LANTRONIX INC
Form 10-K
September 15, 2011

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

FORM 10-K

(Mark One)
S ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended June 30, 2011

£ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________ to ________
Commission File Number 1-16027

LANTRONIX, INC.
(Exact name of registrant as specified in its charter)

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

167 Technology Drive, Irvine, California 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:

Title of each class	Name of each exchange on which registered
Common Stock, $0.0001 par value	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 S

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 S

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 S No £

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. £

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

Large accelerated filer £	Accelerated filer £	Non-accelerated filed £	Smaller reporting company S

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

The aggregate market value of the registrant's common stock held by non-affiliates based upon the closing sales price of the common stock on December 31, 2010, as reported by the NASDAQ Capital Market, was approximately $16,175,050. Shares of common stock held by each current executive officer and director and by each person who is known by the registrant to own 5% or more of the outstanding common stock have been excluded from this computation in that such persons may be deemed to be affiliates of the registrant. Share ownership information of certain persons known by the registrant to own greater than 5% of the outstanding common stock for purposes of the preceding calculation is based solely on information on Schedule 13G filed with the Securities and Exchange Commission and is as of December 31, 2010. This determination of affiliate status is not a conclusive determination for other purposes.

As of August 31, 2011, there were 10,549,852 shares of the Registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Part III of this Form 10-K incorporate information by reference from portions of the registrant's 2011 Definitive Proxy Statement to be filed not later than 120 days after the close of the 2011 fiscal year.

LANTRONIX, INC.
ANNUAL REPORT ON FORM 10-K
For the Fiscal Year Ended June 30, 2011

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FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of the federal securities laws. Statements that are not purely historical should be considered forward-looking statements. Often they can be identified by the use of forward-looking words and phrases, such as “intend,” “may,” “will,” “could,” “project,” “anticipate,” “expect,” “estimate,” “co “potential,” “plan,” “forecasts,” and the like. Statements concerning current conditions may also be forward-looking if they imply a continuation of current conditions. Examples of forward-looking statements include, but are not limited to, statements concerning industry trends, anticipated demand for our products, the impact of pending litigation, our overall business strategy, market acceptance of new products, future customer and sales developments, manufacturing forecasts, including the potential benefits of our contract manufacturers sourcing and supplying raw materials, the significant role of original equipment manufacturers in our business, the future cost and potential benefits of our research and development efforts and liquidity and cash resources forecasts.

Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. Readers are urged to carefully review the cautionary statements made by the Company in this report concerning risks and other factors that may affect the Company’s business and operating results, including those made in this report under the caption “Risk Factors,” in Part I, Item 1A and elsewhere in this report as well as the Company’s other reports filed with the Securities and Exchange Commission (“SEC”). We may from time to time make additional forward-looking statements in our filings with the SEC, in our reports to our stockholders and elsewhere. Readers are cautioned not to place undue reliance on these forward-looking statements. We do not undertake any obligation to update any forward-looking statement that may be made from time to time by us or on our behalf.

PART I

ITEM 1. BUSINESS

Overview

We design, develop, market and sell products that make it possible to access, manage, control and configure electronic products over the Internet, Enterprise, and other networks. In addition, our device management solutions address data centers and remote branch offices to provide reliable management for IT systems. Our network connectivity solutions are sold into broad market segments, including healthcare, industrial, security, energy, information technology (“IT”), data centers, transportation, government and others.

We were initially formed as “Lantronix,” a California corporation, in June 1989. We reincorporated as “Lantronix, Inc.,” a Delaware corporation, in May 2000. Our worldwide headquarters is located in Irvine, California.

Our common stock is currently traded on the NASDAQ Capital Market under the symbol LTRX.

Our Strategy

Our business strategy is based on our proven capability to develop fully-integrated device enablement and remote connection solutions that increase the value of our customers’ products and services by making it easy to access and monitor devices over the Internet or local-area network (“LAN”) using wired, wireless, or mobile solutions. By using our device enablement technology, customers can reduce basic data connection costs, reduce maintenance and repair costs, create differentiation based on better service and can create new revenue sources from device-related services.

We have a robust product pipeline and continue to invest in making our products uniquely differentiated and valuable to our customers. For example, all of our new wireless products support SmartRoam, our proprietary solution for dynamically selecting the best access point connection thereby optimizing wireless connection performance. By providing a complete solution of hardware and integrated software, we have been able to provide “turnkey” solutions for network-enabling a device, eliminating the need for our customers to build expensive design and manufacturing expertise in-house. This results in savings to the customer in terms of financial investment, time, and technology risk.

Products and Solutions

Device Enablement Solutions

Device networking is the technology that enables connectivity within a multitude of vertical markets such as healthcare, industrial, security, energy, IT, data centers, transportation, government and many others. We provide manufacturers, integrators and end-users with device enablement solutions for products to be connected, securely accessed, managed and controlled over networks. Our device enablement solutions dramatically shorten a manufacturer’s development time to implement network connectivity, provide competitive advantages with new features, greatly reducing engineering and marketing risks.

Our device servers and web servers eliminate the high cost of ownership and added support issues associated with networking, which frequently would otherwise require using PCs (personal computers) or workstations to perform connectivity and remote management functions. Our solutions contain high-performance processors capable of not only controlling the attached device, but in many cases are also capable of accumulating data and status. The accumulated data can then be formatted by the device server and presented to users via web pages, e-mail, and other network, transport and application level protocols. Many original equipment manufacturers ("OEM") actually host their application on the device server, further reducing their design cycles and product complexity. Our device servers have a built-in HTTP server, making them easy to manage using any standard Web browser. These device servers include the latest security protocols like AES, IPsec, TLS, SSL, SSH which support the stringent security requirements of the healthcare, banking, and physical security markets. We are making continual enhancements to our product line to make our products even easier to integrate into Enterprise and Cloud infrastructures.

Device Management Solutions

We offer single and multi-port products (up to 48 ports) that provide IT professionals with the tools they need to remotely connect to the out-of-band management ports on computers and associated equipment. These solutions include console servers, remote keyboard, video, mouse ("KVM") servers and managed power distribution products.

Our customers use these solutions to monitor and run their systems to ensure the performance and availability of critical business information systems, network infrastructure and telecommunications equipment. The equipment our solutions manage includes routers, switches, servers, phone switches and public branch exchanges that are often located in remote or inaccessible locations.

Our console servers provide system administrators and network managers an operationally effective way to connect with their remote equipment through an interface called a console port, helping them work more efficiently, without having to leave their desk or office. Console ports are usually found on servers and special purpose data center equipment such as environmental monitoring/ control systems, communications switches and storage devices. With remote access, system downtime and service calls can be reduced, improving business efficiency. Our console servers provide IT professionals with peace-of-mind through extensive security features, and in some cases, provisions for dial-in access via modem. These solutions are provided in various configurations and can manage up to 48 devices from one console server.

Other Products

Our other products are comprised primarily of legacy products such as print servers, software and other miscellaneous products.

Net Revenue by Product Line

Information regarding our net revenue by product line is incorporated by reference from Part IV, Item 15 of this Form 10-K and is presented under footnote 11 to our notes to our consolidated financial statements.

Markets

Our principal target markets include the following:

Healthcare

The healthcare market is undergoing a transformation using IT and medical device connectivity to improve patient care while delivering this care more efficiently. Hospitals, laboratories and medical device manufacturers are rapidly adopting networking technology to maintain quality and patient care while under major cost containment. Staffing constraints compound the challenge, as doctors, nurses, technicians and engineers are working harder than ever to deliver the same quality in patient care. By network enabling medical devices, our solutions automate and safeguard data collection and dissemination, and facilitate remote patient monitoring, asset tracking and reduced service costs.

Our device servers enable the electronic capture of medical device information for disparate medical devices and provide interfaces to health information technology systems including electronic medical records. Such a level of data collection and collaboration between doctors and healthcare professionals will provide shortened diagnosis times, optimized patient care, and ultimately, save lives. Our solutions protect patient privacy with data kept on a highly secured network; eliminate worries about misplaced or overlooked handwritten records; spend less time record keeping; reduce potential for errors like erroneous transcriptions; maximize staff mobility; collaborate easily with on and off-site doctors and specialists; and enable on and off-site monitoring.

Security

Guarding corporate and customer data, protecting company property and ensuring employee safety are among the most important and challenging responsibilities companies face. As a leader in the physical security space, our solutions enable security solutions providers to build network connectivity into their products (such as security systems, including access control panels, biometric readers, surveillance cameras and fire systems) so they can be remotely accessed and managed over a network or the Internet. With secure data center management products, we are also a major provider in the market for data and computer asset security.

Industrial Automation

In the industrial environment – whether it's on the factory floor, oil platform, locomotive, weather station, or a warehouse – our customers have to depend on their equipment. These customers need the ability to remotely access, manage and control that equipment. With our industrial device server, our customers can quickly and reliably connect virtually any piece of factory equipment to a network or the Internet to interactively access, manage, control, evaluate and utilize data from the equipment. This powerful, ruggedized, yet amazingly simple-to-implement technology provides the ability to perform real-time remote diagnostics and repair, automate data capture and be immediately notified of a problem.

Building Automation

An intelligent building automation system enables a facilities manager to better manage resources, improve building safety, and reduce energy costs. With our building automation technology, an intelligent building can be created, allowing managers to control virtually every system from a central location. By network-enabling electronic devices quickly and cost-effectively, our building automation products make it possible to integrate building sub-systems (including security, HVAC, lighting, elevators and safety systems) into a single, efficient building management network. For example, the facilities manager at a large corporate campus can control everything from electrical and water metering to building access from a single terminal, and can even diagnose system problems remotely.

Energy

The energy market is increasingly implementing networking technology to more efficiently generate, transmit, distribute and generate energy. Smart Grid initiatives are all driven by adding intelligence to the power grid with networked information regarding the tighter management of power transmission and distribution all the way to the smart meter. With their versatility and protocol independence, our device servers can bring together a diverse array of devices on the network. In addition, our remote management capability makes them dependable tools for monitoring power allocations during critical high-demand periods. Metering, substations, and power-generating equipment are often located in environments where weather is a real factor. Featuring DIN rail mounting and ruggedized housings, our industrial device servers are frequently the answer for these situations. Our embedded device servers are also equipped to handle temperature extremes.

Our products are address many facets of power management, including alternate sources such as wind and solar. For most power applications, the key is our ability to remotely control and manage devices in the field. Efficient acquisition of data and control across the network are key requirements for the energy industry. Our device servers can reduce power management system costs. And with their inherent scalability, they can network-enable existing serial devices and accommodate power system updates for years to come.

Information Technology and Data Centers

Companies can reduce service costs and system downtime while empowering IT managers and staff to securely, remotely and proactively access and troubleshoot equipment around the clock, even if the network is down. Our remote data center management products enable users to access, monitor, troubleshoot and manage IT and data center equipment from anywhere, at any time. Our data center management products also provide the authentication, authorization, encryption and firewall features needed to preserve data security and prevent hackers from disrupting operations. Our data center management products are beneficial to IT departments in virtually every industry sector and are trusted by major telecom companies, financial institutions, and government agencies.

Transportation

Networked transportation systems play a key role in enhancing public safety by reducing congestion and facilitating traffic management. Devices such as signal controllers, message signs, video scanners and cameras are essential for managing traffic on freeways and major surface streets. Traffic control monitoring systems disseminate traffic and road condition data to optimize traffic management. In-vehicle cameras are used by service fleets, schools, bus companies and transit authorities to record what's going on in the vehicle.

On-vehicle fleet management lends itself well to our device servers. For example, information including mileage, fuel consumption and vehicle performance is transferred from our customer's vehicle monitoring system, making data recording easier and more accurate.

Our device servers have been used to connect an entire baggage claim system to a network. They are also utilized for remote monitoring in airport security systems.

Government

We have been a provider of networking and secure remote management technology to government agencies for nearly two decades. We manufacture several products with final assembly in the U.S. to meet trade compliance requirements.

Customers

Distributors

Sales to our distributors represent the majority of our net revenue. Distributors resell our products to a wide variety of end customers; including OEM's, value added resellers ("VAR"), consumers, corporate customers and government entities. We believe that our channel sales approach provides several advantages. We can engage the customers and end users through their channel of choice, making our solutions available from a variety of sources. We can concentrate on developing new relationships at accounts that we believe represent our largest opportunities while our channel partners continue to identify new incremental opportunities and service existing customers.

OEM Manufacturers

To shorten the development cycle and add network connectivity to a product, OEMs can use our external device servers to network-enable their installed base of products, while board-level embedded device servers are typically used in new product designs. Our capabilities and solutions enable OEMs to focus on their core competencies, resulting in reduced research and development costs, fewer integration problems and faster time-to-market.

End User Businesses

End user businesses require solutions that are simple to install, set up and operate, and can provide immediate results. Generally, these customers need to connect to a diverse range of products and equipment, without modifying existing software and systems.

Customer Concentrations

Information concerning our customer concentrations and sales by geographic region can be found in Part IV, Item 15 of this Annual Report on Form 10-K and is presented in footnote 11 to our notes of our consolidated financial statements. Please see Part I, Item 1A "Risk Factors" below for a discussion of the risks associated with customer concentrations and foreign sales.

	Years Ended June 30,	
	2011	2010
Americas	52.0%	56.3%
EMEA	31.2%	27.9%
Asia Pacific	16.8%	15.8%
Total	100.0%	100.0%

Sales and Marketing

We maintain both an inside and a field sales force to provide management and support to our worldwide network of selling partners. In addition, we use an indirect sales model, using manufacturers' representatives, VARs and other resellers throughout the world. We have sales managers in major regions throughout the world that manage our relationship with our sales partners, identify and develop major new sales opportunities and increase penetration at existing high potential accounts. We implement marketing programs, tools and services specifically geared to drive demand for our products.

Our device enablement solutions are principally sold to manufacturers by our worldwide OEM sales force and our group of manufacturers' representatives. We market and sell our device management solutions and select external device enablement solutions through IT resellers, industry-specific system integrators, VARs and directly to end user organizations. Resellers and integrators will often obtain our products through distributors. These distributors supply our products to a broad range of VARs, system integrators, direct marketers, government resellers and e-commerce resellers. In turn, these distributor customers market, sell, install and, in most cases, support our solutions to the end users.

Manufacturing

A key element of our operations strategy is to outsource manufacturing to produce reliable, high quality products at competitive prices and to achieve on-time delivery to our customers. This practice enables us to concentrate our resources on engineering, sales and marketing. We also manufacture several products with final assembly in the U.S. to meet trade compliance requirements.

We utilize contract manufacturers primarily located in China, Malaysia and Taiwan. Our contract manufacturers source raw materials, components and integrated circuits, in accordance with our pre-determined specifications and forecasts, and perform printed circuit board assembly, final assembly, functional testing and quality control. We believe this arrangement decreases our capital requirements and provides better raw material and component pricing, enhancing our gross margins and operating margins. Please see Part I, Item 1A "Risk Factors" below for a discussion of the risks associated with contract manufacturing.

Research and Development

Our research and development efforts are focused on the development of hardware and software technology and products that will enhance our competitive position in the markets we serve. Products are developed in-house and through outside research and development resources. The following table presents our research and development expenses:

	Years Ended June 30,	
	2011	2010
	(In thousands)	
Research and development expenses	$7,033	$6,338

Developer Relations

Recruiting, engaging and participating with third-party developers are integral parts of our ongoing strategy. We encourage, enable and support others in the development of vertical applications using our hardware, firmware and software products. With their help and investment in creating additional applications and markets for our products, we improve our ability to secure a defensible market position and loyal customers.

Competition

The markets in which we compete are dynamic and highly competitive. As these markets grow and develop, we expect competition to intensify.

Our competitors include companies such as Avocent Corporation, Digi International, Inc., Echelon Corporation, Freescale Semiconductor, Inc., Moxa Technologies, MRV Communications, Inc., Open Gear, Perle Systems, Raritan, Sena Technologies Inc., and Silex Technology, Inc., among others,

The principal competitive factors that affect the market for our products are:

- product quality, technological innovation, compatibility with standards and protocols, reliability, functionality, ease of use and compatibility;
- product pricing;

- potential customers' awareness and perception of our products and of network-enabling technologies; and
- the customer's decision to make versus buy.

Intellectual Property Rights

We have developed proprietary methodologies, tools, processes and software in connection with delivering our services. We have not historically relied on patents to protect our proprietary rights, although we continue to build a patent portfolio and currently hold 17 patents, 21 pending, and four provisional. We have historically relied on a combination of copyright, trademark, trade secret laws and contractual restrictions, such as confidentiality agreements and licenses, to establish and protect our proprietary rights.

On May 2, 2006, we entered into a six-year patent cross-license and litigation dismissal agreement with Digi International, Inc. ("Digi"). The cross-license includes all pre-existing patents (not including design patents) held by us and Digi. In addition, the cross-license covers all future patents (not including design patents) during the six-year cross-license term.

United States and Foreign Government Regulation

Many of our products and the industries in which they are used are subject to federal, state or local regulation in the U.S. In addition, our products are exported worldwide. Therefore, we are subject to the regulation of foreign governments. For example, wireless communication is highly regulated in both the U.S. and elsewhere. Some of our products employ encryption technology; the export of some encryption software is restricted. At this time our activities comply with existing laws, but we cannot determine whether future, more restrictive laws, if enacted, would adversely affect us. Please see Part I, Item 1A "Risk Factors" below for risks associated with foreign operations.

Environmental Matters

Federal, state and local regulations impose various environmental controls on the storage, handling, discharge and disposal of chemicals and gases used in our manufacturing processes. Our company quality manual requires all subcontractors and raw material suppliers to be ISO14001 certified. State agencies require us to report usage of environmentally hazardous materials and we have retained the appropriate personnel to help ensure compliance with all applicable environmental regulations. We actively manage and monitor compliance through our internal auditing program. We believe that our activities conform to present environmental regulations; however, increasing public attention has been focused on the environmental impact of semiconductor operations and these regulations may require us to fund remedial action regardless of fault.

In addition, the use and disposal of electronics is under increasing scrutiny and various countries have begun to adopt regulations such as the European Union's Waste Electrical and Electronic Equipment ("WEEE") and the Reduction of the use of certain Hazardous Substances in electrical and electronic equipment ("RoHS") directives, which could require us to both redesign our products to comply with the standards and develop compliance administration systems. We expect additional countries and locations to adopt similar regulations in the future which may be more stringent than the current regulations. Currently however, we believe the majority of our commercial products are compliant with these emerging regulations.

While we have not experienced any materially adverse effects on our operations from environmental regulations, there can be no assurance that changes in such regulations will not impose the need for additional capital equipment or other requirements. We have already invested significant resources into developing compliance tracking systems, and further investments may be required. Any failure by us to adequately restrict the discharge of hazardous substances could subject us to future liabilities or could cause our manufacturing operations to be suspended.

Employees

As of June 30, 2011, we had 129 full- and part-time employees. We have never experienced a work stoppage, none of our employees are currently represented by a labor union, and we consider our employee relations to be good.

Backlog

Normally, we manufacture our products in advance of receiving firm product orders from our customers based upon our forecasts of worldwide customer demand. Most customer orders are placed on an as-needed basis and may be canceled or rescheduled by the customer without significant penalty. Accordingly, backlog as of any particular date is not necessarily indicative of our future sales. Because most of our business is on an as-needed basis we do not rely on backlog as a metric of our operations.

Available Information

Our annual report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed or furnished pursuant to Section 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), are available free of charge on our website at www.lantronix.com shortly after we electronically file such material with, or furnish it to, the SEC. The public may read and copy any materials we file with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling 1-800-SEC-0330. 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. We assume no obligation to update or revise forward looking statements in this Form 10-K, whether as a result of new information, future events or otherwise, unless we are required to do so by law.

Executive Officers of the Registrant

The following table presents the names, ages and positions held by all our executive officers. There are no family relationships between any director or executive officer and any other director or executive officer of Lantronix. Executive officers serve at the discretion of the board of directors.

Name	Age	Position
Kurt Busch	40	President and Chief Executive Officer
James W. Kerrigan	75	Interim Chief Financial Officer and Secretary

Kurt Busch joined the Company on August 24, 2011 as the Company’s President and Chief Executive Officer. Prior to joining Lantronix, he served in senior leadership positions at Mindspeed Technologies, a leading supplier of semiconductor solutions for network infrastructure applications. Most recently, he served as senior vice president and general manager for the company’s high performance analog division. Under Busch’s leadership, the division launched 40 products during his tenure that yielded substantially increased revenues and expanded demand for the company’s products across broad markets including carrier, enterprise data center, surveillance and professional video. Since 1990, Busch has worked in the networking communications industry. His experience includes business development roles at Analog Devices as well as roles in engineering, sales, marketing and general management at Digital Equipment Corporation, Intel, and two start-ups. He earned a bachelor’s degree in electrical and computer engineering and a bachelor’s degree in biological science from the University of California at Irvine. In 1998, Busch completed an MBA from Santa Clara University.

James W. Kerrigan joined the Company on June 24, 2011 as the Company’s Interim Chief Financial Officer. Mr. Kerrigan also previously served as Interim Chief Financial Officer and Chief Financial Officer during two previous tenures with the Company, in 1999 and from 2002 to 2006 respectively, after which he retired. Earlier in his career, he served as Chief Financial Officer for multiple private and public companies, including public companies Wham-O Mfg. Co., Ceradyne, Inc. and PDA Engineering.

Item 1A. RISK FACTORS

We operate in a rapidly changing environment that involves numerous risks and uncertainties. Before deciding to purchase, hold or sell our common stock, you should carefully consider the risks described in this section. This section should be read in conjunction with the consolidated financial statements and accompanying notes thereto, and Management’s Discussion and Analysis of Financial Condition and Results of Operations included in this Annual

Report on Form 10-K. If any of these risks or uncertainties actually occurs with material adverse effects on Lantronix, our business, financial condition and results of operations could be seriously harmed. In that event, the market price for our common stock could decline and you may lose all or part of your investment.

We have a history of losses.

We incurred a net loss of approximately $5.3 million for the year ended June 30, 2011 and had experienced a net loss of $1.5 million during the year ended June 30, 2010. 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 we fail to achieve profitability in future periods, the value of our common stock may decline. In addition, if we were unable to maintain positive cash flows, we would be required to seek additional funding, which may not be available on favorable terms, if at all.

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

We have experienced, and expect to continue to experience, significant fluctuations in net revenues, expenses and operating results from quarter to quarter. We therefore believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance, and you should not rely on them to predict our future performance or the future performance of our stock. A high percentage of our operating expenses are relatively fixed and are based on our forecast of future net 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 market analysts and investors, the price of our common stock would likely fall. Other factors that might cause our operating results to fluctuate on a quarterly basis include:

- changes in business and economic conditions, including global economic disruptions;
- changes in the mix of net revenue attributable to higher-margin and lower-margin products;
- customers’ decisions to defer or accelerate orders;
- variations in the size or timing of orders for our products;
- changes in demand for our products;
- fluctuations in exchange rates;
- defects and other product quality problems;
- loss or gain of significant customers;
- short-term fluctuations in the cost or availability of our critical components;
- announcements or introductions of new products by our competitors;
- effects of terrorist attacks in the U.S. and abroad;
- natural disasters in the U.S. and abroad;
- changes in demand for devices that incorporate our products; and
- our customers’ decisions to integrate network access and control directly onto their own platforms.

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

Substantial litigation regarding intellectual property rights occurs frequently in our industry. For example, in May 2006, we settled a patent infringement lawsuit with Digi in which we signed an agreement with Digi to cross-license each other’s patents for six years. There is a risk that we will not be able to negotiate a new cross-license agreement when the current cross-license agreement expires in May 2012. 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.

Delays in deliveries or quality 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. In particular, some of our integrated circuits are only available from a single source and in some cases are no longer being manufactured. From time to time, integrated circuits used in our products will be phased out of production 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 might be unable to purchase sufficient components to meet our demands, or we might incorrectly forecast our demands, and purchase too many or too few components. Due to the downturn in the economy, we have been experiencing higher component shortages and extended lead-times. In addition, our products use components that have, in the past, been subject to market shortages and substantial price fluctuations. From time to time, we have been unable to meet our orders because we were unable to purchase necessary components for our products. We do not have long-term supply arrangements with most of our vendors to obtain necessary components or technology for our products. If we are unable to purchase components from these suppliers, product shipments could be prevented or delayed, which could result in a loss of sales. If we are unable to meet existing orders or to enter into new orders because of a shortage in components, we will likely lose net revenues and risk losing customers and harming our reputation in the marketplace, which could adversely affect our business, financial condition or results of operations.

If we are unable to raise additional capital, our business could be adversely affected.

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, which could affect our ability to generate additional cash. If cash generated from operations and financing activities is insufficient to satisfy our working capital requirements, we may need to raise capital by borrowing additional funds through bank loans, the selling of securities or other means. There can be no assurance that we will be able to raise any such capital on terms acceptable to us, if at all. If we are unable to secure additional financing, we may not be able to develop or enhance our products, take advantage of future opportunities, respond to competition or continue to operate our business.

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

The number and timing of sales to our distributors have been difficult for us to predict. While our distributors are customers in the sense that they buy our products from us, they are also part of our product distribution system. One or more of our distributors could be acquired by a competitor and stop buying product from us. The following table presents sales to our significant customers as a percentage of net revenue:

	Years Ended June 30,	
	2011	2010
Top five customers (1)(2)	41%	39%
Ingram Micro	14%	10%
Tech Data	7%	11%
Related parties	2%	1%

(1) Includes Ingram Micro and Tech Data.
(2) All top five customers are distributors

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

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

We may experience difficulties in transitioning to third-party logistics providers.

We recently transitioned a majority of our physical inventory management process, as well as the shipping and receiving of our inventory, to third-party logistics providers in Los Angeles 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.

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

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

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

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

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

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

If our research and development efforts are not successful, our net revenue could decline and our business could be harmed.
If we are unable to develop new products as a result of our research and development efforts, or if the products we develop are not successful, our business could be harmed. Even if we do develop new products that are accepted by our target markets, we do not know whether the net revenue from these products will be sufficient to justify our investment in the research and development of those products. On the other hand, if we do not invest sufficiently in research and development, we may be unable to maintain our competitive position. The continuing effects of the economic recession could require cost-containment measures, which could force us to reduce our investment in research and development and put us at a competitive disadvantage compared to our competitors.

We expect the average selling prices of our products to decline and raw material costs to increase, which could reduce our net revenue and gross margins and adversely affect results of operations.

In the past, we have experienced some reduction in the average selling prices and gross margins of products, and we expect that this will continue for our products as they mature. We expect competition to continue to increase, and we anticipate this could result in additional downward pressure on our pricing. Our average selling prices for our products might also decline as a result of other reasons, including promotional programs and customers who negotiate price reductions in exchange for longer-term purchase commitments. We also may not be able to increase the price of our products if the prices of components or our overhead costs increase. In addition, we may be unable to adjust our prices in response to currency exchange rate fluctuations or in response to price increases by our suppliers, resulting in lower gross margins. Further, as is characteristic of our industry, the average selling prices of our products have historically decreased over the products' life cycles and we expect this pattern to continue. If any of these were to occur, our gross margins could decline and we might not be able to reduce the cost to manufacture our products to keep up with the decline in prices.

Current or future litigation could adversely affect us.

We are subject to a wide range of claims and lawsuits in the course of our business. Any lawsuit may involve complex questions of fact and law and may require the expenditure of significant funds and the diversion of other resources. The results of litigation are inherently uncertain, and adverse outcomes are possible.

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

We currently offer warranties ranging from one to two years on each of our products. Our products could contain undetected errors or defects. If there is a product failure, we might have to replace all affected products without being able to book revenue for replacement units, or we 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 loss of net revenue and claims against us. Significant product warranty claims against us could harm our business, reputation and financial results and cause the price of our stock to decline.

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

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

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

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

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

Our agreements with these manufacturers provide for services on a purchase order basis. If our manufacturers were to become unable or unwilling to continue to manufacture our products at requested quality, quantity, yields and costs, or in a timely manner, our business would be seriously harmed. As a result, we would have to attempt to identify and qualify substitute manufacturers, which could be time consuming and difficult, and might result in unforeseen manufacturing and operations problems.

Due to the downturn in the economy, which has put some suppliers out of business, we have been experiencing higher component shortages. As we shift products among third-party manufacturers, we may incur substantial expenses, risk material delays or encounter other unexpected issues. In addition, a natural disaster could disrupt our manufacturers' facilities and could inhibit our manufacturers' ability to provide us with manufacturing capacity in a timely manner or at all. If this were to occur, we likely would be unable to fill customers' existing orders or accept new orders for our products. The resulting decline in net revenue would harm our business.

We also are responsible for forecasting the demand for our individual products. These forecasts are used by our contract manufacturers to procure raw materials and manufacture our finished goods. If we forecast demand too high, we may invest too much cash in inventory, and we may be forced to take a write-down of our inventory balance, which would reduce our earnings. If our forecast is too low for one or more products, we may be required to pay charges that would increase our cost of revenue or we may be unable to fulfill customer orders, thus reducing net revenue and therefore earnings.

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

The following table presents sales by geographic region as a percentage of net revenue:

	Years Ended June 30,					
		% of Net		% of Net	Change	
	2011	Revenue	2010	Revenue	$	%
	(In thousands, except percentages)					
Americas	$25,648	52.0%	$26,111	56.3%	$(463)	(1.8%)
EMEA	15,370	31.2%	12,953	27.9%	2,417	18.7%
Asia Pacific	8,303	16.8%	7,311	15.8%	992	13.6%
Net revenue	$49,321	100.0%	$46,375	100.0%	$2,946	6.4%

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

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

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

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

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

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

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

	June 30, 2011	2010
	(In thousands)	
Finished goods	$6,475	$4,258
Raw materials	1,912	1,390
Inventory at distributors *	1,436	1,924
Large scale integration chips **	714	516
Inventories, gross	10,537	8,088
Reserve for excess and obsolete inventory	(1,377)	(1,215)
Inventories, net	$9,160	$6,873

* Balance represents finished goods held by distributors
** This item is sold individually and embedded into the Company's products.

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

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

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

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

Our financial performance depends substantially on the performance of our executive officers 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.

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

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

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

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

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

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

- laws and contractual restrictions might not be sufficient to prevent misappropriation of our technology or deter others from developing similar technologies;

- other companies might claim common law trademark rights based upon use that precedes the registration of our marks;

- other companies might assert other rights to market products using our trademarks;

- policing unauthorized use of our products and trademarks is difficult, expensive and time-consuming, and we might be unable to determine the extent of this unauthorized use;

- courts may determine that our software programs use open source software in such a way that deprives the entire programs of intellectual property protection; and

- current federal laws that prohibit software copying provide only limited practical protection from software pirates.

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

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

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

Business interruptions could adversely affect our business.

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

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

Section 404 of the Sarbanes-Oxley Act of 2002 requires companies to evaluate periodically the effectiveness of their internal controls over financial reporting, and to include a management report assessing the effectiveness of their internal controls as of the end of each fiscal year. We are required to comply with the requirement of Section 404 of the Sarbanes-Oxley Act of 2002 to include in each of our annual reports an assessment by our management of the effectiveness of our internal controls over financial reporting.

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

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

In September 2009, we entered into a seven-year lease agreement for our corporate headquarters in Irvine, California. Our corporate headquarters encompasses approximately 33,000 square feet and includes sales, marketing, research and development, operations and administrative functions. In addition, we have sales offices in the Netherlands, Japan and Hong Kong.

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

The legal proceedings as required by this item are incorporated by reference from Part IV, Item 15 of this Form 10-K and are presented under footnote 8 to our notes to our consolidated financial statements.

ITEM 4. RESERVED

PART II

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

Price Range of Common Stock

Our common stock was traded on the NASDAQ National Market under the symbol "LTRX" from our initial public offering on August 4, 2000 through October 22, 2002. On October 23, 2002 our listing was changed to the NASDAQ SmallCap Market, which has since been renamed the NASDAQ Capital Market. The number of holders of record of our common stock as of August 31, 2011 was approximately 51. The following table sets forth, for the periods indicated, the high and low sales prices for our common stock:

	High	Low
Year Ended June 30, 2011		
First Quarter	$4.27	$3.08
Second Quarter	4.00	2.91
Third Quarter	4.06	3.39
Fourth Quarter	4.00	2.47
Year Ended June 30, 2010		
First Quarter	$4.38	$2.16
Second Quarter	3.84	2.76
Third Quarter	3.96	3.14
Fourth Quarter	4.80	3.58

We believe that a number of factors, including but not limited to quarterly fluctuations in results of operations, may cause the market price of our common stock to fluctuate significantly. See Part II, Item 7 of this Form 10-K.

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.

Recent Sales of Unregistered Securities

We did not repurchase any of our common stock during the fourth fiscal quarter of 2011. Since July 1, 2008, we have not issued any unregistered securities.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes thereto included elsewhere in this report. In addition to historical information, the discussion in this report contains forward-looking statements that involve risks and uncertainties. Actual results could differ materially from those anticipated by these forward-looking statements due to factors including, but not limited to, those factors set forth under Part I, Item 1A “Risk Factors” and elsewhere in this report.

Overview

We design, develop, market and sell products that make it possible to access, manage, control and configure electronic products over the Internet or other networks. Our primary products and technology are focused on device enablement solutions that enable individual electronic products to be connected to a network for the primary purpose of remote access. In addition, our device management solutions address applications that manage equipment at data centers and remote branch offices to provide a reliable, single point of control and data flow management for potentially thousands of networked devices.

Our innovative networking solutions include fully-integrated hardware and software devices, as well as software tools, to develop related customer applications. Because we deal with network connectivity, we provide solutions to broad market segments, including industrial, security, energy, IT, data centers, transportation, government and many others.

Fiscal Year 2011 Financial Highlights and Other Information

A summary of the key factors and significant events which impacted our financial performance during the fiscal year ended June 30, 2011 are as follows:

- As reported on Form 8-K dated June 24, 2011, we substantially completed the independent investigation of certain allegations asserted by a director of Lantronix. For the fiscal year ending June 30, 2011, we had incurred approximately $2.1 million of expenses related to the investigation and estimate that we could incur an additional $250,000 of expenses in the first quarter of fiscal 2012 related to activities associated with concluding the investigation.

- Also reported on Form 8-K dated June 24, 2011, the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") resigned and entered into separation agreements with Lantronix. As a result of the separation agreements, we recorded approximately $862,000 of expenses as of June 30, 2011, related to severance and benefits that will be paid according to the terms of the respective agreements. In addition, we will incur approximately $150,000 of expenses in the first quarter of fiscal 2012 related to consulting services per the terms of the separation agreements.

- Net revenues were $49.3 million for the fiscal year ended June 30, 2011, an increase of $2.9 million, or 6.4%, compared to $46.4 million for the fiscal year ended June 30, 2010. The overall increase in net revenues was primarily the result of a $2.5 million, or 6.8%, increase in our device enablement product lines and a $671,000, or 8.0%, increase in our device management product lines; offset by a $237,000, or 26.5%, decrease in our non-core product lines.

- During fiscal 2011, we renegotiated agreements with certain distributors as part of an initiative to optimize the sales channel. These new agreements removed stock rotation and price protection terms, which previously caused the Company to recognize revenue on a sell through basis as opposed to upon shipment. A majority of these customers were redirected to purchase through large Lantronix distributors located in their respective regions. The result of these changes was the recognition of revenue during the second and third fiscal quarters that would have otherwise been deferred to the third and fourth fiscal quarters. These customers are no longer required to provide sell through reports and the majority of these customers are now buying from other Lantronix distributors (whose revenue is recognized on a sell-through basis by Lantronix) and not directly through Lantronix. The net impact of these changes to revenue in the current fiscal year is not practically determinable. It should be noted that the Company has not changed its revenue recognition policy as revenue is still recognized on a sell-through basis for those customers with stock rotation and price protection terms.

- Gross profit as a percentage of net revenues was 49.5% for the fiscal year ended June 30, 2011 as compared to 52.0% for the fiscal year ended June 30, 2010. The decrease in gross profit percentage was due to an increase in inventory reserve expenses related to slow moving products and excess materials for end of life products, an increase in warranty expenses as a result of a specific product issue and product mix as a result of certain lower margin products increasing as a percentage of revenue.

- Operating expenses were $29.5 million for the fiscal year ended June 30, 2011, an increase of $4.1 million, as compared to $25.4 million for the fiscal year ended June 30, 2010. The increase in operating expenses for the fiscal year ended June 30, 2011 was due to $2.1 million of expenses related to the investigation, $561,000 of expenses related to the contested proxy that was settled in November of 2010, $862,000 of expenses related to the separation of the former CEO and CFO in June of 2011 and an increase in personnel-related expenses due to the suspension of a Company-wide furlough program in the equivalent period one year ago and in increase in outside services related to development projects for upcoming product releases.

- Net loss was $5.3 million, or $0.51 per basic and diluted share, for the fiscal year ended June 30, 2011, as compared to $1.5 million, or $0.15 per basic and diluted share, for the fiscal year ended June 30, 2010. Net loss for the fiscal year ended June 30, 2011 included $2.1 million of expenses related to the investigation, $561,000 of expenses related to the contested proxy that was settled in November of 2010 and $862,000 of expenses related to the separation of the former CCEO and CFO in June of 2011.

- Cash and cash equivalents were $5.8 million as of June 30, 2011 as compared to $10.1 million as of June 30, 2010. The decrease in cash is mainly due to payments associated with the increase in inventory and payments of expenses related to the contested proxy and investigation.

- Net accounts receivable were $2.9 million as of June 30, 2011 as compared to $1.3 million as of June 30, 2010. Annual days sales outstanding ("DSO") in receivables were 16 days for the fiscal year ended June 30, 2011 as compared to 13 days for the fiscal year ended June 30, 2010. Our accounts receivable and DSO are primarily affected by the timing of shipments within a quarter, our collections performance and that a significant portion of our revenues are recognized on a sell-through basis (upon shipment from distributor inventories rather than as goods are shipped to distributors). The increase in net accounts receivable was mainly due to renegotiating agreements with certain distributors as part of an initiative to optimize our sales channel as discussed in detail above. The impact to net accounts receivable was a lower deferred revenue balance which is recorded as an offset to accounts receivable.

- Net inventories were $9.2 million as of June 30, 2011 as compared to $6.9 million as of June 30, 2010. Annual inventory turns were 3.1 for the fiscal year ended June 30, 2011 as compared to 3.3 for the fiscal year ended June 30, 2010. The increase in inventory was due to an increase in safety stock of certain products to ensure the on-time fulfillment of customer demand as well as an increase in the SLS Spider product family inventory as a result of lower than forecasted demand.

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board, or FASB, issued guidance regarding the presentation of comprehensive income. The new standard requires the presentation of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The new standard also requires presentation of adjustments for items that are reclassified from other comprehensive income to net income in the statement where the components of net income and the components of other comprehensive income are presented. The updated guidance is effective on a retrospective basis for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. The adoption of this guidance will not have a material impact on our financial statements.

In May 2011, the FASB issued additional guidance on fair value measurements that clarifies the application of existing guidance and disclosure requirements, changes certain fair value measurement principles and requires additional disclosures about fair value measurements. The updated guidance is effective on a prospective basis for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. The adoption of this guidance will not have a material impact on our financial statements.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in accordance with accounting principles generally accepted in the U.S. 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 revenues and expenses during the reporting period. We regularly evaluate our estimates and assumptions related to net revenues, allowances for doubtful accounts, sales returns and allowances, inventory valuation, valuation of deferred income taxes, goodwill and purchased intangible asset valuations, warranty reserves, restructuring costs, 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

We do not recognize revenue until all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; our price to the buyer is fixed or determinable; and collectability is reasonably assured. A significant portion of our sales are made to distributors under agreements which contain a limited right to return unsold product and price protection provisions. Therefore, the recognition of net revenues and related cost of revenues from sales to distributors are deferred until the distributor resells the product.

When product revenues are recognized, we establish an estimated allowance for future product returns based on historical returns experience; when price reductions are approved, we establish an estimated liability for price protection payable on inventories owned by product resellers. Should actual product returns or pricing adjustments exceed our estimates, additional reductions to revenues would result.

Our products typically carry a one- or two-year warranty. Although we engage in extensive product quality programs and processes, our warranty obligation is affected by product failure rates, use of materials or service delivery costs that differ from our estimates. As a result, additional warranty reserves could be required, which could reduce gross margins. Additionally, we sell extended warranty services, which extend the warranty period for an additional one to three years, depending upon the product. Warranty net revenues are recognized ratably over the warranty service period.

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 allowance for doubtful accounts is based on our assessment of the collectability of specific customer accounts, the aging of accounts receivable, our history of bad debts and the general condition of the industry. If a major customer's credit worthiness deteriorates, or our customers' actual defaults exceed our historical experience, our estimates could change and impact our reported results.

We also maintain a reserve for uncertainties relative to the collection of former officer notes receivable. Factors considered in determining the level of this reserve include the value of the collateral securing the notes, our ability to effectively enforce collection rights and the ability of the former officers and Lantronix directors to honor their obligations.

Inventory Valuation

Our policy is to value inventories at the lower of cost or market on a part-by-part basis. This policy requires us to 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, generally three to twelve months. The estimates we use for demand are also used for near-term capacity planning and inventory purchasing and are consistent with our revenue forecasts. In addition, specific reserves are recorded to cover risks in the area of end of life products, inventory located at our contract manufacturers, deferred inventory in our sales channel and warranty replacement stock.

If our sales forecast is less than the inventory we have on hand at the end of an accounting period, we may be required to take excess and obsolete inventory charges, which will decrease gross margin and net operating results for that period.

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 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, which currently has a valuation allowance, we would be required to reverse the valuation allowance that would be reflected as an income tax benefit at that time.

Goodwill and Purchased Intangible Assets

The acquisition method of accounting for acquisitions requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair value of the net tangible and intangible assets acquired, including in-process research and development. The amounts and useful lives assigned to intangible assets impact future amortization. If the assumptions and estimates used to allocate the purchase price are not correct, purchase price adjustments or future asset impairment charges could be required.

We perform goodwill impairment tests on an annual basis, and more frequently if events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Goodwill impairment testing requires us to compare the fair value of our one reporting unit to its carrying amount, including goodwill, and record an impairment charge if the carrying amount of a reporting unit exceeds its estimated fair value. The determination of the reporting unit's fair value requires significant judgment and is based on management's best estimate, which generally uses valuation techniques based on multiples of revenue for similar companies and the Company's market capitalization. In addition, management may consider the reporting unit's expected future earnings. If actual results are not consistent with our assumptions and judgments used in estimating fair value, we may be exposed to goodwill impairment losses. As of April 1, 2011, the fair value of the reporting unit was estimated to be $39.7 million based upon the Company's market capitalization compared to the reporting unit's carrying amount, including goodwill, of $18.1 million. As of June 30, 2011 we have $9.5 million of goodwill reflected in our consolidated balance sheet.

We evaluate purchased intangible assets when indicators of impairment, such as reductions in demand or significant economic slowdowns, are present. Reviews are performed to determine whether the carrying values of these assets are impaired based on a comparison to the undiscounted expected future cash flows. If the comparison indicates that there is impairment, the expected future cash flows using a discount rate based upon our weighted average cost of capital is used to estimate the fair value of the assets. Impairment is based on the excess of the carrying amount over the fair value of those assets. Significant management judgment is required in the forecast of future operating results that is used in the preparation of expected discounted cash flows. It is reasonably possible that the estimates of anticipated future net revenues, the remaining estimated economic lives of the products and technologies, or both, could differ from those used to assess the recoverability of our purchased intangible assets. In the event they are lower, additional impairment charges or shortened useful lives of certain purchased intangible assets could be required. As of June 30, 2011, we have approximately $54,000 of purchased intangible assets reflected in our consolidated balance sheet.

Results of Operations

Fiscal Years Ended June 30, 2011 and 2010

Net Revenue by Product Line

The following table presents net revenue by product line:

	Years Ended June 30,					
		% of Net		% of Net	Change	
	2011	Revenue	2010	Revenue	$	%
	(In thousands, except percentages)					
Device enablement	$39,608	80.3%	$37,096	80.0%	$2,512	6.8%
Device management	9,055	18.4%	8,384	18.1%	671	8.0%
Device networking	48,663	98.7%	45,480	98.1%	3,183	7.0%
Non-core	658	1.3%	895	1.9%	(237)	(26.5%)
Net revenue	$49,321	100.0%	$46,375	100.0%	$2,946	6.4%

The overall increase in net revenues was the result of an increase in net revenue from our device enablement and device management product lines, partially offset by a decrease in net revenue from our non-core product lines. The increase in net revenue from our device enablement product line was due to an increase in unit sales of some of our embedded device enablement products, in particular our XPort, XPort Pro, ASIC, MatchPort and WiPort product families, partially offset by a decrease in unit sales of some of our external device enablement products, in particular our WiBox, UBox and MSS product families, offset by an increase in our EDS product family. The increase in net revenue from our device management product line was due to an increase in unit sales of our SLS Spider, SLB and SCS product families, partially offset by a decrease in sales of our SLC product family.

Net Revenues by Geographic Region

The following table presents net revenues by geographic region:

	Years Ended June 30,					
		% of Net		% of Net	Change	

	2011	Revenue	2010	Revenue	$	%
	(In thousands, except percentages)					
Americas	$25,648	52.0%	$26,111	56.3%	$(463)	(1.8%)
EMEA	15,370	31.2%	12,953	27.9%	2,417	18.7%
Asia Pacific	8,303	16.8%	7,311	15.8%	992	13.6%
Net revenue	$49,321	100.0%	$46,375	100.0%	$2,946	6.4%

The Europe, Middle East and Africa (the "EMEA") and Asia Pacific geographic regions primarily contributed to the increase in net revenues for the fiscal year ended June 30, 2011 compared to the fiscal year ended June 30, 2010, partially offset by a decrease in the Americas. The increase in net revenue from the EMEA region was mainly due to an increase in unit sales of our device enablement product lines, in particular our XPort, XPort Pro, ASIC, MICRO, Xpress and EDS product families, partially offset by a decrease in our WiPort and UBox product families. The increase in net revenue in the Asia Pacific region was due to an increase in unit sales of our device management product lines, in particular our SLS and SLC product families, as well as an increase in our device enablement product lines, in particular our XPort Pro, MICRO. MatchPort and WiPort product families, partially offset by a decrease in sales of our XPort product family.

Net Revenues by Significant Customer

The following table presents net revenues by significant customer and a related party as a percentage of net revenues:

	Years Ended June 30,	
	2011	2010
Top five customers (1)(2)	41%	39%
Ingram Micro	14%	10%
Tech Data	7%	11%
Related parties	2%	1%

(1) Includes Ingram Micro and Tech Data.
(2) All top five customers are distributors

Two international customers, Lynx (former transtec AG) and barix AG, are related parties due to common ownership by our largest stockholder and Lantronix director, Bernhard Bruscha.

Gross Profit

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

The following table presents gross profit:

	Years Ended June 30,					
		% of Net		% of Net	Change	
	2011	Revenues	2010	Revenues	$	%
	(In thousands, except percentages)					
Gross profit	$24,414	49.5%	$24,118	52.0%	$296	1.2%

In order of significance, the decrease in gross profit percentage was due to (i) an increase in inventory reserve expenses in the current year mainly as a result of excess materials for end of life products, (ii) an increase in warranty expenses as a result of a specific product issue and (iii) product mix as a result of certain lower margin products increasing as a percentage of sales.

Selling, General and Administrative

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

The following table presents selling, general and administrative expenses:

Years Ended June 30,					
	% of Net		% of Net	Change	
2011	Revenue	2010	Revenue	$	%

	(In thousands, except percentages)					
Personnel-related expenses	$ 11,293		$ 10,135		$ 1,158	11.4%
Professional fees and outside services	4,679		2,054		2,625	127.8%
Advertising and marketing	1,940		2,099		(159)	(7.6%)
Facilities	1,149		1,214		(65)	(5.4%)
Share-based compensation	1,114		1,380		(266)	(19.3%)
Depreciation	661		622		39	6.3%
Bad debt expense (recovery)	27		(7)		34	(485.7%)
Other	1,510		1,538		(28)	(1.8%)
Selling, general and administrative	$ 22,373	45.4%	$ 19,035	41.0%	$ 3,338	17.5%

In order of significance, the increase in selling, general and administrative expense for the fiscal year ended June 30, 2011, as compared to the fiscal year ended June 30, 2010 was primarily due to: (i) an increase in professional fees and outside services due to the $2.1 million of expenses related to the investigation and $561,000 of expenses related to the contested proxy and (ii) an increase in personnel-related expenses due to separation expenses of $862,000 related to the departure of the former Chief Executive Officer and Chief Financial Officer, partially offset by (iii) a decrease in advertising and marketing expenses as a result of cost saving efforts and (iv) a decrease in share-based compensation due to the timing of stock option amortization.

Research and Development

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

The following table presents research and development expenses:

	Years Ended June 30,				Change	
	2011	% of Net Revenue	2010	% of Net Revenue	$	%
	(In thousands, except percentages)					
Personnel-related expenses	$ 4,610		$ 4,027		$ 583	14.5%
Facilities	997		1,096		(99)	(9.0%)
Professional fees and outside services	677		365		312	85.5%
Share-based compensation	293		478		(185)	(38.7%)
Depreciation	42		56		(14)	(25.0%)
Other	414		316		98	31.0%
Research and development	$ 7,033	14.3%	$ 6,338	13.7%	$ 695	11.0%

The increase in research and development expenses for the fiscal year ended June 30, 2011 compared to the fiscal year ended June 30, 2010 was primarily due to: (i) an increase in personnel-related expenses due to the suspension of a Company-wide furlough program in the equivalent period one year ago and (ii) an increase in professional fees and outside services related to development projects for upcoming product releases; partially offset by (iii) a decrease in share-based compensation due to the timing of stock option amortization and (iv) a decrease in facility related expenses as a result of cost saving efforts. Research and development expenses could increase in future periods as we continue to invest in new development efforts.

Interest Expense, Net

The following table presents interest expense, net:

Years Ended June 30,				Change	
2011	% of Net Revenues	2010	% of Net Revenues	$	%
(In thousands, except percentages)					
$(123)	(0.2%)	$(149)	(0.3%)	$26	(17.4%)

Interest expense, net											

The change in interest expense, net, is primarily due to lower interest expenses related to capital leases in the current year.

Other Expense, Net

The following table presents other expense, net:

	Years Ended June 30,										
	2011		% of Net Revenues		2010		% of Net Revenues		Change $		%
	(In thousands, except percentages)										
Other expense, net	$(28	)	(0.1%	)	$(19	)	(0.0%	)	$(9	)	47.4%

The change in other expense, net, is primarily due to 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 the income tax provision:

	Years Ended June 30,					
	2011	% of Net Revenues	2010	% of Net Revenues	Change $	%
	(In thousands, except percentages)					
Provision for income taxes	$56	0.1%	$24	0.1%	$32	133.3%

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

	Years Ended June 30, 2011	2010
Effective tax rate	(1.1%)	(1.6%)

We utilize the liability method of accounting for income taxes. The federal statutory rate was 34% for all periods presented. 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 will more likely than not be realized.

As a result of our cumulative losses, we provided a full valuation allowance against our net deferred tax assets for the fiscal years ended June 30, 2011 and 2010. The following table summarizes our net operating loss ("NOL") carryovers:

	June 30, 2011
	(In thousands)
Federal	$84,188
State	$61,437

Our NOL carryovers for federal and state income tax purposes begin to expire in fiscal years 2021 and 2013, respectively. At June 30, 2011, our fiscal 2003 through fiscal 2010 tax years remain open to examination by Federal, state, and foreign taxing authorities. However, we have NOLs beginning in fiscal 2001 which would cause the statute of limitations to remain open for the year in which the NOL was incurred.

Liquidity and Capital Resources

Liquidity

Since inception through fiscal 2011, we have financed our operations primarily through the issuance of common stock, a term loan and operating activities.

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

	June 30, 2011	2010	Increase (Decrease)
	(In thousands)		
Working capital	$5,222	$7,623	$(2,401)
Cash and cash equivalents	$5,836	$10,075	$(4,239)

In order of significance, our working capital as of June 30, 2011 decreased, as compared to June 30, 2010 primarily due to: (i) a decrease in cash as a result of payments related to the investigation, proxy contest and inventory and (ii) an increase in accounts payable as a result of the increase in inventory and the timing of cash payments to vendors.

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

In September 2010, we entered into an Amendment to the Loan and Security Agreement (the “Loan Agreement”), which provides for a two-year $4.0 million maximum revolving line (the “Revolving Line”) with a three-year $2.0 million term loan (the “Term Loan”). Per the Loan Agreement, the proceeds from the Term Loan were used to pay the balance of $611,000 outstanding on the term loan that was made under the original agreement in 2008. The Term Loan was funded on September 28, 2010 and is payable in 36 equal monthly installments of principal and accrued interest. There are no borrowings outstanding on the Revolving Line as of year end.

Borrowings under the Loan Agreement bear interest at the greater of 4.75% or prime rate plus 0.75% per annum. Upon entering into the Loan Agreement, we paid a fully earned, non-refundable commitment fee of $20,000 and will pay an additional $15,000 on September 28, 2011, the first anniversary of the effective date of the Loan Agreement.

The Borrowing Base (as defined in the Loan Agreement) under the Revolving Line is based upon eligible accounts receivable as defined per the Loan Agreement. The “Amount Available under the Revolving Line” is defined as at any time (a) the lesser of (i) the Revolving Line maximum or (ii) the Borrowing Base, minus (b) the amount of all outstanding letters of credit (including drawn but unreimbursed letters of credit), minus (c) an amount equal to the letter of credit reserves, minus (d) the foreign currency reserve, minus (e) the outstanding principal balance of any advances, and minus (f) one-half of the principal balance then outstanding of the Term Loan.

The Company failed to meet the minimum tangible net worth covenant for the months of May and June in fiscal 2011. On August 18, 2011, we entered into an amendment (“Amendment”) to the Loan Agreement. The Amendment provided for (1) a limited waiver to the minimum tangible net worth financial covenant, (2) a modification of the minimum tangible net worth financial covenant, and (3) a modification to the interest rate such that the interest will accrue at a per annum rate equal to 2.50 percentage points above the prime rate, payable monthly. If the Company achieves two consecutive fiscal quarters of earnings before interest, taxes, depreciation and amortization (“EBITDA”) greater than $1.00 (commencing with the fiscal quarter ending September 30, 2011), and only for so long as the Company maintains EBITDA greater than $1.00 at the end of each subsequent fiscal quarter, the interest shall accrue at a per annum rate equal to 1.50 percentage point above the Prime Rate, payable monthly.

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

	June 30,	
	2011	2010
	(In thousands)	
Term Loan	$1,500	$778
Available borrowing capacity	$2,302	$1,031

Outstanding letters of credit	$84	$343

As of June 30, 2011, approximately $339,000 of our cash was held in foreign subsidiary bank accounts. This cash is unrestricted with regard to foreign liquidity needs; however, our ability to utilize a portion of this cash to satisfy liquidity needs outside of such foreign locations may be subject to approval by the foreign location board of directors.

Cash Flows

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

	Years Ended June 30, 2011	2010
	(In thousands)	
Net cash provided by (used in):		
Net loss	$(5,271)	$(1,519)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:	2,992	2,720
Changes in operating assets and liabilities:		
Accounts receivable	(1,594)	516
Inventories	(2,455)	(202)
Contract manufacturers' receivable	379	(360)
Prepaid expenses and other current assets	(140)	(36)
Other assets	(90)	(13)
Accounts payable	1,808	924
Accrued payroll and related expenses	422	149
Warranty reserve	85	(41)
Restructuring reserve	-	(76)
Other liabilities	(280)	560
Cash received related to tenant incentives	32	290
Net cash (used in) provided by operating activities	(4,112)	2,912
Net cash used in investing activities	(413)	(860)
Net cash provided by (used in) financing activities	212	(1,070)
Effect of foreign exchange rate changes on cash	74	(44)
Increase (decrease) in cash and cash equivalents	$(4,239)	$938

Operating activities used cash during the fiscal year ended June 30, 2011. This was the result of a net loss and cash used by operating assets and liabilities, offset by non-cash operating expenses. Significant non-cash items included share-based compensation and depreciation. In order of significance, the changes in operating assets and liabilities that had a significant impact on the cash used by operating activities included: (i) an increase in inventories due to an increase in safety stock of certain products to ensure the on-time fulfillment of customer demand as well as an increase in the SLS Spider product family inventory as a result of lower than forecasted demand and (ii) an increase in accounts receivable as a result of lower deferred revenue balance which is recorded as a contra to accounts receivable due to the renegotiating agreements with certain distributors as part of an initiative to optimize its sales channel; offset by an increase in accounts payable as a result of the increase in inventory and expenses related to the investigation.

Operating activities provided cash during the fiscal year ended June 30, 2010. This was the result of cash provided by operating assets and liabilities and non-cash operating expenses offset by a net loss. Significant non-cash items included share-based compensation and depreciation. In order of significance, the changes in operating assets and liabilities that had a significant impact on the cash provided by operating activities included: (i) an increase in accounts payable as a result of the timing of inventory receipts and cash payments to vendors, (ii) an increase in other current liabilities and a decrease in accounts receivable as a result of an increase in deferred revenue at distributors; and (iii) cash received related to tenant incentives in connection with a building lease we entered into during fiscal 2010 for our corporate headquarter facility; offset by an increase in our inventories as a result of an increase in inventory held by our distributors.

Investing activities used cash during the fiscal years ended June 30, 2011 and 2010. This was due to the purchase of property and equipment.

Financing activities provided cash during the fiscal year ended June 30, 2011. This was due to (i) proceeds from the amended term loan and (ii) proceeds from the sale of common shares through employee stock option exercises; offset by (iii) payments related to the Term Loan, (iv) payments on capital lease obligations and (v) minimum tax withholding paid on behalf of employees related to the vesting of restricted shares.

Financing activities used cash during the fiscal year ended June 30, 2010. This was due to (i) payments on the term loan, (ii) payments of capital lease obligations and (iii) minimum tax withholding paid on behalf of employees related to the vesting of restricted shares.

Off-Balance Sheet Arrangements

We did not have any off-balance sheet arrangements as of June 30, 2011 and 2010.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our financial statements, related notes thereto and supplementary data required by this item are incorporated by reference from Part IV, Item 15 of this Form 10-K and are presented beginning on page F-1.

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures

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

(b) Changes in internal controls over financial reporting

There have been no changes in our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) identified during the fiscal quarter that ended June 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management’s Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f). Our internal control system was designed to provide reasonable assurance to management and the board of directors regarding the effectiveness of our internal control processes over the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

We have assessed the effectiveness of our internal controls over financial reporting as of June 30, 2011. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework. Based on our assessment, we believe that, as of June 30, 2011, our internal control over financial reporting is effective based on those criteria.

This annual report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's independent registered public accounting firm pursuant to the rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

ITEM 9B. OTHER INFORMATION

None.

PART III

Certain information required by Part III is included in our 2011 Definitive Proxy Statement (or “Proxy Statement) and is incorporated herein by reference. The Proxy Statement will be filed pursuant to Regulation 14A of the Exchange Act not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

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 Part I, Item 1 in the section entitled “Executive Officers of the Registrant” above, and are incorporated herein by reference.

The following information is included in our Proxy Statement and is incorporated herein by reference:

- Information regarding our directors is set forth under the proposal “Election of Directors.”

- Information regarding our Audit Committee and designated “audit committee financial experts” is set forth under “Election of Directors — Audit Committee.”

- Information regarding Section 16(a) beneficial ownership reporting compliance is set forth Other Information — Section 16(a) Beneficial Ownership Reporting Compliance.”

- Information on our code of business conduct and ethics for directors, officers and employees (or “Code of Ethics”) is set forth under “Election of Directors — Code of Ethics and Complaint Procedure.”

We have adopted the Code of Ethics, which applies to all of our directors, officers, and employees. The Code of Ethics operates as a tool to help our directors, officers, and employees understand and adhere to the high ethical standards we expect. Our Code of Ethics can be found on our website at www.lantronix.com. We intend to satisfy the disclosure requirement under Item 10 of Form 8-K regarding an amendment to, or waiver from, a provision of the Code of Ethics by posting such information on our website at the address specified above.

ITEM 11. EXECUTIVE COMPENSATION

Information regarding executive compensation is incorporated herein by reference to the sections in the Proxy Statement under the headings “Compensation Discussion and Analysis,” “Compensation Committee Interlocks and Insider Participation in Compensation Decisions,” “Compensation Committee Report,” “Executive Officers,” “Summary Compensation Table,” “Grant of Plan Based Awards,” “Outstanding Equity Awards,” “Option Exercises and Stock Vested,” “Pension Benefits,” and “Nonqualified Deferred Compensation.”

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

Information regarding security ownership of certain beneficial owners, directors and executive officers is set forth under “Election of Directors” and “Security Ownership of Certain Beneficial Owners and Management” in the Proxy Statement and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

Information regarding certain relationships and related transactions is set forth under "Election of Directors" and "Other Information — Related Party Transactions" in the Proxy Statement and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information regarding principal auditor fees and services is set forth under the proposal "Ratification of Appointment of Independent Registered Public Accountants" in the Proxy Statement and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) 1. Consolidated Financial Statements

The following financial statements of the Company and related Report of Independent Registered Public Accounting Firm is filed as part of this Annual Report on Form 10-K.

2. Exhibits

The exhibits listed on the accompanying index to exhibits immediately following the financial statements are filed as part of, or hereby incorporated by reference into, this Form 10-K.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Lantronix, Inc.

We have audited the accompanying consolidated balance sheets of Lantronix, Inc. as of June 30, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we do not express an opinion thereon. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Lantronix, Inc. as of June 30, 2011 and 2010, and the results of its operations and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ McGladrey & Pullen, LLP

Irvine, California
September 15, 2011

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

	June 30, 2011	June 30, 2010
Assets		
Current Assets:		
Cash and cash equivalents	$5,836	$10,075
Accounts receivable (net of allowance for doubtful accounts of $102 and $93 at June 30, 2011 and 2010, respectively)	2,908	1,342
Inventories, net	9,160	6,873
Contract manufacturers' receivable	636	1,015
Prepaid expenses and other current assets	605	515
Deferred tax assets	569	542
Total current assets	19,714	20,362
Property and equipment, net	1,761	2,392
Goodwill	9,488	9,488
Purchased intangible assets, net	54	155
Other assets	175	135
Total assets	$31,192	$32,532
Liabilities and stockholders' equity		
Current Liabilities:		
Accounts payable	$8,358	$6,545
Accrued payroll and related expenses	2,000	1,568
Warranty reserve	268	183
Short-term debt	667	667
Other current liabilities	3,199	3,776
Total current liabilities	14,492	12,739
Non-Current Liabilities:		
Long-term liabilities	550	646
Long-term capital lease obligations	45	153
Long-term debt	833	111
Deferred tax liabilities	569	542
Total non-current liabilities	1,997	1,452
Total liabilities	16,489	14,191
Commitments and contingencies		
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; 10,549,852 and 10,322,597 shares issued and outstanding at June 30, 2011 and 2010, respectively	1	1
Additional paid-in capital	192,780	191,147
Accumulated deficit	(178,477)	(173,206)

Accumulated other comprehensive income	399	399
Total stockholders' equity	14,703	18,341
Total liabilities and stockholders' equity	$31,192	$32,532

See accompanying notes.

LANTRONIX, INC.

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

	Years Ended June 30, 2011	2010
Net revenue (1)	$49,321	$46,375
Cost of revenue	24,907	22,257
Gross profit	24,414	24,118
Operating expenses:		
Selling, general and administrative	22,373	19,035
Research and development	7,033	6,338
Amortization of purchased intangible assets	72	72
Total operating expenses	29,478	25,445
Loss from operations	(5,064)	(1,327)
Interest expense, net	(123)	(149)
Other expense, net	(28)	(19)
Loss before income taxes	(5,215)	(1,495)
Provision for income taxes	56	24
Net loss	$(5,271)	$(1,519)
Net loss per share (basic and diluted)	$(0.51)	$(0.15)
Weighted average shares (basic and diluted)	10,434	10,276
(1) Includes net revenue from related parties	$942	$642

See accompanying notes.

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LANTRONIX, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands, except share data)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance at June 30, 2009	10,090,088	$1	$189,584	$(171,687)	$ 426	$18,324
Shares issued pursuant to stock awards, net	232,509	-	158	-	-	158
Minimum tax withholding paid on behalf of employees for restricted shares	-	-	(263)	-	-	(263)
Share-based compensation	-	-	1,668	-	-	1,668
Components of comprehensive loss:						
Translation adjustments	-	-	-	-	(27)	(27)
Net loss	-	-	-	(1,519)	-	(1,519)
Comprehensive loss	-	-	-	-	-	(1,546)
Balance at June 30, 2010	10,322,597	1	191,147	(173,206)	399	$18,341
Shares issued pursuant to stock awards, net	227,255	-	480	-	-	480
Minimum tax withholding paid on behalf of employees for restricted shares	-	-	(295)	-	-	(295)
Share-based compensation	-	-	1,448	-	-	1,448
Components of comprehensive loss:						
Net loss	-	-	-	(5,271)	-	(5,271)
Comprehensive loss	-	-	-	-	-	(5,271)
	10,549,852	$1	$192,780	$(178,477)	$ 399	$14,703

Balance at June 30, 2011	

See accompanying notes.

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

	Years Ended June 30, 2011	2010
Operating activities		
Net loss	$(5,271)	$(1,519)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Share-based compensation	1,603	1,901
Depreciation	1,042	908
Provision (recovery) for inventories	167	(192)
Provision for officer loan	52	-
Amortization of purchased intangible assets	101	110
Provision (recovery) for doubtful accounts	27	(7)
Changes in operating assets and liabilities:		
Accounts receivable	(1,594)	516
Inventories	(2,455)	(202)
Contract manufacturers' receivable	379	(360)
Prepaid expenses and other current assets	(140)	(36)
Other assets	(90)	(13)
Accounts payable	1,808	924
Accrued payroll and related expenses	422	149
Warranty reserve	85	(41)
Restructuring reserve	-	(76)
Other liabilities	(280)	560
Cash received related to tenant incentives	32	290
Net cash (used in) provided by operating activities	(4,112)	2,912
Investing activities		
Purchases of property and equipment, net	(413)	(860)
Net cash used in investing activities	(413)	(860)
Financing activities		
Minimum tax withholding paid on behalf of employees for restricted shares	(295)	(263)
Proceeds from term loan	2,000	-
Payment of term loan	(1,277)	(667)
Net proceeds from issuances of common stock	93	159
Payment of capital lease obligations	(309)	(299)
Net cash provided by (used in) financing activities	212	(1,070)
Effect of foreign exchange rate changes on cash	74	(44)
Increase (decrease) in cash and cash equivalents	(4,239)	938
Cash and cash equivalents at beginning of period	10,075	9,137
Cash and cash equivalents at end of period	$5,836	$10,075
Supplemental disclosure of cash flow information		
Interest paid	$121	$154
Income taxes paid	$33	$27
Shares of common stock issued to settle performance bonus awards	$387	$-

See accompanying notes.

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2011

1. Summary of Significant Accounting Policies

The Company

Lantronix, Inc. (the "Company"), incorporated in California in June 1989 and re-incorporated in the State of Delaware in May 2000, is engaged primarily in the design and distribution of networking and Internet connectivity products on a worldwide basis. The actual assembly and a portion of the engineering of the Company's products are outsourced to third parties.

The Company has incurred losses from operations and has reported negative operating cash flows. As of June 30, 2011, the Company had an accumulated deficit of $178.5 million and cash and cash equivalents of $5.8 million. The Company believes that its existing cash and cash equivalents, and any cash generated from operations, will be sufficient to fund its working capital requirements, capital expenditures and other obligations through the next twelve months. Long-term the Company may face significant risks associated with the successful execution of its business strategy and may need to raise additional capital in order to fund more rapid expansion, to expand its marketing activities, to develop new or enhance existing services or products, and to respond to competitive pressures or to acquire complementary services, businesses, or technologies. If the Company is not successful in generating sufficient cash flow from operations, it may need to raise additional capital through public or private financing, strategic relationships, or other arrangements.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. At June 30, 2011, approximately $2.8 million of the Company's net tangible assets (primarily inventory held at our third party logistics provider in Hong Kong and cash held in foreign bank accounts) were located outside of the U.S. Such assets are unrestricted with regard to foreign liquidity needs, however, the ability of the Company to utilize such assets to satisfy liquidity needs outside of such foreign locations may be subject to approval by the foreign location board of directors.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The industry in which the Company operates is characterized by rapid technological change and short product life cycles. As a result, estimates made in preparing the consolidated financial statements include the allowance for doubtful accounts, sales returns and allowances, inventory reserves, allowance for officer loans, goodwill and purchased intangible asset valuations, deferred income tax asset valuation allowances and warranty reserves. To the extent there are material differences between estimates and the actual results, future results of operations will be affected.

Revenue Recognition

The Company does not recognize revenue until all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the Company's price to the buyer is fixed or determinable; and collectability is reasonably assured. A significant portion of the Company’s sales are made to distributors under agreements which contain a limited right to return unsold product and price protection provisions. Therefore, the recognition of net revenue and related cost of revenue from sales to certain large distributors are deferred until the distributor resells the product.

When product revenues are recognized, the Company establishes an estimated allowance for future product returns based on historical returns experience; when price reductions are approved, it establishes an estimated liability for price protection payable on inventories owned by distributors. Should actual product returns or pricing adjustments exceed the Company’s estimates, additional reductions to revenue could result.

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

Net revenue from the licensing of software is recognized at the time of shipment (or at the time of resale in the case of software products sold through distributors), provided the Company has vendor-specific objective evidence of the fair value of each element of the software offering and collectability is probable. Additionally, the Company sells extended warranty services which extend the warranty period for an additional one to three years, depending upon the product. Warranty net revenue is recognized ratably over the warranty service period.

The following table presents our hardware and non-hardware sales as a percentage of total net revenue:

	Years Ended June 30,	
	2011	2010
Hardware	99%	99%
Non-hardware	1%	1%
Total net revenue	100%	100%

Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company's allowance for doubtful accounts is based on its assessment of the collectability of specific customer accounts, the aging of accounts receivable, the Company's history of bad debts and the general condition of the industry. Accounts that are deemed uncollectible are written off against the allowance for doubtful accounts. If a major customer's creditworthiness deteriorates, or the Company's customers' actual defaults exceed its historical experience, such estimates could change and impact reported results.

The Company also maintains a reserve for uncertainties relative to the collection of former officer and former director notes receivable that originated in fiscal 2001. Factors considered in determining the level of this reserve include the value of the collateral securing the notes, the Company's ability to effectively enforce collection rights and the ability of the former officer and former director to honor their obligations.

Concentration of Credit Risk

The Company's accounts receivable are primarily derived from revenue earned from customers located throughout North America, Europe and Asia. The Company performs ongoing credit evaluations of its customers' financial condition and maintains allowances for potential credit losses. Credit losses have historically been within management's expectations. The Company generally does not require collateral or other security from its customers.

Fair Value of Financial Instruments

The Company's financial instruments consist principally of cash and cash equivalents, accounts receivable, notes receivable, contract manufacturers' receivable, accounts payable, accrued liabilities and long-term debt. The Company believes all of the financial instruments' recorded values approximate current values because of the nature and short duration of these instruments. The fair value of long-term debt approximates its carrying value because the related effective rates of interest approximate current market rates available to us for debt with similar terms and similar remaining maturities.

Foreign Currency Translation

The functional currency for all 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. Revenue and expenses are translated at average exchange rates in effect during each period. Exchange gains and losses from foreign currency transactions and translations are recognized in the consolidated statements of operations. Translation adjustments for foreign subsidiaries whose functional currency was previously the local currency are suspended in accumulated other comprehensive income (loss).

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

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 market. The Company provides reserves for excess and obsolete inventories determined primarily based upon estimates of future demand for the Company's 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, the Company sells raw materials to its contract manufacturers and subsequently repurchases finished goods from the contract manufacturers which contain such raw materials. Net sales of raw materials to the contract manufacturers are eliminated from the Company's net revenue as the Company intends to repurchase the raw materials from the contract manufacturers in the form of finished goods. Raw materials sold to the contract manufacturers which the Company intends to purchase as part of finished goods are recorded on the Company's consolidated balance sheets as contract manufacturers' receivable.

Property and Equipment

Property and equipment are carried at cost. Depreciation is provided using the straight-line method over the assets' estimated useful lives 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 lives of the respective assets, are expensed as incurred.

Capitalized Internal Use Software Costs

The Company capitalizes the costs of computer software developed or obtained for internal use. Capitalized computer software costs consist of purchased software licenses and implementation costs. The capitalized software costs are being amortized on a straight-line basis over a period of three to five years.

Goodwill and Purchased Intangible Assets

Goodwill is recorded as the difference, if any, between the aggregate consideration paid for an acquisition and the fair value of the net tangible and intangible assets acquired. The Company tests goodwill for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis in the fourth fiscal quarter or more frequently if the Company believes indicators of impairment exist. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair value of the single reporting unit with its aggregate carrying amount, including goodwill. The Company determines the fair value of its single reporting unit using the market or income approach methodology of valuation that includes comparing it to the market values of similar companies. If the carrying amount of the reporting unit exceeds the reporting unit's fair value, the Company performs the second step of the goodwill impairment test to determine the amount of impairment loss. The second step of the goodwill impairment test involves comparing the implied fair value of the affected reporting unit's goodwill with the carrying value of that goodwill.

During the fourth fiscal quarters ended June 30, 2011 and 2010, the Company completed its annual goodwill impairment tests and determined that no impairment was indicated as the reporting unit's estimated fair value exceeded its carrying amount. As of April 1, 2011, the fair value of the reporting unit was estimated to be $39.7 million based upon the Company's market capitalization compared to the reporting unit's carrying amount of $18.1 million.

The Company accounts for long-lived assets, including other purchased intangible assets, which requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present. Reviews are performed to determine whether the carrying value of an asset is impaired, based on comparisons to undiscounted expected future cash flows. If this comparison indicates that there is impairment, the impaired asset is written down to fair value, which is typically calculated using (i) quoted market prices and/or (ii) discounted expected future cash. Impairment is based on the excess of the carrying amount over the fair value of those assets.

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

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 the Company's 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. 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 has a more likely than not likelihood of being realized upon ultimate settlement with a taxing authority. The Company recognizes potential accrued interest and penalties related to unrecognized tax benefits as income tax expense.

Share-Based Compensation

The Company accounts for share-based compensation by expensing the estimated fair value of stock options and similar equity instruments issued to employees over the requisite service period. The Company records amortization of share-based compensation expense ratably over the requisite service period of the grant or as market conditions are achieved. The Company estimates forfeitures in its calculation of share-based compensation.

Net Income (Loss) Per Share

Net income (loss) per share (basic) is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the fiscal year. Net income (loss) per share (diluted) is calculated by adjusting the weighted average number of common shares outstanding, assuming any dilutive effects of options 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. The Company believes its current process for developing products is essentially completed concurrently with the establishment of technological feasibility. Software development costs incurred after the establishment of technological feasibility have not been material and, therefore, have been expensed as incurred.

Warranty

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

Advertising Expenses

Advertising costs are expensed in the period incurred.

Accumulated Comprehensive Income

Accumulated other comprehensive income is composed of accumulated translation adjustments as of June 30, 2011 and 2010.

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

Segment Information

The Company has one operating and reportable segment, networking and Internet connectivity.

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board, or FASB, issued guidance regarding the presentation of comprehensive income. The new standard requires the presentation of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The new standard also requires presentation of adjustments for items that are reclassified from other comprehensive income to net income in the statement where the components of net income and the components of other comprehensive income are presented. The updated guidance is effective on a retrospective basis for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. The adoption of this guidance will not have a material impact on the Company's financial statements.

In May 2011, the FASB issued additional guidance on fair value measurements that clarifies the application of existing guidance and disclosure requirements, changes certain fair value measurement principles and requires additional disclosures about fair value measurements. The updated guidance is effective on a prospective basis for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. The adoption of this guidance will not have a material impact on the Company's financial statements.

2. Supplemental Financial Information

Inventories

The following table presents details of the Company's inventories:

	June 30,	
	2011	2010
	(In thousands)	
Finished goods	$6,475	$4,258
Raw materials	1,912	1,390
Inventory at distributors *	1,436	1,924
Large scale integration chips **	714	516
Inventories, gross	10,537	8,088
Reserve for excess and obsolete inventory	(1,377)	(1,215)
Inventories, net	$9,160	$6,873

* Balance represents finished goods held by distributors
** This item is sold individually and embedded into the Company's products.

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

Property and Equipment

The following table presents details of the Company's property and equipment:

	June 30, 2011	2010
	(In thousands)	
Computer and office equipment	$3,356	$3,323
Furniture and fixtures	862	874
Production and warehouse equipment	1,799	1,581
Construction-in-progress	99	-
Property and equipment, gross	6,116	5,778
Less accumulated depreciation	(4,355)	(3,386)
Property and equipment, net	$1,761	$2,392

The following table presents details of property and equipment recorded in connection with capital lease obligations:

	June 30, 2011	2010
	(In thousands)	
Property and equipment	$446	$526
Less accumulated depreciation	(317)	(266)
Total	$129	$260

The following table presents details of the unamortized costs capitalized as internal use software included in construction-in-progress and computer and office equipment:

	June 30, 2011	2010
	(In thousands)	
Capitalized internal use software	$403	$786

The following table presents the details of depreciation of capitalized internal use software:

	Years Ended June 30, 2011	2010
	(In thousands)	
Depreciation of capitalized internal use software	$400	$358

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

Purchased Intangible Assets

The following table presents details of the Company's purchased intangible assets:

		June 30, 2011			June 30, 2010		
	Useful Lives in Years	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
				(In thousands)			
Existing technology	1 - 5	$ 7,259	$ (7,259)	$ -	$ 7,259	$ (7,231)	$ 28
Patent/core technology	6	839	(785)	54	839	(712)	127
Total purchased intangible assets		$ 8,098	$ (8,044)	$ 54	$ 8,098	$ (7,943)	$ 155

Warranty Reserve

The following table presents details of the Company's warranty reserve:

	June 30, 2011	2010
	(In thousands)	
Beginning balance	$183	$224
Charged to cost of revenues	288	84
Usage	(203)	(125)
Ending balance	$268	$183

Other Liabilities

The following table presents details of the Company's other liabilities:

	June 30, 2011	2010
	(In thousands)	
Current		
Customer deposits and refunds	$1,047	$1,829
Deferred revenue	178	174
Capital lease obligations	100	301
Taxes payable	211	205
Other	1,663	1,267

Total other current liabilities	$3,199	$3,776
Long-term		
Deferred rent	$250	$288
Severance accrual	153	-
Deferred revenue	147	124
Performance bonus	-	234
Total other long-term liabilities	$550	$646

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

Advertising Expenses

The following table presents details of the Company's advertising expenses:

	Years Ended June 30,	
	2011	2010
	(In thousands)	
Advertising expenses	$390	$511

Interest Expense

The following table presents details of the Company's interest expense:

	Years Ended June 30,	
	2011	2010
	(In thousands)	
Interest expense	$123	$150

Computation of Net Loss per Share

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

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

	Years Ended June 30,	
	2011	2010
	(In thousands, except per share data)	
Numerator:		
Net loss	$(5,271)	$(1,519)
Denominator:		
Weighted-average shares outstanding	10,541	10,568
Less: Unvested common shares outstanding	(107)	(292)
Weighted average shares (basic and diluted)	10,434	10,276
Net loss per share (basic and diluted)	$(0.51)	$(0.15)

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

Years Ended June 30,

	2011	2010
	(In thousands)	
Common stock equivalents	826	1,232

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LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

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,	
	2011	2010
	(In thousands)	
Non-cash acquisition of property and equipment	$-	$208

3. Officer Loans

The Company has outstanding notes receivable from a former officer and a former director primarily related to taxes on exercised stock options. These notes are non-recourse, secured by shares of common stock, and bear interest at rates ranging from 5.19% to 7.50% per annum. Principal and any unpaid interest are due upon any transfer or disposition of the secured common stock. Former officer and former director loans are included in other assets on the balance sheet.

One of the note holders is a former Chief Executive Officer who assumed the role of Chief Technology and Strategy Officer of the Company effective May 30, 2002 and resigned from the Company effective September 1, 2002. During fiscal 2002, the Company reduced the carrying amount of the former officer’s loans to zero by establishing a reserve for uncertainties relative to collection of the related notes receivable. Factors considered in determining the level of this reserve include the value of the collateral securing the notes, the ability of the Company to effectively enforce its collection rights and the ability of the former officer to honor his obligations to the Company.

Due to the decline in the Company’s stock price during fiscal 2011, the Company reduced the carrying amount of the former director’s loan to the fair value of the collateralized shares as of June 30, 2011 which resulted in a $52,000 charge to other expense.

4. Line of Credit and Term Loan

Line of Credit

In September 2010, the Company entered into an Amendment to the Loan and Security Agreement (the “Loan Agreement”), which provides for a two-year $4.0 million maximum revolving line (the “Revolving Line”) with a three-year $2.0 million term loan (the “Term Loan”). Per the Loan Agreement, the proceeds from the Term Loan were used to pay the balance of $611,000 outstanding on the term loan that was made under the original agreement in 2008. The Term Loan was funded on September 28, 2010 and is payable in 36 equal monthly installments of principal and accrued interest. There are no borrowings outstanding on the Revolving Line as of June 30, 2011.

Borrowings under the Loan Agreement bear interest at the greater of 4.75% or prime rate plus 0.75% per annum. Upon entering into the Loan Agreement, the Company paid a fully earned, non-refundable commitment fee of $20,000 and will pay an additional $15,000 on September 28, 2011, the first anniversary of the effective date of the

Loan Agreement.

The Borrowing Base (as defined in the Loan Agreement) under the Revolving Line is based upon eligible accounts receivable as defined per the Loan Agreement. The “Amount Available under the Revolving Line” is defined as at any time (a) the lesser of (i) the Revolving Line maximum or (ii) the Borrowing Base, minus (b) the amount of all outstanding letters of credit (including drawn but unreimbursed letters of credit), minus (c) an amount equal to the letter of credit reserves, minus (d) the foreign currency reserve, minus (e) the outstanding principal balance of any advances, and minus (f) one-half of the principal balance then outstanding of the Term Loan.

The Company failed to meet the minimum tangible net worth covenant for the months of May and June in fiscal 2011. On August 18, 2011, the Company entered into an amendment (“Amendment”) to the Loan Agreement. The Amendment provided for (1) a limited waiver to the minimum tangible net worth financial covenant, (2) a modification of the minimum tangible net worth financial covenant, and (3) a modification to the interest rate such that the interest will accrue at a per annum rate equal to 2.50 percentage points above the Prime Rate, payable monthly. If the Company achieves two consecutive fiscal quarters of EBITDA greater than $1.00 (commencing with the fiscal quarter ending September 30, 2011), and only for so long as the Company maintains EBITDA greater than $1.00 at the end of each subsequent fiscal quarter, the interest shall accrue at a per annum rate equal to 1.50 percentage point above the Prime Rate, payable monthly.

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

Availability under the Line of Credit

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

	June 30, 2011	2010
	(In thousands)	
Term Loan	$1,500	$778
Available borrowing capacity	$2,302	$1,031
Outstanding letters of credit	$84	$343

5. Stockholders' Equity

Share-Based Plans

As reported in Form 8-K dated June 24, 2011, as a result of the findings of the independent investigation of certain allegations asserted by a director of the Company, it was determined that certain grants to the former Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") exceeded the annual limitation on the numbers of stock options that could be granted to an individual in a single year contained in the Company's 2000 Stock Plan and therefore were invalid (the "invalid options"). As a result, the Company removed the total of 121,124 invalid stock options from the balance of outstanding stock options as of June 30, 2010 and 2011. It was determined that the former CEO and CFO most likely had a valid compensation claim against the Company due to the fact that the grants were approved in fiscal 2010 by the Compensation Committee of the Company and the executives continued to provide services based upon an expectation that valid awards had been granted. As such, the shared-based compensation expense related to the original awards was properly charged to expenses as previously presented in the Company's financial statements. Effective upon their resignation, the former CEO and CFO relinquished any and all rights to the invalid option grants as part of their respective separation agreements signed in June of 2011. Accordingly, the previously recognized expense of approximately $149,000 was reversed in June 2011.

As part of the separation agreements with the former CEO and CFO discussed above, their outstanding share based awards, other than the invalid options, were modified to increase the post-termination exercise period for all outstanding stock options and to accelerate and fully vest all outstanding unvested share based awards. The modifications resulted in a charge to share based compensation of approximately $126,000 in June of 2011.

The Company has share-based plans under which non-qualified and incentive stock options have been granted to employees, non-employees and board members. In addition, the Company has granted restricted stock awards to employees and board members under these share-based plans.

The board of directors determines eligibility, vesting schedules and exercise prices for options and shares granted under the plans. Share-based awards are generally granted with an exercise price equal to the market price of the Company's stock at the date of grant. Option awards generally have a term of 7 to10 years. Share-based awards generally vest and become exercisable over a one- to four-year service period. The Company has granted share-based awards with market conditions whereby vesting is accelerated upon achieving certain stock price thresholds. In addition, the board of directors has approved a share-based performance plan whereby employees will be paid in vested common shares if minimum revenue, income and management objectives are met. The Company issues new shares to satisfy stock option exercises, restricted stock grants, and stock purchases under its share-based plans.

No income tax benefit was realized from activity in the Company’s share-based plans during the fiscal years ended June 30, 2011 and 2010.

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

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

	Years Ended June 30, 2011	2010
	(In thousands)	
Cost of revenues	$63	$43
Selling, general and administrative	1,114	1,380
Research and development	426	478
Total share-based compensation	$1,603	$1,901

The following table presents a summary of share-based compensation for the Company's share-based plans:

	Years Ended June 30, 2011	2010
	(In thousands)	
Stock options	$1,089	$1,319
Restricted stock	359	349
Performance Plan	155	233
Total share-based compensation	$1,603	$1,901

The following table presents a summary of remaining unrecognized share-based compensation expense for the Company's share-based plans as of June 30, 2011:

Vesting Condition	Remaining Unrecognized Compensation Cost	Weighted-Average Remaining Years To Vest
	(In thousands)	
Stock Option Awards:		
Service based	$1,031	
All stock option awards	$1,031	2.7
Restricted Stock Awards:		
Service based	$200	
All restricted stock awards	$200	1.2

Stock Option Awards

The fair value of each stock option grant was estimated on the grant date using the Black-Scholes-Merton ("BSM") option-pricing formula. To the extent that the stock option grant included market conditions, the Company used a lattice model to estimate the fair value for each stock option grant. Expected volatilities were based on the historical volatility of the Company's stock price. The expected term of options granted was estimated using the simplified method. To the extent that stock option grants included market conditions and do not meet the rules for the simplified method, the Company used a lattice model to estimate the expected term of stock options granted. The risk-free rate for periods within the contractual life of the stock option grant was based on the U.S. Treasury interest rates in effect at the time of grant.

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

The fair value of options granted was estimated using the following weighted-average assumptions for all of the Company's stock option plans:

	Years Ended June 30, 2011	2010
Expected term (in years)	4.92	6.21
Expected volatility	0.79	0.80
Risk-free interest rate	1.96%	2.77%
Dividend yield	0.00%	0.00%

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

	Number of Shares	Weighted-Average Exercise Price	Remaining Contractual Term	Aggregate Intrinsic Value
	(In thousands, except share and per share data)			
Balance at June 30, 2010	1,769,215	$4.85		
Options granted	436,363	3.46		
Options forfeited	(204,528)	3.55		
Options expired	(148,651)	7.26		
Options exercised	(34,411)	2.70		
Balance at June 30, 2011	1,817,988	$4.50	6.7	$84
Vested or expected to vest at June 30, 2011	1,716,222	$4.59	6.7	$76
Options exercisable at June 30, 2011	1,147,998	$5.43	6.2	$22

The following table presents a summary of option grant-date fair value and intrinsic value information for all of the Company's stock option plans:

	Years Ended June 30, 2011	2010
	(In thousands, except per share data)	
Weighted-average grant-date fair value per share	$2.20	$1.95
Intrinsic value of options exercised	$26	$38

Nonvested Share Awards

The following table presents a summary of the activity for all of the Company's nonvested shares:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value

Balance of nonvested shares at June 30, 2010	291,646	$ 3.16
Granted	-	-
Forfeited	(24,804)	3.00
Vested	(159,957)	3.25
Balance of nonvested shares at June 30, 2011	106,885	$ 3.06

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

The following table presents a summary of the total fair value of shares vested for all of the Company's nonvested share awards:

	Years Ended June 30, 2011	2010
	(In thousands)	
Fair value of shares vested	$540	$443

Market-Based Share Awards

During the fiscal year ended June 30, 2008, the Company granted market-based option and restricted stock awards to certain employees and directors. The market-based share awards cliff vest over 3-years; however, the vesting may accelerate upon the Company's stock price reaching the following thresholds for 120 consecutive days: (i) 30% vests at $9.00; (ii) 30% vests at $15.00; and (iii) 40% vests at $24.00. The vesting percentages do not cumulate.

A lattice model was used to estimate the fair value and expected life for the market-based option awards. The following table presents a summary of option activity for the Company's market-based option awards:

	Number of Shares	Weighted-Average Exercise Price	Remaining Contractual Term	Aggregate Intrinsic Value
	(In thousands, except share and per share data)			
Balance at June 30, 2010	382,790	$4.74		
Options granted	-	-		
Options forfeited	(22,352)	5.06		
Options expired	(33,530)	5.06		
Options exercised	-	-		
Balance at June 30, 2011	326,908	$4.69	6.7	$-
Vested or expected to vest at June 30, 2011	326,908	$4.69	6.7	$-
Options exercisable at June 30, 2011	326,908	$4.69	6.7	$-

The fair value of market-based nonvested shares was determined upon the closing trading price of the Company's shares on the grant date. A lattice model was used to estimate the expected life for the market-based nonvested shares. The following table presents a summary of the activity for the Company's market-based nonvested shares:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value
Balance of nonvested shares at June 30, 2010	6,666	$ 4.98
Granted	-	-
Forfeited	-	-

Vested	(6,666)	4.98
Balance of nonvested shares at June 30, 2011	-	$ -

Performance-Based Share Awards

The board of directors approved Performance Plans for the fiscal years ended June 30, 2010 and June 30, 2011, respectively, to be paid in all or part of vested common shares if minimum revenue, non-GAAP income and management objectives were met. Included in long-term liabilities on the consolidated balance sheet as of June 30, 2010 was $234,000 that was settled by the issuance of 44,528 fully vested common shares in September of 2010. In February of 2011, 24,279 fully vested common shares were issued to settle a $155,000 bonus liability for the fiscal 2011 first half Performance Plan. As of June 30, 2011, $102,000 was recorded in accrued payroll and related expenses related to the fiscal 2011 second half Performance Plan which will be settled in cash after the filing of this Form 10-K.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

6. 401(k) Plan

The Company has a savings plan (the "Plan") which is qualified under Section 401(k) of the Internal Revenue Code. Eligible employees may elect to make contributions to the Plan through salary deferrals up to 15% of their base pay, subject to limitations. The Company's contributions are discretionary and are subject to limitations. Historically, the Company contributed $0.50 for each $1.00 of employee salary deferral contributions up to a maximum of 6% of the employee's annual gross wages, subject to limitations. During the fiscal year ended June 30, 2009, the Company suspended its discretionary contributions to the Plan.

7. Stock Warrants

During March 2008, the Company issued warrants to purchase approximately 180,000 shares of Lantronix common stock to class action plaintiffs as final consideration for a shareholder settlement liability. The warrants had an exercise price of $28.08 and expired on February 10, 2011.

8. Litigation

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

9. Income Taxes

The income tax provision consists of the following components:

	Years Ended June 30,	
	2011	2010
	(In thousands)	
Current:		
Federal	$-	$-
State	11	8
Foreign	45	16
	56	24
Deferred:		
Federal	-	-
State	-	-
	-	-
Provision for income taxes	$56	$24

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

	Years Ended June 30,	
	2011	2010

	(In thousands)	
United States	$(5,453)	$(1,581)
Foreign	238	86
Loss before income taxes	$(5,215)	$(1,495)

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

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

	Years Ended June 30, 2011	2010
	(In thousands)	
Deferred tax assets:		
Tax losses and credits	$33,149	$33,171
Reserves not currently deductible	3,135	3,245
Deferred compensation	2,389	1,987
Inventory capitalization	839	696
Marketing rights	638	739
Depreciation	70	-
Gross deferred tax assets	40,220	39,838
Valuation allowance	(38,420)	(37,904)
Deferred tax assets, net	1,800	1,934
Deferred tax liabilities:		
State taxes	(1,746)	(1,797)
Depreciation	-	(109)
Other	(54)	(28)
Deferred tax liabilities	(1,800)	(1,934)
Net deferred tax assets (liabilities)	$-	$-

The Company has recorded a valuation allowance against its net deferred tax assets. If or when realized, the tax benefits relating to, and the reversal of, approximately $4.3 million of the valuation allowance will be accounted for as an increase in additional paid-in capital as a result of tax deductible compensation arising from stock option exercises. The valuation allowance was established due to uncertainties surrounding the realization of the deferred tax assets.

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

	Years Ended June 30, 2011	2010
	(In thousands)	
Statutory federal provision (benefit) for income taxes	$(1,773)	$(510)
Increase (decrease) resulting from:		
Permanent differences	49	211
Change in valuation allowance	1,636	199
Deferred compensation	174	135
Foreign tax rate variances	(36)	(13)
Investment in foreign subsidiaries	-	-
Other	6	2
Provision for income taxes	$56	$24

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

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

	June 30, 2011 (In thousands)
Federal	$84,188
State	$61,437

The federal and state NOL carryovers begin to expire in fiscal years 2021 and 2013, respectively. Deferred income taxes were not provided on undistributed earnings of certain foreign subsidiaries because such undistributed earnings are expected to be reinvested indefinitely.

The following table summarizes the Company’s liability for uncertain tax position for the year ended June 30, 2011 (in thousands):

Balance as of June 30, 2010	$6,700
Change in balances related to uncertain tax positions	-
Balance as of June 30, 2011	$6,700

At June 30, 2011, the Company had $6.7 million of gross unrecognized tax benefits. Of the total unrecognized benefits at June 30, 2011, $6.6 million was recorded as a reduction to deferred tax assets, which caused a corresponding reduction in the Company's valuation allowance of $6.6 million. 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. The Company's continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense. At June 30, 2011, the Company had approximately $105,000 of accrued interest and penalties related to uncertain tax positions.

At June 30, 2011, the Company's fiscal 2008 through 2011 tax years remain open to examination by the federal taxing jurisdiction and the fiscal 2007 through 2011 tax years remain open to examination by the state taxing jurisdictions. However, the Company has NOLs beginning in fiscal 2001 which would cause the statute of limitations to remain open for the year in which the NOL was incurred. The Company's fiscal 2004 through fiscal 2011 tax years remain open to examination by the foreign taxing authorities. The Company does not anticipate that the amount of unrecognized tax benefits as of June 30, 2011 will significantly increase or decrease within the next 12 months.

10. Commitments and Contingencies

Leases

The Company leases office equipment and its office and warehouse facilities under non-cancelable capital and operating leases.

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

The following schedule represents minimum lease payments for all non-cancelable operating and capitalized leases as of June 30, 2011:

Years Ended June 30,	Capital Leases	Operating Leases	Total
		(In thousands)	
2012	$114	$826	$940
2013	32	520	552
2014	10	489	499
2015	6	411	417
2016	-	171	171
Thereafter	-	-	-
Total	162	$2,417	$2,579
Amounts representing interest	(17)		
Present value of net minimum lease payments	145		
Less: capital lease obligations, short-term portion (included in other current liabilities)	100		
Capital lease obligations, long-term portion	$45		

The following table presents facilities rent expense:

	Years Ended June 30, 2011	2010
	(In thousands)	
Facilities rent expense	$676	$703

11. Significant Geographic, Product Line, Customer and Supplier Information

The following table presents the Company’s sales within geographic regions as a percentage of net revenue:

	Years Ended June 30, 2011	2010
Americas	52.0%	56.3%
EMEA	31.2%	27.9%
Asia Pacific	16.8%	15.8%
Total	100.0%	100.0%

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

	Years Ended June 30, 2011	2010
U.S.	36%	45%
Germany	17%	15%

Canada	15%	11%

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

Product Line

The following table presents the Company's net revenue by product line:

	Years Ended June 30, 2011	2010
	(In thousands)	
Device enablement	$39,608	$37,096
Device management	9,055	8,384
Non-core	658	895
Total net revenues	$49,321	$46,375

Customers

The following table presents sales to the Company's significant customers and a related party as a percentage of net revenue:

	Years Ended June 30, 2011	2010
Top five customers (1)(2)	41%	39%
Ingram Micro	14%	10%
Tech Data	7%	11%
Related parties	2%	1%

(1) Includes Ingram Micro and Tech Data.
(2) All top five customers are distributors

No other customer represented more than 10% of the Company's annual net revenue during these fiscal years. Two international customers, Lynx (former transtec AG) and barix AG, are related parties due to common ownership by the Company's largest stockholder and Lantronix director, Bernhard Bruscha.

Suppliers

The Company does not own or operate a manufacturing facility. Five independent third-party contract manufacturers located in Asia manufacture substantially all of the Company's products and two independent third party foundries located in Asia manufacture substantially all of the Company's large scale integration chips. Any sudden demand for an increased amount of products or sudden reduction or elimination of any existing source or sources of products could result in a material delay in the shipment of the Company's products. Any problems associated with the manufacturing facilities or the delivery, quality or cost of the Company's products could have a material adverse effect on the Company's business, results of operations and financial condition.

12. Quarterly Financial Data (Unaudited)

The following table presents unaudited quarterly financial data of the Company. In the Company's opinion, this information has been prepared on a basis consistent with that of its audited consolidated financial statements and all necessary material adjustments, consisting of normal recurring accruals and adjustments, have been included to present fairly the unaudited quarterly financial data. The Company's quarterly results of operations for these periods are not necessarily indicative of future results of operations.

LANTRONIX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

	Quarter Ended Fiscal 2011				
	Sept 30,	Dec 31,	Mar 31,	June 30,	Total
	(In thousands, except per share data)				
Net revenue	$ 12,192	$ 12,719	$ 12,382	$ 12,028	$ 49,321
Gross profit	$ 6,227	$ 6,278	$ 6,359	$ 5,550	$ 24,414
Net loss	$ (678) (1)	$ (579) (2)	$ (399) (3)	$ (3,615) (4)	$ (5,271) (5)
Basic and diluted net loss per share	$ (0.07)	$ (0.06)	$ (0.04)	$ (0.34)	$ (0.51) *

	Quarter Ended Fiscal 2010				
	Sep 30,	Dec 31,	Mar 31,	June 30,	Total
	(In thousands, except per share data)				
Net revenue	$10,954	$11,478	$12,124	$11,819	$46,375
Gross profit	$5,717	$6,049	$6,352	$6,000	$24,118
Net loss	$(499)	$(375)	$(136)	$(509)	$(1,519)
Basic and diluted net loss per share	$(0.05)	$(0.04)	$(0.01)	$(0.05)	$(0.15) *

* Annual per share amounts may not agree to the sum of the quarterly per share amounts due to differences between average shares outstanding during the periods.

(1) Includes $189,000 of expenses related to the contested proxy.
(2) Includes $372,000 of expenses related to the contested proxy.
(3) Includes $460,000 of expenses related to the investigation.
(4) Includes $1.7 million of expenses related to the investigation and $862,000 of expenses related to the separation of the former Chief Executive Officer and Chief Financial Officer
(5) Includes $2.1 million of expenses related to the investigation, $862,000 of expenses related to the separation of the former Chief Executive Officer and Chief Financial Officer and $561,000 of expenses related to the contested proxy.

INDEX TO EXHIBITS

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Filed Herewith
3.1	Amended and Restated Certificate of Incorporation of Lantronix, Inc.	8 – K	001-16027	99.1	07/29/2005	
3.2	Amended and Restated Bylaws as amended on July 28, 2005	8 – K	001-16027	99.2	07/29/2005	
3.3	Amended and Restated Bylaws of Lantronix, Inc.	10 – Q	001-16027	3.1	05/14/2009	
3.4	Amended and Restated Bylaws	10 – Q	001-16027	3.1	11/12/2009	
3.5	Certificate of Amendment to Amended and Restated Certificate of Incorporation	8 – K	001-16027	3.10	12/21/2009	
4.1	Form of Registrant's common stock certificate	S – 1, Amend. No. 1	333-37508		06/13/2000	
10.1	Form of Indemnification Agreement entered into by Registrant with each of its directors and executive officers	S – 1, Amend. No. 1	333-37508		06/13/2000	
10.2	1993 Stock Option Plan and forms of agreements thereunder	S – 1, Amend. No. 1	333-37508		06/13/2000	
10.3	1994 Nonstatutory Stock Option Plan and forms of agreements thereunder	S – 1, Amend. No. 1	333-37508		06/13/2000	
10.4	2000 Stock Plan and forms of agreement thereunder	S – 8,	333-103395	4.1	02/24/2003	
10.4.1	Form of Stock Option Agreement	10 – K	001-16027	10.4.1	09/11/07	
10.5	Amendment to the 2000 Stock Plan	S – 8	333-103395	4.2	02/24/2003	
10.6	2000 Employee Stock Purchase Plan, amended and restated as of November 18, 2004	S – 8,	333-121000	4.1	12/06/2004	
10.7	Employment Agreement between Registrant and Fred Thiel	S – 1	333-37508		05/19/2000	
10.8	Employment Agreement between Registrant and Steve Cotton	S – 1	333-37508		05/19/2000	
10.9	Employment Agreement between Registrant and Johannes Rietschel	S – 1	333-37508		05/19/2000	
10.10	Lease Agreement between Registrant and The Irvine Company	S – 1, Amend. No. 1	333-37508		06/13/2000	
10.11	First Amendment to Lease Agreement between Registrant and Irvine Technology Partners III dated as of August 10, 1995	S – 1 Amend. No. 1	333-37508		06/13/2000	
10.12	Second Amendment to Lease Agreement between Registrant and Irvine Technology Partners III dated as of July 6, 2000	10 – K	001-16027	10.03	09/28/2000	

10.13	Third Amendment to Lease Agreement between Registrant and Irvine Technology Partners dated as of March 16, 2005	8 – K	001-16027	10.04	03/22/2005
10.14	Research and Development Agreement between Registrant and Gordian * Confidential treatment pursuant to Rule 406	S – 1, Amend. No. 1	333-37508		06/13/2000

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Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Filed Herewith
10.15	Distributor Contract between Registrant and Tech Data Corporation * Confidential treatment pursuant to Rule 406	S – 1, Amend. No. 1	333-37508		06/13/2000	
10.16	Distributor Contract between Registrant and Ingram Micro Inc. * Confidential treatment pursuant to Rule 406	S – 1, Amend. No. 1	333-37508		06/13/2000	
10.17	Offer to Exchange Outstanding Options, dated December 19, 2002	Schedule TO	001-16027	99(a)(1)	12/19/2002	
10.18	Loan and Security Agreement between Registrant and Silicon Valley Bank dated February 14, 2002	10 – Q	001-16027	10.16	02/14/2002	
10.19	Amendment to Loan Documents between Registrant and Silicon Valley Bank dated February 15, 2005	8 – K	001-16027	10.17	02/15/2005	
10.20	Letter from Ernst & Young LLP, dated January 21, 2005	8 – K	001-16027	16.1	01/21/2005	
10.21	Loan and Security Agreement between Registrant and Silicon Valley Bank dated May 31, 2006.	8 – K	001-16027		06/02/2006	
10.22	Consulting, Severance and Release Agreement effective as of January 22, 2007 between Registrant and James Kerrigan.	8 – K	001-16027	10.1	04/27/2007	
10.23	Severance Agreement effective as of May 15, 2007 between the Registrant and Marc Nussbaum.	8 – K	001-16027	10.1	06/15/2007	
10.24	Severance Agreement effective as of May 15, 2007 between the Registrant and Reagan Sakai.	8 – K	001-16027	10.1	06/20/2007	
10.25	Agreement effective February 19, 2008 between the Registrant and Jerry Chase	8 – K	001-16027	10.1	02/26/2008	
10.26	Amendment to the 2000 Stock Plan	8 – K	001-16027	10.1	03/06/2008	
10.27	Amendment to Loan and Security Agreement between the Registrant Silicon Valley Bank	10 – K	001-16027	10.27	09/19/2008	
10.28	Form of Performance Award Agreement	8 – K	001-16027	10.1	11/19/2008	
10.29	Form of Long-Term Incentive Award Agreement	8 – K	001-16027	10.2	11/19/2008	
10.30	Amendment to Letter Agreement effective as of December 26, 2008 between Registrant and Jerry D. Chase.	10 – Q	001-16027	10.1	02/13/2009	

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Filed Herewith
10.31	Amended and Restated Severance Agreement effective as of December 29, 2008 between Registrant and Reagan Y. Sakai.	10 – Q	001-16027	10.2	02/13/2009	
10.32	Second Amendment to Letter Agreement effective as of February 12, 2009 between Registrant and Jerry D. Chase.	10 – Q	001-16027	10.3	02/13/2009	
10.33	Lease Agreement between Registrant and the Irvine Company, LLC dated September 17, 2009	8 – K	001-16027	10.1	09/18/2009	
10.34	Amendment to 2000 Stock Plan	10 – K	001-16027	10.35	09/28/2009	
10.35	Amendment to Loan and Security Agreement	10 – Q	001-16027	10.1	11/8/2010	
10.36	2010 Inducement Equity Incentive Plan	10 – Q	001-16027	10.2	11/8/2010	
10.37	2010 Inducement Equity Incentive Plan Stock Option Agreement	10 – Q	001-16027	10.3	11/8/2010	
10.38	2010 Stock Incentive Plan	10 – Q	001-16027	10.1	02/7/2011	
21.1	Subsidiaries of Registrant	10 – K				X
23.1	Consent of Independent Registered Public Accounting Firm, McGladrey & Pullen, LLP					X
24.1	Power of Attorney (see page II-2)					
31.1	Certificate of Chief Executive Officer Pursuant to Section 302 of the Sarbanes – Oxley Act of 2002					X
31.2	Certificate of Chief 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 18 U.S.C. § 1350, as adopted pursuant to § 906 of Sarbanes Oxley Act of 2002					X

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Lantronix has duly caused this Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Irvine, State of California, on the 15th day of September, 2011.

LANTRONIX, INC.

By: /s/ JAMES W. KERRIGAN
JAMES W. KERRIGAN
INTERIM CHIEF FINANCIAL OFFICER

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints James W. Kerrigan, his attorney-in-fact, with the power of substitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Form 10-K and to file the same, with all exhibits thereto in all documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, 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 and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that such attorneys-in-fact and agents or any of them, or his or their substitute or 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 on Form 10-K has been signed by the following persons in the capacities and on the dates indicated:

Signature	Title	Date
/s/ Thomas M. Wittenschlaeger Thomas M. Wittenschlaeger	Chairman of the Board	September 15, 2011
/s/ Kurt Busch Kurt Busch	President and Chief Executive Officer and Director (Principal Executive Officer)	September 15, 2011
/s/ James W. Kerrigan James W. Kerrigan	Interim Chief Financial Officer and Secretary (Principal Financial and Accounting Officer)	September 15, 2011
/s/ John Rehfeld John Rehfeld	Director	September 15, 2011
/s/ Bernhard Bruscha Bernhard Bruscha	Director	September 15, 2011
/s/ Hoshi Printer Hoshi Printer	Director	September 15, 2011

/s/ Howard T. Slayen Howard T. Slayen	Director	September 15, 2011

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