Lantronix, Inc.

First Quarter 2024 Earnings Conference Call

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CORPORATE PARTICIPANTS

Jeremy Whitaker - *Interim Chief Executive Officer and Chief Financial Officer*

Jacques Issa - *Vice President of Marketing*

Robert Adams - *Head-Corporate Development and Investor Relations*

PRESENTATION

Operator
Good day, and welcome to the Lantronix Inc., First Quarter 2024 Results Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on a touchtone phone, and if you need to withdraw your question, please press "*" then "2." Please note, this event is being recorded.

And now, I would like to turn the conference over to Robert Adams. Please go ahead.

Robert Adams
Good afternoon and thank you for joining the first quarter fiscal 2024 conference call.

Joining us on the call today are, Jeremy Whitaker, Interim CEO and Chief Financial Officer, and Jacques Issa, Vice President of Marketing. A live and archived webcast of today's call will be available on the company's website. In addition, you can find the call-in details for the phone replay in today's earnings release.

During this call, management may make forward-looking statements, which involves risks and uncertainties that could cause our results to differ materially from management's current expectations. We encourage you to review the cautionary statements and risk factors contained in the earnings release, which was furnished to the SEC today and is available on our website as well as the company's SEC filings, such as its 10-K and 10-Qs. Lantronix undertakes no obligation to revise or update publicly any forward-looking statements to reflect future events or circumstances. Please refer to the news release and the financial information in the Investor Relations section of our website for additional details that will supplement management's commentary.

Furthermore, during the call, the company will discuss some non-GAAP financial measures. Today's earnings release, which is posted in the Investor Relations section of our website, describes the differences between our non-GAAP and GAAP reporting and presents reconciliations for the non-GAAP financial measures that we use.

With that, I'll now turn the call over to Jeremy Whitaker, our Interim CEO and Chief Financial Officer.

Jeremy Whitaker
Thank you, Rob, and welcome to everyone joining us for this afternoon's call. First, I'd like to acknowledge the passing of our Chairman, Paul Folino, and thank him for the many years of leadership and service he provided to the Lantronix team. Paul will be missed by all.

Now, I'll provide the financial results and some business highlights for our first quarter of fiscal 2024 before commenting on our financial targets for the full fiscal year. For FQ1 2024, we reported revenue of $33 million, which was higher than our initial expectations for the quarter. Sequentially, revenue was down 5% and up 4% from the year ago period.

System Solutions increased significantly, driven by record revenues from our out-of-band deployments, strong sales to federal customers and revenue recognition for the remaining QED pilot production units for Gridspertise. We see continuing strength from our IoT System

Solutions, driven by contributions from out-of-band, the coming production ramp of the QED and initial shipments of telematics asset tracking solutions to a Tier 1 telecom carrier.

As expected, we experienced a sequential decline in embedded systems as a result of a couple of large shipments in the prior quarter that did not repeat this quarter. Looking forward, we see improving results from this product group driven by our EV customers across multiple geographies for both hardware and design services. We also expect to begin ramping production of an AI-powered video conferencing product for a large enterprise customer that should contribute meaningfully throughout the remainder of fiscal 2024.

In FQ1 2024, Software & Services revenues were up sequentially, a function of increased design services revenue, and we expect similar activity in the upcoming quarter. GAAP gross margin was 42.7% for FQ1 2024 compared to 39.5% in the prior quarter and 44.1% in the year ago quarter. The improvement in gross margin was primarily a function of a change in product mix from the prior quarter as a result of the record quarter in out-of-band sales during FQ1 2024. For FQ2 2024, we expect a similar product margin as a percentage of revenue.

GAAP SG&A expenses for FQ1 2024 were $9.2 million compared with $9.2 million in the year ago quarter and $8 million in the prior quarter. The sequential increase in GAAP SG&A was primarily due to lower-than-normal share-based compensation expense during FQ4 2023.

GAAP R&D expenses for FQ1 2024 were $5.1 million compared with $4.5 million in the year ago quarter and relatively flat with the prior quarter. GAAP net loss was $1.9 million or $0.05 per share during FQ1 2024 compared to a GAAP net loss of $1.7 million or $0.05 per share in the year ago quarter. Non-GAAP net income was $2.5 million or $0.07 per share during FQ1 2024 compared to non-GAAP net income of $2.7 million or $0.07 per share in the year ago quarter.

Now, turning to the balance sheet. We ended FQ1 2024 with cash and cash equivalents of $19.5 million, an increase of $6 million from the prior quarter. Working capital was $50.2 million as of FQ1 2024 and remained steady with the prior quarter. Net inventories were $45.8 million as of FQ1 2024, a decrease of $3.9 million from the prior quarter.

Now, turning to the upcoming second quarter and fiscal year 2024. We expect that revenue in the second quarter will be up sequentially as the QED ramps into volume production. We have commissioned the production lines, and the customer has approved the firmware to begin manufacturing.

Based upon these factors, we expect to begin volume shipments in the next several weeks. As such, we maintain our prior guidance for the QED revenue ramp, expecting approximately $5 million in December 2023, double that in our March 2024 quarter, with the remainder of the shipments falling in our fourth quarter ending June 2024.

In a cautious but relatively stable demand environment, we remain optimistic about the fiscal year ahead of us and expect to deliver the fiscal 2024 guidance that we provided during our previous earnings call. We're, therefore, reiterating our guidance with revenue in a range of $175 million to $185 million; and non-GAAP EPS in a range of $0.50 to $0.60 per share.

Finally, for those who may not have seen it, I'm excited to report that Lantronix has selected Saleel Awsare as its next President and CEO. Saleel comes to Lantronix from Synaptics, where he was the SVP and GM of the company's mobile and enterprise division, the largest

business unit within the company. Saleel was instrumental in the company's pivot from mobile markets in IoT and enterprise application and drove a multifold increase in market cap for the company's shareholders. Saleel will officially join Lantronix on November 20, and I look forward to introducing him to you on our next earnings call.

That completes our prepared remarks for today, so I'll now turn it over to the operator to conduct our Q&A session.

QUESTION AND ANSWER

Operator
Thank you. We will now begin the question and answer session. To ask a question, you may press "*" then "1" on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. And if at any time your question has been addressed and you would like to withdraw your question, please press "*" then "2." At this time, we'll pause momentarily to assemble our roster.

And our first question comes from Mike Walkley from Canaccord Genuity. Mike, please go ahead.

Michael Walkley
Great, thanks. Congratulations on the strong quarter and reiterating guidance for the year despite the tough macro. I guess to start my question, just on the IoT solutions business, it was down as you highlighted before, but just wondering how maybe that pipeline is growing. And Qualcomm had its recent Snapdragon, some that was an exciting new announcement that seemed like it could help drive your business. Can you maybe update us on how that pipeline generation is coming for that section of your business?

Jeremy Whitaker
Yes. The second half of the year, we do have a number of design wins that are expected to go into production. And so we are expecting to see the embedded compute business to improve over the next several quarters. That business has tended to be a little bit lumpy, because we tend to have a few larger customers driving some of that growth. And as one design win potentially goes away, we have some others coming in, but the timing of those don't always overlap just how we like them. As for some of the new products with Qualcomm, we do have some new modules that we are working on and expect to be delivering. So as those products do come to market, typically what we'll see is an increase in our kit sales and design services and then that typically then translates into design wins if we're...the customer is successful on the design services. So we do expect to continue to see strong growth coming from the compute business, both on the embedded side and also on the System Solutions, more specifically as it relates to the Gridspertise design win, which is also based upon a Qualcomm process.

Mike Walkley
Great. That's helpful. And I guess, Jeremy, just building on that on a big picture, you shared in the past 40-plus deals with over $150 million. How is that pipeline holding up given the challenging macro out there?

Jeremy Whitaker
Yes. We're still seeing good progress in pipeline and opportunities. I think we provided an update on that, maybe it was about six weeks ago on our year-end call and haven't seen any

significant change in that outlook or pipeline. But we do continue to see a lot of really good opportunities in the markets that we're playing in. And so, we're pretty optimistic about the remainder of fiscal 2024 and fiscal 2025 based upon the opportunity pipeline.

Mike Walkley
Great. Last question from me, and I'll pass the line. Just on the telematics deal with the Tier 1 carrier, anything you can share on just size of the opportunity or timing of ramp or what you're doing for that carrier?

Jeremy Whitaker
Yes. This is something we've been working on with them over several quarters. We did receive our first large order from them, a little bit less than $1 million order. I believe most of that will be shipped in the next couple of quarters. We do expect it to be a multimillion-dollar annual opportunity with this carrier. And it is in an application where it's helping them monitor...I'm blanking on the application, to monitor power generators in towers or at towers.

Mike Walkley
Great. Thanks for taking my questions. I'll pass the line.

Operator
And our next question comes from Jaeson Schmidt from Lake Street. Jaeson, please go ahead.

Jaeson Schmidt
Hey, guys, thanks for taking my questions. Just following up on Mike's question on the telematics deal, do you anticipate any potential follow-on orders eventually from this customer?

Jeremy Whitaker
Yes. We are expecting this to be a longer-term engagement. And so, our expectation is this is just the initial order from them and likely to be a multiyear rollout.

Jaeson Schmidt
Got it. And then what are you seeing as far as inventory levels in the distributor channel?

Jeremy Whitaker
Yes. Our distributor’s inventories have remained relatively consistent. If anything, they're down a little bit from the prior quarter. I don't...we didn't see, I would say, an unusual increase in our distributor inventories over the last several quarters as I've heard other companies indicate. So, they're remaining relatively consistent and, if anything, down a little bit.

Jaeson Schmidt
Okay. That's good to hear. And then just the last one from me, and I'll jump back in the queue. Can you just give us an update on Togg and any change in expectations there?

Jeremy Whitaker
Yes. We're continuing to ship to Togg under the purchase order that we received I'd say last quarter or the quarter before. As I mentioned on the previous call, we received an order for about $13 million from them. So most of that within the fiscal year and at a run rate that was about 2x from what we were doing before. So, no change to our current forecast. That was already baked into the numbers that we previously provided to everybody on the last call, and it continues to progress well and we're shipping against the contract.

Jaeson Schmidt
Sounds good. Thanks for the color.

Jeremy Whitaker
Thank you

Operator
And as a reminder, you may press "*", "1" if you would like to join the question queue. And now we are going to take a question from Christian Schwab from Craig-Hallum Capital. Christian, please go ahead.

Tyler
Hey guys. This is Tyler on behalf of Christian. Thanks for letting us ask a couple of questions here. So I guess on Gridspertise, great to hear that the production shipments are ramping this quarter and was as expected, I guess. Any update there with conversations and negotiations on follow-on orders from that customer.

Jeremy Whitaker
Yes. We've been, over the last several months, negotiating a follow-on contract with Gridspertise. So that is still in progress. We are expecting that Gridspertise will remain a partner and customer of ours for several years. I think probably the…as soon as we begin volume shipments and they can begin their production rollout that those negotiations will probably remain somewhat stalled until we can…you know, they actually start delivering to their customers. But still feel good about fiscal 2025 and continuing with them as a significant customer going forward.

Tyler
Great. That sounds great. Yes, I think all the rest of my questions have really been answered, so I'll pass it on. Thanks, guys.

Jeremy Whitaker
Thank you.

Operator
And we'll take a question from Scott Searle from ROTH MKM. Scott, you may proceed.

Scott Searle
Hey, good afternoon. Thanks for taking my questions. Hey Jeremy, just to follow-up on the prior Enel question. As you're starting to contemplate what that follow-on looks like, do you see it as being a similar magnitude or otherwise? So, your comment about growth in fiscal 2025 implies that it's still relatively sizable. So, I'm kind of wondering about how you think of the magnitude and size as we get beyond these initial deployments?

Jeremy Whitaker
Yes. From what they've indicated to us as it relates to the size of this business for them, the total business is at a magnitude that's much greater than what we're doing with them in fiscal 2024. They have indicated that they may want to dual source the business going forward. And then there will be…as the business grows, there will be more price pressure on the delivery as well. So I think it has the potential to be greater than what we've seen in fiscal 2024, that entire business. You know, what portion we get of that is still being discussed and negotiated.

Scott Searle
Got you. And maybe a follow-up to that. I believe the design that you've done with Enel is applicable into other markets, geographies and customers. Is that correct or is their interest building beyond just Gridspertise in the Italian market?

Jeremy Whitaker
So there is opportunity in other markets for this type of solution and other solutions that were, you know, have the ability to play in. This specific design is Gridspertise design. So us taking that into other markets, unless we're working with them, would not be allowable. That said, this is still a big market, and we do have a number of other products and designs that can work within it.

Scott Searle
Got it. And a couple of other things quickly, gross margins, as we progress over the course of the fiscal year, now as we start to see the Enel contract ramping up, how should we be thinking about that trajectory? And as well, I was just wondering if you could quickly comment on the EV market in general. I know there's a lot of design activity. And I think in terms of your $150 million plus pipeline or some EV design wins in there. I'm just wondering how the visibility on that has progressed. There have been some headwinds on that front. Thanks.

Jeremy Whitaker
Yes. So on the margin front; we're still expecting gross margins in slightly below the mid-40s consistent with what we've been seeing on average over the last several quarters. And even with Gridspertise coming in, we do pick up, although some of that is at a margin that's slightly lower than our corporate average, we do get more leverage in the operations model. So, we do make up for some of that by absorbing more of our fixed overhead costs.

On the EV front, we're working a number of different opportunities. They're all in various stages. A few of those are design service contracts that are currently in play. Expectation is some of those design services contracts will then roll into production agreements. And then we're also continuing to, some of the work that we did for Togg, we do have some shared IP around that, and we're looking at how we commercialize that work we've done and take that into the EV market as well. So, we have a couple of different areas that we're progressing on as it relates to EV. And this current fiscal year, I would expect we'll see a continued good growth, or continued growth from Togg and then we…and also as it relates to some of the other service contracts that are in play. And then those service contracts to the extent they become production contracts, would most likely benefit us in fiscal 2025.

Scott Searle
Great. Thanks so much. Nice job on the quarter.

Jeremy Whitaker
Thank you.

CONCLUSION

Operator
Thank you, very much. And this will conclude our question and answer session as well as the conference. We thank you very much for attending today's presentation. You may now disconnect.