

Enphase Energy, Inc.  
Form 10-Q  
November 13, 2012  
Table of Contents

**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, 2012

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)

Edgar Filing: Enphase Energy, Inc. - Form 10-Q

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**20-4645388**  
(I.R.S. Employer  
Identification No.)

**1420 N. McDowell Blvd.**  
**Petaluma, California**  
(Address of principal executive offices)

**94954**  
(Zip Code)

**(707) 774-7000**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

As of October 31, 2012, there were 40,829,676 shares of the registrant's common stock outstanding, \$0.00001 par value per share.

**Table of Contents**

**ENPHASE ENERGY, INC.**

**FORM 10-Q FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2012**

**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
Item 1. <u>Financial Statements (Unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets</u>	3
<u>Condensed Consolidated Statements of Operations</u>	4
<u>Condensed Consolidated Statements of Comprehensive Loss</u>	5
<u>Condensed Consolidated Statement of Stockholders' Equity</u>	6
<u>Condensed Consolidated Statements of Cash Flows</u>	7
<u>Notes to Condensed Consolidated Financial Statements</u>	8
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	25
Item 4. <u>Controls and Procedures</u>	25
<b><u>PART II. OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	26
Item 1A. <u>Risk Factors</u>	26
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	42
Item 3. <u>Defaults Upon Senior Securities</u>	42
Item 4. <u>Mine Safety Disclosure</u>	42
Item 5. <u>Other Information</u>	42
Item 6. <u>Exhibits</u>	42
<u>Signature</u>	43

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)****ENPHASE ENERGY, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except par value)****(Unaudited)**

	September 30, 2012	December 31, 2011
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 41,717	\$ 51,524
Accounts receivable, net of allowances of \$169 and \$144 as of September 30, 2012 and December 31, 2011, respectively	32,734	17,771
Inventory	16,650	11,228
Prepayment to supplier	5,000	
Prepaid expenses and other	2,030	1,264
Total current assets	98,131	81,787
Property and equipment, net	24,926	18,411
Other assets	1,042	6,044
Total assets	\$ 124,099	\$ 106,242
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 15,197	\$ 12,928
Accrued liabilities	15,331	10,100
Deferred revenues	769	23,414
Current portion of term loans	6,844	4,529
Convertible preferred stock warrant liability		1,399
Total current liabilities	38,141	52,370
Long-term liabilities:		
Deferred revenues	6,151	3,670
Warranty obligations	11,904	6,733
Other liabilities	272	145
Term loans	5,103	10,148
Convertible notes		19,202
Total long-term liabilities	23,430	39,898
Total liabilities	61,571	92,268
Commitments and contingencies		
Stockholders' equity:		

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

Convertible preferred stock, \$0.00001 par value, no shares authorized, issued or outstanding at September 30, 2012; 23,559 shares authorized, 22,221 shares issued and outstanding at December 31, 2011		93,596	
Preferred stock, \$0.00001 par value, 10,000 shares authorized, none issued and outstanding at September 30, 2012; no shares authorized, issued or outstanding at December 31, 2011			
Common stock, \$0.00001 par value, 100,000 shares authorized, 40,757 shares issued and outstanding at September 30, 2012; 41,410 shares authorized, 1,698 shares issued and outstanding at December 31, 2011			
Additional paid-in capital	181,814	9,103	
Accumulated deficit	(119,284)	(88,808)	
Accumulated other comprehensive income (loss)	(2)	83	
 Total stockholders' equity	 62,528	 13,974	
 Total liabilities and stockholders' equity	 \$ 124,099	 \$ 106,242	

See accompanying notes to the unaudited condensed consolidated financial statements.

**Table of Contents****ENPHASE ENERGY, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share data)****(Unaudited)**

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Net revenues	\$ 60,813	\$ 44,728	\$ 159,110	\$ 92,389
Cost of revenues	44,489	36,185	119,878	76,391
<b>Gross profit</b>	<b>16,324</b>	<b>8,543</b>	<b>39,232</b>	<b>15,998</b>
Operating expenses:				
Research and development	10,571	6,431	27,068	17,919
Sales and marketing	7,039	4,567	18,448	11,842
General and administrative	6,911	3,980	18,698	11,119
Total operating expenses	24,521	14,978	64,214	40,880
Loss from operations	(8,197)	(6,435)	(24,982)	(24,882)
Other expense, net:				
Interest income	3		17	4
Interest expense	(527)	(886)	(5,411)	(1,626)
Other income (expense)	(56)	145	246	(249)
Total other expense, net	(580)	(741)	(5,148)	(1,871)
Loss before income taxes	(8,777)	(7,176)	(30,130)	(26,753)
Provision for income taxes	(130)		(346)	
<b>Net loss attributable to common stockholders</b>	<b>\$ (8,907)</b>	<b>\$ (7,176)</b>	<b>\$ (30,476)</b>	<b>\$ (26,753)</b>
Net loss per share attributable to common stockholders, basic and diluted	\$ (0.22)	\$ (4.77)	\$ (1.11)	\$ (23.68)
Shares used in computing net loss per share attributable to common stockholders, basic and diluted	40,755	1,503	27,356	1,130

See accompanying notes to the unaudited condensed consolidated financial statements.

**Table of Contents**

**ENPHASE ENERGY, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

**(In thousands)**

**(Unaudited)**

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Net loss attributable to common stockholders	\$ (8,907)	\$ (7,176)	\$ (30,476)	\$ (26,753)
Other comprehensive loss:				
Foreign currency translation adjustments	(102)	(104)	(85)	(94)
Other comprehensive loss	(102)	(104)	(85)	(94)
Comprehensive loss attributable to common stockholders	\$ (9,009)	\$ (7,280)	\$ (30,561)	\$ (26,847)

See accompanying notes to the unaudited condensed consolidated financial statements.

**Table of Contents****ENPHASE ENERGY, INC.****CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY****(In thousands)****(Unaudited)**

	Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders Equity
	Shares	Amount	Shares	Amount				
BALANCE December 31, 2011	22,221	\$ 93,596	1,698	\$	\$ 9,103	\$ (88,808)	\$ 83	\$ 13,974
Exercise of stock options			39		47			47
Stock-based compensation					3,159			3,159
Common stock issued upon initial public offering ( IPO ), net of offering costs			10,315		53,826			53,826
Conversion of convertible preferred stock into common stock upon IPO	(22,221)	(93,596)	25,171		93,596			
Conversion of convertible notes and paid-in-kind interest into common stock upon IPO			3,534		21,204			21,204
Conversion of convertible preferred stock warrants to common stock warrants upon IPO					879			879
Net loss						(30,476)		(30,476)
Foreign currency translation adjustment							(85)	(85)
BALANCE September 30, 2012		\$	40,757	\$	\$ 181,814	\$ (119,284)	\$ (2)	\$ 62,528

See accompanying notes to the unaudited condensed consolidated financial statements.



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

	<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (30,476)	\$ (26,753)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	3,938	2,020
Provision for doubtful accounts	60	64
Net loss on disposal of assets	110	
Non-cash interest expense	3,969	745
Stock-based compensation	3,159	1,439
Change in fair value of convertible preferred stock warrants	(520)	273
Changes in operating assets and liabilities:		
Accounts receivable	(15,023)	(9,609)
Inventory	(5,422)	(5,739)
Prepayment to supplier	(5,000)	
Prepaid expenses and other assets	(448)	(2,005)
Accounts payable, accrued and other liabilities	13,543	14,685
Deferred revenues	(20,164)	1,651
Net cash used in operating activities	(52,274)	(23,229)
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(11,054)	(9,589)
Net cash used in investing activities	(11,054)	(9,589)
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of convertible notes		12,500
Proceeds from private placement of common stock		1,097
Proceeds from term loans and debt	2,600	9,248
Term loan and debt issuance costs		(189)
Repayments of term loans	(5,522)	(1,381)
Principal payments under capital leases	(96)	(130)
Proceeds from the exercise of stock options	47	182
Proceeds from issuance of common stock in IPO, net of underwriting discounts and commissions	58,609	
Payment of offering costs	(2,032)	(1,886)
Net cash provided by financing activities	53,606	19,441
Effect of exchange rate changes on cash	(85)	(94)
Net decrease in cash and cash equivalents	(9,807)	(13,471)
Cash and cash equivalents Beginning of period	51,524	39,993

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

Cash and cash equivalents End of period	\$ 41,717	\$ 26,522
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 1,250	\$ 909
Noncash financing and investing activities:		
Assets acquired under capital lease	\$	\$ 295
Purchases of property and equipment included in accounts payable	\$ 412	\$ 1,720
Offering costs not yet paid	\$	\$ 575
Conversion of convertible notes into common stock upon IPO	\$ 21,204	\$
Reclassification of convertible preferred stock warrant liability to additional paid-in capital upon IPO	\$ 879	\$

See accompanying notes to the unaudited condensed consolidated financial statements.

---

**Table of Contents**

**ENPHASE ENERGY, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. ORGANIZATION AND DESCRIPTION OF BUSINESS**

Enphase Energy, Inc. and subsidiaries (the "Company") designs, develops, and sells microinverter systems for the solar photovoltaic industry. The Company was incorporated in 2006 and began selling its products in 2008. The Company's microinverter system consists of (i) an Enphase microinverter that attaches to the racking beneath solar modules and converts direct current ("DC") power to grid-compliant alternating current ("AC") power; (ii) an Envoy communications gateway device that collects and transmits performance information from each solar module to the Company's hosted data center; and (iii) the Enlighten web-based software platform that collects and processes this information to enable customers to monitor and manage their solar power systems. The Company sells microinverter systems primarily to distributors who resell them to solar installers. The Company also sells directly to large installers as well as through original equipment manufacturers ("OEMs") and strategic partners.

On April 4, 2012, the Company consummated its initial public offering ("IPO"). As a result, the following transactions were recorded in the Company's consolidated financial statements during the second quarter of 2012:

the Company issued 10,315,151 shares of common stock (including exercise of the full over-allotment by the underwriters of 1,345,454 shares of common stock), at an offering price of \$6.00 per share, for gross proceeds of \$61.9 million. Certain related parties, who owned convertible preferred and common stock and held convertible notes, purchased 2,500,000 shares of the total amount of shares issued of the Company's common stock at the \$6.00 offering price. The net proceeds from the sale of the shares were \$53.8 million, after deducting the underwriters' discounts and commissions of \$3.3 million and other offering costs of \$4.8 million;

the 22,220,856 outstanding shares of the Company's convertible preferred stock (\$93.6 million carrying value) automatically converted into 25,171,017 shares of common stock;

the convertible preferred stock warrant liability (\$0.9 million carrying value) was reclassified to additional paid-in capital and the warrants to purchase 187,243 shares of convertible preferred stock became warrants to purchase 199,458 shares of common stock;

the outstanding balance of principal and accrued paid-in-kind interest thereon (\$21.2 million gross carrying value) for the Convertible Notes (see Note 8) automatically converted into 3,533,988 shares of common stock at a conversion price equal to the initial public offering price of \$6.00 per share;

the aggregate debt issuance costs and debt discounts of \$2.8 million related to the Convertible Facility (see Note 9) were written-off to interest expense as a result of the conversion of the outstanding notes and the automatic termination of the \$80.0 million Convertible Facility; and

the Company filed an amended and restated certificate of incorporation, which authorized 100,000,000 shares of common stock and 10,000,000 shares of preferred stock.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation** The accompanying interim condensed consolidated financial statements are unaudited. These interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

America ( GAAP ) and the applicable rules and regulations of the Securities and Exchange Commission ( SEC ) for interim financial information. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. The December 31, 2011 condensed consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP. However, the Company believes that the disclosures are adequate to ensure that the information presented is not misleading. These interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s Prospectus filed pursuant to Rule 424(b) under the Securities Act, as amended (the Exchange Act ) with the SEC on March 30, 2012 (the Prospectus ).

In the opinion of management, the accompanying condensed consolidated financial statements of the Company contain all adjustments, including normal recurring adjustments, necessary to present fairly the statement of financial position as of September 30, 2012, its results of operations and statements of cash flows for the three and nine months ended September 30, 2012 and 2011, respectively. The results of operations for the three and nine months ended September 30, 2012 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

**Table of Contents**

The accompanying condensed consolidated financial statements reflect the application of certain significant accounting policies. There have been no material changes to the Company's significant accounting policies that are disclosed in its audited consolidated financial statements and notes thereof as of December 31, 2011 included in its Prospectus.

**3. INVENTORY**

Inventory as of September 30, 2012 and December 31, 2011 consists of the following (in thousands):

	September 30, 2012	December 31, 2011
Raw materials	\$ 3,076	\$ 1,848
Finished goods	13,574	9,380
<b>Total inventory</b>	<b>\$ 16,650</b>	<b>\$ 11,228</b>

During the nine months ended September 30, 2012, \$1.6 million of inventory write-downs were offset by a corresponding decrease in the warranty expense related to such inventory (see Note 5). During the nine months ended September 30, 2011, \$0.4 million of the inventory write-down was offset by a corresponding decrease in the warranty expense related to such inventory (see Note 5).

**4. PREPAYMENT TO SUPPLIER**

	September 30, 2012	December 31, 2011
Prepayment to supplier	\$ 5,000	\$

The Company made a prepayment of \$5.0 million to its primary contract manufacturer in August 2012 for inventories to be delivered in the fourth quarter of 2012.

**5. WARRANTY OBLIGATIONS**

The Company's microinverters include a limited warranty of 15 to 25 years. The potential liability is generally in the form of product replacement. Estimated warranty costs are included in cost of revenues and are accrued at the time of sale on a per unit sold basis. Such estimates are based on various factors including historical warranty claims, anticipated frequency of future warranty claims, and assumptions about the frequency of product failures, derived from results of accelerated lab testing, field monitoring and the Company's reliability estimates. Product failure rates are estimated primarily by using field monitoring of the actual failure rates of the microinverters the Company has sold to date. Predicted failure rates are updated periodically based on field return data. Corresponding replacement costs are updated periodically to reflect changes in the actual and estimated production costs for the Company's microinverters. The Company's estimated costs of warranty for previously sold products may change to the extent future products are not compatible with earlier generation products under warranty.

Changes in the Company's product warranty liability during the nine months ended September 30, 2012 and 2011 were as follows (in thousands):

	Nine Months Ended September 30,	
	2012	2011
Balance, at beginning of period	\$ 8,738	\$ 2,668
Warranty expense	9,110	4,552
Settlements	(2,355)	(1,040)
 Balance, at end of period	 15,493	 6,180
Less current portion	(3,589)	(1,800)

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

Long-term portion	\$ 11,904	\$ 4,380
-------------------	-----------	----------

During the three months ended September 30, 2012, warranty expense includes \$2.9 million resulting from changes in estimates which increased warranty expense by \$4.8 million related to analyses of accumulated information with respect to the estimated long-term performance and related replacement costs of our previous generation products, offset by changes in estimates which decreased warranty expense by \$1.9 million resulting from decreases in estimated replacement, servicing and shipping costs.

**Table of Contents**

During the nine months ended September 30, 2012, warranty expense includes \$2.5 million resulting from changes in estimates which increased warranty expense by \$6.0 million related to analyses of accumulated information with respect to the estimated long-term performance and related replacement costs of our previous generation products, offset by changes in estimates which decreased warranty expense by \$1.9 million resulting from decreases in estimated replacement, servicing and shipping costs and a change in estimate which decreased warranty expense by \$1.6 million to reflect lower replacement costs resulting from inventory write-downs (see Note 3).

During the nine months ended September 30, 2011, warranty expense includes \$0.8 million resulting from changes in estimates which increased warranty expense by \$1.2 million to reflect increased estimated replacement costs for certain products and increases to other estimated cost assumptions, offset by a change in estimate which decreased warranty expense by \$0.4 million to reflect lower replacement costs resulting from inventory write-downs (see Note 3).

**6. DERIVATIVE INSTRUMENTS**

**Foreign Currency Forward Contracts** The Company operates and conducts business in foreign countries where its foreign entities use the local currency as their respective functional currency and, as a result, are exposed to movements in foreign currency exchange rates. In June 2012, the Company began to utilize foreign currency forward contracts to reduce the impact of foreign currency fluctuations related to anticipated cash receipts from expected future revenues denominated in Euros and intercompany transaction gains or losses. The foreign currency forward contracts are accounted for as derivatives whereby the fair value of the contracts is reported as other current assets or current liabilities in the accompanying condensed consolidated balance sheets, and gains and losses resulting from changes in the fair value are reported in other income (expense), net, in the accompanying condensed consolidated statements of operations.

A summary of open foreign currency forward contracts at September 30, 2012 is as follows (all open contracts are obligations for the Company to deliver the foreign currency) (in thousands):

Maturity Date	Foreign Quantity	Contract Value	Market Value	Asset (Liability)
October 15, 2012	4,500	\$ 5,640	\$ 5,503	\$ (137)
January 15, 2013	4,000	5,024	4,912	(112)
<b>Total</b>		<b>\$ 10,664</b>	<b>\$ 10,415</b>	<b>\$ (249)</b>

For the three and nine months ended September 30, 2012, the Company recognized losses of \$249,000 and \$236,000, respectively, related to foreign currency forward contracts.

**7. 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 required to be 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 has the ability 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.

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

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.



**Table of Contents**

The following table presents the Company's financial instruments that were measured at fair value on a recurring basis by level within the fair value hierarchy (in thousands):

	September 30, 2012	December 31, 2011
<b>Financial Liabilities:</b>		
Preferred stock warrant liability (Level 3)	\$	\$ 1,399
Foreign currency forward contracts (Level 2)	249	
Total	\$ 249	\$ 1,399

**8. LONG-TERM DEBT**

The Company's long-term debt consists of the following (in thousands):

	September 30, 2012	December 31, 2011
Term loans, net of unamortized discount of \$283 and \$435, respectively	\$ 7,724	\$ 9,935
Equipment financing facility, net of unamortized discount of \$110 and \$156, respectively	4,223	4,742
Total debt	11,947	14,677
Less current portion	(6,844)	(4,529)
Long-term portion	\$ 5,103	\$ 10,148

As of September 30, 2012, the Company was a party to three debt agreements: (i) the term loan with Horizon Technology Finance Corporation ( Horizon ), (ii) the equipment financing facility with Hercules Technology Growth Capital, Inc. ( Hercules ), and (iii) the revolving line of credit under a loan and security agreement with Bridge Bank, National Association and Comerica Bank. Each of these debt agreements is described in greater detail in the Prospectus.

On November 7, 2012, the Company repaid the entire outstanding term loan balance of \$7.4 million owed to Horizon and entered into a new credit facility with Hercules, pursuant to which Hercules agreed to make an initial term loan of \$7.4 million and provide up to \$15.6 million of additional borrowing capacity. The initial term loan will bear interest at an annual rate equal to the greater of 11.5% or the prime rate plus 8.25% with a 45-month term. All borrowings are collateralized by substantially all assets of the Company and are subject to certain financial covenants and events of default. Borrowings of additional term loans are subject to certain conditions precedent. All loans under the facility mature on August 1, 2016. As of November 13, 2012, the \$23.0 million credit facility has not been drawn upon.

On November 7, 2012, the Company terminated its \$33.0 million revolving line of credit under a loan and security agreement with Bridge Bank, National Association and Comerica, which did not have an outstanding balance. In its place, the Company entered into a new \$50.0 million senior revolving credit facility with Wells Fargo Bank, National Association with a term of three years (the Revolver ). The amounts available under the Revolver are based on the sum of 85% of eligible domestic accounts receivable and a percentage of inventory (valued at the lesser of 65% of cost or 85% of liquidation value). Amounts borrowed under the Revolver are secured by a first priority lien on cash, accounts receivable and inventory and a second priority lien on all of the Company's assets, excluding its intellectual property. The Revolver contains certain financial covenants and events of default. Borrowings under the Revolver have an interest rate based on the LIBOR or prime rate plus between 250 to 425 basis points, depending on the undrawn availability under the Revolver. As of November 13, 2012, the Revolver has not been drawn upon.

**9. CONVERTIBLE FACILITY**

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

In 2011, the Company entered into a junior secured convertible loan facility, or Convertible Facility, with certain existing preferred stockholders that provided for up to \$80.0 million in borrowings. Pursuant to the facility, the Company issued \$20.0 million in convertible notes, or Convertible Notes, which provided the note holders the right to convert, at their election, all principal and accrued interest into shares of the Company's common stock at a conversion price of \$8.8984 per share. In addition, the Company issued to the note holders (i) 352,665 shares of common stock at \$5.27 per share, and (ii) warrants to purchase 131,516 shares of the Company's common stock at \$5.27 per share that were immediately exercisable and have a contractual term of five years from the date of issuance. The Company recorded \$3.1 million in debt discounts and debt issuance costs related to the transactions at the respective issuance dates.

**Table of Contents**

On March 27, 2012, the Convertible Facility was amended to provide for the automatic conversion of the principal and accrued paid-in-kind interest into common stock upon consummation of an initial public offering at a conversion price equal to the lesser of \$8.8984 or the IPO price. On April 4, 2012, the convertible notes and accrued paid-in-kind interest automatically converted into 3,533,988 shares of common stock, based upon the IPO price of \$6.00 per share. As a result of the conversion, the Company recorded a charge of \$2.8 million to interest expense during the nine months ended September 30, 2012 for the extinguishment of debt relative to the unamortized debt issuance costs and debt discounts. Pursuant to its terms, the Convertible Facility terminated upon consummation of the IPO on April 4, 2012.

**10. COMMITMENTS AND CONTINGENCIES**

**Contingencies** From time to time, the Company may become involved in litigation. Management is not currently aware of any litigation matters or other contingencies that could have a material adverse effect on the financial position, results of operations, or cash flows of the Company.

**11. STOCKHOLDERS EQUITY**

**Reverse Stock Split** On March 8, 2012, the Company's board of directors approved a 1-for-9.08 reverse stock split of the Company's common stock and convertible preferred stock, which became effective on March 23, 2012 upon the filing of the Company's amended and restated certificate of incorporation. On the effective date, (i) every 9.08 shares of authorized, issued and outstanding common stock was reduced to one share of authorized, issued and outstanding common stock, (ii) every 9.08 shares of authorized, issued and outstanding convertible preferred stock was reduced to one share of authorized, issued and outstanding convertible preferred stock, (iii) the number of shares of common stock into which each outstanding warrant or option to purchase common stock is exercisable was proportionally reduced on a 1-for-9.08 basis, (iv) the number of shares of convertible preferred stock into which each outstanding warrant to purchase convertible preferred stock is exercisable was proportionately reduced on a 1-for-9.08 basis, (v) the number of shares of common stock issuable upon conversion of each convertible note (including shares issuable related to paid-in-kind interest) was proportionately reduced on a 1-for-9.08 basis, and (vi) all per share prices, conversion prices and exercise prices were proportionately increased. All references to share numbers, share prices, conversion prices and exercise prices have been adjusted within these unaudited condensed consolidated financial statements, on a retroactive basis, to reflect this 1-for-9.08 reverse stock split.

**Series A, B, C, D and E Convertible Preferred Stock**

Prior to the consummation of the Company's initial public offering on April 4, 2012, the Company had the following convertible preferred stock outstanding, all of which was converted to common stock in connection with the IPO on April 4, 2012 (see Note 1):

Convertible Preferred Stock	Shares Outstanding	Original Issuance Price	Number of Shares of Common Stock Issued Upon Conversion
Series A	206,492	\$ 2.9056	253,183
Series B	1,065,234	6.0150	2,021,881
Series C	1,285,890	11.6650	3,232,710
Series D	12,232,495	2.1340	12,232,498
Series E	7,430,745	6.1740	7,430,745
	22,220,856		25,171,017

**Warrants****Warrants to Purchase Convertible Preferred Stock**

In September 2008, the Company entered into a strategic collaboration agreement with a third party, under which the third party would test and evaluate the Enphase microinverter for European certification. As part of the agreement, the third party was granted a warrant to purchase 11,013 shares of Series C convertible preferred stock at an approximate price of \$11.67 per share. Exercisability of the warrant was contingent upon completion of several milestones prior to the Company's IPO. As a result of the Company's IPO in April 2012, the warrant expired due to non-achievement of the performance criteria.

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

During 2010 and 2011, the Company issued warrants to purchase up to an aggregate of 187,243 shares of Series E convertible preferred stock with a weighted-average exercise price of approximately \$6.54 per share in connection with financing arrangements. The warrants were immediately exercisable upon issuance and have a contractual term of 10 years from the date of issuance. Upon the consummation of the IPO in April 2012, these warrants automatically converted into warrants to purchase 199,458 of shares of common stock. As a result, the warrants were no longer subject to fair value accounting and the Company reclassified the liability to additional paid-in capital in the second quarter of 2012. As of September 30, 2012, these warrants remained outstanding.

**Table of Contents**

The following table summarizes the changes in fair value (see Note 7) of the Company's convertible preferred stock warrant liability and subsequent reclassification to additional paid-in capital (in thousands):

Balance at December 31, 2011	\$ 1,399
Fair value adjustments recognized in other (income) expense, net	(520)
Reclassification of convertible preferred stock warrant liability to additional paid-in capital	(879)
Balance at September 30, 2012	\$

*Warrants to Purchase Common Stock*

In February 2010, the Company entered into a supply and services agreement with a customer. As part of the agreement, the Company issued a warrant to purchase up to 11,013 shares of the Company's common stock at a price of \$4.54 per share as a sales incentive to the customer. The customer was required to meet certain minimum purchase thresholds by March 4, 2012 in order for the warrant to become exercisable. Effective March 5, 2012, this warrant expired due to non-achievement of the performance criteria.

In connection with the Convertible Facility (see Note 9), the Company issued warrants to purchase 131,516 shares of the Company's common stock at approximately \$5.27 per share that are immediately exercisable with a contractual term of five years from the date of issuance. As of September 30, 2012, these warrants remained outstanding.

**12. STOCK-BASED COMPENSATION***Equity Incentive Plans*

Prior to the adoption and effectiveness of the 2011 Equity Incentive Plan (the 2011 Plan), certain employees, officers, directors and non-employees were granted options to purchase shares of common stock and stock purchase rights under the 2006 Equity Incentive Plan (the 2006 Plan). In 2011, the board of directors adopted the 2011 Plan as a successor to the 2006 Plan. On March 29, 2012, the 2011 Plan became effective immediately upon the execution and delivery of the underwriting agreement for the Company's IPO. As a result, no additional stock options or other stock awards will be granted under the 2006 Plan. All outstanding stock options and other equity awards previously granted under the 2006 Plan will remain subject to the terms of the 2006 Plan.

**2006 Plan** Under the 2006 Plan, equity awards permitted to be issued include incentive stock options (ISOs), nonstatutory stock options (NSOs), and stock purchase rights. ISOs may be granted only to employees (including officers and directors who are also employees) of the Company, and NSOs and restricted stock awards may be granted to employees, officers, directors and non-employees of the Company. Equity awards granted under the 2006 Plan generally vest over a four-year period from the date of grant with a contractual term of up to 10 years. Common shares purchased under the 2006 Plan are subject to certain restrictions, including the right of first refusal by the Company for sale or transfer of these shares to outside parties. The Company's right of first refusal terminated upon completion of the IPO (see Note 1). As of September 30, 2012 and December 31, 2011, stock options to purchase 6.4 million and 6.3 million shares of common stock, respectively, were outstanding under the 2006 Plan.

**2011 Plan** Under the 2011 Plan, the Company may, initially, issue up to 2,643,171 shares of its common stock pursuant to stock options, stock appreciation rights, restricted stock awards, restricted stock unit awards, performance-based stock awards, and other forms of equity compensation, or collectively, stock awards, all of which may be granted to employees, including officers, and to non-employee directors and consultants. However, the Company considers stock options as its primary vehicle for equity compensation. Options granted under the 2011 Plan before August 2012 generally expire 10 years after the grant date and options granted in or after August 2012 generally expire seven years after the grant date. Equity awards granted under the 2011 Plan generally vest over a four-year period from the date of grant based on continued employment. The number of shares of our common stock reserved for issuance under the 2011 Plan will automatically increase, on each January 1, by 4.5% of the total number of shares of our common stock outstanding on December 31 of the preceding calendar year, or such lesser number of shares of common stock as determined by the board of directors. As of September 30, 2012, there were 336,294 shares of common stock available for issuance pursuant to future grants under the 2011 Plan.

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

**2011 Employee Stock Purchase Plan** In 2011, the board of directors adopted the 2011 Employee Stock Purchase Plan ( ESPP ) which became effective immediately upon the execution and delivery of the underwriting agreement for the Company s IPO on March 29, 2012. The ESPP initially authorizes the issuance of 669,603 shares of our common stock pursuant to purchase rights granted to employees. The number of shares of our common stock reserved for issuance will automatically increase, on each January 1, by 330,396 shares of our common stock or a lesser number of shares of common stock as determined by our board of directors. The ESPP is administered by the board of directors, who has delegated its authority to administer the ESPP to the compensation committee.

**Table of Contents**

The ESPP is implemented by concurrent offering periods, the duration of which may not exceed 27 months. An offering period may contain up to four interim purchase periods. Except for the first offering period, offering periods shall consist of the 24 month periods commencing on each May 1 and November 1 of a calendar year. The first offering period commenced on the effective date of the Company’s IPO and will end on April 30, 2014.

Generally, all full time employees, including executive officers, will be eligible to participate in the ESPP. The ESPP permits eligible employees to purchase the Company’s common stock through payroll deductions, which may not exceed 15% of the employee’s total compensation subject to certain limits. Stock may be purchased under the plan at a price equal to 85% of the fair market value of the Company’s stock on either the date of purchase or the first day of an offering period, whichever is lower. A two year look-back feature in our ESPP causes an offering period to reset if the fair value of the Company’s common stock on a purchase date is less than that on the initial offering date for that offering period. The reset feature, when triggered, will be accounted for as a modification to the original offering, resulting in additional expense to be recognized over the 24-month period of the new offering. During any calendar year, participants may not purchase shares of common stock having a value greater than \$25,000, based on the fair market value per share of the common stock at the beginning of an offering period.

The board of directors may terminate or amend the ESPP, subject to stockholder approval in some circumstances. Unless terminated earlier by the board of directors, the ESPP has a term of ten years.

The first offering period began on March 29, 2012 and has a duration of 25 months consisting of four purchase periods. For the first purchase period only, eligible participants are permitted to remit catch-up amounts (up to a maximum aggregate withholding of 15 percent of their earnings during the first purchase period) to the Company at any time through October 15, 2012. As such, a mutual understanding of the key terms between the employer and employee has not yet been reached. Accordingly, the first offering period will not have a grant date for accounting purposes until October 15, 2012, and no stock-based compensation expense has been recorded as of September 30, 2012.

A summary of the Company’s stock option activity for the nine months ended September 30, 2012 is as follows (in thousands, except per share data):

	<b>Number of Shares Outstanding</b>	<b>Weighted- Average Exercise Price per Share</b>
Options outstanding December 31, 2011	6,256	\$ 1.83
Granted (weighted-average fair value of \$4.82 per share)	2,377	7.54
Exercised	(39)	1.24
Canceled	(174)	7.43
<b>Options outstanding September 30, 2012</b>	<b>8,420</b>	<b>3.33</b>

**Stock-Based Compensation Expense** The fair value of options granted to employees for purposes of calculating stock-based compensation expense is estimated on the grant date using the Black-Scholes option-pricing model. This valuation model requires the Company to make assumptions and judgments about the inputs used in the calculation, including the expected term (weighted-average period of time that the options granted are expected to be outstanding), the volatility of the Company’s common stock, a risk-free interest rate, and expected dividend yield. The expected term for an option grant is calculated based on the simplified method. The expected volatility is based on an average of the historical volatilities of the common stock of several entities with characteristics similar to those of the Company. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option. The Company’s expected dividend yield input was zero as it has not historically paid, nor does it expect in the future to pay, cash dividends on its common stock.

**Table of Contents**

The following table summarizes the components of total stock-based compensation expense included in the condensed consolidated statements of operations for the periods presented (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Cost of revenues	\$ 62	\$ 11	\$ 119	\$ 25
Research and development	514	215	1,171	528
Sales and marketing	362	183	826	484
General and administrative	513	174	1,043	402
<b>Total</b>	<b>\$ 1,451</b>	<b>\$ 583</b>	<b>\$ 3,159</b>	<b>\$ 1,439</b>

The fair value of each option granted during the periods presented was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Expected term (in years)	4.8	6.0	5.8	6.0
Expected volatility	78.0%	71.6%	74.4%	71.9%
Annual risk-free rate of return	0.6%	1.2%	0.9%	1.8%
Dividend yield	0.0%	0.0%	0.0%	0.0%

As of September 30, 2012 and December 31, 2011, there was approximately \$15.0 million and \$6.5 million, respectively, of total unrecognized compensation cost related to unvested equity awards, net of expected forfeitures, which is expected to be recognized over a weighted-average period of 3.1 and 3.0 years, respectively.

**13. INCOME TAXES**

No provision for U.S. federal or state income taxes has been made due to cumulative losses since the commencement of operations. A provision for income taxes of \$130,000 and \$346,000 has been recognized for the three and nine months ended September 30, 2012, respectively, related to the Company's subsidiaries located outside of the United States.

**14. NET LOSS PER SHARE ATTRIBUTABLE TO COMMON STOCKHOLDERS**

In April 2012, all of the Company's then outstanding convertible preferred stock automatically converted into common stock in connection with its IPO. For periods that ended prior to the conversion, basic and diluted net income per common share were presented in conformity with the two-class method required for participating securities.

Under the two-class method, net loss is allocated between common shares and other participating securities to the extent that the securities are required to share in the losses. The Company's convertible preferred stock did not meet the definition of a participating security in periods of net losses as the convertible preferred stockholders did not have a contractual obligation to share in the Company's losses. Accordingly, net losses were attributable to common stockholders. Subsequent to the Company's IPO and the automatic conversion of the outstanding convertible preferred stock, the Company had no other participating securities and the two-class method is no longer applicable.

Basic net loss per share attributable to common stockholders is calculated by dividing net loss attributable to common stockholders by the weighted average number of shares outstanding for the period.

Diluted net loss per share attributable to common stockholders is calculated by dividing net loss attributable to common stockholders by the weighted average number of common shares and potential dilutive common share equivalents outstanding during the period if the effect is dilutive. The Company's potentially dilutive common shares include convertible notes and convertible preferred stock prior to their conversion, outstanding stock options and warrants and non-vested restricted stock units.





**Table of Contents**

The following table presents the potential common shares outstanding at period-end that were excluded from the computation of diluted net loss per share attributable to common stockholders for the three and nine months ended September 30, 2012 and 2011, respectively, because including them would have been antidilutive (in thousands):

	2012	2011
Stock options to purchase common stock	8,420	5,935
Restricted stock units	268	
Warrants to purchase common stock	331	88
Warrants to purchase convertible preferred stock		214
Convertible preferred stock		25,171
Convertible notes		1,411
<b>Total</b>	<b>9,019</b>	<b>32,819</b>

**15. GEOGRAPHIC INFORMATION**

The Company considers operating segments to be components of the Company in which separate financial information is available that is evaluated regularly by the Company's chief operating decision maker in deciding how to allocate resources and in assessing performance. The chief operating decision maker for the Company is the Chief Executive Officer. The Chief Executive Officer reviews financial information presented on a consolidated basis. The Company has one business activity, which entails the design, development, manufacture and sale of microinverter systems for the solar photovoltaic industry. There are no segment managers who are held accountable for operations, operating results or plans for levels or components below the consolidated unit level. Accordingly, the Company has determined that it has a single reporting segment and operating unit structure.

The following table presents long-lived assets by geographic region (in thousands):

**Long-Lived Assets**

	September 30, 2012	December 31, 2011
United States	\$ 16,411	\$ 11,199
China	6,735	5,974
Other	1,780	1,238
<b>Total</b>	<b>\$ 24,926</b>	<b>\$ 18,411</b>

**16. RELATED PARTY TRANSACTIONS**

In December 2011, the Company entered into sales transactions with customers which are majority-owned by KPCB Holdings, Inc., as nominee ( KPCB ), a related party which has a significant ownership interest in the Company, and received cash in advance from these customers. During the nine months ended September 30, 2012, the Company recognized revenues of \$16.8 million, which included all previously deferred revenues under these sales transactions.

\* \* \* \* \*

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**Forward-Looking Statements**

*The following discussion and analysis of our financial condition and results of operations should be read together with our condensed consolidated financial statements and the other financial information appearing elsewhere in this Quarterly Report on Form 10-Q. This discussion contains forward-looking statements reflecting our current expectations and involves risks and uncertainties. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expect, plan, anticipate, believe, estimate, predict, intend, potential or continue or the negative of these terms or other comparable terminology. For example, statements regarding our expectations as to future financial performance, expense levels and liquidity sources are forward-looking statements. Our actual results and the timing of events may differ materially from those discussed in our forward-looking statements as a result of various factors, including those discussed below and those discussed in the section entitled Risk Factors included in this Quarterly Report on Form 10-Q and our prospectus filed pursuant to Rule 424(b) under the Securities Act, as amended, with the Securities and Exchange Commission, or SEC, on March 30, 2012, or the Prospectus.*

**Overview**

We deliver microinverter technology for the solar industry that increases energy production, simplifies design and installation, improves system uptime and reliability, reduces fire safety risk and provides a platform for intelligent energy management. We were founded in March 2006 and have grown rapidly to become the market leader in the microinverter category. Since our first commercial shipment in mid-2008, we have sold over 2.6 million microinverter units as of September 30, 2012. Our products have been installed in all 50 U.S. states, eight Canadian provinces, Italy, United Kingdom, France, and the Benelux region.

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. A substantial majority of our revenue has been generated by sales within North America. We anticipate that the majority of our 2012 net revenues will continue to come from North America, with the balance from Europe.

We continue to experience significant revenue growth. Our net revenues were \$60.8 million and \$44.7 million for the three months ended September 30, 2012 and 2011, respectively, and \$159.1 million and \$92.4 million for the nine months ended September 30, 2012 and 2011, respectively, reflecting deeper market penetration and broader acceptance of microinverter technology. We incurred net losses of \$8.9 million and \$7.2 million for the three months ended September 30, 2012 and 2011, respectively, and \$30.5 million and \$26.8 million for the nine months ended September 30, 2012 and 2011, respectively, as we invested significant resources to develop new product offerings, expand our operations into new product markets and geographies, and focus on critical

research and development activities required to enhance product quality and foster innovation. While we will continue to focus on new product development and market expansion activities, we expect the growth in our workforce to moderate in the near term. As of September 30, 2012, we had 384 full-time employees, compared to 286 full-time employees at September 30, 2011, an increase of 34%. However, our workforce only increased by 4% from the second quarter ended June 30, 2012. We believe the investments we have made in our corporate infrastructure will enable us to deliver higher levels of net revenues without material increases in sales and marketing, and general and administrative expenses.

On April 4, 2012, we consummated our initial public offering ( IPO ). As a result, the following transactions were recorded in our condensed consolidated financial statements in the second quarter of 2012:

we issued 10,315,151 shares of common stock (including exercise of the full over-allotment by the underwriters of 1,345,454 shares of common stock), at an offering price of \$6.00 per share, for gross proceeds of \$61.9 million. Certain related parties, who owned convertible preferred and common stock and held convertible notes, purchased 2,500,000 shares of the total amount of shares issued of our common stock at the \$6.00 offering price. The net proceeds from the sale of the shares were \$53.8 million, after deducting the underwriters' discounts and commissions of \$3.3 million and other estimated offering costs of \$4.8 million;

the 22,220,856 outstanding shares of our convertible preferred stock (\$93.6 million carrying value) automatically converted into 25,171,017 shares of common stock;

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

the convertible preferred stock warrant liability (\$0.9 million carrying value) was reclassified to additional paid-in capital and the warrants to purchase 187,243 shares of convertible preferred stock became warrants to purchase 199,458 shares of common stock;

the outstanding balance of principal and accrued paid-in-kind interest thereon for our convertible notes (\$21.2 million gross carrying value) automatically converted into 3,533,988 shares of common stock at a conversion price equal to the initial public offering price of \$6.00 per share;

---

## **Table of Contents**

the aggregate debt issuance costs and debt discounts of \$2.8 million related to our convertible facility were written-off to interest expense as a result of the conversion of the outstanding notes and the automatic termination of our \$80.0 million convertible facility; and

we filed an amended and restated certificate of incorporation, which authorized 100,000,000 shares of common stock and 10,000,000 shares of preferred stock.

### **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 device, and our Enlighten web-based monitoring service. We sell to distributors, large installers, OEMs and strategic partners.

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

#### ***Cost of Revenues and Gross Profit***

Cost of revenues is comprised primarily of product costs consisting of purchases from our contract manufacturers and other suppliers, warranty, personnel and logistics costs, depreciation and amortization of test equipment and hosting services costs. Our product costs are impacted by technological innovations, such as advances in semiconductor integration and new product introductions, economies of scale resulting in lower component costs, and improvements in production processes and automation. Certain costs, primarily personnel and depreciation 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. In addition, a contract manufacturer also serves as our logistics provider by warehousing and delivering our products in North America and Europe. We believe our contract manufacturing partners have sufficient production capacity to meet the growing demand for our products for the foreseeable future. However, shortages in the supply of certain key raw materials could adversely affect our ability to meet customer demand for our products.

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

#### ***Operating Expenses***

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

Research and development expense includes personnel-related expenses such as salaries, stock-based compensation and employee benefits. Research and development employees are engaged in the design and development of power electronics, semiconductors, powerline communications and networking and software functionality. Research and development expense also includes third-party design and development costs, testing and evaluation costs, depreciation expense and other indirect costs. We devote substantial resources in ongoing 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 drive down product costs. We intend to continue to invest substantial resources 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, stock-based compensation, employee benefits and travel. It also includes trade shows, marketing, customer support and other indirect costs. We expect to continue to make the necessary investments to enable us to execute our strategy to increase our market penetration geographically and into new markets by expanding our customer base of distributors, large installers, OEMs and strategic partners. Historically, substantially all of our sales have been in North America. We began selling into France, Italy and the Benelux region in the fourth quarter of 2011 and commenced volume shipments to

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

such regions in the second quarter of 2012. In addition, we opened a sales office in the United Kingdom during the second quarter of 2012 and began shipping products in the third quarter of 2012. We believe the investments we have made in sales and marketing to date will enable us to deliver higher levels of net revenues without material increases from current levels of sales and marketing expenses. However, we expect to continue to expand the geographic reach of our product offerings and explore new sales channels in strategic markets in the future.

---

## **Table of Contents**

General and administrative expense consists primarily of salaries, stock-based compensation and employee benefits for personnel related to our executive, finance, human resources, information technology and legal organizations, facilities cost, and fees for professional services. Professional services consist primarily of outside legal, accounting and information technology consulting costs. We believe the investments we have made in our corporate infrastructure to date will enable us to deliver higher levels of net revenues without material increases from current levels of general and administrative expenses.

### ***Other Income (Expense), Net***

Other income (expense), net includes interest income on invested cash balances and interest expense on amounts outstanding under our credit and convertible note facilities and non-cash interest expense related to the amortization of debt discounts and deferred financing costs. Other income (expense), net also includes mark-to-market adjustments to record our preferred stock warrants at fair value, which were issued in conjunction with credit facilities, as well as losses or gains on conversion of non-U.S. dollar transactions into U.S. dollars and foreign currency forward contracts.

### ***Provision (Benefit) 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. We anticipate that as we expand the sale of products to customers outside the United States in the future, we will become subject to taxation based on the foreign statutory rates in the countries where these sales took place and our effective tax rate may fluctuate accordingly. We have not recorded any U.S. federal or state income tax provision for any of the periods presented because we have experienced operating losses since inception. Due to the history of losses we have generated since inception, we have recorded a full valuation allowance on our deferred tax assets.

### **Critical Accounting Policies and Significant Management Estimates**

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

We consider an accounting policy to be critical if it is important to our financial condition and results of operations, and if it entails significant judgment, subjectivity and complexity on the part of management in its application. We consider the following to be our critical accounting policies:

Revenue recognition;

Inventory valuation;

Product warranty; and

Stock-based compensation.

For a complete description of our critical accounting policies that involve our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements, refer to the Prospectus under Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Significant Management Estimates.





**Table of Contents****Results of Operations for the Three and Nine Months Ended September 30, 2012 and 2011****Net Revenues**

	Three Months Ended September 30,		Change in		Nine Months Ended September 30,		Change in	
	2012	2011	\$	%	2012	2011	\$	%
(In thousands, except percentages)								
Net revenues	\$ 60,813	\$ 44,728	\$ 16,085	36%	\$ 159,110	\$ 92,389	\$ 66,721	72%

*Three Months Ended September 30, 2012 and 2011*

Net revenues increased by 36% for the three months ended September 30, 2012, compared to the same period in the prior year. The increase in net revenues was primarily due to the increase in the overall volume of our products shipped. The number of microinverter units sold increased by 51% from approximately 286,000 units in the three months ended September 30, 2011, to approximately 431,000 units in the three months ended September 30, 2012. The overall increase in units sold was attributable primarily to sales of our third generation microinverter, which was introduced during the second quarter of 2011. In addition, the increase in unit sales was driven by deeper penetration of our existing customer base, the addition of new customers, and broader acceptance of our products resulting from, among other factors, investments made in sales and marketing.

*Nine Months Ended September 30, 2012 and 2011*

Net revenues increased by 72% for the nine months ended September 30, 2012, compared to the same period in the prior year. The increase in net revenues was primarily due to the increase in the overall volume of our products shipped. The number of microinverter units sold increased by 83% from approximately 614,000 units in the nine months ended September 30, 2011, to approximately 1,125,000 units in the nine months ended September 30, 2012. The overall increase in units sold was attributable primarily to sales of our third generation microinverter, which was introduced during the second quarter of 2011. In addition, the increase in unit sales was driven by deeper penetration of our existing customer base, the addition of new customers, and broader acceptance of our products resulting from, among other factors, investments made in sales and marketing.

**Cost of Revenues and Gross Profit**

	Three Months Ended September 30,		Change in		Nine Months Ended September 30,		Change in	
	2012	2011	\$	%	2012	2011	\$	%
(In thousands, except percentages)								
Cost of revenues	\$ 44,489	\$ 36,185	\$ 8,304	23%	\$ 119,878	\$ 76,391	\$ 43,487	57%
Gross profit	16,324	8,543	7,781	91%	39,232	15,998	23,234	145%
Gross profit percentage	27%	19%			25%	17%		

*Three Months Ended September 30, 2012 and 2011*

Cost of revenues increased by 23% for the three months ended September 30, 2012, compared to the same period in the prior year. The increase in cost of revenues was primarily due to an increase in the number of microinverter units sold to customers, consistent with the overall increase in net revenues as described above. Gross profit percentage increased by 8 percentage points during the three months ended September 30, 2012, compared to the same period in the prior year. The increase was attributable to a 5 percentage point increase from a larger mix of our higher-margin third generation microinverter, which has a lower per unit manufacturing cost than our second generation microinverter. The lower per unit cost was achieved primarily through design enhancements, which resulted in a higher level of product integration, and improved efficiencies on increased production volume. In addition, gross profit percentage improved by 5 percentage points in the third quarter of 2012 as a result of a reduction in usage of expedited air-freight for finished goods due to improvements in delivery scheduling. These increases were partially offset by a 2 percentage point reduction to gross profit percentage due to a net increase in warranty expense primarily attributable to changes in estimated replacement costs as well as the estimated long-term performance of our previous generation products.

*Nine Months Ended September 30, 2012 and 2011*

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

Cost of revenues increased by 57% for the nine months ended September 30, 2012, compared to the same period in the prior year. The increase in cost of revenues was primarily due to an increase in the number of microinverter units sold to customers, consistent with the overall increase in net revenues as described above. Gross profit percentage increased by 8 percentage points during the nine months ended September 30, 2012, compared to the same period in the prior year. The increase was primarily driven by a 7 percentage point increase from a larger mix of our higher-margin third generation microinverter, which has a lower per unit manufacturing cost than our second generation microinverter. The lower per unit cost was achieved primarily through design

**Table of Contents**

enhancements, which resulted in a higher level of product integration, and improved efficiencies on increased production volume. In addition, gross profit percentage improved by 2 percentage points in the nine months ended September 30, 2012 as a result of a reduction in usage of expedited air-freight for finished goods due to improvements in delivery scheduling. These increases were partially offset by a 1 percentage point reduction to gross profit percentage due to a net increase in warranty expense primarily attributable to changes in estimated replacement costs as well as the estimated long-term performance of our previous generation products.

**Research and Development**

	Three Months Ended September 30,		Change in		Nine Months Ended September 30,		Change in	
	2012	2011	\$	%	2012	2011	\$	%
	(In thousands, except percentages)							
Research and development	\$ 10,571	\$ 6,431	\$ 4,140	64%	\$ 27,068	\$ 17,919	\$ 9,149	51%
Percentage of net revenues	17%	14%			17%	19%		

*Three Months Ended September 30, 2012 and 2011*

The increase in research and development expenses in the three months ended September 30, 2012, as compared to the same period in the prior year, was primarily attributable to a \$2.1 million increase in personnel-related costs as we increased our headcount to support continued investment in our future product offerings. The remaining increase was due to third-party development costs for semiconductor design and other projects.

*Nine Months Ended September 30, 2012 and 2011*

The increase in research and development expenses in the nine months ended September 30, 2012, as compared to the same period in the prior year, was primarily attributable to a \$6.1 million increase in personnel-related costs as we increased our headcount to support continued investment in our future product offerings. In addition, expenditures related to the use of outside services to develop our new products increased by \$2.1 million. The remaining increase was due to higher depreciation costs from test equipment acquired for use in development and facilities related costs.

**Sales and Marketing**

	Three Months Ended September 30,		Change in		Nine Months Ended September 30,		Change in	
	2012	2011	\$	%	2012	2011	\$	%
	(In thousands, except percentages)							
Sales and marketing	\$ 7,039	\$ 4,567	\$ 2,472	54%	\$ 18,448	\$ 11,842	\$ 6,606	56%
Percentage of net revenues	12%	10%			12%	13%		

*Three Months Ended September 30, 2012 and 2011*

The increase in sales and marketing expenses in the three months ended September 30, 2012, as compared to the same period in the prior year, resulted primarily from increased staffing levels to support higher sales volumes and international expansion. Personnel-related costs increased by \$1.7 million as a result of increases in sales and marketing headcount. The remaining increase was primarily due to expenses related to industry trade shows and increased promotional activities.

*Nine Months Ended September 30, 2012 and 2011*

The increase in sales and marketing expenses in the nine months ended September 30, 2012, as compared to the same period in the prior year, resulted primarily from increased staffing levels to support higher sales volumes and international expansion. Personnel-related costs increased by \$5.1 million as a result of increases in sales and marketing headcount. The remaining increase was primarily due to expenses related to industry trade shows and increased promotional activities.

**General and Administrative**

Edgar Filing: Enphase Energy, Inc. - Form 10-Q

	Three Months Ended		Change in		Nine Months Ended		Change in	
	September 30, 2012	September 30, 2011	\$	%	September 30, 2012	September 30, 2011	\$	%
			(In thousands, except percentages)					
General and administrative	\$ 6,911	\$ 3,980	\$ 2,931	74%	\$ 18,698	\$ 11,119	\$ 7,579	68%
Percentage of net revenues	11%	9%			12%	12%		

**Table of Contents***Three Months Ended September 30, 2012 and 2011*

The increase in general and administrative expenses in the three months ended September 30, 2012, as compared to same period in the prior year, was primarily attributable to increases in personnel-related costs of \$1.0 million due to additions to general and administrative headcount, professional service fees associated with accounting and legal services normally provided in connection with regulatory filings of a public company of \$0.8 million, facilities-related costs of \$0.7 million, board of director fees and director and officer liability insurance of \$0.3 million.

*Nine Months Ended September 30, 2012 and 2011*

The increase in general and administrative expenses in the three months ended September 30, 2012, as compared to the same period in the prior year, was primarily attributable to increases in personnel-related costs of \$2.7 million due to additions to general and administrative headcount. In addition, professional service fees associated with accounting services, legal services and services related to post-implementation of our new ERP system increase by \$2.2 million. The remaining increase consists of facilities-related costs of \$2.0 million and board of director fees and director and officer liability insurance of \$0.6 million.

*Other Expense, Net*

	Three Months Ended		Change in		Nine Months Ended		Change in	
	September 30, 2012	September 30, 2011	\$	%	September 30, 2012	September 30, 2011	\$	%
	(In thousands)							
Other expense, net	\$ (580)	\$ (741)	\$ 161	(22)%	\$ (5,148)	\$ (1,871)	\$ (3,277)	175%

*Three Months Ended September 30, 2012 and 2011*

Other expense, net decreased primarily due to lower interest expense in the three months ended September 30, 2012, as compared to the same period in the prior year. The decrease in interest expense was primarily the result of the conversion of our \$12.5 million convertible notes to common stock, as no interest expense was incurred following their conversion on April 4, 2012.

*Nine Months Ended September 30, 2012 and 2011*

Other expense, net increased in the nine months ended September 30, 2012, as compared to the same period in the prior year. The increase in other expense, net was primarily due to an increase in interest expense related to the write-offs of deferred debt issuance costs and debt discounts of \$2.8 million associated with the conversion of our convertible notes and \$1.0 million in interest expense from higher average debt balances. In addition, foreign currency losses accounted for \$0.3 million of the increase, which was partially offset by a \$0.8 million increase to other income from the remeasurement of our preferred stock warrant liability.

**Liquidity and Capital Resources**

Through March 2012, we funded our operations primarily through private placements of convertible preferred stock and convertible notes, and proceeds from term loans. In April 2012, we completed our IPO, in which we issued and sold 10,315,151 shares and received net proceeds of approximately \$53.8 million. As of September 30, 2012, we had \$41.7 million in cash and cash equivalents, which are held primarily in bank deposits and money market accounts, and \$60.3 million in working capital. The following table summarizes our cash flows for the periods indicated:

	Nine Months Ended	
	September 30, 2012	September 30, 2011
	(In thousands)	
Net cash used in operating activities	\$ (52,274)	\$ (23,229)
Net cash used in investing activities	(11,054)	(9,589)
Net cash provided by financing activities	53,606	19,441

*Net Cash Used in Operating Activities*

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

We have experienced negative operating cash flows principally due to our significant investments in our infrastructure including increases in headcount to grow our business. We anticipate that we will continue to incur net losses and use cash in operating activities in the near term as we continue to make the necessary investments to grow and penetrate our markets.

For the nine months ended September 30, 2012, net cash used in operating activities was \$52.3 million primarily resulting from a net loss of \$30.2 million and changes in our net operating assets and liabilities used cash of \$32.8 million. This was partially offset by non-cash items including interest expense of \$4.0 million, depreciation and amortization of \$3.9 million and stock-based compensation of \$3.2 million.

---

## **Table of Contents**

Changes in our net operating assets and liabilities was primarily attributable to a \$20.2 million decrease in deferred revenues, which was due to shipments of products during the nine months ended September 30, 2012 for which upfront payments were received from customers in December 2011. In addition, the net change included a \$15.0 million increase in accounts receivable as a significant amount of sales occurred in the last month of the third quarter of 2012, an increase in inventory-related purchases of \$5.4 million, and an increase in prepaid expenses and other assets of \$5.4 million primarily due to prepayments to our contract manufacturers. Sources of cash partially offsetting the net change resulted from an increase in accounts payable, accrued and other liabilities of \$13.2 million primarily due to the corresponding increase in inventory purchases and the timing of payments.

For the nine months ended September 30, 2011, net cash used in operating activities was \$23.2 million. The largest component of our cash used during this period related to our net loss of \$26.8 million. This was partially offset by non-cash charges of \$2.0 million in depreciation and amortization, \$1.4 million in stock-based compensation expense, \$0.7 million in amortization of debt issuance costs and debt discounts to interest expense and \$0.3 million from the decrease in fair value of our convertible preferred stock warrants. Changes in operating assets and liabilities provided \$1.0 million of operating cash flow primarily due to a \$14.7 million increase in accounts payable and other accrued liabilities as a result of timing of payments and a \$1.7 million increase in deferred revenues. This was partially offset by a \$9.6 million increase in accounts receivable, a \$5.7 million increase in inventory purchases and a \$2.0 million increase in prepaid expenses and other assets.

### ***Net Cash Used in Investing Activities***

Net cash used in investing activities primarily related to capital expenditures to support our growth.

For the nine months ended September 30, 2012, net cash used in investing activities was \$11.0 million resulting from purchases of manufacturing test equipment and expenditures on leasehold improvements and furniture and fixtures in connection with our relocation to a new headquarter facility.

For the nine months ended September 30, 2011, net cash used in investing activities was \$9.6 million resulting from expenditures for manufacturing test equipment as well as internally developed software.

### ***Net Cash Provided by Financing Activities***

For the nine months ended September 30, 2012, net cash provided by financing activities primarily consisted of net proceeds of \$56.6 million received from our IPO, after deducting underwriting discounts and commissions and other offering costs paid during the nine months ended September 30, 2012. Cash used in financing activities consisted of \$5.5 million in principal repayments of term loans offset by \$2.6 million in proceeds from term loan borrowings.

For the nine months ended September 30, 2011, net cash provided by financing activities primarily consisted of proceeds of \$12.5 million from the issuance of convertible notes, \$9.2 million from borrowings, and \$1.3 million from the issuance of common stock partially offset by \$1.5 million related to repayments of our term loans, capital lease and debt issuance costs, and \$1.9 million in payments for initial public offering costs.

### ***Debt and Convertible Facilities***

As of September 30, 2012, we were a party to three debt agreements: (i) the term loan with Horizon Technology Finance Corporation ( Horizon ), (ii) the equipment financing facility with Hercules Technology Growth Capital, Inc. ( Hercules ), and (iii) the revolving line of credit under a loan and security agreement with Bridge Bank, National Association and Comerica Bank. Each of these debt agreements is described in greater detail in the Prospectus.

On November 7, 2012, we repaid the entire outstanding term loan balance of \$7.4 million owed to Horizon and entered into a new credit facility with Hercules, pursuant to which Hercules agreed to make an initial term loan of \$7.4 million and provide up to \$15.6 million of additional borrowing capacity. Upon satisfaction of conditions precedent for disbursement, which is expected to be by the end November 2012, we intend to borrow the initial \$7.4 million term loan. The initial term loan will bear interest at an annual rate equal to the greater of 11.5% or the prime rate plus 8.25% with a 45-month term. All borrowings are collateralized by substantially all of our assets and are subject to certain financial covenants and events of default. Borrowings of additional term loans are subject to certain conditions precedent. All loans under the facility mature on August 1, 2016. As of November 13, 2012, the \$23.0 million credit facility has not been drawn upon.

On November 7, 2012, we terminated our \$33.0 million revolving line of credit under a loan and security agreement with Bridge Bank, National Association and Comerica, which did not have an outstanding balance. In its place, we entered into a new \$50.0 million senior revolving credit

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

facility with Wells Fargo Bank, National Association with a term of three years (the Revolver ). The amounts available under the Revolver are based on the sum of 85% of eligible domestic accounts receivable and a percentage of inventory (valued at the lesser of 65% of cost or 85% of



## **Table of Contents**

liquidation value). Amounts borrowed under the Revolver are secured by a first priority lien on cash, accounts receivable and inventory and a second priority lien on all of the Company's assets, excluding its intellectual property. The Revolver contains certain financial covenants and events of default. Borrowings under the Revolver have an interest rate based on the LIBOR or prime rate plus between 250 to 425 basis points, depending on the undrawn availability under the Revolver. As of November 13, 2012, the Revolver has not been drawn upon.

In 2011, we entered into a junior secured convertible loan facility, or Convertible Facility, with certain existing preferred stockholders that provided for up to \$80.0 million in borrowings. Pursuant to the facility, we issued \$20.0 million in convertible notes, or Convertible Notes, which provided the note holders the right to convert, at their election, all principal and accrued interest into shares of our common stock at a conversion price of \$8.8984 per share. In addition, we issued to the note holders (i) 352,665 shares of common stock at \$5.27 per share, and (ii) warrants to purchase 131,516 shares of our common stock at \$5.27 per share that were immediately exercisable and have a contractual term of five years from the date of issuance. We recorded \$3.1 million in debt discounts and debt issuance costs related to the transactions at the respective issuance dates.

On March 27, 2012, the Convertible Facility was amended to provide for the automatic conversion of the principal and accrued paid-in-kind interest under the Convertible Facility into common stock upon consummation of an initial public offering at a conversion price equal to the lesser of \$8.8984 or the IPO price. On April 4, 2012, the Convertible Notes and accrued paid-in-kind interest automatically converted into 3,533,988 shares of common stock, based upon the IPO price of \$6.00 per share. The Convertible Facility terminated pursuant to its terms as a result of the consummation of the IPO on April 4, 2012.

## **Operating and Capital Expenditure Requirements**

Our future capital requirements may vary materially in the future and will depend on many factors, including, but not limited to, our rate of revenue growth, the expansion of our sales and marketing activities and the timing and extent of spending to support product development efforts and other costs necessary to support our anticipated growth.

We believe our current cash and cash equivalents of \$41.7 million on hand, as of September 30, 2012, together with borrowings available under our Revolver and credit facility with Hercules, will be adequate to fund our debt obligations as well as our planned capital expenditures and operations over the next 12 months.

If additional sources of liquidity were 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.

## **Contractual Obligations**

Upon the consummation of our IPO on April 4, 2012, all of our Convertible Notes automatically converted to common stock, and hence, no amounts were outstanding at September 30, 2012.

As noted above, we paid off the \$7.4 million term loan balance with Horizon on November 7, 2012.

On November 7, 2012, we entered into a new credit facility with Hercules, pursuant to which we agreed to borrow a \$7.4 million term loan upon satisfaction of conditions precedent for disbursement, which is expected to be by the end of November 2012.

**Table of Contents****Off-Balance Sheet Arrangements**

Since our inception and through September 30, 2012, we have not engaged in any off-balance sheet arrangements.

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

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

In June 2012, we began to utilize foreign currency forward contracts to reduce the impact of foreign currency fluctuations related to anticipated cash receipts from expected future revenues denominated in Euros and intercompany transaction gains or losses. The contracts we enter into typically have maturities of less than one year. We do not enter into derivative financial instruments for trading or speculative purposes. The foreign currency forward contracts are accounted for as derivatives whereby the fair value of the contracts is reported as other current assets or current liabilities in the accompanying condensed consolidated balance sheets, and gains and losses resulting from changes in the fair value are reported in other income (expense), net, in the accompanying condensed consolidated statements of operations.

A summary of our open foreign currency forward contracts at September 30, 2012 is as follows (all outstanding contracts are obligations for the Company to deliver the foreign currency) (in thousands):

<b>Maturity</b>	<b>Foreign</b>	<b>Contract</b>	<b>Market</b>	<b>Asset</b>
<b>Date</b>	<b>Quantity</b>	<b>Value</b>	<b>Value</b>	<b>(Liability)</b>
October 15, 2012	4,500	\$ 5,640	\$ 5,503	\$ (137)
January 15, 2013	4,000	5,024	4,912	(112)
<b>Total</b>		<b>\$ 10,664</b>	<b>\$ 10,415</b>	<b>\$ (249)</b>

The foreign currency exchange rate risk associated with our forward currency exchange contracts is limited as the exposure is substantially offset by exchange rate changes of the underlying hedged amounts. A hypothetical 10% strengthening of the Euro compared to the U.S. Dollar at September 30, 2012 would have decreased the fair value of our open contracts by \$1.0 million.

**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, 2012. 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, 2012, 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.

---

**Table of Contents**

**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 immaterial may also significantly impair our business operations. Our business could be harmed by any of these risks. We have marked with an asterisk (\*) those risks described below that reflect substantive changes from the risks described in our prospectus filed pursuant to Rule 424(b) with the Securities and Exchange Commission, or SEC, on March 30, 2012, or the Prospectus. In assessing these risks, you should also refer to the other information contained in this Quarterly Report on Form 10-Q, including our financial statements and related notes.*

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

We have incurred net losses in each quarter since our inception, and we may continue to incur additional net losses in future years as we continue to invest substantial resources to support the growth of our business. We incurred a net loss of \$8.9 million and \$30.5 million for the three and nine months ended September 30, 2012, respectively, and have incurred net losses of approximately \$119.3 million from our inception through September 30, 2012. We expect to incur additional costs and expenses related to the continued development and expansion of our business, including marketing and developing our products, expanding into new product markets and geographies, and maintaining and enhancing our research and development operations. In addition, revenue growth may slow or revenue may decline for a number of possible reasons, many of which are outside our control, including a decline in demand for our offerings, increased competition, a decrease in the growth of the solar industry or our market share, or our failure to continue to capitalize on growth opportunities. If we fail to generate sufficient revenue to support our operations, we may not be able to achieve or sustain profitability.

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

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

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

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

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

Our microinverter solution is 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 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

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

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:

market acceptance of solar PV systems based on our product platform;

---

**Table of Contents**

cost competitiveness, reliability and performance of solar PV systems compared to conventional and non-solar renewable energy sources and products;

availability and amount of government subsidies and incentives to support the development and deployment of solar energy solutions;

the extent to which the electric power industry and broader energy industries are deregulated to permit broader adoption of solar electricity generation;

the cost and availability of key raw materials and components used in the production of solar PV systems;

prices of traditional carbon-based energy sources;

levels of investment by end-users of solar energy products, which tend to decrease when economic growth slows; and

the emergence, continuance or success of, or increased government support for, other alternative energy generation technologies and products.

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

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

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

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

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

To date, we have generated substantially all of our revenues from North America and expect to generate a substantial amount of 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. The Renewable Energy and Job Creation Act of 2008 provides a 30% federal tax credit for residential and commercial solar installations. The American Recovery and Reinvestment Act of 2009, as amended, created a renewable energy grant program that offered cash payments in lieu of investment tax credits to renewable energy project developers for eligible property placed in service prior to December 31, 2011 or placed in service by the specified credit termination date, if construction began prior to December 31, 2011. The guidelines include a

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

safe harbor provision setting the beginning of construction at the point where the applicant has incurred or paid at least 5% of the total cost of the property, excluding land and certain preliminary planning activities. We believe the December 31, 2011 deadline associated with this program had a positive effect on our sales in the fourth quarter of 2011, as customers and installers took actions to begin construction or place eligible property into service before the deadline, and in 2012 as deferred revenues recorded in connection with these sales were recognized. However, unless this program is further extended, the eventual phase-out of this program could adversely affect sales of our products in the future.

California is the largest single solar market in the United States, based on SEIA data, and a significant portion of our revenues are generated in California. In 2007, the State of California launched its 10-year, \$3 billion Go Solar California campaign, which encourages the installation of an aggregate of 3,000 MW of solar energy systems in homes and businesses by the end of 2016. The largest part of the campaign, the California Solar Initiative, provides performance-based incentives which decrease in intervals over time. The Go Solar California program is scheduled to expire on December 31, 2016, but if the pace of installations is high the program may conclude sooner.

---

**Table of Contents**

We also sell our products in Ontario, Canada. The Ontario Power Authority Green Energy and Green Economy Act of 2009 created two separate FiT programs for projects greater than 10kW and for projects less than 10kW. Both programs were recently suspended while they underwent a review. The program for projects less than 10kW was re-opened to new applications in July 2012. The Ontario Power Authority had announced that it expects to re-open the program for projects greater than 10kW in October 2012 but this re-opening has been delayed. These FiT programs provide participants with a fixed price for the electricity produced over a 20-year contract term. The Government of Ontario has the authority to change the FiTs for future contracts at its discretion. These suspensions and any future suspensions and any changes to FiT programs in Ontario could negatively affect our business, financial condition and results of operations.

In the fourth quarter of 2011, we began selling our products in France, Italy and the Benelux region. During the second quarter of 2012, we opened a sales office in the United Kingdom and began selling our products there at the beginning of the third quarter. A number of European countries, including Germany, Italy, Belgium and the United Kingdom, have adopted reductions to their FiTs, and Spain recently announced a temporary suspension of all subsidies for new renewable energy projects. 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. As we seek to do increased business in Europe, reductions in European tariffs and subsidies and other requirements or incentives, including local content requirements or incentives could negatively affect our business, financial condition and results of operations.

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 could result in decreased demand for and lower revenue from solar PV systems, 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.

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

The 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 may also 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, may adversely impact our existing or future business.

***Our microinverter systems may not achieve broad market acceptance, which would prevent us from increasing our revenue and market share.***

If we fail to achieve broad 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 broad market acceptance for our products will be impacted by a number of factors, including:

our ability to timely introduce and complete new designs and timely qualify and certify our products;

whether installers and system owners will continue to adopt our microinverter solution, which is a relatively new technology with a limited history with respect to reliability and performance;

whether installers and system owners will be willing to purchase microinverter systems from us given our limited operating history;

the ability of prospective system owners to obtain long-term financing for solar PV installations based on our product platform on acceptable terms or at all;



## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

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

our ability to develop products that comply with local standards and regulatory requirements, as well as potential in-country manufacturing requirements; and

our ability to develop and maintain successful relationships with our customers and suppliers.

**Table of Contents**

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

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

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

changes in customer, geographic or product mix;

increased price competition, including the impact of customer discounts and rebates; ability to reduce and control product costs;

increased warranty costs and reserves;

increased our ability to reduce and control product costs;

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;

price reductions on older generation products to sell remaining inventory;

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

changes in shipment volume;

changes in distribution channels;

excess and obsolete inventory and inventory holding charges; and

expediting costs incurred to meet customer delivery requirements.

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

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

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

To date, we have competed primarily against central inverter manufacturers and have faced little direct competition in selling our microinverter systems. Marketing and selling our microinverter solutions against traditional inverter solutions is highly competitive and we expect competition to intensify as new and existing competitors enter the microinverter market. We believe that a number of companies have developed or are developing microinverters and other products that will compete directly with our microinverter systems. SMA Solar Technology AG, Power-One Inc. and SunPower Corp., leading inverter vendors serving the residential and small commercial inverter markets, have introduced in 2012 or announced plans to introduce microinverter products in 2012 or 2013. In addition, several new entrants to the microinverter market have recently announced plans to ship or have already shipped products, including some of our OEM customers and partners.

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

We also may face competition from some of our customers who evaluate our capabilities against the merits of manufacturing products internally. For instance, solar module manufacturers could attempt to develop components that directly perform DC to AC

## **Table of Contents**

conversion in the module itself. Due to the fact that such customers may not seek to make a profit directly from the manufacture of these products, they may have the ability to manufacture competitive products at a lower cost than we would charge such customers. As a result, these customers may purchase fewer of our microinverter systems or sell products that compete with our microinverters systems, which would negatively impact our revenue and gross profit.

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

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

manage a larger organization;

expand third-party manufacturing, testing and distribution capacity;

build additional custom manufacturing test equipment;

manage an increasing number of relationships with customers, suppliers and other third parties;

increase our sales and marketing efforts;

train and manage a growing employee base;

broaden our customer support capabilities;

implement new and upgrade existing operational and financial systems; and

enhance our financial disclosure controls and procedures.

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

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

We currently offer microinverter systems targeting the residential and commercial markets in North America, France, Italy, the United Kingdom, the Benelux region and certain other select European markets. However, we 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:

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

acceptance of microinverters in markets in which they have not traditionally been used;

our ability to compete in new product markets to which we are not accustomed;

our ability to manage an increasing manufacturing capacity and production;

willingness of our potential customers to incur a higher upfront capital investment than may be required for competing solutions;

our ability to develop solutions to address the requirements of the larger commercial and utility-scale markets;

timely qualification and certification of new products for larger commercial and utility-scale installations;

our ability to reduce production costs in order to price our products competitively over time;

availability of government subsidies and economic incentives for solar energy solutions;

accurate forecasting and effective management of inventory levels in line with anticipated product demand; and

our customer service capabilities and responsiveness.

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

differing regulatory requirements, including tax laws, trade laws, labor, safety, local content and consumer protection regulations, tariffs, export quotas, customs duties or other trade restrictions;

limited or unfavorable intellectual property protection;

risk of change in international political or economic conditions;

restrictions on the repatriation of earnings;

---

**Table of Contents**

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.

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

We believe that a system owner's decision to purchase a solar PV system is strongly influenced by the cost of electricity generated by solar PV installations relative to the retail price of electricity from the utility grid and the cost of other renewable energy sources, including electricity from solar PV installations using central inverters. Decreases in the retail prices of electricity from the utility grid would make it more difficult for all solar PV systems to compete. In particular, growth in unconventional natural gas production and an increase in global liquefied natural gas capacity are expected to keep natural gas prices relatively low for the foreseeable future. Persistent low natural gas prices, lower prices of electricity produced from other energy sources, such as nuclear power, or improvements to the utility infrastructure could reduce the retail price of electricity from the utility grid, making the purchase of solar PV systems less economically attractive and lowering sales of our microinverter systems. In addition, energy conservation technologies and public initiatives to reduce demand for electricity also could cause a fall in the retail price of electricity from the utility grid. Moreover, technological developments by our competitors in the solar components industry, including manufacturers of central inverters, could allow these competitors or their partners to offer electricity at costs lower than those that can be achieved from solar PV installations based on our product platform, which could result in reduced demand for our products. 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 incur warranty expenses and may damage our market reputation and cause our revenue and gross profit to decline.***

We have offered 15-year limited warranties for our first and second generation microinverters and offer a limited warranty of up to 25 years on our third 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 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

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

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.

Because of the limited operating history of our products, we have been required to make assumptions and apply judgments, based on our accelerated life cycle testing, regarding a number of factors, including our anticipated rate of warranty claims and the durability and reliability of our products. Our assumptions could prove to be materially different from the actual performance of our products, causing us to incur substantial expense to repair or replace defective products in the future. An increase in our estimates of future warranty obligations due to product failure rates, shipment volumes, field service obligations and rework costs incurred in correcting product failures have caused and could in the future cause us to increase the amount of warranty reserves 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.

---

## **Table of Contents**

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

We manufacture our products according to our estimates of customer demand. This process requires us to make multiple forecasts and assumptions relating to the demand of our distributors, their end customers and general market conditions. Because we sell most of our products to distributors, who in turn sell to their end customers, we have limited visibility as to end-customer demand. We depend significantly on our distributors to provide us visibility into their end-customer demand, and we use these forecasts to make our own forecasts and planning decisions. If the information from our distributors turns out to be incorrect, then our own forecasts may also be inaccurate. Furthermore, we do not have long-term purchase commitments from our distributors or end customers, and our sales are generally made by purchase orders that may be cancelled, 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 cancelled or shipments are delayed, we may have excess inventory that we cannot sell. Historically, provisions for write-downs of inventories have not been significant. In the future we may have to make significant provisions for inventory write-downs based on events that are currently not known, and such provisions or any adjustments to such provisions could be material. Conversely, if we underestimate demand, we may not have sufficient inventory to meet end-customer demand, and we may lose market share, damage relationships with our distributors and end customers and forego 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.

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

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

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

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

---

**Table of Contents**

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/or expand our capacity. In addition, our failure to maintain appropriate quality assurance processes could result in increased product failures, loss of customers, increased production costs and delays. Any of these developments could have a material adverse effect on our business, financial condition, and results of operations.

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

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

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

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

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

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

The manufacturing and packaging processes used by our contract manufacturers depend on raw materials such as copper, aluminum, silicon and petroleum-based products. From time to time, suppliers may extend lead times, limit supplies or increase prices due to capacity constraints or other factors. Certain of our suppliers have the ability to pass along to us directly or through our contract manufacturers any increases in the price of raw materials. If the prices of these raw materials rise significantly, we may be unable to pass on the increased cost to our customers. While we may from time to time enter into hedging transactions to reduce our exposure to wide fluctuations in the cost of raw materials, the availability and effectiveness of these hedging transactions may be limited. Due to all these factors, our results of operations could be adversely affected if we or our contract manufacturers are unable to obtain adequate supplies of raw materials in a timely manner or at reasonable cost. In addition, from time to time, we or our contract manufacturers may need to reject raw materials that do not meet our 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.



**Table of Contents**

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

Many owners of solar PV systems depend on financing to purchase their systems. The limited use of microinverters to date, coupled with our limited operating history, could result in lenders refusing to provide the financing necessary to purchase solar PV systems based on our product platform on favorable terms, or at all. Moreover, in the case of debt financed projects, even if lenders are willing to finance the purchase of these systems, an increase in interest rates or a change in tax incentives could make it difficult for owners to secure the financing necessary to purchase a solar PV system on favorable terms, or at all. In addition, we believe that a significant percentage of owners purchase solar PV systems as an investment, funding the initial capital expenditure through a combination of upfront cash and financing. Difficulties in obtaining financing for solar PV installations on favorable terms, or increases in interest rates or changes in tax incentives, could lower an investor's return on investment in a solar PV installation, or make alternative solar PV systems or other investments more attractive relative to solar PV systems based on our product platform. Any of these events could result in reduced demand for our products, which could have a material adverse effect on our financial condition and results of operations. In addition, an increasing share of residential solar installations has been provided through third party financing structures, such as power purchase or lease agreements. Our sales growth therefore increasingly depends on sales to developers of third party solar finance offerings who provide solar as a service via power purchase agreements or leasing structures. The third party finance market for residential solar in the US and elsewhere is or may become highly concentrated, with a few significant finance companies and several smaller entrants. If Enphase is unable to develop relationships and gain a significant share of inverter sales to the major finance companies or new entrants, our overall sales growth will be constrained.

***\*We rely primarily on distributors to assist in selling our products, and the failure of these distributors 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. For the year ended December 31, 2011, Focused Energy, Inc., Sunwise Technologies, Inc., and Solarnet Holdings, LLC collectively accounted for 38% of our total net revenues. In the nine months ended September 30, 2012, net revenues generated from three customers accounted for approximately 15%, 12% and 11% of the Company's total net revenues. We do not have exclusive arrangements with these third parties and, as a result, many of our distributors also market and sell products from our competitors, which may reduce our sales. Our distributors may terminate their relationships with us at any time, or with short notice. Our distributors 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. Our future performance depends on our ability to effectively manage our relationships with our existing distributors, as well as to attract additional distributors 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 distributors, failure by these distributors to perform as expected, or failure by us to cultivate new distributor relationships, could hinder our ability to expand our operations and harm our revenue and operating results.

***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.

***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 a variant 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 microinverter solutions. 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.

***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.***



---

## **Table of Contents**

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 with us, or provide us with an adequate remedy in the event of such disclosure. Furthermore, competitors or other third parties may independently discover our trade secrets, in which case we would not be able to assert trade secret rights, copy or reverse engineer our products or portions thereof or develop similar technology. If we fail to protect our intellectual property and other proprietary rights, or if such intellectual property and proprietary rights are infringed, misappropriated or otherwise violated, our business, results of operations or financial condition could be materially harmed.

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

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

Our competitors and other third parties hold numerous patents related to technology used in our industry, and claims of patent or other intellectual property right infringement or violation have been litigated against certain of our competitors. From time to time we may also be subject to such claims and litigation. Regardless of their merit, responding to such claims can be time consuming, divert management's attention and resources and may cause us to incur significant expenses. While we believe that our products and technology do not infringe in any material respect upon any valid intellectual property rights of third parties, we cannot be certain that we would be successful in defending against any such claims. Furthermore, patent applications in the United States and most other countries are confidential for a period of time before being published, so we cannot be certain that we are not infringing third parties' patent rights or that we were the first to conceive inventions covered by our patents or patent applications. As we become more visible as a publicly traded company, the possibility that third parties may make claims of intellectual property infringement or other violations against us may grow. An adverse outcome with respect to any such claim could invalidate our proprietary rights and force us to do one or more of the following:

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

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

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

---

**Table of Contents**

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.

***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.

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

We have been and could continue to be subject to industry-specific seasonal fluctuations in the future, particularly in climates that experience colder weather during the winter months, such as northern Europe, Canada, and the United States. In general, we expect our product revenue in the third and fourth quarters to be positively affected by seasonal customer demand trends, including solar economic incentives, weather patterns and construction cycles. 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





## **Table of Contents**

are typically slower in colder months. In European countries with FiTs, the construction of solar PV systems may be concentrated during the second half of the calendar year, largely due to the annual reduction of the applicable minimum FiT and the fact that the coldest winter months are January through March. Accordingly, our business and quarterly results of operations could be affected by seasonal fluctuations in the future.

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

We have lending arrangements with several financial institutions, including loan and security agreements with Wells Fargo Bank, National Association ( Wells Fargo ) and with Hercules Technology Growth Capital, Inc. ( Hercules ). The loan and security agreements with Wells Fargo and with Hercules restrict our ability to take certain actions such as incurring additional debt, encumbering our tangible or intangible property, paying dividends, or engaging in certain transactions, such as mergers and acquisitions, investments and asset sales. Our loan and security agreement with Wells Fargo also requires us to maintain certain financial covenants, including liquidity ratios while our agreement with Hercules includes a condition precedent to borrowing that is subject to us achieving certain financial objectives. These restrictions may limit our flexibility in responding to business opportunities, competitive developments and adverse economic or industry conditions. In addition, our obligations under our loan and security agreements with Wells Fargo and Hercules are secured by substantially all of our assets (excluding intellectual property), which limits our ability to provide collateral for additional financing. A breach of any of these covenants, or a failure to pay interest or indebtedness when due under any of our credit facilities, could result in a variety of adverse consequences, including the acceleration of our indebtedness and the forfeiture of our assets subject to security interests in favor of the lenders.

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

Effective internal controls are necessary for us to provide reliable financial reports and prevent fraud. In addition, Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, requires us to evaluate and report on our internal control over financial reporting beginning with our Annual Report on Form 10-K for the year ending December 31, 2013. In addition, our independent registered public accounting firm is required to evaluate and report on our internal control over financial reporting beginning with the later of our Annual Report on Form 10-K for the year ending December 31, 2013, or our first Annual Report on 10-K for the year in which we cease to be an emerging growth company, as defined in the Jumpstart Our Business Startups Act enacted in April 2012, or the JOBS Act. The process of implementing our internal controls and complying with Section 404 will be expensive and time consuming, and will require significant attention of management. We cannot be certain that these measures will ensure that we implement and maintain adequate controls over our financial processes and reporting in the future. Even if we conclude, and our independent registered public accounting firm concurs, that our internal control over financial reporting provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, because of its inherent limitations, internal control over financial reporting may not prevent or detect fraud or misstatements. Failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our results of operations or cause us to fail to meet our reporting obligations. If we or our independent registered public accounting firm discover a material weakness, the disclosure of that fact, even if quickly remedied, could reduce the market's confidence in our financial statements and harm our stock price. In addition, a delay in compliance with Section 404 could subject us to a variety of administrative sanctions, including SEC action, ineligibility for short form resale registration, the suspension or delisting of our common stock from the stock exchange on which it is listed and the inability of registered broker-dealers to make a market in our common stock, which would further reduce our stock price and could harm our business.

With respect to 2011, we and our independent registered public accounting firm identified a significant deficiency in our internal controls over financial reporting but this deficiency did not create a material weakness. The significant deficiency related to our need for continued improvements in the documentation of accounting policies and procedures and segregation of duties. We have made efforts to remediate this significant deficiency through hiring additional experienced accounting personnel and by realigning certain roles and responsibilities to improve segregation of duties. If significant deficiencies in our internal controls are not fully remediated or if additional significant deficiencies are identified, those significant deficiencies could lead to material weaknesses in the future, potentially causing us to fail to meet our future reporting obligations and the price of our common stock to decline.

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

Sections 382 and 383 of the Internal Revenue Code of 1986, as amended, contain rules that limit the ability of a company that undergoes an ownership change, which is generally any cumulative change in ownership of more than 50% of its stock over a three-year period, to utilize its net operating loss and tax credit carryforwards and certain built-in losses recognized in the years after the ownership change. These rules generally operate by focusing on ownership changes involving stockholders who directly or indirectly own 5% or more of the stock of a

Edgar Filing: Enphase Energy, Inc. - Form 10-Q

company and any change in ownership arising from a new issuance of stock by the company.

---

## **Table of Contents**

Generally, if an ownership change occurs, the yearly taxable income limitation on the use of net operating loss and tax credit carryforwards is equal to the product of the applicable long-term tax exempt rate and the value of the company's stock immediately before the ownership change. As a result, we may be unable to offset our taxable income with net operating losses, or our tax liability with credits, before these losses and credits expire.

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

***\*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 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 for up 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.

***We will incur increased costs as a result of operating as a public company, and our management will be required to devote substantial time to new compliance initiatives.***

As a public company we incur legal, accounting and other expenses that we did not incur as a private company. The Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, the Sarbanes-Oxley Act and the rules implemented by the SEC and the NASDAQ Global Market impose significant regulatory requirements on public companies, including specific corporate governance practices. For example, the listing requirements of the NASDAQ Global Market require that we satisfy certain corporate governance requirements relating to independent directors, audit and compensation committees, distribution of annual and interim reports, stockholder meetings, stockholder approvals, solicitation of proxies, conflicts of interest, stockholder voting rights and codes of conduct. Our management and other personnel will need to devote a substantial amount of time to these compliance initiatives. Moreover, these rules and regulations increase our legal and financial compliance costs and make some activities more time-consuming and costly. For example, these rules and regulations may make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantial additional costs to maintain the same or similar coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers.

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

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

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

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

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.

---

## **Table of Contents**

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

### ***Natural disasters, terrorist 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, could hinder or delay the development and sale of our products. In the event that an earthquake, tsunami, typhoon, terrorist 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 for any extended period of time, our business, financial condition and results of operations would be materially adversely affected.

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

Changes in current laws or regulations applicable to us or the imposition of new laws and regulations in the United States or other jurisdictions in which we do business, such as Canada, France, Italy, the United Kingdom, the Benelux region and China, could materially and adversely affect our business, financial condition and results of operations. In addition, changes in our products or changes in export and import laws and implementing regulations may create delays in the introduction of new products in international markets, prevent our customers from deploying our products internationally or, in some cases, prevent the export or import of our products to certain countries altogether. For example, the Italian energy authority (AEEG) recently enacted a new set of interconnection standards for solar energy installations, which took effect in July 2012. We are currently developing a solution to meet these requirements. However, in the event that we cannot implement our intended solution in the near term the total market available for our microinverter products in Italy, and our business as a result, may be adversely impacted.

While we are not aware of any other current or proposed export or import regulations which would materially restrict our ability to sell our products in countries such as Canada, France, Italy, the United Kingdom, the Benelux region or China, 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 market price of our common stock may be volatile or may decline regardless of our operating performance.***

The market price of our common stock could be subject to wide fluctuations in response to, among other things, the risk factors described in this section of 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;

**Table of Contents**

changes in our pricing and sales policies or the pricing and sales policies of our competitors;

our ability to design, manufacture and deliver products to our customers in a timely and cost-effective manner and that meet customer requirements;

our ability to manage our relationships with our contract manufacturers, customers and suppliers;

quality control or yield problems in our manufacturing operations;

the anticipation, announcement or introductions of new or enhanced products by our competitors and ourselves;

reductions in the retail price of electricity;

changes in laws, regulations and policies applicable to our business and products, particularly those relating to government incentives for solar energy applications;

unanticipated increases in costs or expenses;

the amount and timing of operating costs and capital expenditures related to the maintenance and expansion of our business operations;

the impact of government-sponsored programs on our customers;

our exposure to the credit risks of our customers, particularly in light of the fact that some of our customers are relatively new entrants to the solar market without long operating or credit histories;

our ability to estimate future warranty obligations due to product failure rates;

our ability to forecast our customer demand, manufacturing requirements and manage our inventory;

fluctuations in our gross profit;

our ability to predict our revenue and plan our expenses appropriately; and

fluctuations in foreign currency exchange rates.

The foregoing factors are difficult to forecast, and these, as well as other factors, could materially and adversely affect our quarterly and annual results of operations. Any failure to adjust spending quickly enough to compensate for a revenue shortfall could magnify the adverse impact of



## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

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

As of October 31, 2012, our executive officers, directors, greater than 5% stockholders and entities that are affiliated with them, beneficially owned nearly three-quarters of our outstanding common stock, on an as-converted basis. This significant concentration of share ownership may adversely affect the trading price for our common stock because investors often perceive disadvantages in owning stock in companies with controlling stockholders. Also, as a result, these stockholders, acting together, may be able to control our management and affairs and matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, such as mergers, consolidations or the sale of substantially all of our assets. Consequently, this concentration of ownership may have the effect of delaying or preventing a change in control, including a merger, consolidation or other business combination involving us, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control, even if this change in control would benefit our other stockholders.

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

Sales of a substantial number of shares of our common stock in the public market or the perception that these sales might occur, could depress the market price of our common stock and could impair our ability to raise capital through the sale of additional equity securities. We are unable to predict the effect that sales may have on the prevailing market price of our common stock. As of

## **Table of Contents**

October 31, 2012, we had approximately 41 million shares of common stock outstanding, all of which is eligible for sale in the public market, subject in some cases to the volume limitations and manner of sale requirements of Rule 144 under the Securities Act. Sales of stock by our stockholders could have a material adverse effect on the trading price of our common stock.

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

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

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

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

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

providing for a classified board of directors with staggered, three-year terms, which could delay the ability of stockholders to change the membership of a majority of our board of directors;

not providing for cumulative voting in the election of directors, which limits the ability of minority stockholders to elect directory candidates;

authorizing our board of directors to issue, without stockholder approval, preferred stock rights senior to those of common stock, which could be used to significantly dilute the ownership of a hostile acquiror;

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.

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

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

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

**Table of Contents**

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

*Use of Proceeds from Public Offering of Common Stock*

On March 29, 2012, our registration statements on Form S-1 (Registration Nos. 333-174925 and 333-180467) were declared effective by the SEC for our initial public offering, pursuant to which we registered 10,315,151 shares of common stock to be sold by us. The stock was offered at \$6.00 per share. Our common stock commenced trading on March 30, 2012. The offering closed on April 4, 2012 after the sale of all 10,315,151 shares registered, including 1,345,454 shares sold pursuant to the over-allotment option granted by the Company to the underwriters. As a result, we received net proceeds of approximately \$53.8 million, after underwriters' discounts of approximately \$3.3 million and other direct offering expenses of \$4.8 million. Morgan Stanley & Co. LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Deutsche Bank Securities Inc. acted as joint book-running managers for the offering. Jefferies & Company, Inc. acted as joint lead manager, and Lazard Capital Markets LLC and ThinkEquity LLC acted as co-managers. No offering expenses were paid directly or indirectly to our directors, officers or their associates, or to persons owning 10% or more of any of our equity securities.

We used a portion of the proceeds from the offering for working capital and other general purposes. We invested the remaining proceeds in investment-grade, interest bearing instruments, pending their use to fund working capital and other general corporate purposes.

**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.

**Table of Contents**

**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 13, 2012

**ENPHASE ENERGY, INC.**

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

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
3.1	Amended and Restated Certificate of Incorporation of Enphase Energy, Inc. <sup>(1)</sup>
3.2	Amended and Restated Bylaws of Enphase Energy, Inc. <sup>(2)</sup>
4.1	Specimen Common Stock Certificate of Enphase Energy, Inc. <sup>(3)</sup>
4.2	2010 Amended and Restated Investors Rights Agreement by and between Enphase Energy, Inc. and the investors listed on Exhibit A thereto, dated March 15, 2010, as amended. <sup>(3)</sup>
4.3	Common Stock Purchase Warrant, between the Company and MS Solar Solutions Corp, dated March 4, 2010. <sup>(3)</sup>
4.4	Warrant to Purchase Shares of Series Preferred Stock, between the Company and Compass Horizon Funding Company LLC, dated March 11, 2010. <sup>(3)</sup>
4.5	Warrant to Purchase Shares of Series Preferred Stock, between the Company and Horizon Technology Finance Corporation, dated March 25, 2011. <sup>(3)</sup>
4.6	Warrant Agreement to Purchase Shares of Preferred Stock, between the Company and Hercules Technology Growth Capital, Inc., dated September 13, 2011. <sup>(3)</sup>
4.7	Form of September 2011 Warrant to Purchase Common Stock of Enphase Energy, Inc., pursuant to that certain Amended and Restated Subordinated Convertible Loan Facility and Security Agreement. <sup>(3)</sup>
4.8	Form of November 2011 Warrant to Purchase Common Stock of Enphase Energy, Inc., pursuant to that certain Amended and Restated Subordinated Convertible Loan Facility and Security Agreement. <sup>(3)</sup>
10.40	Second Amendment to Redwood Business Park NNN Lease, between Enphase Energy, Inc. & Sequoia Center LLC, dated July 3, 2012.
10.41	Separation Agreement, dated August 6, 2012, by and between Sanjeev Kumar and Enphase Energy, Inc.+
10.42	Amendment No. 4 to Loan and Security Agreement, dated July 27, 2012, by and between Hercules Technology Growth Capital, Inc. and Enphase Energy, Inc.
10.43	Offer Letter by and between Enphase Energy, Inc. and Kris Sennesael, dated September 17, 2012.
10.44	Offer Letter by and between Enphase Energy, Inc. and Stephen Lapointe, dated July 31, 2012.
10.45	Offer Letter by and between Enphase Energy, Inc. and Ciaran Fox, dated May 2, 2012.
10.46	Form of Change of Control and Severance Agreement to be entered into by Enphase Energy, Inc. and each of its new executive officers.
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.**

## Edgar Filing: Enphase Energy, Inc. - Form 10-Q

- (1) Previously filed as Exhibit 3.1 to the Company's Current Report on Form 8-K (001-35480), filed with the Securities and Exchange Commission on April 6, 2012, and incorporated by reference herein.

**Table of Contents**

- (2) Previously filed as Exhibit 3.5 to Amendment No. 7 to the Company's Registration Statement on Form S-1/A (Registration No. 333-174925), filed with the Securities and Exchange Commission on March 12, 2012, and incorporated by reference herein.
- (3) Filed as the like-numbered exhibit to our Registration Statement on Form S-1/A (Registration No. 333-174925), and incorporated herein by reference.
- + Management compensatory plan or arrangement.
- \* 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.
- \*\* Pursuant to applicable securities laws and regulations, we are deemed to have complied with the reporting obligation relating to the submission of interactive data files in such exhibits and are not subject to liability under any anti-fraud provisions of the federal securities laws as long as we have made a good faith attempt to comply with the submission requirements and promptly amend the interactive data files after becoming aware that the interactive data files fail to comply with the submission requirements. In accordance with Rule 406T of Regulation S-T, the information in these exhibits is furnished and deemed not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.