

Lantronix Inc.

Fiscal 2025 Second Quarter Results
Conference Call

Thursday, February 06, 2025, 4:30 PM Eastern

CORPORATE PARTICIPANTS

Saleel Awsare - *Chief Executive Officer*

Brent Stringham - *Chief Financial Officer*

PRESENTATION

Operator

Good day, and welcome to the Fiscal 2025 Second Quarter Results Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing "*" 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, to withdraw your question, please press "*" then "2." Please note, this event is being recorded.

I would now like to turn the conference over to Brent Stringham, Chief Financial Officer. Please go ahead.

Brent Stringham

Good afternoon, and thank you for joining our quarterly earnings call. Joining me on the call today is our President and Chief Executive Officer, Saleel Awsare. A live and archived webcast of today's call will be available on the company's website. In addition, you can find the call and details for the phone replay in today's earnings release.

During this call, management may make forward-looking statements, which involve 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 and in 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 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 Saleel.

Saleel Awsare

Thanks, Brent, and thank you, everyone, for joining us on the call today. We reported revenue of \$31.2 million for the second quarter of fiscal 2025, and our non-GAAP EPS was \$0.04. Both metrics was solidly within the guidance range. Brent Stringham, our newly appointed CFO, will be providing more details on the second quarter financial results shortly.

On the call today, I would like to cover four topics briefly with you, an update of our Netcomm acquisition, which closed in late December, expected growth of the Edge AI market and comments from CES in Las Vegas, our strengthening relationship and AI developments with Qualcomm and an update of our internal cost-saving initiatives.

First, we are pleased with the strategic acquisition of Netcomm, for \$6.5 million, which expands our Connect business with 4G and 5G gateways. The integration process is going well, and we are working closely with our supply chain partners to fill orders for their blue-chip customers. We recently met with several key customers at CES, including Vodafone, Netcomm's largest

customer. We believe we are off to a good start and are excited about the growth prospects for the business.

Australia and New Zealand present Greenfield opportunities for us, and we're exploring new cross-selling opportunities for Lantronix. To help us grow our Connect product offerings and integrate Netcomm's gateway line, we hired Daniel Quant to Head up our Industrial IoT Group. Daniel will play a pivotal role in integrating AI into our new IoT devices and gateways for industrial and enterprise customers. With over 20 years of experience in industrial IoT and wireless communications, including his most recent role as Vice President and General Manager at Multi-Tech Systems in Minnesota. We are delighted to have him join the team.

Second, a recent Gartner report highlights a significant shift towards edge computing. By 2025, 79% [ph] of data is expected to be captured at the edge of the network, up from 25% in 2018. Additionally, more than 50% of enterprise-generated data will be processed outside for digital data centers by 2028 as compared to only 25% in 2018. This trend represents a substantial market opportunity edge AI and machine learning projected to be a \$76 billion market by 2031.

Lantronix is strategically positioning itself to capitalize on this mega trend by focusing on compute and connect of edge. Through both organic growth and strategic acquisitions, Lantronix aims to be the picks and shovels of the edge AI build-out. We provide the necessary hardware, software and services to enable edge AI applications helping customers deploy IoT edge solutions more efficiently. We showcased our edge intelligence technology to our key customers and partners at CES and received enthusiastic feedback.

Third, we continue to strengthen our strong collaboration with Qualcomm and Edge Intelligence and some broader AI initiatives. For example, we are integrating Qualcomm's advanced AI frameworks into our Lantronix edge AI systems to enhance modeling and real-time analytics. We are positioned as one of Qualcomm's key partners with edge AI, supporting their AI hub program and their expansion into mid-tier and enterprise customers.

For example, new opportunities include working on prototype solutions for banking institutions to test customer traffic analytics. Working with an electronics manufacturer for quality control and predictive maintenance and working with a large agriculture customer to explore real-time monitoring and maintenance for advanced farming footprint. While we invest in edge AI solutions, we remain very focused on securing new customers and design wins.

Several of note to share are: In out-of-band management, we're shipping to a large enterprise-ready AI data center business that is deploying our top-of-rack solution including hardware, software and services that enable out-of-band management or remote configuration, fast recovery and maintenance of the customers' AI cloud servers. This is critical for maintaining access to their assets at all times.

In compute, we recently secured a design win with a US based drone manufacturer. We are providing our production ready computing modules that are embedded in the drones for short range reconnaissance by the military. The system is TAA compliant.

In Connect, we are building on our strong relationship with a leading telecom provider to deliver gateway and routers to manufacturers of critical infrastructure assets such as generators and power plants. Our intelligent gateway allows customers to increase the operational readiness, reducing operating costs and improving alerts and reporting.

Finally, regarding the cost reduction initiatives we spoke about last quarter, I'm pleased to report that we are on track and made good progress in the fiscal second quarter. These initiatives are now substantially complete. Our process of consolidating our seven geographic locations down to four centers of excellence is progressing with Taipei for operations and hardware, Hyderabad for software and firmware, Vancouver for software and Qualcomm initiatives, Minneapolis for operations and United States certified warehousing.

We are making these changes to better serve our customers, help our future growth initiatives and streamline operations. In addition to the four centers of excellence, we're retaining a small administrative head office in Irvine.

With that, I will now turn the call over to Brent to provide you with the quarterly financial review.

Brent Stringham

Thank you, Saleel. I will review the financial results and some business highlights for our second quarter of fiscal year 2025 before commenting on our financial outlook for the third quarter of fiscal 2025.

For FQ2 2025, we reported revenue of \$31.2 million which was near the midpoint of our guidance range. This did not include any revenue from the acquisition of the Netcomm IoT products as the transaction closed right at the end of the quarter.

As expected, revenue was down sequentially from the prior quarter, principally due to lower volume from our largest automotive customer and slightly lower activity in our enterprise vertical market. On a year-over-year basis, revenue in FQ2 2025 was down approximately \$5.9 million or 16% as we saw lower activity in some of our out-of-band management and switch products.

GAAP gross margin was 42.6% in FQ2 2025 compared to 42.1% in the prior quarter and 40.6% in the year ago quarter. Non-GAAP gross margin was 43.2% in FQ2 2025 compared to 42.6% in the prior quarter and 41.6% in the year ago quarter. The sequential improvement in gross margin reflects favorable product mix toward higher margin system solution products.

GAAP operating expenses for FQ2 2025 were \$15.4 million compared to \$16.8 million in the year ago quarter and \$16.6 million in the prior quarter. Similarly, our non-GAAP OPEX for FQ2 2025 was down by approximately \$700,000 compared to the year ago quarter and down approximately \$600,000 sequentially, reflecting the progress we're making on cost reductions, which I will speak more about in a moment.

GAAP net loss was \$2.4 million or \$0.06 per share during FQ2 2025 compared to GAAP net loss of \$2.6 million or \$0.07 per share in the year ago quarter. Non-GAAP net income was \$1.8 million or \$0.04 per share during FQ2 2025 compared to non-GAAP net income of \$3 million or \$0.08 per share in the year ago quarter.

Further to Saleel's comments regarding our cost reduction initiatives, activities to reduce our operating costs have been substantially completed as of last month in January. We reported in the prior quarter that we expected these initiatives to result in quarterly non-GAAP OPEX in the range of \$11.25 million to \$11.75 million and on a full year basis reduced fiscal 2025 OPEX by \$4.5 million compared to fiscal 2024. With the initiatives implemented to-date, we are on track to deliver these cost reductions. Note this quarterly OPEX estimate did not include incremental costs attributable to the acquisition of the Netcomm IoT products, which we currently expect to add approximately \$300,000 to \$400,000 per quarter.

Turning to the balance sheet, we ended FQ2 2025 with cash and cash equivalents of \$19.2 million which includes the disbursement of \$6.5 million in late December for the acquisition of the Netcomm IoT products. For the six month period ended December 31st, 2024 we generated positive operating cash flow of \$3 million. Net inventories decreased slightly to \$29.1 million as of FQ2 2025 as compared to \$29.5 million in the prior quarter.

Now for the outlook. For the third quarter of fiscal 2025, we expect revenue to be in the range of \$27 million to \$31 million. We're expecting sequentially lower revenue in FQ3, primarily reflecting a slower than anticipated rollout by our large smart grid customer in Europe. We anticipate resuming shipments once the initial deployment is complete. The revenue impact in FQ3 is partially offset by expected organic growth in gateways, routers and out-of-band management. As a result, we're expecting non-GAAP EPS in the range of \$0.01 to \$0.05 per share in FQ3.

On a general housekeeping note, when filing our Form 10Q for the current quarter, we also intend to file a Form S3 registration statement, which renews our existing shelf registration that recently expired. This is consistent with the company's long standing practice.

Saleel Awsare

Thanks, Brent. In conclusion, I believe Lantronix has the key asset of compute and connect to drive edge intelligence. We will continue to focus on three key verticals enterprise, smart cities, which includes critical infrastructure and transportation. And as new reports indicate, more and more data traffic will be generated at the edge of the network with a higher percentage of processing happening there because it's secure and it makes a fast and efficient decision making rather than doing data back and forth to the cloud. We are very well positioned for this megatrend.

While we have experienced the effects of customer concentration, we set our corporate strategy, focused the business, executed well operationally, while delivering consistent profitability. We are driving ahead with edge AI solutions, securing new design wins, integrating the newly acquired assets from Netcomm and positioning the company for exciting future growth.

With that, we complete our prepared remarks for today. So I'll now turn it over to the operator to conduct our Q&A session. Thank you.

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. 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 will pause momentarily to assemble our roster.

And our first question comes from Jaeson Schmidt with Lake Street. Please go ahead.

Jaeson Schmidt

Hey guys, thanks for taking my questions. I just want to focus on your smart grid customer. I know fiscal '25 was always going to be that transition year. But just based on your commentary on how the March quarter is shaking out, have your thoughts changed about potential follow on orders from this customer later this calendar year?

Saleel Awsare

Hi, Jaeson, it's Saleel. Thanks for that question. Our thoughts haven't changed around the smart grid customer. As you know, we shipped to Gridspertise. You've said that in the past. They then work with Enel on the rollout, and we are kind of need to just work around with them on the rollout. So, we are sole sourced. We are continuing to work with them closely, and I'm going to be visiting them shortly in Europe. So not a lot of change on the future. They've been committing to us that longer term, they know what the size of the opportunities, and I believe we've spoken to that in the past. But right now, it's a matter of getting the rollout done.

Jaeson Schmidt

Okay. That makes sense. And any update on sort of the opportunity here in North America?

Saleel Awsare

Up to my recent discussions with them, they have two pilots going on, one in the Carolinas and one in the Northeast.

Jaeson Schmidt

Perfect. And then just the last one from me and I'll jump back in the queue. How should we think about gross margin trending the remaining kind of fiscal 2025 here?

Brent Stringham

Hi, Jaeson. This is Brent. Thanks for the question. As you know, margins are pretty heavily dependent on our product mix. And we expect at least the next quarter's non-GAAP gross margin to be...to come in slightly higher than what we saw here in FQ2.

Jaeson Schmidt

Okay, perfect. Thanks a lot, guys.

Saleel Awsare

Thanks Jaeson. Thanks for the questions.

Operator

The next question comes from George Gianarikas with Canaccord Genuity. Please go ahead.

George Gianarikas

Thank you for taking my questions. Good afternoon. I was wondering first if you can talk a little bit more about what's happening in your out-of-band business, any color and how you expect that to proceed into the March quarter. Thank you.

Saleel Awsare

Thanks for the question, George. I spoke about out-of-band. Let me give you like a specific case that I said in my prepared remarks. We got a design win and we're shipping to AI edge data center where our box sits at the top of the rack. So that's good as you see the data center build out happen. And without getting into the specifics, we expect it to grow from Q2 fiscal, which ended in December, to Q3 fiscal, which is going to be ending in March.

George Gianarikas

Great. But in the December quarter, what did you see? I think you mentioned on the call there was some weakness in out-of-band. Can you just talk a little bit about what happened there and any verticals specifically that were impacted?

Saleel Awsare

The weakness was primarily with some...one government related entity.

George Gianarikas

Thank you. And then moving maybe to auto, can you just talk about a little bit about your progress with TOG and also whether you have been able to leverage that into additional conversations with other OEMs?

Saleel Awsare

Yes. So, TOG, our relationship is good. They've gone through some soft pockets, but we are anticipating to be very well engaged with them. More importantly, we have started to ship a new product to them for their new upcoming car. So good work going on there. We're also working with them on some services business as they move to the new levels of Android. So we are as I said in the past, we've been two of the cars. In Europe, as you know, we've been working with one truck manufacturer and that's ongoing. That's the update on the automotive side, George. And thank you for that.

George Gianarikas

Thank you so much.

Operator

And our next question comes from Ryan Koontz with Needham. Please go ahead.

Ryan Koontz

Great. Thanks for the question. I want to expand the question around smart grid and your opportunities there as it relates apart from what Gridspertise is doing, I know you've got your own product there. How do you look at that market? Where do you see opportunities? Is it a different competitive playing field than your traditional scene? Maybe just high level reflections on the smart grid opportunity, particularly in light of modernization and new power needs from AI infrastructure? Thanks.

Saleel Awsare

Hey, great question, Ryan. And this really dwells into how we think about the company longer term and about the future growth that I talked about, which is around AI. And when I had spoken at CES and maybe when I had even come to your conference, we talked about our smart LV box, which is a Edge box using a Qualcomm SoM that we've created adding our firmware software really defining how the grid is managed at the edge device. So this could be sitting at a low voltage substation or even if you go further, even at your house. But right now, our focus is around the low voltage substations where you decide where the power needs to be sent, decide, hey, is Saleel at home or not? So it kind of is doing a lot of the traffic management of how the power comes. And we believe we've got a POC happening in Europe, which is we are progressing well. And then once we finish that and start going after more customers, I expect to see some results in that. And again, this is using a Qualcomm SoM for getting after the power at the edge device. You'll be able to see this one shortly again at Embedded World at the Qualcomm suite.

Ryan Koontz

That's really helpful. That's really great. And is that a different set of competitors than you typically face in the smart grid arena? And in terms of channels, would you develop new channels for this market, folks that are more aligned at the utility business?

Saleel Awsare

Yes. So we're looking at the channels that we want to develop in that. And specifically, we're going to focus a little bit in Europe because you've got some traction in that area. And we talked about our biggest smart grid customer, they're also interested in it because they also believe they want to go one more level from the medium voltage substation to the low voltage substation, it's early days, but we're also engaged with them. So that would be one channel and then we would have some of our own channels that our sales team is working on.

Ryan Koontz

Great. Super. And I guess in terms of the...your legacy business in switching and out-of-band, I mean how do you think about that in the big picture of...is that a low growth TAM at all or do you think it's going to be a headwind as far as your opportunity for your traditional products?

Saleel Awsare

Yes. Great question, right? So if I think about compute and connect, and you specifically talked about switching and out-of-band. I'll take out-of-band for a minute. Out-of-band, we expect this to be a growing business for us. And it's higher than corporate gross margins, as we've said before. We have services on ARR with it. So we like it. And we believe as the data center build out happens, we are going to benefit from that. So that's number one.

The switches, media converters, some of the other businesses that we have, I believe our market share is not large. Thus, I see an opportunity for us moving forward to grow some of that from the base that we are at. And you'd say, hey, why are you getting confidence around it. I'm seeing some good traction in North America, primarily because we are a western supplier. That's becoming more and more important now.

Ryan Koontz

Okay. That's great, Saleel. Thanks for that color. Appreciate it.

Saleel Awsare

Thank you, Ryan.

Operator

And the next question comes from Scott Searle with Roth Capital. Please go ahead.

Scott Searle

Hey, good afternoon. Thanks for taking my questions. Hey, Saleel, maybe just too quickly follow-up on the out-of-band management opportunity. I wonder if you could frame what you think the growth rate is going forward. And then on the edge AI opportunity, I know it's very early days, but it seems like there was some good traction coming out of CES. Can you just provide a little bit more color on design cycles, metrics that we should be paying attention to and how this will start to ramp up in fiscal '26?

Saleel Awsare

Yes. So let me take the edge AI first and then we'll go to out-of-band. Edge AI, Scott, we had good momentum out of CES. I spoke specifically about three customer programs that we're working on. One is for the banking industry, and I think you saw that demo when you were at our suite of CES. The other one is around a manufacturing where they've got predictive maintenance that they're looking at the existing box that we've added some technology in. And the last one is really with farming. So in fiscal '26, we will start to see green shoots and we anticipate to have revenue in fiscal '26 in these areas. I don't know whether you saw the news that Qualcomm also

spoke about it yesterday that more and more inference is going to run on the device making AI more accessible and customizable. And we're going to be right there with that. So I'm expecting to see growth. And the industry is talking about a 12% growth rate. So I expect we should be in that area, if you may.

And out-of-band management, sorry. Let me get to that. Out-of-band management should be growing more at the rate that we talked about, 10%, 12%. The market is about \$400 million to \$500 million as I've spoken in the past. And the reason we like it, high gross margins, very sticky, and it's a differentiated sale for Lantronix.

Scott Searle

Great. And if I could just to follow-up on supply chain issues. Obviously, it's a key topic of discussion in the broader community right now. But could you kind of take us through some of your exposures, how the current or potential tariff environment impacts you or does it impact you? Thanks.

Saleel Awsare

Great question and thank you for asking me that, Scott. So on the tariff side of it, we have initiatives in place to address potential tariff increases. We are in the process of transitioning the majority out our manufacturing out of China in the near term, Scott. And I'm very confident this is not going to have any material impact on our business.

Scott Searle

Great. Thank you.

Operator

And the next question comes from Christian Schwab with Craig-Hallum Capital Group. Please go ahead.

Christian Schwab

Hey, guys. Most of my questions have been answered. I just have one. You kind of ended the conference call talking about exciting growth to come. I'm just wondering if you could kind of frame that on a multiyear basis for us what you are expecting.

Saleel Awsare

You got cut out at the end, Christian, but I think you were talking about the growth that we are focused on. So we anticipate we expect that we should be growing around the 12% rate. That's what we are planning on. And once some of these edge AI things hit, we should start growing faster than that in the longer term.

Christian Schwab

Great. And then as far as...

Saleel Awsare

Let me make one more add to that. I believe the Netcomm asset is also going to be additive to that. Sorry, please go ahead, sir.

Christian Schwab

Yes, no worries. So my last question is just gross margins. Would you say gross margins stay kind of at the level that you're kind of guiding to March? Or do you see something more aspirational in the future?

Brent Stringham

Yes, Christian, this is Brent. We think in the near term, especially this next quarter Q3, we expect gross margins to be slightly higher than what we saw here in Q2, especially given the mix that we're projecting for that quarter and shortly thereafter in the quarters to come.

Saleel Awsare

And Christian, if you think about longer term, we anticipate the margins to keep improving closer to the 45% rate without giving too much color. But yes, we are really seeing that happening. We've got a laser focus on the supply chain right now.

Christian Schwab

Great. No other questions. Thank you.

Operator

This concludes our question and answer session. I would like to turn the conference back over to Saleel Awsare for any closing remarks.

CONCLUSION**Saleel Awsare**

Yes. Thank you everyone for joining our call. We are always available for more discussions. Thank you again. Bye-bye.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.