

Enphase Energy, Inc.  
 Form 10-Q  
 August 06, 2014  
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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, 2014

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: 001-35480

Enphase Energy, Inc.  
 (Exact name of registrant as specified in its charter)

Delaware  
 (State or other jurisdiction of incorporation or organization) 20-4645388  
 (I.R.S. Employer Identification No.)

1420 N. McDowell Blvd.  
 Petaluma, California 94954  
 (Address of principal executive offices) (Zip Code)

(707) 774-7000  
 (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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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As of July 31, 2014, there were 42,942,058 shares of the registrant's common stock outstanding, \$0.00001 par value per share.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements (Unaudited)

## ENPHASE ENERGY, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

(Unaudited)

	June 30, 2014	December 31, 2013
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$37,621	\$38,190
Accounts receivable, net of allowances of \$2,711 and \$2,000	46,537	32,084
Inventory	15,724	16,580
Prepaid expenses and other	5,588	3,655
Total current assets	105,470	90,509
Property and equipment, net	25,127	24,853
Other assets	1,486	1,307
Total assets	\$132,083	\$116,669
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$19,509	\$7,363
Accrued liabilities	18,983	14,780
Deferred revenues	2,182	2,773
Warranty obligations, current portion (includes \$508 and \$0 measured at fair value at June 30, 2014 and December 31, 2013, respectively)	8,477	4,942
Term loans, current portion	2,805	3,507
Total current liabilities	51,956	33,365
Long-term liabilities:		
Deferred revenues, noncurrent	13,398	11,284
Warranty obligations, noncurrent (includes \$1,298 and \$0 measured at fair value at June 30, 2014 and December 31, 2013, respectively)	24,492	25,490
Other liabilities	1,357	1,154
Term loans, noncurrent	3,726	5,170
Total liabilities	94,929	76,463
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.00001 par value, 10,000 shares authorized; none issued and outstanding	—	—
Common stock, \$0.00001 par value, 100,000 shares authorized; 42,835 and 42,123 shares issued and outstanding as of June 30, 2014 and December 31, 2013, respectively	—	—
Additional paid-in capital	199,124	192,916
Accumulated deficit	(162,206)	(152,939)
Accumulated other comprehensive income	236	229
Total stockholders' equity	37,154	40,206
Total liabilities and stockholders' equity	\$132,083	\$116,669
See notes to condensed consolidated financial statements.		



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## ENPHASE ENERGY, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Net revenues	\$82,004	\$58,167	\$139,584	\$103,744
Cost of revenues	55,172	41,883	94,097	75,259
Gross profit	26,832	16,284	45,487	28,485
Operating expenses:				
Research and development	11,148	8,484	20,234	17,510
Sales and marketing	10,493	7,365	19,321	14,215
General and administrative	7,679	5,926	14,205	11,962
Total operating expenses	29,320	21,775	53,760	43,687
Loss from operations	(2,488	) (5,491	) (8,273	) (15,202
Other income (expense), net:				
Interest expense	(486	) (484	) (935	) (948
Other income (expense)	58	(297	) 165	(346
Total other expense, net	(428	) (781	) (770	) (1,294
Loss before income taxes	(2,916	) (6,272	) (9,043	) (16,496
Provision for income taxes	(115	) (124	) (224	) (306
Net loss	\$(3,031	) \$(6,396	) \$(9,267	) \$(16,802
Net loss per share, basic and diluted	\$(0.07	) \$(0.15	) \$(0.22	) \$(0.41
Shares used in per share calculation, basic and diluted	42,648	41,617	42,428	41,384

See notes to condensed consolidated financial statements.

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## ENPHASE ENERGY, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Net loss	\$ (3,031	) \$ (6,396	) \$ (9,267	) \$ (16,802
Other comprehensive (loss) income:				
Foreign currency translation adjustments	6	219	7	41
Comprehensive loss	\$ (3,025	) \$ (6,177	) \$ (9,260	) \$ (16,761

See notes to condensed consolidated financial statements.

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ENPHASE ENERGY, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (In thousands)  
 (Unaudited)

	Six Months Ended	
	June 30,	
	2014	2013
Cash flows from operating activities:		
Net loss	\$(9,267	) \$(16,802 )
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,902	3,369
Provision for doubtful accounts	711	28
Net loss on disposal of assets	28	31
Non-cash interest expense	191	215
Stock-based compensation	4,507	2,910
Changes in operating assets and liabilities:		
Accounts receivable	(15,164	) (4,389 )
Inventory	856	1,937
Prepaid expenses and other assets	(2,272	) (526 )
Accounts payable, accrued compensation and other accrued liabilities	16,582	(2,265 )
Warranty obligations	2,537	5,439
Deferred revenues	1,523	2,091
Net cash provided by (used in) operating activities	4,134	(7,962 )
Cash flows from investing activities:		
Purchases of property and equipment	(4,333	) (3,467 )
Net cash used in investing activities	(4,333	) (3,467 )
Cash flows from financing activities:		
Repayments of term loans	(2,177	) (1,196 )
Principal payments under capital leases	—	(40 )
Proceeds from issuance of common stock under employee stock plans	1,701	1,534
Net cash (used in) provided by financing activities	(476	) 298
Effect of exchange rate changes on cash	106	(187 )
Net decrease in cash and cash equivalents	(569	) (11,318 )
Cash and cash equivalents—Beginning of period	38,190	45,294
Cash and cash equivalents—End of period	\$37,621	\$33,976
Supplemental disclosures of non-cash investing and financing activities:		
Purchases of property and equipment included in accounts payable	\$675	\$305
See notes to condensed consolidated financial statements.		



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ENPHASE ENERGY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Overview and Summary of Significant Accounting Policies

The Company

Enphase Energy, Inc. (“Enphase” or the “Company”) designs, develops, and sells microinverter systems for the solar photovoltaic industry. The Company’s microinverter system consists of (i) an Enphase microinverter and related accessories that convert direct current (“DC”) power to grid-compliant alternating current (“AC”) power; (ii) an Envoy communications gateway device that collects and transmits performance information from each solar module to the Company’s hosted data center; and (iii) the Enlighten web-based software platform that collects and processes this information to enable customers to monitor and manage their solar power systems. The Company sells microinverter systems primarily to distributors who resell them to solar installers. The Company also sells directly to large installers as well as through original equipment manufacturers (“OEMs”) and strategic partners.

Basis of Presentation and Consolidation

The accompanying condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”). The 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 consolidation.

Certain reclassifications of prior year's balances have been made to conform to current year presentation, including separately presenting balances for “Warranty obligations” in current liabilities on the condensed consolidated balance sheet and under changes in operating assets and liabilities on the condensed consolidated statements of cash flow.

Unaudited Interim Financial Information

These accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”) for interim financial reporting. In the opinion of management, these unaudited condensed consolidated interim financial statements reflect all adjustments, consisting of normal recurring items, considered necessary to present fairly the Company's financial condition, results of operations, comprehensive loss and cash flows for the periods indicated. The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the operating results for the full year. Certain information and footnote disclosures typically included in annual consolidated financial statements have been condensed or omitted. Accordingly, 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 for the year ended December 31, 2013.

Other than as described under “Fair Value Option for Microinverters Sold Since January 1, 2014” below, there have been no material changes in the Company's significant accounting policies since the date of the Company's Annual Report on Form 10-K for the year ended December 31, 2013. Reference is made to the disclosures therein for a summary of all of the Company’s significant accounting policies.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions about future events, and apply judgments that affect the reported amounts of assets, liabilities, revenue, expenses and the related disclosures. Significant estimates and assumptions reflected in the financial statements include revenue recognition, inventory valuation and accrued warranty obligations. Actual results could differ from those estimates.

Fair Value Option for Microinverters Sold Since January 1, 2014

The Company’s warranty obligations related to microinverters sold since January 1, 2014 provide the Company the right, but not the requirement, to assign its warranty obligations to a third-party. Under Accounting Standards Codification (“ASC”) 825—Financial Instruments, (“fair value option”), an entity may choose to elect the fair value option for such warranties at the time it first recognizes the eligible item. The Company made an irrevocable election to account for all eligible warranty obligations associated with microinverters sold since January 1, 2014 at fair value. This election was made to reflect the underlying economics of the time value of money for an obligation that will be

settled over an extended period of up to 25 years. See Note 4—Fair Value Measurements.

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The Company estimates the fair value of warranty obligations by calculating the warranty obligations in the same manner as for sales prior to January 1, 2014 and applying an expected present value technique to that result. The expected present value technique, an income approach, converts future amounts into a single current discounted amount. In addition to the key estimates of failure rates, claim rates and replacement costs, the Company used certain Level 3 inputs which are unobservable and significant to the overall fair value measurement. Such additional assumptions included a discount rate based on the Company's credit-adjusted risk-free rate and compensation comprised of a profit element and risk premium required of a market participant to assume the obligation. Warranty obligations initially recorded at fair value at the time of sale will be subsequently re-measured to fair value at each reporting date. In addition, the fair value of the liability will be accreted over the corresponding term of the warranty of up to 25 years using the interest method. Any changes in fair value of the liability from period-to-period, including accretion expense, will be recognized in cost of revenues. As of June 30, 2014, warranty obligations associated with sales prior to December 31, 2013 were \$31.0 million and warranty obligations associated with sales subsequent to December 31, 2013 were \$1.9 million, of which \$1.8 million were eligible for fair value accounting. The portion of warranty obligations arising from sales subsequent to December 31, 2013 that was not eligible for fair value accounting relates to sales of non-microinverter products. Periodic adjustments necessitated by actual experience of claims and any future changes in estimates to amounts not eligible for fair value accounting will continue to be accounted for on an undiscounted basis.

**Recent Accounting Pronouncements Not Yet Effective**

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers, which will replace most existing revenue recognition guidance under U.S. GAAP. The updated standard is based on the principle that revenue is recognized to depict the transfer of 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. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts. The updated standard becomes effective for the Company in the first quarter of 2017 and permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the potential impact of implementing this ASU on its consolidated financial statements and related disclosures.

**2. INVENTORY**

Inventory as of June 30, 2014 and December 31, 2013 consists of the following (in thousands):

	June 30, 2014	December 31, 2013
Raw materials	\$2,311	\$1,428
Finished goods	13,413	15,152
Total inventory	\$15,724	\$16,580

**3. WARRANTY OBLIGATIONS**

The Company's warranty activities during the three and six months ended June 30, 2014 and 2013 were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Warranty obligations, beginning of period	\$30,728	\$23,895	\$30,432	\$21,338
Accruals for warranties issued during period	1,138	1,936	1,751	3,410
Changes in estimates	2,960	2,664	4,360	4,714
Settlements	(1,893 )	(1,718 )	(3,625 )	(2,685 )
Increase due to accretion expense	20	—	40	—
Other	16	—	11	—
Warranty obligations, end of period	\$32,969	\$26,777	\$32,969	\$26,777
Less current portion			\$(8,477 )	\$(7,987 )
Noncurrent			\$24,492	\$18,790

As of June 30, 2014, the \$33.0 million in warranty obligations included \$1.8 million measured at fair value (see Note 4—Fair Value Measurements).

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## Changes in Estimates

On a quarterly basis, the Company uses the best and most complete underlying information available, following a consistent, systematic and rational methodology to determine its warranty obligations. The Company considers all available evidence to assess the reasonableness of all key assumptions underlying its estimated warranty obligations for each generation of microinverter. The changes in estimates discussed below arose from new information available to management and subsequent developments, and accordingly, from better insight and improved judgment.

For the three and six months ended June 30, 2014, incremental charges from changes in estimates comprised of \$2.9 million and \$3.1 million, respectively, to reflect higher estimated failure rates and \$0.1 million and \$1.3 million, respectively, to reflect higher estimated replacement costs. These incremental charges were primarily related to the Company's second generation microinverter.

For the three and six months ended June 30, 2013, incremental charges from changes in estimates comprised of \$7.2 million and \$8.6 million, respectively, to reflect higher estimated failure rates offset by \$0.3 million and \$0.2 million, respectively, for lower estimated replacement costs. These net incremental charges were primarily related to the Company's second generation microinverter. Other adjustments relate to all product generations and included a \$0.5 million incremental charge for higher estimated replacement costs in the six months ended June 30, 2013. In addition, for the three and six months ended June 30, 2013, the Company updated its projected warranty claim rates for its covered installed base, which reduced warranty expense by \$4.2 million.

## 4. FAIR VALUE MEASUREMENTS

The accounting guidance defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of nonperformance.

The fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. An asset's or liability's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Three levels of inputs may be used to measure fair value:

Level 1—Valuations based on quoted prices in active markets for identical assets or liabilities that the Company is able to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of such assets or liabilities do not entail a significant degree of judgment.

Level 2—Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3—Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

## Financial Instruments

The carrying amounts of the Company's cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate fair value because of the short maturity of those instruments. The carrying amounts of the Company's term loans approximate fair value because they are variable interest rate debt.

## Derivative Instruments

The Company utilizes foreign currency forward contracts from time to time to reduce the impact of foreign currency fluctuations arising from both sales and purchases denominated in Euros and the British Pound Sterling.

The Company did not have any foreign currency forward contracts outstanding at June 30, 2014. The following table presents the Company's financial instruments that were measured at fair value on a recurring basis by level within the fair value hierarchy at December 31, 2013 (in thousands):

	As of December 31, 2013	
	Asset	Liability
	Derivatives	Derivatives
Foreign currency forward contracts (Level 2)	\$ 325	\$ 605



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For the six months ended June 30, 2014 and 2013, the Company recorded net gains related to foreign currency forward contracts of \$50,000 and \$56,000, respectively, in other income (expense), net.

#### Fair Value Option for Warranty Obligations Related to Microinverters Sold Since January 1, 2014

The Company estimates the fair value of warranty obligations by calculating the warranty obligations in the same manner as for sales prior to January 1, 2014 and applying an expected present value technique to that result. The expected present value technique, an income approach, converts future amounts into a single current discounted amount. In addition to the key estimates of failure rates, claim rates and replacement costs, the Company used certain Level 3 inputs which are unobservable and significant to the overall fair value measurement. Such additional assumptions included a discount rate based on the Company's credit-adjusted risk-free rate and compensation comprised of a profit element and risk premium required of a market participant to assume the obligation.

The following table presents the Company's warranty obligations measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the six months ended June 30, 2014 (in thousands):

	Warranty Obligations Measured at Fair Value
Balance—December 31, 2013	\$—
Accruals for warranties issued during period	1,638
Changes in estimates	117
Settlements	—
Increase due to accretion expense	40
Other	11
Balance—June 30, 2014	\$1,806

#### Quantitative and Qualitative Information about Level 3 Fair Value Measurements

As of June 30, 2014, the significant unobservable inputs used in the fair value measurement of the Company's warranty obligations designated as Level 3 are as follows:

Item Measured at Fair Value	Valuation Technique	Description of Significant Unobservable Input	Percent Used
Warranty obligations for microinverters sold since January 1, 2014	Discounted cash flows	Profit element and risk premium	18%
		Credit-adjusted risk-free rate (discount rate)	14%

An increase (decrease) in the profit element and risk premium input in isolation would result in a higher (lower) fair value measurement of the liability. An increase (decrease) in the discount rate in isolation would result in a substantially lower (higher) fair value measurement of the liability.

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## 5. TERM LOANS

The Company's long-term debt at June 30, 2014 and December 31, 2013 consists of the following (in thousands):

	June 30, 2014	December 31, 2013
Term loans	\$6,531	\$7,400
Equipment financing facility, net of unamortized discount of \$0 and \$31, respectively	—	1,277
Total term loans	6,531	8,677
Less current portion	(2,805	) (3,507
Term loans, noncurrent	\$3,726	\$5,170

During the six months ended June 30, 2014, the Company was a party to three debt agreements: (i) a \$50.0 million revolving credit facility (the "Revolver") with Wells Fargo Bank, N.A., (ii) a facility with Hercules Technology Growth Capital, Inc. ("Hercules Facility") consisting of an initial draw in the amount of \$7.4 million under the facility and a commitment to provide an incremental line of credit of up to \$15.6 million through March 31, 2014, and (iii) a \$5.0 million equipment financing facility, also with Hercules. Each of these debt agreements is described in greater detail in the consolidated financial statements and related notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

On February 14, 2014, the Company entered into an amendment to the Revolver which extended the maturity date from November 7, 2015 to November 7, 2016. In addition, the amendment lowered the minimum liquidity covenant in undrawn availability from \$8.0 million to \$5.0 million in cash while maintaining at least \$15.0 million of liquidity (defined as the sum of cash and the borrowing base) at all times. To date, the Company has not drawn on the Revolver.

On March 31, 2014, the undrawn \$15.6 million incremental line of credit under the Hercules Facility expired in accordance with its terms as the Company elected not to renew this incremental line of credit.

On June 1, 2014, the \$5.0 million equipment financing facility with Hercules expired in accordance with its terms and all remaining amounts outstanding were repaid in full.

## 6. COMMITMENTS AND CONTINGENCIES

Contingencies—The Company is not currently involved in any material legal proceedings. The Company may become involved in various legal proceedings and claims that arise in the ordinary course of business. Such matters are subject to uncertainty and there can be no assurance that such legal proceedings will not have a material adverse effect on its business, results of operations, financial position or cash flows.

## 7. STOCK-BASED COMPENSATION

The Company has adopted certain equity incentive and stock purchase plans as described in the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

## Equity Awards Activity

## Stock Options

The following is a summary of stock option activity for the six months ended June 30, 2014 (in thousands, except per share data):

	Number of Shares Outstanding	Weighted- Average Exercise Price per Share
Outstanding at December 31, 2013	8,509	\$3.94
Granted	547	7.82
Exercised	(399	) 2.51
Canceled	(198	) 7.61
Outstanding at June 30, 2014	8,459	4.17





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The intrinsic value of options exercised in the six months ended June 30, 2014 was \$2.1 million. At June 30, 2014, the intrinsic value of options outstanding was \$37.8 million based on the closing share price of the Company's stock as of June 30, 2014.

**Restricted Stock Units**

The following is a summary of restricted stock unit activity for the six months ended June 30, 2014 (in thousands, except per share data):

	Restricted Stock Units	Weighted Average Fair Value per Share at Grant Date
Outstanding at December 31, 2013	418	\$6.31
Granted	1,165	8.44
Vested	(68)	) 6.28
Canceled	(14)	) 7.73
Outstanding at June 30, 2014	1,501	7.95

The total fair value of restricted stock units that vested in the six months ended June 30, 2014 was \$0.5 million. At June 30, 2014, the aggregate intrinsic value of restricted stock units outstanding was \$12.8 million based on the closing share price of the Company's stock as of June 30, 2014.

**Stock-Based Compensation Expense**

Compensation cost for all stock-based awards expected to vest is measured at fair value on the date of grant and recognized ratably over the requisite service period. The following table summarizes the components of total stock-based compensation expense included in the condensed consolidated statements of operations for the periods presented (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Cost of revenues	\$194	\$64	\$343	\$172
Research and development	778	438	1,391	916
Sales and marketing	649	397	1,181	775
General and administrative	873	576	1,592	1,047
Total	\$2,494	\$1,475	\$4,507	\$2,910

The following table summarizes stock-based compensation associated with each type of award for the periods presented (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Stock options and restricted stock units	\$2,309	\$1,432	\$4,148	\$2,717
Employee stock purchase plan	185	43	359	193
Total	\$2,494	\$1,475	\$4,507	\$2,910

**Valuation Assumptions**

The fair value of option awards was estimated on the date of the grant using the Black-Scholes option valuation pricing model with the following input assumptions:

**Expected term**—The expected term of the option awards represents the period of time between the grant date of the option awards and the date the option awards are either exercised, converted or canceled, including an estimate for those option awards still outstanding. The Company used the simplified method, as permitted by the SEC for companies with a limited history of stock option exercise activity, to determine the expected term



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for its option grants.

**Expected volatility**—The expected stock price volatility for option awards granted prior to March 31, 2014 was determined based on an average of the historical volatilities of the common stock of several peer companies with characteristics similar to those of the Company. For option awards granted after March 31, 2014, the Company used a blended volatility estimate consisting of its own historical share price volatility (as the Company had at least two years of historical stock price data) augmented with historical volatility of peer companies for periods preceding the Company's initial public offering such that the time period over which historical volatility data used was at least equal to the expected term of the option award.

**Risk-free interest rate**—The risk-free interest rate was based on the U.S. Treasury yield curve in effect at the time of grant and with a maturity that approximated the Company's expected term.

**Dividend yield**—The dividend yield was based on the Company's dividend history and the anticipated dividend payout over its expected term.

The following table presents the weighted-average assumptions used to estimate the fair values of the stock options granted in the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,		
	2014	2013	2014	2013	
Expected term (in years)	4.3	4.3	4.4	4.4	
Expected volatility	69.5	% 69.7	% 66.4	% 70.3	%
Annual risk-free rate of return	1.4	% 0.6	% 1.4	% 0.7	%
Dividend yield	0.0	% 0.0	% 0.0	% 0.0	%
Weighted average grant date fair value	\$4.24	\$3.74	\$4.13	\$3.59	

The fair value of restricted stock units granted was determined based on the price of the Company's common stock on the date of grant.

As of June 30, 2014, there was approximately \$19.7 million of total unrecognized compensation cost related to unvested equity awards expected to be recognized over a weighted-average period of 2.9 years.

## 8. INCOME TAXES

No provision for U.S. federal or state income taxes has been made due to cumulative losses since the commencement of operations. The Company had a provision for income taxes of \$115,000 and \$124,000 for the three months ended June 30, 2014 and 2013, respectively, and \$224,000 and \$306,000 for the six months ended June 30, 2014 and 2013, respectively. The provision relates to the Company's subsidiaries located outside of the United States.

## 9. CONCENTRATION OF CREDIT RISK AND MAJOR CUSTOMERS

### Revenue Concentration

Two customers represented approximately 30% and 12% of total net revenues for the three months ended June 30, 2014, and 27% and 14% of total net revenues for the six months ended June 30, 2014. The same two customers represented approximately 15% and 11% of total net revenues for the three months ended June 30, 2013, and 14% and 10% of total net revenues for the six months ended June 30, 2013.

### Concentration of Credit Risk

At June 30, 2014, one customer accounted for 33% of net accounts receivable. At December 31, 2013, two customers accounted for 16% and 10% of net accounts receivable, respectively.

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## 10. NET LOSS PER SHARE

The following table presents the computation of basic and diluted net loss per share (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Numerator:				
Net loss	\$(3,031 )	\$(6,396 )	\$(9,267 )	\$(16,802 )
Denominator:				
Weighted average number of common shares outstanding	42,648	41,617	42,428	41,384
Net loss per share, basic and diluted	\$(0.07 )	\$(0.15 )	\$(0.22 )	\$(0.41 )

As the Company incurred a net loss for all periods presented, potential dilutive securities from employee stock options, restricted stock units and warrants have been excluded from the diluted net loss per share computations because the effect of including such shares would have been antidilutive. The following table sets forth the potentially dilutive securities excluded from the computation of the diluted net loss per share (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Employee stock options	8,443	7,878	8,466	7,893
Restricted stock units	1,520	358	1,128	303
Warrants to purchase common stock	261	312	277	322
Total	10,224	8,548	9,871	8,518

## 11. RELATED PARTY TRANSACTIONS

KPCB Holdings, Inc. ("KPCB"), as nominee for certain funds of Kleiner Perkins Caufield & Byers, is a related party which has a significant ownership interest in the Company. Sales of microinverters to entities that are majority-owned by KPCB entities were \$2.1 million in the three and six months ended June 30, 2013. There were no sales to these entities for the three and six months ended June 30, 2014.

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

Forward-Looking Statements

The following discussion and analysis of our financial condition and results of operations should be read together with our condensed consolidated financial statements and the other financial information appearing elsewhere in this Quarterly Report on Form 10-Q. This discussion contains forward-looking statements reflecting our current expectations and involves risks and uncertainties. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "intend," "potential" or the negative of these terms or other comparable terminology. For example, statements regarding our expectations as to future financial performance, expense levels and liquidity sources are forward-looking statements. Our actual results and the timing of events may differ materially from those discussed in our forward-looking statements as a result of various factors, including those discussed below and those discussed in the section entitled "Risk Factors" included in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2013.

Overview

We deliver microinverter technology for the solar industry that increases energy production, simplifies design and installation, improves system uptime and reliability, reduces fire safety risk and provides a platform for intelligent energy management. We were founded in March 2006 and have grown rapidly to become the market leader in the microinverter category. Since our first commercial shipment in mid-2008, we have sold over 5,700,000 microinverters as of June 30, 2014. We currently offer microinverter systems targeting the residential and commercial markets in the United States, Canada, the United Kingdom, France, the Benelux region, certain other European markets and Australia.

We sell our microinverter systems primarily to distributors who resell them to solar installers. We also sell directly to large installers and through original equipment manufacturers ("OEMs"), developers of third party solar financing offerings and strategic partners.

Components of Condensed Consolidated Statements of Operations

Net Revenues

We generate revenues from sales of our microinverter systems, which include microinverter units and related accessories, an Envoy communications gateway device, and our Enlighten web-based monitoring service.

Our revenue is affected by changes in the volume and average selling prices of our microinverter systems, driven by supply and demand, sales incentives, and competitive product offerings. Our revenue growth is dependent on our ability to market our products in a manner that increases awareness for microinverter technology, the continual development and introduction of new products to meet the changing technology and performance requirements of our customers, and the expansion of our customer base.

Cost of Revenues and Gross Profit

Cost of revenues is comprised primarily of product costs, warranty, purchasing and production planning personnel and related expenses, logistics costs, depreciation on manufacturing test equipment and hosting services costs. Our product costs are impacted by technological innovations, such as advances in semiconductor integration and new product introductions, economies of scale resulting in lower component costs, and improvements in production processes and automation. Certain costs, primarily personnel and depreciation on manufacturing test equipment, are not directly affected by sales volume.

We outsource our manufacturing to third-party contract manufacturers and generally negotiate product pricing with them on a quarterly basis. In addition, a contract manufacturer also serves as our logistics provider by warehousing and delivering our products. We believe our contract manufacturing partners have sufficient production capacity to meet the growing demand for our products for the foreseeable future. However, shortages in the supply of certain key raw materials could adversely affect our ability to meet customer demand for our products.

Gross profit may vary from quarter to quarter and is primarily affected by our average selling prices, product cost, product mix, warranty costs, changes in estimates to pre-existing warranties and sales volume fluctuations resulting from seasonality.



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## Operating Expenses

Operating expenses consist of research and development, sales and marketing and general and administrative expenses. Personnel-related costs are the most significant component of each of these expense categories and include salaries and related payroll taxes and benefits, recruiting costs, sales commissions and stock-based compensation. We believe the investments we have made in our corporate infrastructure will enable us to deliver higher levels of net revenues without proportionate increases in research and development, sales and marketing, and general and administrative expenses.

Research and development expense includes personnel-related expenses such as salaries, stock-based compensation and employee benefits. Research and development employees are engaged in the design and development of power electronics, semiconductors, powerline communications and networking and software functionality. Research and development expense also includes third-party design and development costs, testing and evaluation costs, depreciation on research and development related equipment and other indirect costs.

Sales and marketing expense consists primarily of personnel-related expenses such as salaries, commissions, stock-based compensation, employee benefits and travel. It also includes trade shows, marketing, customer support and other indirect costs.

General and administrative expense consists primarily of salaries, stock-based compensation and employee benefits for personnel related to our executive, finance, human resources, information technology and legal organizations. General and administrative expense also includes facilities costs and fees for professional services. Professional services consist primarily of outside legal, accounting and information technology consulting costs.

## Other Income (Expense), Net

Other income (expense), net includes interest income on invested cash balances and interest expense on amounts outstanding under our credit facilities and non-cash interest expense related to the amortization of debt discounts and deferred financing costs. Other income (expense), net also includes transaction gains and losses arising from transactions denominated in a currency other than the functional currency of the entity involved, as well as from foreign currency forward contracts.

## Provision for Income Taxes

We are subject to income taxes in the countries where we sell our products. Historically, we have primarily been subject to taxation in the United States because we have sold the vast majority of our products to customers in the United States. As we have expanded the sale of products to customers outside the United States, we have become subject to taxation based on the foreign statutory rates in the countries where these sales took place. As sales in foreign jurisdictions increase in the future, our effective tax rate may fluctuate accordingly. We have not recorded any U.S. federal or state income tax provision for any of the periods presented because we have experienced operating losses since inception. The provision for income taxes related to our foreign operations was not material for all periods presented. Due to the history of losses we have generated since inception, we have recorded a full valuation allowance on our net deferred tax assets.

## Results of Operations for the Three and Six Months Ended June 30, 2014 and 2013

## Net Revenues

	Three Months Ended June 30,		Change in		Six Months Ended June 30,		Change in		
	2014	2013	\$	%	2014	2013	\$	%	
	(dollars in thousands)				(dollars in thousands)				
Net revenues	\$82,004	\$58,167	\$23,837	41	% \$139,584	\$103,744	\$35,840	35	%

## Three Months Ended June 30, 2014 and 2013

Net revenues increased by 41% for the three months ended June 30, 2014, as compared to the same period in 2013, due to higher volume of microinverter systems sold. We sold 598,000 microinverter units in the three months ended June 30, 2014, compared to 399,000 units in the same period in 2013. The growth in net revenues was primarily driven by increased demand in the U.S., U.K. and Australian solar markets. The favorable impact of the higher volume was partially offset by a decline in the average selling price of our products.





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## Six Months Ended June 30, 2014 and 2013

Net revenues increased by 35% for the six months ended June 30, 2014, as compared to the same period in 2013, due to higher volume of microinverter systems sold. We sold 1,021,000 microinverter units in the six months ended June 30, 2014, compared to 714,000 units in the same period in 2013. The growth in net revenues was primarily driven by increased demand in the U.S., U.K. and Australian solar markets. The favorable impact of the higher volume was partially offset by a decline in the average selling price of our products.

## Cost of Revenues and Gross Profit

	Three Months Ended June 30,				Change in	Six Months Ended June 30,				Change in
	2014	2013	\$	%		2014	2013	\$	%	
	(dollars in thousands)					(dollars in thousands)				
Cost of revenues	\$55,172	\$41,883	\$13,289	32	%	\$94,097	\$75,259	\$18,838	25	%
Gross profit	26,832	16,284	10,548	65	%	45,487	28,485	17,002	60	%
Gross margin	32.7	% 28.0	%			32.6	% 27.5	%		

## Three Months Ended June 30, 2014 and 2013

Cost of revenues for the three months ended June 30, 2014 increased by 32%, or \$13.3 million, as compared to the same period in 2013. Gross margin increased by 4.7 percentage points to 32.7% for the three months ended June 30, 2014, as compared to 28.0% for the same period in 2013. The increase was primarily attributable to a lower per-microinverter unit cost achieved through product cost reductions, higher production efficiencies, a larger sales mix of our fourth generation microinverter and lower warranty expense. Gross margin for the three months ended June 30, 2014 benefited from the favorable impact from measuring our warranty obligations related to microinverters sold since January 1, 2014 at fair value, which improved gross margin by approximately one percentage point. Costs of revenues for the three months ended June 30, 2014 and 2013 included net changes in estimates to previously recorded warranty obligations of \$3.0 million and \$2.7 million, respectively, which reduced gross margin by approximately 3.6 percentage points and 4.6 percentage points, respectively. See Note 3 to the Condensed Consolidated Financial Statements.

## Six Months Ended June 30, 2014 and 2013

Cost of revenues for the six months ended June 30, 2014 increased by 25%, or \$18.8 million, as compared to the same period in 2013. Gross margin increased by 5.1 percentage points to 32.6% for the six months ended June 30, 2014, as compared to 27.5% for the same period in 2013. The increase was primarily attributable to a lower per microinverter-unit cost achieved through product cost reductions, higher production efficiencies, a larger sales mix of our fourth generation microinverter and lower warranty expense. Gross margin for the six months ended June 30, 2014 benefited from the favorable impact from measuring our warranty obligations related to microinverters sold since January 1, 2014 at fair value, which improved gross margin by approximately one percentage point. Costs of revenues for the six months ended June 30, 2014 and 2013 included net changes in estimates to previously recorded warranty obligations of \$4.4 million and \$4.7 million, respectively, which reduced gross margin by approximately 3.1 percentage points and 4.5 percentage points, respectively. See Note 3 to the Condensed Consolidated Financial Statements.

## Research and Development

	Three Months Ended June 30,				Change in	Six Months Ended June 30,				Change in
	2014	2013	\$	%		2014	2013	\$	%	
	(dollars in thousands)					(dollars in thousands)				
Research and development	\$11,148	\$8,484	\$2,664	31	%	\$20,234	\$17,510	\$2,724	16	%
Percentage of net revenues	14	% 15	%			14	% 17	%		

## Three Months Ended June 30, 2014 and 2013

Research and development expenses for the three months ended June 30, 2014 increased by 31%, or \$2.7 million, as compared to the same period in 2013. The increase was primarily attributable to a \$1.8 million in compensation-related costs including growth in headcount and increased employee stock-based compensation expense. The remaining \$0.9 million increase was primarily attributable to third-party development costs and increased prototype material expense. The amount of

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research and development expenses may fluctuate from period to period due to the differing levels and stages of development activity.

**Six Months Ended June 30, 2014 and 2013**

Research and development expenses for the six months ended June 30, 2014 increased by 16%, or \$2.7 million, as compared to the same period in 2013. The increase was primarily attributable to a \$2.2 million increase in compensation-related costs including growth in headcount and increased employee stock-based compensation expense. The remaining \$0.5 million increase was primarily attributable to third-party development costs and increased prototype material expense. The amount of research and development expenses may fluctuate from period to period due to the differing levels and stages of development activity.

We intend to continue to commit significant resources to our research and development efforts because we believe they are essential to maintaining our competitive position. As a result, we anticipate that our research and development expenses will increase on a year-over-year basis for the remainder of 2014.

**Sales and Marketing**

	Three Months Ended June 30,		Change in		Six Months Ended June 30,		Change in		
	2014	2013	\$	%	2014	2013	\$	%	
	(dollars in thousands)				(dollars in thousands)				
Sales and marketing	\$10,493	\$7,365	\$3,128	42	% \$19,321	\$14,215	\$5,106	36	%
Percentage of net revenues	13	% 13	%		14	% 14	%		

**Three Months Ended June 30, 2014 and 2013**

Sales and marketing expenses for the three months ended June 30, 2014 increased by 42%, or \$3.1 million, as compared to the same period in 2013. The increase was primarily attributable to a \$2.2 million increase in compensation-related costs as a result of growth in headcount related to the expansion of our United Kingdom and Australian offices. The remaining difference was primarily due to a \$0.7 million increase in bad debt expense and a \$0.2 million increase related to international expansion efforts.

**Six Months Ended June 30, 2014 and 2013**

Sales and marketing expenses for the six months ended June 30, 2014 increased by 36%, or \$5.1 million, as compared to the same period in 2013. The increase was primarily attributable to a \$3.9 million increase in compensation-related costs as a result of growth in headcount related to the expansion of our United Kingdom and Australian offices. The remaining difference was primarily due to a \$0.7 million increase in bad debt expense and a \$0.5 million increase related to international expansion efforts.

In order to increase the market penetration of our products and grow our business, we intend to continue to commit significant resources to our sales and marketing efforts. As a result, we anticipate that sales and marketing expenses will increase on a year-over-year basis for the remainder of 2014.

**General and Administrative**

	Three Months Ended June 30,		Change in		Six Months Ended June 30,		Change in		
	2014	2013	\$	%	2014	2013	\$	%	
	(dollars in thousands)				(dollars in thousands)				
General and administrative	\$7,679	\$5,926	\$1,753	30	% \$14,205	\$11,962	\$2,243	19	%
Percentage of net revenues	9	% 10	%		10	% 12	%		

**Three Months Ended June 30, 2014 and 2013**

General and administrative expenses for the three months ended June 30, 2014 increased by 30%, or \$1.8 million, as compared to the same period in 2013. The increase was primarily attributable to a \$1.4 million increase in compensation-related costs due to annual salary adjustments, higher incentive compensation and increased stock based compensation. Our



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general and administrative headcount remained relatively flat in the comparable periods. The remaining difference was due to a \$0.4 million increase in professional services expense.

**Six Months Ended June 30, 2014 and 2013**

General and administrative expenses for the six months ended June 30, 2014 increased by 19%, or \$2.2 million, as compared to the same period in 2013. The increase was primarily attributable to a \$1.7 million increase in compensation-related costs due to annual salary adjustments, higher incentive compensation and increased stock based compensation. Our general and administrative headcount remained relatively flat in the comparable periods. In addition, increased professional services expense contributed \$0.7 million to the increase. These increases were partially offset by a \$0.2 million decrease in other corporate-level expenses such as insurance.

We anticipate that general and administrative expenses will increase on a year-over-year basis for the remainder of 2014 as we continue to build our infrastructure to support our anticipated growth.

**Other Income (Expense), Net**

	Three Months Ended June 30,		Change in		Six Months Ended June 30,		Change in	
	2014	2013	\$	%	2014	2013	\$	%
	(dollars in thousands)				(dollars in thousands)			
Other expense, net	\$(428 )	\$(781 )	\$353	(45 )%	\$(770 )	\$(1,294 )	\$524	(40 )%

**Three Months Ended June 30, 2014 and 2013**

Other expense, net, for the three months ended June 30, 2014 decreased by \$0.4 million, as compared to the same period in 2013, primarily attributable to favorable foreign currency exchange movements associated with transactions denominated in foreign currencies.

**Six Months Ended June 30, 2014 and 2013**

Other expense, net, for the six months ended June 30, 2014 decreased by \$0.5 million, as compared to the same period in 2013, primarily attributable to favorable foreign currency exchange movements associated with transactions denominated in foreign currencies.

**Liquidity and Capital Resources**

Historically, we funded our operations with proceeds from sale of our equity securities and borrowings from term loans. Our primary uses of cash are operating costs, working capital needs, capital expenditures and debt service requirements. Our future capital requirements are affected by many factors, including our rate of revenue growth; the expansion of our sales and marketing activities; the timing and extent of spending to support product development efforts; and the timing of introductions of new products and enhancements to existing products.

As of June 30, 2014, we had \$37.6 million in cash and cash equivalents, which is held primarily in non-interest bearing checking accounts, and \$53.5 million in working capital. We believe our current cash and cash equivalents, together with borrowings available under our working capital facility, will be adequate to fund our debt obligations as well as our planned capital expenditures and operations over the next 12 months. If additional sources of liquidity are needed, we may consider new debt or equity offerings, but there is no assurance that such transactions could be consummated on acceptable terms or at all. Failure to raise sufficient capital when needed could have a material adverse effect on our business, results of operations and financial position.

The following table summarizes our cash flows for the periods indicated:

	Six Months Ended June 30,	
	2014	2013
	(In thousands)	
Net cash provided by (used in) operating activities	\$4,134	\$(7,962 )
Net cash used in investing activities	(4,333 )	(3,467 )
Net cash (used in) provided by financing activities	(476 )	298

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### Operating Activities

For the six months ended June 30, 2014, net cash provided by operating activities of \$4.1 million consisted of a net loss of \$9.3 million, offset by non-cash charges of \$9.3 million and a net cash inflow from changes in operating assets and liabilities of \$4.1 million. Non-cash charges primarily consisted of stock-based compensation of \$4.5 million, depreciation and amortization of \$3.9 million and provisions for doubtful accounts of \$0.7 million. The increase in cash provided by operating assets and liabilities was primarily attributable to a \$16.6 million increase in accounts payable, accrued compensation and other accrued liabilities, which was partially offset by an increase of \$15.2 million in accounts receivable and a \$2.3 million increase to prepaid expenses and other assets. The increase in accounts payable was the result of higher business volume and the timing of vendor payments. The increase in accrued liabilities included higher anticipated purchase volume rebates earned by customers under our sales incentive programs. The increase in accounts receivable was reflective of the overall growth in revenues. The increase in other assets includes replacement units on-hand for use in servicing our warranty obligations. During the six months ended June 30, 2014, inventory decreased by \$0.9 million as a result of the higher than anticipated demand for our microinverter systems in the second quarter of 2014. In addition, cash from operating activities benefited from a \$1.5 million increase in deferred revenues related to sales of our Enlighten web-based monitoring service and a \$2.5 million increase in warranty obligations due to increased sales of microinverters.

For the six months ended June 30, 2013, net cash used in operating activities of \$8.0 million was primarily attributable to a net loss of \$16.8 million, which was partially offset by non-cash charges of \$3.4 million in depreciation and amortization and \$2.9 million in stock-based compensation. In addition, cash provided by net changes in operating assets and liabilities was \$2.3 million. Sources of cash totaled \$9.5 million resulting from a decrease of \$1.9 million in inventory, an increase of \$5.4 million in warranty obligations and an increase of \$2.1 million in deferred revenues.

The \$1.9 million decrease in inventory was a result of improvements in working capital management. The \$5.4 million increase in warranty obligations was attributable to incremental charges from changes in estimates as well as higher volume of microinverters sold. The increase in deferred revenue of \$2.1 million relates to sales of our Enlighten web-based monitoring service. Uses of cash included a \$4.4 million increase in accounts receivable, a \$2.3 million decrease in accounts payable, accrued compensation and other accrued liabilities and a \$0.5 million increase in prepaid expenses and other assets. The increase in accounts receivable was primarily due to the more linear sales pattern in fourth quarter of 2012 compared to the second quarter of 2013. The decrease in accounts payable, accrued compensation and other accrued liabilities was attributable to the timing of vendor payments as well as incentive compensation payments.

### Investing Activities

For the six months ended June 30, 2014, net cash used in investing activities was \$4.3 million, primarily as a result of purchases of test and assembly equipment as well as additions to internally developed software.

For the six months ended June 30, 2013, net cash used in investing activities was \$3.5 million, primarily as a result of purchases of test and assembly equipment as well as additions to internally developed software.

### Financing Activities

For the six months ended June 30, 2014, net cash used in financing activities of \$0.5 million was attributable to \$2.2 million in principal repayments of outstanding term loans. The outflow of cash was offset by \$1.0 million in cash received from common stock issuance pursuant to our employee equity incentive plans and \$0.7 million in proceeds from our employee stock purchases under our employee stock purchase plan.

For the six months ended June 30, 2013, net cash provided by financing activities was \$0.3 million and consisted of \$1.1 million in cash received from common stock issuance pursuant to our employee equity incentive plans and \$0.4 million in proceeds from our employee stock purchases under our employee stock purchase plan. These inflows of cash were offset by \$1.2 million in principal repayments of outstanding term loans.

### Debt Agreements

During the six months ended June 30, 2014, we were a party to three debt agreements: (i) a \$50.0 million revolving credit facility (the "Revolver") with Wells Fargo Bank, N.A., (ii) a facility with Hercules Technology Growth Capital, Inc. ("Hercules Facility") consisting of an initial draw in the amount of \$7.4 million under the facility and a commitment to provide an incremental line of credit of up to \$15.6 million through March 31, 2014, and (iii) a \$5.0 million

equipment financing facility, also with Hercules. Each of these debt agreements is described in greater detail in the consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2013.



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On February 14, 2014, we entered into an amendment to the Revolver which extended the maturity date from November 7, 2015 to November 7, 2016. In addition, the amendment lowered the minimum liquidity covenant in undrawn availability from \$8.0 million to \$5.0 million in cash while maintaining at least \$15.0 million of liquidity (defined as the sum of cash and the borrowing base) at all times. To date, we have not drawn on the Revolver.

On March 31, 2014, the undrawn \$15.6 million incremental line of credit under the Hercules Facility expired in accordance with its terms as we elected not to renew the incremental line of credit. As of June 30, 2014, the outstanding principal balance under the Hercules Facility was \$6.5 million.

On June 1, 2014, the \$5.0 million equipment financing facility with Hercules expired in accordance with its terms and all remaining amounts outstanding were repaid in full.

**Contractual Obligations**

Other than as described under “Debt Agreements” above, our contractual obligations as of June 30, 2014 have not materially changed from the amounts set forth in our Annual Report on Form 10-K for the year ended December 31, 2013.

**Off-Balance Sheet Arrangements**

As of June 30, 2014, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

**Critical Accounting Policies and Significant Management Estimates**

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the U.S., or GAAP. In connection with the preparation of our condensed consolidated financial statements, we are required to make assumptions and estimates about future events, and apply judgments that affect the reported amounts of assets, liabilities, revenue, expenses and the related disclosures. We base our assumptions, estimates and judgments on historical experience, current trends and other factors that management believes to be relevant at the time our consolidated financial statements are prepared. On a regular basis, we review the accounting policies, assumptions, estimates and judgments to ensure that our consolidated financial statements are presented fairly and in accordance with GAAP. However, because future events and their effects cannot be determined with certainty, actual results could differ from our assumptions and estimates. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.

We consider an accounting policy to be critical if it is important to our financial condition and results of operations, and if it entails significant judgment, subjectivity and complexity on the part of management in its application. Other than as described under “Fair Value Option for Microinverters Sold Since January 1, 2014” below, there have been no material changes to the items that we disclosed as our critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2013.

**Fair Value Option for Microinverters Sold Since January 1, 2014**

Our warranty obligations related to microinverters sold since January 1, 2014 provide us the right, but not the requirement, to assign our warranty obligations to a third-party. Under Accounting Standards Codification (“ASC”) 825—Financial Instruments, (“fair value option”), an entity may choose to elect the fair value option for such warranties at the time it first recognizes the eligible item. We made an irrevocable election to account for all eligible warranty obligations associated with microinverters sold since January 1, 2014 at fair value. This election was made to reflect the underlying economics of the time value of money for an obligation that will be settled over an extended period of up to 25 years. See Note 4—Fair Value Measurements.

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We estimate the fair value of warranty obligations by calculating the warranty obligations in the same manner as for sales prior to January 1, 2014 and applying an expected present value technique to that result. The expected present value technique, an income approach, converts future amounts into a single current discounted amount. In addition to the key estimates of failure rates, claim rates and replacement costs, we used certain Level 3 inputs which are unobservable and significant to the overall fair value measurement. Such additional assumptions included a discount rate based on our credit-adjusted risk-free rate and compensation comprised of a profit element and risk premium required of a market participant to assume the obligation. Warranty obligations initially recorded at fair value at the time of sale will be subsequently re-measured to fair value at each reporting date. In addition, the fair value of the liability will be accreted over the corresponding term of the warranty of up to 25 years using the interest method. Any changes in fair value of the liability from period-to-period, including accretion expense, will be recognized in cost of revenues. As of June 30, 2014, warranty obligations associated with sales prior to December 31, 2013 were \$31.0 million and warranty obligations associated with sales subsequent to December 31, 2013 were \$1.9 million, of which \$1.8 million were eligible for fair value accounting. The portion of warranty obligations arising from sales subsequent to December 31, 2013 that was not eligible for fair value accounting relates to sales of non-microinverter products. Periodic adjustments necessitated by actual experience of claims and any future changes in estimates to amounts not eligible for fair value accounting will continue to be accounted for on an undiscounted basis.

### Recent Accounting Pronouncements Not Yet Effective

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers, which will replace most existing revenue recognition guidance under U.S. GAAP. The updated standard is based on the principle that revenue is recognized to depict the transfer of 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. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts. The updated standard becomes effective for us in the first quarter of 2017 and permits the use of either the retrospective or cumulative effect transition method. We are evaluating the potential impact of implementing this ASU on our consolidated financial statements and related disclosures.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

We operate and conduct business in foreign countries where our foreign entities use the local currency as their respective functional currency and, as a result, are exposed to movements in foreign currency exchange rates. More specifically, we face foreign currency exposure from the effect of fluctuating exchange rates on payables and receivables denominated in Euro, British Pounds Sterling, New Zealand Dollars and Australian Dollars. These payables and receivables primarily arise from both sales and purchases denominated in foreign currencies, as well as intercompany transactions. We also face currency exposure that arises from translating the results of our European, New Zealand and Australian operations, including sales and marketing and research and development expenses, to the U.S. dollar at exchange rates that have fluctuated from the beginning of a reporting period.

From time to time, we utilize foreign currency forward contracts to reduce the impact of foreign currency fluctuations. The contracts we enter into typically have maturities of less than one year. We do not enter into derivative financial instruments for trading or speculative purposes. The foreign currency forward contracts are accounted for as derivatives whereby the fair value of the contracts is reported as other current assets or current liabilities in the accompanying condensed consolidated balance sheets, and gains and losses resulting from changes in the fair value are reported in other income (expense), net, in the accompanying condensed consolidated statements of operations. We did not have any foreign currency forward contracts outstanding at June 30, 2014. At December 31, 2013, the aggregate gross notional amounts of outstanding foreign currency forward contracts were \$12.5 million, all of which matured on January 15, 2014.

### 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, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2014. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or

the Exchange Act, includes, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required

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disclosure. Based on the evaluation of our disclosure controls and procedures as of June 30, 2014, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Changes in Internal Control

There were no changes in our internal control over financial reporting identified in management's evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the period covered by this Quarterly Report that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we may be involved in litigation relating to claims arising out of our operations. We are not currently involved in any material legal proceedings. We may, however, be involved in material legal proceedings in the future. Such matters are subject to uncertainty and there can be no assurance that such legal proceedings will not have a material adverse effect on our business, results of operations, financial position or cash flows.

Item 1A. Risk Factors

We have identified the following risks and uncertainties that may have a material adverse effect on our business, financial condition or results of operations. The risks described below are not the only ones we face. Additional risks not presently known to us or that we currently believe are not material may also significantly impair our business operations. Our business could be harmed by any of these risks. The trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment. In assessing these risks, you should also refer to the other information contained in this Quarterly Report on Form 10-Q, including our condensed consolidated financial statements and related notes.

We have marked with an asterisk (\*) those risks described below that reflect substantive changes from, or additions to, the risks described in our Annual Report on Form 10-K for the year ended December 31, 2013.

\*We have a history of losses which may continue in the future, and we cannot be certain that we will achieve or sustain profitability.

We have incurred net losses in each quarter since inception, and we may continue to incur additional net losses in the future. We incurred net losses of \$9.3 million for the six months ended June 30, 2014. As of June 30, 2014, we had an accumulated deficit of \$162.2 million. Our revenue growth may slow or revenue may decline for a number of possible reasons, many of which are outside our control, including a decline in demand for our offerings, increased competition, a decrease in the growth of the solar industry or our market share, or our failure to continue to capitalize on growth opportunities. If we fail to generate sufficient revenue to support our operations, we may not be able to achieve or sustain profitability.

Our limited operating history makes it difficult to evaluate our current business and future prospects.

We have been in existence since 2006 and did not begin shipping our products in commercial quantities until mid-2008. Much of our growth has occurred in recent periods. Our limited operating history makes it difficult to evaluate our current business and future prospects. We have encountered and will continue to encounter risks and difficulties frequently experienced by growing companies in rapidly changing industries, including increased expenses as we continue to grow our business. If we do not manage these risks and overcome these difficulties successfully, our business will suffer.

Since we began commercial shipments of our products, our revenue, gross profit and results of operations have varied and are likely to continue to vary from quarter to quarter due to a number of factors, many of which are not within our control. It is difficult for us to accurately forecast our future revenue and gross profit and plan expenses accordingly and, therefore, it is difficult for us to predict our future results of operations.

Further, our efforts to achieve broader market acceptance for our microinverter systems and to expand beyond our existing markets may never succeed, which would adversely impact our ability to generate additional revenue or become profitable.

If demand for solar energy solutions does not continue to grow or grows at a slower rate than we anticipate, our business will suffer.

Our microinverter systems are utilized in solar photovoltaic, or PV, installations, which provide on-site distributed power generation. As a result, our future success depends on continued demand for solar energy solutions and the ability of solar equipment vendors to meet this demand. The solar industry is an evolving industry that has experienced substantial changes in recent years, and we cannot be certain that consumers and businesses will adopt solar PV systems as an alternative energy source at levels sufficient to continue to grow our business. Traditional electricity distribution is based on the regulated industry model whereby businesses and consumers obtain their electricity from a government regulated utility. For alternative methods of distributed power to succeed, businesses

and consumers must adopt new purchasing practices. The viability and continued growth in demand for solar energy solutions, and in turn, our products, may be impacted by many factors outside of our control, including:

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market acceptance of solar PV systems based on our product platform;  
cost competitiveness, reliability and performance of solar PV systems compared to conventional and non-solar renewable energy sources and products;  
availability and amount of government subsidies and incentives to support the development and deployment of solar energy solutions;  
the extent to which the electric power industry and broader energy industries are deregulated to permit broader adoption of solar electricity generation;  
the cost and availability of key raw materials and components used in the production of solar PV systems;  
prices of traditional carbon-based energy sources;  
levels of investment by end-users of solar energy products, which tend to decrease when economic growth slows; and  
the emergence, continuance or success of, or increased government support for, other alternative energy generation technologies and products.

If demand for solar energy solutions fails to develop sufficiently, demand for our customers' products as well as demand for our products will decrease, which would have an adverse impact on our ability to increase our revenue and grow our business.

Short-term demand and supply imbalances, especially for solar module technology, recently have caused prices for solar technology solutions to decline rapidly. Furthermore, competition in the solar industry has increased due to the emergence of Asian manufacturers along the entire solar value chain causing further price declines, excess inventory and oversupply. These market disruptions may continue to occur and may increase pressure to reduce prices, which could adversely affect our business and financial results.

The reduction, elimination or expiration of government subsidies and economic incentives for on-grid solar electricity applications could reduce demand for solar PV systems and harm our business.

The market for on-grid applications, where solar power is used to supplement a customer's electricity purchased from the utility network or sold to a utility under tariff, depends in large part on the availability and size of government and economic incentives that vary by geographic market. Because our customers' sales are typically into the on-grid market, the reduction, elimination or expiration of government subsidies and economic incentives for on-grid solar electricity may negatively affect the competitiveness of solar electricity relative to conventional and non-solar renewable sources of electricity, and could harm or halt the growth of the solar electricity industry and our business.

In general, the cost of solar power currently exceeds retail electricity rates, and we believe this tendency will continue in the near term. As a result, national, state and local government bodies in many countries, most notably Australia, Canada, France, Belgium, Germany, Italy, Japan, the People's Republic of China, the United Kingdom, Spain and the United States, have provided incentives in the form of feed-in tariffs, or FiTs, rebates, tax credits and other incentives to system owners, distributors, system integrators and manufacturers of solar PV systems to promote the use of solar electricity in on-grid applications and to reduce dependency on other forms of energy. Many of these government incentives expire, phase out over time, terminate upon the exhaustion of the allocated funding, require renewal by the applicable authority or are being changed by governments due to changing market circumstances or changes to national, state or local energy policy.

Electric utility companies or generators of electricity from other non-solar renewable sources of electricity may successfully lobby for changes in the relevant legislation in their markets that are harmful to the solar industry. Reductions in, or eliminations or expirations of, governmental incentives in regions that we focus our sales efforts could result in decreased demand for and lower revenue from solar PV systems there, which would adversely affect sales of our products. In addition, our ability to successfully penetrate new geographic markets may depend on new countries adopting and maintaining incentives to promote solar electricity, to the extent such incentives are not currently in place. Additionally, electric utility companies may establish pricing structures or interconnection requirements that could adversely affect our sales and be harmful to the solar and distributed rooftop solar generation industry.

Our focus on a limited number of specific markets increases risks associated with the elimination or expiration of governmental subsidies and economic incentives for on-grid solar electricity applications.

To date, we have generated substantially all of our revenues from North America and expect to continue to generate a substantial amount of our revenues from North America in the future. There are a number of important incentives that are

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expected to phase-out or terminate in the future, which could adversely affect sales of our products. A substantial majority of our revenues come from the United States, which has both federal and state incentives. The Renewable Energy and Job Creation Act of 2008 provides a 30% federal tax credit for residential and commercial solar installations, which expire on December 31, 2016. The American Recovery and Reinvestment Act of 2009, as amended, created a renewable energy grant program that offered cash payments in lieu of investment tax credits to renewable energy project developers for eligible property placed in service prior to December 31, 2011 or placed in service by the specified credit termination date, if construction began prior to December 31, 2011. We believe the tax credit and grant programs have had a positive effect on our sales since inception. However, unless the tax credit program is further extended, the eventual phase-out of this program could adversely affect sales of our products in the future.

California is the largest single solar market in the United States, based on analysis from SEIA data and GTM Research, and a significant portion of our revenues are generated in California. In 2007, the State of California launched its 10-year, \$3 billion “Go Solar California” campaign, which encourages the installation of an aggregate of 3,000 MW of solar energy systems in homes and businesses by the end of 2016. The largest part of the campaign, the “California Solar Initiative,” provides rebates and performance-based incentives which decrease in intervals as installation thresholds are met. The “Go Solar California” program is scheduled to expire on December 31, 2016, but the pace of installations has been high and the program is likely to conclude sooner. Both Pacific Gas and Electric and San Diego Gas and Electric have surpassed all installation thresholds in the residential sector and are no longer accepting applications. Pacific Gas and Electric is placing all new applications for the commercial sector on a waiting list, and these applications may not be able to receive incentives. Programs for other utilities and market segments continue, but could conclude prior to December 31, 2016 if installations continue at their current pace.

We also sell our products in Ontario, Canada. The Ontario Power Authority Green Energy and Green Economy Act of 2009 created two separate FiT programs for projects greater than 10kW and for projects less than 10kW. These FiT programs provide participants with a fixed price for electricity produced over a 20-year contract term. Both programs were recently suspended while they underwent a review. The program for projects less than 10kW was re-opened to new applications in July 2012 with a procurement target of 50 MW. The program for projects between 10kW and 500kW was re-opened for new applications between December 14, 2012 and January 18, 2013 with a procurement target of 200 MW. The Government of Ontario has announced plans for annual procurement targets of 50MW of projects under 10kW and 150MW of projects between 10kW and 500kW through 2017. However, all procurement occurs at the direction of the Government of Ontario and these plans could change, or market conditions could result in procurement targets not being met. Furthermore, the Government of Ontario has the authority to change the FiTs for future contracts at its discretion, and has the authority to modify, suspend, or discontinue the program at any time. Suspension of the FiT program in Ontario directly impacted and could continue to impact our business. Furthermore, any future suspension or modification of the program could negatively affect our business, financial condition and results of operations.

In the fourth quarter of 2011, we began selling our products in France, Italy and the Benelux region. During the second quarter of 2012, we opened a sales office in the United Kingdom and began selling our products there at the beginning of the third quarter. A number of European countries, including Germany, Belgium and the United Kingdom, have adopted reductions to their FiTs, Spain announced a suspension of its FiT for new renewable energy projects in January 2012 and Italy concluded its FiT program in July 2013. Certain countries, notably Greece and Spain, have proposed or enacted taxes levied on renewable energy. These and related developments have significantly impacted the solar industry in Europe and may adversely affect the future demand for the solar energy solutions in Europe. The reductions in European tariffs and subsidies and other requirements or incentives, including local content requirements or incentives, have negatively affected and may continue to negatively affect our business, financial condition and results of operations as we seek to increase our sales in Europe.

In the first quarter of 2013, we began selling our products in Australia. In 2012, Australia enacted a national price on carbon emissions intended to increase the cost of traditional energy sources, thereby making renewable energy sources more attractive. Beginning in 2012, several states in Australia began to gradually reduce their FiTs. As of October 2013, all FiT programs in Australia expired. Australia recently elected a new national government. The new

leadership has pledged to revise national energy policy, including potentially reducing Australia's renewable energy target and revising certain renewable energy financing mechanisms. In July 2014, the new leadership successfully repealed the tax on carbon emissions. The reductions in incentives and uncertainty around future energy policy may negatively affect our business financial condition, and results of operations as we seek to increase our business in Australia. Additionally, as we further expand to other countries, changes in incentive programs or electricity policies could negatively affect returns on our investments in those countries as well as our business, financial condition, and results of operations.

The threat of continuing global economic, capital markets and credit disruptions, including sovereign debt issues, pose risks for our business.

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The threat of continuing global economic, capital markets and credit disruptions, including the sovereign debt issues in Europe, pose risks for our business. These risks include slower economic activity and investment in projects that make use of our products and services. These economic developments, particularly decreased credit availability, have reduced demand for solar products. The European sovereign debt crisis has caused and may continue to cause European governments to reduce, eliminate or allow to expire government subsidies and economic incentives for solar energy, which could limit our growth or cause our net sales to decline and materially and adversely affect our business, financial condition, and results of operations. These conditions, including reduced incentives, continued decreases in credit availability, as well as continued economic instability, have and may continue to adversely impact our business, financial condition and results of operations as we seek to increase our sales in Europe. Our microinverter systems may not achieve broader market acceptance, which would prevent us from increasing our revenue and market share.

If we fail to achieve broader market acceptance of our products, there would be an adverse impact on our ability to increase our revenue, gain market share and achieve and sustain profitability. Our ability to achieve broader market acceptance for our products will be impacted by a number of factors, including:

- our ability to timely introduce and complete new designs and timely qualify and certify our products;
- whether installers, system owners and solar financing providers will continue to adopt our microinverter systems, which is a relatively new technology with a limited history with respect to reliability and performance;
- whether installers, system owners and solar financing providers will be willing to purchase microinverter systems from us given our limited operating history;
- the ability of prospective system owners to obtain long-term financing for solar PV installations based on our product platform on acceptable terms or at all;
- our ability to produce microinverter systems that compete favorably against other solutions on the basis of price, quality, reliability and performance;
- our ability to develop products that comply with local standards and regulatory requirements, as well as potential in-country manufacturing requirements; and
- our ability to develop and maintain successful relationships with our customers and suppliers.

In addition, our ability to achieve increased market share will depend on our ability to increase sales to established solar installers, who have traditionally sold central inverters. These installers often have made substantial investments in design, installation resources and training in traditional central inverter systems, which may create challenges for us to achieve their adoption of our microinverter systems.

Our gross profit may fluctuate over time, which could impair our ability to achieve or maintain profitability.

Our gross profit has varied in the past and is likely to continue to vary significantly from period to period. Our gross profit may be adversely affected by numerous factors, some of which are beyond our control, including:

- changes in customer, geographic or product mix;
- increased price competition, including the impact of customer discounts and rebates; ability to reduce and control product costs;
- warranty costs and reserves, including changes resulting from changes in estimates related to the long-term performance of our products, product replacement costs and warranty claim rates;
- loss of cost savings due to changes in component or raw material pricing or charges incurred due to inventory holding periods if product demand is not correctly anticipated;
- introduction of new products;
- ordering patterns from our distributors;
- price reductions on older products to sell remaining inventory;
- our ability to reduce production costs, such as through technology innovations, in order to offset price declines in older products over time;
- changes in shipment volume;



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changes in distribution channels;  
excess and obsolete inventory and inventory holding charges; and  
expediting costs incurred to meet customer delivery requirements.

Fluctuations in gross profit may adversely affect our ability to manage our business or achieve or maintain profitability.

The inverter industry is highly competitive and we expect to face increased competition as new and existing competitors introduce microinverter products, which could negatively impact our results of operations and market share.

To date, we have competed primarily against central inverter manufacturers and until recently have faced little direct competition in selling our microinverter systems. Marketing and selling our microinverter systems against traditional inverter solutions is highly competitive. Currently, competitors in the inverter market range from large companies such as SMA Solar Technology AG, Fronius International GmbH and Power-One Inc. to emerging companies offering alternative microinverter or other solar electronics products. Several of our existing and potential competitors are significantly larger, have greater financial, marketing, distribution, customer support and other resources, are more established than we are, and have significantly better brand recognition. Some of our competitors have more resources to develop or acquire, and more experience in developing or acquiring, new products and technologies and in creating market awareness for these products and technologies. Further, certain competitors may be able to develop new products more quickly than we can and may be able to develop products that are more reliable or that provide more functionality than ours. In addition, some of our competitors have the financial resources to offer competitive products at aggressive or below-market pricing levels, which could cause us to lose sales or market share or require us to lower prices for our microinverter systems in order to compete effectively. Suppliers of solar products, particularly solar modules, have experienced eroding prices over the last several years and as a result many have faced margin compression and declining revenues. If we have to reduce our prices by more than we anticipated, or if we are unable to offset any future reductions in our average selling prices by increasing our sales volume, reducing our costs and expenses or introducing new products, our revenues and gross profit would suffer.

We expect competition to intensify as new and existing competitors enter the microinverter market and additional add-on components like DC-to-DC optimizers that can be used with central inverters gain traction. We believe that a number of companies have developed or are developing microinverters and other products that will compete directly with our microinverter systems. SMA Solar Technology AG and Power-One Inc. have recently introduced microinverter products. In addition, several new entrants to the microinverter market have recently announced plans to ship or have already shipped products, including some of our OEM customers and partners.

We also may face competition from some of our customers who evaluate our capabilities against the merits of manufacturing products internally. For instance, solar module manufacturers could attempt to develop components that directly perform DC to AC conversion in the module itself. Due to the fact that such customers may not seek to make a profit directly from the manufacture of these products, they may have the ability to manufacture competitive products at a lower cost than we would charge such customers. As a result, these customers may purchase fewer of our microinverter systems or sell products that compete with our microinverters systems, which would negatively impact our revenue and gross profit.

Problems with product quality or product performance may cause us to continue to incur additional warranty expenses and may damage our market reputation and cause our revenue and gross profit to decline.

We have offered 15-year limited warranties for our first and second generation microinverters and offer a limited warranty of up to 25 years on our third and fourth generation microinverters. Our limited warranties cover defects in materials and workmanship of our microinverters under normal use and service conditions for up to 25 years following installation. As a result, we bear the risk of warranty claims long after we have sold the product and recognized revenue. Our estimated costs of warranty for previously sold products may change to the extent future products are not compatible with earlier generation products under warranty.

While we offer warranties of up to 25 years, our microinverters have only been in use since mid-2008, when we first commenced commercial sales of our products. Although we conduct accelerated life cycle testing to measure performance and reliability, our microinverter systems have not been tested over the full warranty cycle and do not

have a sufficient operating history to confirm how they will perform over their estimated useful life. In addition, under real-world operating conditions, which may vary by location and design, as well as insolation, soiling and weather conditions, a typical solar PV installation may perform in a different way than under standard test conditions. If our products perform below expectations or have unexpected reliability problems, we may be unable to gain or retain customers and could face substantial warranty expense.

We are required to make assumptions and apply judgments, based on our accelerated life cycle testing and the limited operating history of our products, regarding a number of factors, including the durability and reliability of our products, our

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anticipated rate of warranty claims and the costs of replacement of defective products. Our assumptions have proven and could in the future prove to be materially different from the actual performance of our products, which has caused and may in the future cause us to incur substantial expense to repair or replace defective products. Increases in our estimates of future warranty obligations due to actual product failure rates, field service obligations and rework costs incurred in correcting product failures have caused and could in the future cause us to materially increase the amount of warranty obligations, and have had and may have in the future a corresponding negative impact on our results of operations.

We also depend significantly on our reputation for reliability and high-quality products and services, exceptional customer service and our brand name to attract new customers and grow our business. If our products and services do not perform as anticipated or we experience unexpected reliability problems or widespread product failures, our brand and reputation could be significantly impaired and we may lose, or be unable to gain or retain, customers.

Defects and poor performance in our products could result in loss of customers, decreased revenue and unexpected expenses, and we may face warranty, indemnity and product liability claims arising from defective products.

Our products must meet stringent quality requirements and may contain undetected errors or defects, especially when first introduced or when new generations are released. Errors, defects or poor performance can arise due to design flaws, defects in raw materials or components or manufacturing difficulties, which can affect both the quality and the yield of the product. These errors or defects may be dangerous, as defective power components may cause power overloads, potentially resulting in explosion or fire. As we develop new generations of our products and enter new markets, we face higher risk of undetected defects, because our testing protocols may not be able to fully test the products under all possible operating conditions. In the past, we have experienced defects in our products due to certain errors in the manufacturing and design process. Any actual or perceived errors, defects or poor performance in our products could result in the replacement or recall of our products, shipment delays, rejection of our products, damage to our reputation, lost revenue, diversion of our engineering personnel from our product development efforts in order to address or remedy any defects and increases in customer service and support costs, all of which could have a material adverse effect on our business and operations.

Furthermore, defective, inefficient or poorly performing power components may give rise to warranty, indemnity or product liability claims against us that exceed any revenue or profit we receive from the affected products. We could incur significant costs and liabilities if we are sued and if damages are awarded against us. We currently maintain a moderate level of product liability insurance, and there can be no assurance that this insurance will provide sufficient coverage in the event of a claim. Also, we cannot predict whether we will be able to maintain this coverage on acceptable terms, if at all, or that a product liability claim would not harm our business or financial condition. Costs or payments we may make in connection with warranty and product liability claims or product recalls may adversely affect our financial condition and results of operations.

Our Enlighten web-based monitoring service, which our customers use to track and monitor the performance of their solar PV systems based on our product platform, may contain undetected errors, failures, or bugs, especially when new versions or enhancements are released. We have from time to time found defects in our service and new errors in our existing service may be detected in the future. Any errors, defects, disruptions in service or other performance problems with our monitoring service could harm our reputation and may damage our customers' businesses.

If we are unable to effectively manage our growth, our business and operating results may suffer.

We have recently experienced, and expect to continue to experience, significant growth in our sales and operations.

Our historical growth has placed, and planned future growth is expected to continue to place, significant demands on our management, as well as our financial and operational resources, to:

- manage a larger organization;
- expand third-party manufacturing, testing and distribution capacity;
  - build additional custom manufacturing test equipment;
- manage an increasing number of relationships with customers, suppliers and other third parties;
- increase our sales and marketing efforts;
- train and manage a growing employee base;

broaden our customer support capabilities;  
implement new and upgrade existing operational and financial systems; and  
enhance our financial disclosure controls and procedures.

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We cannot assure you that our current and planned operations, personnel, systems, internal procedures and controls will be adequate to support our future growth. If we cannot manage our growth effectively, we may be unable to take advantage of market opportunities, execute our business strategies or respond to competitive pressures, any of which could have a material adverse effect on our financial condition, results of operation, business or prospects.

Our recent and planned expansion into new markets could subject us to additional business, financial and competitive risks.

We currently offer microinverter systems targeting the residential and commercial markets in the United States, Canada, the United Kingdom, France, the Benelux region, certain other European markets and Australia. We also intend to expand into other international markets and to introduce new microinverter systems targeted at larger commercial and utility-scale installations. Our success in these new geographic and product markets will depend on a number of factors, such as:

- acceptance of microinverters in markets in which they have not traditionally been used;
- our ability to compete in new product markets to which we are not accustomed;
- our ability to manage an increasing manufacturing capacity and production;
- willingness of our potential customers to incur a higher upfront capital investment than may be required for competing solutions;
- our ability to develop solutions to address the requirements of the larger commercial and utility-scale markets;
- timely qualification and certification of new products for larger commercial and utility-scale installations;
- our ability to reduce production costs in order to price our products competitively over time;
- availability of government subsidies and economic incentives for solar energy solutions;
- accurate forecasting and effective management of inventory levels in line with anticipated product demand; and
- our customer service capabilities and responsiveness.

Further, new geographic markets and the larger commercial and utility-scale installation markets have different characteristics from the markets in which we currently sell products, and our success will depend on our ability to properly address these differences. These differences may include:

- differing regulatory requirements, including tax laws, trade laws, labor, safety, local content and consumer protection regulations, tariffs, export quotas, customs duties or other trade restrictions;
- limited or unfavorable intellectual property protection;
- risk of change in international political or economic conditions;
- restrictions on the repatriation of earnings;
- fluctuations in the value of foreign currencies and interest rates;
- difficulties and increased expenses in complying with a variety of U.S. and foreign laws, regulations and trade standards, including the Foreign Corrupt Practices Act;
- potentially longer sales cycles;
- higher volume requirements;
- increased customer concentrations;
- warranty expectations and product return policies; and
- cost, performance and compatibility requirements.

Failure to develop and introduce these new products successfully, to generate sufficient revenue from these products to offset associated research and development, marketing and manufacturing costs, or to otherwise effectively anticipate and manage the risks and challenges associated with our potential expansion into new product and geographic markets, could adversely affect our revenues and our ability to achieve or sustain profitability.

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A drop in the retail price of electricity derived from the utility grid or from alternative energy sources, or a change in utility pricing structures, may harm our business, financial condition and results of operations.

We believe that a system owner's decision to purchase a solar PV system is strongly influenced by the cost of electricity generated by solar PV installations relative to the retail price of electricity from the utility grid and the cost of other renewable energy sources, including electricity from solar PV installations using central inverters. Decreases in the retail prices of electricity from the utility grid would make it more difficult for all solar PV systems to compete. In particular, growth in unconventional natural gas production and an increase in global liquefied natural gas capacity are expected to keep natural gas prices relatively low for the foreseeable future. Persistent low natural gas prices, lower prices of electricity produced from other energy sources, such as nuclear power, or improvements to the utility infrastructure could reduce the retail price of electricity from the utility grid, making the purchase of solar PV systems less economically attractive and lowering sales of our microinverter systems. In addition, energy conservation technologies and public initiatives to reduce demand for electricity also could cause a fall in the retail price of electricity from the utility grid. Moreover, technological developments by our competitors in the solar components industry, including manufacturers of central inverters, could allow these competitors or their partners to offer electricity at costs lower than those that can be achieved from solar PV installations based on our product platform, which could result in reduced demand for our products. Additionally, as increasing adoption of distributed generation places pressure on traditional utility business models or utility infrastructure, utilities may change their pricing structures to make installation or operation of solar distributed generation more costly. Such measures can include grid access fees, costly or lengthy interconnection studies, limitations on distributed generation penetration levels, or other measures. If the cost of electricity generated by solar PV installations incorporating our microinverter systems is high relative to the cost of electricity from other sources, our business, financial condition and results of operations may be harmed.

If we do not forecast demand for our products accurately, we may experience product shortages, delays in product shipment, excess product inventory, or difficulties in planning expenses, which will adversely affect our business and financial condition.

We manufacture our products according to our estimates of customer demand. This process requires us to make multiple forecasts and assumptions relating to the demand of our distributors, their end customers and general market conditions. Because we sell most of our products to distributors, who in turn sell to their end customers, we have limited visibility as to end-customer demand. We depend significantly on our distributors to provide us visibility into their end-customer demand, and we use these forecasts to make our own forecasts and planning decisions. If the information from our distributors turns out to be incorrect, then our own forecasts may also be inaccurate.

Furthermore, we do not have long-term purchase commitments from our distributors or end customers, and our sales are generally made by purchase orders that may be canceled, changed or deferred without notice to us or penalty. As a result, it is difficult to forecast future customer demand to plan our operations.

If we overestimate demand for our products, or if purchase orders are canceled or shipments are delayed, we may have excess inventory that we cannot sell. We may have to make significant provisions for inventory write-downs based on events that are currently not known, and such provisions or any adjustments to such provisions could be material.

Conversely, if we underestimate demand, we may not have sufficient inventory to meet end-customer demand, and we may lose market share, damage relationships with our distributors and end customers and forgo potential revenue opportunities. Obtaining additional supply in the face of product shortages may be costly or impossible, particularly in the short term and in light of our outsourced manufacturing processes, which could prevent us from fulfilling orders in a timely and cost efficient manner or at all. In addition, if we overestimate our production requirements, our contract manufacturers may purchase excess components and build excess inventory. If our contract manufacturers, at our request, purchase excess components that are unique to our products and are unable to recoup the costs of such excess through resale or return or build excess products, we could be required to pay for these excess parts or products and recognize related inventory write-downs.

In addition, we plan our operating expenses, including research and development expenses, hiring needs and inventory investments, in part on our estimates of customer demand and future revenue. If customer demand or revenue for a particular period is lower than we expect, we may not be able to proportionately reduce our fixed operating expenses

for that period, which would harm our operating results for that period.

Ordering patterns from our distributors may cause our revenue to fluctuate significantly from period to period.

Our distributors place purchase orders with us based on their assessment of end-customer demand and their forecasts. Because these forecasts may not be accurate, channel inventory held at our distributors may fluctuate significantly due to the difference between their forecasts and actual demand. As a result, distributors adjust their purchase orders placed with us in response to changing channel inventory levels, as well as their assessment of the latest market demand trends. We have limited visibility into future end customer demand. A significant decrease in our distributors' channel inventory in one period may lead to a significant rebuilding of channel inventory in subsequent periods, or vice versa, which may cause our quarterly revenue

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and operating results to fluctuate significantly. This fluctuation may cause our results to fall short of analyst or investor expectations in a certain period, which may cause our stock price to decline.

Changes in current laws or regulations or the imposition of new laws or regulations, or new interpretations thereof, by federal or state agencies or foreign governments could impair our ability to compete in international markets.

Changes in current laws or regulations applicable to us or the imposition of new laws and regulations in the United States or other jurisdictions in which we do business, such as Australia, Canada, France, Italy, the United Kingdom, the Benelux region and China, could materially and adversely affect our business, financial condition and results of operations. In addition, changes in our products or changes in export and import laws and implementing regulations may create delays in the introduction of new products in international markets, prevent our customers from deploying our products internationally or, in some cases, prevent the export or import of our products to certain countries altogether.

For example, the Italian energy authority (AEEG) enacted a new set of interconnection standards for solar energy installations that became effective in July 2012, which has negatively impacted our sales in Italy. We continue to explore potential solutions to meet these requirements. However, in the event that we cannot implement a solution in the near term the total market available for our microinverter products in Italy, and our business as a result, may continue to be adversely impacted.

In addition, several states, including California, have either implemented or are considering implementing new restrictions on incentives or rule regulating the installation of solar systems that we may not be able to currently comply with. In the event that we cannot comply with these or other new regulations or implement a solution to such noncompliance as they arise, the total market available for our microinverter products in such states, and our business as a result, may be adversely impacted.

While we are not aware of any other current or proposed export or import regulations which would materially restrict our ability to sell our products in countries where we offer our products for sale, any change in export or import regulations or related legislation, shift in approach to the enforcement or scope of existing regulations, or change in the countries, persons or technologies targeted by these regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers with international operations. In such event, our business and results of operations could be adversely affected.

We depend upon a small number of outside contract manufacturers. Our operations could be disrupted if we encounter problems with these contract manufacturers.

We do not have internal manufacturing capabilities, and rely upon a small number of contract manufacturers to build our products. In particular, we rely on contract manufacturers for the manufacture of microinverter products, cabling and our communications gateway related to our microinverter systems. Our reliance on a small number of contract manufacturers makes us vulnerable to possible capacity constraints and reduced control over component availability, delivery schedules, manufacturing yields and costs. We do not have long-term supply contracts with our other manufacturing partners. Consequently, these manufacturers are not obligated to supply products to us for any period, in any specified quantity or at any certain price.

The revenues that our contract manufacturers generate from our orders represent a relatively small percentage of their overall revenues. As a result, fulfilling our orders may not be considered a priority in the event of constrained ability to fulfill all of their customer obligations in a timely manner. In addition, the facilities in which our microinverters, related cabling and communications gateway products are manufactured are located outside of the United States. We believe that the location of these facilities outside of the United States increases supply risk, including the risk of supply interruptions or reductions in manufacturing quality or controls.

If any of our contract manufacturers were unable or unwilling to manufacture our products in required volumes and at high quality levels or renew existing terms under supply agreements, we would have to identify, qualify and select acceptable alternative contract manufacturers. An alternative contract manufacturer may not be available to us when needed or may not be in a position to satisfy our quality or production requirements on commercially reasonable terms, including price. Any significant interruption in manufacturing would require us to reduce our supply of products to our customers, which in turn would reduce our revenues, harm our relationships with our customers and damage our relationships with our distributors and end customers and cause us to forgo potential revenue

opportunities.

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Manufacturing problems could result in delays in product shipments to customers and could adversely affect our revenue, competitive position and reputation.

We may experience delays, disruptions or quality control problems in our manufacturing operations. Our product development, manufacturing and testing processes are complex and require significant technological and production process expertise. Such processes involve a number of precise steps from design to production. Any change in our processes could cause one or more production errors, requiring a temporary suspension or delay in our production line until the errors can be researched, identified and properly addressed and rectified. This may occur particularly as we introduce new products, modify our engineering and production techniques, and expand our capacity. In addition, our failure to maintain appropriate quality assurance processes could result in increased product failures, loss of customers, increased production costs and delays. Any of these developments could have a material adverse effect on our business, financial condition, and results of operations.

A disruption could also occur in our manufacturing partner's fabrication facility due to any number of reasons, such as equipment failure, contaminated materials or process deviations, which could adversely impact manufacturing yields or delay product shipments. As a result, we could incur additional costs that would adversely affect our gross profit, and product shipments to our customers could be delayed beyond the shipment schedules requested by our customers, which would negatively affect our revenue, competitive position and reputation.

Additionally, manufacturing yields depend on a number of factors, including the stability and manufacturability of the product design, manufacturing improvements gained over cumulative production volumes and the quality and consistency of component parts. Capacity constraints, raw materials shortages, logistics issues, labor shortages, changes in customer requirements, manufacturing facilities or processes, or those of some third-party contract manufacturers and suppliers of raw materials and components have historically caused, and may in the future cause, reduced manufacturing yields, negatively impacting the gross profit on, and our production capacity for, those products. Moreover, an increase in the rejection and rework rate of products during the quality control process before, during or after manufacture would result in our experiencing lower yields, gross profit and production capacity.

The risks of these types of manufacturing problems are further increased during the introduction of new product lines, which has from time to time caused, and may in the future cause, temporary suspension of production lines while problems are addressed or corrected. Since our business is substantially dependent on a limited number of product lines, any prolonged or substantial suspension of manufacturing production lines could result in a material adverse effect on our revenue, gross profit, competitive position, and distributor and customer relationships.

We depend on sole source and limited source suppliers for key components and products. If we are unable to source these components on a timely basis, we will not be able to deliver our products to our customers.

We depend on sole source and limited source suppliers for key components of our products. For example, our ASICs are purchased from a sole source supplier or developed for us by sole source suppliers. Any of the sole source and limited source suppliers upon whom we rely could experience quality and reliability issues, could stop producing our components, cease operations or be acquired by, or enter into exclusive arrangements with, our competitors. We generally do not have long-term supply agreements with our suppliers, and our purchase volumes are currently too low for us to be considered a priority customer by most of our suppliers. As a result, most of these suppliers could stop selling to us at commercially reasonable prices, or at all. Any such quality or reliability issue, or interruption or delay may force us to seek similar components or products from alternative sources, which may not be available on commercially reasonable terms, including price, or at all. Switching suppliers may require that we redesign our products to accommodate new components, and may potentially require us to re-qualify our products, which would be costly and time-consuming. Any interruption in the quality or supply of sole source or limited source components for our products would adversely affect our ability to meet scheduled product deliveries to our customers, could result in lost revenue or higher expenses and would harm our business.

If we or our contract manufacturers are unable to obtain raw materials in a timely manner or if the price of raw materials increases significantly, production time and product costs could increase, which may adversely affect our business.

The manufacturing and packaging processes used by our contract manufacturers depend on raw materials such as copper, aluminum, silicon and petroleum-based products. From time to time, suppliers may extend lead times, limit

supplies or increase prices due to capacity constraints or other factors. Certain of our suppliers have the ability to pass along to us directly or through our contract manufacturers any increases in the price of raw materials. If the prices of these raw materials rise significantly, we may be unable to pass on the increased cost to our customers. While we may from time to time enter into hedging transactions to reduce our exposure to wide fluctuations in the cost of raw materials, the availability and effectiveness of these hedging transactions may be limited. Due to all these factors, our results of operations could be adversely affected if we or our contract manufacturers are unable to obtain adequate supplies of raw materials in a timely manner or at reasonable cost. In addition, from time to time, we or our contract manufacturers may need to reject raw materials that do not meet our

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specifications, resulting in potential delays or declines in output. Furthermore, problems with our raw materials may give rise to compatibility or performance issues in our products, which could lead to an increase in customer returns or product warranty claims. Errors or defects may arise from raw materials supplied by third parties that are beyond our detection or control, which could lead to additional customer returns or product warranty claims that may adversely affect our business and results of operations.

If potential owners of solar PV systems based on our product platform are unable to secure financing on acceptable terms, we could experience a reduction in the demand for our solar PV systems.

Many owners of solar PV systems depend on financing to purchase their systems. The limited use of microinverters to date, coupled with our limited operating history, could result in lenders refusing to provide the financing necessary to purchase solar PV systems based on our product platform on favorable terms, or at all. Moreover, in the case of debt financed projects, even if lenders are willing to finance the purchase of these systems, an increase in interest rates or a change in tax incentives could make it difficult for owners to secure the financing necessary to purchase a solar PV system on favorable terms, or at all. In addition, we believe that a significant percentage of owners purchase solar PV systems as an investment, funding the initial capital expenditure through a combination of upfront cash and financing. Difficulties in obtaining financing for solar PV installations on favorable terms, or increases in interest rates or changes in tax incentives, could lower an investor's return on investment in a solar PV installation, or make alternative solar PV systems or other investments more attractive relative to solar PV systems based on our product platform.

Any of these events could result in reduced demand for our products, which could have a material adverse effect on our financial condition and results of operations. In addition, an increasing share of residential solar installations has been provided through third party financing structures, such as power purchase or lease agreements. Our sales growth therefore increasingly depends on sales to developers of third party solar finance offerings who provide solar as a service via power purchase agreements or leasing structures. The third party finance market for residential solar in the US and elsewhere is or may become highly concentrated, with a few significant finance companies and several smaller entrants. If we are unable to develop relationships and gain a significant share of inverter sales to the major finance companies or new entrants, our overall sales growth will be constrained.

\*We rely primarily on distributors, large installers and providers of solar financing to assist in selling our products, and the failure of these customers to perform as expected could reduce our future revenue.

We sell our microinverter systems primarily through distributors, as well as through direct sales to solar equipment installers and sales to developers of third party solar finance offerings. For the six months ended June 30, 2014, Vivint Solar, Inc. and CED Greentech accounted for 27% and 14% of total revenues, respectively. In 2013, Vivint Solar, Inc., CED Greentech and Focused Energy, Inc. accounted for 15%, 14% and 11% of total net revenues, respectively. We do not have exclusive arrangements with these third parties and, as a result, many of our customers also market and sell products from our competitors, which may reduce our sales. Our customers may terminate their relationships with us at any time, or with short notice. Our customers may fail to devote resources necessary to sell our products at the prices, in the volumes and within the time frames that we expect, or may focus their marketing and sales efforts on products of our competitors. In addition, participants in the solar industry are becoming increasingly focused on vertical integration of the solar financing and installation process, which may lead to an overall reduction in the number of potential parties who may purchase and install our products.

Our future performance depends on our ability to effectively manage our relationships with our existing customers, as well as to attract additional customers that will be able to market and support our products effectively, especially in markets in which we have not previously distributed our products. Termination of agreements with current customers, failure by these customers to perform as expected, or failure by us to cultivate new customer relationships, could hinder our ability to expand our operations and harm our revenue and operating results.

Our success in an "AC module" version of our microinverter system may depend in part upon our ability to continue to work closely with leading solar module manufacturers.

We are currently working on variants of our microinverter system that will enable an "AC module" for direct attachment of the microinverter to the solar modules. The market success of such solutions will depend in part on our ability to continue to work closely with solar module manufacturers to design solar modules that are compatible with such direct attachment of our microinverter. We may not be able to encourage solar module manufacturers to work with us



on the development of such compatible solutions combining our microinverter system and solar modules for a variety of reasons, including differences in marketing or selling strategy, competitive considerations, lack of competitive pricing, and technological compatibility. In addition, our ability to form effective partnerships with solar module manufacturers may be adversely affected by the substantial changes faced by many of these manufacturers due to declining prices and revenues from sales of solar modules.

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If we fail to retain our key personnel or if we fail to attract additional qualified personnel, we may not be able to achieve our anticipated level of growth and our business could suffer.

Our future success and ability to implement our business strategy depends, in part, on our ability to attract and retain key personnel, and on the continued contributions of members of our senior management team and key technical personnel, each of whom would be difficult to replace. All of our employees, including our senior management, are free to terminate their employment relationships with us at any time. Competition for highly skilled technical people is extremely intense, and we face challenges identifying, hiring and retaining qualified personnel in many areas of our business. If we fail to retain our senior management and other key personnel or if we fail to attract additional qualified personnel, we may not be able to achieve our strategic objectives and our business could suffer.

If we fail to protect, or incur significant costs in defending, our intellectual property and other proprietary rights, our business and results of operations could be materially harmed.

Our success depends to a significant degree on our ability to protect our intellectual property and other proprietary rights. We rely on a combination of patent, trademark, copyright, trade secret and unfair competition laws, as well as confidentiality and license agreements and other contractual provisions, to establish and protect our intellectual property and other proprietary rights. We have applied for patent and trademark registrations in the United States and in certain other countries, some of which have been issued. We cannot guarantee that any of our pending applications will be approved or that our existing and future intellectual property rights will be sufficiently broad to protect our proprietary technology, and any failure to obtain such approvals or finding that our intellectual property rights are invalid or unenforceable could force us to, among other things, rebrand or re-design our affected products. In countries where we have not applied for patent protection or where effective intellectual property protection is not available to the same extent as in the United States, we may be at greater risk that our proprietary rights will be misappropriated, infringed or otherwise violated.

To protect our unregistered intellectual property, including our trade secrets and know-how, we rely in part on trade secret laws and confidentiality and invention assignment agreements with our employees and independent consultants. We also require other third parties who may have access to our proprietary technologies and information to enter into non-disclosure agreements. Such measures, however, provide only limited protection, and we cannot assure that our confidentiality and non-disclosure agreements will prevent unauthorized disclosure or use of our confidential information, especially after our employees or third parties end their employment or engagement with us, or provide us with an adequate remedy in the event of such disclosure. Furthermore, competitors or other third parties may independently discover our trade secrets, in which case we would not be able to assert trade secret rights, copy or reverse engineer our products or portions thereof or develop similar technology. If we fail to protect our intellectual property and other proprietary rights, or if such intellectual property and proprietary rights are infringed, misappropriated or otherwise violated, our business, results of operations or financial condition could be materially harmed.

In the future, we may need to take legal action to prevent third parties from infringing upon or misappropriating our intellectual property or from otherwise gaining access to our technology. Protecting and enforcing our intellectual property rights and determining their validity and scope could result in significant litigation costs and require significant time and attention from our technical and management personnel, which could significantly harm our business. In addition, we may not prevail in such proceedings. An adverse outcome of any such proceeding may reduce our competitive advantage or otherwise harm our financial condition and our business.

Third parties may assert that we are infringing upon their intellectual property rights, which could divert management's attention, cause us to incur significant costs and prevent us from selling or using the technology to which such rights relate.

Our competitors and other third parties hold numerous patents related to technology used in our industry, and claims of patent or other intellectual property right infringement or violation have been litigated against certain of our competitors. From time to time we may also be subject to such claims and litigation. Regardless of their merit, responding to such claims can be time consuming, divert management's attention and resources and may cause us to incur significant expenses. While we believe that our products and technology do not infringe in any material respect upon any valid intellectual property rights of third parties, we cannot be certain that we would be successful in

defending against any such claims. Furthermore, patent applications in the United States and most other countries are confidential for a period of time before being published, so we cannot be certain that we are not infringing third parties' patent rights or that we were the first to conceive inventions covered by our patents or patent applications. As we become more visible as a publicly traded company, the possibility that third parties may make claims of intellectual property infringement or other violations against us may grow. An adverse outcome with respect to any such claim could invalidate our proprietary rights and force us to do one or more of the following:

- obtain from a third party claiming infringement a license to sell or use the relevant technology, which may not be available on reasonable terms, or at all;

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stop manufacturing, selling, incorporating or using our products that embody the asserted intellectual property; pay substantial monetary damages; our customers pursuant to indemnification obligations under some of our customer contracts; or expend significant resources to redesign the products that use the infringing technology and to develop or acquire non-infringing technology.

Any of these actions could result in a substantial reduction in our revenue and could result in losses over an extended period of time.

Our failure to obtain the right to use necessary third-party intellectual property rights on reasonable terms, or our failure to maintain, and comply with the terms and conditions applicable to, these rights, could harm our business and prospects.

From time to time we have licensed, and in the future we may choose to or be required to license, technology or intellectual property from third parties in connection with the development of our products. We cannot assure that such licenses will be available to us on commercially reasonable terms, or at all, and our inability to obtain such licenses could require us to substitute technology of lower quality or of greater cost. In addition, we incorporate open source software code in our proprietary software. Use of open source software can lead to greater risks than use of third-party commercial software since open source licensors generally do not provide warranties or controls with respect to origin, functionality or other features of the software. Some open source software licenses require users who distribute open source software as part of their products to publicly disclose all or part of the source code in their software and make any derivative works of the open source code available for limited fees or at no cost. Although we monitor our use of open source software, open source license terms may be ambiguous, and many of the risks associated with the use of open source software cannot be eliminated. If we were found to have inappropriately used open source software, we may be required to release our proprietary source code, re-engineer our software, discontinue the sale of certain products in the event re-engineering cannot be accomplished on a timely basis or take other remedial action. Furthermore, if we are unable to obtain or maintain licenses from third parties or fail to comply with applicable open source licenses, we may be subject to costly third party claims of intellectual property infringement or ownership of our proprietary source code. Any of the foregoing could harm our business and put us at a competitive disadvantage.

Our business has been and could continue to be affected by seasonal trends and construction cycles.

We have been and could continue to be subject to industry-specific seasonal fluctuations in the future, particularly in climates that experience colder weather during the winter months, such as northern Europe, Canada, and the United States. In general, we expect our products in the second, third and fourth quarters will be positively affected by seasonal customer demand trends, including solar economic incentives, weather patterns and construction cycles, preceded by a seasonally softer first quarter. In the United States, customers will sometimes make purchasing decisions towards the end of the year in order to take advantage of tax credits or for budgetary reasons. In addition, construction levels are typically slower in colder months. In European countries with FiTs, the construction of solar PV systems may be concentrated during the second half of the calendar year, largely due to the annual reduction of the applicable minimum FiT and the fact that the coldest winter months are January through March. Accordingly, our business and quarterly results of operations could be affected by seasonal fluctuations in the future.

Covenants in our credit facilities may limit our flexibility in responding to business opportunities and competitive developments and increase our vulnerability to adverse economic or industry conditions.

We have lending arrangements with several financial institutions, including loan and security agreements with Wells Fargo Bank, National Association (“Wells Fargo”) and with Hercules Technology Growth Capital, Inc. (“Hercules”). The loan and security agreements with Wells Fargo and with Hercules restrict our ability to take certain actions such as incurring additional debt, encumbering our tangible or intangible property, paying dividends, or engaging in certain transactions, such as mergers and acquisitions, investments and asset sales. Our loan and security agreement with Wells Fargo also requires us to maintain certain financial covenants, including liquidity ratios. These restrictions may limit our flexibility in responding to business opportunities, competitive developments and adverse economic or industry conditions. In addition, our obligations under our loan and security agreements with Wells Fargo and Hercules are secured by substantially all of our assets (excluding intellectual property), which limits our ability to

provide collateral for additional financing. A breach of any of these covenants, or a failure to pay interest or indebtedness when due under any of our credit facilities, could result in a variety of adverse consequences, including the acceleration of our indebtedness and the forfeiture of our assets subject to security interests in favor of the lenders.

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We are an “emerging growth company,” and may elect to comply with reduced public company reporting requirements applicable to emerging growth companies, which could make our common stock less attractive to investors.

We are an “emerging growth company,” as defined in the Jumpstart Our Business Startups Act enacted in April 2012, or the JOBS Act, and, for as long as we continue to be an “emerging growth company,” we may choose to take advantage of exemptions from various reporting requirements applicable to other public companies but not to “emerging growth companies,” including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002, or Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. We could be an “emerging growth company” until December 31, 2017 (the last day of the fiscal year following the fifth anniversary of our initial public offering), although we could cease to be an “emerging growth company” earlier if certain events occur as specified in the JOBS Act, such as our achieving annual revenue of at least \$1 billion or our becoming a “large accelerated filer” as defined in Rule 12b-2 of the Exchange Act. We cannot predict if investors will find our common stock less attractive if we choose to rely on these exemptions. If some investors find our common stock less attractive as a result of any choices to reduce future disclosure, there may be a less active trading market for our common stock and our stock price may be more volatile.

If we fail to maintain an effective system of internal controls or are unable to remediate any deficiencies in our internal controls, we might not be able to report our financial results accurately or prevent fraud; in that case, our stockholders could lose confidence in our financial reporting, which would harm our business and could negatively impact the price of our stock.

Effective internal controls are necessary for us to provide reliable financial reports and prevent fraud. In addition, Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, requires us to establish and maintain internal control over financial reporting and disclosure controls procedures. The process of implementing our internal controls and complying with Section 404 has required, and will continue to require, significant attention of management. Although we are currently not required to provide an auditor’s attestation report on management’s assessment of the effectiveness of our internal control over financial reporting, otherwise required by Section 404(b) of the Sarbanes-Oxley Act of 2002, this exemption will no longer be available to us beginning with our first Annual Report on 10-K for the year in which we cease to be an “emerging growth company,” as defined in the JOBS Act. If we or our independent registered public accounting firm discover a material weakness in the future, the disclosure of that fact, even if quickly remedied, could reduce the market's confidence in our financial statements and harm our stock price. In addition, a delay in compliance with Section 404 could subject us to a variety of administrative sanctions, including SEC action, ineligibility for short form resale registration, the suspension or delisting of our common stock from the stock exchange on which it is listed and the inability of registered broker-dealers to make a market in our common stock, which would further reduce our stock price and could harm our business. To the extent any material weaknesses in our internal control over financial reporting are identified in the future, we could be required to expend significant management time and financial resources to correct such material weaknesses or to respond to any resulting regulatory investigations or proceedings.

Our ability to use net operating losses to reduce future tax payments may be limited by provisions of the Internal Revenue Code, and may be subject to further limitation as a result of future transactions.

Sections 382 and 383 of the Internal Revenue Code of 1986, as amended, contain rules that limit the ability of a company that undergoes an ownership change, which is generally any cumulative change in ownership of more than 50% of its stock over a three-year period, to utilize its net operating loss and tax credit carryforwards and certain built-in losses recognized in the years after the ownership change. These rules generally operate by focusing on ownership changes involving stockholders who directly or indirectly own 5% or more of the stock of a company and any change in ownership arising from a new issuance of stock by the company. Generally, if an ownership change occurs, the yearly taxable income limitation on the use of net operating loss and tax credit carryforwards is equal to the product of the applicable long-term tax exempt rate and the value of the company's stock immediately before the ownership change. As a result, we may be unable to offset our taxable income with net operating losses, or our tax liability with credits, before these losses and credits expire.

In addition, it is possible that future transactions (including issuances of new shares of our common stock and sales of shares of our common stock) will cause us to undergo one or more additional ownership changes. In that event, we generally would not be able to use our net operating losses from periods prior to this ownership change to offset future taxable income in excess of the annual limitations imposed by Sections 382 and 383 and those attributes that are already subject to limitations (as a result of our prior ownership changes) may be subject to more stringent limitations.

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The requirements of being a public company may strain our resources and divert management's attention from other aspects of our business.

We are subject to a wide variety of rules and regulations as a public reporting company. The Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, the Sarbanes-Oxley Act and the rules implemented by the SEC and the NASDAQ Global Market impose significant regulatory requirements on public companies, including specific corporate governance practices. For example, the listing requirements of the NASDAQ Global Market require that we satisfy certain corporate governance requirements relating to independent directors, audit and compensation committees, distribution of annual and interim reports, stockholder meetings, stockholder approvals, solicitation of proxies, conflicts of interest, stockholder voting rights and codes of conduct. Our management and other personnel are required to devote a substantial amount of time to these compliance initiatives. Moreover, these rules and regulations increase our legal and financial compliance costs and make some activities more time-consuming and costly. As a public company, being subject to these rules and regulations makes it more difficult and more expensive for us to obtain director and officer liability insurance, and in the future, we may be required to accept reduced policy limits and coverage or incur substantial additional costs to maintain the same or similar coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers.

These rules and regulations also contain requirements that apply to manufacturers of products incorporating specified minerals. The Dodd-Frank Act requires public companies to report on their use of so-called conflict minerals originating from the Democratic Republic of Congo or its nine immediate neighbors. Certain minerals commonly used in semiconductors are on the list of conflict minerals, and additional minerals may be added to the list in the future. Compliance with these rules, which requires us to disclose our use of these minerals and may require us to obtain an annual audit of our sourcing and the chain of custody of these minerals, may be time-consuming and costly.

We may not be able to raise additional capital to execute on our current or future business opportunities on favorable terms, if at all, or without dilution to our stockholders.

We believe that our existing cash and cash equivalents, available credit facilities and cash flows from our operating activities, will be sufficient to meet our anticipated cash needs for at least the next 12 months. However, we may need to raise additional capital to execute on our current or future business strategies, including to:

- invest in our research and development efforts by hiring additional technical and other personnel;
- expand our operations into new product markets and new geographies;
- acquire complementary businesses, products, services or technologies; or
- otherwise pursue our strategic plans and respond to competitive pressures.

We do not know what forms of financing, if any, will be available to us. If financing is not available on acceptable terms, if and when needed, our ability to fund our operations, expand our research and development, sales and marketing functions, develop and enhance our products, respond to unanticipated events, including unanticipated opportunities, or otherwise respond to competitive pressures would be significantly limited. In any such event, our business, financial condition and results of operations could be materially harmed, and we may be unable to continue our operations. Moreover, if we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders could be significantly diluted, and these newly issued securities may have rights, preferences or privileges senior to those of existing stockholders.

Natural disasters, terrorist or cyber attacks, or other catastrophic events could harm our operations.

Our worldwide operations could be subject to natural disasters and other business disruptions, which could harm our future revenue and financial condition and increase our costs and expenses. For example, our corporate headquarters in Petaluma, California is located near major earthquake fault lines. Further, a terrorist attack, including one aimed at energy or communications infrastructure suppliers or our web-based monitoring service, could hinder or delay the development and sale or performance of our products. In the event that an earthquake, tsunami, typhoon, terrorist or cyber attack, or other natural, manmade or technical catastrophe were to destroy any part of our facilities or those of our contract manufacturer, destroy or disrupt vital infrastructure systems or interrupt our operations or services for any extended period of time, our business, financial condition and results of operations would be materially adversely



affected.

The market price of our common stock may be volatile or may decline regardless of our operating performance.

The market price of our common stock has been and could be subject to wide fluctuations in response to, among other things, the risk factors described in “Part II. Item 1A. Risk Factors” of this Quarterly Report on Form 10-Q, and other factors

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beyond our control, such as fluctuations in the valuation of companies perceived by investors to be comparable to us. Furthermore, the stock markets have experienced price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political and market conditions, such as recessions, interest rate changes or international currency fluctuations, may negatively affect the market price of our common stock. In the past, many companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may become the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could seriously harm our business. Our financial results may vary significantly from quarter to quarter due to a number of factors, which may lead to volatility in our stock price.

Our quarterly revenue and results of operations have varied in the past and may continue to vary significantly from quarter to quarter. This variability may lead to volatility in our stock price as research analysts and investors respond to these quarterly fluctuations. These fluctuations are due to numerous factors, including:

- fluctuations in demand for our products;
- the timing, volume and product mix of sales of our products, which may have different average selling prices or profit margins;
- changes in our pricing and sales policies or the pricing and sales policies of our competitors;
- our ability to design, manufacture and deliver products to our customers in a timely and cost-effective manner and that meet customer requirements;
- our ability to manage our relationships with our contract manufacturers, customers and suppliers;
- quality control or yield problems in our manufacturing operations;
- the anticipation, announcement or introductions of new or enhanced products by our competitors and ourselves;
- reductions in the retail price of electricity;
- changes in laws, regulations and policies applicable to our business and products, particularly those relating to government incentives for solar energy applications;
- unanticipated increases in costs or expenses;
- the amount and timing of operating costs and capital expenditures related to the maintenance and expansion of our business operations;
- the impact of government-sponsored programs on our customers;
- our exposure to the credit risks of our customers, particularly in light of the fact that some of our customers are relatively new entrants to the solar market without long operating or credit histories;
- our ability to estimate future warranty obligations due to product failure rates, claim rates or replacement costs;
- our ability to forecast our customer demand, manufacturing requirements and manage our inventory;
- fluctuations in our gross profit;
- our ability to predict our revenue and plan our expenses appropriately; and
- fluctuations in foreign currency exchange rates.

The foregoing factors are difficult to forecast, and these, as well as other factors, could materially and adversely affect our quarterly and annual results of operations. Any failure to adjust spending quickly enough to compensate for a revenue shortfall could magnify the adverse impact of this revenue shortfall on our results of operations. Moreover, our results of operations may not meet our announced guidance or the expectations of research analysts or investors, in which case the price of our common stock could decrease significantly. There can be no assurance that we will be able to successfully address these risks.

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If research analysts do not publish research about our business or if they issue unfavorable commentary or downgrade our common stock, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that research analysts publish about us and our business. The price of our common stock could decline if one or more research analysts downgrade our stock or if those analysts issue other unfavorable commentary or cease publishing reports about us or our business. If one or more of the research analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our common stock could decrease, which could cause our stock price or trading volume to decline. Our principal stockholders, executive officers and directors own a significant percentage of our stock, and they may take actions that our stockholders may not view as beneficial.

Our principal stockholders, executive officers and directors own more than 50% of our common stock. This significant concentration of share ownership may adversely affect the trading price for our common stock because investors often perceive disadvantages in owning stock in companies with controlling stockholders. Also, as a result, these stockholders, acting together, may be able to control our management and affairs and matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, such as mergers, consolidations or the sale of substantially all of our assets. Consequently, this concentration of ownership may have the effect of delaying or preventing a change in control, including a merger, consolidation or other business combination involving us, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control, even if this change in control would benefit our other stockholders.

Sales of a substantial number of shares of our common stock in the public market by our existing stockholders could cause our stock price to fall.

Sales of a substantial number of shares of our common stock in the public market or the perception that these sales might occur, could depress the market price of our common stock and could impair our ability to raise capital through the sale of additional equity securities. We are unable to predict the effect that sales may have on the prevailing market price of our common stock. All outstanding shares of our common stock are eligible for sale in the public market, subject in some cases to the volume limitations and manner of sale requirements of Rule 144 under the Securities Act. Sales of stock by our stockholders could have a material adverse effect on the trading price of our common stock.

Certain holders of our securities are entitled to rights with respect to the registration of their shares under the Securities Act. Registration of these shares under the Securities Act would result in the shares becoming freely tradable without restriction under the Securities Act. Any sales of securities by these stockholders could have a material adverse effect on the trading price of our common stock.

We currently do not intend to pay dividends on our common stock and, consequently, your only opportunity to achieve a return on your investment is if the price of our common stock appreciates.

We currently do not plan to declare dividends on shares of our common stock in the foreseeable future. In addition, the terms of our bank loan agreements restrict our ability to pay dividends. Consequently, an investor's only opportunity to achieve a return on its investment in our company will be if the market price of our common stock appreciates and the investor sells its shares at a profit.

Our charter documents and Delaware law could prevent a takeover that stockholders consider favorable and could also reduce the market price of our stock.

Our certificate of incorporation and our bylaws contain provisions that could delay or prevent a change in control of our company. These provisions could also make it more difficult for stockholders to elect directors and take other corporate actions, including effecting changes in our management. These provisions include:

- providing for a classified board of directors with staggered, three-year terms, which could delay the ability of stockholders to change the membership of a majority of our board of directors;
- not providing for cumulative voting in the election of directors, which limits the ability of minority stockholders to elect directory candidates;
- authorizing our board of directors to issue, without stockholder approval, preferred stock rights senior to those of common stock, which could be used to significantly dilute the ownership of a hostile acquiror;
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prohibiting stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;

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requiring the affirmative vote of holders of at least 66 2/3% of the voting power of all of the then outstanding shares of voting stock, voting as a single class, to amend provisions of our certificate of incorporation relating to the management of our business, our board of directors, stockholder action by written consent, advance notification of stockholder nominations and proposals, forum selection and the liability of our directors, or to amend our bylaws, which may inhibit the ability of stockholders or an acquiror to effect such amendments to facilitate changes in management or an unsolicited takeover attempt;

requiring special meetings of stockholders may only be called by our chairman of the board, if any, our chief executive officer, our president or a majority of our board of directors, which could delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors; and requiring advance notification of stockholder nominations and proposals, which may discourage or deter a potential acquiror from conducting a solicitation of proxies to elect the acquiror's own slate of directors or otherwise attempting to obtain control of us.

In addition, the provisions of Section 203 of the Delaware General Corporate Law may prohibit large stockholders, in particular those owning 15% or more of our outstanding common stock, from engaging in certain business combinations without approval of substantially all of our stockholders for a certain period of time.

These provisions in our certificate of incorporation, our bylaws and under Delaware law could discourage potential takeover attempts, reduce the price that investors might be willing to pay for shares of our common stock in the future and result in the market price being lower than it would be without these provisions.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

In June 2014, the Company issued 46,962 shares of common stock upon the net exercise of outstanding warrants by Horizon Technology Finance Corporation and its affiliates. The Company received no additional consideration in connection with this issuance. The warrants were initially exercisable into 161,958 shares of common stock with an exercise price of \$6.17. The warrants were issued in March 2010 and March 2011 in connection with the execution of venture loan facilities in private placement transactions not involving a public offering pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended. The conversion of these warrants into common stock was an exempt exchange under Section 3(a)(9) of the Securities Act.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

See the Exhibit Index which follows the signature page of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: August 6, 2014

ENPHASE ENERGY, INC.

By: /s/ Kris Sennesael  
Kris Sennesael  
Vice President and Chief Financial Officer

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EXHIBIT INDEX

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation of Enphase Energy, Inc. <sup>(1)</sup>
3.2	Amended and Restated Bylaws of Enphase Energy, Inc. <sup>(2)</sup>
4.1	Specimen Common Stock Certificate of Enphase Energy, Inc. <sup>(3)</sup>
4.2	2010 Amended and Restated Investors' Rights Agreement by and between Enphase Energy, Inc. and the investors listed on Exhibit A thereto, dated March 15, 2010, as amended. <sup>(3)</sup>
4.4	Warrant to Purchase Shares of Series Preferred Stock, between the Company and Compass Horizon Funding Company LLC, dated March 11, 2010. <sup>(3)</sup>
4.5	Warrant to Purchase Shares of Series Preferred Stock, between the Company and Horizon Technology Finance Corporation, dated March 25, 2011. <sup>(3)</sup>
4.6	Warrant Agreement to Purchase Stock, between Enphase, Energy, Inc. and Hercules Technology Growth Capital, Inc., dated June 13, 2011. <sup>(3)</sup>
4.7	Form of June 2011 Warrant to Purchase Common Stock of Enphase Energy, Inc., pursuant to that certain Amended and Restated Subordinated Convertible Loan Facility and Security Agreement. <sup>(3)</sup>
4.8	Form of November 2011 Warrant to Purchase Common Stock of Enphase Energy, Inc., pursuant to that certain Amended and Restated Subordinated Convertible Loan Facility and Security Agreement. <sup>(3)</sup>
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a).
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a).
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Document.

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(1)



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Previously filed as Exhibit 3.1 to the Current Report on Form 8-K (File No. 001-35480), filed with the Securities and Exchange Commission on April 6, 2012, and incorporated by reference herein.

(2) Previously filed as Exhibit 3.5 to Amendment No. 7 to the Registration Statement on Form S-1/A (File No. 333-174925), filed with the Securities and Exchange Commission on March 12, 2012, and incorporated by reference herein.

(3) Previously filed as the like-numbered exhibit to the Registration Statement on Form S-1/A (File No. 333-174925), and incorporated herein by reference.

The certifications attached as Exhibit 32.1 accompany this quarterly report on Form 10-Q pursuant to 18 U.S.C.

\*Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and shall not be deemed "filed" by Enphase Energy, Inc. for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.