

Lantronix, Inc.

Fourth Quarter 2024 Results Conference
Call

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CORPORATE PARTICIPANTS

Saleel Awsare - *President, Chief Executive Officer*

Jeremy Whitaker - *Chief Financial Officer*

PRESENTATION

Operator

Good day, and welcome to the Lantronix Fourth 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 questions, you may press "*" then "1" on your telephone keypad. 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 Jeremy Whitaker, Chief Financial Officer. Please go ahead.

Jeremy Whitaker

Good afternoon, everyone, 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-in 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, Jeremy, and thank you, everyone, for joining us on the call today. I'm pleased to report record revenue of \$49.1 million for the fourth quarter of fiscal year 2024, a year-over-year increase of 41% compared to the same period of 2023 and a sequential increase of 19% compared to the March quarter.

Non-GAAP EPS in fiscal year Q4 grew 150% compared to the same period last year, demonstrating the leverage in our operating model as revenue grows. Jeremy will provide you with more details and analysis on fiscal year 2024 and the fourth quarter financial results shortly.

At Lantronix, we enable Edge Intelligence with our compute and connect solutions, allowing our customers to improve both the operational efficiency and real-time decision-making. We understand the complexity of Edge compute requirements, and we provide our customers with complete solutions, including hardware, software, device management and design services.

Because our offerings are differentiated, sticky and help our customers solve problems, we have able to achieve a relatively higher value for these solutions in the marketplace.

We remain focused on three key vertical markets: smart cities, automotive and enterprise that have double-digit growth rates, favorable secular trends and combined serviceable addressable market, of approximately \$8.5 billion representing a tremendous opportunity for Lantronix.

Today, let me start with the enterprise vertical market. Our out-of-band management solutions business is performing very well and grew more than 70% from fiscal year 2023 to fiscal year 2024. Our out-of-band management product portfolio makes it easier to securely manage distributed enterprise networks and devices by providing access, resiliency and tools for daily management tasks and when a disruption occurs.

For example, during the global CrowdStrike outage that occurred last month, our out-of-band management products with remote access were likely used to reduce network downtime. Our solutions minimized mean time to recovery, allowing network administrators to restore the affected window devices and get businesses back up and running again.

In addition to providing resiliency and recovery during emergency, our out-of-band management solutions make daily operational tasks easier, more efficient and highly secure. In fact, our LM-Series products are a leader in the industry with patented automation that can greatly reduce time to recovery during network outage events, malicious or accidental.

Our out-of-band management solutions have higher than our average corporate gross margins and are often combined with other Lantronix products such as IoT gateways, media converters and recurring services. Also in the enterprise vertical, we began shipping to our largest video conferencing customer that recently announced their next-generation product.

In the automotive vertical, our relationship with Togg continues to progress. The Turkish automotive OEM is looking at new software features that will require higher performance compute modules, and we are engaged with them on that. Togg is also continuing to focus on its goal of introducing its new vehicles to Germany next calendar year. With these developments, we expect continued growth with this customer into the future.

Additionally, we recently secured a design services purchase order with a large German OEM that is developing a new infotainment platform for long and short haul trucks. We are pleased to have entered into this new relationship, and it shows great progress in our longer-term goal of winning new compute designs in our emerging automotive infotainment business.

In the smart cities vertical, we continue to work closely with our lead smart grid customer. During the June quarter, we shipped over \$21 million in product to them as we expected. And while it will take them some time to digest and deploy this product with their customer, we believe that this can be an ongoing business for several years. In the current quarter, fiscal Q1 2025, we expect to deliver approximately \$5 million in product to them.

We believe that as the initial inventories consumed, this business is transitioning into a run rate business. We are also very pleased to be partnering with them on expanding into the North American market. They're currently working with a large US energy company on a similar smart grid solution, and we'll be supplying demo units for a proof of concept.

Many electrical grids are having to be upgraded significantly given the rise in energy demands and these networks are requiring real-time decision-making at the Edge, which this device provides. While it is still early days, we are pleased to be assisting our customers as they enter the large US market.

Lastly, we are very excited to be working on new projects with our key partner, Qualcomm related to Edge AI computing. In late June, we demonstrated our PercepXion Edge AI solution fully integrated with Qualcomm's AI Hub at Qualcomm's Industry Analyst Day. This platform enables deployment of Edge AI solutions for vertical markets such as smart city and enterprise. Qualcomm's AI Hub when combined with our PercepXion platform reduces the complexity of Edge AI applications and simplifies the deployment of AI models.

Building on our platform, we are closely collaborating with our compute partner, who we expect to deploy our software tools at scale to help their developers build leading Edge AI Edge Solutions. While it's still early days for us, the opportunity in Edge AI for Lantronix lies in providing integrated solutions using our compute modules and Edge AI gateways for customers looking to deploy solutions with compute power needed to drive AI models at the edge of the network. In support of this, we are pleased to see our PercepXion platform win the 2024 Product of the Year Award from the IoT Evolution World earlier this month.

To conclude, I'm very optimistic about Lantronix future. Given our strong balance sheet, the momentum in our enterprise verticals, specifically in videoconferencing and out-of-band solutions, new engagements in automotive infotainment, diversifying into additional geographic regions with our smart grid customer and our deepening relationship with Qualcomm enabling us to participate in the new megatrend of Edge AI.

We are also mindful of inorganic accretive growth opportunities, and we will pursue those that fit within our portfolio and make economic sense. Our goal is to increase shareholder value through both organic and inorganic growth.

With that, I will now hand the call back over to Jeremy.

Jeremy Whitaker

Thank you, Saleel. Now, I will provide the financial results and some business highlights for our fiscal year 2024 and fourth quarter before commenting on our financial outlook for the first quarter of fiscal 2025.

I will start with a brief recap of our fiscal 2024. We reported record revenue of \$160.3 million, representing 22% growth from the prior year. In addition, we reported record non-GAAP earnings of \$15.4 million, representing 83% growth from the prior year. We also reported record non-GAAP EPS of \$0.40 per share or 76% growth from the prior year.

The significant growth in non-GAAP earnings demonstrates the leverage in our operating model and our commitment to maintain financial discipline while still delivering record revenue for the fiscal year. Not only did the team deliver record revenue and earnings, we also improved our balance sheet and liquidity from the prior year.

We ended the year with cash of \$26.2 million, up 95% from the prior year by generating \$18.6 million in cash flow from operations. We reduced inventories from \$49.7 million in the prior year to \$27.7 million, a reduction of 44%. Furthermore, we increased our working capital to \$59 million, an increase of 17% from the prior year.

In addition, this week, we extended the maturity of our \$16.2 million term loan by one year, further improving our short-term liquidity. With these balance sheet and working capital improvements, we remain well-positioned to drive our strategic growth plan.

Now, turning to the FQ4 2024 results. For FQ4 2024, we reported revenue of \$49.1 million, slightly above the midpoint of our guide and an all-time record for Lantronix. Revenue was up 19% and 41% from the sequential and year-ago periods, respectively.

IoT System Solutions increased by 33% and 156% from the sequential and year-ago periods, respectively. The increase was primarily driven by the continued ramp of production shipments for our lead smart grid customer. In addition, the year-over-year increase was impacted by strong sales of our out-of-band management products.

Sequentially, embedded IoT solutions were down 9%, with continued contribution from our lead automotive customer. As expected, we experienced a year-on-year decline in embedded IoT solutions, as the year ago period included two large customer designs that ended in FQ4 2023. In FQ4 2024, software and services were down from the year-ago period, primarily a function of the completion of two large design services projects that transitioned into production during the first half of fiscal 2024.

GAAP gross margin was 38.1% for FQ4 2024, compared to 40.1% in the prior quarter and 39.5% in the year ago quarter. Non-GAAP gross margin was 38.8% for FQ4 2024, compared to 41% in the prior quarter and 39.9% in the year-ago quarter. The decline in gross margin percent was primarily related to charges taken related to the buildup of excess inventory costs. We expect gross margin percent to improve to the low to mid-40s as we don't expect similar charges and an improvement in product mix in FQ1.

GAAP SG&A expenses for FQ4 2024 were \$11 million, compared with \$8 million in the year ago quarter and \$9.8 million in the prior quarter. GAAP R&D expenses for FQ4 2024 were \$5.3 million, compared with \$4.9 million in the year ago quarter and \$5.2 million in the prior quarter. The increases in SG&A and R&D were driven by a record year for revenue and earnings, which resulted in higher share-based and variable compensation during fiscal 2024 as compared to fiscal 2023. In the upcoming quarter, we expect a sequential decrease in non-GAAP operating expenses related to continued cost containment and lower variable compensation.

GAAP net income was \$386,000 or \$0.01 per share during FQ4 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 increased by 160% from the year ago quarter, demonstrating leverage in our operating model and strong cost control.

Non-GAAP net income was \$5.8 million or \$0.15 per share and came in at the midpoint of our guide for FQ4 2024 compared to non-GAAP net income of \$2.2 million or \$0.06 per share in the year ago quarter.

Now turning to our outlook, for the first quarter of fiscal 2025, we expect revenue to be in the range of \$34 million to \$38 million, and non-GAAP EPS in a range of \$0.07 to \$0.11 per share. The sequential decline for FQ1 was anticipated due to the steep ramp of our smart grid customer in FQ4 2024, as discussed on our previous earnings calls.

During FQ4 2024, we delivered a record \$21.4 million to this customer. In addition, we have received a follow-on order from this customer and in FQ1 2025 we expect to deliver them approximately \$5 million of additional products.

If we exclude this expected shipment from our FQ1 guidance, the balance of our revenue is expected to grow sequentially by approximately 10%. As we look forward, we are focused on continued improvement of financial performance by enhancing the operational leverage of the business.

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.

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 telephone keypad. 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."

The first question comes from Scott Searle with ROTH Capital. Please go ahead.

Scott Searle

Good afternoon. Thanks for taking my questions. A quick clarification, Jeremy. You mentioned charges impacting gross margins in the fourth quarter. Could you detail them a little bit what was the magnitude of the impact there? It sounds like they go away as we go into the September quarter. And given the favorable mix from the out-of-band management solutions that gross margin should come back a little bit.

Jeremy Whitaker

Yes. We...it was several hundred basis points, probably 200 or 300 basis points, and it was primarily related to some charges for excess and obsolete inventory. And in addition to that, some costs that were accumulated with the growth of inventory during the pandemic. And as inventories have come down significantly, those costs also came off the books.

Scott Searle

Okay. Very helpful. And Saleel, on the out-of-band management front, it's very exciting to hear the growth that's going on in that business. Could you size it a little bit or give us a range in terms of how big that business is right now? And maybe what the expected growth outlook would be as we look into fiscal 2025 and how and where that pipeline is shaping up?

Saleel Awsare

Sure thing, Scott, we are very pleased with our out-of-band management growth. And as I mentioned, it grew 70% Y-o-Y. We wouldn't expect the same 70% growth, but it's got double-digit growth as we get into fiscal year 2025. And it's above average gross margins for the business. So the way the market has been sized is approximately all in with all vendors around \$400 million to \$500 million as our data shows in that area. So the market sizing. Now we don't, Scott, break out revenue by sub-segments, so I won't go into that, but really exciting business for us.

Scott Searle

Got you.

Jeremy Whitaker

And for clarification, the gross margins are on the upper end of our scale as well. So it's a nice high margin product.

Scott Searle

Got you. And two more questions, if I could. The Qualcomm relationship has obviously been very favorable. And more and more, we're seeing Edge AI pushing into the equation these days. I'm wondering, is there some way to help us better understand the design funnel, the opportunity funnel of what you're seeing out there on that front? And then coupling that with inorganic...organic growth. You talked about 10% sequential growth from June to September, and if we x-out [ph] Gridspertise. What is the normalized number we should be thinking out about taking Gridspertise out of the numbers of the organic growth we should be looking for over the next several quarters?

Saleel Awsare

So let me take the Edge AI first. And this one is really exciting as I think about it, right? And what would Lantronix offer? We will offer compute SOMs and a full Edge AI Box. And we demoed the Edge AI Box at the Industry Analyst Day in June at Qualcomm headquarters.

As from a sizing, it's early for me to give you a revenue number for that, but we are very closely aligned with Qualcomm on this. Additionally, if you caught in my prepared remarks, you're building on the platform, we're working with our partner, who we expect to deploy our software tools into their tool chain to enable developers to rapidly build and deploy solutions. So that would make what they're doing a little bit more unique to us and we can be differentiated in the market. So that's specific to Qualcomm. So it's early days, as you know, for Edge AI data centers already happened. So that's in the early days.

On the market, we are doing...we're giving you quarterly guidance. Sequentially, as Jeremy mentioned, we grew 10%. The SAMs that we are addressing are...gives us a lot of headroom, so \$8.5 billion plus, as I've said in the past, I'll say again, we expect to be growing at or better than the growth rate that we've said in that area. And the growth rate that we mentioned is about 12%. So we expect to be growing better than that in the longer term, Scott.

Scott Searle

Okay. Thanks so much. I'll get back in the queue.

Operator

The next question comes from Jaeson Schmidt with Lake Street. Please go ahead.

Jaeson Schmidt

Yes, thanks for taking my questions. Just want to follow up on your comments on the North American smart grid opportunity. I know you mentioned demoing some units. How should we think about the potential timing of this opportunity contributing to the P&L?

Saleel Awsare

Yes. As you know, the...we work with our partner there. And they have just started demoing with a pretty large North American utility, a proof-of-concept system that's going in there. Its early days to give you revenue ramps on that, but the key point is the system is very similar to what got

deployed in Italy. So it's not like the brand-new system. Now, it's going through lots of testing like it does. I expect it's out 18 months to 24 months before you see a big ramp on that, but it's out there, but they've started the POCs with it already as I speak. And it's a proof of concept is what we are doing.

Jaeson Schmidt

Okay. That's helpful. And then, Jeremy, just a clarification on gross margin in September. I know you mentioned low to mid-40%. Does that include any continued excess inventory charges though?

Jeremy Whitaker

No, it doesn't. We currently don't anticipate meaningful charges going forward. We do forecast kind of a historical run rate as part of our modeling. But with the significant decline in revenue coming down nearly 50% from the year ago period, and also at this point in time, having amortized off, pretty much all of the costs, like purchase price variances and capitalized overhead related to the buildup during the pandemic, we have some nice tailwinds there that should help drive that improvement. In addition to that, with a lower contribution anticipated from our smart grid customer in fiscal 2025, we'll also expect to see improvement from mix as well.

Jaeson Schmidt

Got you. Thanks a lot guys.

Jeremy Whitaker

Thank you.

Operator

Once again, if you have a question, please press "*" then "1." The next question comes from George Gianarikas with Canaccord Genuity. Please go ahead.

George Gianarikas

Hi, good afternoon, everyone. Thank you for taking my questions.

Saleel Awsare

Hi, George.

George Gianarikas

So maybe to start, can you just sort of give us a little more detail on this engagement that you have on the auto side? Any profile on the average selling price and margins there?

Saleel Awsare

So let me give you a little bit more on the specific things that we're doing there. So we've signed a purchase order with a German truck OEM for software and services. They are developing a new infotainment platform focused on long and short-haul trucks. We know the cycle is long for automotive customers, but it really adds to our customer diversification in this emerging automotive infotainment business. I expect the gross margins should be you know, what we have done in the automotive in the past. We haven't given a specific number out there, but I expect it to be around that area. And by the way, George, this is the key point here, what's really exciting, it's Greenfield. Part of the story is to go beyond our one customer or a couple of customers that we have into many more, and this is really the start of that. And it shows that our technology is getting adapted.

George Gianarikas

Okay. Thank you. And maybe just on the M&A side, the inorganic side, I'm sort of new, obviously, to the story. I'd love to understand a little bit about your philosophy around accretion...earnings accretion when you look at acquisitions in addition to strategic fit? Thank you.

Jeremy Whitaker

Yes. So on the financial side, the type of things we've done in the past and that we look at doing on a go-forward basis are very focused on becoming accretive, straight out of the gate or at least having a very short timeline to get there through synergy capture. So that's been a pretty significant focus for us in the past, and I'd say all four of the last deals that we've done have met that criteria. And at this point that's also how we're evaluating deals on a go-forward basis. And I'll let Saleel comment on the strategic side of things.

Saleel Awsare

Yes. So George, great question, right? We have three verticals we really like, smart cities, enterprise and automotive infotainment. We like compute, we like connect, and in those spaces where we are going to be looking at acquisitions, and we are seeing a pipeline now coming, so we're starting to evaluate stuff. And I'll just add my own personal experience with acquisitions in my previous company, being accretive from day one is really important, and we're going to be focused on that for sure.

George Gianarikas

Thank you.

Operator

The next question comes from Ryan Koontz with Needham & Co. Please go ahead.

Ryan Koontz

Thanks for the question. Quick clarification on your autonomous truck. Did you mention your timeframe at all, when you thought that might be able to move into first revenue?

Jeremy Whitaker

We did not mention the timing of first revenue right now. What we said is we got our first PO [ph] for working with them closely on software and services. The hardware revenue is going to be out a little bit. As you know, the cycles, Ryan, for automotive are longer, so we did not give you a schedule on the hardware revenue yet. But we said we did get our PO for software and service, which then in the future leads to hardware.

Ryan Koontz

That's great. And Jeremy, quick housekeeping on...it looked like the inventory was down substantially Q-over-Q. Is that mostly related to your shipments to your large smart grid customer or was it a write-off high impact there or other things afoot that are driving inventories down?

Jeremy Whitaker

Yes. The biggest impact was the shipments to our smart grid customer. Then after that, we also brought down inventory levels in other areas. That's been a focus of ours. And then some of the write-downs were probably the smallest impact to the bringing down the inventory for the quarter.

Ryan Koontz

Got it. So our lead times, I'm sure much more manageable now. Anything you can share there about your lead times you're seeing for kind of key component...strategic components?

Saleel Awsare

No, the lead times are very manageable. And to what Jeremy said for the past three quarters, the two of us have been uber-focused on getting this inventory right sized. And I think we are sitting there now. We've made some tremendous progress. And the lead times, to your point, Ryan, we're okay...we're okay now.

Ryan Koontz

Great, and circling back to the Edge AI topic, it sounds really exciting. Anything more you can share there in terms of the architecture of what these sort of devices would do? Are they part of a larger AI cloud and this is kind of the Edge cloud that you're involved in the inferencing from kind of a core or anything you can share there about the architecture on the AI cloud?

Saleel Awsare

Yes. Great question, Ryan. So obviously, this is the Edge inferencing is what we are going to differentiate and win in.

Ryan Koontz

Yes.

Saleel Awsare

And let me give you like two examples. You can see where it really fits with what we do, right. In videoconferencing, AI tools are now being used to enhance both video and audio. And we've got some great video conferencing customers. So I'm talking about the future, right. Right now, we're already shipping to them. But in the future, with our SOMs, they will be able to have auto framing, tracking, gesture recognition, interesting things like that. We won't be making the models. The models are going to be what they have, but we will have the ability to run up. And we've actually created tools, as I mentioned, our partners going to embed it in their tool chain. So that's one example.

In the smart grid, both the low voltage and medium voltage substations are going to allow inferencing of large set of variables. So the variables and the data are going to come from the energy companies. But our products in the future will be able to kind of understand the grid loading and steer energy in anticipation of loads. So it's really...it's early days because Edge AI is early days on the edge, but we're really working with a key partner, and you know who they are, Qualcomm, and we've indexed to them quite a bit, and they have some nice low-power chips and that's a great focus for them also. So good alignment on our side.

Ryan Koontz

Great. That's all I've got. Thanks for the questions.

Saleel Awsare

Thank you.

CONCLUSION**Operator**

This concludes the question and answer session and today's conference call. Thank you for attending today's presentation. You may now disconnect.