the broader Internet of Things (IoT) stack and increase our scale to drive better operating efficiency and profitability. As you can see from my recap of fiscal 2020, we were able to make significant progress over the course of our first full year together but we are not yet the world class franchise I envisioned. In fiscal 2021, we will work diligently to deliver on our current forecasts, and we will also be focused on continued growth of our product portfolio and capturing value-added technologies within the IoT stack so as to create a leading world-class franchise.

I am excited about the future of Lantronix. We are thankful for the loyalty of our customers, shareholders, and talented employees who are working hard to make Lantronix a world-class company. I look forward to sharing our successes with you over the course of the coming year.

Sincerely,



Paul Pickle
President and Chief Executive Officer

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

FORM 10-K

(Mark One)

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

For the fiscal year ended June 30, 2020

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

LANTRONIX, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

33-0362767

(I.R.S. Employer Identification No.)

7535 Irvine Center Drive, Suite 100, Irvine, California 92618

(Address of principal executive offices)

(949) 453-3990

(Registrant's telephone number, including area code)

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

<u>Title of each class</u>	<u>Trading Symbol(s)</u>	<u>Name of each exchange on which registered</u>
Common Stock, \$0.0001 par value	LTRX	The Nasdaq Stock Market LLC

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report.

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

The aggregate market value of the registrant's common stock held by non-affiliates based upon the closing sales price of the common stock as reported by the Nasdaq Capital Market on December 31, 2019, the last trading day of the registrant's second fiscal quarter, was approximately \$43,842,000. The determination of affiliate status for this purpose shall not be a conclusive determination for any other purpose.

As of August 31, 2020, there were 28,292,841 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement on Schedule 14A relating to the registrant's 2020 annual meeting of stockholders, which will be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K, are incorporated by reference into Part III of this Annual Report on Form 10-K.

LANTRONIX, INC.
ANNUAL REPORT ON FORM 10-K
For the Fiscal Year Ended June 30, 2020

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* Not required for a “smaller reporting company.”

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K for the fiscal year ended June 30, 2020, or this Report, contains forward-looking statements within the meaning of the federal securities laws, which statements are subject to substantial risks and uncertainties. These forward-looking statements are intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact included in this Report, or incorporated by reference into this Report, are forward-looking statements. Throughout this Report, we have attempted to identify forward-looking statements by using words such as “may,” “believe,” “will,” “could,” “project,” “anticipate,” “expect,” “estimate,” “should,” “continue,” “potential,” “plan,” “forecasts,” “goal,” “seek,” “intend,” other forms of these words or similar words or expressions or the negative thereof.

We have based our forward-looking statements on management’s current expectations and projections about trends affecting our business and industry and other future events. Although we do not make forward-looking statements unless we believe we have a reasonable basis for doing so, we cannot guarantee their accuracy. Forward-looking statements are subject to substantial risks and uncertainties that could cause our future business, financial condition, results of operations or performance to differ materially from our historical results or those expressed or implied in any forward-looking statement contained in this Report. Factors which could have a material adverse effect on our operations and future prospects or which could cause actual results to differ materially from our expectations include, but are not limited to those set forth under “Risk Factors” in Item 1A of Part I of this Report, as such factors may be updated, amended or superseded from time to time by subsequent quarterly reports on Form 10-Q or current reports on Form 8-K. In addition, actual results may differ as a result of additional risks and uncertainties of which we are currently unaware or which we do not currently view as material to our business.

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

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

PART I

ITEM 1. BUSINESS

Overview

Lantronix, Inc. is a global provider of software as a service (“SaaS”), engineering services, and hardware for Edge Computing, the Internet of Things (“IoT”), and Remote Environment Management (“REM”). Lantronix enables its customers to provide reliable and secure solutions while accelerating their time to market. Lantronix’s products and services dramatically simplify operations through the creation, development, deployment, and management of customer projects at scale while providing quality, reliability and security.

Lantronix’s portfolio of services and products address each layer of the IoT Stack including Collect, Connect, Compute, Control and Comprehend, enabling its customers to deploy successful IoT and REM solutions. Lantronix’s services and products deliver a holistic approach, addressing its customers’ needs by integrating a SaaS management platform with custom application development layered on top of external and embedded hardware, enabling intelligent edge computing, secure communications (wired, Wi-Fi, and cellular), location and positional tracking, and environmental sensing and reporting.

With three decades of proven experience in creating robust industry and customer specific solutions, Lantronix is an innovator in enabling its customers to build new business models, leverage greater efficiencies and realize the possibilities of the IoT and REM. Lantronix’s solutions are deployed inside millions of machines at data centers, offices, and remote sites serving a wide range of industries, including energy, agriculture, medical, security, manufacturing, distribution, transportation, retail, financial, environmental, infrastructure and government.

We were incorporated in California in 1989 and reincorporated in Delaware in 2000.

References in this Report to “fiscal 2020” refer to the fiscal year ended June 30, 2020 and references to “fiscal 2019” refer to the fiscal year ended June 30, 2019.

Our Strategy

Today, more and more businesses are seeking to streamline their operations by connecting their machines and electronic devices to the Internet, manage them remotely, and create new business models. The growth in the IoT and REM markets are being driven by the growing importance of data, being able to act on that data, and the rapidly falling cost of sensors, connectivity, compute, and storage. While the promise is great, designing and deploying these projects is complex, costly and time-consuming. Our offerings are designed to help companies increase speed and reduce friction for their deployments through reduced complexity, decreased development costs, and increased ease of management for web-scale applications and real-world solutions; thus, driving customer value and success. We plan to address the market opportunity by offering our customers turnkey solutions by leveraging the layers of the IoT Stack, such as Collect, Connect, Compute, Control and Comprehend, through a combination of services, hardware and software solutions, accessible and manageable through our SaaS platform.

We are executing a growth strategy that includes continuous innovation complemented by strategic acquisitions to expand our ability to offer complete IoT and REM solutions with the intent of increasing our scale and broadening our scope so that we can increase our value proposition to our customers. This strategy will allow us to address a larger portion of our customers’ operational needs, and engage with customers as a strategic "total solution" partner. We believe this will strengthen our position in the market as our customers come to us for a wider variety of solutions. For example, on July 5, 2019 we acquired Maestro Wireless Solutions Limited and its subsidiaries (together, “Maestro”). This acquisition added to our Connect and Collect solutions by providing additional and complementary cellular connectivity, LPWAN, and telematic technologies and devices to our portfolio. On January 16, 2020 we acquired Intrinsic Technologies Corporation (“Intrinsic”). This acquisition provided additional and complementary edge computing with embedded product design and application development capabilities, crucial to the development of intelligent Compute functionality for advanced customer implementations. These two acquisitions allow us to offer more value to our customers and substantially increased the markets that we serve.

Products and Solutions

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

IoT

IoT Connectivity

Our IoT connectivity products typically connect to one or more existing machines or are built into new industrial devices to provide network connectivity. Our products are designed to enhance the value and utility of machines by making the data from the machines available to users, systems and processes or by controlling their properties and features over the network. Our IoT connectivity products may be embedded into new designs or attached to existing machines. These products include wired and wireless connections that enhance the value and utility of modern electronic systems and equipment by providing secure network connectivity, application hosting, protocol conversion, secure access for distributed IoT deployments and many other functions. Many of the products are offered with software tools intended to further accelerate our customer's time-to-market and increase their value add. Most of our IoT connectivity products are pre-certified in a number of countries thereby significantly reducing our original equipment manufacturer ("OEM") customers' regulatory certification costs and accelerating their time to market.

IoT Compute

Our IoT compute products typically are embedded into a customer product, enabling advanced application functionality at the edge. Our products are designed to deliver advanced functionality and reduce time to market by leveraging our engineering expertise, engineering services, manufacturing experience, and strategic System on Chip ("SoC") partners. Our compute products are normally embedded into new designs. These products include application processing that delivers compute to meet customer needs for data transformation, computer vision, machine learning, augmented / virtual reality, audio / video aggregation and distribution, custom applications at the edge. Many of the products are offered with software tools intended to further accelerate our customer's time-to-market and increase their value add. Most of our IoT compute products are pre-certified in a number of countries thereby significantly reducing our OEM customers' regulatory certification costs and accelerating their time to market.

IoT Telematics

Our IoT telematics products are typically integrated into an OEM's or System Integrator's ("SI") products. Our smart tracking devices are designed to deliver robust data logging and positional tracking functionality and reliability for supply chain and logistics solutions. Our telematics devices are designed to be flexible in the field and offer a variety of connectivity options to suit the customers' needs across 2G, 3G, 4G, and LTE cellular networks. These power efficient products are designed to support communications across interfaces and industrial protocols for vehicle, fleet, and asset tracking and management. Many of the products are offered with software tools intended to further accelerate our customer's time-to-market and increase their value add. Most of our IoT Telematics products are pre-certified in a number of countries thereby significantly reducing our OEM customers' regulatory certification costs and accelerating their time to market.

Engineering Services

We leverage our unparalleled engineering expertise and product development best practices to deliver high quality, innovative products, cost-effectively and on time. With over 1,400 projects successfully delivered to leading global brand companies, customers trust Lantronix to deliver timely and quality results, accelerating time to market.

Our engineering services flexible business model allows for choosing turnkey product development or team augmentation for accelerating complex areas of product development such as; camera development and tuning, voice control, machine learning, artificial intelligence, computer vision, augmented / virtual reality, mechanical and radio-frequency design, thermal and power optimization, or in any specific area a customer needs assistance.

In addition to our production-ready edge computing solutions, we offer experienced multidisciplinary engineering services across complete aspects of IoT product development, including: hardware engineering, software engineering, mechanical engineering, rapid prototyping, and quality assurance.

Software as a Service

Our SaaS platform provides single pane of glass management for IoT deployments. Our platform enables customers to easily deploy, monitor, manage, and automate across their global deployments, all from a single platform login. OEMs and SIs can leverage its multitenancy functionality for supporting a wide customer base while ensuring customer separation. Over the Air ("OTA") updates make it easy to ensure the latest security patches, firmware, and configurations are deployed and functional.

The following product families are included in our IoT product line: EDS, EDS-MD, PremierWave® EN, PremierWave® XC, SGX™, UDS, WiPort®, xDirect®, xPico®, xPico® Wi-Fi, xPress™, XPort®, XPort® Pro, MicroM110, E210, E220, Bolero45, FOX3-2G, FOX3-3G, FOX3-4G, S40, and D2Sphere. In addition, we offer System on Module ("SoM"), Single Board Computer

("SBC"), and Development Kits. We also offer services for mechanical, hardware, and software engineering for camera, audio, and artificial intelligence / machine learning development.

REM

Today, organizations are managing an ever-increasing number of devices and data on enterprise networks where 24/7 reliability is mission critical. Remote environment management allows for full comprehension and control of an IT deployment, across a range of sensors data (temperature, humidity, light, acceleration, open / close, etc.) providing status and alerting, automation, and remote control of devices and end stations. REM designs may be part of an out of band ("OOB") or in band network design. OOB is a technique that uses a dedicated management network to access critical infrastructure components to ensure production independent management connectivity. REM allows organizations to effectively monitor, manage, and control their enterprise IT equipment and facilities (environments), either in or out of band, optimizing their IT support resources.

Our SaaS platform provides single pane of glass management for REM (and IoT) deployments. Our platform enables customers to easily deploy, monitor, manage, and automate across their global deployments, all from a single platform login, virtually connected as though directly on each device. Our platform eliminates the need to have 24/7 personnel on site, and makes it easy to see and drill into an issue quickly, even in large scale deployments.

Our REM product line includes out-of-band management, console management, power management, and IP connected keyboard-video-mouse (commonly referred to as "IPKVM") products that provide remote access to IT and networking infrastructure deployed in test labs, data centers, branch offices, remote sites, and server rooms.

The following product families are included in our REM product line: SLB™, SLC™8000, Spider™, ConsoleFlow, and EMG™ 8500.

Other

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

Net Revenue by Product Line

We have one operating and reportable business segment. A summary of our net revenue by product line is found in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in Part II, Item 7 of this Report, which is incorporated herein by reference. A discussion of factors potentially affecting our net revenue and other operating results is set forth in "Risk Factors" included in Part I, Item 1A of this Report, which is incorporated herein by reference.

Sales Cycle

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

Our REM product line and external IoT solutions are typically sold to end users through value added resellers ("VARs") systems integrators, distributors, online retailers and, to a lesser extent, OEMs. The design cycles for these products generally ranges from three to 18 months and are often project-based.

Sales Channels

Distributors

A majority of our sales are made through distributors. Distributors resell our products to a wide variety of resellers and end customers including OEMs, ODMs, VARs, systems integrators, consumers, online retailers, IT resellers, corporate customers and government entities.

Resellers

Our products are sold by industry-specific system integrators and VARs, who often obtain our products from our distributors. Additionally, our products are sold by direct market resellers such as CDW, ProVantage, and Amazon.com.

Direct Sales

To a lesser extent, we sell products directly to larger OEMs and end users. We also maintain an ecommerce site for direct sales.

Sales and Marketing

We sell our products primarily through an internal sales force, which includes regional sales managers, inside sales personnel and field applications engineers in major regions throughout the world. This team manages our relationships with our partners and end users, identifies and develops new sales opportunities and increases penetration at existing accounts. We implement marketing programs, tools and services, including displaying our products at industry-specific events, to generate sales leads and increase demand for our products.

Manufacturing

Our manufacturing operations are primarily conducted through three third-party contract manufacturers. We currently utilize Plexus, primarily located in Malaysia, Hana Microelectronics, primarily located in Thailand, and Honortone, primarily located in China, as our contract manufacturers for most of our products. In addition, we use eSilicon Corporation to manage Taiwan Semiconductor Manufacturing Company, Ltd., a third-party foundry located in Taiwan, which manufactures our large-scale integration chips. We manufacture certain products with final assembly in the U.S. to meet trade compliance requirements.

Our contract manufacturers source raw materials, components and integrated circuits, in accordance with our specifications and forecasts, and perform printed circuit board assembly, final assembly, functional testing and quality control. Our products are manufactured and tested to our specifications with standard and custom components. Many of these components are available from multiple vendors. However, we have several single-sourced supplier relationships, either because alternative sources are not available or because the relationship is advantageous to us.

Research and Development

Our research and development efforts are focused on the development of hardware and software technology to differentiate our products and enhance our competitive position in the markets we serve. Product research and development is primarily performed in-house and supplemented with outsourced resources.

Competition

Our industry is highly competitive and characterized by rapid technological advances and evolving industry standards. The market can be affected significantly by new product introductions and marketing activities of industry participants. We believe that we compete for customers based on product features, software capabilities, company reputation, brand recognition, technical support, relationships with partners, quality, reliability, product development capabilities, price and availability. A discussion of factors potentially affecting our ability to compete in the markets in which we operate is set forth in "Risk Factors" included in Part I, Item 1A of this Report, which is incorporated herein by reference.

Intellectual Property Rights

We believe that a considerable portion of our value resides in our intellectual property. We have developed proprietary methodologies, tools, processes and software in connection with delivering our products and services. We protect our intellectual property through a combination of patents, copyrights, trademarks, trade secrets, licenses, non-disclosure agreements and contractual provisions. We enter into a non-disclosure and confidentiality agreement with each of our employees, consultants and third parties that have access to our proprietary technology. Pursuant to assignment of inventions agreements, all of our employees and consultants assign to us all intellectual property rights for the relevant inventions created in connection with their employment or contract with us. We currently hold U.S. and international patents covering various aspects of our products, with additional patent applications pending.

U.S. and Foreign Government Regulation

Many of our products are subject to certain mandatory regulatory approvals in the regions in which our products are deployed. In particular, wireless products must be approved by the relevant government authority prior to these products being offered for sale. In addition, certain jurisdictions have regulations requiring products to use environmentally friendly components. Some of our products employ security technology, which is subject to various U.S. export restrictions.

Employees

As of August 12, 2020, we had 242 full time employees, none of whom is represented by a labor union. We have not experienced any labor problems resulting in a work stoppage and believe we have good relationships with our employees.

Customer and Geographic Concentrations

We conduct our business globally and manage our sales teams by three geographic regions: the Americas; Europe, Middle East, and Africa (“EMEA”); and Asia Pacific Japan (“APJ”). A discussion of sales to our significant customers and related parties, sales within geographic regions as a percentage of net revenue and sales to significant countries as a percentage of net revenue is set forth in Note 11 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Report, which is incorporated herein by reference. A discussion of factors potentially affecting our customer and geographic concentrations is set forth in “Risk Factors” included in Part I, Item 1A of this Report, which is incorporated herein by reference.

Available Information

Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements on Schedule 14A and other reports and information that we file or furnish pursuant to the Securities Exchange Act of 1934, as amended (the “Exchange Act”) are available free of charge on our website at www.lantronix.com as soon as reasonably practicable after filing or furnishing such reports with the SEC. The SEC also maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically. The contents of our website are not incorporated by reference into this Report. References to our website address in this Report are inactive textual references only.

Information About Our Executive Officers

Executive officers serve at the discretion of our board of directors. There are no family relationships between any of our directors or executive officers. The following table presents the names, ages, and positions held by our executive officers as of the date of this report:

Name	Age	Position
Paul H. Pickle	50	President and Chief Executive Officer
Jeremy R. Whitaker	50	Chief Financial Officer
Mohammed F. Hakam	52	Vice President of Engineering
Roger Holliday	61	Vice President of Worldwide Sales

PAUL H. PICKLE joined Lantronix as its President and Chief Executive Officer and as a member of its Board of Directors in April 2019. Most recently, Mr. Pickle served as President and Chief Operating Officer of Microsemi Corporation, a leading provider of semiconductor and system solutions, from November 2013 until Microsemi was acquired by Microchip Technology Inc. in May 2018. Prior to his position as President and Chief Operating Officer, he served at Microsemi as Executive Vice President, leading business operations of the company’s Integrated Circuits group, where he played an integral role in the planning, developing, and execution of Microsemi’s leading edge IC solutions for communications, industrial, aerospace, and defense/security markets.

JEREMY R. WHITAKER has served as our Chief Financial Officer since September 2011. Mr. Whitaker returned to Lantronix after serving as Vice President, Corporate Controller at Mindspeed from January 2011 to September 2011. Mr. Whitaker previously served as our Vice President of Finance and Accounting from September 2010 to January 2011, where he was responsible for managing all worldwide finance and accounting functions. Mr. Whitaker also served as our Senior Director of Finance and Accounting from February 2006 to September 2010 and our Director of Finance and Accounting from August 2005 to February 2006. Prior to August 2005, Mr. Whitaker held vice president and director level finance and accounting positions with two publicly-traded companies and worked in the assurance practice at Ernst & Young LLP for six years.

MOHAMMED F. HAKAM joined Lantronix in August of 2018 and serves as our Vice President of Engineering. Prior to joining Lantronix, Mr. Hakam served as the interim Senior Vice President of International Operations at Viewstream, Inc., a provider of videos and marketing content to technology companies, from September 2016 to July 2018, where he was instrumental in planning and expanding the company’s global media strategy. Before joining Viewstream, Mr. Hakam was founder and Senior Vice President of Engineering and Product Management of SwitchRay Inc., a global provider of communication service platforms for global telecom carriers, from 2012 until its acquisition by 46 Labs in September 2016. He previously spent 20+ years at a number of large companies such as Motorola and Kyocera Wireless in various engineering leadership roles, and has also been the founder of two technology companies (including SwitchRay Inc.) in the networking and telecom segment. Mr. Hakam has been a professor at National University in San Diego, instructing undergraduate and graduate courses in program and project management, international management, six sigma and statistical process control.

ROGER HOLLIDAY joined Lantronix in January 2020 and serves as our Vice President of Worldwide Sales. Prior to joining Lantronix, Mr. Holliday served in various positions at Microsemi Corporation since 1999, serving most recently as Executive Vice President and General Manager from 2013 until Microsemi was acquired by Microchip Technology Inc. in May 2018. Prior to his time at Microsemi, Mr. Holliday served in various product marketing, applications and sales management roles at Linfinity Microelectronics until its acquisition by Microsemi in 1999..

ITEM 1A. RISK FACTORS

We operate in a rapidly changing environment that involves numerous risks and uncertainties. Before deciding to purchase, hold or sell our common stock, you should carefully consider the risks described in this section, as well as other information contained in this Report and in our other filings with the SEC. This section should be read in conjunction with the consolidated financial statements and accompanying notes thereto included in Item 8 of this Report, and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in Item 7 of this Report. If any of these risks or uncertainties actually occurs, our business, financial condition, results of operations or prospects could be materially harmed. In that event, the market price for our common stock could decline and you could lose all or part of your investment. In addition, risks and uncertainties not presently known to us or that we currently deem immaterial may also adversely affect our business.

The effect of COVID-19 and other possible pandemics and similar outbreaks could result in material adverse effects on our business, financial position, results of operations and cash flows.

The COVID-19 outbreak has spread globally and has led governments and other authorities around the world, including federal, state and local authorities in the United States and abroad, to impose measures intended to reduce its spread, including restrictions on freedom of movement and business operations such as travel bans, border closings, business limitations and closures (subject to exceptions for essential operations and businesses), quarantines and shelter-in-place orders. Although many of these governmental restrictions have since been lifted or scaled back, a recent surge of COVID-19 resulted in the reimposition of certain restrictions and may lead to other restrictions being implemented in response to efforts to reduce the spread of COVID-19. Given the dynamic nature of these circumstances and the related adverse impact these restrictions have had, and may continue to have, on the economy generally, our business and the business of our suppliers, our results of operations and financial condition may be adversely impacted by the COVID-19 pandemic.

Beginning in March 2020, most of our employees transitioned to remote working arrangements, which are continuing through the date of this Report. While remote working has not had a significant adverse impact on our financial results or our operations to date, there can be no assurance that these arrangements will not ultimately result in lower work efficiency and productivity, which in turn may adversely affect our business. In addition, the COVID-19 pandemic has resulted in industry events, trade shows and business travel being suspended, cancelled and/or significantly curtailed. The cessation of trade shows and business travel has resulted in and could continue to result in our lead pipeline being negatively impacted, which has negatively affected and may continue to negatively affect our sales during fiscal 2020 and beyond.

In addition, the impact of the COVID-19 pandemic and measures to prevent its spread subject us to various risks and uncertainties that could materially adversely affect our business, results of operations and financial condition, including the following:

- significant volatility or decreases in the demand for our products or extended sales cycles;
- changes in customer behavior and preferences, as customers may experience financial difficulties and/or may delay orders or reduce their spending in light of COVID-19;
- adverse impacts on our ability to distribute or deliver our products or services, including due to the negative impact of COVID-19 on air travel, as well as temporary disruptions, restrictions or closures of the facilities of our suppliers or customers and their contract manufacturers;
- further disruptions in our ability to manufacture our products, as some suppliers of materials used in the production of our products are located in areas more severely impacted by COVID-19, which could limit our ability to obtain sufficient materials to produce our products; and
- volatility in the availability of raw materials and components that our contract manufacturers purchase in China and volatility in raw material and other input costs.

The duration and extent of the COVID-19 pandemic’s effect on our operations and financial condition will depend on future developments, which are highly uncertain and cannot be predicted at this time, including new information which may emerge concerning the severity of COVID-19, actions taken to contain COVID-19, any future resurgence of COVID-19 that may occur after the initial outbreak subsides, and how quickly and to what extent normal economic and operating conditions can resume. Even after the COVID-19 pandemic has subsided, we may experience adverse impacts to our business, financial condition, results of operations, and prospects as a result of its global economic impact, including any economic downturn or recession that has occurred or may occur in the future. The adverse impact of the COVID-19 pandemic on our business, results of operations and financial condition could be material.

Certain of our products are sold into mature markets, which could limit our ability to continue to generate revenue from these products. Our ability to sustain and grow our business depends on our ability to develop, market, and sell new products.

Certain of our products are sold into mature markets that are characterized by a trend of declining demand. As the overall market for these products decreases due to the adoption of new technologies, we expect that our revenues from these products will continue to decline. As a result, our future prospects will depend on our ability to develop and successfully market new products that address new and growing markets. Our failure to develop new products or failure to achieve widespread customer acceptance of any new products could cause us to lose market share and cause our revenues to decline. There can be no assurance that we will not experience difficulties that could delay or prevent the successful development, introduction, marketing and sale of new products or product enhancements. Factors that could cause delays include regulatory and/or industry approvals, product design cycle and failure to identify products or features that customers demand. In addition, the introduction and sale of new products often involves a significant technical evaluation, and we often face delays because of our customers' internal procedures for evaluating, approving and deploying new technologies. For these and other reasons, the sales cycle associated with new products is typically lengthy, often lasting six to 24 months and sometimes longer. Therefore, there can be no assurance that our introduction or announcement of new product offerings will achieve any significant or sustainable degree of market acceptance or result in increased revenue in the near term.

Our new software offerings represent a new product line for us and are subject to the risks faced by a new business.

During the fiscal year ended June 30, 2020, we continued to dedicate significant engineering resources to our management software platform, applications, and SaaS offerings, including ConsoleFlow™. Our management has limited experience in this marketplace. These product and service offerings will be subject to significant additional risks that are not necessarily related to our hardware products. Our ability to succeed with these offerings will depend in large part on our ability to provide customers with software products and services that offer features and functionality that address the needs of particular businesses. We may face challenges and delays in the development of this product line as the marketplace for products and services evolves to meet the needs and desires of customers. We cannot provide assurances that we will be successful in operating and growing this product line.

In light of these risks and uncertainties, we may not be able to establish or maintain market share for our software and SaaS offerings. As we develop new product lines, we must adapt to market conditions that are unfamiliar to us, such as competitors and distribution channels that are different from those we have known in the past. We have and will encounter competition from other solutions providers, many of whom may have more significant resources than us with which to compete. There can be no assurance that we will recover our investments in this new product line, that we will receive meaningful revenue from or realize a profit from this new product line or that diverting our management's attention to this new product line will not have a material adverse effect on our existing business, and in turn on our results of operations, financial condition and prospects.

We may experience significant fluctuation in our revenue because the timing of large orders placed by some of our customers is often project-based.

Our operating results fluctuate because we often receive large orders from customers that coincide with the timing of the customer's project. Sales of our products and services may be delayed if customers delay approval or commencement of projects due to budgetary constraints, internal acceptance review procedures, timing of budget cycles or timing of competitive evaluation processes. In addition, sometimes our customers make significant one-time hardware purchases for projects which are not repeated. We sell primarily on a purchase order basis rather than pursuant to long-term contracts, and we expect fluctuations in our revenues as a result of one-time project-based purchases to continue in the future. In addition, our sales may be subject to significant fluctuations based on the acceleration, delay or cancellation of customer projects, or our failure to complete one or a series of significant potential sales. Because a significant portion of our operating expenses are fixed, even a single order can have a disproportionate effect on our quarterly revenues and operating results. As a result of the factors discussed above, and due to the complexities of the industry in which we operate, it is difficult for us to forecast demand for our current or future products with any degree of certainty, which means it is difficult for us to forecast our sales. If our quarterly or annual operating results fall below the expectations of investors or securities analysts, the price of our common stock could decline substantially.

The lengthy sales cycle for our products and services, along with delays in customer completion of projects, make the timing of our revenues difficult to predict.

We have a lengthy sales cycle for many of our products that generally extends between six and 24 months and sometimes longer due to a lengthy customer evaluation and approval process. The length of this process can be affected by factors over which we have little or no control, including the customer's budgetary constraints, timing of the customer's budget cycles, and concerns by the customer about the introduction of new products by us or by our competitors. As a result, sales cycles for customer orders vary substantially among different customers. The lengthy sales cycle is one of the factors that has caused, and may continue to cause, our revenues and operating results to vary significantly from quarter to quarter. In addition, we may incur substantial expenses and devote significant management effort and expense to develop potential relationships that do not result in agreements or revenues, which may prevent us

from pursuing other opportunities. Accordingly, excessive delays in sales could be material and adversely affect our business, financial condition or results of operations.

The nature of our products, customer base and sales channels causes us to lack visibility into future demand for our products, which makes it difficult for us to predict our revenues or operating results.

We use forecasts based on anticipated product orders to manage our manufacturing and inventory levels and other aspects of our business. However, several factors contribute to a lack of visibility with respect to future orders, including:

- the lengthy and unpredictable sales cycle for our products that can extend from six to 24 months or longer;
- the project-driven nature of many of our customers' requirements;
- we primarily sell our products indirectly through distributors;
- the uncertainty of the extent and timing of market acceptance of our new products;
- the need to obtain industry certifications or regulatory approval for our products;
- the lack of long-term contracts with our customers;
- the diversity of our product lines and geographic scope of our product distribution;
- we have some customers who make single, non-recurring purchases; and
- a large number of our customers typically purchase in small quantities.

This lack of visibility impacts our ability to forecast our inventory requirements. If we overestimate our customers' future requirements for products, we may have excess inventory, which would increase our costs and potentially require us to write-off inventory that becomes obsolete. Additionally, if we underestimate our customers' future requirements, we may have inadequate inventory, which could interrupt and delay delivery of our products to our customers, harm our reputation, and cause our revenues to decline. If any of these events occur, they could prevent us from achieving or sustaining profitability and the value of our common stock may decline.

We have a history of losses.

We have historically incurred net losses. There can be no assurance that we will generate net profits in future periods. Further, there can be no assurance that we will be cash flow positive in future periods. In the event that we fail to achieve profitability in future periods, the value of our common stock may decline. In addition, if we are unable to achieve or maintain positive cash flows, we would be required to seek additional funding, which may not be available on favorable terms, if at all.

Delays in qualifying revisions of existing products for certain of our customers could result in the delay or loss of sales to those customers, which could negatively impact our business and financial results.

Our industry is characterized by intense competition, rapidly evolving technology and continually changing customer preferences and requirements. As a result, we frequently develop and introduce new versions of our existing products, which we refer to as revisions.

Prior to purchasing our products, some of our customers require that products undergo a qualification process, which may involve testing of the products in the customer's system. A subsequent revision to a product's hardware or firmware, changes in the manufacturing process or our selection of a new supplier may require a new qualification process, which may result in delays in sales to customers, loss of sales, or us holding excess or obsolete inventory.

After products are qualified, it can take additional time before the customer commences volume production of components or devices that incorporate our products. If we are unsuccessful or delayed in qualifying any new or revised products with a customer, that failure or delay would preclude or delay sales of these products to the customer, and could negatively impact our financial results. In addition, new revisions to our products could cause our customers to alter the timing of their purchases, by either accelerating or delaying purchases, which could result in fluctuations of our net revenue from quarter to quarter.

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

We and our contract manufacturers are responsible for procuring raw materials for our products. Our products incorporate some components and technologies that are only available from single or limited sources of supply. Depending on a limited number of suppliers exposes us to risks, including limited control over pricing, availability, quality and delivery schedules. Moreover, due to our limited sales, we may not be able to convince suppliers to continue to make components available to us unless there is demand for these components from their other customers. If any one or more of our suppliers cease to provide us with sufficient quantities of components in a timely manner or on terms acceptable to us, we would have to seek alternative sources of supply and we may have difficulty identifying additional or replacement suppliers for some of our components.

We may experience constraints in the supply of certain materials and components that could affect our operating results.

Some of our integrated circuits are only available from a single source and in some cases, are no longer being manufactured. From time to time, integrated circuits, and potentially other components used in our products, will be phased out of production by the manufacturer. When this happens, we attempt to purchase sufficient inventory to meet our needs until a substitute component can be incorporated into our products. Nonetheless, we may be unable to purchase sufficient components to meet our demands, or we may incorrectly forecast our demands, and purchase too many or too few components. In addition, our products use components that have been subject to market shortages and substantial price fluctuations in the past. From time to time, we have been unable to meet customer orders because we were unable to purchase necessary components for our products. We do not have long-term supply arrangements with most of our vendors to obtain necessary components or technology for our products and instead purchase components on a purchase order basis. If we are unable to purchase components from these suppliers, our 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 revenue, risk losing customers and risk harm to our reputation in the marketplace, which could adversely affect our business, financial condition or results of operations.

We outsource substantially all of our manufacturing to contract manufacturers in Asia. 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 use contract manufacturers based in Asia to manufacture substantially all of our products. Generally, we do not have guaranteed supply agreements with our contract manufacturers or suppliers. If any of these subcontractors or suppliers were to cease doing business with us, we might not be able to obtain alternative sources in a timely or cost-effective manner. Our reliance on third-party manufacturers, especially in countries outside of the U.S., 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;
- reliance on these manufacturers to maintain competitive manufacturing technologies;
- unexpected changes in regulatory requirements, taxes, trade laws and tariffs;
- reduced protection for intellectual property rights in some countries;
- differing labor regulations;
- disruptions to the business, financial stability or operations, including due to strikes, labor disputes or other disruptions to the workforce, of these manufacturers;
- 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 abroad;
- greater difficulty in staffing and managing foreign operations; and
- increased financial accounting and reporting burdens and complexities.

Any problems that we may encounter with the delivery, quality or cost of our products from our contract manufacturers or suppliers could cause us to lose net revenue, damage our customer relationships and harm our reputation in the marketplace, each of which could materially and adversely affect our business, financial condition or results of operations.

From time to time, we may transition the manufacturing of certain products from one contract manufacturer to another. When we do this, we may incur substantial expenses, risk material delays or encounter other unexpected issues.

We depend on distributors for a majority of our sales and to complete order fulfillment.

We depend on the resale of products through distributor accounts for a substantial majority of our worldwide net revenue. In addition, sales through our top five distributors accounted for approximately 36% of our net revenue in fiscal 2020. A significant reduction of effort by one or more distributors to sell our products or a material change in our relationship with one or more distributors may reduce our access to certain end customers and adversely affect our ability to sell our products. Furthermore, if a key distributor materially defaults on a contract or otherwise fails to perform, our business and financial results would suffer.

In addition, the financial health of our distributors and our continuing relationships with them are important to our success. Our business could be harmed if the financial health of these distributors impairs their performance and we are unable to secure alternate distributors.

Our ability to sustain and grow our business depends in part on the success of our distributors and resellers.

A substantial part of our revenues is generated through sales by distributors and resellers. To the extent they are unsuccessful in selling our products, or if we are unable to obtain and retain a sufficient number of high-quality distributors and resellers, our operating results could be materially and adversely affected. In addition, our distributors and resellers may devote more resources to marketing, selling and supporting products and services that are competitive with ours, than to our products. They also may have incentives to promote our competitors' products over our products, particularly for our competitors with larger volumes of orders, more diverse product offerings and a longer relationship with our distributors and resellers. In these cases, one or more of our important distributors or resellers may stop selling our products completely or may significantly decrease the volume of products they sell on our behalf. This sales structure also could subject us to lawsuits, potential liability and reputational harm if, for example, any of our distributors or resellers misrepresents the functionality of our products or services to customers, violates laws or our corporate policies. If we fail to effectively manage our existing or future distributors and resellers effectively, our business and operating results could be materially and adversely affected.

Changes to the average selling prices of our products could affect our net revenue and gross margins and adversely affect results of operations.

In the past, we have experienced reductions in the average selling prices and gross margins of our products. We expect competition to continue to increase, and we anticipate this could result in additional downward pressure on our pricing. Our average selling prices for our products might also decline as a result of other reasons, including promotional programs introduced by us or our competitors and customers who negotiate price concessions. To the extent we are able to increase prices, we may experience a decline in sales volumes if customers decide to purchase competitive products. If any of these were to occur, our gross margins could decline and we might not be able to reduce the cost to manufacture our products enough or at all to keep up with the decline in prices.

If we are unable to sell our inventory in a timely manner, it could become obsolete, which could require us to write-down or write off obsolete inventory, which could harm our operating results.

At any time, competitive products may be introduced with more attractive features or at lower prices than ours. If this occurs, and for other reasons, we may not be able to accurately forecast demand for our products and our inventory levels may increase. There is a risk that we may be unable to sell our inventory in a timely manner to avoid it becoming obsolete. If 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 inventory reserves or write off obsolete inventory and our operating results could be substantially harmed.

Our failure to compete successfully in our highly competitive market could result in reduced prices and loss of market share.

The market in which we operate is intensely competitive, subject to rapid technological advances and highly sensitive to evolving industry standards. The market can also be affected significantly by new product and technology introductions and marketing and pricing activities of industry participants. Our products compete directly with products produced by a number of our competitors. Many of our competitors and potential competitors have greater financial and human resources for marketing and product development, more experience conducting research and development activities, greater experience obtaining regulatory approval for new products, larger distribution and customer networks, more established relationships with contract manufacturers and suppliers, and more established reputations and name recognition. For these and other reasons, we may not be able to compete successfully against our current or potential future competitors. In addition, the amount of competition we face in the marketplace may change and grow as the market for IoT and M2M networking solutions grows and new companies enter the marketplace. Present and future competitors may be able to identify new markets, adapt new technologies, develop and commercialize products more quickly and gain market acceptance of products with greater success. As a result of these competitive factors, we may fail to meet our business objectives and our business, financial condition and operating results could be materially and adversely affected.

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

We currently offer warranties ranging from one to five years on each of our products. Our products could contain undetected software or hardware errors or defects. If there is a product failure, we might have to replace all affected products, or we might have to refund the purchase price for the units. 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 financial losses and claims against us. Significant product warranty claims against us could harm our business, reputation and financial results and cause the market price of our common stock to decline.

Our inability to obtain appropriate industry certifications or approvals from governmental regulatory bodies could impede our ability to grow revenues in our wireless products.

The sale of our wireless products in some geographical markets is sometimes dependent on the ability to gain certifications and/or approvals by relevant governmental bodies. In addition, many of our products are certified as meeting various industry quality and/or compatibility standards. Failure to obtain these certifications or approvals, or delays in receiving any needed certifications or approvals, could impact our ability to compete effectively or at all in these markets and could have an adverse impact on our revenues.

If software that we 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 software developed and maintained by third-party software vendors or which 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.

We face risks associated with our international operations that could impair our ability to grow our revenues abroad as well as our overall financial condition.

We believe that our future growth is dependent in part upon our ability to increase sales in international markets. These sales are subject to a variety of risks, including geopolitical events, fluctuations in currency exchange rates, tariffs, import restrictions and other trade barriers, unexpected changes in regulatory requirements, longer accounts receivable payment cycles, potentially adverse tax consequences, and export license requirements. In addition, we are subject to the risks inherent in conducting business internationally, including political and economic instability and unexpected changes in diplomatic and trade relationships. In many markets where we operate, business and cultural norms are different than those in the U.S., and practices that may violate laws and regulations applicable to us such as the Foreign Corrupt Practices Act (the “FCPA”) unfortunately are more commonplace. Although we have implemented policies and procedures with the intention of ensuring compliance with these laws and regulations, our employees, contractors and agents, as well as distributors and resellers involved in our international sales, may take actions in violation of our policies. Many of our vendors and strategic business allies also have international operations and are subject to the risks described above. Even if we are able to successfully manage the risks of international operations, our business may be adversely affected if one or more of our business partners are not able to successfully manage these risks. There can be no assurance that one or more of these factors will not have a material adverse effect on our business strategy and financial condition.

Rising concern regarding international tariffs could materially and adversely affect our business and results of operations.

The current political landscape has introduced significant uncertainty with respect to future trade regulations and existing international trade agreements, as shown by the recent U.S.-initiated renegotiation of the North America Free Trade Agreement, and Brexit in Europe. This uncertainty includes the possibility of imposing tariffs or penalties on products manufactured outside the U.S., including the US government’s institution of a 25% tariff on a range of products from China and subsequent tariffs imposed by the U.S. as well as tariffs imposed by trading partners on U.S. goods, and the potential for increased trade barriers between the UK and the European Union. The institution of trade tariffs both globally and between the U.S. and China specifically, carries the risk of negatively affecting the overall economic conditions of both China and the U.S., which could have a negative impact on us.

We cannot predict whether, and to what extent, there may be changes to international trade agreements or whether quotas, duties, tariffs, exchange controls or other restrictions on our products will be changed or imposed. If we are unable to source our products from the countries where we wish to purchase them, either because of regulatory changes or for any other reason, or if the cost of doing so increases, it could have a material adverse effect on our business, financial condition and results of operations. Furthermore, imposition of tariffs may result in local sourcing initiatives, or other developments that make it more difficult to sell our products in foreign countries, which would negatively impact our business and operating results.

Our failure to comply effectively with regulatory laws pertaining to our foreign operations could have a material adverse effect on our revenues and profitability.

We are required to comply with U.S. government export regulations in the sale of our products to foreign customers, including requirements to properly classify and screen our products against a denied parties list prior to shipment. We are also required to comply with the provisions of the FCPA and all other anti-corruption laws, such as the UK Anti-Bribery Act, of all other countries in which we do business, directly or indirectly, including compliance with the anti-bribery prohibitions and the accounting and recordkeeping requirements of these laws. Violations of the FCPA or other similar laws could trigger sanctions, including ineligibility

for U.S. government insurance and financing, as well as large fines. Failure to comply with the aforementioned regulations could also affect our decision to sell our products in international jurisdictions, which could have a material adverse effect on our revenues and profitability.

Our failure to comply effectively with the requirements of applicable environmental legislation and regulation could have a material adverse effect on our revenues and profitability.

Certain states and countries have passed regulations relating to chemical substances in electronic products and requiring electronic products to use environmentally friendly components. For example, the European Union has the Waste Electrical and Electronic Equipment Directive, the Restrictions of Hazardous Substances Directive, and the Regulation on Registration, Evaluation, Authorization and Restriction of Chemicals. In the future, China and other countries including the U.S. are expected to adopt further environmental compliance programs. In order to comply with these regulations, we may need to redesign our products to use different components, which may be more expensive, if they are available at all. If we fail to comply with these regulations, we may not be able to sell our products in jurisdictions where these regulations apply, which could have a material adverse effect on our revenues and profitability.

Foreign currency exchange rates may adversely affect our results.

We are exposed to market risk primarily related to foreign currencies and interest rates. In particular, we are exposed to changes in the value of the U.S. dollar versus the local currency in which our products are sold and our services are purchased, including devaluation and revaluation of local currencies. Accordingly, fluctuations in foreign currency rates could adversely affect our revenues.

In particular, the uncertainty with respect to the ability of certain European countries to continue to service their sovereign debt obligations and the related European financial restructuring efforts may cause the value of the Euro and other European currencies to fluctuate. If the value of European currencies, including the Euro, deteriorates, thus reducing the purchasing power of European customers, our sales could be adversely affected.

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. 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.

In particular, litigation regarding intellectual property rights occurs frequently in our industry. 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 rely primarily on a combination of laws, such as patent, 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 intellectual property rights based upon prior use that negatively impacts our ability to enforce our trademarks and patents; and
- policing unauthorized use of our patented technology and trademarks is difficult, expensive and time-consuming, and we might be unable to determine the extent of this unauthorized use.

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 technology, 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.

The impact of natural disasters and other business interruptions could negatively impact our supply chain and customers resulting in an adverse impact to our revenues and profitability.

Certain of our components and other materials used in producing our products are from regions susceptible to natural disasters. A natural disaster could damage equipment and inventory at our suppliers' facilities, adversely affecting our supply chain. If we are unable to obtain these materials, we could experience a disruption to our supply chain that would hinder our ability to produce our products in a timely manner, or cause us to seek other sources of supply, which may be more costly or which we may not be able to procure on a timely basis. In addition, our customers may not follow their normal purchasing patterns or temporarily cease purchasing from us due to impacts to their businesses in the region, creating unexpected fluctuations or decreases in our revenues and profitability. Natural disasters in other parts of the world on which our operations are reliant also could have material adverse impacts on our business.

In addition, our operations and those of our suppliers are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure, cybersecurity breaches, Information Technology ("IT") systems 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, whether due to a natural disaster or otherwise, our business could be materially and adversely affected.

If our products become subject to cybersecurity breaches, or if public perception is that they are vulnerable to cyberattacks, our reputation and business could suffer.

We could be subject to liability or our reputation could be harmed if technologies integrated into our products fail to prevent cyberattacks, or if our partners or customers fail to safeguard the systems with security policies that conform to industry best practices. In addition, any cyberattack or security breach that affects a competitor's products could lead to the negative perception that our solutions are or could be subject to similar attacks or breaches.

Cybersecurity breaches and other disruptions could compromise our information and expose us to liability, which could cause our business and reputation to suffer.

In the ordinary course of our business, we collect and store sensitive data, including intellectual property, our proprietary business information and that of our customers, suppliers and business partners, and personally identifiable information of our employees, on our networks and third-party cloud software providers. The secure processing, maintenance and transmission of this information is critical to our operations. Although we have taken steps to protect the security of our information systems, we have, from time to time, experienced threats to our data and systems, including malware and computer virus attacks and it is possible that in the future our safety and security measures will not prevent the systems' improper functioning or damage, or the improper access or disclosure of personally identifiable information such as in the event of cyber-attacks. In addition, due to the fast pace and unpredictability of cyber threats, long-term implementation plans designed to address cybersecurity risks become obsolete quickly and, in some cases, it may be difficult to anticipate or immediately detect such incidents and the damage they cause. Any unauthorized access, disclosure or other loss of information could result in legal claims or proceedings, disrupt our operations, damage our reputation, and cause a loss of confidence in our products and services, which could adversely affect our business.

Some of our new software offerings may be subject to various cybersecurity risks, which are particularly acute in the cloud-based technologies operated by us and other third parties that form a part of our solutions.

In connection with certain implementations of our management software platform, application, and SaaS offering, ConsoleFlow, we expect to store, convey and potentially process data produced by devices. This data may include confidential or proprietary information, intellectual property or personally identifiable information of our customers or other third parties with whom they do business. It is important for us to maintain solutions and related infrastructure that are perceived by our customers and other parties with whom we do business to provide a reasonable level of reliability and security. Despite available security measures and other precautions, the infrastructure and transmission methods used by our products and services may be vulnerable to interception, attack or other disruptive problems.

If a cyberattack or other security incident were to allow unauthorized access to or modification of our customers' data or our own data, whether due to a failure with our systems or related systems operated by third parties, we could suffer damage to our brand and reputation. The costs we would incur to address and fix these incidents could significantly increase our expenses. These types of security incidents could also lead to lawsuits, regulatory investigations and increased legal liability, including in some cases contractual costs related to customer notification and fraud monitoring. Further, as regulatory focus on privacy and data security issues continues to increase and worldwide laws and regulations concerning the protection of information become more complex, the potential risks and costs of compliance to our business will intensify.

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, OEMs and ODMs. Any future acquisition, partnership, joint venture or investment may require that we pay significant cash, issue equity or incur substantial debt. Acquisitions, partnerships or joint ventures may also result in the loss of key personnel and the dilution of existing stockholders to the extent we are required to issue 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 not result in an increase in revenues or earnings or the delivery of new products, may contribute to increased fixed costs, and may expose us to unanticipated liabilities. If any of these occur, we may fail to meet our business objectives and our business, financial condition and operating results could be materially and adversely affected.

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 and of key engineers, marketing and sales employees. We are particularly 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.

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

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

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

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

To remain competitive, we must continue to make significant investments to operate our business and develop our products. Our future capital requirements will depend on many factors, including the timing and amount of our net revenue, research and development expenditures, expenses associated with any strategic partnerships or acquisitions and infrastructure investments, and expenses related to litigation, each of which could negatively affect our ability to generate additional cash from operations. If cash

generated from operations is insufficient to satisfy our working capital requirements, we may need to raise additional capital. Looking ahead at long-term needs, we may need to raise additional funds for a number of purposes, including:

- to fund working capital requirements;
- to update, enhance or expand the range of products we offer;
- to increase our sales and marketing activities; or
- to respond to competitive pressures or perceived opportunities, such as investment, acquisition and international expansion activities.

We may seek additional capital from public or private offerings of our capital stock, borrowings under our existing or future credit lines or other sources. If we issue equity or debt securities to raise additional funds, our existing stockholders may experience dilution, and the new equity or debt securities may have rights, preferences and privileges senior to those of our existing stockholders. In addition, if we raise additional funds through collaborations, licensing, joint ventures, or other similar arrangements, it may be necessary to relinquish valuable rights to our potential future products or proprietary technologies, or grant licenses on terms that are not favorable to us. There can be no assurance that we will be able to raise any needed capital on terms acceptable to us, if at all. If we are unable to secure additional financing in sufficient amounts or on favorable terms, 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.

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

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

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

We have experienced, and expect to continue to experience, significant fluctuations in net revenue, expenses and operating results from quarter to quarter. We therefore believe that quarter to quarter comparisons of our operating results are not a good indication of our future performance, and you should not rely on them to predict our future operating or financial performance or the future performance of the market price of our common stock. A high percentage of our operating expenses are relatively fixed and are based on our forecast of future revenue. If we were to experience an unexpected reduction in net revenue in a quarter, we would likely be unable to adjust our short-term expenditures significantly. If this were to occur, our operating results for that fiscal quarter would be harmed. In addition, if our operating results in future fiscal quarters were to fall below the expectations of equity analysts and investors, the market price of our common stock would likely fall.

The market price of our common stock may be volatile based on a number of factors, many of which are not under our control.

The market price of our common stock has been highly volatile. The market price of our common stock could be subject to wide fluctuations in response to a variety of factors, many of which are out of our control, including:

- adverse changes in domestic or global economic, market and other conditions;
- new products or services offered by our competitors;
- our completion of or failure to complete significant one-time sales of our products;
- actual or anticipated variations in quarterly operating results;
- changes in financial estimates by securities analysts;
- announcements of technological innovations;
- our announcement of significant acquisitions, strategic partnerships, joint ventures or capital commitments;
- conditions or trends in the industry;
- additions or departures of key personnel;
- increased competition from industry consolidation;
- mergers and acquisitions; and
- sales of common stock by our stockholders or us or repurchases of common stock by us.

In addition, the Nasdaq Capital Market often experiences price and volume fluctuations. These fluctuations often have been unrelated or disproportionate to the operating performance of companies listed on the Nasdaq Capital Market.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The following table presents details regarding our leased facilities:

<u>Locations</u>	<u>Primary Use</u>	<u>Approximate Square Footage</u>
Irvine, California, U.S.A.	Corporate headquarters; sales and marketing, research and development, operations and administration	27,000
Vancouver, British Columbia, Canada	Engineering, operations and marketing	12,000
Hyderabad, India	Engineering and design	18,000
Illmenau, Germany	Engineering, operations, sales and marketing	13,000
Taiwan	Engineering, sales and marketing	3,000
Shanghai, China	Sales and marketing	1,000

We believe our existing facilities are adequate to meet our needs. If additional space is needed in the future, we believe that suitable space will be available on commercially reasonable terms.

ITEM 3. LEGAL PROCEEDINGS

From time to time we are involved in various legal and government proceedings incidental to our business. These proceedings are in various procedural stages. Although the results of these legal proceedings and claims cannot be predicted with certainty, we believe we are not currently a party to any legal proceedings which, if determined adversely to us, would, individually or taken together, have a material adverse effect on our business, operating results, financial condition or cash flows. However, the outcome of legal proceedings is inherently uncertain, and if unfavorable outcomes were to occur, there is a possibility that they could, individually or in the aggregate, have a materially adverse effect on our financial position, operating results or liquidity.

ITEM 4. MINE SAFETY DISCLOSURES

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Common Stock

Our common stock is traded on the Nasdaq Capital Market under the symbol "LTRX." The number of holders of record of our common stock as of August 31, 2020 was approximately 29.

Dividend Policy

We have never declared or paid cash dividends on our common stock. We do not anticipate paying any cash dividends on our common stock in the foreseeable future, and we intend to retain any future earnings for use in the expansion of our business and for general corporate purposes. Any future decision to declare or pay dividends will be made by our board of directors in its sole discretion and will depend upon our financial condition, operating results, capital requirements and other factors that our board of directors deems appropriate at the time of its decision.

Issuer Repurchases

We did not repurchase any shares of our common stock during the fourth quarter of fiscal 2020.

ITEM 6. SELECTED FINANCIAL DATA

Not required for a "smaller reporting company."

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis in conjunction with our consolidated financial statements and the accompanying notes thereto included in Part II, Item 8 of this Report. This discussion and analysis contains forward-looking statements that are based on our management's current beliefs and assumptions, which statements are subject to substantial risks and uncertainties. Our actual results may differ materially from those expressed or implied by these forward-looking statements as a result of many factors, including those discussed in "Risk Factors" included in Part I, Item 1A of this Report. Please also see "Cautionary Note Regarding Forward Looking Statements" at the beginning of this Report.

Overview

Lantronix, Inc., which we refer to herein as the Company, Lantronix, we, our, or us, is a global provider of software as a service ("SaaS"), engineering services, and hardware for Edge Computing, the Internet of Things ("IoT"), and Remote Environment Management ("REM"). Lantronix enables its customers to provide reliable and secure solutions while accelerating their time to market. Lantronix's products and services dramatically simplify operations through the creation, development, deployment, and management of customer projects at scale while providing quality, reliability and security.

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

References to "fiscal 2020" refer to the fiscal year ended June 30, 2020 and references to "fiscal 2019" refer to the fiscal year ended June 30, 2019.

Products and Solutions

We organize our products and solutions into three product lines: IoT, REM, and Other. Refer to "Products and Solutions" included in Part I, Item 1 of this Report, which is incorporated herein by reference, for further discussion.

Impact of COVID-19

In order to protect our employee population and comply with local directives, most of our employees transitioned to remote working arrangements commencing in March 2020 and still continuing through the date hereof. To facilitate the increased data traffic associated with remote access, we have upgraded some of our information technology systems. We have also made changes relating to

videoconferencing by providing most of our employees with a new videoconferencing and collaboration platform to accommodate better remote collaboration and communication. To date, remote working has not had a significant adverse impact on our financial results or our operations, including, financial reporting and disclosure controls and procedures. We do not believe that our productivity has been substantially affected by working remotely. However, we recognize that a certain degree of employee enthusiasm, teamwork, creativity, encouragement and support is normally generated by being present at a physical location, and we believe that prolonged remote working may have a negative impact over time on our business and on employee productivity. We may have to take further actions that we determine are in the best interests of our employees or as required by federal, state, or local authorities.

Supply Chain and Shipping

The COVID-19 epidemic continues to challenge our supply chain, and if prolonged, may have an adverse impact on our ability to produce and ship our products. In early January 2020, we began to anticipate some supply chain issues. To mitigate, we built-up our inventory position. This increased inventory helped alleviate some, but not all, of the impact of subsequent shutdowns that occurred in China during the period. However, there were instances where we were unable to fulfill orders, resulting in revenue decline and causing us to miss our initial revenue target.

Our supply chain still faces significant challenges. Most of our manufacturing is performed in Malaysia, Thailand and China. Our major contract manufacturer in Malaysia is not at full capacity because of temporary local stay-at-home orders, and we expect to experience supply constraints if the partial shutdown of this contract manufacturer is prolonged or expanded. Similar issues could arise with either one or both of our major contract manufacturers in Thailand and China, although as of the date of this Report we have not been informed of any issues.

Our ability to ship products has also been affected by the impact that COVID-19 has had and continues to have on air travel. Most of our products are shipped via air freight. With the reduction of air travel, shipping costs have increased, and shipping delays have occurred and may continue to occur.

We are attempting to mitigate both production and shipping risks by asking our contract manufacturers to expedite orders where possible, and otherwise taking and shipping products from our contract manufacturers as soon as they are available. We have also had to sell into the United States products in inventory that were manufactured in China for our non-U.S. markets, thus incurring tariffs in the United States and negatively impacting our profits.

Our ability to manufacture products is also dependent on the availability of certain raw materials and components that our contract manufacturers purchase in China, and our sales are subject to demand for certain of our products that are purchased by our customers for assembly in China into our customers' end-products. If a resurgence of COVID-19 and associated shutdowns were to occur in China, this would likely have an adverse impact on our ability to manufacture and sell our products due to related shortages of materials and components and delays in customer orders. Depending on the severity of any such future shutdowns, we could experience a materially diminished ability to produce products or longer lead times. This would result in delayed or reduced revenue from the affected orders in production and potentially higher operating costs. Because COVID-19 is a global pandemic, it may be difficult or impossible to move our manufacturing capability in a timely manner as needed, or to put in place any additional mitigation actions other than to pull and ship products as fast as our manufacturers can manufacture them. These mitigation efforts, if needed, could have a negative impact on our financial results, including by increasing inventory levels.

Sales and Marketing

Our sales and marketing efforts have been impacted by COVID-19 in a variety of ways. On the positive side, we saw an increase in orders for videoconferencing-related and medical-related products and services. But this increase has been offset primarily by a reduction in other product sales caused by global shutdowns and overall uncertainty arising as a result of COVID-19.

Many of our leads are generated through industry events, trade shows and business travel necessary to support customer engagement. With the recent sudden cessation of all trade shows and business travel, our lead pipeline has been negatively impacted, which has negatively affected and may continue to negatively affect our sales in the coming quarters. We are attempting to mitigate this risk by using this time to focus our sales and marketing teams on greater customer engagement, particularly with anchor customers. However, prolonged shutdowns, or additional future shutdowns as a result of a resurgence of COVID-19, would negate our mitigation efforts and lead to a reduction in revenue during the coming quarters. In addition, to mitigate the potential declines, we are also changing our go-to-market approach by adding more distributors and value-added resellers, who are closer to the customers and end-customers.

Research and Development

Our research and development efforts have not been impacted in any material respect as a result of our transition to a remote working arrangement or due to any cost containment efforts. However, if the shutdowns persist, we may experience project delays because of lack of access for our engineers to use testing and other equipment that is situated in our office labs. We have attempted to mitigate

any such prolonged impact by enabling engineers to have limited access to our office labs while imposing procedures that ensure that only a few people are in the office at any given time, social distancing and other guidelines are observed, and appropriate disinfection is taking place. Prolonged shutdowns at third-party partners, especially relating to product certifications, may also delay our sales and shipments. In the event of prolonged shutdowns, we believe we can mitigate by putting in place, where possible, agreements with our customers covering the sale of non-certified products.

Recent Accounting Pronouncements

Refer to Note 1 of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Report, which is incorporated herein by reference, for a discussion of recent accounting pronouncements.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in accordance with U.S. generally accepted accounting principles requires us to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of net revenue and expenses during the reporting period. We regularly evaluate our estimates and assumptions related revenue recognition, sales returns and allowances, allowance for doubtful accounts, inventory valuation, warranty reserves, restructuring charges, valuation of deferred income taxes, valuation of goodwill and long-lived and intangible assets, share-based compensation, litigation and other contingencies. We base our estimates and assumptions on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. To the extent there are material differences between our estimates and the actual results, our future results of operations will be affected.

We believe the following critical accounting policies require us to make significant judgments and estimates in the preparation of our consolidated financial statements:

Revenue Recognition

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

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

A portion of our revenues are derived from engineering and related consulting service contracts with customers. These contracts generally include performance obligations in which control is transferred over time because the customer either simultaneously receives and consumes the benefits provided or our performance on the contract creates or enhances an asset that the customer controls. These contracts typically provide services on the following basis:

- Time & Materials (“T&M”) – services consist of revenues from software modification, consulting implementation, training and integration services. These services are set forth separately in the contractual arrangements such that the total price of the customer arrangement is expected to vary depending on the actual time and materials incurred based on the customer’s needs.
- Fixed Price – arrangements to render specific consulting and software modification services which tend to be more complex.

Performance obligations for T&M contracts qualify for the "Right to Invoice" practical expedient within the revenue guidance. Under this practical expedient, we may recognize revenue, over time, in the amount to which we have a right to invoice. In addition, we are not required to estimate variable consideration upon inception of the contract and reassess the estimate each reporting period. We determined that this method best represents the transfer of services as, upon billing, we have a right to consideration from a customer in an amount that directly corresponds with the value to the customer of our performance completed to date.

We recognize revenue on fixed price contracts, over time, using the proportion of our actual costs incurred (generally labor hours expended) to the total costs expected to complete the contract performance obligation. We determined that this method best represents the transfer of services as the proportion closely depicts the efforts or inputs completed towards the satisfaction of a fixed price contract performance obligation.

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

Allowance for Doubtful Accounts

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. Our evaluation of the collectability of customer accounts receivable is based on various factors. In cases where we are aware of circumstances that may impair a specific customer's ability to meet its financial obligations subsequent to the original sale, we will record an allowance against amounts due based on those particular circumstances. For all other customers, we estimate an allowance for doubtful accounts based on the length of time the receivables are past due, our bad debt collection experience and general industry conditions. If a major customer's credit-worthiness deteriorates, or our customers' actual defaults exceed our estimates, our financial results could be impacted.

Inventory Valuation

We value inventories at the lower of cost (on a first-in, first-out basis) or net realizable value, whereby we make estimates regarding the market value of our inventories, including an assessment of excess and obsolete inventories. We determine excess and obsolete inventories based on an estimate of the future sales demand for our products within a specified time horizon, which is generally 12 months. The estimates we use for demand are also used for near-term capacity planning and inventory purchasing. In addition, specific reserves are recorded to cover risks for end-of-life products, inventory located at our contract manufacturers, deferred inventory in our sales channel and warranty replacement stock. If actual product demand or market conditions are less favorable than our estimates, additional inventory write-downs could be required, which would increase our cost of revenue and reduce our gross margins.

Warranty Reserve

The standard warranty periods we provide for our products typically range from one to five years. We establish reserves for estimated product warranty costs at the time revenue is recognized based upon our historical warranty experience, and for any known or anticipated product warranty issues. Our warranty obligations are impacted by a number of factors, including historical warranty costs, actual product failure rates, service delivery costs, and the use of materials. If our actual results are different from our assumptions, increases or decreases to warranty reserves could be required, which could impact our cost of revenue and gross margins.

Restructuring Charges

We recognize costs and related liabilities for restructuring activities when they are incurred. Our restructuring charges are primarily comprised of employee separation costs, asset impairments and contract exit costs. Employee separation costs include one-time termination benefits that are recognized as a liability at estimated fair value, at the time of communication to employees, unless future service is required, in which case the costs are recognized ratably over the future service period. Ongoing termination benefits are recognized as a liability at estimated fair value when the amount of such benefits are probable and reasonably estimable. Contract exit costs include contract termination fees and right-of-use asset impairments recognized on the date that we have vacated the premises or ceased use of the leased facilities. A liability for contract termination fees is recognized in the period in which we terminate the contract. Restructuring accruals are based upon management estimates at the time they are recorded and can change depending upon changes in facts and circumstances subsequent to the date the original liability is recorded. If actual results differ, or if management determines revised estimates are necessary, we may record additional liabilities or reverse a portion or existing liabilities.

Valuation of Deferred Income Taxes

We have recorded a valuation allowance to reduce our net deferred tax assets to zero, primarily due to historical net operating losses (“NOLs”) and uncertainty of generating future taxable income. We consider estimated future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance. If we determine that it is more likely than not that we will realize a deferred tax asset that currently has a valuation allowance, we would be required to reverse the valuation allowance, which would be reflected as an income tax benefit in our consolidated statements of operations at that time.

Business Combinations

We allocate the fair value of the purchase consideration of a business acquisition to the tangible assets, liabilities, and intangible assets acquired, including in-process research and development (“IPR&D”), if applicable, based on their estimated fair values. The excess of the fair value of purchase consideration over the fair values of these identifiable assets and liabilities is recorded as goodwill. IPR&D is initially capitalized at fair value as an intangible asset with an indefinite life and assessed for impairment thereafter. When an IPR&D project is completed, the IPR&D is reclassified as an amortizable purchased intangible asset and amortized over the asset’s estimated useful life. The valuation of acquired assets and assumed liabilities requires significant judgment and estimates, especially with respect to intangible assets. The valuation of intangible assets, in particular, requires that we use valuation techniques such as the income approach. The income approach includes the use of a discounted cash flow model, which includes discounted cash flow scenarios and requires significant estimates such as future expected revenue, expenses, capital expenditures and other costs, and discount rates. We estimate the fair value based upon assumptions we believe to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates. Estimates associated with the accounting for acquisitions may change as additional information becomes available regarding the assets acquired and liabilities assumed. Acquisition-related expenses and any related restructuring costs are recognized separately from the business combination and are expensed as incurred.

Goodwill Impairment Testing

We evaluate goodwill for impairment on an annual basis in our fourth fiscal quarter or more frequently if we believe indicators of impairment exist that would more likely than not reduce the fair value of our single reporting unit below its carrying amount.

We begin our evaluation of goodwill for impairment by assessing qualitative factors to determine whether it is more likely than not that the fair value of our single reporting unit is less than its carrying value. Based on that qualitative assessment, if we conclude that it is more likely than not that the fair value of our single reporting unit is less than its carrying value, we conduct a quantitative goodwill impairment test, which involves comparing the estimated fair value of our single reporting unit with its carrying value, including goodwill. We estimate the fair value of our single reporting unit using a combination of the income and market approach. If the carrying value of the reporting unit exceeds its estimated fair value, we recognize an impairment loss for the difference.

Significant management judgment is required in estimating the reporting unit’s fair value and in the creation of the forecasts of future operating results that are used in the discounted cash flow method of valuation, including (i) estimation of future cash flows, which is dependent on internal forecasts, (ii) estimation of the long-term rate of growth of our business, (iii) estimation of the period during which cash flows will be generated and (iv) the determination of our weighted-average cost of capital, which is a factor in determining the discount rate. Our estimate of the reporting unit’s fair value would also generally include the consideration of a control premium, which is the amount that a buyer is willing to pay over the current market price of a company as indicated by the traded price per share (i.e., market capitalization) to acquire a controlling interest. If our actual financial results are not consistent with our assumptions and judgments used in estimating the fair value of our reporting unit, we may be exposed to goodwill impairment losses.

During the fourth quarter of fiscal 2020, we made a qualitative assessment of whether goodwill impairment existed. Since our assessment of the qualitative factors did not result in a determination that it was more likely than not that the fair value of our single reporting unit is less than its carrying value, we were not required to perform the quantitative goodwill impairment test. As of June 30, 2020, the carrying value of our single reporting unit was \$46,520,000, while our market capitalization was \$104,737,000. We concluded that no goodwill impairment existed as of June 30, 2020.

Long-Lived Assets and Intangible Assets

We assess the impairment of long-lived assets and intangible assets whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Circumstances which could trigger a review include, but are not limited to the following:

- significant decreases in the market price of the asset;
- significant adverse changes in the business climate or legal factors;
- accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of the asset;

- current period cash flow or operating losses combined with a history of losses or a forecast of continuing losses associated with the use of the asset; and
- current expectation that the asset will more likely than not be sold or disposed of significantly before the end of its estimated useful life.

Whenever events or changes in circumstances suggest that the carrying amount of long-lived assets and intangible assets may not be recoverable, we estimate the future cash flows expected to be generated by the asset from its use or eventual disposition. If the sum of the expected future cash flows is less than the carrying amount of those assets, we recognize an impairment loss based on the excess of the carrying amount over the fair value of the assets. Significant management judgment is required in the forecasts of future operating results that are used in the discounted cash flow method of valuation. These significant judgments may include future expected revenue, expenses, capital expenditures and other costs, and discount rates.

Share-Based Compensation

We record share-based compensation in our consolidated statements of operations as an expense, based on the estimated grant date fair value of our share-based awards, with the fair values amortized to expense over the requisite service period. Our share-based awards are currently comprised of restricted stock units, performance stock units, common stock options, and common stock purchase rights granted under our 2013 Employee Stock Purchase Plan (“ESPP”).

The fair value of our restricted stock units is based on the closing market price of our common stock on the date of grant.

The fair value of our performance share units is estimated as of the grant date based upon the expected achievement of the performance metrics specified in the grant and the closing market price of our common stock on the date of grant. To the extent a grant contains a market condition, the grant date fair value is estimated using a Monte Carlo simulation, which incorporates estimates of the potential outcomes of the market condition on the grant date fair value of each award.

The fair value of our common stock options and common stock purchase rights is generally estimated on the grant date using the Black-Scholes-Merton (“BSM”) option-pricing formula. While utilizing the BSM model meets established requirements, the estimated fair values generated by the model may not be indicative of the actual fair values of our share-based awards as the model does not consider certain factors important to those awards to employees, such as continued employment and periodic vesting requirements as well as limited transferability. The determination of the fair value of share-based awards utilizing the BSM model is affected by our stock price and various assumptions, including the expected term, expected volatility, risk-free interest rate and expected dividend yields. The expected term of our stock options is generally estimated using the simplified method, as permitted by guidance issued by the Securities and Exchange Commission (“SEC”). We use the simplified method because we believe we are unable to rely on our limited historical exercise data or alternative information as a reasonable basis upon which to estimate the expected term of these options. The expected volatility is based on the historical volatility of our stock price. The risk-free interest rate assumption is based on the U.S. Treasury interest rates appropriate for the expected term of our stock options and common stock purchase rights.

If factors change and we employ different assumptions, share-based compensation expense may differ significantly from what we have recorded in the past. If there are any modifications or cancellations of the underlying unvested share-based awards, we may be required to accelerate, increase or cancel any remaining unearned share-based compensation expense. If these events were to occur, it could increase or decrease our share-based compensation expense, which would impact our operating expenses and gross margins.

Results of Operations - Fiscal Years Ended June 30, 2020 and 2019

Summary

For fiscal 2020, our net revenue increased by approximately \$12,988,000, or 27.7%, as compared to fiscal 2019. We incurred a net loss for fiscal 2020 of \$10,738,000, compared to a net loss of \$408,000 for fiscal 2019, which was driven primarily by a \$10,677,000, or 39.9%, increase in operating expenses, partially offset by a \$627,000, or 2.4%, increase in gross profit. Fiscal 2020 operating expenses included approximately \$8,162,000 of costs related to our acquisitions of Intrinsyc and Maestro and our efforts to integrate and take advantage of synergies of the combined companies.

Net Revenue

The following tables present our net revenue by product lines and by geographic region:

	Years Ended June 30,				Change	
	2020	% of Net Revenue	2019	% of Net Revenue	\$	%
	(In thousands, except percentages)					
IoT	\$ 49,911	83.4%	\$ 35,299	75.3%	\$ 14,612	41.4%
REM	9,228	15.4%	10,845	23.1%	(1,617)	(14.9%)
Other	739	1.2%	746	1.6%	(7)	(0.9%)
	<u>\$ 59,878</u>	<u>100.0%</u>	<u>\$ 46,890</u>	<u>100.0%</u>	<u>\$ 12,988</u>	<u>27.7%</u>

	Years Ended June 30,				Change	
	2020	% of Net Revenue	2019	% of Net Revenue	\$	%
	(In thousands, except percentages)					
Americas	\$ 33,279	55.6%	\$ 25,179	53.7%	\$ 8,100	32.2%
EMEA	15,588	26.0%	14,586	31.1%	1,002	6.9%
APJ	11,011	18.4%	7,125	15.2%	3,886	54.5%
	<u>\$ 59,878</u>	<u>100.0%</u>	<u>\$ 46,890</u>	<u>100.0%</u>	<u>\$ 12,988</u>	<u>27.7%</u>

IoT

Net revenue from our IoT product line increased in fiscal 2020 across all regions compared to fiscal 2019 due to the addition of sales of products and services obtained through the acquisitions of (i) Maestro Wireless Solutions Limited and its subsidiaries (“Maestro”) on July 5, 2019 and (ii) Intrinsic Technologies Corporation (“Intrinsic”) on January 16, 2020. Net revenue related to products and services from the acquisitions contributed approximately 33% to 38% of net sales for fiscal 2020. We also saw growth in unit sales of our SGX, a newer product family, primarily in the Americas region. The overall increase in IoT net revenues was partially offset by decreases in unit sales of (i) our XPort, UDS, and Premierwave EN product families across all regions, (ii) our XPort Pro family, mostly in the Americas and (iii) our large-scale integration chips in the EMEA region.

REM

Net revenue from our REM product line for fiscal 2020 decreased compared to fiscal 2019 due primarily to decreased unit sales of both our SLC8000 product family in the EMEA region and SLB product family in the Americas region. In the prior year, we saw stronger demand for both product families partially driven by the timing of sales to certain large customers. During the current fiscal year, we saw moderate growth in unit sales of our SLS product family and EMG, a new product family.

Other

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

Gross Profit

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

The following table presents our gross profit:

	Years Ended June 30,				Change	
	2020	% of Net Revenue	2019	% of Net Revenue	\$	%
	(In thousands, except percentages)					
Gross profit	<u>\$ 26,900</u>	<u>44.9%</u>	<u>\$ 26,273</u>	<u>56.0%</u>	<u>\$ 627</u>	<u>2.4%</u>

Gross margin for fiscal 2020 decreased compared to fiscal 2019 due primarily to sales of products obtained through the acquisitions of Maestro and Intrinsyc, which typically have lower margins than the Lantronix products that existed prior to the acquisitions. Gross margin in fiscal 2020 was also negatively impacted by the amortization of unrealized profit in acquired inventory in the amount of approximately \$255,000, along with additional charges in fiscal 2020 for inventory reserves.

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, advertising and marketing expenses and professional legal and accounting fees.

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

	Years Ended June 30,				Change	
	2020	% of Net Revenue	2019	% of Net Revenue	\$	%
	(In thousands, except percentages)					
Personnel-related expenses	\$ 11,400		\$ 11,048		\$ 355	3.2%
Professional fees and outside services	2,137		1,122		1,015	90.5%
Marketing and advertising	828		705		123	17.4%
Facilities and insurance	1,384		874		510	58.4%
Share-based compensation	2,959		1,441		1,518	105.3%
Depreciation	238		192		46	24.0%
Other	636		469		167	35.6%
Selling, general and administrative	<u>\$ 19,582</u>	<u>32.7%</u>	<u>\$ 15,851</u>	<u>33.8%</u>	<u>\$ 3,734</u>	<u>23.6%</u>

Selling, general and administrative expenses increased in fiscal 2020 primarily due to (i) higher share-based compensation primarily due to the issuance of equity awards to certain executive and other employees, including employees brought on from our acquisitions, (ii) higher professional fees and outside services resulting from increased legal and accounting fees, (iii) higher facilities and insurance costs resulting from additional facility space obtained through the acquisitions of Maestro and Intrinsyc, and (iv) increased personnel-related expenses resulting from increases in headcount from acquisitions.

Research and Development

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

The following table presents our research and development expenses:

	Years Ended June 30,				Change	
	2020	% of Net Revenue	2019	% of Net Revenue	\$	%
	(In thousands, except percentages)					
Personnel-related expenses	\$ 6,750		\$ 6,418		\$ 332	5.2%
Facilities	1,189		911		278	30.5%
Outside services	573		772		(199)	(25.8%)
Product certifications	326		141		185	131.2%
Share-based compensation	453		345		108	31.3%
Depreciation	122		75		47	62.7%
Other	278		417		(139)	(33.3%)
Research and development	<u>\$ 9,691</u>	<u>16.2%</u>	<u>\$ 9,079</u>	<u>19.4%</u>	<u>\$ 612</u>	<u>6.7%</u>

Research and development expenses increased in fiscal 2020 primarily due to increases in (i) personnel-related expenses resulting from an increase in headcount from the acquisitions of Maestro and Intrinsyc, (ii) product certification costs related to new product development projects and (iii) facilities costs, resulting from our new facility lease in India and additional facility space gained through the acquisitions of Maestro and Intrinsyc.

Restructuring, Severance and Related Charges

Fiscal 2020

During fiscal 2020, we continued a plan to realign certain personnel resources to better fit our current business needs, particularly as it relates to identifying cost savings and synergies to be gained from the acquisitions of Maestro and Intrinsyc. These activities resulted in total charges of approximately \$3,844,000 in fiscal 2020. We may incur additional restructuring, severance and related charges in future periods as we continue to identify cost savings and synergies resulting from our acquisitions.

Fiscal 2019

During fiscal 2019, we executed several plans to realign certain personnel resources to better meet our business needs, for which we recorded a total of approximately \$1,146,000 in severance-related costs. In connection with these actions, we also recorded approximately \$271,000 in share-based compensation expense, which is categorized in the applicable functional line items in our consolidated statement of operations for fiscal 2019.

Acquisition-Related Costs

During fiscal 2020, we incurred approximately \$2,284,000 of acquisition-related costs in connection with the acquisitions of Maestro and Intrinsyc. During fiscal 2019, we incurred approximately \$410,000 of acquisition-related costs in connection with the acquisition of Maestro. These costs are mainly comprised of banking, legal, accounting and other professional fees.

Amortization of Purchased Intangible Assets

We acquired certain intangible assets through our fiscal 2020 acquisitions, which we recorded at fair-value as of the acquisition dates. These assets are generally amortized on a straight-line basis over their estimated useful lives, and resulted in charges of \$2,037,000 during fiscal 2020.

Interest Income (Expense), Net

For fiscal 2020, we incurred net interest expense as a result of interest incurred on borrowings on our term loan. We also earn interest on our domestic cash balances.

Other Expense, Net

Other expense, net, is comprised primarily of foreign currency remeasurement and transaction adjustments related to our foreign subsidiaries whose functional currency is the U.S. dollar.

Provision for Income Taxes

The following table presents our provision for income taxes:

	Years Ended June 30,				Change	
	2020	% of Net Revenue	2019	% of Net Revenue	\$	%
Provision for income taxes	\$ 144	0.2%	\$ 141	0.3%	\$ 3	2.1%

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

	Years Ended June 30,	
	2020	2019
Effective tax rate	(1.4%)	(52.8%)

We utilize the liability method of accounting for income taxes. The difference between our effective tax rate and the federal statutory rate resulted primarily from the effect of our domestic losses recorded without a 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 are more likely than not to be realized. As a result of our cumulative losses and uncertainty of generating future taxable income, we provided a full valuation allowance against our net deferred tax assets for fiscal 2020 and fiscal 2019.

Due to the “change of ownership” provision of the Tax Reform Act of 1986, utilization of our NOL carryforwards and tax credit carryforwards may be subject to an annual limitation against taxable income in future periods. Due to the annual limitation, a portion of these carryforwards may expire before ultimately becoming available to reduce future income tax liabilities. The following table presents our NOLs:

	June 30, 2020
	(In thousands)
Federal	\$ 92,824
State	\$ 14,560

For federal income tax purposes, our NOL carryovers generated for tax years beginning before July 1, 2018 will begin to expire in the fiscal year ending June 30, 2021. Of our federal NOLs as of June 30, 2020 in the table above, approximately \$51,900,000 will expire by June 30, 2023. For state income tax purposes, our NOLs began to expire in the fiscal year ended June 30, 2013. Pursuant to the Tax Cuts and Jobs Act enacted by the U.S. federal government in December 2017, for federal income tax purposes, NOL carryovers generated for our tax years beginning after June 30, 2018 can be carried forward indefinitely, but will be subject to a taxable income limitation.

Liquidity and Capital Resources

Liquidity

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

	June 30,		
	2020	2019	Change
	(In thousands)		
Working capital	\$ 18,741	\$ 26,718	\$ (7,977)
Cash and cash equivalents	\$ 7,691	\$ 18,282	\$ (10,591)

In fiscal 2020, we made cash payments of \$13,402,000 for the acquisitions of Intrinsic and Maestro. In addition, direct costs related to these acquisitions were a primary contributor to our use of cash in operating activities for fiscal 2020.

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

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

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

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

Impact of COVID-19

We have not experienced any material delays or payment defaults by our customers. However, a prolonged economic shutdown or downturn may lead to significant declines in billings and cash collection and result in an unfavorable impact on our financial results. See above under “Impact of COVID-19” for additional information. While we do have a Revolving Facility (as defined below), financial covenants associated with the Revolving Facility may not enable us to draw down funds as needed. We have in place a contingency plan that significantly reduces operating costs in the event that we experience liquidity issues in order to help mitigate our liquidity risk.

In April 2020, we executed a promissory note with Silicon Valley Bank in the principal amount of approximately \$2,438,000 as part of the Paycheck Protection Program administered by the Small Business Administration and authorized under the Coronavirus Aid, Relief, and Economic Security Act, or the CARES Act. On May 6, 2020, we repaid the promissory note in full.

Bank Loan Agreements

On November 12, 2019, we entered into a Second Amended and Restated Loan and Security Agreement (“Amended Agreement”) with Silicon Valley Bank (“SVB”), which amended, restated and superseded our previous agreement with SVB in its entirety. Pursuant to the Amended Agreement, SVB made available to us a senior secured revolving line of credit of up to \$6,000,000 (“Revolving Facility”) and a senior secured term loan of \$6,000,000 (“Term Loan Facility”). The \$6,000,000 proceeds of the Term Loan Facility were drawn in full in November 2019 and were used to fund our acquisition of Intrinsic, which occurred in January 2020. The Revolving Facility matures on November 12, 2021. There were no borrowings on the Revolving Facility at June 30, 2020. The Term Loan Facility is repayable over a 48 month period commencing January 1, 2020. Refer to *Note 6* of Notes to Consolidated Financial Statements, included in Part II, Item 8 of this Report, which is incorporated herein by reference, for additional information regarding our Revolving Facility and Term Loan Facility.

Cash Flows

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

	Years Ended June 30,		(Decrease) Increase
	2020	2019	
		(In thousands)	
Net cash used in operating activities	\$ (2,521)	\$ (1,748)	\$ 773
Net cash used in investing activities	\$ (13,974)	\$ (891)	\$ 13,083
Net cash provided by financing activities	\$ 5,904	\$ 11,353	\$ (5,449)

Operating Activities

Cash used from operating activities during fiscal 2020 increased compared to fiscal 2019 as a result of an increase in our net loss, which was impacted during fiscal 2020 by an increase in operating expenses and acquisition-related costs for the acquisitions of Maestro and Intrinsic. Our net loss included \$6,733,000 of non-cash charges and the changes in operating assets and liabilities provided net cash of \$1,484,000.

Investing Activities

Net cash used in investing activities during fiscal 2020 was driven by the acquisitions of Maestro and Intrinsic, which used net cash of \$5,073,000 and \$8,329,000, respectively. We also used cash for the purchase of property and equipment, primarily related to various tooling and test equipment.

Financing Activities

For fiscal 2020, financing activities provided cash from the issuance of the Term Loan Facility for \$6,000,000 with SVB as well as stock option exercises by employees. These inflows were partially offset by (i) repayments on the Term Loan Facility and (ii) withholding taxes paid related to the vesting of restricted stock units. Net cash provided by financing activities during fiscal 2019 resulted primarily from the public offering of 2,700,000 shares of common stock, which resulted in us receiving proceeds net of underwriting discounts and expenses of approximately \$9,774,000.

Off-Balance Sheet Arrangements

As of June 30, 2020, we did not have any relationships with unconsolidated organizations or financial partnerships, including structured finance or special purpose entities, that have been established for the purpose of facilitating off-balance sheet arrangements or for other purposes.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not required for a “smaller reporting company.”

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

All financial statements required by this Item 8, including the report of our independent registered public accounting firm, are included in Part IV, Item 15 of this Report, as set forth beginning on page F-1 of this Report, and are incorporated by reference into this Item 8.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) that are designed to ensure that information required to be disclosed in our reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and that this information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2020. Based on the evaluation of our disclosure controls and procedures as of June 30, 2020, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Management’s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate “internal control over financial reporting,” as defined in Rule 13a-15(f) under the Exchange Act. Our management conducted an assessment of the effectiveness of our internal control over financial reporting as of June 30, 2020 based on the criteria set forth in the *Internal Control-Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the assessment, our management has concluded that our internal control over financial reporting was effective as of June 30, 2020.

Exemption from Attestation Report of Independent Registered Public Accounting Firm

This Report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management’s report was not subject to attestation by our independent registered public accounting firm pursuant to the rules of the SEC that permit us to provide only Management’s Report because we are a non-accelerated filer.

Changes in Internal Controls over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the quarter ended June 30, 2020 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

Portions of our definitive Proxy Statement on Schedule 14A relating to our 2020 annual meeting of stockholders, which will be filed with the SEC within 120 days after the end of the fiscal year covered by this Report, are incorporated by reference into Part III of this Report, as indicated below.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The names of our executive officers and their ages, titles and biographies as of the date hereof are set forth in Item 1 in the section entitled “Information About Our Executive Officers” in Part I, Item 1 of this Report, which is incorporated herein by reference.

We have adopted a code of business conduct and ethics that applies to all employees, including employees of our subsidiaries, as well as each member of our Board of Directors. The code of business conduct and ethics is available at our website at www.lantronix.com under the Investor Relations-Corporate Governance section. We intend to satisfy any disclosure requirement under applicable rules of the SEC or Nasdaq Stock Market regarding an amendment to, or waiver from, a provision of this code of business conduct and ethics by posting such information on our website, at the web address specified above.

The other information required by this Item is incorporated by reference to our Proxy Statement on Schedule 14A relating to our 2020 annual meeting of stockholders.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference to our Proxy Statement on Schedule 14A relating to our 2020 annual meeting of stockholders.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item is incorporated by reference to our Proxy Statement on Schedule 14A relating to our 2020 annual meeting of stockholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated by reference to our Proxy Statement on Schedule 14A relating to our 2020 annual meeting of stockholders.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is incorporated by reference to our Proxy Statement on Schedule 14A relating to our 2020 annual meeting of stockholders.

PART IV

ITEM 15. EXHIBIT AND FINANCIAL STATEMENT SCHEDULES

1. Consolidated Financial Statements

The following consolidated financial statements and related Report of Independent Registered Public Accounting Firm are filed as part of this Report.

	Page
Report of Independent Registered Public Accounting Firm	F-1
Consolidated Balance Sheets as of June 30, 2020 and 2019	F-2
Consolidated Statements of Operations for the fiscal years ended June 30, 2020 and 2019	F-3
Consolidated Statements of Stockholders' Equity for the fiscal years ended June 30, 2020 and 2019	F-4
Consolidated Statements of Cash Flows for the fiscal years ended June 30, 2020 and 2019	F-5
Notes to Consolidated Financial Statements	F-6 – F-27

2. Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference		
		Filed Herewith	Form	Exhibit
2.1#	Share Purchase Agreement, dated July 5, 2019, by and among Lantronix Holding Company, Maestro Wireless Solutions Limited, Fargo Telecom Asia Limited and Maestro & FALCOM Holdings Limited	8-K	2.1	07/10/2019
2.2#	Arrangement Agreement, dated October 30, 2019, by and between Lantronix and Intrinsic	8-K	2.1	11/01/2019
3.1	Amended and Restated Certificate of Incorporation of Lantronix, Inc., as amended	10-K	3.1	08/29/2013
3.2	Amended and Restated Bylaws of Lantronix, Inc.	8-K	3.2	11/15/2012
4.1	Description of Lantronix Common Stock	10-K	4.1	09/11/2019

10.1*	Lantronix, Inc. 2010 Inducement Equity Incentive Plan	10-Q	10.2	11/08/2010
10.2*	Form of Stock Option Agreement under the Lantronix, Inc. 2010 Inducement Equity Incentive Plan	10-Q	10.3	11/08/2010
10.3*	Lantronix, Inc. Amended and Restated 2010 Stock Incentive Plan, as Amended on November 14, 2017	8-K	99.1	11/15/2017
10.4*	Form of Stock Option Agreement under the Lantronix, Inc. Amended and Restated 2010 Stock Incentive Plan	S-8	4.3	05/09/2013
10.5*	Form of Restricted Stock Award Agreement under the Lantronix, Inc. Amended and Restated 2010 Stock Incentive Plan	S-8	4.4	05/09/2013
10.6*	Lantronix, Inc. 2013 Employee Stock Purchase Plan	S-8	4.1	05/09/2013
10.7*	Letter Agreement dated September 8, 2011 between Lantronix, Inc. and Jeremy Whitaker	8-K	10.1	09/26/2011
10.8*	Amendment to Offer Letter between Lantronix, Inc. and Jeremy Whitaker, dated as of November 13, 2012	8-K	99.2	11/15/2012
10.9*	Form of Indemnification Agreement entered into between Lantronix, Inc. with its directors and certain of its executive officers	8-K	10.2	06/20/2016
10.10	Lease dated January 9, 2015 between Lantronix, Inc. and The Irvine Company, LLC	8-K	99.1	01/20/2015
10.11	First Amendment to Lease Agreement dated May 7, 2020 between Lantronix, Inc. and The Irvine Company, LLC	8-K	10.1	05/12/2020
10.12*	Summary of Lantronix, Inc. Annual Bonus Program	8-K	99.1	09/08/2015
10.13*	Lantronix, Inc. Non-Employee Director Compensation Policy, as revised	8-K	99.3	09/08/2015
10.14*	Form of Inducement Stock Option Agreement by and between Lantronix, Inc. and Kevin Yoder	S-8	4.5	04/28/2016
10.15*	Offer Letter dated January 22, 2016 between Lantronix, Inc. and Kevin Yoder	10-K	10.30	08/24/2016
10.16*	Transition and Separation Agreement, dated as of January 17, 2020, by and between Lantronix, Inc. and Kevin Yoder.	8-K	10.1	01/22/2020
10.17*	Letter Agreement dated August 31, 2016 between Lantronix, Inc. and Jeremy Whitaker	8-K	10.1	09/02/2016

10.18	Lantronix, Inc. 2013 Employee Stock Purchase Plan, as amended on November 13, 2018	8-K	99.1	11/15/2018
10.19*	Offer Letter dated March 23, 2019 between Lantronix, Inc. and Paul H. Pickle	8-K	99.1	03/27/2019
10.20*	Inducement Stock Option Agreement, dated April 22, 2019, between Lantronix, Inc. and Paul H. Pickle	S-8	4.1	04/26/2019
10.21*	Inducement Restricted Stock Unit Agreement, effective as of May 1, 2019, between Lantronix, Inc. and Paul H. Pickle	S-8	4.2	04/26/2019
10.22*+	Offer Letter dated January 4, 2020, between Lantronix, Inc. and Roger Holliday	X		
10.23*	Form of Inducement Stock Option Agreement	S-8	4.1	09/04/2020
10.24*	Form of Inducement Restricted Stock Unit Agreement	S-8	4.2	09/04/2020
10.25	Form of Voting Agreement	8-K	10.1	11/01/2019
10.26	Second Amended and Restated Loan and Security Agreement dated as of November 12, 2019, by and among Lantronix, Inc., Lantronix Holding Company and Silicon Valley Bank	8-K	10.1	11/14/2019
10.27	Intrinsyc Technologies Corporation Amended and Restated Incentive Stock Option Plan	10-Q	10.1	05/15/2020
10.28	Intrinsyc Technologies Corporation Restricted Share Unit Plan	10-Q	10.2	05/15/2020
21.1	Subsidiaries of Lantronix, Inc.	X		
23.1	Consent of Independent Registered Public Accounting Firm, Squar Milner LLP	X		
24.1	Power of Attorney (included on the signature page)	X		
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X		
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X		
32.1++	Certification of Chief Executive Officer and Chief Financial Officer furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X		
101.INS	XBRL Instance Document			
101.SCH	XBRL Taxonomy Extension Schema Document			
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document			
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document			
101.LAB	XBRL Taxonomy Extension Label Linkbase Document			
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document			

Portions of this Exhibit, including certain schedules and exhibits to this Exhibit, have been omitted in accordance with Item 601(b) of Regulation S-K. A copy of any omitted information, schedule and/or exhibit will be furnished to the Securities and Exchange Commission upon request.

* Indicates management contract or compensatory plan, contract or arrangement.

+ Filed herewith

++ Furnished herewith.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

LANTRONIX, INC.

By: /s/ PAUL PICKLE
Paul Pickle
President, Chief Executive Officer and
Director
(Principal Executive Officer)

Date: September 11, 2020

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each individual whose signature appears below hereby constitutes and appoints Paul Pickle and Jeremy Whitaker, and each or either of them, acting individually, as his or her true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this Report, and to file the same, with all exhibits thereto and other documents in connection therewith, with the SEC, granting unto said attorney-in-fact and agent, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully for all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, or any of them, or their or his or her substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ PAUL PICKLE</u> Paul Pickle	President, Chief Executive Officer and Director (Principal Executive Officer)	September 11, 2020
<u>/s/ JEREMY WHITAKER</u> Jeremy Whitaker	Chief Financial Officer (Principal Financial and Accounting Officer)	September 11, 2020
<u>/s/ BERNHARD BRUSCHA</u> Bernhard Bruscha	Chairman of the Board	September 11, 2020
<u>/s/ BRUCE EDWARDS</u> Bruce Edwards	Director	September 11, 2020
<u>/s/ MARGARET EVASHENK</u> Margaret Evashenk	Director	September 11, 2020
<u>/s/ PAUL FOLINO</u> Paul Folino	Director	September 11, 2020
<u>/s/ HOSHI PRINTER</u> Hoshi Printer	Director	September 11, 2020

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors
Lantronix, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Lantronix, Inc. and its subsidiaries (the Company) as of June 30, 2020 and 2019, the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of June 30, 2020 and 2019, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Change in Accounting Principle

As discussed in Note 4 to the financial statements, the Company has changed its method of accounting for leases due to the adoption of Accounting Standards Update No. 2016-02 or Topic 842. The Company adopted the new lease standard using the modified retrospective approach.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Squar Milner LLP

We have served as the Company's auditor since 2011.

Irvine, California
September 11, 2020

LANTRONIX, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and par value data)

	June 30, 2020	June 30, 2019
Assets		
Current Assets:		
Cash and cash equivalents	\$ 7,691	\$ 18,282
Accounts receivable (net of allowance for doubtful accounts of \$460 and \$36 at June 30, 2020 and 2019, respectively)	11,411	7,388
Inventories, net	13,781	10,509
Contract manufacturers' receivable	337	1,324
Prepaid expenses and other current assets	1,290	687
Total current assets	34,510	38,190
Property and equipment, net	1,587	1,199
Goodwill	15,810	9,488
Purchased intangible assets, net	12,449	-
Other assets	3,577	67
Total assets	\$ 67,933	\$ 48,944
Liabilities and stockholders' equity		
Current Liabilities:		
Accounts payable	\$ 5,331	\$ 4,716
Accrued payroll and related expenses	2,658	2,060
Short-term debt, net	1,472	-
Other current liabilities	6,308	4,696
Total current liabilities	15,769	11,472
Long-term debt, net	3,682	-
Other non-current liabilities	1,962	206
Total liabilities	21,413	11,678
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Preferred stock, \$0.0001 par value; 5,000,000 shares authorized; none issued and outstanding	-	-
Common stock, \$0.0001 par value; 100,000,000 shares authorized; 28,231,054 and 22,811,743 shares issued and outstanding at June 30, 2020 and 2019, respectively	3	2
Additional paid-in capital	246,265	226,274
Accumulated deficit	(200,119)	(189,381)
Accumulated other comprehensive income	371	371
Total stockholders' equity	46,520	37,266
Total liabilities and stockholders' equity	\$ 67,933	\$ 48,944

See accompanying notes.

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

	Years Ended June 30,	
	2020	2019
Net revenue	\$ 59,878	\$ 46,890
Cost of revenue	32,978	20,617
Gross profit	<u>26,900</u>	<u>26,273</u>
Operating expenses:		
Selling, general and administrative	19,582	15,851
Research and development	9,691	9,079
Restructuring, severance and related charges	3,844	1,146
Acquisition-related costs	2,284	410
Impairment of long-lived asset	–	275
Amortization of purchased intangible assets	2,037	–
Total operating expenses	<u>37,438</u>	<u>26,761</u>
Loss from operations	(10,538)	(488)
Interest income (expense), net	(133)	236
Other income (expense), net	77	(15)
Loss before income taxes	(10,594)	(267)
Provision for income taxes	144	141
Net loss and comprehensive loss	<u>\$ (10,738)</u>	<u>\$ (408)</u>
Net loss per share - basic and diluted	<u>\$ (0.42)</u>	<u>\$ (0.02)</u>
Weighted-average common shares - basic and diluted	<u>25,281</u>	<u>21,580</u>

See accompanying notes.

LANTRONIX, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Shares	Amount				
Balance at June 30, 2018	18,908	\$ 2	\$ 212,995	\$ (189,555)	\$ 371	\$ 23,813
Cumulative effect of accounting change (Note 2)	—	—	—	582	—	582
Shares issued pursuant to equity offering, net	2,700	—	9,774	—	—	9,774
Shares issued pursuant to stock awards, net	1,204	—	1,823	—	—	1,823
Tax withholding paid on behalf of employees for restricted shares	—	—	(189)	—	—	(189)
Share-based compensation	—	—	1,871	—	—	1,871
Net loss	—	—	—	(408)	—	(408)
Balance at June 30, 2019	22,812	2	226,274	(189,381)	371	37,266
Shares issued pursuant to stock awards, net	1,140	—	1,158	—	—	1,158
Tax withholding paid on behalf of employees for restricted shares	—	—	(379)	—	—	(379)
Share-based compensation	—	—	3,639	—	—	3,639
Issuance of shares related to acquisition	4,279	1	15,573	—	—	15,574
Net loss	—	—	—	(10,738)	—	(10,738)
Balance at June 30, 2020	28,231	\$ 3	\$ 246,265	\$ (200,119)	\$ 371	\$ 46,520

See accompanying notes.

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

	Years Ended June 30,	
	2020	2019
Operating activities		
Net loss	\$ (10,738)	\$ (408)
Adjustments to reconcile net loss to net cash used in operating activities:		
Share-based compensation	3,639	1,871
Amortization of purchased intangible assets	2,037	–
Depreciation and amortization	768	464
Amortization of manufacturing profit in acquired inventory associated with acquisitions	255	–
Impairment of long-lived asset	–	275
Loss on disposal of property and equipment	16	10
Amortization of deferred debt issuance costs	18	–
Changes in operating assets and liabilities:		
Accounts receivable	2,809	(1,967)
Inventories	3,365	(2,532)
Contract manufacturers' receivable	987	(675)
Prepaid expenses and other current assets	366	(224)
Other assets	1,065	(18)
Accounts payable	(2,599)	765
Accrued payroll and related expenses	349	(748)
Other liabilities	(4,858)	1,439
Net cash used in operating activities	<u>(2,521)</u>	<u>(1,748)</u>
Investing activities		
Purchases of property and equipment	(572)	(891)
Cash payment for acquisitions, net of cash and cash equivalents acquired	(13,402)	–
Net cash used in investing activities	<u>(13,974)</u>	<u>(891)</u>
Financing activities		
Net proceeds from issuances of common stock	1,158	11,597
Tax withholding paid on behalf of employees for restricted shares	(379)	(189)
Net proceeds from issuance of debt	5,886	–
Payment of borrowings on term loan	(750)	–
Payment of lease liabilities	(11)	(55)
Net cash provided by financing activities	<u>5,904</u>	<u>11,353</u>
Increase (decrease) in cash and cash equivalents	(10,591)	8,714
Cash and cash equivalents at beginning of year	18,282	9,568
Cash and cash equivalents at end of year	<u>\$ 7,691</u>	<u>\$ 18,282</u>
Supplemental disclosure of cash flow information		
Interest paid	<u>\$ 218</u>	<u>\$ 18</u>
Income taxes paid	<u>\$ 101</u>	<u>\$ 115</u>

See accompanying notes.

LANTRONIX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2020

1. Summary of Significant Accounting Policies

The Company

Lantronix, Inc., which we refer to herein as the Company, Lantronix, we, our, or us, is a global provider of software as a service (“SaaS”), engineering services, and hardware for Edge Computing, the Internet of Things (“IoT”), and Remote Environment Management (“REM”). Lantronix enables its customers to provide reliable and secure solutions while accelerating their time to market. Lantronix’s products and services dramatically simplify operations through the creation, development, deployment, and management of customer projects at scale while providing quality, reliability and security.

We were incorporated in California in 1989 and re-incorporated in Delaware in 2000.

Basis of Presentation

The consolidated financial statements include the accounts of Lantronix and our wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. At June 30, 2020, approximately \$6,426,000 of our tangible assets were located outside of the United States (“U.S.”), a large portion of which was comprised of inventory held at (i) our warehouse in Canada, (ii) our third-party logistics provider in Hong Kong and (iii) our contract manufacturers in China, Malaysia and Thailand.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (“U.S. GAAP”) requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The industry in which we operate is characterized by rapid technological change. As a result, estimates made in preparing the consolidated financial statements include the allowance for doubtful accounts, revenue recognition, business combinations, inventory valuation, goodwill valuation, deferred income tax asset valuation allowances, share-based compensation, restructuring charges and warranty reserves. To the extent there are material differences between our estimates and actual results, future results of operations will be affected.

Impact of COVID-19

The spread of the COVID-19 virus has caused an economic downturn on a global scale, as well as significant volatility in the financial markets. In March 2020, the World Health Organization declared the spread of the COVID-19 virus a pandemic. Government reactions to the public health crisis with mitigation measures have created significant uncertainties in the U.S. and global economies. The extent to which the COVID-19 pandemic impacts our business, operations and financial results will depend on numerous evolving factors that we may not be able to accurately predict and which may cause the actual results to differ from the estimates and assumptions we are required to make in the preparation of financial statements according to U.S. GAAP.

In order to protect our employee population and comply with local directives, most of our employees transitioned to remote working arrangements commencing in March 2020, which are still continuing through the date hereof. To facilitate the increased data traffic associated with remote access, we have upgraded some of our information technology systems. We have also made changes relating to videoconferencing by providing most of our employees with a new videoconferencing and collaboration platform to accommodate better remote collaboration and communication. To date, remote working has not had a significant adverse impact on our financial results or our operations, including, financial reporting and disclosure controls and procedures.

Reclassifications

Certain reclassifications have been made to the prior fiscal year financial information to conform to the current fiscal year presentation.

Revenue Recognition

Refer to *Note 2* below for a discussion of our significant accounting policy over revenue recognition.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are stated at the amount we expect to collect, which is net of an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. Our evaluation of the collectability of customer accounts receivable is based on various factors, including the length of time the receivables are past due, our history of bad debts and general industry conditions. Accounts that are deemed uncollectible are written off against the allowance for doubtful accounts.

Concentration of Credit Risk

Our accounts receivable are primarily derived from revenue earned from customers located throughout North America, Europe and Asia. We perform periodic credit evaluations of our customers' financial condition and maintain allowances for potential credit losses. Credit losses have historically been within our expectations. We generally do not require collateral or other security from our customers.

Fair Value of Financial Instruments

Our financial instruments consist primarily of cash and cash equivalents, accounts receivable, contract manufacturers' receivable, accounts payable, and accrued liabilities. The fair value of a financial instrument is the amount that would be received in an asset sale or paid to transfer a liability in an orderly transaction between unaffiliated market participants. Assets and liabilities measured at fair value are categorized based on whether or not the inputs are observable in the market and the degree to which the inputs are observable. The categorization of financial instruments within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The hierarchy is prioritized into three levels (with Level 3 being the lowest) defined as follows:

Level 1: Inputs are based on quoted market prices for identical assets and liabilities in active markets at the measurement date.

Level 2: Inputs include quoted prices for similar assets or liabilities in active markets and/or quoted prices for identical or similar assets or liabilities in markets that are not active near the measurement date.

Level 3: Inputs include management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. The inputs are unobservable in the market and significant to the instrument's valuation.

The hierarchy noted above requires us to minimize the use of unobservable inputs and to use observable market data, if available, when determining fair value. We do not have any assets or liabilities that were measured at fair value on a recurring basis, and during the fiscal years ended June 30, 2020 and 2019 we did not have any assets or liabilities that were measured at fair value on a non-recurring basis.

We believe all of our financial instruments' recorded values approximate their current fair values because of the nature and short duration of these instruments.

Foreign Currency Remeasurement

The functional currency for all our foreign subsidiaries is currently the U.S. dollar. Non-monetary and monetary foreign currency assets and liabilities are valued in U.S. dollars at historical and end-of-period exchange rates, respectively. Exchange gains and losses from foreign currency transactions and remeasurements are recognized in the consolidated statements of operations. Translation adjustments for foreign subsidiaries whose functional currencies were previously their respective local currencies are suspended in accumulated other comprehensive income.

Accumulated Other Comprehensive Income

Accumulated other comprehensive income is composed of accumulated translation adjustments as of June 30, 2020 and 2019. We did not have any other comprehensive income or losses during the fiscal years ended June 30, 2020 or 2019.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and short-term investments, with original maturities of 90 days or less.

Inventories

Inventories are stated at the lower of cost (on a first-in, first-out basis) or net realizable value. We provide reserves for excess and obsolete inventories determined primarily based upon estimates of future demand for our products. Shipping and handling costs are classified as a component of cost of revenue in the consolidated statements of operations.

Inventory Sale and Purchase Transactions with Contract Manufacturers

Under certain circumstances, we sell raw materials to our contract manufacturers and subsequently repurchase finished goods from the contract manufacturers which contain such raw materials. Net sales of raw materials to the contract manufacturers are recorded on the consolidated balance sheets as contract manufacturers' receivables and are eliminated from net revenue as we intend to repurchase the raw materials from the contract manufacturers in the form of finished goods.

We have contractual arrangements with certain of our contract manufacturers that require us to purchase unused inventory that the contract manufacturer has purchased to fulfill our forecasted manufacturing demand. To the extent that inventory on-hand at one or more of these contract manufacturers exceeds our contractually reported forecasts, we record the amount we may be required to purchase as part of other current liabilities and inventories on the consolidated balance sheets.

Property and Equipment

Property and equipment are carried at cost. Depreciation is provided using the straight-line method over the assets' estimated useful lives, generally ranging from three to five years. Depreciation and amortization of leasehold improvements are computed using the shorter of the remaining lease term or five years. Major renewals and betterments are capitalized, while replacements, maintenance and repairs, which do not improve or extend the estimated useful lives of the respective assets, are expensed as incurred.

Business Combinations

We allocate the fair value of the purchase consideration of a business acquisitions to the tangible assets, liabilities, and intangible assets acquired, including in-process research and development ("IPR&D"), based on their estimated fair values. The excess of the fair value of purchase consideration over the fair values of these identifiable assets and liabilities is recorded as goodwill. IPR&D is initially capitalized at fair value as an intangible asset with an indefinite life and assessed for impairment thereafter. When an IPR&D project is completed, the IPR&D is reclassified as an amortizable purchased intangible asset and amortized over the asset's estimated useful life. Acquisition-related expenses and related restructuring costs are recognized separately from the business combination and are expensed as incurred.

Goodwill

Goodwill is recorded as the difference, if any, between the aggregate consideration paid for an acquisition and the fair value of the acquired net tangible and intangible assets acquired. We evaluate goodwill for impairment on an annual basis in our fiscal fourth quarter or more frequently if we believe indicators of impairment exist that would more likely than not reduce the fair value of our single reporting unit below its carrying amount. We begin by assessing qualitative factors to determine whether it is more likely than not that the fair value of our single reporting unit is less than its carrying value. Based on that qualitative assessment, if we conclude that it is more likely than not that the fair value of our single reporting unit is less than its carrying value, we conduct a quantitative goodwill impairment test, which involves comparing the estimated fair value of our single reporting unit with its carrying value, including goodwill. We estimate the fair value of our single reporting unit using a combination of the income and market approach. If the carrying value of the reporting unit exceeds its estimated fair value, we recognize an impairment loss for the difference.

During the fourth quarter of the fiscal year ended June 30, 2020, we performed a qualitative assessment of whether goodwill impairment existed and did not determine that it was more likely that not that the fair value of our single reporting unit was less than its carrying amount.

Purchased Intangible Assets

Included within "purchased intangible assets, net" at June 30, 2020 are customer lists, developed technology, tradenames, and other intangible assets acquired in connection with various business combinations. Such capitalized costs and intangible assets are being amortized over a period of one to five years.

Long-Lived Assets and Intangible Assets

We assess the impairment of long-lived assets and intangible assets whenever events or changes in circumstances indicate that the carrying amount of long-lived assets may not be recoverable. We estimated the future cash flows, undiscounted and without interest

charges, expected to be generated by the assets from its use or eventual disposition. If the sum of the expected undiscounted future cash flows is less than the carrying amount of those assets, we recognize an impairment loss based on the excess of the carrying amount over the fair value of the assets.

Income Taxes

Income taxes are computed under the liability method. This method requires the recognition of deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities. The impact on deferred taxes of changes in tax rates and laws, if any, are applied to the years during which temporary differences are expected to be settled and are reflected in the consolidated financial statements in the period of enactment. A valuation allowance is recorded when it is more likely than not that some of the deferred tax assets will not be realized.

Financial statement effects of a tax position are initially recognized when it is more likely than not, based on the technical merits, that the position will be sustained upon examination by a taxing authority. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that meets the more-likely-than-not threshold of being realized upon ultimate settlement with a taxing authority. We recognize potential accrued interest and penalties related to unrecognized tax benefits as income tax expense.

Share-Based Compensation

We account for share-based compensation by expensing the estimated grant date fair value of our share-based awards ratably over the requisite service period. We recognize the impact of forfeitures on our share-based compensation expense as such forfeitures occur.

Net Income (Loss) Per Share

Basic net income (loss) per share is calculated by dividing net income (loss) by the weighted-average number of common shares outstanding during the fiscal year. Diluted net income (loss) per share is calculated by adjusting the weighted-average number of common shares outstanding, assuming any dilutive effects of outstanding share-based awards using the treasury stock method.

Research and Development Costs

Costs incurred in the research and development of new products and enhancements to existing products are expensed as incurred. Development costs of computer software to be sold, leased or otherwise marketed are subject to capitalization beginning when a product's technological feasibility has been established and ending when a product is available for general release to customers. In most instances, we believe our current process for developing products is essentially completed concurrently with the establishment of technological feasibility and thus, software development costs have been expensed as incurred.

Warranty

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

Restructuring Charges

We recognize costs and related liabilities for restructuring activities when they are incurred. Our restructuring charges are primarily comprised of employee separation costs, asset impairments and contract exit costs. Employee separation costs include one-time termination benefits that are recognized as a liability at estimated fair value, at the time of communication to employees, unless future service is required, in which case the costs are recognized ratably over the future service period. Ongoing termination benefits are recognized as a liability at estimated fair value when the amount of such benefits are probable and reasonably estimable. Contract exit costs include contract termination fees and right-of-use asset impairments recognized on the date that we have vacated the premises or ceased use of the leased facilities. A liability for contract termination fees is recognized in the period in which we terminate the contract.

Advertising Expenses

Advertising expenses are recorded in the period incurred and totaled \$185,000 and \$118,000 for the fiscal years ended June 30, 2020 and 2019, respectively.

Segment Information

We have one operating and reportable business segment.

Recent Accounting Pronouncements

Shared-Based Compensation

On July 1, 2019, Lantronix adopted Accounting Standard Update (“ASU”) No. 2018-07 that expands the scope of existing share-based compensation guidance for employees. The standard includes share-based payment transactions for acquiring goods and services from nonemployees, whereby share-based payments to nonemployees will be measured and recorded at the fair value of the equity instruments that an entity is obligated to issue on the grant date. The adoption of the standard did not have a material impact on our financial statements.

Leases

In February 2016, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2016-02 (“ASU 2016-02” or “Topic 842”) that revises lease accounting guidance. Most prominent among the changes in the standard is the recognition of right-of-use (“ROU”) assets and lease liabilities based on the present value of lease payments over the lease term by lessees for those leases classified as operating leases under the existing guidance.

We adopted Topic 842 on July 1, 2019 using the modified retrospective approach by applying the new standard to leases existing at the date of adoption and not restating comparative prior periods. The adoption did not have a material impact on our results of operations or cash flows. Refer to *Note 4* below for additional information.

Current Expected Credit Losses

In June 2016, the FASB issued a new standard requiring financial assets measured at amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The standard eliminates the threshold for initial recognition in current GAAP and reflects an entity’s current estimate of all expected credit losses. The measurement of expected credit losses is based on historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the financial assets. The standard is effective beginning in the first quarter of our fiscal year 2024. The adoption of this guidance is not expected to have a material effect on our consolidated financial statements.

2. Business Combinations

Acquisition of Maestro

On July 5, 2019 (the "Acquisition Date"), Lantronix acquired all outstanding shares of Maestro Wireless Solutions Limited, a Hong Kong private company limited by shares (“MWS”), Fargo Telecom Asia Limited, a Hong Kong private company limited by shares (“FTA” and together with MWS and their respective subsidiaries, the “Acquired Companies” or “Maestro”) for \$5,355,000 in cash. The acquisition provides complementary cellular connectivity technologies to our portfolio of IoT solutions.

We recorded Maestro’s tangible and intangible assets and liabilities based on their estimated fair values as of the Acquisition Date and allocated the remaining purchase consideration to goodwill. Our valuation assumptions of acquired assets and assumed liabilities require significant estimates, especially with respect to intangible assets. During fiscal 2020 we adjusted the preliminary purchase price allocation to increase accounts receivable and inventories by \$18,000 and \$32,000, respectively, and to reduce certain amounts allocated to other assets, accounts payable, and other liabilities totaling \$195,000, which resulted in a net offsetting decrease to goodwill of \$93,000.

The purchase price allocation is as follows (in thousands):

Cash and cash equivalents	\$	282
Accounts receivable		1,338
Inventories, net		1,643
Other assets		529
Purchased intangible assets		1,910
Goodwill		2,876
Accounts payable		(1,545)
Other liabilities		(1,678)
Total consideration	\$	<u>5,355</u>

The factors that contributed to a purchase price resulting in the recognition of goodwill include our belief that the acquisition will create a more diverse IoT company with respect to product offerings and our belief that we are committed to improving cost structures in accordance with our operational and restructuring plans which should result in a realization of cost savings and an improvement of overall efficiencies.

Depending on the structure of a particular acquisition, goodwill and identifiable intangible assets may not be deductible for tax purposes. We have determined that goodwill and identifiable intangible assets related to this acquisition are deductible.

Acquisition-related costs were expensed in the periods in which the costs were incurred.

The valuation of identifiable intangible assets and their estimated useful lives are as follows:

	<u>Asset Fair Value</u> <u>(In thousands)</u>	<u>Weighted</u> <u>Average Useful</u> <u>Life (years)</u>
Developed technology	\$ 1,530	5.0
Customer relationship	100	2.0
Order backlog	110	1.0
Non-compete agreements	30	2.0
Trade name	140	1.0

The intangible assets are amortized on a straight-line basis over the estimated weighted-average useful lives.

Acquisition of Intrinsic

On January 16, 2020 (the “Closing Date”), we completed the acquisition of Intrinsic Technologies Corporation (“Intrinsic”), a company existing under the laws of British Columbia, Canada. Pursuant to the terms of the agreement, dated October 30, 2019 (the “Agreement”), by and between Lantronix and Intrinsic, all of the outstanding common shares of Intrinsic were acquired by Lantronix. Under the Agreement, we paid \$0.50 in cash and 0.2275 of a share of our common stock for each issued and outstanding common share of Intrinsic. Pursuant to the Agreement, we paid, in the aggregate, approximately \$11,519,000 in cash and issued approximately 4,279,000 shares of Lantronix common stock to Intrinsic shareholders. Following the acquisition, Intrinsic shareholders owned just under 16% of the outstanding shares of Lantronix common stock. Pursuant to the Agreement, Lantronix agreed to exchange certain options to purchase Intrinsic shares and restricted stock units (“RSUs”) for cash payments, Lantronix common stock options or RSUs or a combination thereof, as further outlined in the Agreement.

The acquisition provides us with complementary IoT computing and embedded product development capabilities and expands our IoT market opportunity.

A summary of the purchase consideration for Intrinsic is as follows (in thousands):

Cash consideration to selling shareholders	\$ 11,022
Cash consideration for vested equity awards	497
Share consideration	<u>15,574</u>
Total purchase consideration	<u>\$ 27,093</u>

We recorded Intrinsic’s tangible and intangible assets and liabilities based on their estimated fair values as of the Closing Date and allocated the remaining purchase consideration to goodwill. Our valuation assumptions of acquired assets and assumed liabilities require significant estimates, especially with respect to intangible assets. During fiscal 2020 we adjusted the preliminary purchase price allocation to reduce certain amounts allocated to other assets by \$18,000 and other liabilities by \$21,000, which resulted in a net offsetting decrease to goodwill of \$3,000.

The purchase price allocation is as follows (in thousands):

Cash and cash equivalents	\$ 3,190
Accounts receivable	5,524
Inventories, net	5,281
Other assets	2,606
Purchased intangible assets	12,576
Goodwill	3,446

Accounts payable	(1,552)
Other liabilities	(3,978)
Total consideration	<u>\$ 27,093</u>

The factors that contributed to a purchase price resulting in the recognition of goodwill include our belief that the acquisition will create a more diverse IoT company with respect to product offerings and our belief that we are committed to improving cost structures in accordance with our operational and restructuring plans which should result in a realization of cost savings and an improvement of overall efficiencies.

Depending on the structure of a particular acquisition, goodwill and identifiable intangible assets may not be deductible for tax purposes. We have determined that goodwill and identifiable intangible assets related to this acquisition are deductible.

Acquisition-related costs were expensed in the periods in which the costs were incurred.

The valuation of identifiable intangible assets and their estimated useful lives are as follows:

	<u>Asset Fair Value</u> (In thousands)	<u>Weighted Average Useful Life (years)</u>
Developed technology	\$ 2,311	5.0
Customer relationship	8,930	6.0
Order backlog	730	1.2
Non-compete agreements	370	1.0
Trademarks and trade names	235	1.0

The intangible assets are amortized on a straight-line basis over the estimated weighted-average useful lives.

Valuation Methodology

Completed technology for Maestro and order backlog for both Maestro and Intrinsic were valued by performing a discounted cash flow analysis using the multiperiod excess earnings method. This method includes discounting the projected cash flows associated with each technology over its expected life. Projected cash flows attributable to the completed technology and order backlog were discounted to their present value at a rate commensurate with the perceived risk.

Customer relationships were valued based on the distributor method, which is a variation of the multiperiod excess earnings method, and considers the profit margin a market participant distributor would obtain in selling the related products. The useful lives of customer relationships are estimated based primarily upon customer turnover data.

Non-compete agreements were valued using a with and without method. Under this method, estimated prospective financial information ("PFI") is calculated with the existence and ownership of an intangible asset and compared to the PFI in the absence of the ownership of the intangible asset. The after-tax differential PFI attributable to the intangible asset is then discounted to its present value.

Completed technology for Intrinsic and trademarks and trade names for both Maestro and Intrinsic were valued using the relief-from-royalty method. This method is an income approach that estimates the portion of a company's earnings attributable to an asset based on the royalty rate the company would have paid for the use of the asset if it did not own it. Royalty payments are estimated by applying a royalty rate to the prospective revenue attributable to the intangible asset. The resulting annual royalty payments are tax-affected and then discounted to present value.

Assumptions used in forecasting cash flows for each of the identified intangible assets included consideration of the following:

- Historical performance including sales and profitability.
- Business prospects and industry expectations.
- Estimated economic life of asset.
- Development of new technologies.

- Acquisition of new customers
- Attrition of existing customers.
- Obsolescence of technology over time.

Supplemental Pro Forma Information (Unaudited)

The following supplemental pro forma data summarizes our results of operations for the periods presented, as if we completed the acquisitions of Maestro and Intrinsic as of the first day of fiscal 2019. The supplemental pro forma data reports actual operating results adjusted to include the pro forma effect and timing of the impact in amortization expense of identified intangible assets, restructuring costs, the purchase accounting effect on inventories acquired, and transaction costs. In accordance with the pro forma acquisition date, we recorded in the fiscal 2019 supplemental pro forma data (i) cost of goods sold from manufacturing profit in acquired inventory of \$262,000, (ii) acquisition related restructuring costs of \$2,845,000 and (iii) acquisition-related costs of \$2,284,000, with a corresponding reduction in the fiscal 2020 supplemental pro forma data. Additionally, we recorded \$3,754,000 of amortization expense in the fiscal 2019 supplemental pro forma data, and additional amortization expense of \$414,000 in the fiscal 2020 supplemental pro forma data to represent the amount related to assets that would not have been fully amortized.

Net sales related to products and services from the acquisitions of Maestro and Intrinsic contributed approximately 33% to 38% of net sales for the fiscal year ended June 30, 2020. Post-acquisition net sales and earnings on a standalone basis are generally impracticable to determine, as on the Acquisition Date and Closing Date, we implemented a plan developed prior to the completion of the acquisitions and began to immediately integrate the acquisition into existing operations, engineering groups, sales distribution networks and management structure.

Supplemental pro forma data is as follows:

	Years Ended June 30,	
	2020	2019
	(In thousands, except per share amounts)	
Pro forma net revenue	\$ 73,883	\$ 82,395
Pro forma net loss	(5,643)	(11,115)
Pro forma net loss per share:		
Basic and Diluted	\$ (0.22)	\$ (0.43)

3. Revenue

Revenue is recognized upon the transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We apply the following five-step approach in determining the amount and timing of revenue to be recognized: (i) identifying the contract with a customer, (ii) identifying the performance obligations in the contract, (iii) determining the transaction price, (iv) allocating the transaction price to the performance obligations in the contract and (v) recognizing revenue when the performance obligation is satisfied. On occasion we enter into contracts that can include various combinations of products and services, which are generally capable of being distinct and accounted for as separate performance obligations.

Revenue is recognized net of (i) any taxes collected from customers, which are subsequently remitted to governmental authorities and (ii) shipping and handling costs collected from customers.

Product Shipments

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

A significant portion of our products are sold to distributors under agreements which contain (i) limited rights to return unsold products and (ii) price adjustment provisions, both of which are accounted for as variable consideration when estimating the amount of revenue to recognize. We base our estimates for returns and price adjustments primarily on historical experience; however, we also consider contractual allowances, approved pricing adjustments and other known or anticipated returns and price adjustments in a given period. Such estimates are generally made at the time of shipment to the customer and updated at the end of each reporting period as additional information becomes available and only to the extent that it is probable that a significant reversal of any incremental

revenue will not occur. Our estimates of accrued variable consideration are included in other current liabilities in the accompanying consolidated balance sheets.

Services

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

As a result of our recent acquisition of Intrinsic (see *Note 2*), we now derive an increased portion of our revenues from engineering and related consulting service contracts with customers. These contracts generally include performance obligations in which control is transferred over time because the customer either simultaneously receives and consumes the benefits provided or our performance on the contract creates or enhances an asset that the customer controls. These contracts typically provide services on the following basis:

- Time & Materials (“T&M”) – services consist of revenues from software modification, consulting implementation, training and integration services. These services are set forth separately in the contractual arrangements such that the total price of the customer arrangement is expected to vary depending on the actual time and materials incurred based on the customer’s needs.
- Fixed Price – arrangements to render specific consulting and software modification services which tend to be more complex.

Performance obligations for T&M contracts qualify for the “Right to Invoice” practical expedient within the revenue guidance. Under this practical expedient, we may recognize revenue, over time, in the amount to which we have a right to invoice. In addition, we are not required to estimate variable consideration upon inception of the contract and reassess the estimate each reporting period. We determined that this method best represents the transfer of services as, upon billing, we have a right to consideration from a customer in an amount that directly corresponds with the value to the customer of our performance completed to date.

We recognize revenue on fixed price contracts, over time, using the proportion of our actual costs incurred (generally labor hours expended) to the total costs expected to complete the contract performance obligation. We determined that this method best represents the transfer of services as the proportion closely depicts the efforts or inputs completed towards the satisfaction of a fixed price contract performance obligation.

Multiple Performance Obligations

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

Net Revenue by Product Line and Geographic Region

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

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

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

	Years Ended June 30,	
	2020	2019
	(In thousands)	
IoT	\$ 49,911	\$ 35,299

REM	9,228	10,845
Other	739	746
	<u>\$ 59,878</u>	<u>\$ 46,890</u>

	Years Ended June 30,	
	2020	2019
	(In thousands)	
Americas	\$ 33,279	\$ 25,179
EMEA	15,588	14,586
APJ	11,011	7,125
	<u>\$ 59,878</u>	<u>\$ 46,890</u>

The following table presents product revenues and service revenues as a percentage of our total net revenue:

	Year Ended June 30,	
	2020	2019
Product revenues	96%	99%
Service revenues	4%	1%

Service revenue is comprised primarily of professional services, software license subscriptions, and extended warranties.

Contract Balances

In certain instances, the timing of revenue recognition may differ from the timing of invoicing to our customers. We record a contract asset receivable when revenue is recognized prior to invoicing, and a contract or deferred revenue liability when revenue is recognized subsequent to invoicing. With respect to product shipments, we expect to fulfill contract obligations within one year and so we have elected not to separately disclose the amount nor the timing of recognition of these remaining performance obligations. For contract balances related to contracts that include services and multiple performance obligations, refer to the deferred revenue discussion below.

Deferred Revenue

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

The following table presents the changes in our deferred revenue balance for the year ended June 30, 2020 (in thousands):

Balance, July 1, 2019	\$ 486
New performance obligations	392
Performance obligations assumed from acquisitions	738
Recognition of revenue as a result of satisfying performance obligations	<u>(792)</u>
Balance, June 30, 2020	\$ 824
Less: non-current portion of deferred revenue	<u>(166)</u>
Current portion, June 30, 2020	<u>\$ 658</u>

We expect to recognize substantially all of the non-current portion of deferred revenue over the next 2 to 4 years.

4. Leases

On July 1, 2019, we adopted Topic 842 and elected the available practical expedient to recognize the cumulative effect of initially adopting the standard as an adjustment to the opening balance sheet of the period of adoption (i.e., July 1, 2019). We also elected other available practical expedients and will not separate lease components from non-lease components for office leases, or reassess historical lease classification, whether existing or expired contracts are or contain leases, or the initial direct costs for existing leases as of July 1, 2019. The consolidated balance sheets and results from operations for reporting periods beginning after July 1, 2019 are presented under Topic 842, while prior period amounts are not adjusted and continue to be reported in accordance with the historic accounting under Topic 840.

Adoption of the standard resulted in the recording of net operating and financing lease ROU assets and corresponding operating and financing lease liabilities of \$984,000 and \$1,114,000, respectively, on July 1, 2019. The adoption of the standard did not materially affect the consolidated statements of operations and had no impact on cash flows.

Our leases include office buildings for facilities worldwide and car leases in Germany, which are all classified as operating leases. We also have financing leases related to office equipment in the United States. On October 1, 2019 we entered into a lease agreement for an office in Hyderabad, India, which replaced and expanded our existing office space there. In May 2020 we entered into an extension to our office lease for our corporate headquarters in Irvine, California. The amendment extends the term of the lease by 13 months through January 2022.

We determine if an arrangement is a lease at inception. Certain leases include renewal options that are under the Company's sole discretion. The renewal options were included in the ROU asset and lease liability calculation if it is reasonably assured that we will exercise the option. As our leases generally do not provide an implicit rate, we use our collateralized incremental borrowing rate based on the information available at the lease commencement date, including lease term, in determining the present value of lease payments. Lease expense for these leases is recognized on a straight-line basis over the lease term.

Components of lease expense and supplemental cash flow information:

	Year Ended June 30, 2020
	(In thousands)
Components of lease expense	
Operating lease cost	\$ 1,579
Financing lease cost	\$ 14
Supplemental cash flow information	
Cash paid for amounts included in the measurement of operating lease liabilities	\$ 1,131
Cash paid for amounts included in the measurement of financing lease liabilities	\$ 11
Right-of-use assets obtained in exchange for lease obligation	\$ 1,857

The weighted-average remaining lease term is 1.3 years. The weighted-average discount rate is 6.14 percent.

Maturities of lease liabilities as of June 30, 2020 were as follows:

Years ending June 30,	Operating	Financing
	(In thousands)	
2021	\$ 1,472	\$ 9
2022	1,106	9
2023	376	9
2024	274	3
2025	72	—
Total remaining lease payments	<u>3,300</u>	<u>30</u>
less: imputed interest	(261)	—
Lease liability	<u>\$ 3,039</u>	<u>\$ 30</u>
Reported as:		
Current liabilities	\$ 1,264	\$ 9
Non-current liabilities	\$ 1,775	\$ 21

The lease liabilities and ROU assets as of June 30, 2020 include leases assumed in the acquisitions of Maestro and Intrinsyc if the remaining lease term at the acquisition date was determined to exceed one year. Refer to *Note 2* above for further information on the acquisitions. As of June 30, 2020, the ROU assets totaled \$3,345,000 and were recorded in other assets in the consolidated balance sheet.

5. Supplemental Financial Information

Inventories

The following table presents details of our inventories:

	June 30,	
	2020	2019
	(In thousands)	
Finished goods	\$ 7,522	\$ 6,084
Raw materials	6,259	4,425
Inventories, net	<u>\$ 13,781</u>	<u>\$ 10,509</u>

Property and Equipment

The following table presents details of property and equipment:

	June 30,	
	2020	2019
	(In thousands)	
Computer, software and office equipment	\$ 3,992	\$ 3,839
Furniture and fixtures	511	450
Production, development and warehouse equipment	4,777	4,229
Construction-in-progress	—	201
Property and equipment, gross	<u>9,280</u>	<u>8,719</u>
Less accumulated depreciation	<u>(7,693)</u>	<u>(7,520)</u>
Property and equipment, net	<u>\$ 1,587</u>	<u>\$ 1,199</u>

Impairment of Long-Lived Asset

During the fourth quarter of the fiscal year ended June 30, 2019, we determined that the carrying value of a software platform license we had previously purchased from a third party was impaired. This asset had been recorded as part of the “Computer, software and office equipment” category in the table above. We purchased this platform and contemplated utilizing it in connection with the development of certain of our software offerings. Based on strategic changes in our product roadmap plan, along with key changes in our executive management team that occurred during the fiscal year ended June 30, 2019, we concluded that that we would not achieve future cash flows related to this asset. Accordingly, we recorded a charge of \$275,000 in the accompanying consolidated statement of operations for the year ended June 30, 2019 to write off the asset’s carrying value.

Purchased Intangible Assets

The following table presents details of purchased intangible assets:

	June 30, 2020			June 30, 2019		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
	(In thousands)					
Developed technology	\$ 3,841	\$ (497)	\$ 3,344	\$ —	\$ —	\$ —
Customer relationship	9,030	(726)	8,304	—	—	—
Order backlog	840	(384)	456	—	—	—
Non-compete agreements	400	(184)	216	—	—	—
Trademark and trade name	375	(246)	129	—	—	—
	<u>\$ 14,486</u>	<u>\$ (2,037)</u>	<u>\$ 12,449</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

We do not currently have any purchased intangible assets with indefinite useful lives.

As of June 30, 2020, future estimated amortization expense is as follows:

Years Ending June 30,	
(In thousands)	
2021	\$ 3,094
2022	2,240
2023	2,240
2024	2,240
2025	1,784
Thereafter	851
	<u>\$ 12,449</u>

Goodwill

The following table presents details of our goodwill balance:

	Year Ended June 30, 2020
	(In thousands)
Balance at June 30, 2019	\$ 9,488
Acquisition of Maestro	2,876
Acquisition of Intrinsic	3,446
Balance at June 30, 2020	<u>\$ 15,810</u>

Warranty Reserve

The following table presents details of our warranty reserve:

	Years Ended June 30,	
	2020	2019
	(In thousands)	
Beginning balance	\$ 116	\$ 99
Warranty reserve assumed from acquisition of Intrinsic	118	—
Charged to cost of revenues	181	96
Usage	(234)	(79)
Ending balance	<u>\$ 181</u>	<u>\$ 116</u>

Other Liabilities

The following table presents details of our other liabilities:

	June 30,	
	2020	2019
	(In thousands)	
Current		
Accrued variable consideration	\$ 1,462	\$ 1,313
Customer deposits and refunds	628	168
Accrued raw materials purchases	272	1,155
Deferred revenue	658	328
Lease liability	1,273	4
Taxes payable	395	322
Warranty reserve	181	116
Accrued operating expenses	1,439	1,290
Total other current liabilities	<u>\$ 6,308</u>	<u>\$ 4,696</u>
Non-current		
Lease liability	\$ 1,796	\$ 48
Deferred revenue	166	158

Total other non-current liabilities	\$ <u>1,962</u>	\$ <u>206</u>
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Computation of Net Loss per Share

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

	<u>Years Ended June 30,</u>	
	<u>2020</u>	<u>2019</u>
	<u>(In thousands, except per share data)</u>	
Numerator:		
Net loss	\$ <u>(10,738)</u>	\$ <u>(408)</u>
Denominator:		
Weighted-average shares outstanding - basic and diluted	25,281	21,580
Net loss per share - basic and diluted	\$ <u>(0.42)</u>	\$ <u>(0.02)</u>

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

	<u>Years Ended June 30,</u>	
	<u>2020</u>	<u>2019</u>
	<u>(In thousands)</u>	
Common stock equivalents	<u>1,675</u>	<u>1,513</u>

Severance and Related Charges

Current Fiscal Year

During the year ended June 30, 2020, we continued a plan to realign certain personnel resources to better fit our current business needs, which includes identifying cost savings and synergies to be gained from the acquisitions of Maestro and Intrinsic. Additionally, the current year charges include costs incurred pursuant to change-in-control agreements for certain employees of Intrinsic.

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

	<u>Year Ended June 30, 2020</u>
	<u>(In thousands)</u>
Beginning balance	\$ 651
Charges	3,844
Payments	<u>(3,880)</u>
Ending balance	<u>\$ 615</u>

The ending balance is recorded in accrued payroll and related expenses on the accompanying consolidated balance sheet at June 30, 2020.

Prior Fiscal Year

During the prior fiscal year ended June 30, 2019, we executed several plans to realign certain personnel resources to better meet our business needs. These activities resulted in total charges of approximately \$1,417,000, which included \$1,146,000 in severance-related costs and \$271,000 in share-based compensation expense. The share-based compensation expenses are included in the applicable functional line items within the accompanying consolidated statement of operation for the year ended June 30, 2019.

Supplemental Cash Flow Information

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

	Years Ended June 30,	
	2020	2019
	(In thousands)	
Share consideration for acquisition of Intrinsic	\$ 15,574	\$ —
Accrued property and equipment paid for in the subsequent period	\$ 149	\$ 9
Accrued stock option exercise proceeds	\$ —	\$ 1

6. Bank Loan Agreements

On November 12, 2019, we entered into a Second Amended and Restated Loan and Security Agreement (“Amended Agreement”) with Silicon Valley Bank (“SVB”), which amended, restated and superseded our previous agreement with SVB in its entirety.

Pursuant to the Amended Agreement, SVB made available to us a senior secured revolving line of credit of up to \$6,000,000 (“Revolving Facility”) and a senior secured term loan of \$6,000,000 (“Term Loan Facility”). Advances under the Revolving Facility may be borrowed from time to time prior to November 12, 2021, subject to the satisfaction of certain conditions, and may be used to fund our working capital and general business requirements. The \$6,000,000 proceeds of the Term Loan Facility were drawn in full in November 2019 and were used to fund our acquisition of Intrinsic, which occurred in January 2020 (refer to *Note 2* above). The Revolving Facility matures on November 12, 2021. There were no borrowings on the Revolving Facility at June 30, 2020. The Term Loan Facility is repayable over a 48 month period commencing January 1, 2020.

The interest rate on the Revolving Facility floats at a rate per annum equal to the greater of the prime rate and 5.00 percent. The interest rate on the Term Loan Facility floats at a rate per annum equal to the greater of 1.00 percent above the prime rate and 6.00 percent. We may elect to repay and reborrow the amounts outstanding under the Revolving Facility at any time prior to the maturity date of the Revolving Facility without premium or penalty. We may elect to repay the Term Loan Facility at any time without premium or penalty in minimum amounts equal to at least \$1,000,000. A commitment fee in the amount of \$60,000 was paid to SVB on the closing date and a \$10,000 anniversary fee is payable to SVB on the earliest to occur of the one year anniversary of the effective date, the termination of the Amended Agreement or the Revolving Facility, or the occurrence of an event of default.

The following table summarizes our outstanding debt:

	June 30,	
	2020	2019
	(In thousands)	
Outstanding borrowings on Term Loan Facility	\$ 5,250	\$ —
Less: Unamortized debt issuance costs	(96)	—
Net Carrying amount of debt	5,154	—
Less: Current portion	(1,472)	—
Non-current portion	\$ 3,682	\$ —

During the year ended June 30, 2020 we recognized \$239,000 of interest expense in our consolidated statements of operations related to interest and amortization of debt issuance associated with the outstanding Term Loan Facility.

As of June 30, 2020, the aggregate future contractual maturities of the Company's outstanding debt, at face value, were as follows:

Years Ending June 30,	
(In thousands)	
2021	\$ 1,500
2022	1,500
2023	1,500
2024	750
	<u>\$ 5,250</u>

The Amended Agreement includes a financial covenant that requires that we maintain a minimum cash balance of \$3,000,000 at SVB, as measured at the end of each month. The Amended Agreement also requires that we do not exceed a maximum leverage ratio,

calculated as the ratio of funded debt to the consolidated trailing 12 month earnings before interest, taxes, depreciation and amortization, and certain other allowable exclusions of (i) 3.0 to 1.0 for each calendar quarter ending December 31, 2019 through and including December 31, 2020, (ii) 2.5 to 1.0 for each calendar quarter ending March 31, 2021 through and including December 31, 2021, and (iii) 2.0 to 1.0 for each calendar quarter ending after January 1, 2022. We are currently in compliance with all covenants.

The following table presents certain information with respect to the line of credit:

	June 30,	
	2020	2019
	(In thousands)	
Outstanding borrowings on the line of credit	\$ —	\$ —
Available borrowing capacity on the line of credit	\$ 5,602	\$ 3,842
Outstanding letters of credit	\$ 51	\$ 51

Our outstanding letters of credit at June 30, 2020 and 2019 were used as security deposits.

7. Stockholders' Equity

Stock Incentive Plans

We have stock incentive plans in effect under which non-qualified and incentive stock options to purchase shares of Lantronix common stock ("stock options") have been granted to employees, non-employees and board members. In addition, we have previously granted restricted common stock awards ("non-vested shares") to employees and board members under these plans. Our current stock incentive program is governed by our Amended and Restated 2010 Stock Incentive Plan (as amended, the "2010 SIP"). Shares reserved for issuance under the 2010 SIP include rollover shares, which are any shares subject to equity compensation awards granted under our previous stock plan that expire or otherwise terminate without having been exercised in full or that are forfeited or repurchased by us by virtue of their failure to vest. A maximum of 2,100,000 of such shares are eligible for rollover. The 2010 SIP authorizes awards of stock options (both non-qualified and incentive), stock appreciation rights, non-vested shares, RSUs and performance shares. New shares are issued to satisfy stock option exercises and share issuances. At June 30, 2020, approximately 1,200,000 shares remain available for issuance under the 2010 SIP. We have also granted stock options and RSUs under individual inducement award agreements.

The Compensation Committee of our board of directors determines eligibility, vesting schedules and exercise prices for stock options and shares granted under the plans. Stock options are generally granted with an exercise price equal to the market price of our common stock on the grant date. Stock options generally have a contractual term of seven to ten years. Share-based awards generally vest and become exercisable over a one to four-year service period. As of June 30, 2020, no stock appreciation rights or non-vested stock was outstanding. No income tax benefit was realized from activity in the share-based plans during the fiscal years ended June 30, 2020 and 2019.

Stock Option Awards

The fair value of each stock option grant is estimated on the grant date using the Black-Scholes-Merton option-pricing formula. Expected volatilities are based on the historical volatility of our stock price. The expected term of stock options granted is estimated using the simplified method, as permitted by guidance issued by the Securities and Exchange Commission. We use the simplified method because we believe we are unable to rely on our limited historical exercise data or alternative information as a reasonable basis upon which to estimate the expected term of such options. The risk-free interest rate assumption is based on the U.S. Treasury interest rates appropriate for the expected term of our stock options.

The following weighted-average assumptions were used to estimate the fair value of all of our stock option grants:

	Years Ended June 30,	
	2020	2019
Expected term (in years)	4.3	4.8
Expected volatility	65%	67%
Risk-free interest rate	1.56%	2.23%
Dividend yield	0.00%	0.00%

The following table presents a summary of activity for all of our stock options:

	Number of Shares (In thousands)	Weighted-Average		Aggregate Intrinsic Value (In thousands)
		Exercise Price Per Share	Remaining Contractual Term (In years)	
Balance of options outstanding at June 30, 2019	3,147	\$ 2.29		
Options granted	249	3.34		
Options forfeited	(181)	2.35		
Options expired	(84)	2.18		
Options exercised	(1,076)	1.71		
Balance of options outstanding at June 30, 2020	<u>2,055</u>	<u>\$ 2.72</u>	<u>4.3</u>	<u>\$ 2,209</u>
Options exercisable at June 30, 2020	<u>1,339</u>	<u>\$ 2.35</u>	<u>3.7</u>	<u>\$ 1,908</u>

The following table presents a summary of grant date fair value and intrinsic value information for all of our stock options:

	Years Ended June 30,	
	2020	2019
	(In thousands, except per share data)	
Weighted-average grant date fair value per share	\$ 1.90	\$ 2.15
Intrinsic value of options exercised	\$ 1,850	\$ 2,400

Employee Stock Purchase Plan

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

The ESPP currently operates with six month offering periods commencing on the first trading day on or after May 16 and November 16 of each year (an “Offering Period”). Common stock may be purchased under the ESPP at the end of each six-month Offering Period unless the participant withdraws or terminates employment earlier. Shares of the Company’s common stock may be purchased under the ESPP at a price not less than 85% of the lesser of the fair market value of our common stock on the first or last trading day of each Offering Period.

For purposes of measuring share-based compensation expense and calculating net income (loss) per share, we account for common stock purchase rights granted under the ESPP in the same manner as our other share-based awards.

The per share fair value of stock purchase rights granted under the ESPP was estimated using the following weighted-average assumptions:

	Years Ended June 30,	
	2020	2019
Expected term (in years)	0.5	0.5
Expected volatility	61%	79%
Risk-free interest rate	1.00%	2.45%
Dividend yield	0.00%	0.00%

The following table presents a summary of activity under our ESPP during the fiscal year ended June 30, 2020:

	Year Ended June 30, 2020
	(In thousands, except per share data)
Shares available for issuance at June 30, 2019	517
Shares issued	(113)
Shares available for issuance at June 30, 2020	404
Weighted-average purchase price per share	\$ 2.75
Intrinsic value of ESPP shares on purchase date	\$ 57

Restricted Stock Units

The fair value of our RSUs is based on the closing market price of our common stock on the grant date.

The following table presents a summary of activity with respect to our RSUs during the fiscal year ended June 30, 2020:

	Number of Shares	Weighted- Average Grant Date Fair Value per Share
	(In thousands)	
Balance of RSUs outstanding at June 30, 2019	866	\$ 4.24
Granted	517	3.36
Forfeited	(111)	3.67
Vested	(345)	3.94
Balance of RSUs outstanding at June 30, 2020	927	\$ 3.93

Performance Stock Units

In October 2019, we granted 975,000 RSUs with performance-based vesting requirements (“performance stock units” or “PSUs”) to certain executive employees. In February 2020, we granted an additional 70,000 PSUs with performance-based vesting requirements and vesting schedule identical to those granted in October 2019. One third of the PSUs will be eligible to vest in each of the three years beginning in fiscal 2020 if certain earnings per share, revenue targets and market conditions are met. The estimate of the grant date fair value and related share-based compensation expense of these awards included the use of a Monte Carlo simulation. The Monte Carlo simulation incorporates estimates of the potential outcomes of the market condition of these awards, which is based on the relative total shareholder return of the Company as compared to that of the Russell Microcap Index.

The following table presents a summary of activity with respect to our PSUs during the fiscal year ended June 30, 2020:

	Number of Shares
	(In thousands)
Balance of PSUs outstanding at June 30, 2019	–
Granted	1,045
Forfeited	(60)
Vested	–
Balance of PSUs outstanding at June 30, 2020	985

Share-Based Compensation Expense

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

	Years Ended June 30,	
	2020	2019
	(In thousands)	
Cost of revenues	\$ 227	\$ 85
Selling, general and administrative	2,959	1,441
Research and development	453	345
Total share-based compensation expense	<u>\$ 3,639</u>	<u>\$ 1,871</u>

The following table presents a summary of the remaining unrecognized share-based compensation expense related to our outstanding share-based awards as of June 30, 2020:

	Remaining Unrecognized Compensation Expense (In thousands)	Remaining Weighted- Average Years to Recognize
Stock options	\$ 1,309	2.3
RSUs	3,135	3.0
PSUs	574	2.0
Common stock purchase rights under ESPP	71	0.4

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

Public Offering

On September 18, 2018, we entered into an underwriting agreement with Needham & Company, LLC and Lake Street Capital Markets, LLC (the “Underwriters”) relating to the offer and sale of 2,500,000 shares of our common stock, par value \$0.0001 per share, to the public at a price of \$4.00 per share. We also granted the Underwriters a 30-day option to purchase up to 375,000 additional shares of our common stock to cover over-allotments, if any (the “Option Shares”). Pursuant to the underwriting agreement, we sold an aggregate of 2,700,000 shares, including 200,000 Option Shares, to the Underwriters and received proceeds net of underwriting discounts and expenses of approximately \$9,774,000.

8. Retirement Plan

We have a retirement savings plan (the “Plan”) to which eligible employees may elect to make contributions through salary deferrals up to 100% of their base pay, subject to limitations. We made approximately \$219,000 and \$155,000 in matching contributions to participants in the Plan during the fiscal years ended June 30, 2020 and 2019, respectively.

In addition, we may make discretionary profit-sharing contributions, subject to limitations. During the fiscal years ended June 30, 2020 and 2019, we made no such contributions to the Plan.

9. Commitments and Contingencies

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

10. Income Taxes

The provision for income taxes consists of the following components:

	Years Ended June 30,	
	2020	2019
	(In thousands)	
Current:		
Federal	\$ (2)	\$ —
State	4	3
Foreign	142	138
	<u>144</u>	<u>141</u>
Deferred:		
Federal	—	—
State	—	—
Foreign	—	—
Provision for income taxes	<u>\$ 144</u>	<u>\$ 141</u>

The following table presents U.S. and foreign income (loss) before income taxes:

	Years Ended June 30,	
	2020	2019
	(In thousands)	
United States	\$ (7,048)	\$ (623)
Foreign	(3,546)	356
Loss before income taxes	<u>\$ (10,594)</u>	<u>\$ (267)</u>

The tax effects of temporary differences that give rise to deferred tax assets and liabilities are as follows:

	Years Ended June 30,	
	2020	2019
	(In thousands)	
Deferred tax assets:		
Tax losses and credits	\$ 20,640	\$ 20,158
Reserves not currently deductible	1,222	1,366
Deferred compensation	986	383
Inventory capitalization	631	481
Acquisition costs	—	91
Depreciation and amortization	790	8
Other	130	151
Gross deferred tax assets	<u>24,399</u>	<u>22,638</u>
Valuation allowance	<u>(24,056)</u>	<u>(22,353)</u>
Deferred tax assets, net	<u>343</u>	<u>285</u>
Deferred tax liabilities:		
State taxes	(343)	(285)
Deferred tax liabilities	<u>(343)</u>	<u>(285)</u>
Net deferred tax assets (liabilities)	<u>\$ —</u>	<u>\$ —</u>

We have recorded a valuation allowance against our net deferred tax assets, due to uncertainties surrounding the realization of the deferred tax assets.

The following table presents a reconciliation of the provision for income taxes to taxes computed at the U.S. federal statutory rate:

	Years Ended June 30,	
	2020	2019
	(In thousands)	
Statutory federal provision (benefit) for income taxes	\$ (2,224)	\$ (56)
Increase (decrease) resulting from:		
Officer compensation	–	10
Stock options	(121)	(223)
Other permanent differences	10	15
Change in valuation allowance	1,467	289
Foreign tax credit	(67)	(72)
Global intangible low-tax income inclusion	86	76
Controlled foreign corporation inclusion	4	–
Foreign tax rate variances	886	64
Other	103	38
Provision for income taxes	<u>\$ 144</u>	<u>\$ 141</u>

Due to the “change of ownership” provision of the Tax Reform Act of 1986, utilization of our net operating loss (“NOL”) carryforwards and tax credit carryforwards may be subject to an annual limitation against taxable income in future periods. Due to the annual limitation, a portion of these carryforwards may expire before ultimately becoming available to reduce future income tax liabilities.

The following table presents our NOLs:

	June 30,
	2020
	(In thousands)
Federal	<u>\$ 92,824</u>
State	<u>\$ 14,560</u>

For federal income tax purposes, our NOL carryovers generated for tax years beginning before July 1, 2018 will begin to expire in the fiscal year ending June 30, 2021. Of our federal NOLs as of June 30, 2020 in the table above, approximately \$51,900,000 will expire by June 30, 2023. Pursuant to the Tax Cuts and Jobs Act (the “2017 Act”) enacted by the U.S. federal government in December 2017, for federal income tax purposes, NOL carryovers generated for our tax years beginning after June 30, 2018 can be carried forward indefinitely but will be subject to a taxable income limitation. For state income tax purposes, our NOLs began to expire in the fiscal year ended June 30, 2013.

We continue to assert that our foreign earnings are indefinitely reinvested in our overseas operations and as such, deferred income taxes were not provided on undistributed earnings of certain foreign subsidiaries. The 2017 Act created a requirement that certain income earned by foreign subsidiaries, known as global intangible low-tax income (“GILTI”), must be included in the gross income of their U.S. shareholder. The FASB allows an accounting policy election of either recognizing deferred taxes for temporary differences expected to reverse as GILTI in future years or recognizing such taxes as a current-period expense when incurred. During the fiscal years ended June 30, 2020 and 2019, we elected to treat the tax effect of GILTI as a current-period expense when incurred.

Unrecognized Tax Benefits

The following table summarizes our liability for uncertain tax positions for the fiscal year ended June 30, 2020:

	Year Ended
	June 30, 2020
	(In thousands)
Balance as of June 30, 2019	\$ 6,600
Change in balances related to uncertain tax positions	–
Balance as of June 30, 2020	<u>\$ 6,600</u>

At June 30, 2020, we had \$6,600,000 of gross unrecognized tax benefits which was recorded as a reduction to deferred tax assets, and a corresponding reduction in our valuation allowance of \$6,600,000. To the extent such portion of unrecognized tax benefits is recognized at a time such valuation allowance no longer exists, the recognition would reduce the effective tax rate. Our continuing practice is to recognize interest and penalties related to income tax matters in income tax expense. During the fiscal years ended June

30, 2020 and 2019 we recorded an immaterial expense for interest and penalties related to income tax matters in the provision for income taxes. At June 30, 2020, we had approximately \$244,000 of accrued interest and penalties related to uncertain tax positions.

At June 30, 2020, our fiscal years ended June 30, 2017 through 2020 remain open to examination by the federal taxing jurisdiction and our fiscal years ended June 30, 2016 through 2020 remain open to examination by the state taxing jurisdictions. However, we have NOLs beginning in the fiscal year ended June 30, 2001 which would cause the statute of limitations to remain open for the year in which the NOL was incurred. Our fiscal years ended June 30, 2013 through 2020 remain open to examination by foreign taxing authorities. We currently do not anticipate that the amount of unrecognized tax benefits as of June 30, 2020 will significantly increase or decrease within the next 12 months.

11. Significant Geographic, Customer and Supplier Information

The following table presents our sales within geographic regions as a percentage of net revenue, which is based on the “bill-to” location of our customers:

	Years Ended June 30,	
	2020	2019
Americas	56%	54%
Europe, Middle East, and Africa	26%	31%
Asia Pacific Japan	18%	15%
Total	100%	100%

The following table presents sales to significant countries as a percentage of net revenue, which is based on the “bill-to” location of our customers:

	Years Ended June 30,	
	2020	2019
U.S. and Canada	48%	54%
Germany	18%	22%
Hong Kong	6%	1%
Japan	5%	8%

Customers

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

	Years Ended June 30,	
	2020	2019
Top five customers (1)	36%	57%
Ingram Micro	16%	24%
Arrow	*	13%

* Less than 10%

(1) Includes Ingram Micro and Arrow for the fiscal years ended June 30, 2020 and 2019.

No other customer represented more than 10% of our annual net revenue during these fiscal years.

Related Party Transactions

We had no net revenue from related parties for the fiscal years ended June 30, 2020 and 2019.

Suppliers

We do not own or operate a manufacturing facility. All of our products are manufactured by third-party contract manufacturers and foundries primarily located in Malaysia, Thailand and China. We have several single-sourced supplier relationships, either because alternative sources are not available or because the relationship is advantageous to us. If these suppliers are unable to provide a timely and reliable supply of components, we could experience manufacturing delays that could adversely affect our consolidated results of operations.

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Board of Directors

Bernhard Bruscha

Chairman of the Board of Lantronix, Inc.

Paul Pickle

President & Chief Executive Officer of Lantronix, Inc.

Bruce Edwards

CEO, Palagon Partners, LLC

Margaret Evashenk

Former Chief Executive Officer, Kazan Networks

Paul Folino

Former Executive Chairman, Emulex Corporation

Hoshi Printer

Board Advisor and Member for various private companies

Management Team

Paul Pickle

President & Chief Executive Officer

Jeremy Whitaker

Chief Financial Officer

Michael Fink

Vice President, Operations

David Goren

Vice President, Human Resources, Legal & Business Affairs; Secretary

Fathi Hakam

Vice President, Engineering

Roger Holliday

Vice President, Worldwide Sales

Jonathan Shipman

Vice President, Strategy

Stockholder Information

Corporate Headquarters

Lantronix, Inc.
7535 Irvine Center Drive, Suite 100
Irvine, CA 92618

☎ 949.453.3990

🌐 www.lantronix.com

Stock Listing

The Company's common stock trades on The Nasdaq Stock Market LLC under the symbol LTRX.

Annual Stockholder Meeting

The Annual Meeting of Stockholders for Lantronix, Inc. will be held on November 3, 2020, at the Company's corporate headquarters.

Independent Auditors

Squar Milner LLP
Newport Beach, CA 92660

Transfer Agent and Registrar

Computershare
250 Royall Street
Canton, MA 02021
☎ 877.854.4580

🌐 www.computershare.com

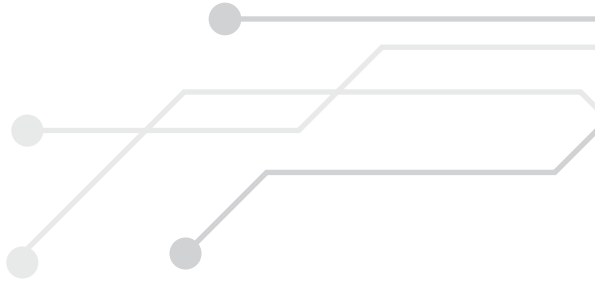
Investor Relations

Jeremy Whitaker
Chief Financial Officer

✉ investors@lantronix.com

☎ 949.450.7241

This Annual Report contains forward-looking statements, including statements concerning our projected operating and financial performance for fiscal 2021, our growth plan for fiscal 2021 and the anticipated improvements to profitability, and the expected effects and benefits of the efforts of our team to grow our product portfolio and capture value-added technologies within the IoT stack. These forward-looking statements are based on the company's current expectations and are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements, including: the impact of COVID-19 and the measures to reduce its spread on our employees, supply and distribution chains, the global economy and our financial condition and liquidity; the effects of negative or worsening regional and worldwide economic conditions or market instability on our business; constraints or delays in the supply of certain materials or components; difficulties associated with our contract manufacturers or suppliers; difficulties associated with our distributors or resellers; our ability to successfully implement our acquisitions strategy or integrate acquired companies; and other risks and uncertainties listed in this Annual Report. You should not place undue reliance on these forward-looking statements, which speak only as of the date hereof, and the company undertakes no obligation to update these forward-looking statements to reflect subsequent events or circumstances.



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