CONTROL4 CORP
Form 10-Q
November 03, 2017
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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, 2017

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 (State or other jurisdiction of incorporation or organization)	42-1583209 (I.R.S. Employer Identification No.)
11734 S. Election Road Salt Lake City, Utah (Address of principal executive offices)	84020 (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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b 2 of the Exchange Act.

Large accelerated filer Accelerated filer Non accelerated filer Smaller reporting company Emerging growth company

(Do not check if a
smaller
reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 27, 2017, 25,266,497 shares of the registrant's Common Stock, $0.0001 par value, were outstanding.

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PART I — Financial Information

ITEM 1. Condensed Consolidated Financial Statements

CONTROL4 CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	September 30, 2017 (unaudited)	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 28,627	$ 34,813
Restricted cash	271	247
Short-term investments	41,467	22,970
Accounts receivable, net	29,992	24,727
Inventories	33,149	26,231
Prepaid expenses and other current assets	3,418	3,662
Total current assets	136,924	112,650
Property and equipment, net	7,419	6,463
Long-term investments	1,513	4,008
Intangible assets, net	25,675	23,120
Goodwill	21,855	16,809
Other assets	3,121	2,008
Total assets	$ 196,507	$ 165,058
Liabilities and stockholders’ equity		
Current liabilities:		
Accounts payable	$ 22,953	$ 17,010
Accrued liabilities	9,397	8,912
Current portion of deferred revenue	2,151	1,553

Total current liabilities	34,501	27,475
Other long-term liabilities	879	701
Total liabilities	35,380	28,176
Commitments and contingencies (Note 10)	—	—
Stockholders' equity:		
Common stock, $0.0001 par value; 500,000,000 shares authorized; 25,266,497 and 23,729,780 shares issued and outstanding at September 30, 2017 and December 31, 2016, respectively	3	2
Additional paid-in capital	234,640	220,370
Accumulated deficit	(73,038)	(82,626)
Accumulated other comprehensive loss	(478)	(864)
Total stockholders' equity	161,127	136,882
Total liabilities and stockholders' equity	$ 196,507	$ 165,058

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

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CONTROL4 CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(unaudited)		(unaudited)	
Revenue	$ 64,742	$ 55,185	$ 176,386	$ 151,435
Cost of revenue	31,520	27,566	86,572	77,303
Gross margin	33,222	27,619	89,814	74,132
Operating expenses:				
Research and development	10,347	9,190	30,246	26,708
Sales and marketing	12,692	10,852	36,082	32,101
General and administrative	5,109	5,407	16,413	15,279
Litigation settlement	—	—	—	400
Total operating expenses	28,148	25,449	82,741	74,488
Income (loss) from operations	5,074	2,170	7,073	(356)
Other income (expense), net:				
Interest, net	125	12	224	17
Other income (expense), net	79	(89)	183	(306)
Total other income (expense), net	204	(77)	407	(289)
Income (loss) before income taxes	5,278	2,093	7,480	(645)
Income tax expense (benefit)	93	316	(2,441)	(9,585)
Net income	$ 5,185	$ 1,777	$ 9,921	$ 8,940
Net income per common share:				
Basic	$ 0.21	$ 0.08	$ 0.40	$ 0.38
Diluted	$ 0.19	$ 0.07	$ 0.38	$ 0.37
Weighted-average number of shares:				
Basic	25,050	23,424	24,551	23,307
Diluted	27,122	24,530	26,393	24,149

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

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(unaudited)		(unaudited)	
Net income	$ 5,185	$ 1,777	$ 9,921	$ 8,940
Other comprehensive income (loss):				
Foreign currency translation adjustment, net of tax	(155)	172	383	197
Net unrealized gains (losses) on available-for-sale investments, net of tax	6	(10)	3	60
Total other comprehensive income (loss)	(149)	162	386	257
Comprehensive income	$ 5,036	$ 1,939	$ 10,307	$ 9,197

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

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CONTROL4 CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended September 30,	
	2017	2016
	(unaudited)	
Operating activities		
Net income	$ 9,921	$ 8,940
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	2,703	2,402
Amortization of intangible assets	3,885	3,393
(Gain) loss on disposal of fixed assets	(1)	13
Provision for doubtful accounts	491	313
Investment discount and premium amortization	(57)	293
Stock-based compensation	9,191	5,933
Tax benefit from business acquisition	(2,415)	(9,402)
Changes in assets and liabilities:		
Accounts receivable, net	(4,890)	(3,469)
Inventories	(5,347)	(6,776)
Restricted cash	(3)	—
Prepaid expenses and other current assets	390	1,740
Other assets	(1,002)	(341)
Accounts payable	3,495	2,333
Accrued liabilities	(1,675)	421
Deferred revenue	588	291
Other long-term liabilities	172	(451)
Net cash provided by operating activities	15,446	5,633
Investing activities		
Purchases of available-for-sale investments	(52,472)	(10,147)
Proceeds from sales of available-for-sale investments	1,950	900
Proceeds from maturities of available-for-sale investments	34,580	33,858
Purchases of property and equipment	(3,003)	(1,780)
Business acquisitions, net of cash acquired	(7,881)	(32,891)
Net cash used in investing activities	(26,826)	(10,060)
Financing activities		
Proceeds from exercise of options for common stock	11,290	3,021
Payments for taxes related to net share settlement of equity awards	(4,591)	—
Repurchase of common stock	(1,821)	(3,242)

Repayment of notes payable	—	(581)
Proceeds from revolving credit facility	—	5,000
Repayment of revolving credit facility	—	(3,500)
Payment of debt issuance costs	—	(89)
Net cash provided by financing activities	4,878	609
Effect of exchange rate changes on cash and cash equivalents	316	(41)
Net change in cash and cash equivalents	(6,186)	(3,859)
Cash and cash equivalents at beginning of period	34,813	29,530
Cash and cash equivalents at end of period	$ 28,627	$ 25,671
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 65	$ 164
Cash paid for taxes	1,120	858
Supplemental schedule of non-cash investing and financing activities		
Business acquisitions holdback liability	1,068	—
Purchases of property and equipment financed by accounts payable	396	—
Net unrealized gains on available-for-sale investments	3	60

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

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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 smart home and business solutions that are designed to personalize and enhance how consumers 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. 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, 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, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017, 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 15, 2017. The December 31, 2016 condensed 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 euros, respectively. There were no individual account balances greater than 10% of total accounts receivable as of September 30, 2017 and December 31, 2016.

No dealer or distributor accounted for more than 10% of total revenue for the three and nine months ended September 30, 2017 and 2016.

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While the Company partners with many manufacturers, in many cases one manufacturer is our sole source for a particular product or product family. A significant disruption in the operations of one 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, 2017 and 2016. 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,	
	2017	2016	2017	2016
Revenue-United States	$ 44,839	$ 39,670	$ 122,993	$ 108,506
Revenue-Canada	5,403	4,246	14,911	11,355
Revenue-all other international sources	14,500	11,269	38,482	31,574
Total revenue	$ 64,742	$ 55,185	$ 176,386	$ 151,435
International revenue (excluding Canada) as a percent of total revenue	22 %	20 %	22 %	21 %

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, three, or ten years depending on product type and brand. 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.

The following table presents the changes in the product warranty liability for the nine months ended September 30, 2017 (in thousands):

	Warranty Liability
Balance at December 31, 2016	$ 1,945
Warranty costs accrued	2,854
Warranty claims	(2,509)
Balance at September 30, 2017	$ 2,290

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Net Income Per Share

Basic net income per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income 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 per share (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Numerator:				
Net income	$ 5,185	$ 1,777	$ 9,921	$ 8,940
Denominator:				
Weighted average common stock outstanding for basic net income per common share	25,050	23,424	24,551	23,307
Effect of dilutive securities—stock options and restricted stock units	2,072	1,106	1,842	842
Weighted average common shares and dilutive securities outstanding	27,122	24,530	26,393	24,149

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 per share (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Options to purchase common stock	23	2,221	881	2,490
Restricted stock units	—	—	6	23
Total	23	2,221	887	2,513

Recent Accounting Pronouncements

In January 2017, the FASB issued ASU 2017-04, “Intangibles—Goodwill and Other (Topic 350), Simplifying the Test for Goodwill Impairment”. The amendments in this update simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. This update is effective for annual or interim goodwill impairment tests in fiscal years beginning after December 31, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing after January 1, 2017. The Company notes that this guidance applies to its reporting requirements and will implement the new guidance accordingly in performing goodwill impairment testing; however, the Company does not believe this update will have a material impact on the consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business,” which narrows the definition of a business. This update is effective for annual periods beginning after December 15, 2017, including interim periods within those years. Early adoption is permitted. The guidance will impact the Company’s acquisitions beginning January 1, 2018 and could cause fewer acquired sets of assets to be identified as a business.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash,” which provides amendments to current guidance to address the classifications and presentation of changes in restricted cash in the statement of cash flows. The effective date for the standard is for fiscal years beginning after

December 15, 2017. Early adoption is permitted. Upon the adoption of this standard, the Company will combine restricted cash with unrestricted cash and cash and cash equivalents in the statement of cash flows.

In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory." The amendments in this update will require recognition of current and deferred income taxes resulting from an intra-entity transfer of an asset other than inventory when the transfer occurs. This update is effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted. The Company is currently evaluating the impact of adopting this guidance.

In August 2016, the 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 June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses (Topic 326)" which introduces new guidance for the accounting for credit losses on instruments within its scope. The new guidance introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. For trade receivables, the Company will be required to use a forward-looking expected loss model rather than the incurred loss model for recognizing credit losses which reflects losses that are probable. The guidance is effective for fiscal years beginning after December 31, 2019, including interim periods within those years. Early application of the guidance is permitted for all entities for fiscal years beginning after December 15, 2018, including the interim periods within those fiscal years. Application of the amendments is through a cumulative-effect adjustment to retained earnings as of the effective date. The Company is currently evaluating the impact of this update on the consolidated financial statements.

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. The Company adopted the new guidance on January 1, 2017. The primary impact of adoption was the recognition of excess tax benefits in our provision for income taxes rather than paid-in capital. Adoption of the new standard resulted in the recognition of excess tax benefits in our provision for income taxes rather than paid-in capital of $9.6 million for the nine months ended September 30, 2017. However, as the Company has a full valuation allowance against its domestic net deferred tax asset, a corresponding adjustment was recorded to increase the valuation allowance by $9.6 million.

As of December 31, 2016, the Company had $20.6 million and $17.6 million of gross federal and state net operating losses ("NOLs"), respectively, attributable to excess windfall benefits from share-based compensation. As a result of the adoption of this new standard, on January 1, 2017, the Company increased its net deferred tax asset for NOL carryforwards, with an offsetting cumulative effect of adoption adjustment to accumulated deficit, in the amount of

$7.7 million. A corresponding adjustment was recorded to increase the valuation allowance by $7.7 million with an offsetting adjustment to accumulated deficit, resulting in no net impact to the financial statements. In addition, the Company has elected to apply the presentation requirements for cash flows related to excess tax benefits retrospectively which had no impact on the statement of cash flows for the nine months ended September 30, 2016. Further, under the provisions of ASU 2016-09, the Company has elected to recognize forfeitures as they occur to determine the amount of compensation cost to be recognized in each period. This resulted in an increase of $0.3 million to accumulated deficit with a corresponding increase to additional paid-in capital on January 1, 2017. The amendment related to the accounting for minimum statutory withholding requirements had no impact on retained earnings as of January 1, 2017.

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

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retrospective application is required. Early adoption is permitted. The Company is evaluating the impact of adopting this guidance.

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 it is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The Company does not plan to early adopt, and accordingly, will adopt the new standard effective January 1, 2018.

The guidance permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective method). The Company plans to adopt the standard using the full retrospective method to restate each prior reporting period presented. The Company's ability to adopt using the full retrospective method is dependent on completion of the analysis of information necessary to restate prior period financial statements.

The Company has reached conclusions on key provisions of this standard as it relates to the sale of the Company's products to dealers, retailers and distributors. The Company is in the process of finalizing revenue recognition policies under the new standard and will be calculating the expected impact during the final quarter of 2017.

The Company is making progress on its assessment of the impact of this new standard as it relates to other ancillary revenue streams such as software licenses, subscription services, and third-party products sold through an online dealer portal. As these revenue streams represented less than 5% of overall revenue in 2016, the results of this assessment are not expected to have a significant impact on the Company's financial statements.

2. Balance Sheet Components

Inventories consisted of the following (in thousands):

	September 30, 2017	December 31, 2016
Finished goods	$ 29,667	$ 24,138
Component parts	3,312	1,880
Work-in-process	170	213
	$ 33,149	$ 26,231

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

	September 30, 2017	December 31, 2016
Computer equipment and software	$ 4,801	$ 3,855
Manufacturing tooling and test equipment	4,962	4,216
Lab and warehouse equipment	4,661	3,649
Leasehold improvements	3,780	3,438
Furniture and fixtures	3,671	3,254
Other	1,215	753
	23,090	19,165
Less: accumulated depreciation	(15,671)	(12,702)
	$ 7,419	$ 6,463

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Accrued liabilities consisted of the following (in thousands):

	September 30, 2017	December 31, 2016
Sales returns and current portion of warranty accruals	$ 2,917	$ 2,892
Compensation accruals	4,533	4,445
Other accrued liabilities	1,947	1,575
	$ 9,397	$ 8,912

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;

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, 2017 and 2016, 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, 2017 and December 31, 2016 (in thousands):

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	September 30, 2017						
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-term Investments	Long-term Investments
Cash	$ 20,170	$ —	$ —	$ 20,170	$ 20,170	$ —	$ —
Level 1:							
Money market funds	5,061	—	—	5,061	5,061	—	—
U.S. government notes	6,998	—	(4)	6,994	1,899	5,095	—
Subtotal	12,059	—	(4)	12,055	6,960	5,095	—
Level 2:							
Asset-backed securities	1,000	—	—	1,000	—	1,000	—
Corporate bonds	18,367	—	(8)	18,359	—	16,846	1,513
Commercial paper	20,023	—	—	20,023	1,497	18,526	—
Subtotal	39,390	—	(8)	39,382	1,497	36,372	1,513
Total	$ 71,619	$ —	$ (12)	$ 71,607	$ 28,627	$ 41,467	$ 1,513

	December 31, 2016						
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-term Investments	Long-term Investments
Cash	$ 24,708	$ —	$ —	$ 24,708	$ 24,708	$ —	$ —
Level 1:							
Money market funds	10,105	—	—	10,105	10,105	—	—
U.S. government notes	2,001	—	(1)	2,000	—	2,000	—
Subtotal	12,106	—	(1)	12,105	10,105	2,000	—
Level 2:							
Asset-backed securities	4,008	—	—	4,008	—	—	4,008
Corporate bonds	13,902	—	(14)	13,888	—	13,888	—
Commercial paper	7,082	—	—	7,082	—	7,082	—
Subtotal	24,992	—	(14)	24,978	—	20,970	4,008
Total	$ 61,806	$ —	$ (15)	$ 61,791	$ 34,813	$ 22,970	$ 4,008

As of September 30, 2017, 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, 2017 and 2016, the Company did not recognize any significant impairment charges. The Company invests in highly-rated securities, and its investment policy limits the amount of credit exposure to any one issuer. The policy requires investments 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 condensed 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.

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Derivative Financial Instruments

The Company has foreign currency exposure related to the operations in the United Kingdom, Canada, Australia, the European Union, 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.

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, 2017. However, the notional principal of foreign exchange contracts for October 2017 was $12.8 million as of September 30, 2017.

The following table shows the pre-tax 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	2017	2016	2017	2016
Foreign exchange forward contracts	Other income (expense), net	$ (501)	$ (60)	$ (1,433)	$ (17)

4. Acquisitions

Acquisition of Triad Holdings, Inc.

On February 27, 2017, the Company entered into a definitive agreement to acquire Triad Holdings, Inc., ("Triad Holdings"), along with its wholly owned subsidiary Triad Speakers, Inc. ("Triad Speakers" and together with Triad Holdings "Triad") through the purchase of all the outstanding shares of common stock of Triad for a purchase price of $9.6 million (the "Triad Purchase Agreement"), which included cash acquired of $0.3 million. In accordance with the purchase agreement, $1.4 million of the purchase price will be held for up to 18 months from the acquisition date (the "Holdback"), to cover any of the sellers' post-closing obligations, including without limitation any indemnification obligations that may arise. Due to customary net working capital adjustments, the purchase price of Triad was reduced to $9.2 million during the three months ended June 30, 2017, resulting in a reduction to the Holdback and goodwill. The Company has classified the remaining $1.1 million Holdback in other current liabilities.

Total consideration transferred for the Triad 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 due to tax-related matters that could have a material impact on the condensed consolidated financial statements. Due to new information obtained related to net working capital and based on facts that existed at the acquisition date, the Company recorded measurement period adjustments to cash, goodwill, accounts payable and other liabilities. The Company expects the allocation of the consideration transferred to be final within the measurement period (up to one year from the acquisition date).

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

	Triad Acquisition
Cash	$ 269
Accounts receivable	516
Inventory	1,078
Other assets acquired	430
Intangible assets	6,271
Goodwill	4,785
Total assets acquired	13,349
Accounts payable	878
Deferred tax liability	2,415
Warranty liability	237
Other liabilities assumed	601
Total net assets acquired	$ 9,218

Identifiable Intangible Assets

The Company acquired intangible assets that consisted of customer relationships, trademarks/trade names, and developed technology, which had estimated fair values of $2.5 million, $2.4 million, and $1.4 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. The customer relationships and trademarks/trade names were valued 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 16%, 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; royalty rates; and tax savings. The acquired technology was valued using a cost savings approach that calculates the asset's reproduction cost by estimating all the costs associated with creating the technology. The Company will amortize the intangible assets on a straight-line basis over their estimated useful lives of 10 years for the customer relationships, 12 years for the trademark/trade name, and 12 years for the developed technology. The amortization of these intangible assets is not deductible for income tax purposes.

Goodwill

Goodwill of $4.8 million represents the excess of consideration transferred over the fair value of assets acquired and liabilities assumed and is attributable to Triad's assembled workforce, synergies and the projected profits from new products and dealers. This goodwill is not deductible for income tax purposes.

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

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, 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.

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

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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 $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 held until August 2017 to cover the sellers’ post-closing obligations.

5. Goodwill and Intangible Assets

Goodwill

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

	Amount
Balance at December 31, 2016	$ 16,809
Current period acquisitions	4,785
Foreign currency translation adjustment	261
Balance at September 30, 2017	$ 21,855

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

Amortizable Intangible Assets

The Company’s intangible assets and related accumulated amortization consisted of the following as of September 30, 2017, and December 31, 2016 (in thousands):

	September 30, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net

Developed technology	$ 18,187	$ (8,122)	$ 10,065
Customer relationships	11,720	(2,197)	9,523
Trademark/trade name	6,776	(728)	6,048
Non-competition agreements	295	(256)	39
Total intangible assets	$ 36,978	$ (11,303)	$ 25,675

	December 31, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net
Developed technology	$ 16,618	$ (5,738)	$ 10,880
Customer relationships	9,196	(1,160)	8,036
Trademark/trade name	4,410	(337)	4,073
Non-competition agreements	295	(164)	131
Total intangible assets	$ 30,519	$ (7,399)	$ 23,120

The weighted average amortization period for developed technology, customer relationships, trademarks/trade names, and non-competition agreements is 5.4 years, 8.3 years, 12.0 years, and 2.0 years, respectively; and 7.5 years for all amortizable intangible assets in total.

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The Company recorded amortization expense during the three and nine months ended September 30, 2017 and 2016 for these intangible assets as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Cost of revenue	$ 802	$ 800	$ 2,367	$ 2,266
Research and development	50	50	145	140
Sales and marketing	482	371	1,373	987
Total amortization of intangible assets	$ 1,334	$ 1,221	$ 3,885	$ 3,393

Amortization of finite lived intangible assets as of September 30, 2017 for the next five years is as follows (in thousands):

	Amount
2017	$ 1,315
2018	5,075
2019	4,959
2020	4,053
2021	2,196
Thereafter	8,077
	$ 25,675

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 amended the 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. Control4 is assessed an unused facility fee of 0.25% in any quarter where the advances are less than $15.0 million. As of September 30, 2017, Control4 had no outstanding borrowings under the revolving credit facility.

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, 2017.

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 $0.1 million and $0.3 million for the three months ended September 30, 2017 and 2016, respectively, or approximately 2% and 15% of income (loss) before income taxes, respectively. Income tax benefit was $2.4 million and $9.6 million for the nine months ended September 30, 2017 and 2016, respectively, or

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approximately 33% and 1486% of income (loss) before income taxes, respectively. The effective tax rate for the three and nine months ended September 30, 2017 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 Triad acquisition, primarily due to the differences between the book and tax basis of the acquired intangible assets. The rate is further increased by foreign income taxes, 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, 2016, the Company’s NOL carryforward amounts for U.S. federal income and state tax purposes were $59.5 million and $61.0 million, respectively. The NOL carryforwards will expire between 2017 and 2034. In addition to the NOL carryforwards, as of December 31, 2016, the Company had U.S. federal and state research and development credit carryforwards of $7.1 million and $2.8 million, respectively, which will expire between 2017 and 2034.

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, tax credits, the effect of stock-based compensation windfalls or shortfalls, and 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. We are subject to federal income tax as well as income tax of multiple state and foreign jurisdictions. We are no longer subject to income tax examinations for the following jurisdictions and years: federal, for years before 2014; state and local, for years before 2013; or foreign; for years before 2010. However, federal net operating loss and credit carryforwards from all years are subject to examination and adjustments for at least three years following the year in which the attributes are used.

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. On January 1, 2017, the number of reserved shares was increased by 1,186,489 in accordance with the provisions of the 2013 Plan.

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A summary of stock option activity for the nine months ended September 30, 2017 is presented below:

	Shares Subject to Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
Balance at December 31, 2016	3,776,405	11.55	
Exercised	(1,111,583)	10.16	
Expired	(59,552)	17.50	
Forfeited	(26,045)	16.82	
Balance at September 30, 2017	2,579,225	11.95	
Exercisable options at September 30, 2017	2,201,595	11.58	5.2
Vested and expected to vest at September 30, 2017	2,579,225	11.95	5.5

The following table summarizes information about stock options outstanding and exercisable at September 30, 2017:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	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)
$ 3.59 - 6.14	5.98	875,988	3.7	875,988	3.7
$ 6.34 - 9.93	8.42	359,858	5.8	287,269	5.1
$ 11.28 - 16.97	13.79	783,732	6.7	542,383	6.6
$ 17.66 - 22.92	20.99	559,647	6.3	495,955	6.3
		2,579,225		2,201,595	

For the stock option awards vested during the three and nine months ended September 30, 2017, the total fair value was $0.8 million and $3.0 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,	
	2017	2016

Options Exercised	$ 8,927	$ 2,978
Options Exercisable	39,360	10,491
Options Vested and Expected to Vest	45,152	11,065

The Company did not award stock options during the three and nine months ended September 30, 2017. The fair value of each option awarded during the nine months ended September 30, 2016, was estimated using an expected volatility of 62%, no expected dividends, an expected term of 6.1 years, and a risk-free rate of 1.1%.

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Restricted stock units

A summary of restricted stock unit activity for the nine months ended September 30, 2017 is presented below:

	Number of Shares	Weighted Average Grant Date Fair Value
Non-vested balance at December 31, 2016	1,396,387	7.60
Awarded	782,310	11.26
Vested	(746,819)	7.65
Forfeited	(57,917)	8.66
Non-vested balance at September 30, 2017	1,373,961	9.61

During the nine months ended September 30, 2017, 746,819 restricted stock units vested of which 255,838 shares were withheld for tax purposes resulting in the issuance of 490,981 shares of common stock.

Company Matching Contribution to our 401(k) Plan

The Company offers a 401(k) Plan and in November 2016, our Board of Directors authorized a matching contribution by the Company starting in 2017. Matching contributions are as follows: the Company will match 100% of the first 1% of salary contributed by a participant, and 50% of the next 5% of salary contributed by a participant, for a maximum matching contribution of 3.5% of the salary of a participant up to the limit on contributions imposed by the IRS. Currently, the Company funds its match in contribution with shares of Control4’s common stock. During the nine months ended September 30, 2017, the Company contributed 53,159 shares of stock to employees under this plan and recorded $1.0 million of expenses associated with this contribution.

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,	
	2017	2016	2017	2016
Cost of revenue	$ 66	$ 38	$ 185	$ 128
Research and development	1,031	789	3,210	2,493
Sales and marketing	883	496	2,831	1,605
General and administrative	1,048	660	2,965	1,707
Total stock-based compensation expense	$ 3,028	$ 1,983	$ 9,191	$ 5,933

At September 30, 2017, there was $3.3 million of total unrecognized compensation cost related to non-vested stock option awards that will be recognized over a weighted-average period of 1.1 years. At September 30, 2017, there was $10.2 million of total unrecognized compensation cost related to non-vested restricted stock units that will be recognized over a weighted-average period of 1.9 years.

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 2017, the Board of Directors authorized an extension to this repurchase program to May 31, 2018, unless terminated earlier. During the nine months ended September 30, 2017, the Company repurchased 119,007 shares for $1.8 million compared to 427,646 shares for $3.2 million in the same period in 2016. As of September 30, 2017, the Company has $5.9 million remaining to repurchase shares of common stock under this share repurchase program.

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10. 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 $0.7 million for the three months ended September 30, 2017 and 2016, respectively, and $2.2 million and $1.9 million for the nine months ended September 30, 2017 and 2016, 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, 2017 (in thousands):

2017	$ 916
2018	2,527
2019	901
2020	453
2021	31
	$ 4,828

The Company vacated one of the Pakedge facilities during 2016, which resulted in a loss of $0.4 million recorded to general and administrative expenses. The Company subleased this facility during the three months ended September 30, 2017 for the remaining lease term. The terms of the sublease did not result in a significant change to the initial loss recorded during 2016.

Purchase Commitments

The Company had non-cancellable purchase commitments for the purchase of inventory, which extend through June 2018 totaling approximately $51.8 million at September 30, 2017.

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, 2017, 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.

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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, 2016, which was filed with the U.S. Securities and Exchange Commission (the “SEC”) on February 15, 2017, 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 2017 to 2016.
- 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, 2017, including an 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 consumers 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, network management 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 as well as certain specialty display products and associated installation sales in Australia. 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, 2017, over 4,100 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 29 distributors were authorized to cover an additional 44 countries where we do not have direct dealer relationships. These distributors sell our solutions through dealers and provide warehousing, training, technical support, and billing for dealers in each of those countries. We have an additional 1,100 active dealers and 22 distributors that are currently authorized to sell only our Pakedge and Triad line of products.

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 personalize their automation system through simple homeowner directed programming, referred to as “When >> Then” automation; 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.

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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,									
	2016		2015		2014		2013		2012	
Core revenue	$ 203.9		$ 160.7		$ 144.7		$ 126.4		$ 105.6	
Core revenue growth over prior year	27	%	11	%	14	%	20	%	20	%
Other revenue	$ 4.9		$ 2.5		$ 4.1		$ 2.1		$ 3.9	
Other revenue changes over prior year	96	%	-39	%	95	%	-46	%	-24	%
Total revenue	$ 208.8		$ 163.2		$ 148.8		$ 128.5		$ 109.5	
Total revenue growth over prior year	28	%	10	%	16	%	17	%	17	%

Over the past five years, we have experienced double-digit annual growth in Core revenue. Our Core revenue growth during that period has been the result of a combination of 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 the addition of new products 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. Some recent developments that we believe may enhance our offerings and help drive growth include, but are not limited to, the following:

- Launched an extensive line of Triad® high-resolution multi-room audio products featuring a single-zone streaming amplifier, a power amplifier, and two audio matrix switches, designed to deliver high-resolution audio in every corner of the home, from the source to the listener’s ears;
- Released OS 2.10, featuring expanded music service integrations with iHeartRadio, Sirius XM, and Spotify supported by our EA Controllers;
- Released an updated version of 4Sight which includes a new homeowner customization functionality called “When >> Then” automation;
- Launched the Pakedge® WR-1 wireless router with BakPak Lite, a high-performance integrated network router and wireless access point with built-in cloud-based network management. Designed for small homes and simpler smart home installations, this wireless router provides reliable, affordable wired and wireless networking;
- Launched the Pakedge Certified Network Administrator (PCNA) program. PCNA is a training experience that employs a unique blend of comprehensive online coursework with hands-on practical learning using Pakedge networking gear to provide dealers and technicians the networking knowledge they need to design, install, and manage wired and wireless IP networks;
- Launched the new Triad Garden Array outdoor speakers, a family of all-weather, landscape speakers that include a premium satellite speaker and subwoofer designed to be placed throughout flower beds or around the yard to blanket outdoor spaces with rich, beautiful audio;
- Launched the new Pakedge PowerPak family of power control devices that provide centralized power control and management with surge protection for all equipment in a connected home. Dealers can use the Bak-Pak enabled PowerPak power distribution units (“PDUs”) to monitor and manage their entire customer base in a single interface; and,
- Integrated the latest release of our BakPak management software on the Pakedge RK-1 Router enabling our independent dealer network to offer more homeowners the benefits of a monitored, intelligent home network.

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

- In February 2017, we acquired Triad, a leader in advanced audio technology with best-in-class, customizable speaker solutions. Entertainment is integral to the connected home and the acquisition of Triad brings premium-acoustics experience and innovation to Control4, enhancing our entertainment offering and enabling the future development of new integrated-audio experiences;
- 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; and
- 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. The Pakedge acquisition contributed to the Company a deep networking expertise, innovative technologies, and a sophisticated suite of networking products and rich software capability.

Adoption by the Control4 dealer network of Triad products continues to steadily expand with 1,645 dealers, or 32% of our active dealers, ordering Triad speakers year-to-date.

We continue to invest in and grow the Pakedge networking product category. A total of 2,904 dealers, or 56% of our active dealers, have purchased Pakedge networking products during 2017. As mentioned above, adding to our industry leading networking product lineup, we recently announced our new WR-1 wireless router with an MSRP of $300, which broadens the selling opportunity for our dealers. We've successfully integrated each of our recent acquisitions and our channel is actively selling these new products, which enhance our core solution categories and help sustain our target organic growth rate.

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 their 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 are a recent example of an emerging technology in our connected world, and our 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 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 includes over 10,900 drivers and more than 2,900 Simple Device Discovery Protocol ("SDDP") enabled products. For example, Samsung recently announced the incorporation of SDDP software into its new 4K television line-up and Blu-ray Player products to simplify integration of these Samsung products into Control4 installations. Our broad ecosystem, which includes audio, video, lighting, temperature, network, security and communication device categories, gives consumers flexibility to

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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 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. In new home construction, we continue to engage builders to introduce entry- to mid-level Control4 systems as a standard feature in new home projects.

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 commitment to growing the awareness of our brands, our ability to optimize and expand our dealer and distributor network, our ability to expand internationally, our ability to meet competitive challenges, and our ability to respond to worldwide economic events. 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.
· Growing Our Leadership Position in the Industry. We are committed to growing awareness of the Control4, Pakedge, and Triad brands among our dealers, distributors and partners. We believe that our investments in creating brand awareness in the industry have 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 2017, we received two "Best of Show" Awards from New Bay Media/Residential Systems at the Custom Electronics Design and Installation Association ("CEDIA") 2017 tradeshow for Control4 "When >> Then" automation and the Pakedge WR-1 Wireless Router + BakPak Lite. We were also awarded an EXC!TE Award for our Triad Designer Series Speakers and our Pakedge PowerPak PDU at CEDIA 2017. Finally, we received a BEST Award from CE Pro, a leading trade magazine for technology professionals, at CEDIA 2017 for our Triad Designer Series Speakers. In June 2017, Control4 was named as the top Whole-Home Automation brand, and Pakedge was named the top networking brand, by the "2017 CE Pro 100 Brand Analysis" report. This is the third year in a row that Control4 was recognized as the top Whole-Home Automation brand, and the fifth 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 multiroom audio/video distribution systems, video distribution switchers/extenders, access control, and HVAC/thermostats control; and among the leading brands in the categories of lighting control, remotes/interfaces/smart devices, IR distribution systems, remote managed services, audio amplifiers, and communications (phones/intercoms). In addition, in June 2017, the ProSource Buying Group named Control4 the 2017 Custom Integration Vendor of the Year for the third consecutive 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 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 believe we can improve lead conversion rates and increase 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

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geographic coverage and technical expertise to address our existing markets and new markets into which we plan to expand. We continue to work with all appropriately qualified dealers to explore home control, networking products, and speaker lines, and we continue to cross-train and cross-certify dealers in accordance with our existing standards of technical proficiency and business practices.

- 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 awareness of our brands 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, Germany and Australia, and we will continue to evaluate opportunities in other countries. Furthermore, we recently opened 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 Crestron, Elan, and Savant, a number of large technology companies such as Amazon, Apple, Google, and Samsung offer device control capabilities within some of their own products, applications and services, and are engaged in ongoing efforts to address the broader home automation market. In addition, managed service companies such as ADT, Alarm.com, Comcast, 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.

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,	
	2017	2016	2017	2016
Authorized dealers at the beginning of the period	3,085	2,865	2,994	2,787
Additions	69	92	233	275
Terminations	(15)	(38)	(88)	(143)
Authorized dealers at the end of the period	3,139	2,919	3,139	2,919
Number of active dealers(2)	3,019	2,867	3,019	2,867

Active dealers as a % of authorized dealers(2)	96	%	98	%	96	%	98	%

International Direct Dealers(1)

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017		2016		2017		2016	
Authorized dealers at the beginning of the period	1,242		1,031		1,147		901	
Additions	61		85		178		272	
Terminations	(20)		(12)		(42)		(69)	
Authorized dealers at the end of the period	1,283		1,104		1,283		1,104	
Number of active dealers(2)	1,148		1,023		1,148		1,023	
Active dealers as a % of authorized dealers(2)	89	%	93	%	89	%	93	%

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	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017		2016		2017		2016	
Number of controllers sold	26,814		26,240		74,297		74,893	
Core revenue growth	17	%	24	%	17	%	24	%
International core revenue as a percentage of total revenue	22	%	19	%	21	%	20	%

(1) These dealer figures only include dealers authorized to sell and install the full Control4 line of products and exclude the 1,100 dealers that are currently authorized to sell only the Pakedge and Triad line of products.

(2) An "active dealer" is an authorized dealer that has placed an order with us in the trailing 12-month period.

Number of North America and Direct International Dealers

Because our dealers promote, sell, install and support our products, a broader dealer network allows us to reach more potential consumers across more geographic regions. We expect our dealer network to continue to grow, both in North America and internationally. While we have historically focused on dealers affiliated with CEDIA, we believe there is an opportunity to establish relationships with dealers outside of CEDIA, including non-traditional A/V dealers, electrical contractors, and security system installers.

Strengthening our worldwide dealer channel through business and installation tools, education programs, and new dealer recruitment remains an ongoing priority. Much of our focus in 2017 has been on the successful introduction of new products to our channel, including both the Triad and Pakedge brands. Our sales team will focus over the next few quarters on adding more new dealers, both traditional A/V dealers as well as dealers who historically have focused on IT, security, electrical, or HVAC offerings. Our goal is to continuously increase our dealers' productivity and growth. Enabling our dealers to increase productivity will ultimately drive our revenue growth.

In conjunction with the broad availability of our newest generation products and software, we intend to more aggressively review each of our current dealers with regard to their ability to successfully market, sell and install our current solutions. Part of developing a productive, capable dealer network, requires us to regularly review individual dealer performance and as necessary, terminate dealer licenses where volume, technical training and performance requirements are not fulfilled. We view this as a healthy part of growing our dealer channel worldwide.

As a result of our traditional efforts to expand our channel, the number of active international dealers for our full Control4 line of products increased 12% from September 30, 2016 to September 30, 2017, and we saw an increase of 5% in the number of active North American direct dealers during the same period. Generally, the growth percentage internationally is higher because our presence in these markets is less mature and our base of dealers is much lower than the North American market. Much of this growth in our international dealer network is attributed to new dealer additions in China, Germany and Australia. We plan to continue to monitor markets that are currently served by a single distributor and, when business conditions are favorable, we may decide to establish direct relationships with selected dealers in these regions, which we expect would further increase our number of direct international dealers.

While we believe that we will continue to have significant international opportunities, it is difficult to anticipate the exact timing and amount of growth, particularly in new and emerging markets. Such challenges may cause our growth rate to be slower than anticipated, offsetting our efforts to expand into these emerging geographies. Examples of challenges we must address in order to continue our international expansion include divergent regional and local economic and political trends in Latin America, particularly relating to new home construction and strengthening of the U.S. dollar versus certain local currencies, and the June 2016 vote in the UK to exit the European Union. In response to a weakening Canadian dollar, starting in February 2016, we announced to our dealer network in Canada that we now offer the ability to order and pay for products in Canadian dollars versus U.S. dollars. We believe this offering will help to strengthen our long-term results in Canada while eliminating the

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margin and quoting uncertainty associated with volatility in foreign exchange rates for our dealers. We experienced a recovery in Canada, which contributed to an increase in Canadian revenue of 27% and 31% for the three and nine months ended September 30, 2017, respectively, compared to the same periods in 2016.

Number of Controllers Sold

Our controllers contain our proprietary software and provide consumers with the essential technology to enable home control, automation and personalization. The number of controllers we sell in a given period provides us with an indication of consumer adoption of our technology, though a variety of other factors may also impact controller sales variability from period to period. Our sales of controllers also create significant opportunity to sell our other products and services. Once a consumer has deployed our controller, we believe that the consumer is more likely to remain committed to our technology platform and purchase more of our products, applications and services in the future.

In January 2016, we introduced a new line of entertainment and automation controllers, the EA Series. With three separate models, our EA Series is designed and priced for projects ranging from a single-room to an entire home or estate. As a result of the launch, we saw a significant increase in controller sales. Although end customer adoption, sell-through, and overall revenue growth for the new controllers continues to be strong, the increase in the first half of 2016 was due in part to initial purchases by dealers for their showrooms.

During the three and nine months ended September 30, 2017, we sold 26,814 and 74,297 controllers, respectively, compared to 26,240 and 74,893 controllers sold in the same period in 2016, respectively, an increase of 2% and a decrease of 1%, respectively. We believe severe weather during this past quarter in Florida, Texas and portions of the Central U.S. delayed many projects, which in turn temporarily impacted controller order rates in those regions. Additionally, we launched our EA-Series Controllers in February of 2016, and the first few quarters of 2016 likely benefited from one-time, discounted dealer showroom demo sales typical of new product introductions, creating a difficult year-over-year comparison for unit sales in both the three and nine month periods ended September 30, 2017.

Core Revenue Growth

The majority of our revenue comes from sales of our products through our distribution channels comprised of independent dealers in the United States and Canada, and independent dealers and distributors located throughout the rest of the world. We refer to revenue attributable to sales through dealers located in the United States and Canada as "North America Core revenue", and revenue attributable to sales through dealers and distributors located throughout the rest of the world as "International Core revenue." Core revenue does not include revenue from sales to hotels or certain specialty display products and associated installation sales in Australia.

International Revenue as a Percentage of Total Revenue

We believe that the international market represents a large and underpenetrated opportunity for us. We have established or acquired sales support offices in the United Kingdom, Australia, Germany, China, and India. We have formed relationships with independent international dealers and distributors, and we have expanded foreign language support for our solutions. We track international revenue as a percentage of total revenue as a key measure of our success in expanding our business internationally.

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Results of Operations

Revenue

The following is a breakdown of our revenue between North America and International Core revenue and other revenue:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017		2016		2017		2016	
	(in thousands)							
North America Core Revenue	$ 48,729		$ 42,920		$ 135,345		$ 117,705	
International Core Revenue	14,004		10,534		37,380		30,004	
Other Revenue	2,009		1,731		3,661		3,726	
Total Revenue	$ 64,742		$ 55,185		$ 176,386		$ 151,435	
North America Core Revenue as a % of Total Revenue	75	%	78	%	77	%	78	%
International Core Revenue as a % of Total Revenue	22	%	19	%	21	%	20	%

North America Core revenue increased $5.8 million, or 14%, and $17.6 million, or 15%, for the three and nine months ended September 30, 2017, respectively, compared to the same periods in 2016. International Core revenue increased $3.5 million, or 33%, and $7.4 million, or 25%, in the three and nine months ended September 30, 2017, respectively, compared to the same period in 2016.

Revenue growth in both North America and International Core revenue is driven by a variety of factors including contributions from each of our product brands, channel expansion from acquired products (Pakedge and Triad) sold to existing dealers and distributors, and growth in the majority of our global sales territories. Revenue from Triad was $3.8 million for the three months ended September 30, 2017 and $8.3 million for the period from the February 28, 2017 acquisition date to September 30, 2017. Our total revenue without Triad was $60.9 million and $168.1 million for the three and nine months ended September 30, 2017, respectively, representing organic year-over-year growth of 10% and 11%, respectively.

Our international sales model includes both direct-to-dealer and distribution models. In targeted international regions and countries, we generally invest in some combination of local technical support, training personnel and facilities, warehousing and fulfillment, and sales support personnel. We have made these types of investments in the regions serviced by our offices in the United Kingdom, Germany, Australia, China, and India and these are markets where we see our greatest opportunity for international growth and expansion.

The following table further breaks out our International Core revenue and illustrates the relative revenue growth we are experiencing in the regions serviced by our offices in the United Kingdom, Germany, Australia, China, and India compared to other international regions.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(in thousands)			
Targeted International Regions (1)	$ 10,716	$ 8,504	$ 29,315	$ 23,461
Other International Regions	3,288	2,030	8,065	