CONTROL4 CORP
Form 10-Q
May 04, 2018

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 March 31, 2018

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 April 27, 2018, 26,009,357 shares of the registrant’s Common Stock, $0.0001 par value, were outstanding.

Table of Contents

Control4 Corporation

Index

Table of Contents

Control4 Corporation

PART I — Financial Information

ITEM 1. Condensed Consolidated Financial Statements

CONTROL4 CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	March 31, 2018 (unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 19,989	$ 29,761
Restricted cash	283	273
Short-term investments	49,612	44,057
Accounts receivable, net	26,751	29,925
Inventories	39,314	37,171
Prepaid expenses and other current assets	5,348	4,369
Total current assets	141,297	145,556
Property and equipment, net	7,104	7,337
Long-term investments	6,803	12,038
Intangible assets, net	24,627	26,081
Goodwill	21,828	21,867
Other assets	1,488	1,618
Total assets	$ 203,147	$ 214,497
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 21,881	$ 25,654
Accrued liabilities	8,179	10,835
Current portion of deferred revenue	4,778	4,538

Total current liabilities	34,838	41,027
Other long-term liabilities	3,983	3,942
Total liabilities	38,821	44,969
Commitments and contingencies (Note 10)	—	—
Stockholders’ equity:		
Common stock, $0.0001 par value; 500,000,000 shares authorized; 26,008,294 and 25,832,895 shares issued and outstanding at March 31, 2018 and December 31, 2017, respectively	3	3
Additional paid-in capital	236,229	242,281
Accumulated deficit	(71,260)	(72,225)
Accumulated other comprehensive loss	(646)	(531)
Total stockholders’ equity	164,326	169,528
Total liabilities and stockholders’ equity	$ 203,147	$ 214,497

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

Table of Contents

CONTROL4 CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended March 31,	
	2018	2017
	(unaudited)	
Revenue	$ 59,149	$ 50,208
Cost of revenue	28,410	25,059
Gross margin	30,739	25,149
Operating expenses:		
Research and development	10,940	9,844
Sales and marketing	12,535	11,447
General and administrative	6,293	5,717
Total operating expenses	29,768	27,008
Income (loss) from operations	971	(1,859)
Other income (expense), net:		
Interest, net	236	38
Other expense, net	(357)	(144)
Total other income (expense), net	(121)	(106)
Income (loss) before income taxes	850	(1,965)
Income tax benefit	(116)	(2,786)
Net income	$ 966	$ 821
Net income per common share:		
Basic	$ 0.04	$ 0.03
Diluted	$ 0.04	$ 0.03
Weighted-average number of shares:		
Basic	25,904	24,005
Diluted	27,526	25,657

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

Table of Contents

CONTROL4 CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	Three Months Ended March 31,	
	2018	2017
	(unaudited)	
Net income	$ 966	$ 821
Other comprehensive income (loss):		
Foreign currency translation adjustment, net of tax	(51)	449
Net unrealized losses on available-for-sale investments, net of tax	(64)	(4)
Total other comprehensive income (loss)	(115)	445
Comprehensive income	$ 851	$ 1,266

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

Table of Contents

CONTROL4 CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Three Months Ended March 31,	
	2018	2017
	(unaudited)	
Operating activities		
Net income	$ 966	$ 821
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	969	929
Amortization of intangible assets	1,446	1,230
Loss on disposal of fixed assets	14	—
Provision for doubtful accounts	71	137
Investment discount and premium amortization	(83)	—
Stock-based compensation	3,335	3,254
Tax benefit from business acquisition	—	(2,415)
Changes in assets and liabilities:		
Accounts receivable, net	3,235	2,199
Inventories	(2,003)	(928)
Prepaid expenses and other current assets	(916)	345
Other assets	194	(385)
Accounts payable	(3,923)	(136)
Accrued liabilities	(3,083)	(2,662)
Deferred revenue	163	65
Other long-term liabilities	84	5
Net cash provided by operating activities	469	2,459
Investing activities		
Purchases of available-for-sale investments	(19,501)	(14,678)
Proceeds from sales of available-for-sale investments	1,000	—
Proceeds from maturities of available-for-sale investments	18,200	14,560
Purchases of property and equipment	(892)	(922)
Business acquisitions, net of cash acquired	—	(7,917)
Net cash used in investing activities	(1,193)	(8,957)
Financing activities		
Proceeds from exercise of options for common stock	2,089	3,535
Payments for taxes related to net share settlement of equity awards	(3,614)	(2,067)
Repurchase of common stock	(7,448)	(1,821)
Payment of debt issuance costs	(113)	—

Net cash used in financing activities	(9,086)	(353)
Effect of exchange rate changes on cash and cash equivalents	48	258
Net change in cash and cash equivalents	(9,762)	(6,593)
Unrestricted and restricted cash and cash equivalents at beginning of period	30,034	35,060
Unrestricted and restricted cash and cash equivalents at end of period	$ 20,272	$ 28,467
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 25	$ 34
Cash paid for taxes	167	12
Supplemental schedule of non-cash investing and financing activities		
Business acquisitions holdback liability	—	1,438
Purchases of property and equipment financed by accounts payable	207	93
Net unrealized losses on available-for-sale investments	(64)	(4)

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

Table of Contents

Control4 Corporation

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Description of Business and Summary of Significant Accounting Policies

Control4 Corporation (''Control4'' or the ''Company'') is a leading provider of 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 months ended March 31, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018, 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, 2018. The December 31, 2017 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 March 31, 2018 and December 31, 2017.

No dealer or distributor accounted for more than 10% of total revenue for the three months ended March 31, 2018 and 2017.

Table of Contents

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.

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 three months ended March 31, 2018 (in thousands):

	Warranty Liability
Balance at December 31, 2017	$ 2,032
Warranty costs accrued	1,189
Warranty claims	(854)

Balance at March 31, 2018	$ 2,367

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.

Table of Contents

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 March 31,	
	2018	2017
Numerator:		
Net income	$ 966	$ 821
Denominator:		
Weighted average common stock outstanding for basic net income per common share	25,904	24,005
Effect of dilutive securities—stock options and restricted stock units	1,622	1,652
Weighted average common shares and dilutive securities outstanding	27,526	25,657

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 March 31,	
	2018	2017
Options to purchase common stock	—	1,523
Restricted stock units	166	3
Total	166	1,526

Revenue Recognition

On January 1, 2018, the Company adopted “Revenue from Contracts with Customers (Topic 606),” (“ASC 606”) utilizing the full retrospective method of transition, which required a retrospective adjustment of each prior reporting period presented. The Company applied the new standard using a practical expedient where the consideration allocated to the remaining performance obligations or an explanation of when the Company expects to recognize that amount as revenue for all reporting periods presented before the date of the initial application is not disclosed. Upon adoption of ASC 606, the Company implemented internal controls to enable the preparation of financial information.

Adoption of ASC 606 did not have a significant impact on the Company’s financial statements, however, while preparing for the adoption of ASC 606, the Company evaluated the accounting for technical support and unspecified upgrade rights, which the Company considered inconsequential under ASC 605. While the Company determined that these services are immaterial in the context of the contract under ASC 606, the Company believes that as product offerings continue to mature these services will become more material over time. Accordingly, under ASC 606, the Company will account for technical support and unspecified upgrade rights as a performance obligation, distinct from the hardware product and embedded software, with the associated revenue satisfied over time.

The adoption of ASC 606 impacted the Company's previously reported results as follows (in thousands, except share data):

Table of Contents

	Three Months Ended March 31, 2017 As previously reported	ASC 606 adjustment	As adjusted
Revenue	$ 50,235	$ (27)	$ 50,208
Income tax benefit	(2,781)	(5)	(2,786)
Net income	843	(22)	821
Basic earnings per share	$ 0.04	$ (0.01)	$ 0.03
Diluted earnings per share	$ 0.03	$ —	$ 0.03

	December 31, 2017 As previously reported	ASC 606 adjustment	As adjusted
Other assets	$ 1,576	$ 42	$ 1,618
Current portion of deferred revenue	2,311	2,227	4,538
Other long-term liabilities	882	3,060	3,942
Stockholders' equity	174,773	(5,245)	169,528

Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration expected to be received in exchange for those products or services. Revenue is recognized net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities.

Shipping charges billed to dealers and distributors are included in product revenue and related shipping costs are included in cost of revenue. The Company has elected to account for shipping and handling activities performed after control has been transferred to the customer as a fulfillment cost and accrues for these costs if revenue is recognized before contractually agreed-upon shipping and handling occurs.

Solution Products Revenue

The Company sells its solution products through a network of independent dealers, distributors and retailers. These dealers, distributors and retailers generally sell the Company's products as part of a bundled sale, which typically includes other third party products and related services, project design, installation services and on going support.

The Company's products are generally highly dependent on, and interrelated with, the underlying operating system and cannot function without the operating system. In these cases, the hardware and software license are accounted for as a single performance obligation and revenue is recognized at the point in time when ownership is transferred to dealers, distributors, and retailers, which is typically at the time the product is shipped. In cases where revenue is allocated to software updates and technical support, primarily because the updates and technical support are provided at no additional charge, revenue is recognized as the updates and technical support are provided, which is ratably over the estimated life of the related device.

Certain customers may receive cash-based incentives or credits; which are accounted for as variable consideration. The Company records estimated reductions to revenue for dealer incentives at the time of the initial sale. The estimated reductions to revenue are based on the sales terms and the Company’s historical experience and trend analysis. The most common incentive relates to amounts paid or credited to dealers for achieving defined volume levels or growth objectives.

Table of Contents

Subscription Service Revenue

The Company offers a subscription service that allows consumers to control and monitor their homes remotely and allows the consumer's respective Control4 dealer to perform remote diagnostic services. Subscription revenue is deferred at the time of payment and recognized ratably over the contract period which is typically one year.

Third-Party Product Revenue

The Company recognizes revenue net of cost of revenue for non-inventoried, third party products sold through the Company's online ordering system. The Company's primary role is to arrange for another entity to provide the goods or services and the Company does not control the promised good or service before it is transferred to the customer.

Significant Judgments

The Company's contracts with dealers, distributors, and retailers can include promises to transfer multiple products and services. Determining whether multiple products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment.

Judgment is required to determine the stand-alone selling price ("SSP") for each distinct performance obligation. The Company uses a single amount to estimate SSP for items that are not sold separately, including software updates and technical support provided at no additional charge. In instances where SSP is not directly observable, such as when the Company does not sell the product or service separately, the SSP is determined using information that may include market conditions and other observable inputs.

The Company's products are generally sold with a limited right of return and the Company may provide other credits or incentives, which are accounted for as variable consideration when estimating the amount of revenue to recognize.

Disaggregated Revenue

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 months ended March 31, 2018 and 2017. The following table sets forth revenue from U.S., Canadian and all other international dealers and distributors combined (in thousands):

	Three Months Ended March 31,	
	2018	2017
Revenue-United States	$ 40,964	$ 35,172
Revenue-Canada	5,264	4,247
Revenue-all other international sources	12,921	10,789
Total revenue	$ 59,149	$ 50,208
International revenue (excluding Canada) as a percent of total revenue	22 %	21 %

Contract Balances

As of March 31, 2018 and December 31, 2017, accounts receivable, net of allowance for doubtful accounts, were $26.8 million and $29.9 million, respectively.

The Company extends credit to the majority of its dealers and distributors, which consist primarily of small, local businesses. Issuance of credit is based on ongoing credit evaluations by the Company of dealers’ and distributors’ financial condition and generally requires no collateral. Trade accounts receivable are recorded at the invoiced amount and do not generally bear interest. The Company maintains an allowance for doubtful accounts to reserve for potential uncollectible receivables. The allowance is based upon the creditworthiness of the Company’s

Table of Contents

dealers and distributors, the dealers' and distributors' historical payment experience, the age of the receivables and current market and economic conditions. Provisions for potentially uncollectible receivables are recorded in sales and marketing expenses. The Company writes off accounts receivable balances to the allowance for doubtful accounts when it becomes likely that they will not be collected.

The following table presents the changes in the allowance for doubtful accounts (in thousands):

	Allowance
Balance at December 31, 2017	$ 1,147
Provision	71
Write-offs	(21)
Balance at March 31, 2018	$ 1,197

Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 days. In instances where the timing of revenue recognition differs from the timing of invoicing, the Company has determined the contracts generally do not include a significant financing component. The primary purpose of invoicing terms is to provide customers with simplified and predictable ways of purchasing products and services, not to receive financing from customers, such as invoicing at the beginning of a subscription term with revenue recognized ratably over the contract period.

Deferred revenue is comprised mainly of unearned revenue related to subscription services as well as revenue deferred on the sale of solution products for software updates and technical support. The following table presents the changes in deferred revenue for the three months ended March 31, 2018 (in thousands):

	Deferred Revenue
Balance at December 31, 2017	$ 7,682
Deferred revenue	2,260
Recognition of deferred revenue	(2,067)
Balance at March 31, 2018	$ 7,875

Revenue allocated to remaining performance obligations represent contracted revenue that has not yet been recognized ("contracted not recognized"), which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods. Contracted not recognized revenue was $8.8 million as of March 31, 2018, of which the Company expects to recognize approximately 41% of the revenue over the next 12 months and the remainder over a period of three to four years.

Assets Recognized from the Costs to Obtain a Contract with a Customer

The Company has elected to immediately expense contract acquisition costs that would be amortized in one year or less. The Company recognizes an asset for the incremental costs of obtaining a contract with a customer if the benefit of those costs is expected to be longer than one year; these incremental costs were immaterial during both periods presented.

Restricted Cash

Restricted cash as of March 31, 2018 and December 31, 2017 is composed of a guarantee made by the Company’s subsidiary in the United Kingdom to HM Revenue & Customs related to a customs duty deferment account.

Recent Accounting Pronouncements

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

Table of Contents

December 15, 2017. The Company adopted the standard effective January 1, 2018; the adoption of this standard did not have a material impact on the consolidated financial statements.

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. The Company adopted the standard effective January 1, 2018; the adoption of this standard did not have a material impact on the consolidated financial statements.

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. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. 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 February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which supersedes the guidance in ASC 840, "Leases." The purpose of the new standard is to improve transparency and comparability related to the accounting and reporting of leasing arrangements. The guidance will require balance sheet recognition for assets and liabilities associated with rights and obligations created by leases with terms greater than twelve months. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those years. Modified retrospective application is required. Early adoption is permitted. The Company expects the standard will have a material impact on the Company's consolidated balance sheets but will not have a material impact on the consolidated statements of operations. The most significant impact will be the recognition of right of use assets and lease liabilities for operating leases. The Company is in the process of calculating the right of use assets and lease liabilities and implementing internal controls to enable the preparation of financial statements upon adoption of this standard.

2. Balance Sheet Components

Inventories consisted of the following (in thousands):

	March 31, 2018	December 31, 2017
Finished goods	$ 34,743	$ 33,050
Component parts	4,486	4,025
Work-in-process	85	96
	$ 39,314	$ 37,171

Table of Contents

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

	March 31, 2018	December 31, 2017
Computer equipment and software	$ 5,231	$ 5,030
Manufacturing tooling and test equipment	4,208	4,894
Lab and warehouse equipment	5,014	4,869
Leasehold improvements	4,117	3,960
Furniture and fixtures	3,750	3,698
Other	1,086	1,086
	23,406	23,537
Less: accumulated depreciation	(16,302)	(16,200)
	$ 7,104	$ 7,337

Accrued liabilities consisted of the following (in thousands):

	March 31, 2018	December 31, 2017
Sales returns and current portion of warranty accruals	$ 2,514	$ 2,872
Compensation accruals	3,374	5,241
Other accrued liabilities	2,291	2,722
	$ 8,179	$ 10,835

Other long-term liabilities consisted of the following (in thousands):

	March 31, 2018	December 31, 2017
Deferred revenue	$ 3,097	$ 3,143
Warranty	733	600
Other	153	199
	$ 3,983	$ 3,942

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.

Table of Contents

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 months ended March 31, 2018 and 2017, 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 March 31, 2018 and December 31, 2017 (in thousands):

	March 31, 2018						
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-term Investments	Long-term Investments
Cash	$ 14,739	$ —	$ —	$ 14,739	$ 14,739	$ —	$ —
Level 1:							
Money market funds	5,250	—	—	5,250	5,250	—	—
U.S. government notes	10,017	—	(31)	9,986	—	6,050	3,936
Subtotal	15,267	—	(31)	15,236	5,250	6,050	3,936
Level 2:							
Corporate bonds	26,497	—	(95)	26,402	—	23,535	2,867
Commercial paper	20,027	—	—	20,027	—	20,027	—
Subtotal	46,524	—	(95)	46,429	—	43,562	2,867
Total	$ 76,530	$ —	$ (126)	$ 76,404	$ 19,989	$ 49,612	$ 6,803

	December 31, 2017						
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-term Investments	Long-term Investments
Cash	$ 24,367	$ —	$ —	$ 24,367	$ 24,367	$ —	$ —
Level 1:							
	5,394	—	—	5,394	5,394	—	—

Money market funds							
U.S. government notes	9,060	—	(13)	9,047	—	4,098	4,949
Subtotal	14,454	—	(13)	14,441	5,394	4,098	4,949
Level 2:							
Corporate bonds	24,943	—	(49)	24,894	—	17,805	7,089
Commercial paper	22,154	—	—	22,154	—	22,154	—
Subtotal	47,097	—	(49)	47,048	—	39,959	7,089
Total	$ 85,918	$ —	$ (62)	$ 85,856	$ 29,761	$ 44,057	$ 12,038

As of March 31, 2018, 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 months ended March 31, 2018 and 2017, 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

Table of Contents

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.

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 March 31, 2018.

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

		Three Months Ended March 31,	
	Income Statement Location	2018	2017
Foreign exchange forward contracts	Other income (expense), net	$ (548)	$ (527)

4. Acquisitions

ihiji Acquisition

On December 22, 2017, the Company acquired the intellectual property and key operating assets of ihiji, a provider of remote management services for technical integrators servicing connected home customers. The Company anticipates this acquisition will enable Control4 to combine two network and device management solutions, BakPak from Control4 and Invision from ihiji, into one unified service platform to better service the professional integrators of Control4 products. Total consideration transferred for this acquisition was immaterial. The majority of the consideration transferred was allocated to a developed technology intangible asset.

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 $9.2 million, which included cash acquired of $0.3 million. In accordance with the purchase agreement, $1.4 million of the purchase price was to be held for up to 18 months from the acquisition date to cover any of the sellers' post-closing obligations, including without limitation any indemnification obligations that may arise (the "Holdback"). Due to customary working capital adjustments after the acquisition date, the Holdback was reduced to $1.1 million. The Company has classified the $1.1 million Holdback in other current liabilities.

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

Table of Contents

5. Goodwill and Intangible Assets

Goodwill

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

	Amount
Balance at December 31, 2017	$ 21,867
Foreign currency translation adjustment	(39)
Balance at March 31, 2018	$ 21,828

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 March 31, 2018 and December 31, 2017 (in thousands):

	March 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net
Developed technology	$ 17,252	$ (7,471)	$ 9,781
Customer relationships	12,008	(2,929)	9,079
Trademark/trade name	6,776	(1,009)	5,767
Non-competition agreements	295	(295)	—
Total intangible assets	$ 36,331	$ (11,704)	$ 24,627

	December 31, 2017	
	Gross Carrying	Accumulated

	Amount	Amortization	Net
Developed technology	$ 19,626	$ (8,914)	$ 10,712
Customer relationships	12,009	(2,556)	9,453
Trademark/trade name	6,776	(869)	5,907
Non-competition agreements	295	(286)	9
Total intangible assets	$ 38,706	$ (12,625)	$ 26,081

The weighted average amortization period for developed technology, customer relationships, and trademarks/trade names is 6.9 years, 8.4 years, and 12.0 years, respectively; and 7.3 years for all amortizable intangible assets in total.

The Company recorded amortization expense during the three months ended March 31, 2018 and 2017 for these intangible assets as follows (in thousands):

	Three Months Ended March 31,	
	2018	2017
Cost of revenue	$ 921	$ 774
Research and development	28	48
Sales and marketing	497	408
Total amortization of intangible assets	$ 1,446	$ 1,230

Table of Contents

Amortization of finite lived intangible assets as of March 31, 2018 for the next five years is as follows (in thousands):

	Amount
Remainder of 2018	$ 4,124
2019	5,514
2020	4,598
2021	2,254
2022	2,093
Thereafter	6,044
	$ 24,627

6. Long-Term Obligations

Loan and Security Agreement

On February 6, 2018, Control4 entered into the 2018 Loan Amendment with SVB, which amends the 2013 Loan Agreement.

In the 2018 Loan Amendment, Control4 increased the revolving credit facility from $30.0 million to $40.0 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 29, 2020. Advances made pursuant to the New Credit Facility depend on Control4's leverage ratio and are either: (i) Prime Rate Advances, which bear interest at the Prime Rate plus a Prime Rate Margin of either 0% or 0.25%, or (ii) LIBOR Rate Advances, which bear interest at the LIBOR Rate plus a LIBOR Rate Margin of either 2.50% or 2.75%.

Control4 will be assessed an unused revolving line facility fee of 0.25% in any quarter wherein the amount of advances under the New Credit Facility is less than $15.0 million. As of March 31, 2018, Control4 had no outstanding borrowings under the revolving credit facility.

The 2018 Loan Amendment contains various restrictive and financial covenants, and the Company was in compliance with each of these covenants as of March 31, 2018.

7. Income Taxes

On December 22, 2017, the United States enacted tax reform legislation commonly referred to as the Tax Cuts and Jobs Act ("the Tax Act"). The Tax Act makes broad and complex changes to the U.S. tax code, including a one-time mandatory transition tax on accumulated foreign earnings and a reduction of the corporate income tax rate to 21% effective January 1, 2018, among others. The Company is required to recognize the effect of the tax law changes in the period of enactment, such as determining the transition tax and remeasuring U.S. deferred tax assets and liabilities. In December 2017, the SEC staff issued Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act ("SAB 118"), which allows the Company to record provisional amounts during a measurement period not to extend beyond one year of the enactment date. Where the Company has been able to make reasonable estimates of the effects of the Tax Act for which its analysis is not yet complete, the Company has recorded provisional amounts in accordance with SAB 118. Where the Company has not yet been able to make reasonable estimates of the impact of certain elements of the Tax Act, the Company has not recorded any amounts related to those elements and has continued accounting for them in accordance with the tax laws in effect immediately prior to the enactment of the Tax Act.

Although the accounting for the Tax Act is incomplete, the Company was able to make reasonable estimates of certain effects of the Tax Act and record provisional amounts. The Tax Act reduces the U.S. federal corporate tax rate from 34% to 21% for tax years beginning after December 31, 2017. The Company has evaluated the decrease in the tax rate and in 2017 recorded a provisional, one-time tax expense of approximately $9.0 million. This expense was offset by an equal change in the valuation allowance, resulting in a net tax expense or benefit of $0. The Company also recorded a one-time tax benefit and corresponding reduction to the valuation allowance of

Table of Contents

$0.4 million related to Alternative Minimum Tax credit carryforwards that are expected to be refundable; the Tax Act contributed to $0.2 million of this tax benefit. As of March 31, 2018, the Company is still completing its evaluation of the impact of these changes in accordance with SAB 118.

The financial statements for the three months ended March 31, 2018, do not reflect the impact of certain aspects of the Tax Act as the Company did not have the necessary information available, prepared, or analyzed in sufficient detail to determine an actual or provisional amount for the tax effects of the Tax Act. The tax on unrepatriated foreign earnings is a tax on previously untaxed accumulated and current earnings and profits of the Company's foreign subsidiaries. The Company is not able to complete the accounting for federal and state income tax items related to the one-time deemed repatriation transition tax on unrepatriated foreign earnings and the associated unrecognized deferred tax liability for foreign earnings that will remain indefinitely reinvested. As a result, no provisional amounts have been recorded and the Company continues to account for unrepatriated earnings of foreign subsidiaries under the laws existing prior to the enactment date of the Tax Act. The Company anticipates being able to offset the additional tax expense associated with the one-time tax with available net operating loss carryovers and/or foreign tax credits. Additionally, the Company is still evaluating the unrecognized deferred tax liability related to investment in foreign subsidiaries and joint ventures that will remain indefinitely reinvested subsequent to the one-time transition tax. The Company anticipates that this will not impact tax expense, as the Company intends to continue indefinitely reinvesting its unremitted foreign earnings in Australia and the U.K.

The Tax Act also creates a new requirement on global intangible low-taxed income ("GILTI") earned by foreign subsidiaries. The GILTI provisions require foreign subsidiary earnings in excess of an allowable return on the foreign subsidiary's assets to be included in the Company's U.S. income tax return. Under U.S. GAAP, the Company is permitted to make an accounting policy election to either treat taxes due on future inclusions in U.S. taxable income related to GILTI as a current-period expense when incurred or to factor such amounts into the Company's measurement of its deferred taxes. The Company is estimating a taxable income inclusion related to GILTI for the three months ended March 31, 2018 and has made the election to account for GILTI as a component of current taxes incurred rather than as a component of deferred 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 benefit was $0.1 million for the three months ended March 31, 2018 compared to $2.8 million for the three months ended March 31, 2017, or approximately 14% and 142% of income before income taxes, respectively. The effective tax rate for the three months ended March 31, 2018 differs from the U.S. federal statutory rate of 21% primarily due to the domestic valuation allowance offsetting most of the statutory rate. The rate is increased by foreign income taxes, state income taxes or taxes in states for which net operating loss carryforwards are not available, and the impact of incentive stock options as well as other permanent differences. As of December 31, 2017, the Company's NOL carryforward amounts for U.S. federal income and state tax purposes were $66.7 million and $67.8 million, respectively. The NOL carryforwards will expire between 2020 and 2037. In addition to the NOL carryforwards, as of

December 31, 2017, the Company had U.S. federal and state research and development credit carryforwards of $6.6 million and $2.8 million, respectively, which will expire between 2018 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

Table of Contents

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 2012. 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, 2018, the number of reserved shares was increased by 1,291,644 in accordance with the provisions of the 2013 Plan.

A summary of stock option activity for the three months ended March 31, 2018 is presented below:

	Shares Subject to Options Outstanding	Weighted Average Grant Date Fair Value	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
Balance at December 31, 2017	2,069,802		12.13	
Exercised	(196,476)		10.63	

Expired	(2,809)	5.72	
Forfeited	(1,996)	14.03	
Balance at March 31, 2018	1,868,521	12.30	
Exercisable options at March 31, 2018	1,665,674	12.30	4.8
Vested and expected to vest at March 31, 2018	1,868,521	12.30	5.0

Table of Contents

The following table summarizes information about stock options outstanding and exercisable at March 31, 2018:

				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)
$	4.89	-	7.49	6.08	669,446	3.3	660,753	3.3
$	8.16	-	12.93	10.57	418,169	5.8	309,182	5.5
$	12.98	-	19.56	15.60	359,537	6.6	274,370	6.5
$	20.91	-	22.92	21.07	421,369	5.7	421,369	5.7
					1,868,521		1,665,674	

For the stock option awards vested during the three months ended March 31, 2018, the total fair value was $0.7 million. The following table summarizes the aggregate intrinsic-value of options exercised, exercisable and vested and expected to vest (in thousands):

	For the Three Months Ended and as of March 31,	
	2018	2017
Options Exercised	$ 2,765	$ 3,119
Options Exercisable	15,335	14,761
Options Vested and Expected to Vest	17,203	16,121

Restricted stock units

A summary of restricted stock unit activity for the three months ended March 31, 2018 is presented below:

	Number of Shares	Weighted Average Grant Date Fair Value
Non-vested balance at December 31, 2017	1,290,660	$ 9.75

Awarded	326,150	29.21
Vested	(425,282)	9.83
Forfeited	(34,250)	9.54
Non-vested balance at March 31, 2018	1,157,278	15.21

During the three months ended March 31, 2018, 425,282 restricted stock units vested of which 146,359 shares were withheld for tax purposes resulting in the issuance of 278,923 shares of common stock.

Company Matching Contribution to our 401(k) Plan

The Company offers a 401(k) Plan and in November 2016, the Company's 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 three months ended March 31, 2018, the Company recorded $0.4 million of expenses associated with this contribution.

Table of Contents

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 March 31,	
	2018	2017
Cost of revenue	$ 68	$ 58
Research and development	1,084	1,129
Sales and marketing	959	1,064
General and administrative	1,224	1,003
Total stock-based compensation expense	$ 3,335	$ 3,254

At March 31, 2018, there was $1.8 million of total unrecognized compensation cost related to non-vested stock option awards that will be recognized over a weighted-average period of 0.9 years. At March 31, 2018, there was $15.4 million of total unrecognized compensation cost related to non-vested restricted stock units that will be recognized over a weighted-average period of 2.1 years if all vesting conditions are met.

9. Share Repurchases

In February 2018, 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 until June 2019. During the three months ended March 31, 2018, the Company repurchased 300,000 shares for $7.4 million compared to 119,007 shares for $1.8 million in the same period in 2017. As of March 31, 2018, the Company has $12.6 million remaining under this share repurchase program.

10. Commitments and Contingencies

Operating Leases

The Company leases office and warehouse space under operating leases that expire between 2018 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 $0.8 million and $0.7 million for the three months ended March 31, 2018 and 2017, 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 March 31, 2018 (in thousands):

Remainder of 2018	$ 2,173
2019	2,958
2020	2,502
2021	1,269
2022	534
Thereafter	240
	$ 9,676

Purchase Commitments

The Company had non-cancellable purchase commitments for the purchase of inventory, which extend through March 2019 totaling approximately $53.9 million as of March 31, 2018.

Table of Contents

Indemnification

The Company has agreed to indemnify its officers and directors for certain events or occurrences while the officer or director is or was serving at the Company’s request in such capacity. The maximum amount of potential future indemnification is unlimited; however, the Company has a directors’ and officers’ insurance policy that provides corporate reimbursement coverage that limits its exposure and enables it to recover a portion of any future amounts paid. The Company has no liabilities recorded for these agreements as of March 31, 2018, as there were no outstanding claims.

Legal Matters

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

Table of Contents

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

The following discussion and analysis is intended to provide greater details of our results of operations and financial condition and should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2017, which was filed with the U.S. Securities and Exchange Commission (the “SEC”) on February 15, 2018, 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 2018 to 2017.
- 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.

Table of Contents

- Contractual Obligations and Off-Balance Sheet Arrangements. An overview of our contractual obligations, contingent liabilities, commitments and off-balance sheet arrangements outstanding as of March 31, 2018, 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, distributors and retailers 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, distributors and retailers 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 three months ended March 31, 2018, over 4,300 active direct dealers were authorized to sell and install the full Control4 line of products in the United States, Canada, the United Kingdom, Australia, China, Germany and 49 other countries, and 32 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 approximately 1,090 additional active dealers and 17 distributors that are currently authorized to sell only our Pakedge and Triad product lines.

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 or business and other related ancillary products used in automation projects. 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.

24

Table of Contents

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

	For the Years Ended December 31, 2017 * As adjusted		2016 * As adjusted		2015		2014		2013	
Core revenue	$ 238.8		$ 203.2		$ 160.7		$ 144.7		$ 126.4	
Core revenue growth over prior year	18	%	26	%	11	%	14	%	20	%
Other revenue	$ 5.4		$ 4.9		$ 2.5		$ 4.1		$ 2.1	
Other revenue changes over prior year	10	%	96	%	(39)	%	95	%	-46	%
Total revenue	$ 244.2		$ 208.1		$ 163.2		$ 148.8		$ 128.5	
Total revenue growth over prior year	17	%	28	%	10	%	16	%	17	%

*The revenue growth rate data for the years ended December 31, 2017 and 2016 reflects the adoption of ASC 606. The revenue growth rate data for the years ended December 31, 2015, 2014 and 2013 does not reflect the adoption of ASC 606.

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 the number of projects performed by 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:

- Introduced our new CA-1 controller, an entry level controller for projects that only include lighting, temperature control, and security integration, and do not require additional entertainment features found in our EA series of controllers;
- 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;
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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; and

- 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

25

Table of Contents

the BakPak enabled PowerPak power distribution units ("PDUs") to monitor and manage their entire customer base in a single interface.

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 December 2017, we acquired the intellectual property and key operating assets of ihiji, a leading provider of remote management services for technical integrators servicing connected home customers. By combining two industry-leading network and device management solutions, BakPak from Control4 and Invision from ihiji, into one unified service platform, Control4 will provide thousands of professional integrators with powerful device monitoring and management capability to efficiently and proactively support their connected-home customers; and
- 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 offerings and enabling the future development of new integrated-audio experiences.

Adoption by the Control4 dealer network of Triad products continues to steadily expand with 2,100 dealers, or 40% of our active dealers, ordering Triad during the last twelve months.

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 partners to participate in our smart home ecosystem, which includes over 11,700 drivers and more than 3,300 SDDP-enabled products. For example, LG recently announced that its new lines of OLED and Super UHD TVs would feature SDDP, and Samsung announced the incorporation of SDDP software into its new 4K television line-up and Blu-ray Player products. We believe that these and other companies are increasingly recognizing the value of including SDDP with their new releases to simplify integration of their products into Control4 installations. Our broad ecosystem, which includes audio, video, lighting, temperature, network, security and communication device categories, gives consumers flexibility to integrate nearly any connectable device into their smart home. In addition, our partners are constantly contributing new device integrations. As such, our dynamic ecosystem remains current with the latest product innovations and allows our smart home platform to grow alongside emerging technologies to meet our consumers' changing needs and preferences. We believe that our open platform and the resulting ecosystem is a key competitive advantage that will continue to facilitate our growth.

Table of Contents

Our products leverage both wired and wireless technologies and are designed to be installed in both new construction and existing homes. We expect that future increases in both new home construction and existing home renovations will have a positive impact on our revenue. In new home construction, we continue to engage builders to introduce entry- to mid-level Control4 systems as a standard feature in new home projects, and we believe that the release of our new CA-1 controller, at the lowest price point of any Control4 controller, will help with adoption of control in these types of projects. We further believe home automation is increasingly becoming a higher priority for home buyers, and this is one of the reasons for our investment in national and regional builder programs.

We believe that the growth of our business and our future success are dependent upon many factors, including the rates at which consumers adopt our products and services, our 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 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. Our recent awards include:

o A record nine CE Pro Quest for Quality Awards in 2018, the most ever won by a single company, consisting of Platinum for General Communication/Customer Service, RMR Support Programs, and Shipping Policies; and Silver for Technical Support, Sales/Marketing Assistance, Dealer/Integrator Website, Training Programs, Dealer Protection Policies, and Social Media Presence.

o Three Techhome Mark of Excellence Awards at the Consumer Electronics Show in January 2018: 1) Best Audio Amplification Product of the Year for Control4's new Triad One Streaming Amplifier, 2) Best Automation Device of the Year for Control4's new OS 2.10 with "When >> Then" Then Personalization, and 3) Best Education or Support Program of the Year of Control4's new Pakedge Certified Network Administrator Online Training Curriculum;

o Two "Best of Show" Awards at the CEDIA Expo tradeshow in 2017 for Control4 "When >> Then" automation and the Pakedge WR-1 Wireless Router + BakPak Lite;

o An EXC!TE Award at the CEDIA Expo tradeshow in 2017 for our Triad Designer Series Speakers and our Pakedge PowerPak PDU;

o A BEST Award from CE Pro, a leading trade magazine for technology professionals, at CEDIA 2017 for our Triad Designer Series Speakers.;

o Top Whole-Home Automation brand for Control4 and top networking brand for Pakedge 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.

o 2017 Custom Integration Vendor of the Year by ProSource Buying Group for the third consecutive year.

Table of Contents

- Accelerating and Enhancing Consumer Lead Generation. We determined that there is an opportunity for us to play a more active role in generating and pursuing 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 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 adopted 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 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 March 31,	
	2018	2017
Authorized dealers at the beginning of the period	3,174	2,994
Additions	83	103
Terminations	(42)	(58)
Authorized dealers at the end of the period	3,215	3,039
Number of active dealers(2)	3,108	2,959
Active dealers as a % of authorized dealers(2)	97 %	97 %

Table of Contents

International Direct Dealers(1)

	Three Months Ended March 31,	
	2018	2017
Authorized dealers at the beginning of the period	1,315	1,147
Additions	52	68
Terminations	(9)	(16)
Authorized dealers at the end of the period	1,358	1,199
Number of active dealers(2)	1,195	1,090
Active dealers as a % of authorized dealers(2)	88 %	91 %

	Three Months Ended March 31,	
	2018	2017
Number of controllers sold	23,413	21,341
Core revenue growth	18 %	17 %
International core revenue as a percentage of total revenue	22 %	21 %

(1) These dealer figures only include dealers authorized to sell and install the full Control4 line of products and exclude the approximately 1,090 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 2018 will be the successful introduction of new products to our channel as well as strengthening and expanding our dealer network. 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 comprehensively 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 10% from March 31, 2017 to March 31, 2018, 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.

Table of Contents

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.

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 February 2018, we released our CA-1 controller, which is designed for entry-level projects for homeowners interested in lighting, temperature control, and security. As a result, our dealers have made initial purchases of CA-1 controllers for their showrooms in addition to purchases for end consumers.

Our Entertainment and Audio “EA” and Controller and Automation (“CA”) controllers address a broad range of solutions from simple single room projects to large, elegant whole-home deployments. Our EA-1 and CA-1 controllers broaden the addressable market for our solutions by providing single-room and lower cost solutions which typically involve more narrowly defined use cases with fewer connected devices. In 2017, 29% of the Control4 automation projects our dealers sold were single-room or low-cost projects consisting only of a controller or controller paired with a remote.

During the three months ended March 31, 2018, we sold 23,413 controllers compared to 21,341 controllers sold in the same period in 2017, an increase of 10%.

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.

Table of Contents

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 March 31,	
	2018	2017
	(in thousands)	
North America Core Revenue	$ 45,701	$ 39,206
International Core Revenue	12,790	10,536
Other Revenue	658	466
Total Revenue	$ 59,149	$ 50,208
North America Core Revenue as a % of Total Revenue	77 %	78 %
International Core Revenue as a % of Total Revenue	22 %	21 %

North America Core revenue increased $6.5 million, or 17%, for the three months ended March 31, 2018, compared to the same period in 2017. International Core revenue increased $2.3 million, or 21%, in the three months ended March 31, 2018, compared to the same period in 2017.

Revenue growth in both North America and internationally is driven by a variety of factors. We continue to see growth from net new dealer additions as well as growth from existing dealers driven by an increase in the number of projects that are being performed and increased project share, which is a derivative of our new product innovation and our acquisition strategy.

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 March 31,	
	2018	2017
	(in thousands)	
Targeted International Regions (1)	$ 10,863	$ 8,246
Other International Regions	1,927	2,290
Total International Core Revenue	$ 12,790	$ 10,536

(1) Serviced by our offices in the United Kingdom, Germany, Australia, China, and India.

International Core revenue in the targeted international regions grew 32% during the three months ended March 31, 2018, compared to the same period in 2017, while International Core revenue in the other international regions decreased 16% during the three months ended March 31, 2018, compared to the same period in 2017. Improvements in foreign currency exchange rates and general economic conditions in our targeted international regions have contributed to an increase in revenue compared to 2017. Ownership changes of international distributors and unfavorable geo-political conditions have caused a decrease in revenue in our other international regions compared to 2017.

We continue to make investments internationally to improve our dealers' ability to sell and install our products and believe that these investments will enable us to grow our key international markets. Notwithstanding

Table of Contents

the foregoing, we sell broadly throughout the world and we believe that regional, adverse international economic conditions may create challenges and slow growth in certain geographies in the future.

Gross Margin

As a percentage of revenue, our gross margin has been, and will continue to be, affected by a variety of factors. Our gross margin is relatively consistent across our products. Our gross margin on third-party products that we sell through our online distribution platform is higher than our gross margin on our other product sales because we only recognize our net profit on these sales as revenue. While software licensing and subscription revenue is not material for all periods presented, our gross margin is higher on software licensing and subscription revenue than it is on product sales. Our gross margin is also higher on our sales made directly through dealers than it is on our sales made through distributors. Gross margin may be negatively affected by price competition in our target markets and associated promotional or volume incentive rebates offered to our independent dealers and distributors.

In addition, in conjunction with our acquisition of Triad, we were required to record acquired inventory at fair value, as determined under ASC 805, Business Combinations, resulting in a step-up in the inventory value. Such step-up is recorded through cost of goods sold when the specific inventory is sold, resulting in a negative impact to our gross margin. Also, cost of goods sold includes ongoing, periodic amortization of the acquired technology.

Gross margin for the three months ended March 31, 2018 and 2017 was as follows (in thousands, except percentages):

	Three Months Ended March 31,	
	2018	2017
Gross margin	$ 30,739	$ 25,149
Percentage of revenue	52.0 %	50.1 %

As a percentage of revenue, our gross margin was 52.0% for the three months ended March 31, 2018, compared to 50.1% for the same period in 2017. The increase in gross margin was primarily due to favorable fluctuations in exchange rates in markets where we sell our products in the local currency as well as lower programmatic price reductions during the period.

Our sales in Europe, Australia and Canada are generally priced in the pound sterling or the euro, the Australian dollar and the Canadian dollar, respectively, while our cost of goods sold is denominated in the U.S. dollar. The changing value of the pound sterling, the euro, and the Australian and Canadian dollars relative to the U.S. dollar will continue to contribute to variability in our gross margin for sales in Europe, Australia and Canada.

The impact of distribution and other overhead expenses as a percentage of revenue on our gross margin percentage varies depending on total revenue and overhead spending in a given period.

Beginning in the second quarter of 2018, we anticipate making incremental investments in our global fulfillment centers to accommodate growth and improve delivery times to our dealers, which will moderate our gross margin improvements during the remainder of 2018, but should enable us to continue to scale and improve gross margins in future years.

Research and Development Expenses

Research and development expenses consist primarily of compensation for our engineers and product managers, including non-cash stock compensation expense. Research and development expenses also include prototyping and field-testing expenses incurred in the development of our products. We also include fees paid to agencies to obtain regulatory certifications. Finally, research and development expenses include ongoing, periodic amortization of acquired intangible assets.

Table of Contents

Research and development expenses for the three months ended March 31, 2018 and 2017 were as follows (in thousands, except percentages):

	Three Months Ended March 31,	
	2018	2017
Research and development	$ 10,940	$ 9,844
Percentage of revenue	18 %	20 %

Research and development expenses increased $1.1 million, or 11%, in the three months ended March 31, 2018, compared to the same period in 2017. The increase in absolute dollars primarily relates to personnel costs, which in part can be attributed to increased headcount from our recent business acquisitions as well as support for existing product lines and ongoing innovations.

Our research and development expenses both as a percentage of revenue and in absolute dollars fluctuate depending on our investments in the development of new solutions. For example, the timing of new hardware releases and the expense associated with prototyping, beta testing and compliance and regulatory fees can have an impact on total research and development expenses from period to period.

For the remainder of 2018, we expect research and development expenses to increase in absolute dollars, as we continue to invest in new product development to drive future revenue growth, but to remain flat or decrease slightly as a percentage of revenue.

Sales and Marketing Expenses

Sales and marketing expenses consist primarily of compensation and related travel expenses for our sales, technical support and marketing personnel, including non-cash stock compensation expense. Sales and marketing expenses also include expenses associated with trade shows, marketing events, advertising and other marketing-related programs. We also include the amortization of certain intangible assets such as those related to our dealer network as well as those related to trademarks/trade names.

Sales and marketing expenses for the three months ended March 31, 2018 and 2017 were as follows (in thousands, except percentages):

	Three Months Ended March 31,	
	2018	2017
Sales and marketing	$ 12,535	$ 11,447
Percentage of revenue	21 %	23 %

Sales and marketing expenses increased $1.1 million, or 10%, in the three months ended March 31, 2018, compared to the same period in 2017. The increase in absolute dollars primarily relates to offsite events related to the release of the CA-1 controller as well as increased personnel costs, which can be attributed to expanding our support for our growing channel including additional staffing to support marketing and sales services provided on behalf of our dealers.

We expect our sales and marketing expenses to increase in absolute dollars as we work to grow our global sales channels, but to decrease slightly as a percent of revenue in future periods.

General and Administrative Expenses

General and administrative expenses consist primarily of compensation for our employees in our executive administration, finance, information systems, human resource and legal departments, including non-cash stock-based compensation expense. Also included in general and administrative expenses are outside legal fees, audit fees, facilities expenses and insurance costs. Finally, during a period with an acquisition, we also include acquisition-related costs in general and administrative expenses.

Table of Contents

General and administrative expenses for the three months ended March 31, 2018 and 2017 were as follows (in thousands, except percentages):

	Three Months Ended March 31,	
	2018	2017
General and administrative	$ 6,293	$ 5,717
Percentage of revenue	11 %	11 %

General and administrative expenses increased $0.6 million, or 10%, in the three months ended March 31, 2018 compared to the same period in 2017. The increase in absolute dollars for the three months ended March 31, 2018 primarily relates to personnel costs, including non-cash stock compensation expense.

We expect our general and administrative expenses to increase in absolute dollars as a result of growth in the business, increasing facilities costs associated with our various offices throughout the world, incremental compliance costs incurred when we are no longer considered an “emerging growth company,” as defined in the JOBS Act, in 2018, and increases in administrative expenses and fees that typically occur over time.

Income Tax Benefit

Income tax benefit for the three months ended March 31, 2018 and 2017 was as follows (in thousands, except percentages):

	Three Months Ended March 31,	
	2018	2017
Income tax benefit	$ (116)	$ (2,786)
Percentage of revenue	0 %	6 %

We recognized an income tax benefit of $0.1 million, or approximately 14% of income before income taxes, for the three months ended March 31, 2018, compared to an income tax benefit of $2.8 million, or approximately 142% of income (loss) before income taxes, for the three months ended March 31, 2017. The effective tax rate differs from the U.S. federal statutory rate of 21% primarily due to the domestic valuation allowance offsetting most of the statutory rate, partial reversal of the valuation allowance due to the deferred tax liabilities that were recorded as part of the Triad acquisition in 2017, state income taxes, foreign income taxes, and incentive stock options.

Significant judgment is required in determining our provision for income taxes and evaluating our uncertain tax positions. In evaluating our ability to recover our deferred tax assets, in full or in part, we consider all available positive and negative evidence, including our past operating results, our 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, we have a full valuation allowance against our domestic deferred tax assets. To the extent that we generate positive domestic income and expect, with reasonable certainty, to continue to generate positive income, we may release our valuation allowance in a future period. This release would result in the recognition of certain deferred tax assets and a decrease to income tax expense for the period such release is made.

On December 22, 2017, the United States enacted the Tax Act. The Tax Act makes broad and complex changes to the U.S. tax code, including a one-time mandatory transition tax on accumulated foreign earnings and a reduction of the corporate income tax rate to 21% effective January 1, 2018, among others. We are required to recognize the effect of the tax law changes in the period of enactment, such as determining the transition tax and remeasuring U.S. deferred tax assets and liabilities. In December 2017, the SEC staff issued Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB 118”), which allows us to record provisional amounts during a measurement period not to extend beyond one year of the enactment date. Where we have been able to make reasonable estimates of the effects of the Tax Act for which our analysis is not yet complete, we have recorded provisional amounts in accordance with SAB 118. Where we have not yet been able to make reasonable estimates of the impact of certain elements of the Tax Act, we have not recorded any amounts related to those elements and have continued accounting for them in accordance with the tax laws in effect immediately prior to the enactment of the Tax Act.

For additional information with respect to our accounting for the Tax Act, see Note 7 “Income Taxes” in the notes to condensed consolidated financial statements (unaudited).

Liquidity and Capital Resources

Primary Sources of Liquidity

As of March 31, 2018, we had $76.6 million in unrestricted cash and cash equivalents and net marketable securities, a decrease of $9.4 million from December 31, 2017. The overall decrease in cash and cash equivalents and net marketable securities was primarily due to the following:

- In February 2018, our Board of Directors authorized the expansion of the repurchase program providing approval to repurchase up to $20 million in Control4 common stock from time to time on the open market. For the three months ended March 31, 2018, we repurchased 300,000 shares for $7.4 million.
- We made $3.6 million in payments for taxes related to the net share settlement of restricted stock units that lapsed during the period.
- We received $2.1 million in proceeds from the exercise of options for common stock.
- We generated $0.5 million in cash from operations during the period; and
- Capital purchases of approximately $0.9 million.

We invest in highly-rated securities, and our investment policy generally limits the amount of credit exposure to any one issuer. Our investment policy requires investments to be investment grade, with the primary objective of minimizing the potential risk of principal loss. The maturities of our long-term investments range from one to two years, with the average maturity of our investment portfolio less than one year. Cash equivalents and marketable securities are comprised of money market and other funds, highly liquid debt instruments of the U.S. government and its agencies, debt instruments issued by municipalities in the U.S., corporate securities, and asset-backed securities.

The following table shows selected financial information as of March 31, 2018 and December 31, 2017 (in thousands):

	March 31, 2018	December 31, 2017
Cash and cash equivalents	$ 19,989	$ 29,761
Investments, net(1)	56,655	56,254
Accounts receivable, net	26,751	29,925
Inventories	39,314	37,171
Working capital	106,459	104,529

(1) Includes accrued investment balances not included in the investments line items on the condensed consolidated balance sheet.

We closely monitor accounts receivable and inventory because of their significant impact on cash and working capital. Our accounts receivable balance at March 31, 2018 has decreased by $3.2 million, or 11%, since December 31, 2017, due to our collection efforts made during the first quarter of 2018 as well as lower sales in the first quarter compared to the preceding fourth quarter reflecting the typical seasonality of our business. Furthermore, inventory has increased by $2.1 million from December 31, 2017 to March 31, 2018. The increase in inventory was due primarily to normal inventory buildup associated with revenue growth and the introduction of new products.

Table of Contents

We have an asset-based, revolving credit facility of $40.0 million and at March 31, 2018 we had no outstanding borrowings under the credit facility.

We believe that our existing cash and cash equivalents, as well as our borrowing capacity on our revolving credit facility, will be sufficient to fund our operations for at least the next 12 months.

Cash Flow Analysis

A summary of our cash flows for the three months ended March 31, 2018 and 2017 is set forth below (in thousands):

	Three Months Ended March 31,	
	2018	2017
Unrestricted and restricted cash and cash equivalents at the beginning of the period	$ 30,034	$ 35,060
Net cash provided by operating activities	469	2,459
Net cash used in investing activities	(1,193)	(8,957)
Net cash used in financing activities	(9,086)	(353)
Effect of exchange rate changes on cash and cash equivalents	48	258
Net change in cash and cash equivalents	(9,762)	(6,593)
Unrestricted and restricted cash and cash equivalents at the end of the period	$ 20,272	$ 28,467

Operating Activities

Cash provided by operating activities is net income adjusted for certain non-cash items and changes in certain assets and liabilities.

The decrease in cash provided by operating activities of $2.0 million during the three months ended March 31, 2018 compared to the same period in 2017 is due to the differences in working capital account changes such as accounts receivable, inventory, accounts payable, and accrued liabilities partially offset by net income after adjusting for the non-cash effects of the amortization of intangible assets and tax benefits recorded in 2017 from business acquisitions.

Investing Activities

Cash used in investing activities primarily consist of purchases, maturities, and sales of marketable securities, business acquisitions, net of cash acquired, and purchases of property and equipment.

Cash used in investing activities decreased to $1.2 million in 2018 from $9.0 million in 2017. The year-over-year decrease in cash used in investing activities is due to cash used for business acquisitions in 2017.

Financing Activities

Financing cash flows consist primarily of tax payments related to the net share settlement of restricted stock units, the repurchase of Control4 stock in the open market and proceeds from the exercise of options to acquire common stock.

During the three months ended March 31, 2018, we repurchased 300,000 shares of our stock in the open market for $7.4 million compared to 119,007 shares for $1.8 million in the same period in 2017.

During the three months ended March 31, 2018 and 2017, we received proceeds of $2.1 million and $3.5 million, respectively, from the exercise of options to purchase common stock.

During the three months ended March 31, 2018 and 2017, we made tax payments of $3.6 million and $2.1 million, respectively, related to the net share settlement of restricted stock units that lapsed during the period.

Table of Contents

Non-GAAP Financial Measures

In addition to our GAAP operating results, we use certain non-GAAP financial measures 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. These measures, which we refer to as our non-GAAP financial measures, are not prepared in accordance with generally accepted accounting principles in the United States. Non-GAAP gross margin, non-GAAP income from operations, and non-GAAP net income exclude non-cash expenses related to stock-based compensation, amortization of intangible assets, acquisition-related costs, as well as expenses related to executive severance and litigation settlements.

Management believes that it is useful to exclude stock-based compensation expense because the amount of such expense in any specific period may not directly correlate to the underlying performance of our business operations.

We have recently completed acquisitions which resulted in operating expenses that would not have otherwise been incurred. Management has provided supplementary non-GAAP financial measures, which exclude acquisition-related expense items, to allow more accurate comparisons of the financial results to historical operations, forward-looking guidance and the financial results of less acquisitive peer companies. Management considers these types of costs and adjustments to be largely unpredictable and dependent on a significant number of factors that are outside of our control. Furthermore, we do not consider these acquisition-related costs and adjustments to be related to the organic continuing operations of the acquired businesses and are generally not relevant to assessing or estimating the long-term performance of the acquired assets. In addition, the size, complexity and/or volume of past acquisitions, which often drives the magnitude of acquisition-related costs, may not be indicative of the size, complexity and/or volume of future acquisitions. By excluding acquisition-related costs and adjustments from our non-GAAP measures, management is better able to evaluate our ability to utilize its existing assets and estimate the long-term value that acquired assets will generate for us. We believe that providing a supplemental non-GAAP measure which excludes these items allows management and investors to consider the ongoing operations of the business both with, and without, such expenses.

These acquisition-related costs are included in the following categories: (i) professional service fees, recorded in operating expenses, which include third-party costs related to the acquisition, and legal and other professional service fees associated with diligence, entity formation and corporate structuring, disputes and regulatory matters related to acquired entities; (ii) transition and integration costs, recorded in operating expenses, which include retention payments, transitional employee costs, earn-out payments treated as compensation expense, as well as the costs of integration-related services provided by third parties; and (iii) acquisition-related adjustments, which include adjustments to acquisition-related items such as being required to record inventory at its fair value, resulting in a step-up in the inventory value, and having to reverse part of our valuation allowance in order to offset the deferred tax liability that was recorded based on differences between the book and tax basis of assets acquired and liabilities assumed. The step-up in inventory is recorded through cost of goods sold when the inventory is sold, resulting in a negative impact to our gross margin. Although these expenses are not recurring with respect to past acquisitions, we will generally incur these types of expenses in connection with any future acquisitions.

We exclude the amortization of acquired intangible assets from non-GAAP measures. These amounts are inconsistent in amount and frequency and are significantly impacted by the timing and size of acquisitions. Providing a supplemental measure that excludes these charges allows management and investors to evaluate results “as-if” the acquired intangible assets had been developed internally rather than acquired. Although we exclude amortization of acquired intangible assets from non-GAAP measures, we believe that it is important for investors to understand that such intangible assets contribute to revenue generation. Amortization of intangible assets that relate to past acquisitions will recur in future periods until such intangible assets have been fully amortized. Future acquisitions may result in the amortization of additional intangible assets.

Furthermore, we believe it is useful to exclude expenses related to litigation settlements and executive severance because of the variable and unpredictable nature of these expenses which are not indicative of past or future operating performance. We believe that past and future periods are more comparable if we exclude these expenses.

Table of Contents

We believe these adjustments provide useful comparative information to investors. Non-GAAP results are presented for supplemental informational purposes only for understanding our operating results. The non-GAAP results should not be considered a substitute for financial information presented in accordance with generally accepted accounting principles and may be different from non-GAAP measures used by other companies. Our non-GAAP financial measures may not provide information that is directly comparable to that provided by other companies in our industry, as other companies in our industry may calculate non-GAAP financial results differently, particularly related to non-recurring, unusual items. We urge our investors to review the reconciliation of our non-GAAP financial measures to the comparable GAAP financial measures included below, and not to rely on any single financial measure to evaluate our business.

Table of Contents

	Three Months Ended March 31, 2018		2017	
	(in thousands, except percentages and per share data)			
Reconciliation of Gross Margin to Non-GAAP Gross Margin:				
Gross margin	$ 30,739		$ 25,149	
Stock-based compensation expense in cost of revenue	68		58	
Amortization of intangible assets in cost of revenue	921		774	
Acquisition-related costs in cost of revenue	—		27	
Non-GAAP gross margin	$ 31,728		$ 26,008	
Revenue	$ 59,149		$ 50,208	
Gross margin percentage	52.0	%	50.1	%
Non-GAAP gross margin percentage	53.6	%	51.8	%
Reconciliation of Income (Loss) from Operations to Non-GAAP Income (Loss) from Operations:				
Income (loss) from operations	$ 971		$ (1,859)	
Stock-based compensation expense	3,335		3,254	
Amortization of intangible assets	1,446		1,230	
Acquisition-related costs	16		130	
Non-GAAP income (loss) from operations	$ 5,768		$ 2,755	
Revenue	$ 59,149		$ 50,208	
Operating margin percentage	1.6	%	(3.7)	%
Non-GAAP operating margin percentage	9.8	%	5.5	%
Reconciliation of Net Income (Loss) to Non-GAAP Net Income (Loss):				
Net income (loss)	$ 966		$ 821	
Stock-based compensation expense	3,335		3,254	
Amortization of intangible assets	1,446		1,230	
Acquisition-related costs	16		(2,285)	
Non-GAAP net income (loss) (1)	$ 5,763		$ 3,020	
Non-GAAP net income (loss) (1) per common share:				
Basic	$ 0.22		$ 0.13	
Diluted	$ 0.21		$ 0.12	
Weighted-average number of shares:				
Basic	25,904		24,005	
Diluted	27,526		25,657	

(1) Excludes the calculated effect of non-GAAP adjustments on income tax expense of $0.3 million for the three-month period ended March 31, 2018.

Table of Contents

Off-Balance Sheet Arrangements

We have no material off-balance sheet arrangements as defined in SEC Regulation S-K- 303(a)(4)(ii).

Contractual Obligations

We enter into long-term contractual obligations in the normal course of business, primarily purchase commitments and non-cancellable operating leases.

Our contractual cash obligations as of March 31, 2018 are as follows:

	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
	(in thousands)				
Operating lease obligations	9,676	2,997	5,147	1,429	103
Purchase commitments	53,915	53,915	—	—	—
Total contractual obligations	$ 63,591	$ 56,912	$ 5,147	$ 1,429	$ 103

Critical Accounting Policies and Estimates

Our unaudited condensed consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles, or GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosures. These estimates and assumptions are often based on judgments that we believe to be reasonable under the circumstances at the time made, but all such estimates and assumptions are inherently uncertain and unpredictable. Actual results may differ from those estimates and assumptions, and it is possible that other professionals, applying their own judgment to the same facts and circumstances, could develop and support alternative estimates and assumptions that would result in material changes to our operating results and financial condition. We evaluate our estimates and assumptions on an ongoing basis. Our estimates are based on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Our actual results could differ from these estimates.

Our critical accounting policies and estimates are detailed in Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Annual Report on Form 10-K as filed with the SEC on February 15, 2018. None of our critical accounting policies and estimates have changed significantly since that filing. The acquisition of Triad did not significantly impact our critical accounting policies and estimates because their accounting policies and procedures were aligned with ours.

Recently Issued and Adopted Accounting Pronouncements

For information with respect to recent accounting pronouncements and the impact of these pronouncements on our condensed consolidated financial statements, see Note 1 "Description of Business and Summary of Significant Accounting Policies — Recent Accounting Pronouncements" in the notes to condensed consolidated financial statements (unaudited).

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

Our market risk disclosures are detailed in Quantitative and Qualitative Disclosures about Market Risk contained in the Annual Report on Form 10-K as filed with the SEC on February 15, 2018. Other than our interest rate risk described below, our market risk has not changed significantly since that filing.

Interest Rate Risk

Changes in U.S. interest rates could affect the interest earned on our cash, cash equivalents and investments as well as the fair value of our investments. Our investment policy and strategy are focused on preservation of capital and supporting our liquidity requirements. A portion of our cash is managed by external managers within the guidelines of our investment policy.

Table of Contents

Our exposure to changes in interest rates relates primarily to our investment portfolio. We invest in highly-rated securities, and our investment policy generally 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.

We performed a sensitivity analysis on the value of our investment portfolio assuming a hypothetical change in rates of 100 basis points. Based on investment positions as of March 31, 2018, a hypothetical 100 basis point increase in interest rates across all maturities would result in a $0.3 million incremental decline in the fair market value of the portfolio. Such losses would only be realized if we sold the investments prior to maturity.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a 15(e) and 15d 15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)), as of the end of the period covered by this Form 10-Q. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of such date, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. The adoption of ASC 606 required the implementation of new controls and the modification of certain accounting processes related to revenue recognition. The impact of these changes was not material to our internal control over financial reporting.

Inherent Limitations of Internal Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, do not expect that our disclosure controls and procedures or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Table of Contents

PART II — OTHER INFORMATION

ITEM 1. Legal Proceedings

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.

ITEM 1A. Risk Factors

A description of certain risks and uncertainties associated with our business is set forth below. You should carefully consider such risks and uncertainties, together with the other information contained in this report, and in our other public filings. Factors that could cause our business, financial condition or operating results to differ materially from the plans, projections and other forward-looking statements included in the section titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere in this report and in our other public filings include, but are not limited to, the following risks and uncertainties, which could cause substantial harm to our business, financial condition or operating results and the market price of our stock to decline, perhaps significantly.

Risks Related to Our Business and Industry

The markets in which we participate are highly competitive and many companies, including large technology companies, retailers, broadband and security service providers, as well as other managed service providers, are actively targeting the home automation market. Our failure to differentiate ourselves and compete successfully against these companies would make it difficult for us to add and retain consumers, and our sales and profitability could be adversely affected.

The market for home automation is fragmented, highly competitive and continually evolving. A number of technology companies, including industry leaders such as Amazon, Apple, Google, Honeywell, Lutron and Samsung, offer device control capabilities in some of their products, applications and services and are engaged in ongoing development efforts to address even broader segments of the home automation market. These large technology companies already have broad consumer awareness and sell a variety of devices for the home, and consumers may choose their offerings instead of ours, even if we offer broader interoperability or superior products and services. Additionally, these and other companies may further expand into our industry by developing additional solutions or by acquiring other providers. Similarly, many managed service providers, such as cable TV, telephone and security companies, are offering services that provide device control capability within the home for an additional monthly service fee. For example, Comcast's Xfinity service offers residential security, energy and automation services, and Vivint and ADT have made significant efforts to market its smart home services. These managed service providers have the advantage of leveraging their existing consumer base, network of installation and support technicians and name recognition to gain traction in the home automation market. In addition, consumers may prefer the monthly service fee with little to no upfront cost offered by some of these managed service providers over a larger upfront cost with little to no monthly service fees.

We expect competition from these large technology companies, retailers and managed service providers to increase in the future. This increased competition could result in pricing pressure, reduced sales, lower margins or the failure of our solutions to achieve or maintain broad market acceptance. To remain competitive and to maintain our position as a leading provider of professionally installed automation and control solutions for the connected home, we will need to invest continuously in product development, marketing, dealer and distributor service and support, and product delivery infrastructure. We may not have sufficient resources to continue to make the investments in all of the areas needed to maintain our competitive position. In addition, many of our competitors have longer operating histories, greater name recognition, larger consumer bases and significantly greater financial, technical, sales, marketing and other resources than us, which may provide them with an advantage in developing, marketing or servicing new solutions. Increased competition could reduce our market share, revenue and operating margins, increase our operating costs, harm our competitive position or otherwise harm our business and results of operations.

Table of Contents

Consumers may choose to adopt point products that provide control of discrete home functionality or do-it-yourself (“DIY”) home automation solutions rather than adopt our unified, professionally-installed home automation solution. If we are unable to increase market acceptance of the benefits of our unified solution, our revenue may not continue to grow, or it may decline.

Many vendors have emerged, and may continue to emerge, to provide point products with advanced functionality for use in the home, such as a thermostat, lighting, doorbell or alarm system that can be controlled by an application on a smartphone or control panel. We expect more and more consumer electronic and consumer appliance products to be network-aware and connected—each very likely to have its own smart device (phone or tablet) application. Consumers may be attracted to the relatively low costs and ease of installation of these point products and the ability to expand their home control solution over time with minimal upfront costs, despite the disadvantages of this approach. While we have built our solution to be flexible and support many third-party point products, the adoption of these products may reduce the revenue we receive for each installation. It is therefore important that we provide attractive top-quality products in many areas, such as networking, lighting, audio, video, thermostats and security, and establish broad market awareness and acceptance of these solutions as well as the advantages of integrating them in a unified solution. If a significant number of consumers in our target market choose to rely solely on the functionality included in point products or DIY solutions rather than acquiring our unified automation solution, then our business, financial condition and results of operations will be harmed, and we may not be able to achieve sustained growth or our business may decline.

Providers of luxury integrated installations with long operating histories, established markets, broad user bases and proven consumer acceptance, may be successful in expanding their offerings in the mainstream home automation market, or otherwise compete against our solutions, which may reduce our market share and harm our growth and future prospects.

Many companies with which we directly compete have been operating in this industry for many years, and as a result, have established significant name recognition in the home automation industry. For example, Crestron, a provider of luxury integrated installations, has been in business for over 40 years and has become an established presence in the home and commercial automation industry. Given the strong growth potential of the market, we expect there to be many new entrants in the future. To the extent these providers are able to develop more affordable or attractive products or otherwise compete with our solutions across any of our target demographics, our growth may be constrained and our business could suffer.

Since we rely on third-party dealers and distributors to sell and install our solutions, we do not have a direct sales pipeline, which makes it difficult for us to accurately forecast future sales and correctly predict manufacturing requirements.

We depend on our independent dealer and distributor network to sell and install our solution. As a result, we do not directly develop or control our sales pipeline, making it difficult for us to accurately predict future sales. In addition, because the production of certain of our products requires long lead times, we enter into agreements for the manufacture and purchase of certain of our products well in advance of the time in which those products will be sold. These contracts are based on our best estimates of our near-term product needs. If we underestimate consumer demand, we may forego revenue opportunities, lose market share and damage our relationships. Conversely, if we overestimate consumer demand, we may purchase more inventory than we are able to sell at any given time, or at all. If we fail to accurately estimate demand for our products, we could have excess or obsolete inventory, resulting in a decline in the value of our inventory, which would increase our costs of revenues and reduce our liquidity. Our failure to accurately manage inventory relative to demand would adversely affect our results of operations.

We have relatively limited visibility regarding the consumers that ultimately purchase our products, and we often rely on information from third-party dealers and distributors to help us manage our business. If we are unable to obtain timely or accurate information, our ability to quickly react to market changes and effectively manage our business may be harmed.

We sell our solutions through independent dealers and distributors. These dealers and distributors work with consumers to design, install, update and maintain their home automation installations. While we are able to track orders from dealers and distributors and have access to certain information about the configurations of the Control4 systems they install that we receive through our controllers, we also rely on these dealers and distributors to provide us with information about consumer behavior, product and system feedback, consumer demographics, buying patterns and information about our competitors. We use this channel sell-through data, along with other metrics, to assess consumer demand for our solutions, develop new products, adjust pricing and make other strategic business decisions. Our channel sell-through data

Table of Contents

is subject to limitations due to collection methods and the third-party nature of the data and thus may not be complete or accurate. In addition, from time to time we collect information directly from consumers through surveys that we conduct and other methods, but the consumers who chose to participate self-select and vary by geographic region and from period to period, which may impact the usefulness of the results. If we do not receive consumer information on a timely or accurate basis, or if we do not properly interpret this information, our ability to quickly react to market changes and effectively manage our business may be harmed.

We have incurred operating losses in the past, may incur operating losses in the future, and may not achieve or maintain profitability.

We began our operations in 2003. For most of our history, we have experienced net losses and negative cash flows from operations. As of March 31, 2018, we had an accumulated deficit of $71.3 million. We expect our operating expenses to increase in the future as we expand our operations. If our revenue does not continue to grow to offset any increased expenses, we will not continue to be profitable. After achieving profitability in 2013 and 2014 of $3.5 million and $8.2 million respectively, we sustained a net loss of $1.7 million in 2015. Our net income for the years ended December 31, 2016 and 2017 was $13.0 million and $16.0 million, respectively, but we may incur significant losses in the future for a number of reasons, including without limitation the other risks and uncertainties described herein. Additionally, we may encounter unforeseen operating or legal expenses, difficulties, complications, delays in manufacturing and selling our products and other unknown factors that may result in losses in future periods. If these losses exceed our expectations or our revenue growth expectations are not met in future periods, our profitability will be harmed and our stock price may fall.