LANTRONIX INC
Form 10-Q
February 08, 2008

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

FORM 10-Q

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

For the quarterly period ended December 31, 2007

OR

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

For the transition period from _________ to ___________.

Commission file number: 1-16027

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

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

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

92618
(Zip Code)

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

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

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

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

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

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

As of February 05, 2008, 60,133,661 shares of the Registrant's common stock were outstanding.

LANTRONIX, INC.

FORM 10-Q
FOR THE FISCAL QUARTER ENDED
December 31, 2007

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

LANTRONIX, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

	December 31, 2007	June 30, 2007
	(In thousands)	
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 7,224	$ 7,582
Marketable securities	-	97
Accounts receivable, net	3,260	3,411
Inventories, net	9,963	10,981
Contract manufacturers' receivable	1,001	1,270
Prepaid expenses and other current assets	456	578
Total current assets	21,904	23,919
Property and equipment, net	2,097	1,911
Goodwill	9,488	9,488
Purchased intangible assets, net	435	485
Officer loans	94	129
Other assets	70	26
Total assets	$ 34,088	$ 35,958
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 8,749	$ 11,017
Accrued payroll and related expenses	2,342	1,993
Warranty reserve	342	446
Accrued settlements	1,057	1,068
Other current liabilities	3,541	3,808
Total current liabilities	16,031	18,332
Long-term liabilities	235	256
Long-term capital lease obligations	626	142
Commitments and contingencies		
Stockholders' equity:		
Common stock	6	6
Additional paid-in capital	185,814	184,953
Accumulated deficit	(169,069)	(168,173)
Accumulated other comprehensive income	445	442

Total stockholders' equity	17,196	17,228
Total liabilities and stockholders' equity	$ 34,088	$ 35,958

See accompanying notes.

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LANTRONIX, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended December 31,		Six Months Ended December 31,	
	2007	2006	2007	2006
	(In thousands, except per share data)			
Net revenues (1)	$ 15,277	$ 14,829	$ 28,331	$ 27,343
Cost of revenues (2)	7,414	7,429	14,027	13,336
Gross profit	7,863	7,400	14,304	14,007
Operating expenses:				
Selling, general and administrative	5,331	6,057	11,610	11,555
Research and development	1,758	1,882	3,526	3,600
Litigation settlement costs	-	75	-	90
Amortization of purchased intangible assets	18	18	36	36
Total operating expenses	7,107	8,032	15,172	15,281
Income (loss) from operations	756	(632)	(868)	(1,274)
Interest (expense) income, net	(61)	1	(80)	7
Other income, net	120	730	131	727
Income (loss) before income taxes	815	99	(817)	(540)
(Benefit) Provision for income taxes	(168)	12	(147)	24
Net Income (loss)	$ 983	$ 87	$ (670)	$ (564)
Basic - net income (loss) per share	$ 0.02	$ 0.00	$ (0.01)	$ (0.01)
Diluted - net income (loss) per share	$ 0.02	$ 0.00	$ (0.01)	$ (0.01)
Basic - weighted average shares	60,088	59,562	60,015	59,413
Diluted - weighted average shares	60,542	60,196	60,015	59,413
(1) Includes net revenues from related party	$ 211	$ 302	$ 502	$ 581
(2) Includes amortization of purchased intangible assets	$ 8	$ 4	$ 13	$ 6

See accompanying notes.

LANTRONIX, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended December 31, 2007	2006
	(In thousands)	
Cash flows from operating activities:		
Net Loss	$ (670)	$ (564)
Adjustments to reconcile net loss to net cash used in operating activities:		
Share-based compensation	641	635
Provision for inventories	314	(70)
Depreciation and amortization	267	194
Gain on sale of investment	(104)	(700)
Amortization of purchased intangible assets	50	42
Provision for officer loan	35	-
(Recovery) Provision for doubtful accounts	(3)	20
Litigation settlement costs	-	90
Changes in operating assets and liabilities:		
Accounts receivable	148	(401)
Inventories	704	(345)
Contract manufacturers' receivable	269	16
Prepaid expenses and other current assets	135	(25)
Other assets	(17)	(6)
Accounts payable	(2,272)	1,272
Accrued payroll and related expenses	333	304
Accrued settlements	-	(400)
Warranty reserve	(104)	(219)
Other liabilities	(195)	(617)
Net cash used in operating activities	(469)	(774)
Cash flows from investing activities:		
Purchases of property and equipment, net	(252)	(271)
Proceeds from the sale of investment	104	700
Net cash (used) provided in investing activities	(148)	429
Cash flows from financing activities:		
Net proceeds from issuances of common stock	220	395
Payment of capital lease obligations	(69)	(78)
Net cash provided by financing activities	151	317
Effect of foreign exchange rate changes on cash	108	43
Increase (decrease) in cash and cash equivalents	(358)	15
Cash and cash equivalents at beginning of period	7,582	7,729
Cash and cash equivalents at end of period	$ 7,224	$ 7,744

See accompanying notes.

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LANTRONIX, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Lantronix, Inc. (the “Company” or “Lantronix”) have been prepared by the Company in accordance with generally accepted accounting principles (“GAAP”) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2007, included in the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission (“SEC”) on September 11, 2007. They contain all normal recurring accruals and adjustments which, in the opinion of management, are necessary to present fairly the consolidated financial position of the Company at December 31, 2007, and the consolidated results of its operations and cash flows for the three and six months ended December 31, 2007 and 2006. All intercompany accounts and transactions have been eliminated. It should be understood that accounting measurements at interim dates inherently involve greater reliance on estimates than at year-end. The results of operations for the three and six months ended December 31, 2007 are not necessarily indicative of the results to be expected for the full year or any future interim periods.

2. Computation of Net Income (Loss) per Share

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

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2007	2006	2007	2006
	(In thousands, except per share data)			
Numerator:				
Net Income (loss)	$ 983	$ 87	$ (670)	$ (564)
Denominator:				
Basic weighted-average shares outstanding	60,088	59,562	60,015	59,413
Effect of dilutive shares:				
Stock options	454	634	-	-
Diluted weighted-average shares	60,542	60,196	60,015	59,413
Basic - net income (loss) per share	$ 0.02	$ 0.00	$ (0.01)	$ (0.01)
Diluted - net income (loss) per share	$ 0.02	$ 0.00	$ (0.01)	$ (0.01)

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2007	2006	2007	2006
Common stock equivalents	1,326,975	1,682,991	2,001,466	2,500,146

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3. Inventories

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

	December 31, 2007	June 30, 2007
	(In thousands)	
Finished goods	$ 6,727	$ 7,848
Raw materials	1,906	2,653
Inventory at distributors	1,832	1,876
Large scale integration chips *	2,207	1,530
Inventories, gross	12,672	13,907
Reserve for excess and obsolete inventory	(2,709)	(2,926)
Inventories, net	$ 9,963	$ 10,981

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

4. Warranty

Upon shipment to its customers, the Company provides for the estimated cost to repair or replace products to be returned under warranty. The Company's products typically carry a one- to two-year warranty. In addition, certain products that were sold prior to August 2003 carry a five-year warranty. Although the Company engages in extensive product quality programs and processes, its warranty obligation is affected by product failure rates, use of materials or service delivery costs that differ from the Company's estimates. As a result, additional warranty reserves could be required, which could reduce gross margins. Additionally, the Company sells extended warranty services, which extend the warranty period for an additional one to three years depending upon the product.

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

	Six Months Ended December 31, 2007	Year Ended June 30, 2007
	(In thousands)	
Beginning balance	$ 446	$ 693
Charged to cost of revenues	93	107
Usage	(197)	(354)
Ending balance	$ 342	$ 446

5. Bank Line of Credit and Debt

In May 2006, the Company entered into a two-year secured revolving Loan and Security Agreement ("Line of Credit") with a bank, which provides for borrowings up to $5.0 million. The borrowing capacity is limited to eligible accounts receivable as defined under the Line of Credit. Borrowings under the Line of Credit bear interest at the prime rate plus 1.75% per annum. The Company is required to pay an unused line fee of 0.50% on the unused portion of the Line of Credit. In addition, the Company paid a fully earned, non-refundable commitment fee of $54,000 and paid an additional $54,000 on the first anniversary of the effective date of the Line of Credit.

The Company's obligations under the Line of Credit are secured by substantially all of the Company's assets, including its intellectual property.

The Company is subject to a number of covenants under the Line of Credit, pursuant to which, among other things, the Company has agreed that it will not, without the bank's prior written consent: (a) sell, lease, transfer or otherwise dispose, any of the Company's business or property, provided, however, that the Company may sell inventory in the ordinary course of business consistent with the provisions of the Line of Credit; (b) change the Company's business structure, liquidate or dissolve, or permit a change in beneficial ownership of more than 20% of the outstanding shares; (c) acquire, merge or consolidate with or into any other business organization; (d) incur any debts outside the ordinary course of the Company's business, except for permitted indebtedness, or grant any security interests in or permit a lien, claim or encumbrance upon all or any portion of the Company's assets, except in favor of or agreed to by the bank; (f) make any investments other than permitted investments; (g) make or permit any payments on any subordinated debt, except under the terms of existing subordinated debt or on terms acceptable to the bank, or amend any provision in any document related to the subordinated debt that would increase the amount thereof, or (h) become an "investment company" as such term is defined under the Investment Company Act of 1940. The Line of Credit also contains a number of affirmative covenants, including, among other things, covenants regarding the delivery of financial statements and notice requirements, accounts receivable, payment of taxes, access to collateral and books and records, maintenance of properties and insurance policies, and litigation by third parties.

The Line of Credit includes events of default that include, among other things, non-payment of principal, interest or fees, violation of affirmative and negative covenants, cross default to certain other indebtedness, material adverse change, material judgments, bankruptcy and insolvency events.

As of December 31, 2007, the Company had no borrowings against the Line of Credit.

6. Share-Based Compensation

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

	Number of Shares
Balance of options outstanding at June 30, 2007	5,891,896
Options granted	375,750
Options forfeited	(909,800)
Options expired	(132,500)
Options exercised	(124,396)
Balance of options outstanding at December 31, 2007	5,100,950

The following table presents stock option grant date information:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2007	2006	2007	2006
Weighted-average grant date fair value	$ 0.73	$ 1.18	$ 0.78	$ 1.22
Weighted-average grant date exercise price	$ 0.98	$ 1.54	$ 1.05	$ 1.57

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

	Three Months Ended December 31,	Six Months Ended December 31,

	2007	2006	2007	2006
	(In thousands)			
Cost of revenues	$ 26	$ 24	$ 53	$ 36
Selling, general and administrative	132	202	402	411
Research and development	74	96	186	188
Total share-based compensation	$ 232	$ 322	$ 641	$ 635

7. Income Taxes

On July 1, 2007, the Company adopted Financial Accounting Standards Board Interpretation No. 48, “Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109” (“FIN 48”). In connection with the adoption of FIN 48, the Company recognized an adjustment of approximately $226,000 to the beginning balance of accumulated deficit on its consolidated balance sheet. The Company’s continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense. As of December 31, 2007, the Company had recorded $156,000 of uncertain tax positions including approximately $70,000 of accrued interest and penalties related to these uncertain tax positions.

At July 1, 2007, the Company's fiscal 2001 through fiscal 2007 tax years remain open to examination by Federal and state taxing authorities. However, the Company has net operating losses ("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 utilizes the liability method of accounting for income taxes. The following table presents the Company's effective tax rates based upon the income tax provision for the periods shown:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2007	2006	2007	2006
Effective tax rate	21%	12%	18%	4%

The federal statutory rate was 34% for all periods. The tax benefit during the fiscal quarter ended December 31, 2007 is the result of a reduction in estimated foreign taxes and penalties. 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.

8. Comprehensive Income (Loss)

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2007	2006	2007	2006
	(In thousands)			
Net Income (loss)	$ 983	$ 87	$ (670)	$ (564)
Other comprehensive income (loss):				
Change in net unrealized gain on investment, net of taxes of $0	8	2	7	8
Reclassification adjustment for net realized gain on sale of investment	(96)	-	(97)	-
Change in translation adjustments, net of taxes of $0	29	53	100	39
Total comprehensive income (loss)	$ 924	$ 142	$ (660)	$ (517)

9. Litigation Settlements

Securities Litigation Settlements

Securities Class Action Lawsuits ("Class Action")

Beginning on May 15, 2002, a number of securities class actions were filed against the Company and certain of its current and former directors and former officers alleging violations of the federal securities laws. These actions were consolidated into a single action pending in the United States District Court for the Central District of California entitled In re Lantronix, Inc. Securities Litigation, Case No. CV 02-3899 GPS (JTLx). After the Court appointed a lead plaintiff, amended complaints were filed by the plaintiff, and the defendants filed various motions to dismiss directed at particular allegations. Through that process, certain of the allegations were dismissed by the Court.

On October 18, 2004, the plaintiff filed the third amended complaint, which was the operative complaint in the action. The complaint alleged violations of Sections 11 and 15 of the Securities Act of 1933, as amended (the "Securities Act") and violations of Sections 10(b) and 20(a) and Rule 10b-5 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Securities Act claims were brought on behalf of all persons who purchased common stock of Lantronix pursuant or traceable to the Company's August 4, 2000 initial public offering ("IPO"). The Exchange Act claims were based on alleged misstatements related to the Company's financial results that were contained in the Registration Statement and Prospectus for the IPO. The claims brought under the Exchange Act were brought on behalf of all persons and entities that purchased or acquired Lantronix securities from November 1, 2000 through May 30, 2002 (the "Class Period"). The complaint alleged that defendants issued false and misleading statements concerning the business and financial condition in order to allegedly inflate the value of the Company's securities during the Class Period. The complaint alleged that during the Class Period, Lantronix overstated financial results through improper revenue recognition and failure to comply with GAAP.

The Company reached an agreement with plaintiffs to settle the Class Action lawsuit. The Company also reached agreements with its relevant insurance carriers with respect to the funding of the cash portions of the settlement with plaintiffs, and the cash funding of the settlement has been completed. Under the terms of the agreement with the Class Action plaintiffs, the Company was not required to contribute any cash to the Class Action settlement, as all cash contributed would be from the Company's insurance carriers. However, as part of the agreement with the plaintiffs in the Class Action lawsuit, the Company agreed to issue certain Lantronix securities to the plaintiffs. As a result of the anticipated issuance of such securities, and in connection with the issuance of securities for the settlement of the Synergetic action described in detail in previous filings, the Company recorded a charge of $1.2 million in the consolidated statement of operations for the fiscal year ended June 30, 2006. On December 11, 2006, the United States District Court for the Central District of California gave its final approval to the settlement and issued a final order and judgment in the matter. During the fiscal quarter ended December 31, 2006, the insurance carriers funded their share of the settlement, which totaled $13.9 million. On January 10, 2007, the settlement of the Company's securities litigation became final and effective. During the fiscal quarter ended March 31, 2007, the Company reduced its accrued settlement liability and settlement recovery by $13.9 million in connection with the settlement becoming final and effective. As of December 31, 2007, the Company had an accrued settlement liability of $1.1 million. The Company expects to issue warrants to purchase Lantronix common stock with a fair value of $1.1 million to the class action plaintiffs as final consideration for the remaining settlement liability. Per the terms of the settlement agreement, the number of shares to be issued pursuant to the warrants shall be determined by using the Black-Scholes model option-pricing formula using a contract life of four years and a strike price of $3 above the average trading price of the Company's common stock over the 45 trading days ending two trading days prior to the issuance date (20 days after the settlement date) of the warrants. The escrow administrator for the settlement has provided the Company with a final list of the eligible class action plaintiffs, and the Company will issue the warrants after the Court approves an application brought by the class action plaintiffs on January 28, 2008, for the disbursement of the settlement funds to class members. The Company expects the Court to rule on the application and the warrants to be issued during fiscal 2008.

10. Litigation

From time to time, the Company is subject to other legal proceedings and claims in the ordinary course of business. Except as discussed in Note 9, the Company is currently not aware of any such legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse effect on its business, prospects, financial position, operating results or cash flows.

During 2006, the Company concluded multiple securities lawsuits and litigation with a former executive officer. The Company may have an obligation to continue to indemnify the former executive officer and defend the securities violation that he has been charged with. There is a risk that the Company's insurance carriers may not reimburse us for such costs. Accordingly, legal expenses for this former executive officer's defense are recorded as incurred and reimbursement of the legal expenses from insurance are recorded upon receipt. As of December 31, 2007, the Company had $151,000 of reimbursable legal expenses recorded as a liability on its consolidated balance sheets.

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

Cautionary Statement

You should read the following discussion and analysis in conjunction with our unaudited condensed consolidated financial statements and the related notes thereto contained elsewhere in this Quarterly Report on Form 10-Q. The information contained in this Quarterly Report is not a complete description of our business. We urge you to carefully review and consider the various disclosures made by us in this Quarterly Report and in our other reports filed with the Securities and Exchange Commission ("SEC"), including our Annual Report on Form 10-K for the fiscal year ended June 30, 2007 and subsequent reports on our Current Reports on Form 8-K.

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

Overview

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

We have a history of providing devices that enable information technology (“IT”) equipment to network using standard protocols for connectivity, including Ethernet and wireless. Our first device was a terminal server that allowed “dumb” terminals to connect to a network. Building on the success of our terminal servers, in 1991 we introduced a complete line of print servers that enabled users to inexpensively share printers over a network. Since then, we have continually refined our core technology and have developed additional innovative networking solutions that expand upon the business of providing our customers network connectivity. With the expansion of networking and the Internet, our technology focus has been increasingly expanded beyond IT equipment, so that our device solutions provide a product manufacturer with the ability to network its products within the industrial, service and commercial markets referred to as machine-to-machine (“M2M”) networking.

The following describes our device networking product lines:

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

- Device Management –We offer off-the-shelf appliances such as console servers, digital remote keyboard, video, mouse extenders, and power control products that enable IT professionals to remotely connect, monitor and control network infrastructure equipment, distributed branch office equipment and large groups of servers using highly secure out-of-band management technology. In addition, we offer off-the-shelf appliances that enable IT professionals to reliably, remotely and simply monitor, configure and manage multiple devices from a single point of control.

The following describes our non-core product line:

- Non-core – Over the years, we have innovated or acquired various product lines that are no longer part of our primary, core markets described above. In general, these non-core businesses represent decreasing markets and we minimize research and development in these product lines. Included in this category are terminal servers, visualization solutions, legacy print servers, software and other miscellaneous products. We have announced the end-of-life for almost all of our non-core products and expect a steep decline in non-core revenues in fiscal 2008 while we complete the exit of this product category.

Financial Highlights and Other Information for the Three Months Ended December 31, 2007

The following is a summary of the key factors and significant events that impacted our financial performance during the three months ended December 31, 2007:

- Net revenues were $15.3 million for the three months ended December 31, 2007, an increase of $448,000 or 3.0% as compared to $14.8 million for the three months ended December 31, 2006. The increase was primarily the result of a $767,000 or 5.7% increase in our device networking product lines offset by a $319,000, or 22.2% decrease in our non-core product lines.

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- Gross profit as a percentage of net revenues was 51.5% for the three months ended December 31, 2007 as compared to 49.9% reported for the three months ended December 31, 2006. The increase in gross profit margin percent was primarily attributable to a favorable product mix and inventory overhead absorption offset by an increase in certain inventory reserves in connection with a review of our product offerings as part of our effort to simplify our product portfolio by discontinuing slow-moving and non-strategic products.

- Income from operations was $756,000, or 4.9%, of net revenues for the three months ended December 31, 2007 as compared to a loss from operations of $632,000, or 4.3%, of net revenues for the three months ended December 31, 2006.

- Net income of $1.0 million, or $0.02 per basic and diluted share, for the three months ended December 31, 2007, increased from a net income of $87,000, or $0.00 per basic and diluted share, for the three months ended December 31, 2006. Net income for the quarter ended December 31, 2006 was significantly impacted by the $700,000 of income recognized on the sale of our investment in Xanboo.

- Cash, cash equivalents and marketable securities were $7.2 million as of December 31, 2007 as compared to $7.7 million as of June 30, 2007.

- Net accounts receivable were $3.3 million as of December 31, 2007 as compared to $3.4 million as of June 30, 2007. Annualized days sales outstanding (“DSO”) in receivables as of December 31, 2007 decreased to 20 days from 21 days as of June 30, 2007. Our accounts receivable and DSO are primarily affected by the timing of shipments within a quarter, our collections performance and the fact that a significant portion of our revenues are recognized on a sell-through basis (upon shipment from distributor inventories rather than as goods are shipped to distributors).

- Net inventories were $10.0 million as of December 31, 2007 as compared to $11.0 million as of June 30, 2007. Our annualized inventory turns remained constant at 2.8 annualized turns for the fiscal quarter ended December 31, 2007 as compared to the fiscal quarter ended June 30, 2007.

Critical Accounting Policies and Estimates

The accounting policies that have the greatest impact on our financial condition and results of operations and that require the most judgment are those relating to revenue recognition, warranty reserves, allowance for doubtful accounts, inventory valuation, valuation of deferred income taxes, goodwill and purchased intangible assets and legal settlement costs. These policies are described in further detail in our Annual Report on Form 10-K for the fiscal year ended June 30, 2007. There have been no significant changes in our critical accounting policies and estimates during the six months ended December 31, 2007 as compared to what was previously disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2007.

Recent Accounting Pronouncements

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

Consolidated Results of Operations

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2007	2006	2007	2006
Net revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	48.5%	50.1%	49.5%	48.8%
Gross profit	51.5%	49.9%		