CONTROL4 CORP
Form 10-Q
July 31, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended June 30, 2015

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 or a smaller reporting company. See definition of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company

(do not check if a smaller reporting company)

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

On July 23, 2015, 24,267,944 shares of the registrant's Common Stock, $0.0001 par value, were outstanding.

Control4 Corporation

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PART I — Financial Information

ITEM 1. Condensed Consolidated Financial Statements

CONTROL4 CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	December 31, 2014	June 30, 2015 (unaudited)
Assets		
Current assets:		
Cash and cash equivalents	$ 29,187	$ 17,180
Restricted cash	311	314
Short-term investments	53,523	46,118
Accounts receivable, net	20,155	21,960
Inventories	14,212	18,437
Prepaid expenses and other current assets	2,075	2,533
Total current assets	119,463	106,542
Property and equipment, net	5,089	6,348
Long-term investments	14,509	19,838
Intangible assets, net	1,409	5,503
Goodwill	231	2,742
Other assets	1,329	1,483
Total assets	$ 142,030	$ 142,456
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 15,016	$ 15,423

Accrued liabilities	4,750	5,771
Deferred revenue	843	1,033
Current portion of notes payable	915	797
Total current liabilities	21,524	23,024
Notes payable	913	525
Other long-term liabilities	1,291	923
Total liabilities	23,728	24,472
Commitments and contingencies		
Stockholders' equity:		
Common stock, $0.0001 par value; 500,000,000 shares authorized; 24,305,381 and 24,457,157 shares issued; 24,305,381 and 24,229,882 shares outstanding at December 31, 2014 and June 30, 2015 (unaudited), respectively	2	2
Treasury stock, at cost; 0 and 227,275 shares at December 31, 2014 and June 30, 2015 (unaudited), respectively	—	(2,148)
Additional paid-in capital	212,388	216,626
Accumulated deficit	(93,928)	(96,118)
Accumulated other comprehensive loss	(160)	(378)
Total stockholders' equity	118,302	117,984
Total liabilities and stockholders' equity	$ 142,030	$ 142,456

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

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
	(unaudited)		(unaudited)	
Revenue	$ 36,661	$ 44,641	$ 68,516	$ 76,724
Cost of revenue	17,694	22,312	33,313	38,784
Gross margin	18,967	22,329	35,203	37,940
Operating expenses:				
Research and development	7,097	8,122	13,872	16,117
Sales and marketing	6,364	7,812	12,665	15,179
General and administrative	3,440	4,288	7,128	8,909
Litigation settlement	35	—	35	—
Total operating expenses	16,936	20,222	33,700	40,205
Income (loss) from operations	2,031	2,107	1,503	(2,265)
Other income (expense):				
Interest, net	20	42	1	63
Other income (expense)	63	70	71	(340)
Total other income (expense)	83	112	72	(277)
Income (loss) before income taxes	2,114	2,219	1,575	(2,542)
Income tax expense (benefit)	103	178	103	(352)
Net income (loss)	$ 2,011	$ 2,041	$ 1,472	$ (2,190)
Net income (loss) per common share:				
Basic	$ 0.08	$ 0.08	$ 0.06	$ (0.09)
Diluted	$ 0.08	$ 0.08	$ 0.06	$ (0.09)
Weighted-average number of shares:				
Basic	23,715	24,309	23,417	24,326
Diluted	25,671	25,296	25,709	24,326

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

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CONTROL4 CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
	(unaudited)		(unaudited)	
Net income (loss)	$ 2,011	$ 2,041	$ 1,472	$ (2,190)
Other comprehensive income (loss):				
Foreign currency translation adjustment, net of tax	16	41	17	(246)
Net unrealized gains (losses) on available-for-sale investments, net of tax	34	(12)	1	28
Total other comprehensive income (loss)	50	29	18	(218)
Comprehensive income (loss)	$ 2,061	$ 2,070	$ 1,490	$ (2,408)

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

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CONTROL4 CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Six Months Ended June 30,	
	2014	2015
	(unaudited)	
Operating activities		
Net income (loss)	$ 1,472	$ (2,190)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation expense	1,245	1,321
Amortization of intangible assets	196	728
Provision for doubtful accounts	163	172
Stock-based compensation	2,655	3,528
Excess tax benefit from exercise of options for common stock	(9)	—
Changes in assets and liabilities:		
Accounts receivable	(1,734)	(1,458)
Inventories	(597)	(1,912)
Prepaid expenses and other current assets	(403)	(421)
Other assets	(168)	(116)
Accounts payable	(932)	(1,818)
Accrued liabilities	(1,154)	(256)
Deferred revenue	85	190
Other long-term liabilities	(33)	(369)
Net cash provided by (used in) operating activities	786	(2,601)
Investing activities		
Purchase of available-for-sale investments	(72,536)	(36,272)
Proceeds from sales of available-for-sale investments	1,043	—
Proceeds from maturities of available-for-sale investments	2,100	39,079
Purchases of property and equipment	(1,230)	(1,927)
Business acquisitions, net of cash acquired	—	(8,380)
Net cash used in investing activities	(70,623)	(7,500)
Financing activities		
Proceeds from exercise of options for common stock	4,241	710
Excess tax benefit from exercise of options for common stock	9	—
Repurchase of common stock	—	(2,148)

Repayment of notes payable	(555)	(506)
Net cash provided by (used in) financing activities	3,695	(1,944)
Effect of exchange rate changes on cash and cash equivalents	9	38
Net decrease in cash and cash equivalents	(66,133)	(12,007)
Cash and cash equivalents at beginning of period	84,546	29,187
Cash and cash equivalents at end of period	$ 18,413	$ 17,180
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 78	$ 65
Cash paid for taxes	100	121
Supplemental schedule of non-cash investing and financing activities		
Unsettled purchases of available-for-sale investments	723	703
Net unrealized losses on available-for-sale investments	1	28

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

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Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Description of Business and Summary of Significant Accounting Policies

Control4 Corporation (‘‘Control4’’ or the ‘‘Company’’) is a leading provider of automation and control solutions for the connected home. The Company unlocks the potential of connected devices, making entertainment systems easier to use, homes more comfortable, appliances more energy efficient, and families more secure. The Company was incorporated in the state of Delaware on March 27, 2003.

Immaterial correction of an error

Certain prior-year amounts have been adjusted in order to conform to the current-year presentation. The adjustment is related to $0.7 million of unsettled purchases of available-for-sale investments previously disclosed in the accrued liabilities and purchases of available-for-sale investments line items on the statement of cash flows adjusted to the supplemental schedule of non-cash investing and financing activities.

Unaudited Interim Financial Statements

The accompanying condensed consolidated balance sheets and the condensed consolidated statements of operations, comprehensive income (loss), and 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 of only normal recurring adjustments, considered necessary to present fairly the Company’s financial position, results of operations and cash flows. The results of operations for the three and six months ended June 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015, 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 20, 2015. The December 31, 2014 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 wholly-owned 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 United States dollars, except for sales to dealers and distributors located in the United Kingdom and the European Union, which are generally denominated in pounds sterling and the euro, respectively. There were no individual account balances greater than 10% of total accounts receivable at December 31, 2014 and June 30, 2015.

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No dealer or distributor accounted for more than 10% of total revenue for the three and six months ended June 30, 2014 and 2015.

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

Geographic Information

The Company's revenue includes amounts earned through sales to dealers and distributors located outside of the United States. With the exception of Canada, no single foreign country accounted for more than 10% of total revenue for the three and six months ended June 30, 2014 and 2015. The following table sets forth revenue from the U.S., Canadian and all other international dealers and distributors combined (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
Revenue-United States	$ 24,762	$ 30,055	$ 45,804	$ 51,272
Revenue-Canada	3,415	4,122	6,645	7,208
Revenue-all other international sources	8,485	10,465	16,066	18,245
Total revenue	$ 36,661	$ 44,641	$ 68,516	$ 76,724
International revenue (excluding Canada) as a percent of total revenue	23 %	23 %	23 %	24 %

Use of Accounting Estimates

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

Product Warranty

The Company provides its customers a limited product warranty of two years, which requires 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 number of installed systems, 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 includes 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.

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The following table presents the changes in the product warranty liability (in thousands):

	Warranty Liability
Balance at December 31, 2014	$ 1,191
Warranty costs accrued	1,116
Warranty claims	(963)
Balance at June 30, 2015	$ 1,344

Net Income (Loss) Per Share

Basic net income (loss) per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per share is computed using the weighted-average number of common shares outstanding and potentially dilutive common shares outstanding during the period that have a dilutive effect on net income per share. Potentially dilutive common shares result from the assumed exercise of outstanding stock options. In a net loss position, diluted net loss per share is computed using only the weighted-average number of common shares outstanding during the period, as any additional common shares would be anti-dilutive.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
Numerator:				
Net income (loss)	$ 2,011	$ 2,041	$ 1,472	$ (2,190)
Denominator:				
Weighted average common stock outstanding for basic net income (loss) per common share	23,715	24,309	23,417	24,326
Effect of dilutive securities—stock options	1,956	987	2,292	—
Weighted average common shares and dilutive securities outstanding	25,671	25,296	25,709	24,326

The following weighted-average common stock equivalents were anti-dilutive and therefore were excluded from the calculation of diluted net income (loss) per share (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
Options to purchase common stock	1,115	2,417	746	4,817

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2004-09, “Revenue from Contracts with Customers (Topic 606),” which amends the guidance in ASC 605, “Revenue Recognition.” The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. On July 9, 2015, the FASB voted to defer the effective date of this standard for one year, and is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The deferred standard allows early adoption of the standard on the original effective date of December 15, 2016. The Company is still evaluating the impact of adopting this guidance as well as whether the Company will apply the amendments retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of applying this update at the date of initial application.

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In August 2014, the FASB issued ASU 2014-15, ‘‘Presentation of Financial Statements — Going Concern (Subtopic 205-40).’’ The amended guidance requires an entity to prepare financial statements under the liquidation basis of accounting in accordance with Subtopic 205-30, Presentation of Financial Statements—Liquidation Basis of Accounting, if liquidation of the entity becomes imminent. The guidance is effective for the annual period ending on December 31, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The Company early adopted this guidance, and the adoption of this guidance did not have an impact on the Company's results of operations, financial position, or cash flows.

In April 2015, the FASB issued ASU 2015-05, "Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40) – Customers Accounting for Fees Paid in a Cloud Computing Arrangement." This update provides guidance regarding the accounting for fees paid by a customer in cloud computing arrangements. If a cloud computing arrangement includes a software license, the payment of fees should be accounted for in the same manner as the acquisition of other software licenses. If there is no software license, the fees should be accounted for as a service contract. The guidance is effective in fiscal years beginning after December 15, 2015 and early adoption is permitted. An entity can elect to adopt the amendments either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. The Company is still evaluating the impact of adopting this guidance.

2. Balance Sheet Components

Inventories consisted of the following (in thousands):

	December 31, 2014	June 30, 2015
Finished goods	$ 13,324	$ 14,908
Work-in-process	—	321
Component parts	888	3,208
	$ 14,212	$ 18,437

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

	December 31, 2014	June 30, 2015
Computer equipment and software	$ 4,390	$ 4,478
Manufacturing tooling and test equipment	2,777	3,920
Lab and warehouse equipment	2,652	3,143
Leasehold improvements	2,357	2,900
Furniture and fixtures	2,298	2,801
Marketing equipment	662	663
	15,136	17,905
Less: accumulated depreciation	(10,047)	(11,557)
	$ 5,089	$ 6,348

Other assets consisted of the following (in thousands):

	December 31, 2014	June 30, 2015
Deposits	$ 697	$ 897
Prepaid licensing	632	586
	$ 1,329	$ 1,483

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Accrued liabilities consisted of the following (in thousands):

	December 31, 2014	June 30, 2015
Sales returns and warranty accruals	$ 2,019	$ 2,421
Compensation accruals	1,614	1,857
Other accrued liabilities	1,117	1,493
	$ 4,750	$ 5,771

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.

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

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

data, methodology, inputs summarized by asset class, pricing application and corroborative information.

Cash, Cash Equivalents and Marketable Securities

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

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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 December 31, 2014 and June 30, 2015 (in thousands):

	December 31, 2014						
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-term Investments	Long-term Investments
Cash	$ 13,077	$ —	$ —	$ 13,077	$ 13,077	$ —	$ —
Level 1:							
Money market funds	16,110	—	—	16,110	16,110	—	—
Subtotal	16,110	—	—	16,110	16,110	—	—
Level 2:							
Asset-backed securities	4,458	—	(3)	4,455	—	—	4,455
Corporate bonds	54,321	2	(46)	54,277	—	46,726	7,551
Commercial paper	6,797	—	—	6,797	—	6,797	—
U.S. agency securities	2,503	—	—	2,503	—	—	2,503
Subtotal	68,079	2	(49)	68,032	—	53,523	14,509
Total	$ 97,266	$ 2	$ (49)	$ 97,219	$ 29,187	$ 53,523	$ 14,509

	June 30, 2015						
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-term Investments	Long-term Investments
Cash	$ 9,135	$ —	$ —	$ 9,135	$ 9,135	$ —	$ —
Level 1:							
Money market funds	7,770	—	—	7,770	7,770	—	—
U.S. government notes	999	2	—	1,001	—	—	1,001
Subtotal	8,769	2	—	8,771	7,770	—	1,001

Level 2:							
Asset-backed securities	5,420	2	(1)	5,421	—	202	5,219
Corporate bonds	50,500	7	(33)	50,474	—	37,863	12,611
Commercial paper	4,822	—	—	4,822	275	4,547	—
U.S. agency securities	4,509	4	—	4,513	—	3,506	1,007
Subtotal	65,251	13	(34)	65,230	275	46,118	18,837
Total	$ 83,155	$ 15	$ (34)	$ 83,136	$ 17,180	$ 46,118	$ 19,838

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

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basis, which may be maturity. During the three and six months ended June 30, 2015, the Company did not recognize any significant impairment charges.

Fair Value of Other Financial Instruments

The carrying amounts reported in the accompanying consolidated financial statements for cash and cash equivalents, restricted cash, accounts payable and accrued liabilities approximate their fair value because of the short term nature of the accounts. The fair value of the notes payable approximates its carrying value based on the variable nature of interest rates and current market rates available to the Company (see Note 5). As a result, the balance of the notes payable is categorized within the Level 2 fair value hierarchy.

Derivative Financial Instruments

The Company has foreign currency exposure related to the operations in the United Kingdom, Australia, as well as other foreign locations. The Company has entered into forward contracts to help offset the exposure to movements in foreign currency exchange rates in relation to certain US 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 June 30, 2015. However, the notional principal of foreign exchange contracts for July 2015 was $7.3 million as of June 30, 2015. The Company did not enter into foreign currency forward contracts during 2014.

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

		Three Months Ended June 30,		Six Months Ended June 30,	
	Income Statement Location	2014	2015	2014	2015
Foreign exchange contracts	Other income (expense), net	$ —	$ (100)	$ —	$ (100)

4. Goodwill and Intangible Assets

On January 30, 2015, the Company, through its newly-formed, wholly-owned subsidiary, Control4 Australia Pty Ltd ("Control4 Australia"), completed the acquisition of Nexus Technologies Pty Ltd ("Nexus"), an Australia-based provider of audio/video distribution products (under the brand of "Leaf"), pursuant to a Share Sale Agreement dated January 30, 2015, by and among Control4 Australia and all of the shareholders of Nexus, under which Control4 Australia purchased all of the issued and outstanding shares of Nexus from its shareholders and Nexus became a wholly-owned subsidiary of Control4 Australia. The total consideration transferred was $8.5 million in cash. Of the cash consideration, $750,000 of cash was deposited in escrow as partial security for the indemnification obligations of the Nexus shareholders pursuant to the Share Sale Agreement, which will be released to the Nexus shareholders one year from the acquisition date, provided that there are no claims made against the escrow amount. Additionally, the Company incurred approximately $0.6 million in acquisition-related expenses accounted for in general and administrative expenses. The Company had previously sold select Leaf products to its North American dealer network. Through this acquisition, the Company believes it now offers a complete array of video distribution solutions under the Control4 brand to Control4 customers worldwide, will gain market share in the growing audio and video (A/V) category, and will leverage Leaf's valuable engineering expertise to develop new and innovative A/V solutions.

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

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Total consideration transferred was allocated to tangible and identifiable intangible assets acquired and liabilities assumed based on their fair values at the acquisition date as set forth below. Management estimated the fair values of tangible and intangible assets and liabilities in accordance with the applicable accounting guidance for business combinations. The preliminary amount of consideration transferred is subject to potential adjustments in the event that the preliminary estimates of inventory or intangible assets prove to be inaccurate, and due to tax-related matters that could have a material impact on the consolidated financial statements. The Company expects the allocation of the consideration transferred to be final within the measurement period (up to one year from the acquisition date).

The Company's preliminary allocation of consideration transferred for Nexus is as follows (in thousands):

	Estimated Fair Value	
Cash	$	121
Inventory		2,346
Other assets acquired		1,247
Intangible assets		5,030
Goodwill		2,618
Total assets acquired		11,362
Accounts payable		2,273
Other liabilities assumed		589
Total net assets acquired	$	8,500

Amortizable Intangible assets

The Company's intangible assets and related accumulated amortization consisted of the following as of December 31, 2014 and June 30, 2015 (in thousands):

	December 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net
Developed technology	$ 2,597	$ (1,214)	$ 1,383
Non-competition agreements	53	(27)	26
Total intangible assets	$ 2,650	$ (1,241)	$ 1,409

	June 30, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net
Developed technology	$ 7,061	$ (1,907)	$ 5,154
Customer relationships	358	(30)	328
Non-competition agreements	53	(32)	21
Total intangible assets	$ 7,472	$ (1,969)	$ 5,503

The weighted average amortization period for acquired technology, customer relationships and non-competition agreements is 4.8 years, 5.0 years, and 2.0 years, respectively; and 4.8 years for all amortizable intangible assets in total.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
Amortization of intangible assets	$ 98	$ 403	$ 196	$ 728

Amortization of finite lived intangible assets as of June 30, 2015 for the next five years is as follows (in thousands):

	Amount
2015	$ 773
2016	1,381
2017	1,200
2018	1,106
2019	963
2020	80
	$ 5,503

Goodwill

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

	Amount
Balance at December 31, 2014	$ 231
Current period acquisitions	2,618
Foreign currency translation adjustment	(107)
Balance at June 30, 2015	$ 2,742

Goodwill represents the excess of consideration transferred over the fair value of assets acquired and liabilities assumed and is attributable to assembled workforces as well as the benefits expected from combining the Company's research and engineering operations with the acquired company's. The Company's goodwill associated with Nexus has tax basis but is not currently deductible for income tax purposes, due to Australian tax laws. The Company's remaining goodwill does not have tax basis and, therefore, is not deductible for income tax purposes.

5. Long-Term Obligations

Loan and Security Agreement

In June 2013, the Company entered into an Amended and Restated Loan and Security Agreement with Silicon Valley Bank (the "SVB Agreement"), which consists of a revolving credit facility of $13.0 million (subject to certain borrowing base restrictions) and term borrowings to fund purchases of property and equipment. All borrowings under the SVB Agreement are collateralized by the general assets of the Company. Term borrowings are payable in 42 equal monthly payments of principal plus interest and bear interest at prime plus 0.50%, which was 3.75% at June 30, 2015.

The Company believes that it has sufficient working capital to fund its operating and investing activities and accordingly did not renew the revolving credit facility upon maturity in May 2015.

The SVB Agreement contains various restrictive and financial covenants and the Company was in compliance with each of these covenants as of June 30, 2015.

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6. Income Taxes

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

Income tax expense was $0.1 million and $0.2 million for the three months ended June 30, 2014 and 2015, respectively, or approximately 5% and 8% of income before income taxes, respectively. Income tax expense was $0.1 million and income tax benefit was $0.4 million for the six months ended June 30, 2014 and 2015, respectively, or approximately 7% and 14% of income (loss) before income taxes, respectively. The effective tax rate for the three and six months ended June 30, 2015 differs from the U.S. federal statutory rate of 34% primarily due to the domestic valuation allowance offsetting most of the statutory rate. The rate is increased by foreign income taxes, minimum state income taxes or taxes in states for which net operating loss carryforwards are not available, the U.S. federal alternative minimum tax and the impact of incentive stock options as well as other permanent differences.

Significant judgment is required in determining the provision for income taxes, recording valuation allowances against deferred tax assets and evaluating uncertain tax positions. In evaluating the Company’s ability to recover deferred tax assets, in full or in part, the Company considers all available positive and negative evidence, including past operating results, the 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 all U.S. 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 all or a portion of the 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. In addition, the effective tax rate in subsequent periods would increase, and more closely approximate the federal statutory rate of 34%, excluding state income taxes, foreign income taxes and the effect of incentive stock options and permanent differences.

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, Hong Kong, China, Germany, and India. The Company is subject to examination in the United States, the United Kingdom, Australia, Hong Kong, China, Germany, and India as well as various state jurisdictions. As of June 30, 2015, the Company was not under examination by any tax authorities. Tax years beginning in 2011 are subject to examination by tax authorities in the United States, although net operating loss and credit carryforwards from all years are subject to examinations and adjustments for at least three years following the year in which the attributes are used. Tax years beginning in 2011 are subject to examination by the taxing authorities in Australia and Hong Kong. Tax years beginning in 2012 are subject to examination by the taxing authorities in China, Hong Kong, and India. Tax years beginning in 2013 are subject to examination by the taxing authorities in the United Kingdom. Tax years beginning in 2014 are subject to examination by the taxing authorities in Germany.

7. 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 and restricted stock. 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 subsequent to 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 up to 5% of the outstanding number of shares of the Company’s Common Stock as of the preceding December 31. On

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January 1, 2015, the number of reserved shares was increased by 1,215,269 shares in accordance with the provisions of the 2013 Plan.

A summary of stock option activity for the six months ended June 30, 2015 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, 2014	4,851,221		$ 10.57	
Granted	166,916	$ 5.88	11.64	
Exercised	(151,776)		4.89	
Expired	(5,364)		11.82	
Forfeited	(38,736)		13.92	
Balance at June 30, 2015	4,822,261		10.76	
Exercisable options at June 30, 2015	2,856,014		7.84	5.6
Vested and expected to vest at June 30, 2015	4,666,097		10.59	6.7

The following table summarizes information about stock options outstanding and exercisable at June 30, 2015:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Weighted Average Exercise Price	Number of Underlying Shares	Weighted-Average Remaining Contractual Life (in years)	Number of Underlying Shares	Weighted-Average Remaining Contractual Life (in years)
$ 0.78 - 1.72	$ 1.17	13,880	0.3	13,880	0.3
$ 1.97 - 3.38	2.57	238,101	1.4	238,101	1.4
$ 3.58 - 6.14	5.66	1,478,548	5.2	1,424,564	5.2
$ 6.34 - 9.94	8.32	991,857	6.8	723,881	6.6
$ 11.28 - 16.97	13.72	1,301,220	8.6	188,834	6.0
$ 17.66 - 22.92	21.00	798,655	8.6	266,754	8.5
		4,822,261		2,856,014	

For the stock option awards vested during the three and six months ended June 30, 2015, the total fair value was $1.3 million and $4.3 million, respectively. The following table summarizes the aggregate intrinsic-value of options exercised, exercisable and vested and expected to vest (in thousands):

	For the Six Months Ended and as of June 30,	
	2014	2015
Options Exercised	$ 16,907	$ 1,039
Options Exercisable	37,576	6,991
Options Vested and Expected to Vest	49,142	7,266

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
Expected volatility	59 %	53 %	56 - 60 %	53 - 55 %
Expected dividends	— %	— %	— %	— %
Expected terms (in years)	6.0 - 6.1	5.3 - 6.1	3.8 - 6.1	5.3 - 6.1
Risk-free rate	1.7 - 1.9 %	1.5 - 1.8 %	1.1 - 2.0 %	1.3 - 1.8 %

Total stock-based compensation expense has been classified as follows in the accompanying statements of operations (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
Cost of revenue	$ 28	$ 39	$ 48	$ 86
Research and development	642	667	1,120	1,439
Sales and marketing	292	387	514	841
General and administrative	446	586	973	1,162
Total stock-based compensation expense	$ 1,408	$ 1,679	$ 2,655	$ 3,528

At June 30, 2015, there was $15.7 million of total unrecognized compensation cost related to non-vested stock option awards that will be recognized over a weighted-average period of 2.7 years.

8. Share Repurchases

In May 2015, the Company’s Board of Directors authorized the repurchase of up to $20 million in Control4 common stock from time to time on the open market. The authorization by the Board of Directors will expire after one year, or when terminated earlier. As of June 30, 2015, the Company had repurchased 227,275 shares for $2.1 million and is shown in the accompanying Condensed Consolidated Balance Sheets as a reduction of Stockholders’ Equity.

9. Related Party Transactions

The former owner of Nexus, who is now an employee of the Company, owns and operates a Control4 authorized distributorship in Dubai. The following table sets forth revenue from product sales to that distributor for the period from the acquisition date to June 30, 2015 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
Dubai authorized distributor	$ —	$ 148	$ —	$ 292

As of June 30, 2015, the Company had accounts receivable from this related party totaling $0.1 million. Pursuant to the purchase agreement, future purchases will require cash payment in advance of delivery, and the former owner has agreed to use his best efforts to sell the distributorship.

10. Commitments and Contingencies

Operating Leases

The Company leases office and warehouse space under operating leases that expire between 2015 and 2018. The terms of the leases include periods of free rent, options for the Company to extend the leases (three to five

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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 $0.4 million and $0.5 million for the three months ended June 30, 2014 and 2015, respectively, and $0.8 million and $0.9 million for the six months ended June 30, 2014 and 2015, respectively.

Future minimum rental payments required under non-cancelable operating leases with initial or remaining terms in excess of one year consist of the following as of June 30, 2015 (in thousands):

2015	$ 1,005
2016	1,887
2017	1,655
2018	766
	$ 5,313

Purchase Commitments

The Company had non-cancellable purchase commitments for the purchase of inventory, which extend through December 2015 totaling approximately $28.1 million at June 30, 2015.

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 is unable to reasonably estimate the maximum amount that could be payable under these arrangements since these obligations are not capped but are conditional to the unique facts and circumstances involved. Accordingly, the Company has no liabilities recorded for these agreements as of June 30, 2015.

Employment Agreements

The Company has signed employment agreements with certain executive officers who are entitled to receive certain benefits if their employment is terminated by the Company, including severance payments, accelerated vesting of stock options and continuation of certain insurance benefits.

Legal Matters

On April 15, 2015, Intuitive Building Controls, Inc. (“IBC”), a corporation organized under the laws of Texas, filed a Complaint against the Company in the Eastern District of Texas, and the Company filed its Answer on June 10, 2015. During April 2015, IBC filed similar complaints against many other companies. IBC’s Complaint asserts that the Company’s lighting control systems, specifically including its controllers and in-wall touch screens, infringe three United States patents that IBC owns by assignment: U.S. Patent Nos. 6,118,230 (the “’230 patent”), 6,160,359 (the “’359 patent”) and 5,945,993 (the “’993 patent). The Complaint seeks injunctive relief and monetary damages. Based on the Company’s preliminary investigation of the patents at issue, the Company does not believe its products infringe any valid or enforceable claim of these patents. Accordingly, the Company is vigorously defending the lawsuit.

On April 28, 2015, the Company received a letter from Certified Measurement, LLC ("Certified Measurement"), alleging that some of the Company's products infringe three patents owned by assignment by Certified Measurement because they acquire physical measurements (such as motion, temperature, lighting, etc.), time-stamp the measurement data, and then perform cryptographic operations. Certified Measurement is a wholly-owned subsidiary of Patent Properties, Inc. ("Patent Properties"). The Company is conducting an investigation of the

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claims made by Certified Measurement regarding its three patents. Certified Measurement has not initiated litigation against the Company, but the Company believes that Certified Measurement may do so. The Company intends to defend itself vigorously with respect to this and any other related claims or litigation. Since no complaint has been filed and the outcome of any potential legal proceedings related to these claims is uncertain at this time, the Company cannot estimate the amount of liability, if any, which could result from an adverse resolution of this matter.

The Company establishes reserves for specific liabilities in connection with legal actions that it deems to be probable and estimable. In management's opinion, the Company is not currently involved in any legal proceedings other than specifically identified above, that individually or in the aggregate, could have a material effect on the Company's financial condition, operations, or cash flows. Currently, a range of loss associated with any individual material legal proceeding cannot be reasonably estimated.

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

The following discussion and analysis is intended to provide greater details of our results of operations and financial condition and should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2014 filed with the U.S. Securities and Exchange Commission (the "SEC") on February 20, 2015, and our condensed consolidated financial statements and the notes thereto included elsewhere in this document. 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; 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," "expect," "intend," "may" or "will," and similar express 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 (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. 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 which 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 2015 to 2014.

- 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.

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- Contractual Obligations and Off-Balance Sheet Arrangements. Overview of contractual obligations, contingent liabilities, commitments and off-balance sheet arrangements outstanding as of June 30, 2015, including expected payment schedule.

- Critical Accounting Estimates. Accounting estimates that we believe are most important to understanding the assumptions and judgments incorporated in our reported financial results and forecasts.

Overview

Control4 is a leading provider of personalized, smart home solutions that are designed to enhance the daily lives of our customers. Our entertainment, smart lighting, comfort and convenience and safety and security solutions unlock the potential of connected devices throughout the house, making entertainment systems easier to use and more accessible, homes more comfortable and energy efficient, and families more secure. Our smart home solutions provide consumers with the ability to integrate audio, video, lighting, temperature, security, communications and other functionalities into a unified home automation solution, customized to match their lifestyle. Our advanced software powers this customized experience, and is delivered through our controller products, cloud services and user-interface products, enabling cohesive interoperability with thousands of connected devices in the home.

Consumers purchase our smart home solutions from our worldwide network of certified independent dealers, regional and national retailers and distributors. These dealers, retailers and distributors design and install customized solutions to fit the specific needs of each consumer, whether it is a one-room home theater set-up or a whole-home automation system that features the integration of audio, video, lighting, temperature, security and communications devices. Our products are installed in both new and existing residences, multi-dwelling units and small commercial facilities. We refer to revenue from sales of our products through these dealers, retailers and distributors as our Core revenue ("Core revenue"). In addition, a portion of our revenue is attributable to sales in the hospitality industry, which is excluded from our calculation of Core revenue. Our revenue from sales to hotels is generally project-based and has been significant in some periods and insignificant in other periods. In the future, we expect revenue from hospitality to continue to be attributable to large projects and will continue to be uneven from period to period. During the six months ended June 30, 2015, we sold our products directly to over 3,400 active direct dealers in the United States, Canada, the United Kingdom and 48 other countries, and partnered with 28 distributors to cover an additional 41 countries where we do not have direct dealer relationships. These distributors sell our solutions through dealers for which they independently provide warehousing, training, technical support, billing and service in each corresponding country.

We derive substantially all of our revenue from the sale of products that contain our proprietary software, which functions as the operating system of the home. We also generate revenue from the sale of annual subscriptions to our 4Sight subscription service, which allows consumers to remotely access and control their home control system from their mobile devices, as well as receive e-mail alerts regarding activities in their home. 4Sight also allows dealers to perform remote diagnostic and programming services.

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,				
	2010	2011	2012	2013	2014
Core revenue	$ 70.9	$ 88.3	$ 105.6	$ 126.4	$ 144.7
Core revenue growth over prior year	26 %	25 %	20 %	20 %	14 %
Other revenue	$ 4.0	$ 5.1	$ 3.9	$ 2.1	$ 4.1
Other revenue changes over prior year	(65) %	28 %	(24) %	(46) %	95 %
Total revenue	$ 74.9	$ 93.4	$ 109.5	$ 128.5	$ 148.8
Total revenue growth over prior year	11 %	25 %	17 %	17 %	16 %

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Over the past five years, we have experienced double digit annual Core revenue growth. Our Core revenue growth during that period has been the result of a combination of both the net addition of new independent dealers and distributors to our sales channels and an increase in revenue from our existing network of independent dealers and distributors. We believe our ability to grow our core sales channel has been enhanced through product innovation and expansion of our product offerings and helping our independent dealers and distributors grow their business and gross margins by providing enhanced dealer installation and marketing tools. For example, over the past twelve months we have announced that we:

- Released a new line of 4K Ultra HD audio and video switches which are fully HDCP 2.2 compliant, enabling consumers to distribute video throughout their home;

- Released Control4® OS 2.7, with enhanced functionality including HD video intercom and support for our award winning product suite which includes:

- New gesture-capable, glass-edge, tabletop and in-wall Control4® Touch Screens, which feature a HD camera, high-quality speakers and microphone, and a fast, high-resolution display providing full frame-rate HD video;

- New wireless thermostat solution including enhanced user interface, built for comfort control and automation, and jointly developed with climate control specialist Aprilaire; and

- New handheld system remote which can provide instant access to entertainment and control of the entire home.

- Released an update to our Composer Express software that simplifies installation and configuration for automated entertainment solutions;

- Partnered with over 120 manufacturers of consumer electronics, security, lighting and HVAC that have now adopted the Control4 Simple Device Discovery Protocol (SDDP), making it easier to connect and integrate their products with one another via the Control4 home automation platform. Manufacturers who have embraced SDDP include household names such as Dish Networks, Panasonic, Sony and TiVo; and

- Introduced new lighting design tools and services to assist our independent dealers in the sales and installation of Control4 wireless and panelized lighting systems.

While our historical revenue growth has been primarily organic, we have completed several small acquisitions which 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 January 2015, we acquired Nexus Technologies Pty Ltd. (“Nexus”), a developer and manufacturer of the Leaf Brand of custom audio/video distribution and switching systems. We previously sold certain Leaf products under our Control4 brand and sold other Leaf Products through our on-line ordering platform. Through this acquisition, we now offer a complete array of video distribution solutions under the Control4 brand to Control4 customers worldwide, gain market share in the growing audio and video (A/V) category, and leverage Leaf’s valuable engineering expertise to develop new and innovative A/V solutions. We determined that the Nexus acquisition is not a significant acquisition under Rule 3-05 of Regulation S-X;

- In September 2014, we acquired Extra Vegetables Limited, a UK-based company that developed integration modules and third-party drivers for Control4 and other third-party home automation systems. The acquired drivers are included in Control4’s driver database and made freely available to Control4’s independent dealers through our installation software, strengthening the Company’s interoperability strategy; and,

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- In July 2014, we acquired the home automation products and related intellectual property assets of Card Access, Inc., an engineering and technology company based in Utah. We previously sold these products through a distribution agreement with Card Access. We determined that the Card Access acquisition is not a significant acquisition under Rule 3-05 of Regulation S-X.

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

We have historically 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 Thanksgiving and Christmas holidays. 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. We generally expect these seasonal 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 ubiquity and growth of network-enabled homes. 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. Our products leverage both wired and wireless technologies and are designed to be installed in both new home construction and existing home remodels. We expect that future increases in either new home construction or existing home renovations will have a positive impact on our revenue.

In new home construction, our builder programs continue to gain traction with regional builders as well as with national builders. Toll Brothers' embrace of Control4 solutions continues to expand, and in December 2014, we signed another leading U.S national home-builder, Ryland Homes, to a similar program and started installation in model homes in select communities. We also plan to continue to engage other regional and national builders in similar strategic alliances. We believe home automation is increasingly becoming a higher priority for home buyers, and we are now well-positioned to benefit from the U.S. housing market resurgence.

Our open platform, with a full assortment of royalty-free, intuitive SDKs, makes it easy for a broad community of OEM partners to participate in our rich, smart home ecosystem, which includes over 8,700 drivers and more than 900 SDDP enabled products. Our broad ecosystem, which includes audio, video, lighting, temperature and security device categories, gives consumers flexibility to integrate nearly any device they wish into their smart home. More importantly, 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 so as 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.

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

- Increasing Adoption Rates of Our Products and Services. We are focused on increasing adoption rates of our products and services through enhancements to our software platform and product offerings. We intend to accomplish these enhancements through both continued investment in research and development activities and acquisitions of complementary businesses and technologies.

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- Increasing Our Brand Awareness. We are committed to grow awareness of the Control4 brand among our dealers, distributors and end consumers. We believe that our investments in creating brand awareness have contributed to our revenue growth and increasing adoption of our smart home solutions. In June 2015, we were named as the top Whole-Home Automation brand by the "2015 CE Pro 100 Brand Analysis" report, with our solutions recognized as the top brand in whole home automation, multi-room audio, HVAC, Energy and Smart Grid Management and Access Control. Also, in June 2015, the ProSource Buying Group, named Control4 the 2015 Custom Integration Vendor of the Year. Continuing to enhance our brand is a key factor in our plans for the future.

- Accelerating and Enhancing Lead Generation. In 2014, we tested a number of lead generation strategies that yielded good responses from interested homeowners. In the process, we discovered the need for Control4 to play a more active role in lead qualification and delivery to dealers to ensure effective follow through and closure. In the first quarter of 2015, we created a small team of telemarketing and inside sales representatives to qualify inbound inquiries and direct them to qualified independent dealers. In its first full quarter of operation, these enhanced lead generation strategies are resulting in increased consultations, bids and project installations. Based on this success, we anticipate rolling out in the third quarter of 2015 a targeted test advertising campaign to accelerate lead generation before the holiday season.

- Optimizing 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.

- Expanding our International Dealer and Distributor Network. We believe that our future growth will be significantly impacted by our ability to expand our dealer and distributor network outside of North America, adapt our products and services to foreign markets and increase our brand awareness internationally. In particular, we believe that we will have significant opportunities to expand our business in emerging markets such as China and India. We have added, and expect to continue to add, field sales and service personnel to assist in the optimization of our international channels. In February 2015, we announced a shift in our distribution model in Germany, and we are now working directly with independent home automation integrators and dealers in that region. To support this initiative, we are adding local staff to manage sales, technical support and training activities.

- Managing Competition. The market for home automation is fragmented, highly competitive and continually evolving. A number of large technology companies such as Apple, Google, and Amazon offer device control capabilities among some of their own products, applications and services and are engaged in ongoing development efforts to address the broader home automation market. 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.

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Key Operating and Financial Metrics

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

North America Direct Dealers

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
Authorized dealers at the beginning of the period	2,543	2,672	2,544	2,676
Additions	94	90	169	174
Terminations	(32)	(58)	(108)	(146)
Authorized dealers at the end of the period	2,605	2,704	2,605	2,704
Number of active dealers	2,547	2,667	2,547	2,667
% of active dealers	98 %	99 %	98 %	99 %

International Direct Dealers

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
Authorized dealers at the beginning of the period	683	836	635	787
Additions	53	53	102	117
Terminations	(4)	(11)	(5)	(26)
Authorized dealers at the end of the period	732	878	732	878
Number of active dealers	640	754	640	754
% of active dealers	87 %	86 %	87 %	86 %

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
Number of controllers sold	17,516	20,908	33,740	34,839
Core revenue growth	13 %	23 %	16 %	13 %
International core revenue as a percentage of total revenue	22 %	22 %	22 %	22 %

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 the Custom Electronics Design and Installation Association ("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. We define an active, authorized dealer ("active dealer") as one that has placed an order with us in the trailing 12-month period.

We continue to invest in tools and technologies to help our dealers be more successful and increase the year-over-year sales of our products. Our goal is to continuously increase our dealers' productivity and capacity to grow. Enabling our dealers to increase productivity will ultimately drive our revenue growth. Late in the third quarter of 2014, we announced the availability of Composer Express, a powerful mobile configuration tool available on iOS and Android to empower our dealers to simplify and accelerate the onsite set-up process for Control4 system

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installations. The positive response from our dealers has been tremendous with the majority of them taking advantage of Composer Express to simplify their installations.

As part of our normal process for developing a productive, capable dealer network, we regularly review individual dealer performance and as necessary, terminate dealer agreements where volume and technical training requirements are not being met. As a result, there are times, including in the first quarters of both 2014 and 2015, when the number of dealer terminations exceed the number of new dealer additions in North America. We view this as a healthy part of growing our customer install direct dealer channel worldwide.

We continue to add new dealers, expanding both our North America and international direct dealer networks. The number of active international dealers increased 11% and 10% for the six months ended June 30, 2014 and 2015, respectively, compared to an increase of 3% and 3%, respectively, in the number of active North American direct dealers during the same periods. The growth percentage internationally is higher because our presence in these markets is less mature and our base of dealers much lower than the North America market. Much of this growth in our International dealer network can be attributed to new dealer additions in China and India as well as a shift in our distribution model in Germany in February of 2015. We previously used a single distributor of our products in Germany, but we now work directly with 43 independent home automation integrators and dealers in that region. We plan to continue to monitor markets which are currently served by a single distributor and, when we feel that the opportunity is right, to establish direct relationships with selected dealers in these regions, which we expect will further increase our number of direct international dealers.

While we believe that we continue to have significant international opportunities, it is difficult to anticipate the exact timing and amount of growth, particularly in new and emerging markets. Divergent regional and local economic and political trends, particularly relating to new home construction and strengthening of the U.S. dollar versus certain local currencies are examples of challenges we must address in order to continue our international expansion. 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 software 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. 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.

During the three and six months ended June 30, 2015, we sold 20,908 and 34,839 controllers, respectively, compared to 17,516 and 33,740 controllers sold in the same periods in 2014, respectively. Controller sales for the three months ended June 30, 2015 increased 19% compared to the same period in 2014. Notwithstanding a steeper than usual seasonal drop off in first quarter 2015 revenue, controller sales increased 3% during the six months ended June 30, 2015, compared to the same period in 2014.

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. 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 attributable to large projects and will continue to be uneven from period to period. We therefore believe that our Core revenue growth is a good measure of our market penetration and the growth of our business.

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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 offices in the United Kingdom, China, India and Australia, and we are in the process of opening an office in Germany. 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.

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 June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
	(in thousands)			
North America Core Revenue	$ 27,744	$ 34,280	$ 51,983	$ 58,670
International Core Revenue	8,161	9,792	15,209	17,167
Other Revenue	756	569	1,324	887
Total Revenue	$ 36,661	$ 44,641	$ 68,516	$ 76,724
North America Core Revenue as a % of Total Revenue	76 %	77 %	76 %	76 %
International Core Revenue as a % of Total Revenue	22 %	22 %	22 %	22 %

North America core revenue increased $6.5 million, or 24%, and $6.7 million, or 13%, respectively, in the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014. International core revenue increased $1.6 million, or 20%, and $2.0 million, or 13%, respectively, in the three and six months ended June 30, 2015, respectively.

During 2015, we released a broad range of new products which began shipping towards the end of the first quarter. We were not able to meet the manufacturing and fulfilment demands created by orders for the new products due to the

short period between when products were released for manufacturing and the end of the quarter. As a result, we closed the first quarter with a new-product backlog of approximately $1.5 million which was higher than typical quarter end new-product backlog amounts. During the second quarter, our supply chain operations team was able to manufacture and ship the product associated with the first quarter new-product backlog as well as reduce end of quarter backlog to customary levels. Total revenue grew $12.6 million or 39% in the second quarter of 2015 compared to the first quarter of 2015.

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.

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 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 Nexus Technologies Pty Ltd. ("Nexus"), we were required to record Nexus inventory at its fair value, as determined under ASC 805, Business Combinations, resulting

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in a step-up in the inventory value. Such step-up is recorded through cost of goods sold when the 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 and six months ended June 30, 2014 and 2015 was as follows (in thousands, except percentages):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
Gross margin	$ 18,967	$ 22,329	$ 35,203	$ 37,940
Percentage of revenue	52 %	50 %	51 %	49 %

As a percentage of revenue, our gross margin decreased from 52% and 51%, respectively, in the three and six months ended June 30, 2014, to 50% and 49%, respectively, during the same period in 2015. The decrease was due primarily to amortization of the technology acquired from Nexus as well as the step-up in basis of purchased inventory, foreign currency translation losses associated with strengthening of the U.S. Dollar relative to certain international currencies, enhancements to our volume incentive rebate program resulting in higher volume incentive rebates provided to our dealers and higher freight charges associated with expedited shipments to our fulfillment centers, offset by component cost reductions.

The negative effect on gross margin percentage resulting from the step-up in purchased inventory carrying value is limited to the first and second quarters of 2015, while the amortization of the acquired technology is expected to occur over 5 years. Our sales in Europe are generally priced in Pounds Sterling or the Euro while our cost of goods sold are denominated in U.S. dollars. The changing value of the Pounds Sterling and the Euro relative to the U.S. Dollar will continue to contribute to variability in our gross margin for sales in Europe.

The impact of manufacturing overhead as a percentage of revenue on our gross margin percentage varies depending on total revenue and overhead spending in a given period. Our gross margin percentage increased in the second quarter of 2015 relative to the first quarter of 2015 as revenue increases resulted in lower fixed manufacturing overhead as a percentage of revenue.

Research and Development Expenses

Research and development expenses consist primarily of compensation for our engineers and product managers. 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.

Research and development expenses for the three and six months ended June 30, 2014 and 2015 were as follows (in thousands, except percentages):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
Research and development	$ 7,097	$ 8,122	$ 13,872	$ 16,117
Percentage of revenue	19 %	18 %	20 %	21 %

Research and development expenses increased $1.0 million, or 14%, and $2.2 million, or 16%, respectively, in the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014. These increases were primarily due to an increase in headcount and related expenses, including non-cash stock based compensation expense, to support our ongoing and expanded product development activities. In addition, manufacturing prototype expenses and compliance and regulatory fees associated with our new product introductions contributed to the year over year increase.

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We expect our research and development expenses to increase in absolute dollars for the foreseeable future as we continue to invest in the development of new solutions; however, we expect those expenses to fluctuate as a percentage of our revenue in future periods based on fluctuations in our revenue and the timing of those expenses.

Sales and Marketing Expenses

Sales and marketing expenses consist primarily of compensation and related travel expenses for our sales and marketing personnel. Sales and marketing expenses also include expenses associated with trade shows, marketing events, advertising and other marketing-related programs.

Sales and marketing expenses for the three and six months ended June 30, 2014 and 2015 were as follows (in thousands, except percentages):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
Sales and marketing	$ 6,364	$ 7,812	$ 12,665	$ 15,179
Percentage of revenue	17 %	17 %	18 %	20 %

Sales and marketing expenses increased $1.4 million, or 23%, and $2.5 million, or 20%, respectively, in the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014. The period over period increases in absolute dollars for sales and marketing expenses was primarily due to sales headcount increases and the related expenses. In addition, we increased our marketing expenses to grow our dealer and distributor networks throughout the world and deliver tools to the sales channel to support local marketing and sales lead generation.

We expect our sales and marketing expenses to increase in absolute dollars for the foreseeable future as we add sales personnel, particularly in our international channel, and continue to invest in marketing to increase awareness of our products and brand. During the second half of 2015, we intend to supplement our more traditional marketing programs and roll-out an online media campaign in the United States to increase consumer leads.

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. Also included in general and administrative expenses are outside legal fees, audit fees, facilities expenses and insurance costs.

General and administrative expenses for the three and six months ended June 30, 2014 and 2015 were as follows (in thousands, except percentages):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
General and administrative	$ 3,440	$ 4,288	$ 7,128	$ 8,909
Percentage of revenue	9 %	10 %	10 %	12 %

General and administrative expenses increased $0.8 million, or 25%, and $1.8 million, or 25%, respectively, in the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014. The increase in absolute dollars is due to $0.6 million in acquisition-related expenses incurred during the first quarter of 2015 associated with the acquisition of Nexus as well as higher non-cash stock based compensation expense and facilities related costs.

We expect our general and administrative expenses to increase in absolute dollars primarily as a result of growth of the business. However, we also expect our general and administrative expenses to fluctuate as a percentage of our revenue in future periods based on fluctuations in our revenue and the timing of those expenses.

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Other Income (Expense)

Other income (expense) consists primarily of foreign currency transaction gains (losses) and net interest income (expense). Other income (expense) for the three and six months ended June 30, 2014 and 2015 was as follows (in thousands, except percentages):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
Other income (expense)	$ 83	$ 112	$ 72	$ (277)
Percentage of revenue	0 %	0 %	0 %	0 %

Other income increased $29,000 and decreased $0.3 million, respectively, in the three and six months ended June 30, 2015, respectively, compared to the same periods in 2014. Other expense incurred during the first quarter of 2015 is primarily related to foreign currency losses sustained on our U.S. dollar obligations that are being carried in local currency by our foreign subsidiaries. This is due to the U.S. dollar strengthening against the Pound Sterling, Euro, and Australian Dollar during the quarter, causing those U.S. dollar obligations, primarily intercompany payable to the U.S. entity, to increase in local currency resulting in increased expense.

During the second quarter, we entered into forward contracts to help offset the exposure to movements in foreign currency exchange rates in relation to certain US dollar denominated balance sheet accounts of our subsidiaries in the United Kingdom and Australia. We settle our foreign exchange contracts on the last day of every month and enter into a new forward contract effective on the first day of the next month. Changes in the fair value (i.e. gains or losses) of these derivative instruments are recorded as other income (expense), net.

Income Tax Expense (Benefit)

Income tax expense (benefit) for the three and six months ended June 30, 2014 and 2015 was as follows (in thousands, except percentages):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
Income tax expense (benefit)	$ 103	$ 178	$ 103	$ (352)
Percentage of income (loss) before taxes	5 %	8 %	7 %	14 %

We recognized an income tax expense of $0.2 million and an income tax benefit of $0.4 million, or approximately 8% and 14% of income (loss) before taxes, for the three and six months ended June 30, 2015, respectively. While we have accumulated net operating loss carryforwards in the US, the expense is driven primarily by those jurisdictions that have generated an income or loss, respectively, through the same periods for which net operating loss carryforwards are not available. We anticipate generating income through the remainder of 2015, which we anticipate will offset losses incurred during the first half of the year. Our effective tax rate is increasing and we believe that our tax expense as a percentage of income before taxes will be in a range between 10-15% for 2015 as a result of foreign income generated by Nexus Technologies Pty Ltd, our subsidiary in Australia.

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 all or a portion of 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.

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Liquidity and Capital Resources

Primary Sources of Liquidity

Our future capital requirements will depend on many factors, including our rate of revenue growth, potential acquisitions of businesses, technologies or other assets, the expansion of our sales and marketing activities, continued investment in research and development, expansion into new territories, the timing of new product introductions, and the continued market acceptance of our products.

The following table shows selected financial information and statistics as of December 31, 2014, and June 30, 2015 (in thousands):

	December 31, 2014	June 30, 2015
Cash and cash equivalents	$ 29,187	$ 17,180
Investments, net(1)	68,032	65,253
Accounts receivable, net	20,155	21,960
Inventories	14,212	18,437
Working capital	97,939	83,518

(1) We account for purchases and sales of investments on a trade-date basis. This is a non-GAAP measure representing the fair market value of our available-for-sale investments on a settlement date basis because from time to time, the investment trade date and the investment settlement date will cross a reporting period. We believe presentation of our investments on a settlement date basis is relevant to readers of our financial statements. Please refer to the Non-GAAP Measures section for a reconciliation of investments to investments, net.

As of June 30, 2015, we had $82.4 million in unrestricted cash and cash equivalents and net marketable securities, a decrease of $14.8 million from December 31, 2014. In addition to the change in cash resulting from business operations, the decrease in cash and cash equivalents and net marketable securities was impacted by the following:

· We purchased Nexus Technologies Pty Ltd for $8.5 million in cash, net of cash acquired of $0.1 million, resulting in net cash paid of $8.4 million. In addition, we incurred approximately $0.6 million in acquisition-related expenses. We anticipate that in future periods, this acquisition will have a positive impact on revenue, gross margin and

income from operations.

- In May 2015, our Board of Directors authorized the repurchase of up to $20 million in Control4 common stock from time to time on the open market. As of June 30, 2015, the Company had repurchased 227,275 shares for $2.1 million.

We typically invest in highly-rated securities, and our investment policy generally limits the amount of credit exposure to any one issuer. The policy requires investments generally to be investment grade, with the primary objective of minimizing the potential risk of principal loss. 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.

We closely monitor accounts receivable and inventory because of their significant impact on cash and working capital. Our accounts receivable balance at June 30, 2015 has increased by $1.8 million, or 9% since December 31, 2014. This increase is in line with revenue growth and we have not seen any deterioration in our long-term collection trends. Furthermore, inventory has increased by $4.2 million from December 31, 2014 to June 30, 2015, of which $2.8 million is raw materials and work in process at our Australian subsidiary which we acquired in January 2015.

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We have historically maintained a revolving credit facility of $13.0 million and for all periods presented we have not borrowed against the facility. At our election, we chose to not renew the revolving credit facility in May 2015 on its maturity date. We believe that we have the ability to obtain similar facilities in the future to support our operations and investing activities as needed.

The SVB Agreement contains various restrictive and financial covenants and we were in compliance with each of these covenants as of June 30, 2015.

We believe that our existing cash and cash equivalents will be sufficient to fund our operations for at least the next 12 months. From time to time, we may explore additional financing sources to develop or enhance our product solutions, to fund expansion of our business, to respond to competitive pressures, or to acquire or invest in complementary products, businesses or technologies. We cannot give assurance that any additional financing will be available to us on acceptable terms, if at all. If we raise additional funds through the issuance of equity or convertible debt or other equity-linked securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges senior to those of holders of our common stock.

Cash Flow Analysis

A summary of our cash flows for the six months ended June 30, 2014 and 2015 is set forth below (in thousands):

	Six Months Ended June 30,	
	2014	2015
Cash and cash equivalents at the beginning of the period	$ 84,546	$ 29,187
Net cash provided by (used in) operating activities	786	(2,601)
Net cash used in investing activities	(70,623)	(7,500)
Net cash provided by (used in) financing activities	3,695	(1,944)
Effect of exchange rate changes on cash and cash equivalents	9	38
Net change in cash and cash equivalents	(66,133)	(12,007)
Cash and cash equivalents at the end of the period	$ 18,413	$ 17,180

Operating Activities

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

The decrease in cash flows from operating activities of $3.4 million during the six months ended June 30, 2015 compared to the same period in 2014 is due primarily to the net loss, as adjusted for certain non-cash operating expenses, for the period and changes in working capital which included increases in inventory associated with the increase in sales

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 from 2014 to 2015, primarily attributable to fewer purchases of marketable securities. This decrease was partially offset by the total consideration transferred for Nexus of $8.5 million in cash, net of cash acquired of $0.1 million, resulting in net cash paid of $8.4 million.

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Financing Activities

Financing cash flows consist primarily of borrowing against and repayment of long term debt and proceeds from the exercise of options to acquire common stock.

During the six months ended June 30, 2014 and 2015, we received proceeds of $4.2 million and $0.7 million, respectively, from the exercise of options to purchase common stock. Additionally, during the six months ended June 30, 2015, we repurchased $2.1 million of our common stock through a stock repurchase program.

Repayments on our term loan agreements were $0.6 million and $0.5 million during the six months ended June 30, 2014 and 2015, respectively.

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 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 resulting from acquisitions, 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 a great extent, to be 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 and (ii) acquisition-related adjustments which include adjustments to acquisition-related items such as being required to record Nexus inventory at its fair value, resulting in a step-up in the inventory value. The step-up 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 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 which 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

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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 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 those expenses.

Management provides a non-GAAP measure representing the fair market value of our available-for-sale investments. We account for purchases and sales of investments on a trade-date basis. This is a non-GAAP measure representing the fair market value of our available-for-sale investments on a settlement date basis because from time to time, the investment trade date and the investment settlement date will cross a reporting period. We believe presentation of our investments on a settlement date basis is relevant to readers of our financial statements.

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.

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
	(in thousands, except percentages and per share data)			
Reconciliation of Gross Margin to Non-GAAP Gross Margin:				
Gross margin	$ 18,967	$ 22,329	$ 35,203	$ 37,940
Stock-based compensation expense in cost of revenue	28	39	48	86
Amortization of intangible assets in cost of revenue	98	379	196	684
Acquisition-related costs in cost of revenue	—	—	—	294
Non-GAAP gross margin	$ 19,093	$ 22,747	$ 35,447	$ 39,004
Revenue	$ 36,661	$ 44,641	$ 68,516	$ 76,724
Gross margin percentage	51.7 %	50.0 %	51.4 %	49.4 %
Non-GAAP gross margin percentage	52.1 %	51.0 %	51.7 %	50.8 %
Reconciliation of Income (Loss) from Operations to Non-GAAP Income from Operations:				
Income (loss) from operations	$ 2,031	$ 2,107	$ 1,503	$ (2,265)
Stock-based compensation expense	1,408	1,679	2,655	3,528
Amortization of intangible assets	98	403	196	728
Acquisition-related costs	—	—	—	886
Litigation settlements	35	—	35	—
Non-GAAP income from operations	$ 3,572	$ 4,189	$ 4,389	$ 2,877
Revenue	$ 36,661	$ 44,641	$ 68,516	$ 76,724
Operating margin percentage	5.5 %	4.7 %	2.2 %	(3.0) %
Non-GAAP operating margin percentage	9.7 %	9.4 %	6.4 %	3.7 %
Reconciliation of Net Income (Loss) to Non-GAAP Net Income:				
Net income (loss)	$ 2,011	$ 2,041	$ 1,472	$ (2,190)
Stock-based compensation expense	1,408	1,679	2,655	3,528
Amortization of intangible assets	98	403	196	728
Acquisition-related costs	—	—	—	886
Litigation settlements	35	—	35	—
Non-GAAP net income	$ 3,552	$ 4,123	$ 4,358	$ 2,952
Non-GAAP net income per common share:				
Basic	$ 0.15	$ 0.17	$ 0.19	$ 0.12
Diluted	$ 0.14	$ 0.16	$ 0.17	$ 0.12
Weighted-average number of shares:				
Basic	23,715	24,309	23,417	24,326
Diluted	25,671	25,296	25,709	25,474
Reconciliation of Investments to Investments, net:				
Short-term investments	$ 47,573	$ 46,118	$ 47,573	$ 46,118
Long-term investments	22,543	19,838	22,543	19,838
Investments payable	(723)	(703)	(723)	(703)
Investments, net	$ 69,393	$ 65,253	$ 69,393	$ 65,253

Off-Balance Sheet Arrangements

During the periods presented, we did not engage in any off-balance sheet activities. We do not have any off-balance interest in variable interest entities, which include special purpose entities and other structured finance entities.

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Contractual Obligations

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

Our contractual cash obligations at June 30, 2015 are as follows:

	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
	(in thousands)				
Long-term debt obligations, including interest(1)	$ 1,760	$ 733	$ 1,027	$ —	$ —
Operating lease obligations	5,313	1,990	3,317	6	—
Purchase commitments	28,144	28,144	—	—	—
Total contractual obligations	$ 35,217	$ 30,867	$ 4,344	$ 6	$ —

(1) Interest was calculated on outstanding borrowings at the date indicated in the table above and assumes the rate remains constant during the following years. The credit facility has a variable rate of interest of prime or LIBOR plus 2.50%, as selected by us. The variable rate was 3.25% at June 30, 2015. Term borrowings are payable in equal monthly payments of principal plus interest and bear interest at prime plus 0.50%, which was 3.75% at June 30, 2015.

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 20, 2015. None of our critical accounting policies and estimates have changed significantly since that filing.

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 20, 2015. Other than our interest rate risk described below, our market risk has not changed significantly since that filing.

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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.

Our exposure to changes in interest rates relates primarily to our investment portfolio. We typically invest in highly-rated securities, and our investment policy generally limits the amount of credit exposure to any one issuer. The policy requires investments generally to be investment grade, with the primary objective of minimizing the potential risk of principal loss.

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 June 30, 2015, a hypothetical 100 basis point increase in interest rates across all maturities would result in a $0.4 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.

Inherent Limitations of Internal Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, does 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.

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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, other than specifically identified below, 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. Currently, a range of loss associated with any individual material legal proceeding cannot be reasonably estimated.

On April 15, 2015, Intuitive Building Controls, Inc. (“IBC”), a corporation organized under the laws of Texas, filed a Complaint against us in the Eastern District of Texas, and we filed our Answer on June 10, 2015. During April 2015, IBC filed similar complaints against many other companies. IBC’s Complaint asserts that the Company’s lighting control systems, specifically including its controllers and in-wall touch screens, infringe three United States patents that IBC owns by assignment: U.S. Patent Nos. 6,118,230 (the “’230 patent”), 6,160,359 (the “’359 patent”) and 5,945,993 (the “’993 patent). The Complaint seeks injunctive relief and monetary damages. Based on our preliminary investigation of the patents at issue, we do not believe our products infringe any valid or enforceable claim of these patents. Accordingly, we are vigorously defending the lawsuit.

On April 28, 2015, the Company received a letter from Certified Measurement, LLC ("Certified Measurement"), alleging that some of our products infringe three patents owned by assignment by Certified Measurement because they acquire physical measurements (such as motion, temperature, lighting, etc.), time-stamp the measurement data, and then perform cryptographic operations. Certified Measurement is a wholly-owned subsidiary of Patent Properties, Inc. ("Patent Properties"). We are conducting an investigation of the claims made by Certified Measurement regarding its three patents. Certified Measurement has not initiated litigation against us, but we believe that Certified Measurement may do so. We intend to defend ourselves vigorously with respect to this and any other related claims or litigation. Since no complaint has been filed and the outcome of any potential legal proceedings related to these claims is uncertain at this time, we cannot estimate the amount of liability, if any, which could result from an adverse resolution of this matter.

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 our business, financial condition or operating results to be harmed substantially and the market price of our stock to decline, perhaps significantly.

Risks Related to Our Business and Industry

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 June 30, 2015, we had an accumulated deficit of $96.1 million. We expect our operating expenses to increase in the future as we expand our operations. Furthermore, as a public company, we incur additional legal, accounting and other expenses that we did not incur as a private company. If our revenue does not grow to offset these increased expenses, we will not remain profitable. 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 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 financial performance will be harmed.

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The markets in which we participate are highly competitive and many companies, including large technology companies, retailers, broadband and security service providers and other managed service providers, are actively targeting the home automation market. Our failure to differentiate ourselves and compete successfully with 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 Apple, Google, and Amazon offer device control capabilities among some of their own products, applications and services and are engaged in ongoing development efforts to address the broader 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 superior products and services. Similarly, many managed service providers, such as cable TV, telephone and security companies, are offering services that provide device control and automation capability within the home for an additional monthly service fee. For example, Comcast's Xfinity service now offers residential security, energy and automation 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 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, most 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 solutio