CONTROL4 CORP
Form 10-Q
November 04, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2016

OR

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

For the transition period from to .

Commission file number 001-36017

Control4 Corporation

(Exact name of registrant as specified in its charter)

Delaware (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 (do not check if a smaller reporting company)	Smaller reporting company

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

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

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PART I — Financial Information

ITEM 1. Condensed Consolidated Financial Statements

CONTROL4 CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

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

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

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

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CONTROL4 CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

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

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

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CONTROL4 CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

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

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

CONTROL4 CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

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

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

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

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

Unaudited Interim Financial Statements

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

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

Basis of Presentation

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

Segment Reporting

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

Concentrations of Risk

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

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

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

Geographic Information

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

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

Use of Accounting Estimates

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

Limited Product Warranties

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

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

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

Net Income (Loss) Per Share

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

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

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

Weighted average common shares and dilutive securities outstanding

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

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

Recent Accounting Pronouncements

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

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

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

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

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

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2. Balance Sheet Components

Inventories consisted of the following (in thousands):

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

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

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

Other assets consisted of the following (in thousands):

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

Accrued liabilities consisted of the following (in thousands):

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

3. Financial Instruments

Fair Value Measurements

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

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

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

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

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

Cash, Cash Equivalents and Marketable Securities

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

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

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

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

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

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

Fair Value of Other Financial Instruments

The carrying amounts reported in the accompanying consolidated financial statements for cash and cash equivalents, restricted cash, accounts payable and accrued liabilities approximate their fair value because of the short term nature of the accounts. The fair value of the notes payable and the revolving credit facility approximates the carrying value based on the variable nature of interest rates and current market rates available to the Company (see Note 6). As a result, the balance of the notes payable and revolving credit facility is categorized within Level 2 of the fair value hierarchy.

Derivative Financial Instruments

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

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

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

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

4. Acquisitions

Australia Expansion

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

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

Acquisition of Pakedge Device and Software Inc.

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

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

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

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

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

Identifiable Intangible Assets

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

Goodwill

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

Other

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

Pro Forma Information

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

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

Three Months Ended September 30,	Nine Months Ended