CONTROL4 CORP
Form 10-Q
August 05, 2016

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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, 2016

OR

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

For the transition period from to .

Commission file number 001-36017

Control4 Corporation

(Exact name of registrant as specified in its charter)

Delaware (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 29, 2016, 23,300,047 shares of the registrant's Common Stock, $0.0001 par value, were outstanding.

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PART I — Financial Information

ITEM 1. Condensed Consolidated Financial Statements

CONTROL4 CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	June 30, 2016 (unaudited)	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 22,807	$ 29,530
Restricted cash	268	296
Short-term investments	20,780	37,761
Accounts receivable, net	22,982	21,322
Inventories	32,775	19,855
Prepaid expenses and other current assets	3,395	3,842
Total current assets	103,007	112,606
Property and equipment, net	6,564	6,584
Long-term investments	5,010	13,716
Intangible assets, net	25,633	4,547
Goodwill	16,615	2,760
Other assets	2,097	1,650
Total assets	$ 158,926	$ 141,863
Liabilities and stockholders’ equity		
Current liabilities:		
Accounts payable	$ 19,484	$ 17,588

Accrued liabilities	7,733	5,880
Deferred revenue	1,303	1,099
Current portion of notes payable	441	727
Total current liabilities	28,961	25,294
Revolving credit line	5,000	—
Notes payable	85	186
Other long-term liabilities	805	938
Total liabilities	34,851	26,418
Commitments and contingencies (Note 11)	—	—
Stockholders’ equity:		
Common stock, $0.0001 par value; 500,000,000 shares authorized; 24,753,839 and 24,590,768 shares issued; 23,171,713 and 23,436,288 shares outstanding at June 30, 2016 and December 31, 2015, respectively	2	2
Treasury stock, at cost; 1,582,126 and 1,154,480 shares at June 30, 2016 and December 31, 2015, respectively	(12,262)	(9,020)
Additional paid-in capital	225,396	220,782
Accumulated deficit	(88,417)	(95,580)
Accumulated other comprehensive loss	(644)	(739)
Total stockholders’ equity	124,075	115,445
Total liabilities and stockholders’ equity	$ 158,926	$ 141,863

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

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CONTROL4 CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
Revenue	$ 53,215	$ 44,641	$ 96,250	$ 76,724
Cost of revenue	27,188	22,312	49,737	38,784
Gross margin	26,027	22,329	46,513	37,940
Operating expenses:				
Research and development	9,039	8,122	17,518	16,117
Sales and marketing	11,114	7,812	21,249	15,179
General and administrative	5,059	4,288	9,872	8,909
Litigation settlement	—	—	400	—
Total operating expenses	25,212	20,222	49,039	40,205
Income (loss) from operations	815	2,107	(2,526)	(2,265)
Other income (expense), net:				
Interest, net	—	42	5	63
Other income (expense), net:	(122)	70	(217)	(340)
Total other income (expense), net	(122)	112	(212)	(277)
Income (loss) before income taxes	693	2,219	(2,738)	(2,542)
Income tax expense (benefit)	169	178	(9,901)	(352)
Net income (loss)	$ 524	$ 2,041	$ 7,163	$ (2,190)
Net income (loss) per common share:				
Basic	$ 0.02	$ 0.08	$ 0.31	$ (0.09)
Diluted	$ 0.02	$ 0.08	$ 0.30	$ (0.09)
Weighted-average number of shares:				
Basic	23,162	24,309	23,248	24,326
Diluted	23,930	25,296	23,958	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,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
Net income (loss)	$ 524	$ 2,041	$ 7,163	$ (2,190)
Other comprehensive income (loss):				
Foreign currency translation adjustment, net of tax	(366)	41	25	(246)
Net unrealized gains (losses) on available-for-sale investments, net of tax	(4)	(12)	70	28
Total other comprehensive income (loss)	(370)	29	95	(218)
Comprehensive income (loss)	$ 154	$ 2,070	$ 7,258	$ (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,	
	2016	2015
	(unaudited)	
Operating activities		
Net income (loss)	$ 7,163	$ (2,190)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation expense	1,573	1,321
Amortization of intangible assets	2,172	728
Provision for doubtful accounts	167	172
Investment premium amortization	216	—
Stock-based compensation	3,950	3,528
Tax benefit from business acquisition	(9,708)	—
Changes in assets and liabilities:		
Accounts receivable	(1,600)	(1,458)
Inventories	(6,940)	(1,912)
Prepaid expenses and other current assets	1,513	(421)
Other assets	(347)	(116)
Accounts payable	1,752	(1,818)
Accrued liabilities	514	(256)
Deferred revenue	212	190
Other long-term liabilities	(462)	(369)
Net cash provided by (used in) operating activities	175	(2,601)
Investing activities		
Purchases of available-for-sale investments	(1,996)	(36,272)
Proceeds from maturities of available-for-sale investments	27,208	39,079
Purchases of property and equipment	(1,171)	(1,927)
Business acquisitions, net of cash acquired	(32,891)	(8,380)
Net cash used in investing activities	(8,850)	(7,500)
Financing activities		
Proceeds from exercise of options for common stock	711	710
Repurchase of common stock	(3,242)	(2,148)
Repayment of notes payable	(387)	(506)

Proceeds from revolving credit facility	5,000	—
Payment of debt issuance costs	(89)	—
Net cash provided by (used in) financing activities	1,993	(1,944)
Effect of exchange rate changes on cash and cash equivalents	(41)	38
Net decrease in cash and cash equivalents	(6,723)	(12,007)
Cash and cash equivalents at beginning of period	29,530	29,187
Cash and cash equivalents at end of period	$ 22,807	$ 17,180
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 104	$ 65
Cash paid for taxes	622	121
Supplemental schedule of non-cash investing and financing activities		
Net unrealized losses on available-for-sale investments	70	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 personalized, smart home solutions that are designed to enhance the daily lives of our customers. The Company's solutions unlock the potential of connected devices throughout a home or business, making entertainment systems easier to use and more accessible, spaces more comfortable and energy efficient, and individuals more secure. The Company was incorporated in the state of Delaware on March 27, 2003.

Unaudited Interim Financial Statements

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

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

Basis of Presentation

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

Segment Reporting

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

Concentrations of Risk

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

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

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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. There was no single foreign country that accounted for more than 10% of total revenue for the three and six months ended June 30, 2016 and 2015. The following table sets forth revenue from U.S., Canadian and all other international dealers and distributors combined (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenue-United States	$ 37,461	$ 30,054	$ 68,836	$ 51,271
Revenue-Canada	4,164	4,122	7,109	7,208
Revenue-all other international sources	11,590	10,465	20,305	18,245
Total revenue	$ 53,215	$ 44,641	$ 96,250	$ 76,724
International revenue (excluding Canada) as a percent of total revenue	22 %	23 %	21 %	24 %

Use of Accounting Estimates

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

Limited Product Warranties

The Company provides its customers a limited product warranty of two years, with the exception of networking products that have a limited product warranty of three years. The limited product warranties require the Company, at its option, to repair or replace defective products during the warranty period at no cost to the customer or refund the purchase price. The Company estimates the costs that may be incurred to replace, repair or issue a refund for defective products and records a reserve at the time revenue is recognized. Factors that affect the Company's warranty liability include the 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 include amounts accrued for products at the time of shipment, adjustments for changes in estimated costs for warranties on products shipped in the period, and changes in estimated costs for warranties on products shipped in prior periods. It is not practicable for the Company to determine the amounts applicable to each of these components.

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

	Warranty Liability
Balance at December 31, 2015	$ 1,415
Warranty costs accrued	902
Warranty claims	(562)
Balance at June 30, 2016	$ 1,755

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Net Income (Loss) Per Share

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Numerator:				
Net income (loss)	$ 524	$ 2,041	$ 7,163	$ (2,190)
Denominator:				
Weighted average common stock outstanding for basic net income (loss) per common share	23,162	24,309	23,248	24,326
Effect of dilutive securities—stock options and restricted stock units	768	987	710	—
Weighted average common shares and dilutive securities outstanding	23,930	25,296	23,958	24,326

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

	Three Months	Six Months Ended

	Ended			
	June 30,		June 30,	
	2016	2015	2016	2015
Options to purchase common stock	2,553	2,417	2,624	4,817
Restricted stock units	2	-	35	-
Total	2,555	2,417	2,659	4,817

Recent Accounting Pronouncements

In March 2016, the FASB issued ASU 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.” The amendments in this update simplify several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU 2016-09 will be effective for the Company in fiscal year 2017, but early adoption is permitted. Any adjustments resulting from the adoption of this standard will be reflected as of the beginning of the fiscal year of adoption. The Company is currently evaluating the impact of this update on the consolidated financial statements.

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

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In July 2015, the FASB issued ASU 2015-11, "Inventory (Subtopic 330) – Simplifying the Measurement of Inventory." This update requires that inventory within the scope of the guidance be measured at the lower of cost and net realizable value. Inventory measured using last-in, first-out (LIFO) and the retail inventory method (RIM) are not impacted by the new guidance. The guidance is effective in fiscal years beginning after December 15, 2016, including interim periods within those years. Prospective application is required. Early adoption is permitted as of the beginning of an interim or annual reporting period. The Company is evaluating the impact of adopting this guidance.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," which amends the guidance in ASC 605, "Revenue Recognition." The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, deferring the effective date of this standard for one year, and 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.

2. Balance Sheet Components

Inventories consisted of the following (in thousands):

	June 30, 2016	December 31, 2015
Finished goods	$ 29,731	$ 16,982
Component parts	2,785	2,575
Work-in-process	259	298
	$ 32,775	$ 19,855

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

	June 30, 2016	December 31, 2015
Computer equipment and software	$ 5,254	$ 4,799
Manufacturing tooling and test equipment	4,678	4,267
Lab and warehouse equipment	3,673	3,376
Leasehold improvements	2,946	2,949
Furniture and fixtures	2,879	2,881
Marketing equipment	748	752
	20,178	19,024
Less: accumulated depreciation	(13,614)	(12,440)
	$ 6,564	$ 6,584

Other assets consisted of the following (in thousands):

	June 30, 2016	December 31, 2015
Deposits	$ 664	$ 933
Prepaid licensing	594	664
Deferred tax asset	817	—
Other	22	53
	$ 2,097	$ 1,650

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Accrued liabilities consisted of the following (in thousands):

	June 30, 2016	December 31, 2015
Sales returns and warranty accruals	$ 3,125	$ 2,508
Compensation accruals	3,121	2,331
Other accrued liabilities	1,487	1,041
	$ 7,733	$ 5,880

3. Financial Instruments

Fair Value Measurements

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

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

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

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

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

Cash, Cash Equivalents and Marketable Securities

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

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

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	June 30, 2016						
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalents	Short-term Investments	Long-term Investments
Cash	$ 11,653	$ —	$ —	$ 11,653	$ 11,653	$ —	$ —
Level 1:							
Money market funds	10,156	—	—	10,156	10,156	—	—
U.S. government notes	999						