CONTROL4 CORP
Form 10-Q
November 04, 2016
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016

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 001-36017

Control4 Corporation

(Exact name of registrant as specified in its charter)

Delaware	42-1583209
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
11734 S. Election Road Salt Lake City, Utah	84020
(Address of principal executive offices)	(Zip Code)

(801) 523-3100
(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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of “accelerated filer”, “large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

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

On October 28, 2016, 23,639,120 shares of the registrant's Common Stock, $0.0001 par value, were outstanding.

Table of Contents

Control4 Corporation

Index

Part I — Financial Information

Item 1.		
	Condensed Consolidated Balance Sheets (unaudited) as of September 30, 2016 and December 31, 2015	2
	Condensed Consolidated Statements of Operations (unaudited) for the Three and Nine Months Ended September 30, 2016 and 2015	3
	Condensed Consolidated Statements of Comprehensive Income (Loss) (unaudited) for the Three and Nine Months Ended September 30, 2016 and 2015	4
	Condensed Consolidated Statements of Cash Flows (unaudited) for the Nine Months Ended September 30, 2016 and 2015	5
	Notes to Condensed Consolidated Financial Statements (unaudited)	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	23
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	43
Item 4.	Controls and Procedures	43

Part II — Other Information

Item 1.	Legal Proceedings	45
Item 1A.	Risk Factors	45
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	69
Item 4.	Mine Safety Disclosures	69
Item 6.	Exhibits	70
Signatures		71

Table of Contents

Control4 Corporation

PART I — Financial Information

ITEM 1. Condensed Consolidated Financial Statements

CONTROL4 CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	September 30, 2016 (unaudited)	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 25,671	$ 29,530
Restricted cash	259	296
Short-term investments	21,293	37,761
Accounts receivable, net	24,667	21,322
Inventories	31,714	19,855
Prepaid expenses and other current assets	3,166	3,842
Total current assets	106,770	112,606
Property and equipment, net	6,355	6,584
Long-term investments	5,008	13,716
Intangible assets, net	24,498	4,547
Goodwill	17,016	2,760
Other assets	2,110	1,650
Total assets	$ 161,757	$ 141,863
Liabilities and stockholders’ equity		
Current liabilities:		
Accounts payable	$ 20,028	$ 17,588

Accrued liabilities	7,407	5,880
Deferred revenue	1,378	1,099
Current portion of notes payable	298	727
Total current liabilities	29,111	25,294
Revolving credit line	1,500	—
Notes payable	34	186
Other long-term liabilities	805	938
Total liabilities	31,450	26,418
Commitments and contingencies (Note 11)	—	—
Stockholders’ equity:		
Common stock, $0.0001 par value; 500,000,000 shares authorized; 25,221,246 and 24,590,768 shares issued; 23,639,120 and 23,436,288 shares outstanding at September 30, 2016 and December 31, 2015, respectively	3	2
Treasury stock, at cost; 1,582,126 and 1,154,480 shares at September 30, 2016 and December 31, 2015, respectively	(12,262)	(9,020)
Additional paid-in capital	229,688	220,782
Accumulated deficit	(86,640)	(95,580)
Accumulated other comprehensive loss	(482)	(739)
Total stockholders’ equity	130,307	115,445
Total liabilities and stockholders’ equity	$ 161,757	$ 141,863

See accompanying notes to condensed consolidated financial statements (unaudited).

Table of Contents

CONTROL4 CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
Revenue	$ 55,185	$ 43,558	$ 151,435	$ 120,282
Cost of revenue	27,566	21,748	77,303	60,532
Gross margin	27,619	21,810	74,132	59,750
Operating expenses:				
Research and development	9,190	8,191	26,708	24,308
Sales and marketing	10,852	8,489	32,101	23,668
General and administrative	5,407	4,220	15,279	13,129
Litigation settlement	—	—	400	—
Total operating expenses	25,449	20,900	74,488	61,105
Income (loss) from operations	2,170	910	(356)	(1,355)
Other income (expense), net:				
Interest, net	12	79	17	142
Other income (expense), net:	(89)	(112)	(306)	(452)
Total other income (expense), net	(77)	(33)	(289)	(310)
Income (loss) before income taxes	2,093	877	(645)	(1,665)
Income tax expense (benefit)	316	(314)	(9,585)	(666)
Net income (loss)	$ 1,777	$ 1,191	$ 8,940	$ (999)
Net income (loss) per common share:				
Basic	$ 0.08	$ 0.05	$ 0.38	$ (0.04)
Diluted	$ 0.07	$ 0.05	$ 0.37	$ (0.04)
Weighted-average number of shares:				
Basic	23,424	24,129	23,307	24,260
Diluted	24,530	24,856	24,149	24,260

See accompanying notes to condensed consolidated financial statements (unaudited).

Table of Contents

CONTROL4 CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
Net income (loss)	$ 1,777	$ 1,191	$ 8,940	$ (999)
Other comprehensive income (loss):				
Foreign currency translation adjustment, net of tax	172	(547)	197	(793)
Net unrealized gains (losses) on available-for-sale investments, net of tax	(10)	37	60	65
Total other comprehensive income (loss)	162	(510)	257	(728)
Comprehensive income (loss)	$ 1,939	$ 681	$ 9,197	$ (1,727)

See accompanying notes to condensed consolidated financial statements (unaudited).

Table of Contents

CONTROL4 CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended September 30,	
	2016	2015
	(unaudited)	
Operating activities		
Net income (loss)	$ 8,940	$ (999)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation expense	2,402	2,146
Amortization of intangible assets	3,393	1,113
Loss on disposal of fixed assets	13	—
Provision for doubtful accounts	313	281
Investment premium amortization	293	—
Stock-based compensation	5,933	5,336
Tax benefit from business acquisition	(9,402)	—
Changes in assets and liabilities:		
Accounts receivable	(3,469)	(2,097)
Inventories	(6,776)	(1,779)
Prepaid expenses and other current assets	1,740	(566)
Other assets	(341)	(247)
Accounts payable	2,333	342
Accrued liabilities	421	(622)
Deferred revenue	291	347
Other long-term liabilities	(451)	(298)
Net cash provided by operating activities	5,633	2,957
Investing activities		
Purchases of available-for-sale investments	(10,147)	(49,095)
Proceeds from sales of available-for-sale investments	900	2,018
Proceeds from maturities of available-for-sale investments	33,858	49,535
Purchases of property and equipment	(1,780)	(2,917)
Business acquisitions, net of cash acquired	(32,891)	(8,380)
Net cash used in investing activities	(10,060)	(8,839)
Financing activities		
Proceeds from exercise of options for common stock	3,021	1,127
Repurchase of common stock	(3,242)	(4,942)

Repayment of notes payable	(581)	(722)
Proceeds from revolving credit facility	5,000	—
Repayment of revolving credit facility	(3,500)	—
Payment of debt issuance costs	(89)	—
Net cash provided by (used in) financing activities	609	(4,537)
Effect of exchange rate changes on cash and cash equivalents	(41)	(31)
Net decrease in cash and cash equivalents	(3,859)	(10,450)
Cash and cash equivalents at beginning of period	29,530	29,187
Cash and cash equivalents at end of period	$ 25,671	$ 18,737
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 164	$ 85
Cash paid for taxes	858	431
Supplemental schedule of non-cash investing and financing activities		
Net unrealized losses on available-for-sale investments	60	65

See accompanying notes to condensed consolidated financial statements (unaudited).

Table of Contents

Control4 Corporation

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Description of Business and Summary of Significant Accounting Policies

Control4 Corporation (''Control4'' or the ''Company'') is a leading provider of personalized, smart home and business solutions that are designed to enhance the daily lives of our customers. The Company's solutions unlock the potential of connected devices throughout a home or business, making entertainment systems easier to use and more accessible, spaces more comfortable and energy efficient, and individuals more secure. The Company was incorporated in the state of Delaware on March 27, 2003.

Unaudited Interim Financial Statements

The accompanying condensed consolidated balance sheets, condensed consolidated statements of operations, condensed consolidated statements of comprehensive income (loss), and condensed consolidated statements of cash flows are unaudited. These unaudited interim condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (''GAAP'') on the same basis as the audited consolidated financial statements and, in the opinion of management, reflect all adjustments, consisting only of normal recurring adjustments, considered necessary to present fairly the Company's financial position, results of operations and cash flows. The results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016, or any other future interim or annual period.

These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission (the "SEC") on February 16, 2016. The December 31, 2015 consolidated balance sheet included herein was derived from the audited financial statements as of that date.

Basis of Presentation

The unaudited condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated in the unaudited condensed consolidated financial

statements.

Segment Reporting

Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision-maker, the Chief Executive Officer, in making decisions regarding resource allocation and assessing performance. To date, the Company has viewed its operations and manages its business as one operating segment.

Concentrations of Risk

The Company’s accounts receivable are derived from revenue earned from its worldwide network of independent dealers and distributors. The Company’s sales to dealers and distributors located outside the United States are generally denominated in U.S. dollars, except for sales to dealers and distributors located in the United Kingdom, Canada, Australia, and the European Union, which are generally denominated in pounds sterling, Canadian dollars, Australian dollars, and the euro, respectively. There were no individual account balances greater than 10% of total accounts receivable as of September 30, 2016 and December 31, 2015.

No dealer or distributor accounted for more than 10% of total revenue for the three and nine months ended September 30, 2016 and 2015.

Table of Contents

The Company relies on a limited number of suppliers for its contract manufacturing. A significant disruption in the operations of certain of these manufacturers would impact the production of the Company's products for a substantial period of time, which could have a material adverse effect on the Company's business, financial condition and results of operations.

Geographic Information

The Company's revenue includes amounts earned through sales to dealers and distributors located outside of the United States. There was no single foreign country that accounted for more than 10% of total revenue for the three and nine months ended September 30, 2016 and 2015. The following table sets forth revenue from U.S., Canadian and all other international dealers and distributors combined (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenue-United States	$ 39,670	$ 29,300	$ 108,506	$ 80,571
Revenue-Canada	4,246	3,702	11,355	10,910
Revenue-all other international sources	11,269	10,556	31,574	28,801
Total revenue	$ 55,185	$ 43,558	$ 151,435	$ 120,282
International revenue (excluding Canada) as a percent of total revenue	20 %	24 %	21 %	24 %

Use of Accounting Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, the Company evaluates its estimates, including those related to revenue recognition, sales returns, provisions for doubtful accounts, product warranty, inventory obsolescence, litigation, determination of fair value of stock options, deferred tax asset valuation allowances and income taxes. Actual results may differ from those estimates.

Limited Product Warranties

The Company provides its customers a limited product warranty of two years for all Control4 branded products and three years for all Pakedge branded products. The limited product warranties require the Company, at its option, to repair or replace defective products during the warranty period at no cost to the customer or refund the purchase price. The Company estimates the costs that may be incurred to replace, repair or issue a refund for defective products and records a reserve at the time revenue is recognized. Factors that affect the Company’s warranty liability include the cost of the products sold, the Company’s historical experience, and management’s judgment regarding anticipated rates of product warranty returns, net of refurbished products. The Company assesses the adequacy of its recorded warranty liability each period and makes adjustments to the liability as necessary. Warranty costs accrued include amounts accrued for products at the time of shipment, adjustments for changes in estimated costs for warranties on products shipped in the period, and changes in estimated costs for warranties on products shipped in prior periods. It is not practicable for the Company to determine the amounts applicable to each of these components.

Table of Contents

The following table presents the changes in the product warranty liability for the nine months ended September 30, 2016 (in thousands):

	Warranty Liability
Balance at December 31, 2015	$ 1,415
Warranty costs accrued	1,145
Warranty claims	(863)
Balance at September 30, 2016	$ 1,697

Net Income (Loss) Per Share

Basic net income (loss) per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per share is computed using the weighted-average number of common shares outstanding and potentially dilutive common shares outstanding during the period that have a dilutive effect on net income per share. Potentially dilutive common shares result from the assumed exercise of outstanding stock options and settlement of restricted stock units.

The following table presents the reconciliation of the numerator and denominator used in the calculation of basic and diluted net income (loss) per share (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Numerator:				
Net income (loss)	$ 1,777	$ 1,191	$ 8,940	$ (999)
Denominator:				
Weighted average common stock outstanding for basic net income (loss) per common share	23,424	24,129	23,307	24,260
Effect of dilutive securities—stock options and restricted stock units	1,106	727	842	—
	24,530	24,856	24,149	24,260

Weighted average common shares and dilutive securities outstanding

In a net loss position, diluted net loss per share is computed using only the weighted-average number of common shares outstanding during the period, as any additional common shares would be anti-dilutive as they would decrease the loss per share. Potentially dilutive securities, including common equivalent shares, in which the assumed proceeds exceed the average market price of common stock for the applicable period, were not included in the calculation of diluted net income per share as their impact would be anti-dilutive. The following weighted-average common stock equivalents were anti-dilutive and therefore were excluded from the calculation of diluted net income (loss) per share (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Options to purchase common stock	2,221	2,687	2,490	4,796
Restricted stock units	—	—	23	87
Total	2,221	2,687	2,513	4,883

Recent Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments," which clarifies how companies present and classify certain cash receipts and cash payments in the statement of cash flows. This standard is effective for fiscal periods beginning after December 15, 2017, including interim periods within those years. Early adoption is permitted and the guidance must be applied using a retrospective transition method. The Company is currently evaluating the impact of adopting this guidance.

In March 2016, the FASB issued ASU 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." The amendments in this update simplify several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU 2016-09 will be effective for the Company in fiscal year 2017. Any adjustments resulting from the adoption of this standard will be reflected as of the beginning of the fiscal year of adoption. In accordance with the provisions of this standard, the Company will start recognizing excess tax benefits in our provision for income taxes rather than paid-in capital beginning January 1, 2017. The Company doesn't anticipate that additional amendments to the accounting for income taxes and minimum statutory withholding requirements will have a material impact to retained earnings as of January 1, 2017, where the cumulative effect of these amendments are required to be recorded. The Company is still evaluating the accounting policy election to estimate forfeitures, as currently required, or to recognize forfeitures as they occur. If the Company elects to change this accounting policy and recognize forfeitures as they occur, there will be a cumulative effect adjustment recorded to opening retained earnings to reflect the impact of this change. In addition, the Company is still evaluating if the presentation for cash flows related to excess tax benefits will be adopted prospectively or retrospectively.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which supersedes the guidance in ASC 840, "Leases." The purpose of the new standard is to improve transparency and comparability related to the accounting and reporting of leasing arrangements. The guidance will require balance sheet recognition for assets and liabilities associated with rights and obligations created by leases with terms greater than twelve months. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those years. Modified retrospective application is required. Early adoption is permitted. The Company is evaluating the impact of adopting this guidance.

In July 2015, the FASB issued ASU 2015-11, "Inventory (Subtopic 330) – Simplifying the Measurement of Inventory." This update requires that inventory within the scope of the guidance be measured at the lower of cost and net realizable value. The guidance is effective in fiscal years beginning after December 15, 2016, including interim periods within those years. Prospective application is required. Early adoption is permitted as of the beginning of an interim or annual reporting period. The Company early adopted this guidance this quarter, and the adoption of this guidance did not have an impact on the Company's results of operations, financial position, or cash flows.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," which amends the guidance in ASC 605, "Revenue Recognition." The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, deferring the effective date of this standard for one year, and is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The deferred standard allows early adoption of the standard on the original effective date which would be effective for annual reporting periods beginning after December 15, 2016. The Company is still evaluating the impact of adopting this guidance, as well as whether the Company will apply the amendments retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of applying this update at the date of initial application.

9

Table of Contents

2. Balance Sheet Components

Inventories consisted of the following (in thousands):

	September 30, 2016	December 31, 2015
Finished goods	$ 28,963	$ 16,982
Component parts	2,443	2,575
Work-in-process	308	298
	$ 31,714	$ 19,855

Property and equipment, net consisted of the following (in thousands):

	September 30, 2016	December 31, 2015
Computer equipment and software	$ 3,672	$ 4,799
Manufacturing tooling and test equipment	4,222	4,267
Lab and warehouse equipment	3,546	3,376
Leasehold improvements	3,120	2,949
Furniture and fixtures	2,934	2,881
Other	753	752
	18,247	19,024
Less: accumulated depreciation	(11,892)	(12,440)
	$ 6,355	$ 6,584

Other assets consisted of the following (in thousands):

	September 30, 2016	December 31, 2015
Deposits	$ 665	$ 933
Prepaid licensing	552	664
Deferred tax asset	882	—
Other	11	53
	$ 2,110	$ 1,650

Accrued liabilities consisted of the following (in thousands):

	September 30, 2016	December 31, 2015
Sales returns and warranty accruals	$ 3,016	$ 2,508
Compensation accruals	3,249	2,331
Other accrued liabilities	1,142	1,041
	$ 7,407	$ 5,880

3. Financial Instruments

Fair Value Measurements

The Company's financial assets that are measured at fair value on a recurring basis consist of money market funds and available-for-sale investments. The following three levels of inputs are used to measure the fair value of financial instruments:

Level 1: Quoted prices in active markets for identical assets or liabilities;

Table of Contents

Level 2: Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3: Unobservable inputs are used when little or no market data is available.

The fair values for substantially all of the Company's financial assets are based on quoted prices in active markets or observable inputs. For Level 2 securities, the Company uses a third-party pricing service which provides documentation on an ongoing basis that includes, among other things, pricing information with respect to reference data, methodology, inputs summarized by asset class, pricing application and corroborative information.

Cash, Cash Equivalents and Marketable Securities

The Company determines realized gains or losses on the sale of marketable securities on a specific identification method. During the three and nine months ended September 30, 2016 and 2015, the Company did not record significant realized gains or losses on the sales of available-for-sale investments.

The following tables show the Company's cash and available-for-sale investments' adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category, recorded as cash and cash equivalents or short- or long-term investments as of September 30, 2016 and December 31, 2015 (in thousands):

	September 30, 2016						
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-term Investments	Long-term Investments
Cash	$ 14,939	$ —	$ —	$ 14,939	$ 14,939	$ —	$ —
Level 1:							
	10,732	—	—	10,732	10,732	—	—

Money market funds							
U.S. government notes	999	1	—	1,000	—	1,000	—
Subtotal	11,731	1	—	11,732	10,732	1,000	—
Level 2:							
Asset-backed securities	5,005	3	—	5,008	—	—	5,008
Corporate bonds	17,302	1	(6)	17,297	—	17,297	—
Commercial paper	1,996	—	—	1,996	—	1,996	—
U.S. agency securities	1,000	—	—	1,000	—	1,000	—
Subtotal	25,303	4	(6)	25,301	—	20,293	5,008
Total	$ 51,973	$ 5	$ (6)	$ 51,972	$ 25,671	$ 21,293	$ 5,008

Table of Contents

	December 31, 2015						
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-term Investments	Long-term Investments
Cash	$ 7,593	$ —	$ —	$ 7,593	$ 7,593	$ —	$ —
Level 1:							
Money market funds	21,937	—	—	21,937	21,937	—	—
U.S. government notes	998	—	(2)	996	—	—	996
Subtotal	22,935	—	(2)	22,933	21,937	—	996
Level 2:							
Asset-backed securities	6,739	—	(9)	6,730	—	—	6,730
Corporate bonds	39,195	2	(51)	39,146	—	33,156	5,990
Commercial paper	1,100	—	—	1,100	—	1,100	—
U.S. agency securities	3,506	—	(1)	3,505	—	3,505	—
Subtotal	50,540	2	(61)	50,481	—	37,761	12,720
Total	$ 81,068	$ 2	$ (63)	$ 81,007	$ 29,530	$ 37,761	$ 13,716

As of September 30, 2016, the Company considers the declines in market value of its investment portfolio to be temporary in nature and does not consider any of its investments other-than-temporarily impaired. During the three and nine months ended September 30, 2016 and 2015, the Company did not recognize any significant impairment charges. The Company typically invests in highly-rated securities, and its investment policy generally limits the amount of credit exposure to any one issuer. The policy requires investments generally to be investment grade, with the primary objective of minimizing the potential risk of principal loss. Fair values were determined for each individual security in the investment portfolio. The maturities of the Company's long-term investments range from one to two years. When evaluating an investment for other-than-temporary impairment the Company reviews factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer and any changes thereto, changes in market interest rates, and the Company's intent to sell, as well as the fact it is not more likely than not that the Company will be required to sell the investment before recovery of the investment's cost basis, which may be maturity.

Fair Value of Other Financial Instruments

The carrying amounts reported in the accompanying consolidated financial statements for cash and cash equivalents, restricted cash, accounts payable and accrued liabilities approximate their fair value because of the short term nature of the accounts. The fair value of the notes payable and the revolving credit facility approximates the carrying value

based on the variable nature of interest rates and current market rates available to the Company (see Note 6). As a result, the balance of the notes payable and revolving credit facility is categorized within Level 2 of the fair value hierarchy.

Derivative Financial Instruments

The Company has foreign currency exposure related to the operations in the United Kingdom, Canada, Australia, as well as other foreign locations. The Company has entered into forward contracts to help offset the exposure to movements in foreign currency exchange rates in relation to certain U.S. dollar denominated balance sheet accounts of its subsidiaries in the United Kingdom and Australia. The foreign currency derivatives are not designated as accounting hedges. The Company recognizes these derivative instruments as either assets or liabilities in the accompanying Condensed Consolidated Balance Sheets at fair value. The Company records changes in the fair value (i.e. gains or losses) of these derivative instruments in the accompanying Condensed Consolidated Statements of Operations as Other income (expense), net.

Table of Contents

The Company settles its foreign exchange contracts on the last day of every month and enters into a new forward contract for the next month. As a result, there are no assets or liabilities recorded in the accompanying Condensed Consolidated Balance Sheets related to derivative instruments as of September 30, 2016. However, the notional principal of foreign exchange contracts for 2016 was $9.9 million as of September 30, 2016.

The following table shows the pre-tax gains (losses) of the Company's derivative instruments not designated as hedging instruments (in thousands):

		Three Months Ended September 30,		Nine Months Ended September 30,	
	Income Statement Location	2016	2015	2016	2015
Foreign exchange contracts	Other income (expense), net	$ (60)	$ 418	$ (17)	$ 318

4. Acquisitions

Australia Expansion

On April 1, 2016, the Company began working directly with home automation integrators in Australia to better serve and support customers in that country. As part of the shift from its distribution model in Australia, Control4 Corporation, through its wholly owned subsidiary, Control4 Australia Holdings Pty., Ltd, acquired customer lists and inventory from the Company's Australian distributor for $0.7 million. Total consideration transferred for this acquisition was allocated to tangible and identifiable intangible assets acquired and liabilities assumed.

The Company determined this acquisition was not a significant acquisition under Rule 3-05 of Regulation S-X.

Acquisition of Pakedge Device and Software Inc.

On January 29, 2016, the Company entered into a definitive agreement to acquire Pakedge Device and Software Inc. ("Pakedge") through the purchase of all of the outstanding shares of common stock of Pakedge for a price of $32.0 million (the "Purchase Agreement"). After customary working capital adjustments, the total purchase price was

$33.0 million, which included cash acquired of $0.8 million. In accordance with the Purchase Agreement, $5.0 million was deposited in escrow, and will be held for up to 18 months from the acquisition date, to cover any of the sellers' post-closing obligations, including without limitation any indemnification obligations that may arise.

Total consideration transferred for the Pakedge acquisition was allocated to tangible and identifiable intangible assets acquired and liabilities assumed based on their fair values at the acquisition date as set forth below. Management estimated the fair values of tangible and intangible assets and liabilities in accordance with the applicable accounting guidance for business combinations. The preliminary amount of consideration transferred is subject to potential adjustments in the event that the preliminary estimates of inventory, warranty reserves, or sales return liability, and due to tax-related matters that could have a material impact on the consolidated financial statements. The Company expects the allocation of the consideration transferred to be final within the measurement period (up to one year from the acquisition date). Due to new information obtained related to the net working capital adjustments, valuation of inventory, contingent liability, and tax liabilities, based on facts that existed at the acquisition date, the Company recorded measurement period adjustments to inventory, accrued liabilities, goodwill and deferred tax liability. The net change to goodwill was an increase of $0.4 million. Had these adjustments been recorded as of the acquisition date, the Company's deferred tax benefit would have decreased $0.4 million for the three months ended March 31, 2016. In addition, the Company's deferred tax expense for the three months ended June 30, 2016 and September 30, 2016 would have decreased $0.1 million and $0.3 million, respectively.

Table of Contents

The following reflects the Company's preliminary allocation of consideration transferred for the Pakedge acquisition (in thousands):

	Pakedge Acquisition
Cash	$ 843
Accounts receivable	460
Inventory	4,767
Other assets acquired	1,139
Intangible assets	23,156
Goodwill	13,876
Total assets acquired	44,241
Deferred tax liability	9,402
Warranty liability	391
Other liabilities assumed	1,428
Total net assets acquired	$ 33,020

Identifiable Intangible Assets

The Company acquired intangible assets that consisted of customer relationships, trademarks/trade names, developed technology and non-compete agreements, which had estimated fair values of $8.8 million, $4.4 million, $9.7 million and $0.3 million, respectively. The intangible assets were measured at fair value reflecting the highest and best use of nonfinancial assets in combination with other assets and liabilities using an income approach that discounts expected future cash flows to present value. The estimated net cash flows were discounted using discount rates between 15% and 17%, based on the estimated internal rate of return for the acquisition and represent the rates that market participants might use to value the intangible assets based on the risk profile of the asset. The projected cash flows were determined using key assumptions such as: estimates of revenues and operating profits; capital expense investments; and the life of the product. The Company will amortize the intangible assets on a straight-line basis over their estimated useful lives of 8 years for the customer relationships, 12 years for the trademark/trade name, 5 years for the developed technology, and 2 years for non-compete agreements. The amortization of these intangible assets is not deductible for income tax purposes.

Goodwill

Goodwill of $13.9 million represents the excess of consideration transferred over the fair value of assets acquired and liabilities assumed and is attributable to Pakedge's assembled workforce, strategic positioning value and the projected profits from new products and dealers. This goodwill is not deductible for income tax purposes.

Other

From the date of acquisition through September 30, 2016, the Company recorded revenue and pre-tax net income associated with Pakedge of approximately $16.1 million and $2.3 million, respectively. Additionally, the Company incurred approximately $3.2 million in total acquisition-related costs accounted for in the accompanying condensed consolidated statements of operations as cost of revenue and general and administrative expenses for the nine months ended September 30, 2016 related solely to the Pakedge acquisition. Of this amount, approximately $2.0 million is related to the step-up in inventory recorded to cost of revenue as the acquired inventory was sold.

Pro Forma Information

The unaudited pro forma information for the three and nine months ended September 30, 2016 and 2015 presented below includes the effects of the Pakedge acquisition as if it had been consummated as of January 1, 2015, with adjustments to give effect to pro forma events that are directly attributable to the acquisition, including adjustments related to the amortization of acquired intangible assets, stock-based compensation expense, depreciation expense, interest expense, estimated tax benefits and non-recurring transaction costs. These adjustments are based upon information and assumptions available to us at the time of filing this Quarterly Report on Form 10-Q. The income tax benefit related to the reduction in the Company's valuation allowance as a result of the acquisition is excluded from the pro forma information as it is non-recurring. The unaudited pro forma information does not reflect any operating efficiency or potential cost savings that could result from the consolidation of

Table of Contents

Pakedge. Accordingly, the unaudited pro forma information is presented for informational purposes only and is not necessarily indicative of what the actual results of the combined company would have been if the acquisition had occurred at the beginning of the period presented, nor is it indicative of the future results of operations.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenue	$ 55,185	$ 48,519	$ 152,619	$ 134,072
Income (loss) from operations	2,340	81	(1,939)	(3,902)
Net income (loss)	$ 2,006	$ 737	(2,294)	(2,483)
Net income (loss) per common share:				
Basic	$ 0.08	$ 0.03	(0.10)	(0.10)
Diluted	$ 0.08	$ 0.03	(0.10)	(0.10)

Acquisition of Nexus Technologies Pty Ltd.

On January 30, 2015, the Company, through its wholly owned subsidiary, Control4 Australia Pty., Ltd ("Control4 Australia"), acquired Nexus Technologies Pty Ltd. ("Nexus"), an Australia-based provider of audio/video distribution products (under the brand of Leaf), pursuant to a Share Sale Agreement dated January 30, 2015, under which Control4 Australia purchased all of the issued and outstanding shares of Nexus from its shareholders. The total consideration transferred was $8.5 million in cash. Of the cash consideration, $0.8 million of cash was deposited in escrow as partial security for the indemnification obligations of the Nexus shareholders pursuant to the Share Sale Agreement, which was released to the Nexus shareholders on December 18, 2015. The Company incurred $1.2 million in acquisition-related expenses accounted for in the accompanying condensed consolidated statements of operations as general and administrative expenses and cost of revenue for the nine months ended September 30, 2015. Of this amount, approximately $0.3 million is related to the step-up in inventory recorded to cost of revenue as the acquired inventory was sold.

The Company determined the Nexus acquisition was not a significant acquisition under Rule 3-05 of Regulation S-X.

5. Goodwill and Intangible Assets

Goodwill

Changes in the carrying amount of goodwill consisted of the following (in thousands):

	Amount
Balance at December 31, 2015	$ 2,760
Current period acquisitions	14,140
Foreign currency translation adjustment	116
Balance at September 30, 2016	$ 17,016

Goodwill represents the excess of consideration transferred over the fair value of assets acquired and liabilities assumed.

Table of Contents

Amortizable Intangible Assets

The Company's intangible assets and related accumulated amortization consisted of the following as of September 30, 2016 and December 31, 2015 (in thousands):

	September 30, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net
Developed technology	$ 16,761	$ (4,939)	$ 11,822
Customer relationships	9,218	(868)	8,350
Trademark/trade name	4,410	(245)	4,165
Non-competition agreements	295	(134)	161
Total intangible assets	$ 30,684	$ (6,186)	$ 24,498

	December 31, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net
Developed technology	$ 6,907	$ (2,643)	$ 4,264
Customer relationships	342	(66)	276
Non-competition agreements	53	(46)	7
Total intangible assets	$ 7,302	$ (2,755)	$ 4,547

The weighted average amortization period for acquired technology, customer relationships, trademarks/trade names and non-competition agreements is 4.9 years, 7.9 years, 12.0 years, and 2.0 years, respectively; and 6.8 years for all amortizable intangible assets in total.

The Company recorded amortization expense during the respective periods for these intangible assets as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Cost of revenue	$ 800	$ 365	$ 2,266	$ 1,049
Research and development	50	20	140	64
Sales and marketing	371	-	987	-
Total amortization of intangible assets	$ 1,221	$ 385	$ 3,393	$ 1,113

Amortization of finite lived intangible assets as of September 30, 2016 for the next five years is as follows (in thousands):

	Amount
2016	$ 1,209
2017	4,737
2018	4,533
2019	4,370
2020	3,486
Thereafter	6,163
	$ 24,498

6. Long-Term Obligations

Loan and Security Agreement

On January 29, 2016, Control4 entered into the Second Loan Modification Agreement (the “2016 Loan Amendment”) with Silicon Valley Bank, a California corporation (“SVB”), which amends that certain Amended and Restated Loan and Security Agreement dated as of June 17, 2013, between Control4 and SVB (the “2013 Loan Agreement”).

In the 2016 Loan Amendment, Control4 established a revolving credit facility of $30.0 million under the terms of the 2013 Loan Agreement (the "New Credit Facility"). All borrowings under the New Credit Facility are collateralized by the general assets of the Company. Amounts borrowed under the New Credit Facility are due and payable in full on the maturity date, which is January 28, 2018. Advances made pursuant to the New Credit Facility are, at Control4's option, either: (i) Prime Rate Advances, which bear interest at the Prime Rate plus a Prime Rate Margin of either 0% or 0.25%, depending on Control4's leverage ratio for the subject quarter, or (ii) LIBOR Rate Advances, which bear interest at the LIBOR Rate plus a LIBOR Rate Margin of either 2.50% or 2.75%, depending on Control4's leverage ratio for the subject quarter. As of September 30, 2016, the interest rate on the revolving credit facility equaled the prime rate of 3.50%, and Control4 had outstanding borrowings of $1.5 million under the revolving credit facility.

The 2016 Loan Amendment did not amend the term borrowing provisions of the 2013 Loan Agreement. Term borrowings are payable in 42 equal monthly payments of principal plus interest and bear interest at prime plus 0.50%, which was 4.00% as of September 30, 2016. Control4 had outstanding term borrowings of $0.3 million as of September 30, 2016.

The 2016 Loan Amendment contains various restrictive and financial covenants, and the Company was in compliance with each of these covenants as of September 30, 2016.

7. Income Taxes

In order to determine the quarterly provision for income taxes, the Company considers the estimated annual effective tax rate, which is based on expected annual taxable income and statutory tax rates in the various jurisdictions in which the Company operates. Certain significant or unusual items are separately recognized in the quarter during which they occur and can be a source of variability in the effective tax rates from quarter to quarter.

Income tax expense was $0.3 million for the three months ended September 30, 2016 compared to an income tax benefit of $0.3 million for the three months ended September 30, 2015, or approximately 15% and 36% of income (loss) before income taxes, respectively. Income tax benefit was $9.6 million and $0.7 million for the nine months ended September 30, 2016 and 2015, respectively, or approximately 1487% and 40% of income (loss) before income taxes, respectively. The effective tax rate for the three and nine months ended September 30, 2016 differs from the U.S. federal statutory rate of 34% primarily due to the domestic valuation allowance offsetting most of the statutory rate, offset by the partial reversal of the Company's valuation allowance due to the deferred tax liability that was recorded as part of the Pakedge acquisition, primarily due the differences between the book and tax basis of the acquired intangible assets. The rate is further increased by foreign income taxes, minimum state income taxes or taxes in states for which net operating loss carryforwards are not available, the U.S. federal alternative minimum tax and the

impact of incentive stock options as well as other permanent differences. As of December 31, 2015, the Company's net operating loss ("NOL") carryforward amounts for U.S. federal income and state tax purposes were $78.1 million and $76.6 million, respectively. The NOL carryforwards will expire between 2019 and 2035. In addition to the NOL carryforwards, as of December 31, 2015, the Company had U.S. federal and state research and development credit carryforwards of $6.7 million and $2.8 million, respectively, which will expire between 2017 and 2034.

Utilization of the NOL carryforwards and credits may be subject to a substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code of 1986, as amended (the "IRC"), and similar state provisions. The Company recently performed a detailed analysis under Section 382 of the IRC to determine whether any ownership changes had occurred. The effect of an ownership change could limit the use of NOL carryforwards attributable to periods before the change. The detailed analysis confirmed that Section 382 ownership changes occurred from July 29, 2003, through March 27, 2007, and on July 31, 2014, but the Company concluded that the ownership changes should not result in a limitation on the expected utilization of the NOL carryforwards.

Table of Contents

Significant judgment is required in determining the Company's provision for income taxes, recording valuation allowances against deferred tax assets and evaluating the Company's uncertain tax positions. In evaluating the ability to recover its deferred tax assets, in full or in part, the Company considers all available positive and negative evidence, including past operating results, forecast of future market growth, forecasted earnings, future taxable income and prudent and feasible tax planning strategies. Due to historical net losses incurred and the uncertainty of realizing the deferred tax assets, for all the periods presented, the Company has a full valuation allowance against domestic deferred tax assets. To the extent that the Company generates positive income and expects, with reasonable certainty, to continue to generate positive domestic income, the Company may release the valuation allowance in a future period. This release would result in the recognition of certain deferred tax assets, resulting in a decrease to income tax expense for the period such release is made. In addition, the effective tax rate in subsequent periods would increase, and more closely approximate the federal statutory rate of 34%, after giving consideration to state income taxes, foreign income taxes and the effect of exercising incentive stock options.

The Company files income tax returns in the United States, including various state and local jurisdictions. The Company's subsidiaries file income tax returns in the United Kingdom, Australia, China, Germany, India and Serbia. The Company is subject to examination in the United States, the United Kingdom, Australia, Hong Kong, China, Germany, India and Serbia as well as various state jurisdictions. As of September 30, 2016, the Company was not under examination by any tax authorities. Tax years beginning in 2012 are subject to examination by tax authorities in the United States and in some states tax years as early as 2011 are subject to examination by tax authorities, although net operating loss and credit carryforwards from all years are subject to examinations and adjustments for at least three years following the year in which the attributes are used. Tax years beginning in 2011 are subject to examination by the taxing authorities in Australia and Hong Kong. Tax years beginning in 2012 are subject to examination by the taxing authorities in China and India. Tax years beginning in 2013 are subject to examination by the taxing authorities in the United Kingdom. Tax years beginning in 2015 are subject to examination by the taxing authorities in Germany. Tax years beginning in 2016 are subject to examination by the taxing authorities in Serbia.

8. Equity Compensation

Stock Options

In 2003, the Board of Directors adopted the 2003 Equity Incentive Plan (the "2003 Plan"), which provided for the granting of nonqualified and incentive stock options, stock appreciation rights, stock awards, restricted stock units and restricted stock awards. Under the 2003 Plan, the Company was able to grant nonqualified and incentive stock options to directors, employees and non-employees providing services to the Company. On June 11, 2013, the Company's Board of Directors adopted the 2013 Stock Option and Incentive Plan (the "2013 Plan"), which was subsequently approved by the Company's stockholders. The 2013 Plan became effective as of the closing of the Company's initial public offering. To the extent that any awards outstanding under the 2003 Plan are forfeited or lapse unexercised after August 1, 2013, the shares of common stock subject to such awards will become available for issuance under the 2013 Plan. The 2013 Plan provides for annual increases in the number of reserved shares of 5% of the outstanding number of shares of the Company's Common Stock as of the preceding December 31. The Company and its Board of Directors decided to forego increasing the number of reserved shares on January 1, 2016, and will revisit this option for an

annual increase next year.

Table of Contents

A summary of stock option activity for the nine months ended September 30, 2016 is presented below:

	Shares Subject to Options Outstanding	Weighted Average Grant Date Fair Value	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
Balance at December 31, 2015	4,572,672		$ 10.72	
Granted	50,000	4.63	8.16	
Exercised	(619,757)		4.87	
Expired	(69,832)		14.79	
Forfeited	(51,588)		15.68	
Balance at September 30, 2016	3,881,495		11.48	
Exercisable options at September 30, 2016	2,990,429		10.41	5.6
Vested and expected to vest at September 30, 2016	3,822,911		11.44	6.1

The following table summarizes information about stock options outstanding and exercisable at September 30, 2016:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Weighted Average Exercise Price	Number of Underlying Shares	Weighted-Average Remaining Contractual Life (in years)	Number of Underlying Shares	Weighted-Average Remaining Contractual Life (in years)
$ 2.34 - 3.59	3.25	60,694	0.8	60,694	0.8
$ 4.78 - 7.28	5.94	1,246,543	4.6	1,225,444	4.5
$ 7.49 - 11.28	9.77	1,044,374	5.9	838,969	5.4
$ 11.72 - 17.66	14.75	863,004	8.1	427,361	8.0
$ 19.56 - 22.92	21.04	666,880	7.2	437,961	7.1
		3,881,495		2,990,429	

For the stock option awards vested during the three and nine months ended September 30, 2016, the total fair value was $1.3 million and $4.2 million, respectively. The following table summarizes the aggregate intrinsic-value of options exercised, exercisable and vested and expected to vest (in thousands):

	For the Nine Months Ended and as of September 30,	
	2016	2015
Options Exercised	$ 2,978	$ 1,327
Options Exercisable	10,491	5,333
Options Vested and Expected to Vest	11,065	5,389

Table of Contents

The fair value of each option award was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Expected volatility	—	53 %	62 %	53 - 55 %
Expected dividends	—	0 %	0 %	0 %
Expected terms (in years)	—	5.3 - 6.1	6.1	5.3 - 6.1
Risk-free rate	—	1.5 - 1.8 %	1.1 %	1.3 - 1.8 %

No stock options were granted during the three months ended September 30, 2016.

Restricted stock units

A summary of restricted stock unit activity for the nine months ended September 30, 2016 is presented below:

	Number of Shares	Weighted Average Grant Date Fair Value
Non-vested balance at December 31, 2015	425,000	$ 8.18
Awarded	1,139,846	7.37
Vested	(17,670)	7.85
Forfeited	(89,719)	7.84
Non-vested balance at September 30, 2016	1,457,457	7.57

During the nine months ended September 30, 2016, 17,670 restricted stock units vested of which 6,949 shares were withheld for tax purposes resulting in the issuance of 10,721 shares of common stock.

Stock-based compensation expense

Total stock-based compensation expense has been classified as follows in the accompanying Condensed Consolidated Statements of Operations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Cost of revenue	$ 38	$ 40	$ 128	$ 126
Research and development	789	706	2,493	2,145
Sales and marketing	496	457	1,605	1,298
General and administrative	660	605	1,707	1,767
Total stock-based compensation expense	$ 1,983	$ 1,808	$ 5,933	$ 5,336

At September 30, 2016, there was $7.8 million of total unrecognized compensation cost related to non-vested stock option awards that will be recognized over a weighted-average period of 1.9 years. At September 30, 2016, there was $8.5 million of total unrecognized compensation cost related to non-vested restricted stock units that will be recognized over a weighted-average period of 2.4 years.

Table of Contents

9. Share Repurchases

In May 2015, the Company's Board of Directors authorized the repurchase of up to $20.0 million in Control4 common stock from time to time on the open market. In February 2016, the Board of Directors authorized an extension to this repurchase program from its original end-date of May 13, 2016 to June 30, 2017, unless terminated earlier. During the three months ended September 30, 2016, the Company did not repurchase any common stock. During the nine months ended September 30, 2016, the Company repurchased 427,646 shares for $3.2 million. These share repurchases are classified as treasury stock in the accompanying Condensed Consolidated Balance Sheets as a reduction of Stockholders' Equity. As of September 30, 2016, the Company has $7.7 million remaining to repurchase shares of common stock under this share repurchase program.

10. Related Party Transactions

A member of the Company's Board of Directors is also an officer of a company that has a product line the Company began selling in its online store in November 2015. For the three and nine months ended September 30, 2016, Control4 recognized revenue from sales of this product line of $43,000 and $106,000, net of cost of revenue, consistent with the Company's accounting policy on sales of third-party products sold through the Company's online ordering system. As of September 30, 2016, the Company had accounts payable due to this related party of $28,000.

The Company has a royalty agreement with a company that has a director who is also a member of the Company's Board of Directors. For the three months ended September 30, 2016, the Company didn't incur any royalty expenses due to this related party. For the nine months ended September 30, 2016, the Company had incurred royalty expenses of $0.2 million. As of September 30, 2016, the Company was current on all outstanding accounts payable due to this related party.

11. Commitments and Contingencies

Operating Leases

The Company leases office and warehouse space under operating leases that expire between 2017 and 2021. The terms of the leases include periods of free rent, options for the Company to extend the leases (three to five years) and increasing rental rates over time. The Company recognizes rental expense under these operating leases on a straight-line basis over the lives of the leases and has accrued for rental expense recorded but not paid.

Rental expense was approximately $0.7 million and $0.5 million for the three months ended September 30, 2016 and 2015, respectively, and $1.9 million and $1.4 million for the nine months ended September 30, 2016 and 2015, respectively.

Future minimum rental payments required under non-cancelable operating leases with initial or remaining terms in excess of one year consist of the following as of September 30, 2016 (in thousands):

2016	$ 1,062
2017	3,383
2018	2,221
2019	593
2020	187
Thereafter	31
	$ 7,477

Purchase Commitments

The Company had non-cancellable purchase commitments for the purchase of inventory, which extend through March 2017 totaling approximately $28.7 million at September 30, 2016.

Table of Contents

Indemnification

The Company has agreed to indemnify its officers and directors for certain events or occurrences while the officer or director is or was serving at the Company's request in such capacity. The maximum amount of potential future indemnification is unlimited; however, the Company has a directors' and officers' insurance policy that provides corporate reimbursement coverage that limits its exposure and enables it to recover a portion of any future amounts paid. The Company has no liabilities recorded for these agreements as of September 30, 2016, as there were no outstanding claims.

Legal Matters

From time to time, we may become involved in legal proceedings arising in the ordinary course of our business. We are not presently a party to any legal proceedings, that if determined adversely to us, we believe would individually or in the aggregate have a material adverse effect on our business, results of operations, financial condition or cash flows.

Table of Contents

ITEM 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis is intended to provide greater details of our results of operations and financial condition and should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2015, which was filed with the U.S. Securities and Exchange Commission (the “SEC”) on February 16, 2016, and our condensed consolidated financial statements and the notes thereto included elsewhere in this document, as well as other documents we file with the SEC from time to time. Certain statements in this Quarterly Report constitute forward-looking statements and as such, involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. Such forward-looking statements include any expectation of earnings, revenues or other financial items including without limitation statements about the accretive effect of any acquisitions; any statements of the plans, strategies and objectives of management for future operations or growth; factors that may affect our operating results; statements related to adding employees; statements related to future capital expenditures; statements related to future economic conditions or performance; statements as to industry trends or market opportunities and other matters that do not relate strictly to historical facts or statements of assumptions underlying any of the foregoing. These statements are often identified by the use of words such as “anticipate,” “believe,” “continue,” “could,” “estimate,” “exp “intend,” “may” or “will,” and similar expressions or variations. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to those discussed in the section titled “Risk Factors” included in Item 1A of Part II of this Quarterly Report on Form 10-Q, and the risks discussed in our other SEC filings.

We urge you to consider these factors carefully in evaluating the forward-looking statements contained in this Quarterly Report on Form 10-Q and not give undue reliance to these forward-looking statements. These statements are based on the beliefs and assumptions of our management based on information currently available to management. The forward-looking statements included in this Quarterly Report are made only as of the date of this Quarterly Report. All subsequent written or oral forward-looking statements attributable to our company or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. We do not undertake, and specifically disclaim, any obligation to update any forward-looking statements to reflect the occurrence of events or circumstances after the date of such statements, except as required by law.

Our Management’s Discussion and Analysis of Financial Condition and Results of Operations (the “MD&A”) is provided in addition to the accompanying condensed consolidated financial statements and notes to assist readers in understanding our operations, financial condition and cash flows. Our MD&A is organized as follows:

- Overview. Discussion of our business and overall analysis of financial and other highlights affecting our business in order to provide context for the remainder of MD&A.
- Factors and Trends Affecting our Performance. A summary of certain market factors and trends that we believe are important to our business that we must successfully address in order to continue to grow our business.

- Key Operating and Financial Metrics. Key operating and financial metrics that we use to evaluate and manage our business.
- Results of Operations. An analysis of our financial results comparing 2016 to 2015.
- Liquidity and Capital Resources. An analysis of changes in our balance sheets and cash flows, and discussion of our financial condition and potential sources of liquidity.
- Non-GAAP Financial Measures. A reconciliation of certain non-GAAP financial measures used by management to understand and evaluate our operating performance and trends, to prepare and approve our annual budget, and to develop short- and long-term operational plans.

- Contractual Obligations and Off-Balance Sheet Arrangements. An overview of our contractual obligations, contingent liabilities, commitments and off-balance sheet arrangements outstanding as of September 30, 2016, including expected payment schedule.
- Critical Accounting Estimates. Accounting estimates that we believe are most important to understanding the assumptions and judgments incorporated in our reported financial results and forecasts.

Overview

Control4 is a leading provider of smart home and business solutions that are designed to personalize and enhance how you engage with an ever-changing connected world. Our entertainment, smart lighting, comfort and convenience, safety and security, and networking solutions unlock the potential of connected devices, making entertainment systems easier to use and more accessible, homes and businesses more comfortable and energy efficient, and individuals more secure. Our premium smart home and small business solutions provide consumers with the ability to integrate audio, video, lighting, temperature, security, communications, network management and other functionalities into a unified automation solution, customized to match their lifestyles and business needs. Our advanced software, delivered through our controller products, cloud services and user-interface products power this customized experience, enabling cohesive interoperability with thousands of connected Control4 and third-party devices.

Consumers purchase our smart solutions from our worldwide network of certified independent dealers, regional and national retailers and distributors. These dealers, retailers and distributors design and install customized solutions to fit the specific needs of each consumer, whether it is a one-room home theater set-up or a whole-home automation system that features the integration of audio, video, lighting, temperature, security and communications devices. Our products are installed in both new and existing residences, multi-dwelling units and small commercial facilities. We refer to revenue from sales of our products through these dealers, retailers and distributors as our Core revenue ("Core revenue"). In addition, a portion of our revenue is attributable to sales in the hospitality industry, primarily related to products installed in hotels, which is excluded from our calculation of Core revenue. Our revenue from sales to hotels is generally project-based and has been significant in some periods and insignificant in other periods. In the future, we expect revenue from hospitality to continue to be project-based and uneven from period to period. During the nine months ended September 30, 2016, over 3,800 active direct dealers were authorized to sell and install the full Control4 line of products in the United States, Canada, the United Kingdom and 51 other countries, and we partnered with 29 distributors to cover an additional 46 countries where we do not have direct dealer relationships. These distributors sell our solutions through dealers and provide warehousing, training, technical support, billing and service for dealers in each of those countries. We also have an additional 1,100 dealers and 17 distributors that are currently authorized to sell our Pakedge line of products only.

We derive the majority of our revenue from the sale of products that contain our proprietary software, which functions as the operating system of the home. We also generate revenue from the sale of annual subscriptions to our 4Sight subscription service, which allows consumers to remotely access, backup, and control their smart home solutions from their mobile devices; receive e-mail and "push notification" alerts regarding activities in their home; and enable Amazon Alexa voice services.

Table of Contents

We were founded in 2003 and began shipping our products and generating revenue in 2005. Our revenue growth rates for the last five complete calendar years are shown in the following table (dollars in millions):

	For the Years Ended December 31,				
	2015	2014	2013	2012	2011
Core revenue	$ 160.7	$ 144.7	$ 126.4	$ 105.6	$ 88.3
Core revenue growth over prior year	11 %	14 %	20 %	20 %	25 %
Other revenue	$ 2.5	$ 4.1	$ 2.1	$ 3.9	$ 5.1
Other revenue changes over prior year	-39 %	95 %	-46 %	-24 %	28 %
Total revenue	$ 163.2	$ 148.8	$ 128.5	$ 109.5	$ 93.4
Total revenue growth over prior year	10 %	16 %	17 %	17 %	25 %

Over the past five years, we have experienced double-digit annual Core revenue growth. Our Core revenue growth during that period has been the result of a combination of both the net addition of new independent dealers and distributors to our sales channels, an increase in revenue from our existing network of independent dealers and distributors, and new products both developed internally and acquired through business combinations. We believe our ability to grow our core sales channel has been enhanced through product innovation, expansion of our product offerings and helping our independent dealers and distributors grow their business and gross margins by providing enhanced dealer installation and marketing tools. Some recent developments that we believe may enhance our offerings and help drive growth include, but are not limited to, the following:

- Announced integration with Amazon Alexa, the popular voice service that powers Amazon Echo and other Alexa-enabled devices, including Echo Dot, Amazon Tap and Amazon Fire TV. The new Control4 Smart Home Skill provides homeowners with the convenience of whole-home automation through simple and intuitive voice commands that can activate smart home scenes and control individual devices;
- Released Control4 OS 2.9, featuring increased integration support for third party devices, more personalization for the homeowner, and new customization options for our dealers;
- Released Bakpak 4.0, the intelligent cloud-based management system for dealers, enabling rapid response to connectivity issues, proactive device management, and greater visibility of networks and automation systems within connected homes across a dealer’s entire customer base;
- Rolled out a new line of entertainment and automation controllers, the EA Series, featuring high-resolution audio, high-performance automation, and our broad interoperability, in January 2016. With three separate models, the Control4 EA Series is designed and priced to deliver exceptional automation power, reliability, and high-impact entertainment experiences for projects ranging from a single-room to an entire home or estate;
- Announced and began selling a new line of intelligent Square Wireless Lighting products, expanding custom and retrofit lighting opportunities for our dealers in Europe and Asia;
- Announced a new agreement with GreenSky to offer end-user financing to our U.S. dealer network of over 2,700 businesses; and
- Released Control4 OS 2.8, providing an enhanced user experience for our security and media solutions, including native streaming of Pandora, Deezer and TIDAL music services and iOS compatibility with the Apple Watch.

Table of Contents

While our historical revenue growth has been primarily organic, we have completed several acquisitions since our IPO that we believe enhanced our product offerings and positioned us for continued growth in the future. Recent acquisitions of technology and distribution-related business are as follows:

- In April 2016, we transitioned from a two-tier distribution model to direct-to-dealer in Australia, and as part of this process, acquired customer lists and inventory of the former distributor;
- In January 2016, we acquired Pakedge, a developer and manufacturer of networking products, power distribution and management solutions, as well as cloud network-managed services for both wireless and wired networking solutions in the connected home and business. Pakedge's portfolio includes the Connect+ Platform, with wired products such as switches and routers, wireless products such as access points, as well as power management and cloud based network management technologies. Pakedge brings to Control4 deep networking expertise, innovative technologies, and a sophisticated suite of newly refreshed networking products and rich software capability; and
- In January 2015, we acquired Nexus, a developer and manufacturer of the Leaf brand of custom audio/video distribution and switching systems. We previously sold certain Leaf products under our Control4 brand and through our online ordering platform. After this acquisition, we began offering a complete line of video distribution solutions under the Control4 brand to Control4 customers worldwide, we gained market share in the growing audio and video (A/V) category, and we leveraged Nexus's valuable engineering expertise to develop new and innovative A/V solutions.

We plan to continue to identify, acquire and integrate strategic technologies, assets and businesses that we believe will enhance the overall strength of our business, allow us to streamline sales, technical support and training, and enhance our dealers' ability to grow their businesses.

Historically, we have experienced seasonal variations in our revenue as a result of holiday-related factors that are common in our industry. Our revenue is generally highest in the fourth quarter due to consumers' desires to complete home installations prior to the holiday season. We generally see decreased sales in the first quarter due to seasonal purchase tendencies of consumers as well as the impact of winter weather on new construction and travel in certain geographies. In addition, our year-over-year revenue growth on a quarterly basis is not always linear for a variety of reasons including: the timing of new product releases; the use of marketing programs to accelerate intra-quarter sales of certain products or product families; the impact of foreign currency fluctuations; and the impact of general regional economic conditions on consumer buying decisions and harsh weather that delayed or canceled building projects. We generally expect these seasonal and other trends to continue in the future, which may cause quarterly fluctuations in our results of operations and certain financial metrics.

Factors and Trends Affecting Our Performance

A number of industry trends have facilitated our growth over the past several years, including the proliferation of connected devices and the constant growth of network-enabled homes and businesses. From smartphones to smart watches to smart cars, technology is transforming nearly every aspect of our lives, streamlining daily routines and providing quick, easy access to the capabilities and content we want most. Not only are new technologies providing convenience on-the-go, but they are becoming increasingly accessible. Voice services is a recent example of an emerging technology in our connected world, and our recently announced integration with Amazon Alexa helps keep

us at the forefront of our industry in our adoption of voice activated solutions. We remain committed to embracing these emerging technologies through our open platform and broad ecosystem.

Our open platform makes it easy for a broad community of original equipment manufacturer (OEM) partners to participate in our smart home ecosystem, which currently includes approximately 10,000 drivers and more than 1,600 SDDP (Simple Device Discovery Protocol) enabled products. Our broad ecosystem, which includes audio, video, lighting, temperature, network, security and communication device categories, gives consumers flexibility to integrate nearly any connectable device into their smart home. In addition, our partners are constantly

contributing new device integrations. As such, our dynamic ecosystem remains current with the latest product innovations and allows our smart home platform to grow alongside emerging technologies to meet our consumers' changing needs and preferences. We believe that our open platform and the resulting ecosystem is a key competitive advantage that will continue to facilitate our growth.

Our products leverage both wired and wireless technologies and are designed to be installed in both new construction and existing homes. We expect that future increases in both new home construction and existing home renovations will have a positive impact on our revenue. In new home construction, our builder programs continue to gain traction. We continue to engage builders to introduce entry- to mid-level Control4 systems as a standard feature in new home projects. We believe home automation is increasingly becoming a higher priority for home buyers, and this is one of the reasons for our investment in national and regional builder programs.

We believe that the growth of our business and our future success are dependent upon many factors, including the rates at which consumers adopt our products and services, our ability to strengthen and expand our dealer and distributor network, our ability to expand internationally, and our ability to meet competitive challenges. While each of these areas presents significant opportunities for us, they also pose important challenges that we must successfully address in order to sustain or expand the growth of our business and improve our results of operations. These challenges include:

- Increasing Adoption Rates of Our Products and Services. We are focused on increasing adoption rates of our products and services through enhancements to our software platform and product offerings. We intend to accomplish these enhancements through both continued investments in research and development activities and acquisitions of complementary businesses and technologies, such as Pakedge and Nexus.
- Growing Our Leadership Position in the Industry. We are committed to growing awareness of the Control4 and Pakedge brands among our dealers, distributors and partners. We believe that our investments in creating brand awareness in the industry has contributed to dealer recruitment, product adoption, and revenue growth. We are proud of the many awards we received from various industry groups and dealer consortiums, formally recognizing our commitment to excellence. In September 2016, we received two "Best of Show" Awards at the Custom Electronics Design and Installation Association ("CEDIA") 2016 for Control4 Amazon Alexa Smart Home and our NK-1 Wireless Controller + Bakpak. CEDIA 2016 also awarded us the "Technology Integrator Impact!" Award for our EA Series controllers. In June 2016, Control4 was named as the top Whole-Home Automation brand, and Pakedge was named the top networking brand, by the "2016 CE Pro 100 Brand Analysis" report. This is the second year in a row that Control4 was recognized as the top Whole-Home Automation brand, and the fourth year in a row that Pakedge has been named the top brand for home networking. In addition, Control4 solutions were recognized as the top brand in the categories of whole-house Audio/Video, access control, and HVAC/thermostats; and among the leading brands in the categories of lighting control, remote controls, and communications (phones/intercoms). Also, in May 2016, the ProSource Buying Group named Control4 the 2016 Custom Integration Vendor of the Year.
- Accelerating and Enhancing Consumer Lead Generation. We determined that there is an opportunity for us to play a more active role in generating and following up on leads received from our marketing efforts. Therefore, we are continuing to invest in a small team of inside sales representatives to qualify inbound inquiries and direct them to qualified independent dealers. Our enhanced lead generation strategies have increased consultations, bids and project installations. Through the continual optimization of our marketing efforts, coupled with our new inside resources to qualify inbound leads, we have improved lead conversion rates and increased the amount of revenue per lead.
- Optimizing and Expanding Our North America Dealer Network. We intend to continue to optimize the performance of and expand our network of dealers in North America to ensure that we have geographic coverage and technical

expertise to address our existing markets and new markets into which we plan to expand. In addition, through our acquisition of Pakedge, we increased the size of our total independent dealer network from over 3,800 active dealers to over 4,900 dealers. We continue to work with all appropriately qualified dealers to explore both home control and networking product lines,

Table of Contents

and we continue to cross-train and cross-certify dealers in accordance with our existing standards of technical proficiency and business practices. Furthermore, we have expanded the existing training facilities in Salt Lake City, UT and Chicago, IL, which will serve to meet the growing demand by Control4 dealers.

· Expanding our International Dealer and Distributor Network. We believe that our future growth will depend in part on our ability to expand our dealer and distributor network outside of North America, to adapt our products and services to foreign markets, and to increase our brand awareness internationally. We continue to add field sales and service personnel to assist in the optimization of our international channels. We have transitioned to a direct-to-dealer model in specific international regions, namely in the United Kingdom, China, India, Germany and Australia, and we will continue to evaluate opportunities in other countries. Furthermore, we have opened new international training centers in Germany and Australia to help support the transition to a direct-to-dealer model.
· Managing Competition. The market for home automation is fragmented, highly competitive and continually evolving. In addition to competing with traditional players in the luxury segment of the home automation market, including Savant, Crestron and Elan, a number of large technology companies such as Apple, Google, Amazon and Samsung offer device control capabilities within some of their own products, applications and services, and are engaged in ongoing development efforts to address the broader home automation market. In addition, managed service companies such as Alarm.com, Comcast Xfinity and Vivint have broadened their service offerings to include control of devices such as door locks, lights, and cameras. Our ability to compete in the growing home automation market over the next several years will be a key factor in our ability to continue to grow our business and meet or exceed our future expectations.
· Impact of the United Kingdom's Vote to Leave the European Union. On June 23, 2016, the citizens of the United Kingdom ("UK") voted to leave ("Brexit") the European Union ("EU") raising concerns of a potential slowdown in the UK's economy specifically and the EU in general. We engaged with our dealers in the UK to assess their perception of how the Brexit vote might impact their business in the near and long-term. Their responses are varied and reflect the uncertainty that currently exists in the market. We will continue to monitor the risks and uncertainties throughout what is expected to be a lengthy process. The Brexit vote had the immediate impact of devaluing the pound sterling relative to the euro and the U.S. dollar. In Europe, we generally sell our products and incur expense in local currencies including the pound sterling and the euro, but incur exchange rate gains and losses for U.S. dollar denominated assets and liabilities including intercompany and third-party accounts receivables and payables. We enter into forward contracts to help offset our exposure to movements in foreign currency exchange rates relative to these types of U.S. dollar denominated balances. When consolidating the revenue and expenses of our foreign subsidiaries, we translate local currencies to the U.S. dollar using average exchange rates during the period, resulting in either higher or lower net income depending on changes in the relative value of foreign currencies to the U.S. dollar. We do not believe that Brexit will have a material impact on our net income as generated by our subsidiary in the UK in the short-term.

Acquisition of Pakedge

In January 2016, we acquired Pakedge, a developer and manufacturer of networking products, power distribution and management solutions, as well as cloud network-managed services for both wireless and wired networking solutions in the connected home and business. Like Control4, Pakedge conducts its business through a broad channel of independent dealers, of which, only one-third were certified dealers of the entire Control4 product line at the time of acquisition. We expect to grow Pakedge product sales through our network of more than 3,800 active, certified Control4 dealers. From the date of acquisition in January 2016 through September 2016, over 1,200 additional certified Control4 dealers have started purchasing and begun selling Pakedge networking products, generating revenue of approximately $5.0 million.

We intend to grow both the Pakedge product business and the Control4 product business through our combined dealer channel of over 4,900 total active dealers. We encourage all appropriately qualified dealers to

Table of Contents

explore both product lines, and we plan to actively cross-train and cross-certify dealers in accordance with our existing standards of technical proficiency and business practices. We will continue to support the Pakedge product line for all Pakedge dealers, whether or not they become Control4 certified. We believe Pakedge provides a significant boost to our development capabilities, our solution portfolio, and business flexibility moving forward. For 2016, we believe Pakedge will be accretive to our growth rate and gross margin, while contributing positively to our net income for the year.

As of September 30, 2016, we have completed the integration of Pakedge, which includes the consolidation of the warehousing and shipping of products, ERP system, web portal, and training facilities.

Key Operating and Financial Metrics

We use the following key operating and financial metrics to evaluate and manage our business.

North America Direct Dealers(1)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Authorized dealers at the beginning of the period	2,865	2,704	2,787	2,676
Additions	92	86	275	260
Terminations	(38)	(47)	(143)	(193)
Authorized dealers at the end of the period	2,919	2,743	2,919	2,743
Number of active dealers(2)	2,867	2,703	2,867	