LANTRONIX INC
Form 10-Q/A
June 25, 2002

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

FORM 10-Q/A
AMENDMENT NO. 1

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

For the quarterly period ended September 30, 2001

OR

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

For the transition period from _________ to ___________.

Commission file number: 1-16027

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

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

15353 Barranca Parkway Irvine, California 92618
(Address of principal executive offices and zip code)

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

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 [_]

As of October 31, 2001, 49,985,328 shares of the Registrant's common stock were outstanding.

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EXPLANATORY NOTE

This Amendment No. 1 to Quarterly Report on Form 10-Q/A of Lantronix, Inc. (the "Company") amends Part I of the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001, as filed by the Company on November 14, 2001 (the "Original 10-Q"), to reflect the changes described below.

The Company changed its accounting method for recognizing revenue on sales to distributors effective as of the beginning of fiscal 2001, July 1, 2000. Under the new accounting method, recognition of revenue and related gross profit on sales to distributors is deferred until the distributor resells the product to an end customer. Previously, the Company had recognized revenue from these transactions upon shipment of product to the distributor, net of estimates for possible returns and allowances. In addition, for the quarterly period ended September 30, 2001, the Company also made further corrections to its condensed consolidated financial statements (1) to defer the recognition of certain sales made to customers who were not distributors as revenue because they did not meet all of the criteria for revenue recognition at the time of shipment, and (2) to reclassify to other expense certain amounts originally charged in error to other comprehensive income. The effect of these matters is to reduce net revenues by $438,000 and $393,000 and increase loss before cumulative effect of accounting change by $123,000 or $0.00 per share and $206,000 or $0.01 per share in the quarters ended September 30, 2001 and 2000, respectively. Additionally, the cumulative effect of the accounting change recorded as of July 1, 2000 was a charge of $773,000 (net of income taxes of $0) or $0.02 per share. See Note 2 to the financial statements, "Accounting Change and Restatement of Financial Statements," for more detail. Conforming changes reflecting the foregoing are made in: Part I - Item 1 Financial Statements (and footnotes thereto); and Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations.

In addition, the Company made changes to the Original 10-Q to clarify or correct information with respect to the following:

- Part I Item 1 "Financial Statements": separation in the condensed consolidated balance sheet of accounts as follow: "Goodwill" and "Purchased intangible assets, net"; and "Officer loans" and "Other assets";
- Part I Item 1 "Financial Statements": additions to Note 3 "Recent Accounting Pronouncements" and Note 6 "Goodwill and Purchased Intangible Assets" to provide additional information concerning the Company's adoption of SFAS 142 "Goodwill and Other Intangible Assets";
- Part I Item 1 "Financial Statements": clarification in Note 8 "Stockholders' Equity" of the number of shares sold in the secondary offering;
- Part I Item 1 "Financial Statements": addition to Note 3 "Recent Accounting Pronouncements" for newly issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets";
- Part I Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations": Clarification of the number of shares sold in our secondary offering;
- Part I Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations": clarification under the heading "Net Revenues" as to European sales;
- Part I Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations": clarification under the heading "Gross Profit" as to royalty payments to Gordian;
- Part I Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations": additional information under the heading "Impact of Adoption of New Accounting Standards";
- Part I Item 3 "Quantitative and Qualitative Disclosure About Market Risk": clarification of inclusion of short-term investments and foreign cash and cash equivalent balances in discussion;

- Part II Item 2 "Changes in Securities and Use of Proceeds": clarification of the number of shares sold in our secondary offering; and
- Part II Item 2 "Changes in Securities and Use of Proceeds": clarification regarding the acquisition of U.S. Software.

Except as noted above, this Form 10-Q does not reflect events occurring after the filing of the Original 10-Q on November 14, 2001, nor does it modify or update the disclosures contained in such original report, except as necessary or appropriate to reflect the effects of the restatement.

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LANTRONIX, INC.

FORM 10-Q/A
FOR THE QUARTER ENDED SEPTEMBER 30, 2001

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

LANTRONIX, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	Septemb 20 (Unau (
ASSETS	
Current assets:	
Cash and cash equivalents	$ 58
Short-term investments	1
Accounts receivable, net	11
Inventories	13
Deferred income taxes	4
Prepaid income taxes	
Prepaid expenses and other current assets	4
Total current assets	94
Property and equipment, net	6
Long-term investments	3
Goodwill	43
Purchased intangible assets, net	11
Officer loans	4
Other assets	
Total assets	$ 163
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable	$ 5
Due to related party	1
Accrued payroll and related expenses	1
Other current liabilities	3
Total current liabilities	11
Deferred income taxes	5
Stockholders' equity:	

Common stock	
Additional paid-in capital	157
Employee notes receivable	
Deferred compensation	(9
Retained earnings (accumulated deficit)	(1
Accumulated other comprehensive income (loss)	
Total stockholders' equity	146
Total liabilities and stockholders' equity	$ 163

See accompanying notes.

LANTRONIX, INC.

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

	Three Mon Septemb
	2001
	(Restated
Net revenues (A)..	$ 15,831
Cost of revenues (B)..	7,539
Gross profit..	8,292
Operating expenses:	
Selling, general and administrative (C)..................................	7,577
Research and development (C)...	2,092
Stock-based compensation (B) (C)...	1,172
Amortization of purchased intangible assets	286
Total operating expenses..	11,127
Loss from operations..	(2,835)
Interest income (expense), net..	536
Other expense, net..	(628)
Loss before income taxes and cumulative effect of accounting change.......	(2,927)
Benefit for income taxes..	(649)
Loss before cumulative effect of accounting change........................	(2,278)
Cumulative effect of accounting change, net of income tax benefit of $0 (Note 2)...	--
Net loss..	$ (2,278)

Basic and diluted loss per share before cumulative effect of accounting change.....	$ (0.05)
Cumulative effect of accounting change per share..................................	--
Basic and diluted net loss per share..	$ (0.05)
Weighted average shares (basic and diluted)..	47,500
(A) Includes net revenues from related parties..................................	$ 517
(B) Cost of revenues includes the following:	
Amortization of purchased intangible assets..................................	$ 338
Stock-based compensation...	27
	$ 365
(C) Stock-based compensation is excluded from the following:	
Selling, general and administrative expenses................................	$ 833
Research and development expenses..	339
	$ 1,172

See accompanying notes.

LANTRONIX, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Thr
	200
	(
Cash flows from operating activities:	
Net loss	$ (2,27
Adjustments to reconcile net loss to net cash used in operating activities:	
Cumulative effect of accounting change, net of income taxes of $0	-
Depreciation	56
Amortization of purchased intangible assets	62
Stock-based compensation	1,19
Provision for doubtful accounts	16
Deferred income taxes	(45
Revaluation of investment	50
Equity losses from unconsolidated business	29
Changes in operating assets and liabilities:	
Accounts receivable	(2,58
Inventories	38

Prepaid income taxes	43
Prepaid expenses and other assets	(87
Accounts payable	32
Other current liabilities	3
Net cash used in operating activities	(1,66
Cash flows from investing activities:	
Purchase of property and equipment, net	(1,43
Purchase of minority investments, net	(1,52
Net cash used in investing activities	(2,95
Cash flows from financing activities:	
Net proceeds from underwritten offerings of common stock	47,11
Net proceeds from other issuances of common stock	34
Net cash provided by financing activities	47,45
Effect of foreign exchange rates on cash	2
Increase in cash and cash equivalents	42,85
Cash and cash equivalents at beginning of period	15,36
Cash and cash equivalents at end of period	$ 58,22

See accompanying notes.

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LANTRONIX, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2001

1. Basis of Presentation

The condensed consolidated financial statements included herein are unaudited. They contain all normal recurring accruals and adjustments which, in the opinion of management, are necessary to present fairly the consolidated financial position of Lantronix, Inc. and its subsidiaries (collectively, the "Company") at September 30, 2001, and the consolidated results of its operations and its cash flows for the three months ended September 30, 2001 and 2000. All intercompany accounts and transactions have been eliminated. It should be understood that accounting measurements at interim dates inherently involve greater reliance on estimates than at year-end. The results of operations for the three months ended September 30, 2001 are not necessarily indicative of the results to be expected for the full year or any future interim periods.

These financial statements do not include certain footnotes and financial presentations normally required under generally accepted accounting principles. Therefore, they should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended June 30, 2001, included in the Company's Annual Report on Form 10-K/A filed with the Securities and Exchange Commission ("SEC") in June 2002.

In May 2002, the Company undertook a special investigation of its accounting and determined that certain sales to distributors and others made in fiscal 2001 and 2002 did not qualify for recognition as revenue upon shipment. As a result, the Company has restated its condensed consolidated financial statements contained herein as well as all other interim and annual financial statements for periods within fiscal 2001 and the first six months of fiscal 2002 (July 1, 2000 through December 31, 2001) as further described in Note 2. In addition to the Form 10-Q/A, the Company has also filed a Form 10-K/A for the fiscal year ended June 30, 2001, and a Form 10-Q/A for the quarterly period ended December 31, 2001 to reflect the restatement.

Also effective July 1, 2001, the Company elected to early adopt Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). As a result, the Company will no longer amortize goodwill and certain intangible assets deemed to have indefinite lives (Note 3).

2. Accounting Change and Restatement of Financial Statements

In originally preparing the condensed consolidated financial statements at December 31, 2001, the Company changed its accounting method for recognizing revenue on sales to distributors effective as of July 1, 2001, the beginning of fiscal 2002. Under the new accounting method, the recognition of revenue and related gross profit on sales to distributors is deferred until the distributor resells the product to an end customer. Formerly, the Company recognized revenue from these transactions upon shipment of product to the distributor, net of estimates for possible returns and allowances.

In May 2002, the Company undertook a special investigation of its accounting, which revealed that beginning in the third and fourth quarters of fiscal 2001 certain shipments made to distributors and recorded as revenues in fiscal 2001 and 2002 did not qualify for revenue recognition upon shipment due to terms present in agreements with the distributors that were not considered in the Company's original accounting decisions. As a result, the Company's new method of accounting for distributor sales, which is based on recognizing revenue and related gross profit on sales to distributors only as the distributor resells the product to end customers, has been adopted effective as of July 1, 2000, the beginning of fiscal 2001, or one year earlier. This manner of correcting the errors in sales recognition made in previously issued financial statements for fiscal 2001 is deemed to be preferable in the circumstances because (1) it eliminates from revenue any effect of shipping excessive levels of inventory to the distributors; (2) all revenue from distributor sales in fiscal 2001 and 2002 will be recognized on a common basis; and (3) there is assurance that any additional agreements with distributors that may have existed with respect to specific orders but are presently unknown will not have an impact on amounts reported as revenue after the restatement. The restatement for the year ended June 30, 2001, results in a reduction in revenue of approximately $6.2 million and an increase in the loss before cumulative effect of accounting change of $2.9 million or $0.07 per share. The cumulative effect of the accounting change for the three months ended September 30, 2000 recorded as of July 1, 2000 was a charge of $773,000 (net of income tax benefit of $0) or $0.02 per share.

Management believes that the new accounting method better reflects the substance of the transactions considering the Company's recent entry into the semiconductor marketplace and the changing business environment; is consistent with other

companies in the Company's industry thereby providing greater comparability in the presentation of financial results among the Company and its peers, and better focuses the Company on end customer sales.

In the special investigation conducted in May 2002, the Company also discovered (i) that the terms and circumstances of certain sales made in the first six months of fiscal 2002 to customers who were not distributors also preclude revenue from being recognized upon shipment, as originally reported and (ii) that certain amounts initially reported as other comprehensive income (loss) should be accounted for as elements of net loss. Accordingly, in the accompanying restated condensed consolidated financial statements, the Company has made corrections to defer the recognition of such sales as revenue until all revenue recognition criteria have been met and to reclassify to other expense the amounts improperly charged to other comprehensive income (loss). These corrections result in a reduction in revenue of approximately $438,000 and an increase in the loss before cumulative effect of accounting change of $123,000 or $0.00 per share in the three months ended September 30, 2001.

The effects of the corrections on net revenues; loss before cumulative effect of accounting change, net of income tax benefit; cumulative effect of accounting change; net loss; and related per share amounts for the three months ended September 30, 2001 and 2000 are shown in the tables below (in thousands, except per share amounts):

As reported:	
Net revenues	$1
	==
Loss before cumulative effect of accounting change	$(
Cumulative effect of accounting change, net of income tax benefit of $1,049	(
	--
Net loss	$(
	==
Loss per share before cumulative effect of accounting change	$
Cumulative effect of accounting change per share	
	--
Basic and diluted net loss per share	$
	==
As restated:	
Net revenues	$1
Corrections	
	--
Net revenues, as restated	$1
	==
Loss before cumulative effect of accounting change	$(
Corrections, net of tax	
	--
Loss before cumulative effect of accounting change, as restated	(
Cumulative effect of accounting change, net of income tax benefit of $0, as restated	
	--

Net loss, as restated	$(
Loss per share before cumulative effect of accounting change, as restated	$
Cumulative effect of accounting change per share, as restated	
Basic and diluted net loss per share, as restated	$

*As reported information for the three months ended September 30, 2001 reflects the accounting change made in the second quarter of fiscal 2002, but effective as of July 1, 2001 to defer revenue recognition of revenue and related gross profit until the distribution resells the product to an end customer.

3. Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations" ("SFAS No. 141"), effective for acquisitions consummated after June 30, 2001, and SFAS No. 142, effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and certain intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests in accordance with SFAS Nos. 141 and 142. Other intangible assets will continue to be amortized over their useful lives.

The Company has elected to early adopt the new rules set forth in SFAS No. 142 on accounting for goodwill and other intangibles as of July 1, 2001. For the three months ended September 30, 2001, early adoption resulted in non-amortization of goodwill of $1.7 million or $0.03 per share based on the weighted average shares outstanding for the three months ended September 30, 2001.

The transition provisions of SFAS No. 142 require that the Company complete its assessment of whether impairment may exist as of the date of adoption by December 31, 2001 and complete its determination of the amount of any impairment as of the

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date of adoption by June 30, 2002. Any impairment that is required to be recognized when adopting SFAS 142 will be reflected as the cumulative effect of a change in accounting principle as of July 1, 2001. The Company has completed its initial assessment and concluded that goodwill arising from the acquisition of United States Software Corporation (USSC), having a carrying amount of approximately $5.4 million as of July 1, 2001, may be impaired. The Company expects to complete its determination of the amount of the impairment charge, if any, to be reflected as a cumulative effect of a change in accounting principle during the fourth fiscal quarter ending June 30, 2002.

The Company intends to perform the first of the required annual impairment tests of goodwill under the guidelines of SFAS No. 142 effective as of April 1, 2002. The Company has not yet determined the effect, if any, that this test will have on its consolidated statement of operations or financial position. An impairment charge, if any, identified as a result of completing the Company's annual impairment test will be reflected as an operating expense in the fourth quarter of fiscal 2002.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which supersedes SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for

Long-Lived Assets to Be Disposed Of" ("SFAS No. 121") and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." This statement retains certain requirements of SFAS No. 121 relating to the recognition and measurement of impairment of long-lived assets to be held and used. Additionally, this statement results in one accounting model, based on the framework established in SFAS No. 121, for long-lived assets to be disposed of by sales and also addresses certain implementation issues related to SFAS No. 121, including the removal of goodwill from its scope due to the issuance of SFAS No. 142. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. The Company has not yet determined the effect, if any, on the carrying value of its long-lived assets resulting from the adoption of SFAS No. 144.

4. Net Loss per Share

Basic net loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted net loss per share is calculated by adjusting outstanding shares assuming any dilutive effects of options. However, for periods in which the Company incurred a net loss, these shares are excluded because their effect would be to reduce recorded net loss per share. The following table sets forth the computation of net loss per share (in thousands, except per share amounts):

	Three Month September 2001 (Restat
Numerator:	
Loss before cumulative effect of accounting change	$(2,278)
Cumulative effect of accounting change, net of income taxes of $0	--
Net loss	$(2,278)
Denominator:	
Weighted-average shares outstanding	48,140
Less: non-vested common shares outstanding	(640)
Denominator for basic and diluted loss per share	47,500
Loss per share before cumulative effect of accounting change	$ (0.05)
Cumulative effect of accounting change per share	--
Basic and diluted net loss per share	$ (0.05)

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5. Inventories

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

consist of the following (in thousands):

	September 30, 2001
	(Res
Raw materials	$ 4,816
Finished goods	7,554
Inventory at distributors	3,192
	15,562
Reserve for excess and obsolete inventory	(2,390)
	$ 13,172

6. Goodwill and Purchased Intangible Assets

Goodwill

The changes in the carrying amount of goodwill for the three months ended September 30, 2001, are as follows (in thousands):

Balance as of July 1, 2001 ....

Reclassification of assembled workforce in connection with adoption of SFAS No. 142 at July 1, 2001 ....

Less: accumulated amortization ....

Balance as of September 30, 2001 ....

Purchased Intangible Assets

The composition of purchased intangible assets is as follows (in thousands):

		September 30, 2001			
	Useful Lives	Gross	Accumulated Amortization	Net	Gross
Existing technology	5 years	$ 6,745	$ (558)	$ 6,187	$ 6,7
Customer lists	5	3,500	(219)	3,281	3,5
Patent/core technology	5	299	(165)	134	2
Tradename/trademark	5	1,162	(123)	1,039	1,1
Assembled workforce	5	--	--	--	1,4
Distribution network	5	755	(113)	642	7

Total	$ 12,461	$ (1,178)	$ 11,283	$ 13,9

As required by SFAS No. 142, assembled workforce was reclassified as goodwill effective July 1, 2001.

The amortization expense for purchased intangible assets for the three months ended September 30, 2001 was $624,000, of which $338,000 was amortized to cost of revenues and $286,000 was amortized to operating expenses. The estimated amortization expense for the remainder of fiscal 2002 and the next four years is as follows:

Fiscal year ending June 30:	Cost of Revenues	Operating Expenses
2002	$ 1,012	$ 857
2003	1,349	1,146
2004	1,349	1,113
2005	1,349	1,083
2006	1,128	897
Total	$ 6,187	$ 5,096

7. Long-term Investments

In September 2001, the Company purchased a convertible promissory note from Xanboo Inc. ("Xanboo") in the principal amount of $1.5 million. The note has a ten year maturity and will automatically convert into the next round of equity securities of Xanboo that raises at least $5.0 million. If Xanboo does not complete such a financing prior to February 1, 2002, the Company can convert the note into a newly created series of preferred stock of Xanboo. The Company is considering investing additional money in this company as well as other companies (Note 11).

The Company periodically reviews its investments for which fair value is less than cost to determine if the decline in value is other than temporary. If the decline in value is judged to be other than temporary, the cost basis of the security is written down to fair value. During the three months ended September 30, 2001, the Company recorded a $500,000 revaluation of a non-marketable equity investment resulting from an other-than-temporary decline in its value. This amount is included within the condensed consolidated statement of operations as other expense.

8. Stockholders' Equity

In July 2001, the Company completed a public offering of 8,534,000 shares of its common stock, including an underwriters' over-allotment option to purchase an additional 534,000 shares, at an offering price of $8.00 per share. The Company sold 6,000,000 shares and selling stockholders sold 2,000,000 shares of the primary offering. Additionally, the Company sold 400,500 shares and selling stockholders sold 133,500 shares of the over-allotment option. The Company received net proceeds of approximately $47.1 million in connection with

this offering.

In August 2001, the Company began negotiations with the former owners of U.S. Software to remove the earn-out provisions of the merger agreement in exchange for the issuance of a specified number of shares of the Company's stock to the former owners of U.S. Software. In August 2001, in order to eliminate an employee bonus arrangement related to the acquisition, the Company issued 250,000 stock options to employees who were not former owners of U.S. Software. The issuance of these stock options was unrelated to and did not remove the earn-out provisions of the merger agreement. The estimated value of $500,000 related to these stock options will be accounted for as compensation expense over the vesting period of options of up to four years.

9. Comprehensive Loss

SFAS No. 130, "Reporting Comprehensive Income (Loss)," establishes standards for reporting and displaying comprehensive income (loss) and its components in the condensed consolidated financial statements. The components of comprehensive loss are as follows (in thousands):

	Three Sept
	2001
	(Re
Net loss	$ (2,278)
Other comprehensive loss:	
Change in net unrealized loss on investment	134
Change in accumulated translation adjustments	27
Total comprehensive loss	$ (2,117)

10. Litigation

From time to time, we have received letters claiming that our products infringe upon patents or other intellectual property of third-parties. On July 3, 2001, Digi International, Inc. filed a complaint against us in the United States District Court for the District of Minnesota claiming patent infringement and alleging that certain of our Multiport Device Servers, specifically our ETS line of products, when coupled with a device driver called the Comm Port Redirector, infringe upon U.S. Patent No. 6,047,319 owned by Digi. Digi alleges that Lantronix has willfully and intentionally infringed Digi's patent, and its complaint seeks injunctive relief as well as unspecified damages, treble damages, attorney's fees, interest and costs. On August 17, 2001, Lantronix filed its answer to the complaint, asserting affirmative defenses, and counterclaiming for a declaratory judgment that the patent in issue is invalid. To date discovery has not begun and a trial date has not been set. Based on the facts known to date, Lantronix believes that the claims are without merit and intends to vigorously defend this suit.

11. Subsequent Events

On October 18, 2001, the Company completed the acquisition of Synergetic Micro Systems, Inc. (Synergetic), a provider of embedded network communication solutions. In connection with the acquisition, the Company paid cash consideration of $2.7 million and issued an aggregate of 2,234,715 shares of its common stock in exchange for all outstanding shares of Synergetic common stock and reserved 615,705 additional shares of common stock for issuance upon exercise of outstanding employee stock options and other rights of Synergetic. The transaction was exempt from registration pursuant to section 4 (2) of the Securities Act of 1933, as amended. Portions of the cash consideration and shares issued will be held in escrow pursuant to the terms of the acquisition agreement. In connection with the acquisition, the Company will record a one-time charge for purchased in-process research and development expenses related to the acquisition in its second fiscal quarter ending December 31, 2001.

In October 2001, the Company purchased an additional $1.5 million convertible promissory note from Xanboo. The note has a ten year maturity and will automatically convert into the next round of equity securities of Xanboo that raises at least $5.0 million. If Xanboo does not complete such a financing prior to February 1, 2002, the Company can convert the note into a newly created series of preferred stock of Xanboo.

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

You should read the following discussion and analysis in conjunction with the Unaudited Condensed Consolidated Financial Statements and related Notes thereto contained elsewhere in this Report. The information in this Quarterly Report on Form 10-Q/A is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this Report and in other reports filed with the SEC, including our restated Annual Report on Form 10-K/A for the fiscal year ended June 30, 2001, our restated Quarterly Report on Form 10-Q/A for the fiscal quarter ended December 31, 2001, and our subsequent reports on Form 8-K, that discuss our business in greater detail.

We have restated our consolidated financial statements for the fiscal quarter covered hereby and for our fiscal year ended June 30, 2001 and each fiscal quarter therein in a Form 10-K/A filed in June 2002. To the extent the following discussion and analysis refers to data from our consolidated financial statements for such periods, such references are to the data as restated.

The section entitled "Risk Factors" set forth below, and similar discussions in our other SEC filings, discuss some of the important factors that may affect our business, results of operations and financial condition. You should carefully consider those factors, in addition to the other information in this Report and in our other filings with the SEC, before deciding to invest in our company or to maintain or increase your investment.

This report contains forward-looking statements which include, but are not limited to, statements concerning projected net revenues, expenses, gross profit and income (loss), the need for additional capital, market acceptance of our products, our ability to consummate acquisitions and integrate their operations successfully, our ability to achieve further product integration, the status of evolving technologies and their growth potential and our production capacity. 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 intended 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. We undertake no obligation to revise or update publicly any forward-looking statements for any reason.

Accounting Change and Restatement of Financial Statements

In originally preparing the condensed consolidated financial statements at December 31, 2001, we changed our accounting method for recognizing revenue on sales to distributors effective as of July 1, 2001, the beginning of fiscal 2002. Under the new accounting method, the recognition of revenue and related gross profit on sales to distributors is deferred until the distributor resells the product to an end customer. Formerly, we recognized revenue from these transactions upon shipment of product to the distributor, net of estimates for possible returns and allowances.

In May 2002, we undertook a special investigation of our accounting, which revealed that beginning in the third and fourth quarters of fiscal 2001 certain shipments made to distributors and recorded as revenues in fiscal 2001 and 2002 did not qualify for revenue recognition upon shipment due to terms present in agreements with the distributors that were not considered in our original accounting decisions. As a result, our new method of accounting for distributor sales, which is based on recognizing revenue and related gross profit on sales to distributors only as the distributor resells the product to end customers, has been adopted effective as of July 1, 2000, the beginning of fiscal 2001, or one year earlier. This manner of correcting the errors in sales recognition made in previously issued financial statements for fiscal 2001 is deemed to be preferable in the circumstances because (1) it eliminates from revenue any effect of shipping excessive levels of inventory to the distributors; (2) all revenue from distributor sales in fiscal 2001 and 2002 will be recognized on a common basis; and (3) there is assurance that any additional agreements with distributors that may have existed with respect to specific orders but are presently unknown will not have an impact on amounts reported as revenue after the restatement. The restatement for the year ended June 30, 2001, results in a reduction in revenue of approximately $6.2 million and an increase in the loss before cumulative effect of accounting change of $2.9 million or $0.07 per share. The cumulative effect of the accounting change for the three months ended September 30, 2000 recorded as of July 1, 2000 was a charge of $773,000 (net of income tax benefit of $0) or $0.02 per share.

We believe that the new accounting method better reflects the substance of the transactions considering our recent entry into the semiconductor marketplace and the changing business environment; is consistent with other companies in our industry

thereby providing greater comparability in the presentation of financial results among us and our peers, and better focuses us on end customer sales.

In the special investigation conducted in May 2002, we also discovered that (i) the terms and circumstances of certain sales made in the first six

months of fiscal 2002 to customers who were not distributors also preclude revenue from being recognized upon shipment, as originally reported and (ii) that certain amounts initially reported as other comprehensive income (loss) should be accounted for as elements of net loss. Accordingly, in the accompanying restated condensed consolidated financial statements, we have made corrections to defer the recognition of such sales as revenue until all revenue recognition criteria have been met and reclassify to other expense the amounts improperly charged to other comprehensive income (loss). These corrections result in a reduction in revenue of approximately $438,000 and an increase in the loss before cumulative effect of accounting change of $123,000 or $0.00 per share in the three months ended September 30, 2001.

The effects of the corrections on net revenues; loss before cumulative effect of accounting change, net of income tax benefit; cumulative effect of accounting change; net loss; and related per share amounts for the three months ended September 30, 2001 and 2000 are shown in the tables below (in thousands, except per share amounts):

As reported:	
Net revenues	$
Loss before cumulative effect of accounting change	$
Cumulative effect of accounting change, net of income tax benefit of $1,049	
Net loss	$
Loss per share before cumulative effect of accounting change	$
Cumulative effect of accounting change per share	
Basic and diluted net loss per share	$
As restated:	
Net revenues	$
Corrections	
Net revenues, as restated	$
Loss before cumulative effect of accounting change	$
Corrections, net of tax	
Loss before cumulative effect of accounting change, as restated	
Cumulative effect of accounting change, net of income tax benefit of $0, as restated	
Net loss, as restated	$
Loss per share before cumulative effect of accounting change, as restated	$
Cumulative effect of accounting change per share, as restated	
Basic and diluted net loss per share, as restated	$

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* As reported information for the three months ended September 30, 2001 reflects the accounting change made in the second quarter of fiscal 2002, but effective as of July 1, 2001 to defer revenue recognition of revenue and related gross profit until the distributor resells the product to an end customer.

Under the leadership of new management, we are actively working to strengthen our policies, procedures, personnel, controls and internal communications in response to the circumstances that led to the restatement.

Overview

Lantronix designs network-enabling and system management solutions consisting of hardware and software that permit almost any electronic device to be accessed, managed, controlled over the Internet, Intranets or other networks. Since our inception in 1989, we have developed an array of network-enabling products including external Device Servers, embedded Device Servers, Multiport Device Servers, Print Servers and other products. Beginning in fiscal year 1999, we began to experience an increase in sales of our Device Servers reflecting our focus on this higher margin product line. At the same time, we began to experience a decline in sales of Print Server and other products as we shifted resources to our Device Server business, which we believe represents a greater opportunity for long-term growth. We believe sales in our Device Server business will continue to represent an increasing percentage of our net revenues in the future. Our strategy for continuing to increase sales of our Device Server product line involves a two-fold approach. First, we intend to substantially increase our research and development expenditures to enhance our Device Server product line and develop new products. Second, we intend to grow our

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Device Server business through strategic acquisitions, investments and partnerships, which we believe will support our product lines and allow us to secure additional intellectual property, increase our customer base and provide access to new markets.

Our products are sold to original equipment manufacturers (OEMs), value added resellers (VARs), systems integrators and distributors, as well as directly to end-users. One of our distributors, Ingram Micro, accounted for 12.6% of our net revenues for the three months ended September 30, 2001, compared to 11.5% for the three months ended September 30, 2000. Another distributor, Tech Data, accounted for 6.7% of our net revenues for the three months ended September 30, 2001, compared to 15.2% for the three months ended September 30, 2000. transtec AG, an international OEM and related party due to common ownership by our Chairman and major stockholder, accounted for 3.3% of net revenues for the three months ended September 30, 2001, compared to 6.6% for the three months ended September 30, 2000.

In July 2001, the Company completed a public offering of 8,534,000 shares of its common stock, including an underwriters' over-allotment option to purchase an additional 534,000 shares, at an offering price of $8.00 per share. The Company sold 6,000,000 shares and selling stockholders sold 2,000,000 shares of the primary offering. Additionally, the Company sold 400,500 shares and selling stockholders sold 133,500 shares of the over-allotment option. The Company received net proceeds of approximately $47.1 million in connection with this offering.

On October 18, 2001, we completed the acquisition of Synergetic Micro

Systems, Inc. ("Synergetic"), a provider of embedded high performance network communication solutions that complement our external device products. In connection with the acquisition, we paid cash consideration of $2.7 million and issued an aggregate of 2,234,715 shares of our common stock in exchange for all outstanding shares of Synergetic common stock and reserved 615,705 additional shares of common stock for issuance upon exercise of outstanding employee stock options and other rights of Synergetic. Portions of the cash consideration and shares issued will be held in escrow pursuant to the terms of the acquisition agreement.

In September and October 2001, we purchased convertible promissory notes from Xanboo totaling $3.0 million. The notes have ten year maturities and will automatically convert into the next round of equity securities of Xanboo that raises at least $5.0 million. If Xanboo does not complete such a financing prior to February 1, 2002, we can convert the notes into a newly created series of preferred stock of Xanboo. We are considering investing additional money in this company as well as other companies.

Stock-based compensation primarily relates to deferred compensation recorded in connection with the grant of stock options to employees where the option exercise price is less than the estimated fair value of the underlying shares of common stock as determined for financial reporting purposes, as well as the fair market value (determined using the Black-Scholes option pricing model) of the vested portion of non-employee stock options determined. Deferred compensation also includes the value of employee stock options assumed in connection with acquisitions of businesses calculated in accordance with current accounting guidelines. Deferred compensation is presented as a reduction to stockholders' equity and is amortized over the vesting period of the related stock options, which is generally four years. At September 30, 2001, a deferred compensation balance of $9.3 million remains and will be amortized as follows: $2.2 million in the remainder of fiscal 2002, $3.0 million in fiscal 2003, $2.5 million in fiscal 2004, $1.4 million in fiscal 2005 and $153,000 in fiscal 2006. The amount of stock-based compensation in future periods will increase if we grant stock options where the exercise price is less than the quoted market price of the underlying shares or if we assume employee stock options in connection with additional acquisitions of businesses. The amount of stock-based compensation actually recognized in future periods could decrease if options for which deferred compensation has been recorded are forfeited.

Results of Operations

The following table sets forth certain statement of operations data expressed as a percentage of total net revenues:

	Three Mo Ended September (Restat 2001
Net revenues	100.0%
Cost of revenues	47.6
Gross profit	52.4

Operating expenses:	
Selling, general and administrative	47.9
Research and development	13.2
Stock based-compensation	7.4
Amortization of purchased intangible assets	1.8
Total operating expenses	70.3
Loss from operations	(17.9)
Interest income (expense), net	3.4
Other income (expense), net	(4.0)
Loss before income taxes and cumulative effect of accounting change	(18.5)
Benefit for income taxes	(4.1)
Loss before cumulative effect of accounting change	(14.4)
Cumulative effect of accounting change, net of income taxes of $176	--
Net loss	(14.4)%

Net Revenues

Net revenues increased $4.2 million, or 36.0%, to $15.8 million for the three months ended September 30, 2001 from $11.6 million for the three months ended September 30, 2000. The increase was primarily attributable to an increase in net revenues of our Multiport Device Server products, partially offset by a decline in our Device Server, Print Server and other products. Multiport Device Server net revenues increased $5.1 million, or 174.8%, to $8.0 million or 50.6% of net revenues for the three months ended September 30, 2001 from $2.9 million or 25.0% of net revenues for the three months ended September 30, 2000. The increase in our Multiport Device Server net revenues is primarily attributable to the acquisition of Lightwave Communications, Inc. ("Lightwave"). Device Server net revenues decreased $574,000, or 7.4%, to $7.2 million or 45.4% of net revenues for the three months ended September 30, 2001 from $7.8 million or 66.7% of net revenues for the three months ended September 30, 2000. Device Server net revenues for the three months ended September 30, 2001 includes $501,000 of software revenue generated from United States Software Corporation ("USSC"). No software revenue was recorded for the three months ended September 30, 2000. Print Server and other net revenues decreased $331,000, or 34.2%, to $636,000, or 4.0% of net revenues for the three months ended September 30, 2001 from $966,000, or 8.3% of net revenues for the three months ended September 30, 2000. The decreases in our Print Server and other products net revenues are due to an increasinghly rapid transition to our Multiport Device Server and Device Server products.

Net revenues generated from sales in the Americas increased $5.4 million, or 63.3%, to $13.9 million or 87.5% of net revenues for the three months ended September 30, 2001 from $8.5 million or 72.9% of net revenues for the three months ended September 30, 2000. Our net revenues derived from customers located in Europe decreased $1.1 million, or 40.4%, to $1.5 million or 9.8% of net revenues for the three months ended September 30, 2001 from $2.6 million or 22.3% of net revenues for the three months ended September 30, 2000. The decrease in European sales is primarily due to the decrease in sell-through revenue from our largest European distributor, which is due to the economic downturn in Europe. Our net revenues derived from customers located in Europe as a percentage of total net revenues decreased due to the acquisition of Lightwave who primarily sells in the Americas. Our net revenues derived from customers located in other geographic areas decreased slightly to $425,000 or 2.7% of net revenues for the three months ended September 30, 2001 from $566,000 or 4.9% of

net revenues for the three months ended September 30, 2000.

The decrease in European sales is primarily due to the decrease in sell-through revenue from our largest European distributor, which is due to the economic downturn in Europe.

Gross Profit

Gross profit represents net revenues less cost of revenues. Cost of revenues consists primarily of the cost of raw material components, subcontract labor assembly from outside manufacturers and associated overhead costs. Additionally, cost of revenues for the three months ended September 30, 2001 consisted of $338,000 of non-cash amortization of purchased intangible assets. No charges were recorded for the three months ended September 30, 2000. We pay Gordian, Inc., an outside research and development firm, a royalty based on the sale of certain of our products. As a result, a royalty charge is included in cost of revenues and is calculated based on the related products sold. Gross profit increased by $1.9 million, or 29.4%, to $8.3 million or 52.4% of net revenues for the three months ended September 30, 2001 from $6.4 million or 55.0% of net revenues for the three months ended September 30, 2000. For the three months ended September 30, 2001 and 2000, Gordian royalties were $416,000 and $522,000, respectively. The increase in gross profit was mainly attributable to the significant increase in the Multiport Device Server product. The decrease in gross profit as a percentage of net revenues is primarily attributable to non-cash amortization of acquisition related charges, volume-pricing agreements and competitive pricing strategies.

Selling, General and Administrative

Selling, general and administrative expenses consist primarily of personnel-related expenses including salaries and commissions, facility expenses, information technology, trade show expenses, advertising, and professional fees. Selling, general and administrative expenses increased $2.4 million, or 47.0%, to $7.6 million or 47.9% of net revenues for the three months ended September 30, 2001 from $5.2 million or 44.3% of net revenues for the three months ended September 30, 2000. This increase is due primarily to depreciation of deployed fixed assets, increased personnel-related costs and facilities costs from the acquisitions of USSC and Lightwave as well as hiring of sales personnel, legal and other professional fees. We expect selling, general and administrative expenses in absolute dollars will continue to increase in the foreseeable future to support the global expansion of our operations and decrease as a percentage of net revenues due to increased net revenue.

Research and Development

Research and development expenses consist primarily of salaries and the related costs of employees, as well as expenditures to third-party vendors for research and development activities. Research and development expenses increased $1.0 million, or 98.9%, to $2.1 million or 13.2% of net revenues for the three months ended September 30, 2001 from $1.1 million or 9.0% of net revenues for the three months ended September 30, 2000. This increase resulted primarily from increased personnel- related costs due to the acquisition of USSC and Lightwave as well as hiring of senior management and expenses related to new product development.

Stock-based Compensation

Stock-based compensation generally represents the amortization of deferred compensation. We recorded approximately $496,000 of deferred compensation for the three months ended September 30, 2001 and a total of $4.2 million of deferred compensation in fiscal 2001. Deferred compensation represents the difference between the fair value of the underlying common stock for accounting purposes and the exercise price of the stock options at the date of grant. Deferred compensation is presented as a reduction of stockholders' equity and is amortized ratably over the respective vesting periods of the applicable options, which is generally four years. Stock-based compensation increased $520,000 or 79.8% to $1.2 million or 7.4% of net revenues for the three months ended September 30, 2001 from $652,000 or 5.6% of net revenues for the three months ended September 30, 2000. The increase in stock-based compensation primarily reflects stock options assumed in two purchase transactions completed during fiscal 2001 that were accounted for in accordance with the Financial Accounting Standards Board ("FASB") Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation--An Interpretation of APB Opinion No. 25." We expect to incur additional stock-based compensation in future periods as a result of the continued amortization of deferred compensation related to these and other stock option grants. Included in cost of revenues is stock-based compensation of $27,000 and $11,000 for the three months ended September 30, 2001 and 2000, respectively.

Amortization of Purchased Intangible Assets

In connection with the two purchase transactions completed during fiscal 2001, we recorded approximately $12.1 million of identified 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. Generally, we obtain independent appraisals of the fair value of tangible and intangible assets acquired in order to allocate the purchase price. Purchased intangible assets are amortized on a straight-line basis over the economic lives of the respective assets, generally three to five years. The amortization of purchased intangible assets charged to operating expenses increased $83,000 or 40.9%, to $286,000 or 1.8% of net revenues for the three months ended September 30, 2001 from $203,000 or 1.7% of net revenues for the three months ended September 30, 2000. In addition, approximately $338,000 of amortization of purchased intangible assets has been classified as cost of revenue

for the three months ended September 30, 2001. No comparable amortization of purchased intangible assets was classified as cost of revenue for the three months ended September 30, 2000.

Interest Income (Expense), Net

Interest income (expense), net consists primarily of interest earned on cash, cash equivalents, short-term and long-term investments. Interest income (expense), net was $536,000 and $497,000 for the three months ended September 30, 2001 and 2000, respectively. The increase is primarily due to higher average investment balances for the three months ended September 30, 2001 compared to September 30, 2000, as a result of the proceeds from our secondary public offering completed in July 2001.

Other Income (Expense), Net

Other income (expense), net consists primarily of the revaluation of a strategic investment and the effects of exchange gains and losses from foreign currency transactions. Other income (expense), net was $(628,000) and $(74,000)

for the three months ended September 30, 2001 and 2000, respectively. The increase is primarily attributable to the $500,000 revaluation of a strategic investment, less gains on foreign currency translation.

Provision for Income Taxes - Effective Tax Rate

We utilize the liability method of accounting for income taxes as set forth in Financial Accounting Standards Board, or Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes." Our effective tax rate was 22% for the three months ended September 30, 2001, and 0% for the three months ended September 30, 2000. The federal statutory rate was 34% for both periods. Our effective tax rate associated with the income tax benefit for the three months ended September 30, 2000, was lower than the federal statutory rate primarily due to foreign losses and amortization of stock-based compensation for which no current year tax benefit was provided. Our effective tax rate associated with the income tax benefit for the three months ended September 30, 2000, was lower than the statutory rate primarily due to the nondeductible goodwill amortization, amortization of stock-based compensation for which no benefit was provided, and the effects of an unfavorable foreign tax rate variance.

Impact of Adoption of New Accounting Standards

In June 2001, the FASB issued SFAS No. 141, "Business Combinations" ("SFAS No. 141"), effective for acquisitions consummated after June 30, 2001, and SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and certain intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests. Other intangible assets will continue to be amortized over their useful lives.

We have elected to early adopt the rules set forth in SFAS No. 142 on accounting for goodwill and other intangibles effective as of July 1, 2001. For the three months ended September 30, 2001, early adoption resulted in non-amortization of goodwill of $1.7 million or $0.03 per share based on the weighted average shares outstanding for the three months ended September 30, 2001.

The transition provisions of SFAS No. 142 require that we complete our assessment of whether impairment may exist as of the date of adoption by December 31, 2001 and complete our determination of the amount of any impairment as of the date of adoption by June 30, 2002. Any impairment that is required to be recognized when adopting SFAS No. 142 will be reflected as the cumulative effect of a change in accounting principle as of July 1, 2001. We have completed our initial assessment and concluded that goodwill arising from the acquisition of USSC having a carrying amount of approximately $5.4 million as of July 1, 2001 may be impaired. We expect to complete our determination of the amount of the impairment charge, if any, to be reflected as a cumulative effect of a change in accounting principle during the fourth fiscal quarter ending June 30, 2002.

We intend to perform the first of the required annual impairment tests of goodwill under the guidelines of SFAS No. 142 effective as of April 1, 2002. We have not yet determined the effect, if any, that this test will have on our consolidated statement of operations or financial position. An impairment charge, if any, identified as a result of completing our annual impairment test will be reflected as an operating expense in the fourth quarter of fiscal 2002.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" ("SFAS No. 121") and the accounting and reporting provisions of

Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." This statement retains certain requirements of SFAS No. 121 relating to the recognition and measurement of impairment of long-lived assets to be held and used. Additionally, this statement results in one accounting model,

based on the framework established in SFAS No. 121, for long-lived assets to be disposed of by sales and also addresses certain implementation issues related to SFAS No. 121, including the removal of goodwill from its scope due to the issuance of SFAS No. 142. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. We have not yet determined the effect, if any, on the carrying value of our long-lived assets resulting from the adoption of SFAS No. 144.

Liquidity and Capital Resources

Since inception, we have financed our operations through the issuance of common stock and through net cash generated from operations. We consider all highly liquid investments purchased with original maturities of 90 days or less to be cash equivalents. Cash and cash equivalents consisting of money-market funds and commercial paper totaled $58.2 million at September 30, 2001. Short-term investments consist of investments maturing in twelve months or less and totaled $2.0 million at September 30, 2001. Long-term investments consist of investments in two privately held companies and totaled $3.3 million at September 30, 2001.

Our operating activities used cash of $1.7 million for the three months ended September 30, 2001. We incurred a net loss of $2.3 million, which includes amortization and depreciation of $1.2 million, amortization of stock-based compensation of $1.2 million, the revaluation of a strategic investment of $500,000 and equity losses from investments of $294,000, offset by increased deferred income taxes of $450,000, all of which are non-cash. This was reduced by increased accounts receivable of $2.6 million, and increased prepaid expenses and other current assets of $877,000 offset by a decrease in inventory of $388,000 and prepaid income taxes of $430,000. The increase in accounts receivable was due to increased sales in the last month of the quarter as well as slower collections from some of our U.S. distributors and European customers and extended payment terms. The increase in prepaid expenses and other current assets is primarily attributable to a deposit to secure inventory. We decreased our inventory as we transition from procuring our own raw materials to having our contract manufacturers procure our raw materials. Our operating activities used cash of $2.5 million for the three months ended September 30, 2000.

Our investing activities used $3.0 million of cash for the three months ended September 30, 2001. We used $1.5 million of our public offering proceeds to purchase a note with a ten year maturity that will automatically convert into the next round of equity securities of Xanboo. We also used cash to purchase property and equipment, primarily computer hardware and software of $1.3 million pertaining to Oracle software enhancements, support of our international operations and a software package to support our sales force. Our investing activities used cash of $1.2 million for the three months ended September 30, 2000, primarily related to the purchase of property and equipment.

Cash provided by financing activities was $47.5 million for the three months ended September 30, 2001, primarily related to the net proceeds from our secondary public offering completed in July 2001. Cash provided by financing activities was $54.3 million for the three months ended September 30, 2000,

primarily related to the net proceeds from our initial public offering on August 4, 2000.

We intend to use a portion of the proceeds from our recent public offering to substantially increase our research and development activities. Specific amounts allocated to future research and development and sales and marketing expenditures will be budgeted based upon market conditions existing at that time.

We believe that our existing cash, cash equivalents and short-term investments and any available borrowings under our line of credit facility will be adequate to meet our anticipated cash needs through at least the next 12 months. Our future capital requirements will depend on many factors, including the timing and amount of our net revenues and research and development and infrastructure investments as well as our intentions to make strategic acquisitions or investments in other companies, which will 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 borrow funds through bank loans, sales 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.

Risk Factors

You should carefully consider the risks described below before making an investment decision. The risks and uncertainties described below are not the only ones facing our company. Our business operations may be impaired by additional risks and uncertainties that we do not know of or that we currently consider immaterial.

Our business, results of operations or cash flows may be adversely affected if any of the following risks actually occur. In such case, the trading price of our common stock could decline, and you may lose all or part of your investment.

Variations in quarterly operating results, due to factors including changes in demand for our products and changes in our mix of net revenues, could cause our stock price to decline.

Our quarterly net revenues, expenses and operating results have varied in the past and might vary significantly from quarter to quarter in the future. 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 price. Our short-term expense levels are relatively fixed and are based on our expectations of future net revenues. If we were to experience a reduction in net revenues in a quarter, we would likely be unable to adjust our short-term expenditures. If this were to occur, our operating results for that quarter would be harmed. If our operating results in future quarters fall below the expectations of market analysts and investors, the price of our common stock would likely fall. Other factors that might cause our operating results to fluctuate on a quarterly basis include:

- changes in the mix of net revenues attributable to higher-margin and lower-margin products;

- customers' decisions to defer or accelerate orders;
- variations in the size or timing of orders for our products;
- short-term fluctuations in the cost or availability of our critical components, such as flash memory;
- changes in demand for our products generally;
- loss of significant customers;
- announcements or introductions of new products by our competitors;
- defects and other product quality problems; and
- changes in demand for devices that incorporate our connectivity products.

If we make unprofitable acquisitions or are unable to successfully integrate any future acquisitions, our business could suffer.

We have in the past and intend to continue in the future to acquire businesses, client lists, products or technologies that we believe complement or expand our existing business. In October 1998, we acquired ProNet GmbH, a German supplier of industrial application Device Server technology. In December 2000, we acquired USSC, a company that provides software solutions for use in embedded technology applications. In June 2001, we acquired Lightwave, a company that provides console management solutions. In October 2001, we acquired Synergetic, a provider of embedded network communication solutions. We have also announced that we may acquire Premise Systems, a developer of client-side software applications. Acquisitions of this type involve a number of risks, including:

- difficulties in assimilating the operations and employees of acquired companies;
- diversion of our management's attention from ongoing business concerns;
- our potential inability to maximize our financial and strategic position through the successful incorporation of acquired technology and rights into our products and services;
- additional expense associated with amortization of acquired assets;
- maintenance of uniform standards, controls, procedures and policies; and
- impairment of existing relationships with employees, suppliers and customers as a result of the integration of new management employees.

Any acquisition or investment could result in the incurrence of debt and the loss of key employees. Moreover, we often assume specified liabilities of the companies we acquire. Some of these liabilities, such as environmental and tort liabilities, are difficult or impossible to quantify. If we do not receive adequate indemnification for these liabilities our business may be harmed. In addition, acquisitions are likely to result in a dilutive issuance of equity securities. For example, we issued common stock and

assumed options to acquire our common stock in connection with our acquisitions of USSC, Lightwave and Synergetic. We cannot assure you that any acquisitions or acquired businesses, client lists, products or technologies associated therewith will generate sufficient net revenues to offset the associated costs of the acquisitions or will not result in other adverse effects. Moreover, from time to time we may enter into negotiations for the acquisition of businesses, client lists, products or technologies, but be unable or unwilling to consummate the acquisition under consideration. This could cause significant diversion of managerial attention and out of pocket expenses to us. We could also be exposed to litigation as a result of an unconsummated acquisition, including claims that we failed to negotiate in good faith, misappropriated confidential information or other claims.

In addition, from time to time we intend to invest in businesses that we believe present attractive investment opportunities, or provide other synergetic benefits. For example, in March 2001, we purchased 283,476 shares of Series A Preferred Stock of Premise Systems for $2.0 million. In September and October 2001, we paid an aggregate of $3.0 million to Xanboo Inc. for notes with ten year maturities that are convertible into equity securities of Xanboo. These investments are speculative in nature, and there is a significant chance we will lose part or all of our investments.

Terrorist attacks or threats or attacks, and business interruptions caused by such attacks, natural disasters and electrical blackouts in the state of California, could adversely affect our business.

Interruptions in business as a result of actual or threatened terrorist attacks or military action could disrupt our operations in the United States and worldwide. Disruptions could include, but are not limited to, physical damage to our facilities, and disruptions caused by trade restrictions imposed by the United States or foreign governments. In addition, a general economic downturn in any of our target markets or general disruption of the financial markets caused by such attacks could substantially harm our business. Moreover, our operations are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure and other events beyond our control. We do not have a detailed disaster recovery plan. Our facilities in the State of California may be subject to electrical blackouts as a consequence of a shortage of available electrical power. In the event these blackouts continue or increase in severity, they could disrupt the operations of our affected facilities.

Stock-based compensation will negatively affect our operating results.

We have recorded deferred compensation in connection with the grant of stock options to employees where the option exercise price is less than the estimated fair value of the underlying shares of common stock as determined for financial reporting purposes. We have recorded deferred compensation net of forfeitures within stockholders' equity of $496,000 at September 30, 2001 and a total of $14.2 million of deferred compensation through fiscal 2001, which is being amortized over the vesting period of the related stock options, which is generally four years. A balance of $9.3 million remains at September 30, 2001 and will be amortized as follows: $2.2 million in the remainder of fiscal 2002, $3.0 million in fiscal 2003, $2.5 million in fiscal 2004, $1.4 million in fiscal 2005, and $153,000 in fiscal 2006.

The amount of stock-based compensation in future periods will increase if we grant stock options where the exercise price is less than the quoted market price of the underlying shares. The amount of stock-based compensation amortization in future periods could decrease if options for which accrued, but unvested deferred compensation has been recorded are forfeited.

We intend to continue to devote significant resources to our research and development, which, if not successful, could cause a decline in our revenues and

could harm our business.

We intend to continue to devote significant resources to research and development in the coming years to enhance and develop additional products. For the three months ended September 30, 2001, research and development expenses comprised 13.2% of our net revenues. If we are unable to develop new products as a result of this effort, 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 research and development.

Net revenues from our legacy products, which include our Print Servers, switches, hubs and other products, have decreased significantly and we expect that net revenues from these lines of products will continue to decline in the future as we focus our efforts on the development of other product lines.

Since 1993, net revenues from our legacy products have accounted for a significant portion of our net revenues but have declined significantly recently. For example, revenues from our legacy products were approximately $636,000 or 4.0% of our net revenues, compared to $966,000 or 8.3% of our total net revenues for the three months ended September 30, 2001 and 2000, respectively. We anticipate that net revenues from our legacy products will continue to decline in the future as we plan to continue to focus on the development of our current Device Server and Multiport Device Server product lines. We do not know if this transition in product development will be successful. We do not know whether our new product lines will be accepted by our

current and future target markets to the extent we anticipate. If the expected decline in net revenues attributable to our legacy products is not offset by increases in net revenues from our Device Server and Multiport Device Server lines of product, our business could be harmed.

There is a risk that our OEM customers will develop their own internal expertise in network-enabling products, which could result in reduced sales of our products.

For most of our existence we primarily sold our products to VARs, system integrators and OEMs. Although we intend to continue to use all of these sales channels, we have begun to focus more heavily on selling our products to OEMs. Selling products to OEMs involves unique risks, including the risk that OEMs will develop internal expertise in network-enabling products or will otherwise provide network functionality to their products without using our Device Server Technology. If this were to occur, our stock price could decline in value and you could lose part or all of your investment.

We might be unable to manage our growth, and if we cannot do so, our business could be harmed.

Our business has grown rapidly. At September 30, 2001, we had 249 employees and as of September 30, 2000 we had 158 employees. In addition, we have experienced expansion in our manufacturing and shipping requirements, our product lines and our customer base. This rapid expansion has placed significant strain on our administrative, operational and financial resources. These changes have increased the complexity of managing our company. Our current systems, management and other resources will need to grow rapidly in order to meet the demands of any future growth. If we are unable to successfully expand and

improve our systems as required, or if we are otherwise unable to manage any future growth, our business will be harmed.

New product introductions and pricing strategies by our competitors could adversely affect our ability to sell our products and could reduce our market share or result in pressure to reduce the price of our products.

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, 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 offer an open architecture, our customers could develop products based on our technology that compete with our offerings. We might not have sufficient engineering staff or other required resources to modify our products to match our competitors. Similarly, competitive pressure could force us to reduce the price of our products. In each case, we could lose new and existing customers to our competition. If this were to occur, our net revenues could decline and our business could be harmed. See Competition.

We primarily depend on three third-party manufacturers to manufacture all of our products, which reduces our control over the manufacturing process. If these manufacturers are unable or unwilling to manufacture our products at the quality and quantity we request, our business could be harmed and our stock price could decline.

We primarily outsource all of our manufacturing to three third-party manufacturers, APW, Inc., Irvine Electronics and Express Manufacturing. We have only recently entered into relationships with APW, Inc. and Irvine Electronics, and we intend to transition a significant portion of our workload to these manufacturers during approximately the next six months. 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 third-party 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 in required volumes, at acceptable quality, quantity, yields and costs, or in a timely manner, our business would be seriously harmed. We may also experience unforeseen problems as we attempt to transition a significant portion of our manufacturing requirements to APW, Inc. and Irvine Electronics. We do not have a significant operating history with either of these entities and if these entities are unable to provide us with satisfactory service, or we are unable to successfully complete the transition, our operations could be interrupted. 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. In addition, a natural disaster could disrupt our manufacturers' facilities and could inhibit our manufacturers' ability to provide us with manufacturing capacity on a timely basis, or at all. If this were to occur, we likely would be unable to fill customers' existing orders or accept new orders for our products. The resulting decline in net

revenues would harm our business. In addition, we are responsible for forecasting the demand for our individual products by regional location. 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 expedite charges which would increase our cost of sales or we may be unable to fulfill customer orders thus reducing net revenues and therefore earnings.

Inability or delays in deliveries from our component suppliers could damage our reputation and could cause our net revenues to decline and harm our results of operations.

Our contract manufacturers and we are responsible for procuring raw materials for our products. Our products incorporate components or technologies that are only available from single or limited sources of supply. In particular, some of our integrated circuits are available from a single source. From time to time in the past, integrated circuits we use in our products have been phased out of production. When this happens, we attempt to purchase sufficient inventory to meet our needs until a substitute component can be incorporated into our products. Nonetheless, we might be unable to purchase sufficient components to meet our demands, or we might incorrectly forecast our demands, and purchase too many or too few components. In addition, our products use components that have in the past been subject to market shortages and substantial price fluctuations. From time to time, we have been unable to meet our orders because we were unable to purchase necessary components for our products. We rely on a number of different component suppliers. Because we do not have long-term supply arrangements with any vendor 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.

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

Our top five customers accounted for 30.6% and our top ten customers accounted for 37.0% of our net revenues for the three months ended September 30, 2001. Ingram Micro, a domestic distributor, accounted for 12.6% of our net revenues for the three months ended September 30, 2001. The number and timing of sales to our customers have been difficult for us to predict. For the three months ended September 30, 2001, large individual sales have occurred in the last weeks or even days of a quarter, which has resulted in a substantial portion of the net revenues for that quarter being realized in the last month of the quarter. The loss or deferral of one or more significant sales in a quarter could harm our operating results. We have in the past, and might in the future, lose one or more major customers. If we fail to continue to sell to our major customers in the quantities we anticipate, or if any of these customers terminate our relationship, our reputation, the perception of our products and technology in the marketplace and the growth of our business 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 Server Technology. Our sales are usually completed on a purchase order basis and we have no long-term purchase commitments from our

customers.

Our future success also depends on our ability to attract new customers, which often involves an extended process. The sale of our products often involves a significant technical evaluation, and we often face delays because of our customers' internal procedures used to evaluate and deploy 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 on a timely basis or at all. This would cause our net revenues to decrease and could cause the price of our stock to decline.

The average selling prices of our products might decrease, which could reduce our gross margins.

In the past, we have experienced some reduction in the average selling prices of products and we expect that this will continue for our products as they mature. In the future, we expect competition to increase, and we anticipate this could result in additional pressure on our pricing. In addition, our average selling prices for our products might decline as a result of other reasons, including promotional programs and customers who negotiate price reductions in exchange for longer-term purchase commitments. Average selling prices and gross margins for our products also might decline as the products mature in their life cycles. In addition, we might not be able to increase the price of our products in the event that the price of components or our overhead costs increase. If this were to occur, our gross margins would decline.

We might become involved and are currently involved in litigation over proprietary rights, which could be costly and time consuming.

Substantial litigation regarding intellectual property rights exists in our industry. There is a risk that third-parties, including current and potential competitors, current developers of our intellectual property, our manufacturing partners, or parties with which we have contemplated a business combination will 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 infringe on the proprietary rights we use. Any of these third parties might make a claim of infringement against us.

From time to time we have received letters claiming that our products infringe upon patents or other intellectual property of third-parties. On July 3, 2001, Digi International, Inc. filed a complaint against us in the United States District Court for the District of Minnesota claiming patent infringement and alleging that certain of our Multiport Device Servers, specifically our ETS line of products, when coupled with a device driver called the Comm Port Redirector, infringe upon U.S. Patent No. 6,047,319 owned by Digi. Digi alleges that Lantronix has willfully and intentionally infringed Digi's patent, and its complaint seeks injunctive relief as well as unspecified damages, treble damages, attorneys fees, interest and costs. On August 17, 2001, Lantronix filed its answer to the complaint, asserting affirmative defenses, and counterclaiming for a declaratory judgment that the patent in issue is invalid. To date discovery has not begun and a trial date has not been set. Based on the facts known to date, Lantronix believes that the claims are without merit and intends to vigorously defend this suit.

Although we believe that the claims or any litigation arising there from will have no material impact on us or our business, the litigation is in the preliminary stage, and we cannot predict its outcome with certainty. The litigation process is inherently uncertain and we may not prevail. Patent litigation is particularly complex and can extend for a protracted time, which can substantially increase the cost of such litigation. The Digi litigation will likely divert the efforts and attention of some of our key management and technical personnel. Should the outcome of the litigation be adverse to us, we would be required to pay monetary damages to Digi and we could be enjoined from selling those of our products found to infringe Digi's patent unless and until we are able to negotiate a license from Digi which may not be available on acceptable terms or at all. If we are required to pay significant monetary damages, are enjoined from selling any of our products or are required to make substantial royalty payments pursuant to any such license agreement, our business would be harmed. This litigation, or other similar litigation brought by us or others, could result in the expenditure of significant financial resources and the diversion of management's time and efforts.

In addition, from time to time we could encounter other disputes over rights and obligations concerning intellectual property. We cannot assume that we will prevail in intellectual property disputes regarding infringement, misappropriation or other disputes. Litigation in which we are accused of infringement or misappropriation might cause a delay in the introduction of new products, require us to develop non-infringing technology, require us to enter into royalty or license agreements, which might not be available on acceptable terms, or at all, or require us to pay substantial damages, including treble damages if we are held to have willfully infringed. In addition, we have obligations to indemnify certain of our customers under some circumstances for infringement of third-party intellectual property rights. If any claims from third-parties were to require us to indemnify customers under our agreements, the costs could be substantial, and our business could be harmed. If a successful claim of infringement were made against us and we could not develop non-infringing technology or license the infringed or similar technology on a timely and cost-effective basis, our business could be significantly harmed.

If our agreement with Gordian, Inc. is terminated, we could lose the rights to valuable intellectual property.

Gordian, Inc. developed intellectual property used in our Micro Serial Server, or MSS, Print Servers and ETS and LRS lines of Multiport Device Server products. These products represent a substantial portion of our net revenues. Under the terms of an agreement dated February 29, 1989 between Gordian and us, Gordian owns the rights to the intellectual property developed by it. The agreement with Gordian currently provides that we are required to pay royalties based on the gross margin of products sold under the agreement. For the three months ended September 30, 2001 and 2000, we paid Gordian approximately $416,000 and $522,000 in royalties, respectively. In the event that the Gordian agreement is terminated, we could lose our rights to the intellectual property developed under the Gordian agreement and this might prevent us from marketing some or all of our MSS line of products in the future. If the Gordian contract is cancelled, we could lose customers and net revenues, which would harm our business.

Because we are dependent on international sales for a substantial amount of our net revenues, we face the risks of international business and associated currency fluctuations, which might adversely affect our operating results.

Net revenues from international sales represented 12.5% and 27.2% of net

revenues for the three months ended September 30, 2001 and 2000, respectively. Net revenues from Europe represented 9.8% and 22.3% of our net revenues for the three months ended September 30, 2001 and 2000, respectively.

We expect that international revenues will continue to represent a significant portion of our net revenues in the foreseeable future. Doing business internationally involves greater expense and many additional risks. For example, because the products we sell abroad and the products and services we buy abroad are priced in foreign currencies, we are affected by fluctuating exchange rates. In the past, we have from time to time 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 face other risks of doing business internationally, 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;
- changes in a country's or region's political or economic conditions;
- greater difficulty in staffing and managing foreign operations; and
- increased financial accounting and reporting burdens and complexities.

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

Our executive officers and technical personnel are critical to our business, and without them we might not be able to execute our business strategy.

Our financial performance depends substantially on the performance of our executive officers and key employees. We are dependent in particular on Frederick G. Thiel, who serves as our President and Chief Executive Officer, and Steven V. Cotton, who serves as our Chief Operating Officer and Chief Financial Officer. We are also dependent upon our technical personnel, due to the specialized technical nature of our business. If we lose the services of Mr. Thiel, Mr. Cotton or any of our key personnel and are not able to find replacements in a timely manner, our business could be disrupted, other key personnel might decide to leave, and we might incur increased operating expenses associated with finding and compensating replacements.

We might be unable to hire and retain the skilled personnel necessary to develop our operations, sales, technical and support capabilities in order to continue to grow, which could harm our business.

Our business cannot continue to grow if we do not hire and retain qualified technical personnel. Competition for these individuals is intense, and we might not be able to attract, assimilate or retain highly qualified technical personnel in the future. In addition, we need to continue to hire and retain operations, sales and support personnel. Our failure to attract and retain highly trained personnel in these areas might limit the rate at which we can develop, which would harm our business.

The market for our products is new and rapidly evolving. If we are not able

to develop or enhance our products to respond to changing market conditions, our net revenues will suffer.

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. The demand for network-enabled products is relatively new and can change as a result of innovations or changes. For example, industry segments might adopt new or different standards, giving rise to new customer requirements. Any failure by us to develop and introduce new products or enhancements directed at new industry standards could harm our business, financial condition and results of operations. These customer requirements might or might not be compatible with our current or future product offerings. We might not be successful in modifying our products

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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, or could decline.

Undetected product errors or defects could result in loss of net revenues, delayed market acceptance and claims against us.

We currently offer warranties ranging from 90 days to five years on each of our products. Our products could contain undetected errors or defects. If there is a product failure, we might have to replace all affected products without being able to book revenue for replacement units, or we may have to refund the purchase price for the units. Because of our recent introduction of our line of Device Servers, we do not have a long history with which to assess the risks of unexpected product failures or defects for this product line. Regardless of the amount of testing we undertake, some errors might be discovered only after a product has been installed and used by customers. Any errors discovered after commercial release could result in loss of net revenues and claims against us. Significant product warranty claims against us could harm our business, reputation and financial results and cause the price of our stock to decline.

Our intellectual property protection might be limited.

We do not rely on patents to protect our proprietary rights. We do rely 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 of marks that precede the registration of our marks;

- 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;

- current federal laws that prohibit software copying provide only limited protection from software pirates; and

. the companies we acquire may not have taken similar precautions to protect their proprietary rights.

Also, the laws of other countries in which we market our products might 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, which could significantly harm our business.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

There has not been any material change in our exposure to interest rate and foreign currency risks since the date of our Annual Report on Form 10-K/A for the year ended June 30, 2001.

Interest Rate Risk. Our exposure to interest rate risk is limited to the exposure related to our cash, cash equivalents, short-term investments and our credit facilities, which are tied to market interest rates. As of September 30, 2001, we had cash, cash equivalents and short-term investments of $60.2 million, which consisted of both domestic and foreign cash, cash equivalents and short-term investments. We believe our short term investments will decline in value by an insignificant amount if interest rates increase, and therefore would not have a material effect on our financial condition or results of operations.

Foreign Currency Risk. We sell products internationally. As a result, our financial results could be harmed by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets.

Investment Risk. At September 30, 2001 our investments in two privately held companies totaled $3.3 million, both of which can still be considered in the start-up or development stages. These investments are inherently risky as the market for the technologies or products they have under development are typically in the early stages and may never materialize. We could lose our entire initial investment in these companies.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time we have received letters claiming that our products infringe upon patents or other intellectual property of third-parties. On July 3, 2001, Digi International, Inc. filed a complaint against us in the United States District Court for the District of Minnesota claiming patent infringement and alleging that certain of our Multiport Device Servers, specifically our ETS line of products, when coupled with a device driver called the Comm Port Redirector, infringe upon U.S. Patent No. 6,047,319 owned by Digi. Digi alleges that Lantronix has willfully and intentionally infringed Digi's patent, and its complaint seeks injunctive relief as well as unspecified damages, treble damages, attorneys fees, interest and costs. On August 17, 2001, Lantronix filed its answer to the complaint, asserting affirmative defenses, and counterclaiming for a declaratory judgment that the patent in issue is invalid. To date discovery has not begun and a trial date has not been set. Based on the facts known to date, Lantronix believes that the claims are without merit and intends to vigorously defend this suit.

Item 2. Changes in Securities and Use of Proceeds

In July 2001, we completed a public offering of 8,534,000 shares of our

common stock, including an underwriter's over-allotment option to purchase an additional 534,000 shares, at an offering price of $8.00 per share. The Company sold 6,000,000 shares and selling stockholders sold 2,000,000 shares of the primary offering. Additionally, we sold 400,500 shares and selling stockholders sold 133,500 shares of the over-allotment option. We received net proceeds of approximately $47.1 million in connection with this offering.

In August 2001, we began negotiations with the former owners of U.S. Software to remove the earn-out provisions of the merger agreement in exchange for the issuance of a specified number of shares of our stock to the former owners of U.S. Software. In August 2001, in order to eliminate an employee bonus arrangement related to the acquisition, we issued 250,000 stock options to employees who were not former owners of U.S. Software. The issuance of these stock options was unrelated to and did not remove the earn-out provisions of the merger agreement. The estimated value of $500,000 related to these stock options will be accounted for as compensation expense over the vesting period of the options of up to four years.

On October 18, 2001, we completed the acquisition of Synergetic Micro Systems, Inc. (Synergetic), a provider of embedded network communication solutions. In connection with the acquisition, we paid cash consideration of $2.7 million and issued an aggregate of 2,234,715 shares of our common stock in exchange for all outstanding shares of Synergetic common stock and reserved 615,705 additional shares of common stock for issuance upon exercise of outstanding employee stock options and other rights of Synergetic. The transaction was exempt from registration pursuant to section 4(2) of the Securities Act of 1933, as amended. Portions of the cash consideration and shares issued will be held in escrow pursuant to the terms of the acquisition agreement as well as various employee share repurchase agreements. In connection with the acquisition, we will record a one- time charge for purchased in-process research and development expenses related to the acquisition in our second fiscal quarter ending December 31, 2001.

Item 3. Defaults upon Senior Securities

None.

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

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit Number	Description of Document
2.1*	Agreement and Plan of Reorganization by and among Lantronix, Inc., S Company Acquisition Corporation, and Synergetic Micro Systems, Inc.

* Incorporated by reference to exhibit 5.1 previously filed with Lantronix's Report on Form 8-K, originally filed September 20, 2001.

(b) Reports on Form 8-K

Date	Item Reported On
September 20, 2001	Lantronix announced it had entered into an agreement to acquire Synergetic Micro Systems, Inc.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1934, as amended, Lantronix has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Irvine, State of California, on the 24 day of June, 2002

LANTRONIX, INC.

By: /s/ James Kerrigan

James Kerrigan
Interim Chief Financial Officer