

Enphase Energy, Inc.
Form 10-Q
November 02, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

or

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

For the transition period from _____ to _____

Commission File Number: 001-35480

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

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

1420 N. McDowell Blvd. 94954
Petaluma, California (Zip Code)
(Address of principal executive offices) (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 October 31, 2016, there were 61,909,348 shares of the registrant's common stock outstanding, \$0.00001 par value per share.

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 FORM 10-Q FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2016
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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)

| | September 30, 2016 | December 31, 2015 |
|---|-----------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 24,112 | \$ 28,452 |
| Accounts receivable, net of allowances of \$5,002 and \$1,808 at September 30, 2016 and December 31, 2015, respectively | 59,482 | 46,099 |
| Inventory | 39,101 | 40,800 |
| Prepaid expenses and other assets | 7,187 | 6,417 |
| Total current assets | 129,882 | 121,768 |
| Property and equipment, net | 32,453 | 32,118 |
| Goodwill | 3,745 | 3,745 |
| Intangibles, net | 1,669 | 2,220 |
| Other assets | 8,679 | 5,677 |
| Total assets | \$ 176,428 | \$ 165,528 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 32,551 | \$ 25,569 |
| Accrued liabilities | 26,667 | 19,292 |
| Deferred revenues, current | 5,942 | 3,915 |
| Warranty obligations, current (includes \$3,500 and \$2,601 measured at fair value at September 30, 2016 and December 31, 2015, respectively) | 6,761 | 7,072 |
| Revolving credit facility | 12,450 | 17,000 |
| Current portion of term loan | 1,197 | — |
| Total current liabilities | 85,568 | 72,848 |
| Long-term liabilities: | | |
| Deferred revenues, noncurrent | 31,827 | 25,115 |
| Warranty obligations, noncurrent (includes \$6,015 and \$3,581 measured at fair value at September 30, 2016 and December 31, 2015, respectively) | 23,588 | 23,475 |
| Other liabilities | 2,408 | 2,641 |
| Term loan, less current portion | 22,808 | — |
| Total liabilities | 166,199 | 124,079 |
| 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; 59,958 and 45,821 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively | 1 | — |
| Additional paid-in capital | 247,829 | 224,732 |
| Accumulated deficit | (237,347 |) (183,073) |

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| | | | |
|--|------------|------------|---|
| Accumulated other comprehensive loss | (254 |) (210 |) |
| Total stockholders' equity | 10,229 | 41,449 | |
| Total liabilities and stockholders' equity | \$ 176,428 | \$ 165,528 | |

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 | | Nine Months Ended | |
|---------------------------------------|--------------------|-----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Net revenues | \$88,684 | \$102,874 | \$231,990 | \$291,620 |
| Cost of revenues | 72,805 | 71,408 | 190,215 | 199,103 |
| Gross profit | 15,879 | 31,466 | 41,775 | 92,517 |
| Operating expenses: | | | | |
| Research and development | 13,169 | 12,059 | 39,326 | 38,275 |
| Sales and marketing | 11,016 | 10,510 | 31,218 | 34,955 |
| General and administrative | 6,708 | 7,118 | 21,121 | 23,425 |
| Restructuring charges | 2,717 | — | 2,717 | — |
| Total operating expenses | 33,610 | 29,687 | 94,382 | 96,655 |
| Income (loss) from operations | (17,731) | 1,779 | (52,607) | (4,138) |
| Other income (expense), net: | | | | |
| Interest expense | (1,234) | (140) | (1,598) | (305) |
| Other income (expense) | 353 | (704) | 655 | (1,152) |
| Total other expense, net | (881) | (844) | (943) | (1,457) |
| Income (loss) before income taxes | (18,612) | 935 | (53,550) | (5,595) |
| Provision for income taxes | (144) | (311) | (724) | (704) |
| Net income (loss) | \$(18,756) | \$624 | \$(54,274) | \$(6,299) |
| Net income (loss) per share: | | | | |
| Basic and diluted | \$(0.40) | \$0.01 | \$(1.16) | \$(0.14) |
| Shares used in per share calculation: | | | | |
| Basic | 47,278 | 44,734 | 46,704 | 44,339 |
| Diluted | 47,278 | 47,996 | 46,704 | 44,339 |

See notes to condensed consolidated financial statements.

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ENPHASE ENERGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|-------|------------------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| Net income (loss) | \$(18,756) | \$624 | \$(54,274) | \$(6,299) |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustments | 54 | 187 | (44) | (132) |
| Comprehensive income (loss) | \$(18,702) | \$811 | \$(54,318) | \$(6,431) |

See notes to condensed consolidated financial statements.

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ENPHASE ENERGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

| | Nine Months Ended September 30, | |
|---|------------------------------------|-----------|
| | 2016 | 2015 |
| Cash flows from operating activities: | | |
| Net loss | \$(54,274) | \$(6,299) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 8,039 | 7,704 |
| Provision for doubtful accounts | 3,194 | 344 |
| Asset impairment charges | 1,440 | 479 |
| Amortization of debt issuance costs | 101 | 120 |
| Stock-based compensation | 8,239 | 9,579 |
| Revaluation of contingent consideration liability | — | (1,600) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (16,577) | (30,547) |
| Inventory | 1,699 | (15,127) |
| Prepaid expenses and other assets | (3,857) | (5,008) |
| Accounts payable, accrued and other liabilities | 14,867 | 5,004 |
| Warranty obligations | (198) | (1,134) |
| Deferred revenues | 8,739 | 7,176 |
| Net cash used in operating activities | (28,588) | (29,309) |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (9,607) | (9,682) |
| Purchases of intangible assets | (678) | — |
| Net cash used in investing activities | (10,285) | (9,682) |
| Cash flows from financing activities: | | |
| Proceeds from public offering of common stock, net of underwriting fees | 14,593 | — |
| Proceeds from term loan | 24,175 | — |
| Proceeds from borrowings under revolving credit facility | 10,000 | 34,000 |
| Payments under revolving credit facility | (14,550) | (17,000) |
| Payments for debt issuance costs and offering costs | (401) | — |
| Contingent consideration payment related to prior acquisition | (29) | — |
| Proceeds from issuance of common stock under employee stock plans | 852 | 2,866 |
| Net cash provided by financing activities | 34,640 | 19,866 |
| Effect of exchange rate changes on cash | (107) | (416) |
| Net decrease in cash and cash equivalents | (4,340) | (19,541) |
| Cash and cash equivalents—Beginning of period | 28,452 | 42,032 |
| Cash and cash equivalents—End of period | \$24,112 | \$22,491 |
| Supplemental disclosures of non-cash investing and financing activities: | | |
| Purchases of fixed and intangible assets included in accounts payable | \$517 | \$584 |
| Deferred public offering costs included in accounts payable | \$446 | \$— |
| See notes to condensed consolidated financial statements. | | |

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ENPHASE ENERGY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Description of Business

Enphase Energy, Inc. and subsidiaries (the “Company”) delivers simple, innovative and reliable energy management solutions that advance the worldwide potential of renewable energy. Our semiconductor-based microinverter system converts direct current (DC) electricity to alternating current (AC) electricity at the individual solar module level and brings a system-based, high technology approach to solar energy generation leveraging our design expertise across power electronics, semiconductors, networking, and cloud-based software technologies. Since inception, the Company has shipped over 12.6 million microinverters representing over 3 gigawatts of solar PV generating capacity, and more than 540,000 Enphase residential and commercial systems have been deployed in over 100 countries.

Basis of Presentation and Consolidation

The accompanying condensed consolidated financial statements are presented in accordance with accounting principles generally accepted in the U.S. or 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 consolidation.

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 financial statements reflect all adjustments, consisting of normal recurring items, considered necessary to present fairly the Company's financial condition, results of operations, comprehensive income (loss) and cash flows for the interim periods indicated. The results of operations for the three and nine months ended September 30, 2016 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, 2015.

There have been no material changes in the Company's significant accounting policies during the nine months ended September 30, 2016, as compared to the significant accounting policies described in the Company's Annual Report on Form 10-K for the year ended December 31, 2015. 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 GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Significant estimates and assumptions reflected in the financial statements include revenue recognition, inventory valuation and accrued warranty obligations. These estimates are based on information available as of the date of the financial statements; therefore, actual results could differ materially from management's estimates using different assumptions or under different conditions.

Recently Issued 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's core principle is that revenue is recognized when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. The standard generally requires an entity to identify performance obligations in its contracts, estimate the amount of variable consideration to be received in the transaction price, allocate the transaction price to each separate performance obligation, and recognize revenue as

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obligations are satisfied. In addition, the updated standard requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts. In 2015, the FASB issued guidance to defer the effective date to fiscal years beginning after December 15, 2017 with early adoption for fiscal years beginning December 15, 2016. The guidance permits the use of either a retrospective or cumulative effect transition method. In March 2016, the FASB issued ASU 2016-08, "Revenue from Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," which clarifies the guidance in ASU 2014-09 and has the same effective date as the original standard. During the three months ended June 30, 2016, the FASB issued ASU 2016-10, "Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing"; ASU 2016-11, "Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting"; and ASU 2016-12, "Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients." These amendments are intended to improve and clarify the implementation guidance of ASU 2014-09 and have the same effective date as the original standard. The Company has not yet selected a transition method and is currently evaluating the impact of adoption on the consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, "Presentation of Financial Statements—Going Concern." The update provides U.S. GAAP guidance on management's responsibility in evaluating whether there is substantial doubt about a company's ability to continue as a going concern and about related footnote disclosures. For each reporting period, management will be required to evaluate whether there are conditions or events that raise substantial doubt about a company's ability to continue as a going concern within one year from the date the financial statements are issued. The amendments in this update are effective for the annual period ending after December 15, 2016 and for annual and interim periods thereafter. The Company is currently evaluating the impact of adoption on the consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory," which requires most entities to measure most inventories at the lower of cost or net realizable value ("NRV"). This simplifies the evaluation from the current method of lower of cost or market, where market is based on one of three measures (i.e. replacement cost, net realizable value, or net realizable value less a normal profit margin). ASU 2015-11 does not apply to inventories measured under the last-in, first-out method or the retail inventory method, and defines NRV as the "estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation." ASU 2015-11 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted for any interim and annual financial statements that have not yet been issued. The Company is currently evaluating the impact of adoption on the consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities," which amends certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Changes to the current guidance include the accounting for equity investments, the presentation and disclosure requirements for financial instruments, and the assessment of valuation allowance on deferred tax assets related to available-for-sale securities. In addition, ASU 2016-01 establishes an incremental recognition and disclosure requirement related to the presentation of fair value changes of financial liabilities for which the fair value option has been elected. Under this guidance, an entity would be required to separately present in other comprehensive income the portion of the total fair value change attributable to instrument-specific credit risk as opposed to reflecting the entire amount in earnings. ASU 2016-01 is effective for fiscal years and interim periods beginning after December 15, 2017, and upon adoption, an entity should apply the amendments by means of a cumulative-effect adjustment to the balance sheet at the beginning of the first reporting period in which the guidance is effective. Early adoption is not permitted except for the provision to record fair value changes for financial liabilities under the fair value option resulting from instrument-specific credit risk in other comprehensive income. The Company is currently evaluating the impact of adoption on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting," which will simplify the income tax consequences, accounting for forfeitures and classification on the Statements of Consolidated Cash Flows. ASU 2016-09 is effective for fiscal years and interim periods beginning after December 15, 2016, with early adoption permitted. The Company is currently evaluating the impact of adoption on the consolidated

financial statements.

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2. INVENTORY

Inventory as of September 30, 2016 and December 31, 2015 consists of the following (in thousands):

| | September 30, 2016 | December 31, 2015 |
|-----------------|-----------------------|----------------------|
| Raw materials | \$ 4,677 | \$ 2,202 |
| Finished goods | 34,424 | 38,598 |
| Total inventory | \$ 39,101 | \$ 40,800 |

3. WARRANTY OBLIGATIONS

The Company's warranty activities during the three and nine months ended September 30, 2016 and 2015 were as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|----------|---------------------------------------|------------|
| | 2016 | 2015 | 2016 | 2015 |
| Warranty obligations, beginning of period | \$30,066 | \$33,763 | \$30,547 | \$33,940 |
| Accruals for warranties issued during period | 1,194 | 1,400 | 2,931 | 3,707 |
| Changes in estimates | 783 | 498 | 1,548 | 736 |
| Settlements | (2,561) | (2,615) | (6,517) | (5,480) |
| Increase due to accretion expense | 461 | 272 | 1,279 | 643 |
| Other | 406 | (512) | 561 | (740) |
| Warranty obligations, end of period | \$30,349 | \$32,806 | \$30,349 | \$32,806 |
| Less current portion | | | \$(6,761) | \$(6,612) |
| Noncurrent | | | \$23,588 | \$26,194 |

As of September 30, 2016, the \$30.3 million of warranty obligations included \$9.5 million measured at fair value. As of December 31, 2015, the \$30.5 million of warranty obligations included \$6.2 million measured at fair value. See Note 4, "Fair Value Measurements" for additional information.

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.

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The following table presents the Company's assets and liabilities that were measured at fair value on a recurring basis and its categorization within the fair value hierarchy at September 30, 2016 and December 31, 2015 (in thousands):

| | Fair Value Hierarchy | September 30, 2016 | December 31, 2015 |
|------------------------------------|----------------------|--------------------|-------------------|
| Assets: | | | |
| Foreign currency forward contracts | Level 2 | \$ — | \$ 86 |
| Liabilities: | | | |
| Foreign currency forward contracts | Level 2 | \$ — | \$ 9 |
| Warranty obligations | Level 3 | 9,515 | 6,182 |
| Contingent consideration | Level 3 | 444 | 473 |

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. At September 30, 2016, the Company did not have any outstanding foreign currency forward contracts. At December 31, 2015, the notional amount of the Company's foreign currency forward contracts outstanding was \$2.4 million. For the three and nine months ended September 30, 2016 and 2015, gains and losses from foreign currency forward contracts recorded in other income (expense), net were insignificant.

Fair Value Option for Warranty Obligations Related to 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.

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.

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The following table provides information regarding changes in nonfinancial liabilities related to the Company's warranty obligations measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the periods indicated (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|---------|-------------------|---------|
| | September 30, | | September 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Balance at beginning of period | \$8,053 | \$5,803 | \$6,182 | \$3,562 |
| Accruals for warranties issued during period | 1,185 | 1,327 | 2,898 | 3,510 |
| Changes in estimates | (200) | — | (678) | — |
| Settlements | (390) | (74) | (726) | (159) |
| Increase due to accretion expense | 461 | 272 | 1,279 | 643 |
| Other | 406 | (512) | 560 | (740) |
| Balance at end of period | \$9,515 | \$6,816 | \$9,515 | \$6,816 |

Contingent Consideration Liability

The following table provides information regarding changes in financial liabilities related to the contingent consideration liability arising from a previous acquisition measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the periods indicated (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|----------------------------------|--------------------|---------|-------------------|----------|
| | September 30, | | September 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Balance at beginning of period | \$444 | \$1,400 | \$473 | \$2,300 |
| Revaluations | — | (700) | — | (1,600) |
| Contingent consideration payment | — | — | (29) | — |
| Balance at end of period | \$444 | \$700 | \$444 | \$700 |

Quantitative and Qualitative Information about Level 3 Fair Value Measurements

As of September 30, 2016, the significant unobservable inputs used in the fair value measurement of the Company's liabilities designated as Level 3 are as follows:

| Item Measured at Fair Value | Valuation Technique | Description of Significant Unobservable Input | Percent Used (Weighted-Average) |
|--|--|---|---------------------------------|
| Warranty obligations for microinverters sold since January 1, 2014 | Discounted cash flows | Profit element and risk premium | 17% |
| | | Credit-adjusted risk-free rate | 21% |
| Contingent consideration liability | Probability-weighted discounted cash flows | Risk-adjusted discount rate | 17% |

As of December 31, 2015, the significant unobservable inputs used in the fair value measurement of the Company's liabilities designated as Level 3 are as follows:

| Item Measured at Fair Value | Valuation Technique | Description of Significant Unobservable Input | Percent Used (Weighted-Average) |
|--|-----------------------|---|---------------------------------|
| Warranty obligations for microinverters sold since January 1, 2014 | Discounted cash flows | Profit element and risk premium | 17% |
| | | Credit-adjusted risk-free rate | 25% |

| | | |
|------------------------------------|---|---------------------------------|
| Contingent consideration liability | Probability-weighted discounted cash flows | Risk-adjusted discount rate 17% |
|------------------------------------|---|---------------------------------|

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Sensitivity of Level 3 Inputs

Warranty Obligations

Each of the significant unobservable inputs is independent of the other. The profit element and risk premium are estimated based on requirements of a third-party participant willing to assume the Company's warranty obligations. The credit-adjusted risk free rate ("discount rate") is determined by reference to the Company's own credit standing at the fair value measurement date. Increasing or decreasing the profit element and risk premium input by 100 basis points would not have a material impact on the fair value measurement of the liability. Increasing the discount rate by 100 basis points would result in a \$0.3 million reduction of the liability. Decreasing the discount rate by 100 basis points would result in a \$0.3 million increase to the liability.

Contingent Consideration Liability

Changes in assumed probability adjustments with respect to achievement of target metrics can materially impact the fair value measurement of contingent consideration as of the acquisition date and for each subsequent period. Assumptions about the probability and amount of payout require less subjectivity over the course of the earnout period as management refines estimates based on actual events. Due to the short duration of the remaining earnout period, increasing or decreasing the risk-adjusted discount rate by 100 basis points would not have a material impact on the fair value measurement of the contingent consideration liability.

5. GOODWILL AND INTANGIBLE ASSETS

The following table presents the details of the Company's goodwill and purchased intangible assets as of September 30, 2016 and December 31, 2015 (in thousands):

| | September 30, 2016 | | | December 31, 2015 | | |
|--------------------------------------|--------------------|-----------------------------|---------|-------------------|-----------------------------|---------|
| | Gross | Accumulated Amortization | Net | Gross | Accumulated Amortization | Net |
| Goodwill | \$3,745 | \$ — | \$3,745 | \$3,745 | \$ — | \$3,745 |
| Other indefinite-lived intangibles | \$286 | \$ — | \$286 | \$286 | \$ — | \$286 |
| Intangible assets with finite lives: | | | | | | |
| Customer relationships | \$900 | \$ (315) | \$585 | \$900 | \$ (180) | \$720 |
| Patents and licensed technology | 1,665 | (867) | 798 | 1,665 | (451) | 1,214 |
| Total | \$2,565 | \$ (1,182) | \$1,383 | \$2,565 | \$ (631) | \$1,934 |

In July 2014, the Company purchased certain patents related to system interconnection and photovoltaic AC module construction. The patents are being amortized over their legal life of 3 years. The customer relationship intangible asset associated with a prior acquisition is being amortized on a straight-line basis over its estimated useful life of 5 years. In October 2015, the Company licensed certain technology related to ASIC development for a 3 year term, which is also its estimated useful life.

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For the nine months ended September 30, 2016, amortization expense related to intangible assets was \$0.6 million. As of September 30, 2016, estimated future amortization expense related to finite-lived intangible assets was as follows:

| Year | (In thousands) |
|-------|----------------|
| 2016 | \$ 184 |
| 2017 | 610 |
| 2018 | 409 |
| 2019 | 180 |
| Total | \$ 1,383 |

6. RESTRUCTURING

In the third quarter of 2016, the Company implemented a restructuring plan to lower its operating expenses. The restructuring plan led to a reduction of its workforce globally by approximately 11% of total headcount throughout all areas of the organization and an elimination of certain non-core projects. The restructuring actions are expected to be completed by the end of the fourth quarter of 2016.

The following table presents the details of the Company's restructuring charges for the periods indicated (in thousands):

| | Three Months Ended September 30, | |
|--|----------------------------------|------|
| | 2016 | 2015 |
| Employee severance and benefit arrangements | \$ 1,308 | \$ — |
| Asset impairments | 1,409 | — |
| Total restructuring and asset impairment charges | \$ 2,717 | \$ — |

The following table provides information regarding changes in the Company's accrued restructuring balance for the periods indicated (in thousands):

| | Employee Severance and Benefits | Asset Impairments | Total |
|--|---------------------------------|-------------------|----------|
| Balance at beginning of period as of December 31, 2015 | \$ — | \$ — | \$ — |
| Charges | 1,308 | 1,409 | 2,717 |
| Cash payments | (85) | — | (85) |
| Non-cash settlement | — | (1,409) | (1,409) |
| Balance at end of period as of September 30, 2016 | \$ 1,223 | \$ — | \$ 1,223 |

7. DEBT**Revolving Credit Facility**

The Company maintains a \$50.0 million revolving credit facility with Wells Fargo Bank, N.A. ("Wells Fargo") that was entered into in November 2012, as first amended on February 14, 2014. On December 18, 2015, the Company entered into an amended and restated revolving credit agreement with Wells Fargo (the "Revolver") which extended the maturity date to November 7, 2019 and added an uncommitted accordion feature that could increase the size of the facility by \$25.0 million, subject to the satisfaction of certain conditions.

Availability under the Revolver is subject to a borrowing base calculation that limits availability to a percentage of eligible domestic accounts receivable plus a percentage of the value of eligible domestic inventory, less certain reserves. Borrowings under the Revolver bear interest in cash at an annual rate equal to, at the Company's option, either LIBOR or a "base rate" that is comprised of, among other things, the prime rate, plus a margin that is

between 1.0% and 3.75% depending on the currency borrowed and the specific term of repayment. The Revolver

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requires the Company to pay an unused line fee between 0.25% and 0.375% based on the average daily unused portion of the revolving credit commitment.

The Revolver is secured by a first-priority security interest on substantially all assets of the Company other than intellectual property and contains customary affirmative and negative covenants (including restrictions on the Company's ability to make dividend payments) and events of default. In addition, the Revolver requires the Company to maintain at least \$15.0 million of liquidity at all times, consisting of cash on hand and undrawn availability under the Revolver (defined as borrowing base less outstanding borrowings under the Revolver) of at least \$5.0 million. In July 2016, the Company entered into an amendment to the Revolver with Wells Fargo. The amendment, among other things, allowed the Company to incur indebtedness related to a term loan (described below) and increased the amount of undrawn availability that must be maintained as part of the Revolver's \$15.0 million minimum liquidity covenant from \$5.0 million to \$12.5 million. The Company was in compliance with such covenants as of September 30, 2016. As of September 30, 2016, outstanding borrowings under the Revolver were \$12.5 million. Based upon its eligible borrowing base, net of the restrictions concerning minimum liquidity requirement, the Company could have borrowed an additional \$8.8 million. The weighted-average interest rate related to the outstanding balance was 5.0%.

Term Loan

In July 2016, the Company entered into a Term Loan Agreement with lenders that are affiliates of Tennenbaum Capital Partners, LLC. Under the agreement, the lenders committed to advance a term loan in an aggregate principal amount of up to \$25.0 million with a maturity date of July 1, 2020. The Company borrowed the entire \$25.0 million of term loan commitments on the loan closing date.

Monthly payments due through June 30, 2017 are interest only, followed by consecutive equal monthly payments of principal plus accrued interest beginning on July 1, 2017 and continuing through the maturity date. The term loan provides for an interest rate per annum equal to the higher of (i) 10.25% or (ii) LIBOR plus 9.5625%, subject to a 1.0% reduction if we achieve minimum levels of Revenue and EBITDA (each as defined in the Term Loan Agreement) for the twelve consecutive month period ending June 30, 2017 as set forth in the Term Loan Agreement. In addition, the Company paid a commitment fee of 3.3% of the loan amount upon closing and a closing fee of 10.0% of the loan amount is payable in four equal installments at each anniversary of the closing date. We may elect to prepay the loan by incurring a prepayment fee between 1% and 3% of the principal amount of the term loan depending on the timing and circumstances of prepayment.

The term loan is secured by a second-priority security interest on substantially all our assets except intellectual property. The Term Loan Agreement does not contain any financial covenants, but is subject to customary affirmative and negative covenants including restrictions on creation of liens, dispositions of assets, dividends, mergers, or changing the nature of the Company's business; in each case, subject to certain customary exceptions. In addition, the Term Loan Agreement contains certain customary events of default including, but not limited to, failure to pay interest, principal and fees or other amounts when due, material breach of any representation or warranty, covenant defaults, cross defaults to other material indebtedness, events of bankruptcy and the occurrence of a material adverse change (as defined in the agreement) to the Company's business.

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Long-term debt was comprised of the following at September 30, 2016 and December 31, 2015 (in thousands):

| | September 30, 2016 | December 31, 2015 | |
|--|-----------------------|----------------------|---|
| Term loan | \$ 25,000 | \$ | — |
| Less unamortized discount and issuance costs | (995 |) | — |
| Carrying amount of debt | 24,005 | — | |
| Less current portion | (1,197 |) | — |
| Long-term debt | \$ 22,808 | \$ | — |

As of September 30, 2016, the amount of scheduled principal payments due on the term loan is as follows (in thousands):

| |
|----------------|
| Year Amounts |
| 2016 \$— |
| 2017 3,032 |
| 2018 7,824 |
| 2019 8,665 |
| 2020 5,479 |
| Total \$25,000 |

8. COMMITMENTS AND 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.

The Company believes its cash on hand of \$24.1 million as of September 30, 2016, its reduced cost structure as a result of its restructuring initiatives implemented in the third quarter of 2016, together with borrowings expected to be available under the Revolver, will be sufficient to fund its operations and satisfy its working capital needs, capital asset purchases, indebtedness payments and outstanding commitments for at least the next 12 months. If the Company is unable to meet its projected performance targets or manage its inventory levels to align with anticipated demand, its liquidity could be adversely impacted and it may need to seek additional sources of liquidity. If additional sources of liquidity are needed, the Company 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 its business, results of operations and financial position.

9. SALE OF COMMON STOCK

On September 28, 2016, the Company completed a public offering of 13,000,000 shares of its common stock at a price to the public of \$1.20 per share. Net proceeds realized were approximately \$14.0 million after deducting underwriting fees and estimated offering costs. The Company intends to use the net proceeds for working capital and general corporate purposes.

On October 11, 2016, the underwriter for the offering exercised in full an over-allotment option to purchase an additional 1,950,000 shares of the Company's common stock, which generated additional net proceeds of approximately \$2.2 million. The sale of the additional shares occurred subsequent to the quarter ended September 30, 2016, and the effect of the sale is not reflected in these condensed consolidated financial statements.

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10. 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, 2015.

Equity Awards Activity

Stock Options

The following is a summary of stock option activity for the nine months ended September 30, 2016 (in thousands, except per share data):

| | Number of Shares Outstanding | Weighted- Average Exercise Price per Share |
|-----------------------------------|------------------------------------|---|
| Outstanding at December 31, 2015 | 8,173 | \$ 5.36 |
| Granted | 2,367 | 2.15 |
| Exercised | (374) | 0.39 |
| Canceled | (831) | 7.01 |
| Outstanding at September 30, 2016 | 9,335 | 4.60 |

The intrinsic value of options exercised in the nine months ended September 30, 2016 was \$0.7 million. As of September 30, 2016, the intrinsic value of options outstanding was \$1.1 million based on the closing price of the Company's stock as of September 30, 2016.

Restricted Stock Units

The following is a summary of restricted stock unit activity for the nine months ended September 30, 2016 (in thousands, except per share data):

| | RSUs | Weighted Average Fair Value per Share at Grant Date |
|-----------------------------------|--------|--|
| Outstanding at December 31, 2015 | 1,313 | \$ 9.31 |
| Granted | 54 | 1.99 |
| Vested | (432) | 9.13 |
| Canceled | (206) | 7.41 |
| Outstanding at September 30, 2016 | 729 | 9.41 |

The total intrinsic value of restricted stock units that were vested in the nine months ended September 30, 2016 was \$0.8 million. As of September 30, 2016, the intrinsic value of restricted stock units outstanding was \$0.9 million based on the closing price of the Company's stock as of September 30, 2016.

Stock-Based Compensation Expense

Compensation expense 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):

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| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|----------------------------|--|---------|---------------------------------------|---------|
| | 2016 | 2015 | 2016 | 2015 |
| Cost of revenues | \$295 | \$331 | \$907 | \$913 |
| Research and development | 941 | 1,141 | 3,047 | 3,379 |
| Sales and marketing | 560 | 803 | 1,760 | 2,510 |
| General and administrative | 736 | 1,008 | 2,525 | 2,777 |
| Total | \$2,532 | \$3,283 | \$8,239 | \$9,579 |

The following table summarizes the various types of stock-based compensation expense for the periods presented (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|---------|---------------------------------------|---------|
| | 2016 | 2015 | 2016 | 2015 |
| Stock options and restricted stock units | \$1,983 | \$2,753 | \$6,703 | \$8,153 |
| Employee stock purchase plan | 549 | 530 | 1,536 | 1,426 |
| Total | \$2,532 | \$3,283 | \$8,239 | \$9,579 |

The following table presents the weighted-average grant date fair value of options granted for the periods presented and the assumptions used to estimate those values using a Black-Scholes option pricing model:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|--------|---------------------------------------|--------|
| | 2016 | 2015 | 2016 | 2015 |
| Weighted average grant date fair value | \$1.25 | \$3.01 | \$1.31 | \$5.40 |
| Expected term (in years) | 4.5 | 4.6 | 4.5 | 4.5 |
| Expected volatility | 84.7 % | 72.2 % | 79.8 % | 72.1 % |
| Annual risk-free rate of return | 1.1 % | 1.5 % | 1.1 % | 1.4 % |
| Dividend yield | 0.0 % | 0.0 % | 0.0 % | 0.0 % |

As of September 30, 2016, there was approximately \$12.5 million of total unrecognized compensation expense related to unvested equity awards expected to be recognized over a weighted-average period of 2.3 years.

11. INCOME TAXES

The Company used the discrete tax approach in calculating the tax expense for the three and nine months ended September 30, 2016 and 2015 due to the fact that a relatively small change in the Company's projected pre-tax net income (loss) could result in a volatile effective tax rate. Under the discrete method, the Company determines its tax (expense) benefit based upon actual results as if the interim period was an annual period. The tax provision recorded was primarily related to income taxes attributable to its foreign operations.

Under Accounting Standards Codification 740, "Income Taxes," a provision for income taxes must be provided on the undistributed earnings of foreign subsidiaries unless such earnings are deemed to be permanently reinvested outside the United States. Prior to 2016, the Company did not provide for U.S. tax on foreign unremitted earnings because the Company considered such earnings to be permanently reinvested outside the U.S. During the nine months ended September 30, 2016, due to recent developments in its business, the Company determined that subsidiaries with cumulative earnings were not deemed to be permanently invested. Accordingly, the Company recorded income tax expense of \$0.1 million on cumulative foreign earnings of approximately \$4.5 million that the Company determined no longer met the criteria to be considered permanently invested.

12. NET INCOME (LOSS) PER SHARE

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period. Diluted income (loss) per share is computed in a similar manner, but it also includes the effect of potential common shares outstanding during the period, when dilutive.

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Potential common shares include outstanding in-the-money stock options, restricted stock units, shares to be purchased under the Company's employee stock purchase plan and warrants to purchase common stock. The dilutive effect of potentially dilutive common shares is reflected in diluted earnings per share by application of the treasury stock method. To the extent these potential common shares are antidilutive, they are excluded from the calculation of diluted net income (loss) per share.

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

| | Three Months Ended September 30, 2016 | | Nine Months Ended September 30, 2015 | |
|--|--|---------|--|-----------|
| Numerator: | | | | |
| Net income (loss) | \$(18,756) | \$ 624 | \$(54,274) | \$(6,299) |
| Denominator: | | | | |
| Weighted average common shares outstanding | 47,278 | 44,734 | 46,704 | 44,339 |
| Effect of dilutive securities | | | | |
| Employee stock-based awards | — | 3,261 | — | — |
| Warrants | — | 1 | — | — |
| Weighted average common shares outstanding for diluted calculation | 47,278 | 47,996 | 46,704 | 44,339 |
| Net income (loss) per share, basic | \$(0.40) | \$ 0.01 | \$(1.16) | \$(0.14) |
| Net income (loss) per share, diluted | \$(0.40) | \$ 0.01 | \$(1.16) | \$(0.14) |

For the three months ended September 30, 2015, the Company excluded 6.3 million of potential common shares outstanding from the calculation of diluted net income per share because their effect would have been antidilutive. In periods of net loss, all potential common shares were excluded from the diluted calculation because their effect would have been antidilutive. The following table summarizes the potential common shares excluded from the diluted calculation for the periods indicated (in thousands):

| | Three Months Ended September 30, 2016 | | Nine Months Ended September 30, 2015 | |
|-----------------------------------|--|-------|---|--------|
| Employee stock options | 9,383 | 4,817 | 8,944 | 8,718 |
| Restricted stock units | 840 | 1,523 | 994 | 1,551 |
| Warrants to purchase common stock | 45 | — | 85 | 111 |
| Total | 10,268 | 6,340 | 10,023 | 10,380 |

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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 related notes 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 "continue" or the negative of 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, 2015.

Overview

We deliver simple, innovative and reliable energy management solutions that advance the worldwide potential of renewable energy. We were founded in March 2006 and have grown rapidly to become the market leader in the microinverter category. Our technology was designed to increase energy production, simplify design and installation, improve system uptime and reliability, reduce fire safety risk, and provide a platform for intelligent energy management. Since inception, we have shipped over 12.6 million microinverters representing over 3 gigawatts of solar PV generating capacity, and more than 540,000 Enphase residential and commercial systems have been deployed in over 100 countries.

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") and strategic partners. Historically, revenue generated from the U.S. market has represented more than 80% of our total revenue.

New Products

Enphase AC Battery™

In the third quarter of 2016, we began shipments of our Enphase AC Battery™ to distributors in Australia and New Zealand. The Enphase AC Battery is a scalable, modular energy storage system with a 1.2kWh energy capacity. We expect to begin shipments to customers in the United States, France, the United Kingdom and the Netherlands in the fourth quarter of 2016.

The Enphase AC Battery is suitable for any home regardless of the brand of inverters or solar panels used. A costly upgrade of the existing solar system's inverter is not required. We believe this makes the Enphase AC Battery a competitive solution for homeowners looking to add energy storage to their existing solar PV system.

The modular size of each Enphase AC Battery enables installers to customize each installation to match a homeowner's unique energy needs, and gives homeowners the flexibility to add more Enphase AC Batteries in the future as energy usage changes over time. Using the Enphase AC Battery, we believe homeowners can achieve sustainable self-consumption or store solar energy generated for use at times when grid-supplied energy rates are at their peak.

The Enphase AC Battery is a key component of the Enphase Home Energy Solution, which consists of our microinverter, Envoy™ Communications Gateway and Enphase Enlighten™, a cloud-based energy management platform. System owners can use Enphase Enlighten to monitor their home's solar generation, energy storage and consumption from any web-enabled device.

Enphase IQ Microinverter System

In September 2016, we announced our Enphase Home Energy Solution with IQ™, our next-generation integrated solar, storage and energy management system. The solution features our sixth-generation microinverter system, which supports high-powered 60 and 72-cell solar modules, integrates with upcoming AC modules from LG, SolarWorld and Jinko Solar, and we believe offers installers faster and simpler installations, saving on soft costs. We expect the Enphase IQ 6 Microinverter System to be available in North America in the first quarter of 2017.

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Enphase Energized AC Modules

We have also recently announced Enphase Energized AC Modules with IQ, which utilize our sixth generation microinverters and will be produced through our AC module partnerships with LG, SolarWorld and Jinko Solar, among others. We expect Enphase Energized AC Modules to be available in the U.S. and Canada in the second quarter of 2017.

Operating Expense Reduction Initiatives

In September 2016, we implemented a restructuring plan to lower operating expenses. This plan led to a reduction of our workforce globally by approximately 11% of total headcount throughout all areas of the organization and an elimination of certain non-core projects. Under the plan, we incurred aggregate restructuring charges of approximately \$2.7 million in the third quarter of 2016, which is comprised of approximately \$1.3 million in cash-based severance and related benefits and \$1.4 million in non-cash charges for asset impairments and write-offs related to property and equipment. We expect the restructuring actions to be completed by the end of the fourth quarter of 2016.

Components of Condensed Consolidated Statements of Operations

Net Revenues

We generate net revenues from sales of our microinverter systems, which include microinverter units, an Envoy communications gateway and other accessories, and our Enlighten cloud-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 compete effectively in the marketplace by developing and introducing new products to meet the changing technology and performance requirements of our customers, the diversification and expansion of our revenue base, and our ability to market our products in a manner that increases awareness for microinverter technology and differentiates us in the marketplace.

Cost of Revenues and Gross Profit

Cost of revenues is comprised primarily of product costs, warranty, manufacturing personnel and logistics costs, freight costs, depreciation and amortization of test equipment and hosting service 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 and amortization of 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. 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.

In addition, third parties, including one of our contract manufacturers, serve as our logistics providers by warehousing and delivering our products in the United States, Europe and Asia.

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

Operating Expenses

Operating expenses consist of research and development, sales and marketing, general and administrative and restructuring expenses. Personnel-related costs are the most significant component of each of these expense categories and include salaries, benefits, payroll taxes, sales commissions, incentive compensation and stock-based compensation.

Research and development expense includes personnel-related expenses such as salaries, incentive compensation, stock-based compensation and employee benefits. Research and development employees are engaged in the design and development of power electronics, semiconductors, powerline communications, networking and software functionality, and storage. Research and development expense also includes third-party design and development costs, testing and evaluation costs, depreciation expense and other indirect costs. We devote substantial resources to research and development programs that focus on enhancements to, and cost efficiencies in, our existing products and timely development of new products that utilize technological innovation to

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drive down product costs, improve functionality, and enhance reliability. We intend to continue to invest in our research and development efforts because we believe they are critical to maintaining our competitive position. Sales and marketing expense consists primarily of personnel-related expenses such as salaries, commissions, incentive compensation, stock-based compensation, employee benefits and travel. It also includes trade shows, marketing, customer support and other indirect costs. We currently offer microinverter systems targeting the residential and commercial markets in the United States, Canada, Mexico and certain Central American markets, the United Kingdom, France, the Benelux region, certain other European markets, Australia, New Zealand and certain other Asian markets. We expect to continue to expand the geographic reach of our product offerings and explore new sales channels in addressable markets in the future.

General and administrative expense consists primarily of salaries, incentive compensation, 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.

Restructuring charges relate to restructuring initiatives implemented in the third quarter of 2016 to improve operational performance and reduce overall operating expense. Costs included in restructuring primarily consist of severance for workforce reduction actions and non-cash charges related to the impairment of certain property and equipment as a result of the actions taken. See Note 6, "Restructuring" for additional information.

Other Income (Expense), Net

Other expense, net includes interest expense and fees under our revolving credit facility and term loan including amortization of debt discount and issuance costs. Other expense, net also includes gains or losses upon conversion of non-U.S. dollar transactions into U.S. dollars and 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. Due to the history of losses we have generated in the United States since inception, we believe that it is more-likely-than-not that all of our U.S. and state deferred tax assets will not be realized as of September 30, 2016.

Results of Operations for the Three and Nine Months Ended September 30, 2016 and 2015

Net Revenues

| Three Months Ended September 30, 2016 | | Change in | | Nine Months Ended September 30, 2016 | | Change in | | |
|---------------------------------------|----------|-----------|------------|--------------------------------------|-----------|-----------|------------|-------|
| 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % | |
| (dollars in thousands) | | | | (dollars in thousands) | | | | |
| Net revenues | \$88,684 | \$102,874 | \$(14,190) | (14)% | \$231,990 | \$291,620 | \$(59,630) | (20)% |

Three Months Ended September 30, 2016 and 2015

Net revenues decreased by 14% for the three months ended September 30, 2016 compared to the same period in 2015 due to a decrease in microinverter systems sold and lower average selling prices. We sold 869,000 microinverter units in the three months ended September 30, 2016 versus 950,000 units in the same period in 2015. The average revenue per watt of microinverter systems sold declined by approximately 7% for the three months ended September 30, 2016, as compared to the same period in 2015. We expect average selling prices for microinverter systems to continue to decline in the future, which may negatively affect net revenues.

Nine Months Ended September 30, 2016 and 2015

Net revenues decreased by 20% for the nine months ended September 30, 2016 versus the same period in 2015 due to a decrease in microinverter systems sold and lower average selling prices. We sold 2,276,000 microinverter units in the nine months ended September 30, 2016 versus 2,528,000 units in the same period in

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2015. The average revenue per watt of microinverter systems sold declined approximately 14% for the nine months ended September 30, 2016 versus the same period in 2015.

Cost of Revenues and Gross Profit

| | Three Months Ended September 30, | | Change in | | Nine Months Ended September 30, | | Change in | |
|------------------|-------------------------------------|----------|-----------|-------|------------------------------------|-----------|-----------|-------|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| | (dollars in thousands) | | | | (dollars in thousands) | | | |
| Cost of revenues | \$72,805 | \$71,408 | \$1,397 | 2 % | \$190,215 | \$199,103 | \$(8,888) | (4)% |
| Gross profit | 15,879 | 31,466 | (15,587) | (50)% | 41,775 | 92,517 | (50,742) | (55)% |
| Gross margin | 17.9 % | 30.6 % | (12.7) | | 18.0 % | 31.7 % | (13.7) | |

Three Months Ended September 30, 2016 and 2015

Cost of revenues increased by 2% for the three months ended September 30, 2016 compared to the same period in 2015. The slight increase in cost of revenues was primarily attributable an increase in warranty expense as a result of fluctuations in the discount factor used in our mark-to-market method of accounting for eligible warranties and incremental expedited delivery costs associated with the launch of our AC battery product, partially offset by lower volume of shipments of our products. Gross margin decreased by 13 percentage points for the three months ended September 30, 2016 compared to the same period in 2015. The primary driver of the decrease in gross margin was the shift towards a more competitive pricing strategy that we implemented in late 2015. Our ability to reduce product costs and the timing of product cost reductions relative to declines in average selling prices can have a significant impact on our gross margin.

Nine Months Ended September 30, 2016 and 2015

Cost of revenues decreased by 4% for the nine months ended September 30, 2016 compared to the same period in 2015, which reflects the lower volume of shipments of our products. Gross margin decreased by 14 percentage points for the nine months ended September 30, 2016 compared to the same period in 2015. The primary driver of the decrease in gross margin was the shift towards a more competitive pricing strategy that we implemented in late 2015.

Research and Development

| | Three Months Ended September 30, | | Change in | | Nine Months Ended September 30, | | Change in | |
|--------------------------|--|----------|-----------|----|---------------------------------------|----------|-----------|----|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| | (dollars in thousands) | | | | (dollars in thousands) | | | |
| Research and development | \$13,169 | \$12,059 | \$1,110 | 9% | \$39,326 | \$38,275 | \$1,051 | 3% |

Three Months Ended September 30, 2016 and 2015

Research and development expense increased by 9% for the three months ended September 30, 2016 compared to the same period in 2015. Personnel-related costs increased by \$0.8 million as the prior year third quarter included a \$1.0 million reversal of accrued incentive compensation. The remaining increase was primarily attributable to an increase in costs related to outside services. The amount of research and development expense may fluctuate from period to period due to the differing levels and stages of research and development activity.

Nine Months Ended September 30, 2016 and 2015

Research and development expense increased by 3% for the nine months ended September 30, 2016 versus the same period in 2015. Costs incurred for outside services increased by \$1.6 million, which was offset by a \$0.5 million decrease in depreciation expense related to research and development equipment.

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Sales and Marketing

| | Three Months Ended September 30, 2016 | | Change in | | Nine Months Ended September 30, 2016 | | Change in | |
|---------------------|---------------------------------------|----------|-----------|----|--------------------------------------|----------|-----------|-------|
| | 2015 | | \$ | % | 2015 | | \$ | % |
| | (dollars in thousands) | | | | (dollars in thousands) | | | |
| Sales and marketing | \$11,016 | \$10,510 | \$506 | 5% | \$31,218 | \$34,955 | \$(3,737) | (11)% |

Three Months Ended September 30, 2016 and 2015

Sales and marketing expense increased by 5% for the three months ended September 30, 2016 compared to the same period in 2015. The increase was primarily attributable to \$1.6 million increase in bad debt expense as a result of certain customers experiencing financial difficulties. In addition, the three months ended September 30, 2015 included a \$0.7 million gain from revaluation of contingent consideration. This increase was offset by a \$1.7 million decrease in personnel-related costs from lower sales and marketing headcount as part of our cost reduction initiatives. In addition, promotional and marketing related activities decreased by \$0.1 million versus the same period in 2015.

Nine Months Ended September 30, 2016 and 2015

Sales and marketing expense decreased by 11% for the nine months ended September 30, 2016 compared to the same period in 2015. The decrease was primarily driven by decreased personnel-related costs of \$7.0 million resulting from reduced sales and marketing headcount as part of our cost reduction initiatives. In addition, costs related to promotional and marketing related activities and use of outside services decreased by \$1.2 million. These decreases were partially offset by a \$2.9 million increase in bad debt expense as a result of certain customers experiencing financial difficulties, including bankruptcy. In addition, the nine months ended September 30, 2015 included a \$1.6 million gain from revaluation of contingent consideration.

General and Administrative

| | Three Months Ended September 30, 2016 | | Change in | | Nine Months Ended September 30, 2016 | | Change in | |
|----------------------------|---------------------------------------|---------|-----------|------|--------------------------------------|----------|-----------|-------|
| | 2015 | | \$ | % | 2015 | | \$ | % |
| | (dollars in thousands) | | | | (dollars in thousands) | | | |
| General and administrative | \$6,708 | \$7,118 | \$(410) | (6)% | \$21,121 | \$23,425 | \$(2,304) | (10)% |

Three Months Ended September 30, 2016 and 2015

General and administrative expense decreased by 6% for the three months ended September 30, 2016 compared to the same period in 2015. Personnel-related costs decreased by \$0.8 million, which was entirely offset by the reversal of accrued incentive compensation recorded in the third quarter of 2015. The \$0.4 million decrease in general and administrative expenses was primarily attributable to a decrease in our usage of professional services.

Nine Months Ended September 30, 2016 and 2015

General and administrative expense decreased by 10% for the nine months ended September 30, 2016 compared to the same period in 2015. The decrease was primarily attributable to a \$1.4 million decrease in our usage of professional services combined with a \$1.3 million decrease in personnel-related costs. These decreases were partially offset by a \$0.4 million increase in facilities-related expenses including rent, utilities and depreciation of corporate fixed assets.

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Restructuring Charges

| | Three Months Ended September 30, 2016 | | Change in | | Nine Months Ended September 30, 2016 | | Change in | |
|-----------------------|---------------------------------------|------|------------------------|-----|--------------------------------------|------|------------------------|-----|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| | (dollars in thousands) | | (dollars in thousands) | | (dollars in thousands) | | (dollars in thousands) | |
| Restructuring charges | \$2,717 | \$— | -\$2,717 | N/A | \$2,717 | \$— | -\$2,717 | N/A |

Three and Nine Months Ended September 30, 2016 and 2015

In the third quarter of 2016, we implemented a restructuring plan to lower operating expenses. The restructuring plan led to a reduction of our workforce globally by approximately 11% of total headcount throughout all areas of the organization and an elimination of certain non-core projects. Restructuring charges consisted of \$1.3 million in cash-based severance and related benefits and \$1.4 million in non-cash charges for asset impairments and write-offs related to property and equipment. The restructuring actions are expected to be completed by the fourth quarter of 2016.

Other Income (Expense), Net

| | Three Months Ended September 30, 2016 | | Change in | | Nine Months Ended September 30, 2016 | | Change in | |
|--------------------|---------------------------------------|---------|------------------------|----|--------------------------------------|-----------|------------------------|-------|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| | (dollars in thousands) | | (dollars in thousands) | | (dollars in thousands) | | (dollars in thousands) | |
| Other expense, net | \$(881) | \$(844) | \$(37) | 4% | \$(943) | \$(1,457) | \$514 | (35)% |

Three Months Ended September 30, 2016 and 2015

Other expense, net remained flat for three months ended September 30, 2016 versus the same period in 2015. Interest expense increased by \$1.1 million due to increased borrowings, which was entirely offset by net gains associated with transactions denominated in Euros and the Australian Dollar.

Nine Months Ended September 30, 2016 and 2015

Other expense, net decreased by \$0.5 million for the nine months ended September 30, 2016 compared to the same period in 2015. The decrease was primarily attributable to a \$1.8 million increase in net gains associated with transactions denominated in Euros and the Australian Dollar. This decrease was offset by a \$1.3 million increase in interest expense resulting from increased borrowings.

Liquidity and Capital Resources

As of September 30, 2016, we had \$24.1 million in cash and cash equivalents and working capital of \$44.3 million. Cash and cash equivalents held in the United States were \$19.5 million and consisted primarily of non-interest bearing checking deposits, with the remainder held in various foreign subsidiaries. We consider amounts held outside the U.S. to be accessible and have provided for the estimated U.S. income tax liability associated with our foreign earnings. During the quarter ended September 30, 2016, we took a number of actions to improve our liquidity. In July 2016, we entered into a \$25.0 million term loan (described below) that provides for interest-only payments for the first twelve months. In addition, we implemented a restructuring initiative that included an 11% reduction in workforce and eliminated certain projects that did not have a near-term return on investment. In September 2016, we completed a public offering of 13,000,000 shares of our common stock at a price to public of \$1.20 per share. Net proceeds realized were approximately \$14.0 million after deducting underwriting fees and estimated offering costs. Additionally, in October 2016, the underwriter for the offering exercised in full the over-allotment option to purchase an additional 1,950,000 shares of our common stock, which generated additional net proceeds of approximately \$2.2 million.

Based on our current financial plan, we believe our cash on hand of \$24.1 million as of September 30, 2016, our reduced cost structure as a result of our restructuring initiatives initiated in the third quarter of 2016 and borrowings expected to be available under our Revolver will enable us to fund our operations and satisfy our working capital

needs, capital asset purchases, indebtedness payments and outstanding commitments for at least the next 12 months. If we are unable to meet our projected performance targets or manage our inventory levels to

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align with anticipated demand, our liquidity could be adversely impacted and we may need to seek additional sources of liquidity. 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.

Revolving Credit Facility

We maintain a \$50.0 million revolving credit facility with Wells Fargo Bank, N.A. (“Wells Fargo”) that was entered into in November 2012, as first amended on February 14, 2014. On December 18, 2015, we entered into an amended and restated revolving credit agreement with Wells Fargo (the “Revolver”) which extended the maturity date to November 7, 2019 and added an uncommitted accordion feature that could increase the size of the facility by \$25.0 million, subject to the satisfaction of certain conditions.

Availability under the Revolver is subject to a borrowing base calculation that limits availability to a percentage of eligible domestic accounts receivable plus a percentage of the value of eligible domestic inventory, less certain reserves. Borrowings under the Revolver bear interest in cash at an annual rate equal to, at our option, either LIBOR or a “base rate” that is comprised of, among other things, the prime rate, plus a margin that is between 1.0% and 3.75% depending on the currency borrowed and the specific term of repayment. The Revolver requires us to pay a commitment fee between 0.25% and 0.375% based on the average daily unused portion of the revolving credit commitment.

The Revolver is secured by a first-priority security interest on substantially all our assets other than intellectual property and contains customary affirmative and negative covenants (including restrictions on our ability to make dividend payments) and events of default. In addition, the Revolver requires us to maintain at least \$15.0 million of liquidity at all times, consisting of cash on hand and undrawn availability under the Revolver (defined as borrowing base less outstanding borrowings under the Revolver) of at least \$5.0 million. In July 2016, we entered into an amendment to the Revolver with Wells Fargo. The amendment, among other things, allowed us to incur indebtedness related to the term loan described below and increased the amount of undrawn availability that must be maintained as part of the Revolver’s \$15.0 million minimum liquidity covenant from \$5.0 million to \$12.5 million. We were in compliance with such covenants as of September 30, 2016.

As of September 30, 2016, outstanding borrowings under the Revolver were \$12.5 million. Based upon our eligible borrowing base, net of the restrictions concerning minimum liquidity requirement, we could have borrowed an additional \$8.8 million. The weighted-average interest rate related to the outstanding balance was 5.0%.

Term Loan

In July 2016, we entered into a loan and security agreement (the “Term Loan Agreement”) with lenders that are affiliates of Tennenbaum Capital Partners, LLC. Under the agreement, the lenders committed to advance a term loan in an aggregate principal amount of up to \$25.0 million with a maturity date of July 1, 2020. We borrowed the entire \$25.0 million of term loan commitments on the loan closing date. We expect to use the proceeds for general corporate purposes.

Monthly payments due through June 30, 2017 are interest only, followed by consecutive equal monthly payments of principal plus accrued interest beginning on July 1, 2017 and continuing through the maturity date. The term loan provides for an interest rate per annum equal to the higher of (i) 10.25% or (ii) LIBOR plus 9.5625%, subject to a 1.0% reduction if we achieve minimum levels of Revenue and EBITDA (each as defined in the Term Loan Agreement) for the twelve consecutive month period ending June 30, 2017 as set forth in the Term Loan Agreement. In addition, we paid a commitment fee of 3.3% of the loan amount upon closing and a closing fee of 10.0% of the loan amount is payable in four equal installments at each anniversary of the closing date. We may elect to prepay the loan by incurring a prepayment fee between 1% and 3% of the principal amount of the term loan depending on the timing and circumstances of prepayment.

The term loan is secured by a second-priority security interest on substantially all our assets except intellectual property. The Term Loan Agreement does not contain any financial covenants, but is subject to customary affirmative and negative covenants including restrictions on creation of liens, dispositions of assets, dividends, mergers, or changing the nature of its business, in each case, subject to certain customary exceptions. In addition, the Term Loan

Agreement contains certain customary events of default including, but not limited to, failure to pay interest, principal and fees or other amounts when due, material breach of any representation or warranty, covenant defaults, cross defaults to other material indebtedness, events of bankruptcy and the occurrence of a material adverse change (as defined in the agreement) to our business.

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

| | Nine Months Ended | |
|---|-------------------|------------|
| | September 30, | |
| | 2016 | 2015 |
| | (In thousands) | |
| Net cash used in operating activities | \$(28,588) | \$(29,309) |
| Net cash used in investing activities | (10,285) | (9,682) |
| Net cash provided by financing activities | 34,640 | 19,866 |
| Effect of exchange rate changes on cash | (107) | (416) |
| Net decrease in cash and cash equivalents | (4,340) | (19,541) |

Operating Activities

For the nine months ended September 30, 2016, net cash used in operating activities of \$28.6 million was primarily attributable to a net loss of \$54.3 million offset by non-cash charges of \$21.0 million and net cash inflows from changes in operating assets and liabilities of \$4.7 million. Non-cash charges included \$8.2 million of stock-based compensation, \$8.0 million of depreciation and amortization, \$3.2 million provision for doubtful accounts and \$1.4 million in asset impairment charges.

The primary driver of cash inflows from changes in operating assets and liabilities was a \$14.9 million increase in accounts payable, accrued and other liabilities resulting from timing of vendor payments. Also contributing to cash inflows was an increase in deferred revenue related to our cloud-based monitoring service of \$8.7 million and a decrease in inventory of \$1.7 million, which was attributable to improved working capital management. Cash outflows from changes in operating assets and liabilities included a \$16.6 million increase in accounts receivable as a result of higher sales in the third quarter of 2016 compared to the fourth quarter of 2015, a \$3.9 million increase in prepaid expenses and other assets attributable to deferral of costs for certain sales arrangements with extended payment terms and a \$0.2 million decrease to warranty obligations.

For the nine months ended September 30, 2015, net cash used in operating activities of \$29.3 million was primarily attributable to a net loss of \$6.3 million, net changes in our operating assets and liabilities of \$39.6 million, offset by non-cash charges of \$16.6 million primarily consisting of stock-based compensation and depreciation and amortization. Cash used for operating assets and liabilities included a \$30.5 million increase in accounts receivable. Other changes in operating assets and liabilities that used cash included a \$15.1 million increase in inventory, a \$5.0 million increase in other assets and a \$1.1 million decrease in warranty obligations. Cash provided by changes in operating assets and liabilities included a \$5.0 million increase in accounts payable, accrued and other liabilities and a \$7.2 million increase in deferred revenue.

Investing Activities

For the nine months ended September 30, 2016, net cash used in investing activities of \$10.3 million primarily resulted from purchases of test and assembly equipment, capitalized costs related to internal-use software and license fees for certain technology related to ASIC development.

For the nine months ended September 30, 2015, net cash used in investing activities of \$9.7 million primarily resulted from purchases of test and assembly equipment and capitalized costs related to internal-use software.

Financing Activities

For the nine months ended September 30, 2016, net cash provided by financing activities of \$34.6 million consisted of net proceeds from our term loan of \$23.9 million, net public equity offering proceeds of \$14.4 million and proceeds received from the issuance of common stock under employee stock plans of \$0.9 million, offset by the net repayment of our revolving credit facility of \$4.6 million.

For the nine months ended September 30, 2015, net cash provided by financing activities was \$19.9 million, consisting of \$17.0 million in net borrowings under our Revolver and \$2.9 million in proceeds received from the issuance of common stock under employee stock plans.

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Contractual Obligations

The following table summarizes our outstanding contractual obligations as of September 30, 2016:

| | Payments Due by Period | | | | |
|--|------------------------|------------------|-----------|-----------|-------------------|
| | Total | Less Than 1 Year | 1-3 Years | 4-5 Years | More Than 5 Years |
| | (in thousands) | | | | |
| Operating leases | \$16,267 | \$2,619 | \$5,464 | \$5,231 | \$2,953 |
| Revolving credit facility (1) | 12,450 | 12,450 | — | — | — |
| Term loan | 25,000 | 1,197 | 16,075 | 7,728 | — |
| Interest and fees related to term loan | 8,933 | 3,182 | 4,607 | 1,144 | — |
| Purchase obligations (2) | 39,612 | 37,525 | 2,087 | — | — |
| Total | \$102,262 | \$56,973 | \$28,233 | \$14,103 | \$2,953 |

(1) Because borrowings outstanding under our revolving credit facility can fluctuate, interest payments have been excluded from this table.

Purchase obligations include amounts related to component inventory that our primary contract manufacturer procures on our behalf in accordance with our production forecast and a take-or-pay supply agreement for the (2) purchase of silicone encapsulates that expires on December 31, 2018. The timing of purchases in future periods could differ materially from estimates presented above due to fluctuations in demand requirements related to varying sales levels as well as changes in economic conditions.

Off-Balance Sheet Arrangements

As of September 30, 2016, 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

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 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 requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the consolidated financial statements.

There have been no significant changes during the nine months ended September 30, 2016 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, 2015.

Recently Issued Accounting Pronouncements Not Yet Effective

See Note 1, Description of Business and Basis of Presentation, of the Notes to Condensed Consolidated Financial Statements under Item 1 for recently issued accounting pronouncements not yet effective.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about market risk, see Item 7A, “Quantitative and Qualitative Disclosures About Market Risk” of our annual report on Form 10-K for the year ended December 31, 2015. Our exposures to market risk have not changed materially since December 31, 2015.

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 September 30, 2016. 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 disclosure. Based on the evaluation of our disclosure controls and procedures as of September 30, 2016, 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, 2015.

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 significant net losses since we began doing business, including a net loss of \$54.3 million during the nine months ended September 30, 2016. As of September 30, 2016, we had an accumulated deficit of \$237.3 million.

We have incurred substantial operating losses since our inception, and we may continue to incur additional losses in the future. 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 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.

The rapidly changing solar industry makes it difficult to evaluate our current business and future prospects.

The rapidly changing solar industry 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.

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 utility-provided 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, have recently 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 loss of, or events affecting, one of our major customers could reduce our sales and have a material adverse effect on our business, financial condition and results of operations.

In 2015, CED Greentech and Vivint Solar, Inc. accounted for 17% and 12% of total net revenues, respectively. In 2014, Vivint Solar, Inc. and CED Greentech accounted for 24% and 16% of total net revenues, respectively. Our customers' decisions to purchase our products are influenced by a number of factors outside of our control, including retail energy prices and government regulation and incentives, among others. Although we have agreements with some of our largest customers, these agreements generally do not have long-term purchase commitments and are generally terminable by either party after a relatively short notice period. In addition, these customers may decide to no longer use, or to reduce the use of, our products and services for other reasons that may be out of our control. For example, beginning in 2015, Vivint Solar, Inc. implemented a multi-sourcing strategy, and therefore, is not sole-sourcing our microinverters, which has resulted in and may continue to result in a reduction in our revenue generated from sales to Vivint. The loss of, or events affecting, Vivint or one or more of our other large customers have had, could have and could continue to have a material adverse effect on our business, financial condition and results of operations.

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 and competitor discounts and rebates;
- our ability to reduce and control product costs, including our ability to make product cost reductions in a timely manner to offset declines in our product prices;
- 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;

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our ability to reduce production costs, such as through technology innovations, in order to offset price declines in our products over time;

changes in shipment volume;

changes in distribution channels;

excess and obsolete inventory and inventory holding charges;

expediting costs incurred to meet customer delivery requirements; and

fluctuations in foreign currency exchange rates.

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

We are under continuous pressure to reduce the prices of our products, which has adversely affected, and may continue to adversely affect, our gross margins.

The solar power industry has been characterized by declining product prices over time. We have reduced the prices of our products in the past, and we expect to continue to experience pricing pressure for our products in the future, including from our major customers. In addition, we are reducing our prices ahead of planned cost reductions of our products, which has adversely affected our gross margins. When seeking to maintain or increase their market share, our competitors may also reduce the prices of their products. In addition, our customers may have the ability or seek to internally develop and manufacture competing products at a lower cost than we would otherwise charge, which would add additional pressure on us to lower our selling prices. 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 gross margins would continue to be adversely affected.

Given the general downward pressure on prices for our products driven by competitive pressure and technological change, a principal component of our business strategy is reducing the costs to manufacture our products to remain competitive. If our competitors are able to drive down their manufacturing costs faster than we can or increase the efficiency of their products, our products may become less competitive even when adjusted for efficiency. Further, if raw materials costs and other third-party component costs were to increase, we may not meet our cost reduction targets. If we cannot effectively execute our cost reduction roadmap, we may not be able to remain price competitive, which would result in lost market share and lower gross margins.

*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 on hand, together with borrowings expected to be available under our Revolver 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:

fund our operations;

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 and 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.

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

The market for PV inverter solutions is highly competitive. To date, we have competed primarily against central and string inverter manufacturers, but as the solar industry rapidly grows, new solutions and technologies

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are emerging that will directly compete with our business. Competitors in the inverter market include, amongst others, SMA Solar Technology AG, Fronius International GmbH, ABB Ltd. and SolarEdge Technologies, Inc., and other emerging companies offering alternative microinverter, DC to DC optimizer and other power electronic solutions. Competition has intensified, and we expect the trend to continue as new and existing competitors enter the microinverter market, or market and sell related products, such as DC to DC optimizers that can be used in conjunction with central or string inverters. SMA Solar Technology AG and ABB Ltd. market and sell microinverter products, and several new entrants to the microinverter market have recently announced plans to ship or have already shipped products. We believe that a number of companies have developed or are developing microinverters and other products that will compete directly with our microinverter systems in the module-level power electronics, or MLPE market, including low-cost Asian manufacturers. In addition, central and string inverter manufacturers continue to reduce their prices, putting additional pressure on us and other alternative technologies.

Several of our existing and potential competitors are significantly larger than we are and may have greater financial, marketing, distribution, and customer support resources, and may have significantly broader brand recognition, especially in certain markets. In addition, some of our competitors have more resources and experience in developing or acquiring new products and technologies and creating market awareness for these offerings. 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 anticipate, 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 also may face competition from some of our customers or potential customers who evaluate our capabilities against the merits of manufacturing products internally. For instance, SunPower Corporation acquired a microinverter company SolarBridge Technologies, Inc. in November of 2014. Other solar module manufacturers could also develop or acquire competing inverter technology or 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 or potential 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.

Developments in alternative technologies or improvements in distributed solar energy generation may have a material adverse effect on demand for our offerings.

Significant developments in alternative technologies, such as advances in other forms of distributed solar PV power generation, storage solutions such as batteries, the widespread use or adoption of fuel cells for residential or commercial properties or improvements in other forms of centralized power production may have a material adverse effect on our business and prospects. Any failure by us to adopt new or enhanced technologies or processes, or to react to changes in existing technologies, could result in product obsolescence, the loss of competitiveness of our products, decreased revenue and a loss of market share to competitors.

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 produce microinverter systems that compete favorably against other solutions on the basis of price, quality, reliability and performance;
- 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;

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• 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 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 or string inverters. These installers often have made substantial investments in design, installation resources and training in traditional central or string inverter systems, which may create challenges for us to achieve their adoption of our microinverter systems.

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, 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.

*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, any of 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

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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.

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

To date, we have generated the majority 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 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. For instance, the Renewable Energy and Job Creation Act of 2008 was recently extended as part of an Omnibus Appropriations Bill and provides a 30% federal tax credit for residential and commercial solar installations through December 31, 2019 and reduced tax credits of 26% and 22% through December 31, 2020 and 2021 respectively, before being reduced to 10% for commercial installations and 0% for residential installations beginning in 2022.

In addition, net energy metering tariffs are being evaluated and in some instances modified which may have a negative impact on future inverter sales. We derive a significant portion of our revenues from California's residential solar market and the existing California net energy metering tariff has been very successful in incentivizing the installation of residential solar systems. California, however, is re-evaluating existing incentives, tariffs and rates for residential systems in order to accommodate a sustainable growth trajectory for residential solar and to also encourage the adoption of other distributed energy resources, such as energy storage, that provide additional benefits to the consumer and the electricity grid. There is a risk that future regulatory changes do not adequately stimulate future growth in the residential solar market. We also sell our products in Europe. A number of European countries, including Germany, Belgium, Spain, Italy and the United Kingdom have adopted reductions or concluded their FiT programs. 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.

We also sell 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. In 2013, Australia elected a new national government. The new leadership 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.

We also sell our products in Ontario, Canada. 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.

We believe the Federal and State tax credits, applicable federal and state grants, applicable tariffs and other incentive programs have had a positive effect on our sales since inception. However, unless these programs are further extended or modified to allow for continued growth in the residential solar market, the phase-out of such programs could adversely affect sales of our products in the future. The reductions in incentives and uncertainty around future energy policy, including local content requirements, have negatively affected and may continue to negatively affect our

business, financial condition, and results of operations as we seek to increase our business domestically and abroad. Additionally, as we further expand to other countries, changes in incentive programs or

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electricity policies could negatively affect returns on our investments in those countries as well as our business, financial condition, and results of operations.

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, Canada, Mexico and certain Central American markets, France, the Benelux region, certain other European markets, Australia, New Zealand and certain other Asian markets, 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 or territories, including California, Hawaii and Queensland, Australia, have either implemented or are considering implementing new restrictions on incentives or rules 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 that 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.

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

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.

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

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price of electricity from the utility grid. Moreover, technological developments by our competitors in the solar components industry, including manufacturers of central inverters and DC to DC optimizers, 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.

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 each subsequent 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 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.

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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 workforce, our business and operating results may suffer.

We have experienced, and expect to experience in the future, volatility in our sales and operations. Our historical growth has placed, and planned future growth plans are expected to continue to place, significant demands on our management as well as our financial and operational resources, to:

- manage a dynamic 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 dynamic employee base;
- broaden our customer support capabilities;
- implement new and upgrade existing operational and financial systems; and
- enhance our financial disclosure controls and procedures.

We cannot assure you that our current and planned operations, personnel, systems, internal procedures and controls will be adequate to support our future operations. If we cannot manage our sales and operations 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.

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We currently offer microinverter systems targeting the residential and commercial markets in the United States, Canada, Mexico and certain Central American markets, the United Kingdom, France, the Benelux region, certain other European markets, Australia, New Zealand and certain other Asian markets. 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, recycling 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.

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 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.

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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 may 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 the vast majority of 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.

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

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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. Similarly, the battery cells for our AC Battery product will also initially be sole sourced. 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 may currently be 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 and 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 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 systems 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 system, 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 United States

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and elsewhere is or may become highly concentrated, with a few significant finance companies and several smaller entrants. If we are unable 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. We do not have exclusive arrangements with these third parties and, as a result, many of our customers also use or market and sell products from our competitors, which may reduce our sales. Our customers may generally 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.

We may fail to capture customers in the new product and geographic markets that we are pursuing.

We are pursuing opportunities in energy management and energy storage which are highly competitive markets. We have made investments in our infrastructure, increased our operating costs and forgone other business opportunities in order to seek opportunities in these areas and will continue to do so. Any new product is subject to certain risks, including component sourcing, strategic partner selection and execution, customer acceptance, competition, product differentiation, market timing, challenges relating to economies of scale in component sourcing and the ability to attract and retain qualified personnel. There can be no assurance that we will be able to develop and grow these or any other new concepts to a point where they will become profitable, or generate positive cash flow. If we fail to execute on our plan with respect to new product introductions, these new potential business segments fail to translate into revenue in the quantities or timeline projected, thus, having a materially adverse impact on our revenue, operating results and financial stability. In addition, we are pursuing new geographic markets. The inability to capture new customers in the high-growth geographic markets could have a material adverse effect on our business, financial condition or results of operations.

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 or protect inventions covered by our patents or patent applications. As we become more visible as a publicly traded company, the possibility that third

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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;
- stop manufacturing, selling, incorporating or using our products that embody the asserted intellectual property;
- pay substantial monetary damages;
- indemnify 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, 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 facility and term loan may limit our flexibility in responding to business opportunities and competitive developments and increase our vulnerability to adverse economic or industry conditions.

We are a party to a loan and security agreement with Wells Fargo Bank, National Association (“Wells Fargo”) and a term loan agreement with affiliates of Tennenbaum Capital Partners, LLC (“TCP”). These agreements restrict our ability to take certain actions such as incurring additional debt, encumbering our tangible or intangible property,

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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 these agreements 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.

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 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 of the Sarbanes-Oxley Act 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, 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 of the Sarbanes-Oxley Act 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 (the “Code”), contain rules that limit the ability of a company that undergoes an “ownership change,” generally defined as a more than 50 percentage point increase in

the percentage of its stock owned by certain stockholders 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

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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. If these limitations apply, 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. We recently completed a study to assess whether an ownership change has occurred or whether there have been multiple ownership changes since we became a loss corporation under the Code. However, we do not anticipate these limitations will significantly impact our ability to utilize the net operating losses and tax credit carryforwards.

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. 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 cloud-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 and adversely affected.

Any unauthorized access to, or disclosure or theft of personal information we gather, store or use could harm our reputation and subject us to claims or litigation.

We receive, store and use certain personal information of our customers, and the end-users of our customers' solar PV systems, including names, addresses, e-mail addresses, credit information and energy production statistics. We also store and use personal information of our employees. We take steps to protect the security, integrity and confidentiality of the personal information we collect, store and transmit, but there is no guarantee that inadvertent or unauthorized use or disclosure will not occur or that third parties will not gain unauthorized access to this information despite our efforts. Because techniques used to obtain unauthorized access or sabotage systems change frequently and generally are not identified until they are launched against a target, we and our suppliers or vendors may be unable to anticipate these techniques or to implement adequate preventative or mitigation measures.

Unauthorized use or disclosure of, or access to, any personal information maintained by us or on our behalf, whether through breach of our systems, breach of the systems of our suppliers or vendors by an unauthorized party, or through employee or contractor error, theft or misuse, or otherwise, could harm our business. If any such unauthorized use or disclosure of, or access to, such personal information were to occur, our operations could be seriously disrupted and we could be subject to demands, claims and litigation by private parties, and investigations, related actions, and penalties by regulatory authorities. In addition, we could incur significant costs in notifying affected persons and entities and otherwise complying with the multitude of foreign, federal, state and local laws and regulations relating to the unauthorized access to, or use or disclosure of, personal information. Finally, any perceived or actual unauthorized access to, or use or disclosure of, such information could harm our reputation, substantially impair our ability to attract and retain customers and have an adverse impact on our business, financial condition and results of operations.

We may be subject to disruptions or failures in information technology systems and network infrastructures that could have a material adverse effect on our business and financial condition.

We rely on the efficient and uninterrupted operation of complex information technology systems and network infrastructures to operate our business. A disruption, infiltration or failure of our information technology systems as a

result of software or hardware malfunctions, system implementations or upgrades, computer viruses, cyber attacks,

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third-party security breaches, employee error, theft or misuse, malfeasance, power disruptions, natural disasters or accidents could cause breaches of data security, loss of intellectual property and critical data and the release and misappropriation of sensitive competitive information and partner, customer and employee personal data. We have been and may in the future be subject to fraud attempts from outside parties through our electronic systems (such as “phishing” e-mail communications to our finance, technical or other personnel), which could put us at risk for harm from fraud, theft or other loss if our internal controls do not operate as intended. Any of these events could harm our competitive position, result in a loss of customer confidence, cause us to incur significant costs to remedy any damages and ultimately materially adversely affect our business and financial condition.

We are dependent on ocean transportation to deliver our products in a cost efficient manner. If we are unable to use ocean transportation to deliver our products, our business and financial condition could be materially and adversely impacted.

We rely on commercial ocean transportation for the delivery of a large percentage of our products to our customers in North America. We also rely on more expensive air transportation when ocean transportation is not available or compatible with the delivery time requirements of our customers. Our ability to deliver our products via ocean transportation could be adversely impacted by shortages in available cargo capacity, changes by carriers and transportation companies in policies and practices, such as scheduling, pricing, payment terms and frequency of service or increases in the cost of fuel, taxes and labor; and other factors, such as labor strikes and work stoppages, not within our control. If we are unable to use ocean transportation and are required to substitute more expensive air transportation, our financial condition and results of operations could be materially and adversely impacted. Material interruptions in service or stoppages in transportation, whether caused by strike, work stoppage, lock-out, slowdown or otherwise, could materially and adversely impact our business, results of operations and financial condition.

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 this Quarterly Report on Form 10-Q, and other factors 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;

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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 and 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.

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 affiliated stockholders, executive officers and directors own a significant percentage of our stock, and they may take actions that our other stockholders may not view as beneficial.

Our affiliated stockholders, executive officers and directors collectively own a significant percentage 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.

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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 revolving credit facility 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 director 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;
- prohibiting stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;

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.

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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

None.

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: November 2, 2016

ENPHASE ENERGY, INC.

By: /s/ Humberto Garcia

Humberto Garcia

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. ⁽¹⁾ |
| 3.2 | Amended and Restated Bylaws of Enphase Energy, Inc. ⁽²⁾ |
| 4.1 | Specimen Common Stock Certificate of Enphase Energy, Inc. ⁽³⁾ |
| 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. ⁽³⁾ |
| 4.3 | 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. ⁽³⁾ |
| 10.1 | Amendment No. 1 to Amended and Restated Credit Agreement and Amended and Restated Guaranty and Security Agreement by and among Enphase Energy, Inc., the lenders identified on the signature pages thereto and Wells Fargo Bank, National Association, as agent, dated July 8, 2016. |
| 10.2 | Loan and Security Agreement by and among Enphase Energy, Inc., Tennenbaum Special Situations Fund IX and the lenders identified on the signature pages thereto and Obsidian Agency Services, Inc.. as administrative agent and collateral agent for the lenders, dated July 8, 2016. |
| 10.3 | Amendment No. 2 to the Cooperation Agreement and Amendment No. 1 by and among Enphase Energy, Inc., Phoenix Contact GmbH & Co. KG and Phoenix Contact USA, Inc., dated September 1, 2016. |
| 10.4 | Amendment No. 1 to Flextronics Logistics Services Agreement by and between Enphase Energy, Inc. and Flextronics America LLC, dated July 28, 2016. |
| 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. |

(1) 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.