ADESTO TECHNOLOGIES Corp
Form 10-Q
November 09, 2018
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, 2018

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 37582

ADESTO TECHNOLOGIES CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	16 1755067
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Adesto Technologies Corporation
3600 Peterson Way
Santa Clara, CA 95054
(408) 400 0578

(Address and telephone number of Registrant’s executive offices)

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 every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b 2 of the Exchange Act:

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at October 26, 2018
Common Stock, $0.0001 par value per share	29,434,142 shares

Table of Contents

Table of Contents

ADESTO TECHNOLOGIES CORPORATION

QUARTERLY REPORT ON FORM 10 Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2018

INDEX

Table of Contents

PART I: FINANCIAL INFORMATION

Item 1.Financial Statements

ADESTO TECHNOLOGIES CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

	September 30, 2018 (unaudited)	December 31, 2017 (1)
Assets		
Current assets:		
Cash and cash equivalents	$ 13,273	$ 30,078
Short-term investments	1,275	—
Accounts receivable, net	24,706	8,668
Inventories	17,541	5,814
Prepaid expenses	1,853	993
Other current assets	1,971	52
Total current assets	60,619	45,605
Property and equipment, net	8,729	7,183
Intangible assets, net	38,013	7,102
Other non-current assets	1,594	900
Goodwill	38,640	22
Total assets	$ 147,595	$ 60,812
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 16,316	$ 7,075
Accrued compensation and benefits	3,701	2,614
Accrued expenses and other current liabilities	6,969	2,359
Price adjustments and other revenue reserves	5,202	—
Earn-out liability, current	9,997	—
Line of credit, current	—	1,500
Term loan, current	—	926
Total current liabilities	42,185	14,474
Term loan, non-current	29,433	10,908
Other non-current liabilities	3,788	75
Deferred rent, non-current	2,063	2,404
Deferred tax liability, non-current	1,797	1
Total liabilities	79,266	27,862
Commitments and contingencies (See Note 9)		
Stockholders' equity:		
Preferred stock, $0.0001 par value, 5,000,000 shares authorized as of September 30, 2018 and December 31, 2017; no shares issued and outstanding as of September 30, 2018 and December 31, 2017	—	—
	3	2

Common stock, $0.0001 par value, 100,000,000 shares authorized; 29,367,787 and 21,291,833 shares issued and outstanding as of September 30, 2018 and December 31, 2017, respectively		
Additional paid-in capital	183,087	133,087
Accumulated other comprehensive loss	(360)	(295)
Accumulated deficit	(114,401)	(99,844)
Total stockholders' equity	68,329	32,950
Total liabilities and stockholders’ equity	$ 147,595	$ 60,812

(1) The condensed consolidated balance sheet as of December 31, 2017 was derived from the audited consolidated financial statements as of that date.

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

ADESTO TECHNOLOGIES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue, net	$ 21,927	$ 15,239	$ 55,412	$ 39,958
Cost of revenue	12,344	7,773	30,885	20,215
Gross profit	9,583	7,466	24,527	19,743
Operating expenses:				
Research and development	5,620	3,606	13,706	10,653
Sales and marketing	4,256	2,897	10,623	8,408
General and administrative	7,130	1,761	12,484	5,569
Total operating expenses	17,006	8,264	36,813	24,630
Loss from operations	(7,423)	(798)	(12,286)	(4,887)
Other income (expense):				
Interest expense, net	(1,046)	(170)	(2,368)	(581)
Other income (expense), net	8	(12)	17	2
Total other income (expense), net	(1,038)	(182)	(2,351)	(579)
Loss before provision for (benefit from) income taxes	(8,461)	(980)	(14,637)	(5,466)
Provision for (benefit from) income taxes	(64)	17	(80)	57
Net loss	$ (8,397)	$ (997)	$ (14,557)	$ (5,523)
Net loss per share:				
Basic and diluted	$ (0.29)	$ (0.05)	$ (0.61)	$ (0.31)
Weighted average number of shares used in computing net loss per share:				
Basic and diluted	28,171,952	21,058,635	23,717,727	17,701,230

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

ADESTO TECHNOLOGIES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net loss	$ (8,397)	$ (997)	$ (14,557)	$ (5,523)
Other comprehensive loss, net of tax:				
Foreign currency translation adjustment	(148)	(20)	(65)	(71)
Comprehensive loss	$ (8,545)	$ (1,017)	$ (14,622)	$ (5,594)

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

ADESTO TECHNOLOGIES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine months ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net loss	$ (14,557)	$ (5,523)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	2,103	2,873
Depreciation and amortization	1,687	1,004
Amortization of intangible assets	2,119	927
Amortization of debt discount	707	64
Deferred income taxes	(463)	—
Gain on investment	(1)	—
Gain on sale of equipment	(18)	—
Changes in assets and liabilities:		
Accounts receivable	(12,826)	(2,699)
Inventories	(6,017)	919
Prepaid expenses and other current assets	949	116
Other non-current assets	(8)	(311)
Accounts payable	5,834	1,426
Accrued compensation and benefits	1,087	533
Accrued expenses and other current liabilities	1,178	(230)
Price adjustments and other revenue reserves	5,202	—
Other non-current liabilities	283	—
Deferred rent	(341)	(315)
Net cash used in operating activities	(13,082)	(1,216)
Cash flows from investing activities:		
Acquisition of property and equipment	(2,631)	(2,054)
Acquisition of Echelon, net of cash acquired	(28,836)	—
Acquisition of S3, net of cash acquired	(34,616)	—
Investment in unconsolidated affiliate	(434)	—
Net cash used in investing activities	(66,517)	(2,054)
Cash flows from financing activities:		
Proceeds from public offering, net of underwriting discounts and commissions	42,658	18,363
Proceeds from exercise of stock options and employee stock purchase plan	813	639
Tax withholdings related to net share settlement of restricted stock units	(372)	(157)
Proceeds from revolving line of credit	—	27,427
Payments on revolving line of credit	(1,500)	(27,234)
Proceeds from term loan, net of fees	33,591	—
Payments on term loan	(12,000)	(4,909)
Net cash provided by financing activities	63,190	14,129
Effect of exchange rates on cash and equivalents	(396)	(70)

Net increase (decrease) in cash and cash equivalents	(16,805)	10,789
Cash and cash equivalents - beginning of period	30,078	19,719
Cash and cash equivalents - end of period	$ 13,273	$ 30,508
Supplemental disclosures of other cash flow information:		
Cash paid for interest expense	$ 1,777	$ 560
Supplemental disclosures of non-cash investing and financing information:		
Purchase of property and equipment included in accounts payable	$ 159	$ 347
Fair value of warrants issued in connection with term loan	$ 4,799	$ —

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 1. Organization and Summary of Significant Accounting Policies.

Organization and Nature of Operations.

Adesto Technologies Corporation (together with its subsidiaries; “Adesto”, “we”, “our”, “us” or the “Company”) was incorporated in the state of California in January 2006 and reincorporated in Delaware in October 2015. We are a leading provider of innovative, application-specific semiconductor and systems for the Internet of Things era. Our corporate headquarters are located in Santa Clara, California.

On May 9, 2018 we acquired 100% of the issued capital of S3 Asic Semiconductors Limited and on September 14, 2018 we acquired 100% of the issued capital of Echelon Corporation. Our financial results include the operating results of those entities from the date of acquisition.

Basis of Presentation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information and with the instructions to Form 10 Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP to complete annual consolidated financial statements. In the opinion of our management, all adjustments (consisting of normal recurring adjustments) considered necessary to present fairly the financial position of the Company and its results of operations and cash flows for the interim periods presented have been included. Operating results for the nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018, for any other interim period or for any other future year.

The condensed consolidated balance sheet as of December 31, 2017 was derived from the audited consolidated financial statements as of that date, but does not include all of the disclosures required by U.S. GAAP. The accompanying condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto contained in the Company’s Annual Report on Form 10 K for the year ended December 31, 2017, filed with the Securities and Exchange Commission on March 13, 2018.

The condensed consolidated financial statements include the results of our operations, and the operations of our wholly owned subsidiaries. All intercompany balances and transactions have been eliminated.

There have been no material changes to our significant accounting policies described in Note 1, Organization and Summary of Significant Accounting Policies, in Notes to Consolidated Financial Statements in Item 8 of Part II of our Annual Report on Form 10 K for the year ended December 31, 2017 that have had a material impact on our condensed consolidated financial statements and related notes, except as described below.

Recent Accounting Pronouncements.

In August 2018, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2018-13, Fair Value Measurement Disclosure Framework - Changes to the Disclosure Requirements for Fair Value

Measurement. As part of the FASB's disclosure framework project, it has eliminated, amended and added disclosure requirements for fair value measurements. Entities will no longer be required to disclose the amount of, and reasons for, transfers between Level 1 and Level 2 of the fair value hierarchy, the policy of timing of transfers between levels of the fair value hierarchy and the valuation processes for Level 3 fair value measurements. Public companies will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. This ASU is effective for public entities for annual and interim periods beginning after December 15, 2019. Early adoption is permitted as of the beginning of any interim or annual reporting period. This ASU will have an impact on the Company's disclosures.

In June 2018, FASB issued ASU No. 2018-07, Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting. ASU 2018-07 applies to all entities that enter into share-based payment transactions for acquiring goods and services from nonemployees. The amendments in ASU 2018-07 expand the scope of Topic 718, Compensation - Stock Compensation, to include share-based payments transactions to nonemployees. Changes to the accounting for nonemployee awards as a result of ASU 2018-07 include: 1) equity-classified nonemployee share-based payment awards are measured at the grant date, instead of the previous requirement to remeasure the awards through the performance completion date, 2) for awards with performance conditions, compensation cost is recognized when the achievement of the performance condition is probable, rather than upon achievement, and 3) the current requirement to reassess the classification (equity or liability) for nonemployee awards upon vesting is eliminated. ASU 2018-07 clarifies that Topic 718 does not apply to financing transactions or awards granted to customers as part of a contract accounted for under Topic 606, Revenue from Contracts with Customers. The amendments in ASU 2018-07 are effective for public business entities for fiscal years beginning after December 15, 2018, and interim periods within that fiscal year. An entity should only remeasure liability-classified awards that have not been settled by the date of adoption and equity-classified awards for which the measurement date has not been established through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption. The Company expects that the adoption will not have a material impact on its consolidated financial statements.

In February 2018, FASB issued ASU No. 2018-02, Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. This ASU allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. This ASU is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. The Company expects that the adoption will not have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. This ASU eliminates Step 2 from the goodwill impairment test. Instead, an entity should recognize an impairment charge for the amount by which the carrying value exceeds the reporting unit’s fair value, not to exceed the total amount of goodwill allocated to that reporting unit. This ASU is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. The Company is currently evaluating the effect of the adoption of this ASU, but anticipates that the adoption will not have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This ASU requires instruments measured at amortized cost to be presented at the net amount expected to be collected. Entities are also required to record allowances for available-for-sale debt securities rather than reduce the carrying amount. This ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company expects that the adoption will not have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. For operating leases, a lessee is required to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is evaluating the effect that the adoption of this ASU will have on its consolidated financial statements. The Company currently expects that most of its operating lease commitments will be subject to the new standard and recognized as right-of-use assets and operating lease liabilities upon

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

the adoption of ASU 2016-02, which will increase the total assets and total liabilities that it reports relative to such amounts prior to adoption.

Recently Adopted Accounting Pronouncements.

Adoption of ASC 606:

In May 2014, the FASB issued an ASU on revenue from contracts with customers, ASU No. 2014-09, Revenue from Contracts with Customers (“Topic 606”). This standard update outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The guidance is effective for annual reporting periods including interim reporting reports beginning after December 15, 2017. Collectively, we refer to Topic 606, its related amendments and Subtopic 340-40 as the “new standard”.

On January 1, 2018, we adopted the new standard using the modified retrospective method applied to all contracts that are not completed contracts at the date of initial application (i.e., January 1, 2018). Results for reporting periods after January 1, 2018 are presented under the new standard, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting. There was no impact on the opening accumulated deficit as of January 1, 2018 due to the adoption of the new standard. We reclassified the allowance for ship from stock and debits (“SSDs”), price protection, rights of return and other activities to current liabilities presented as "Price adjustments and other revenue reserves" from the allowance for accounts receivable due to the adoption of the new standard.

We recorded a cumulative effect adjustment to our January 1, 2018 condensed consolidated balance sheet for the impact of the reclassification of the allowance for SSDs, price protection, rights of return and other activities to current liabilities presented as “Price adjustments and other revenue reserves”. The cumulative effect of the changes made to our January 1, 2018 condensed consolidated balance sheet for the adoption of the new revenue standard were as follows (in thousands):

	Balance as of December 31, 2017	Adjustments Due to ASC 606	Balance as of January 1, 2018
Accounts receivable, net	$ 8,668	$ 3,832	$ 12,500
Price adjustments and other revenue reserves	$ —	$ (3,832)	$ (3,832)

In accordance with the new standard requirements, the disclosure of the impact of adoption on select condensed consolidated balance sheet line items was as follows (in thousands):

	As of September 30, 2018		
	As Reported	Balances without ASC 606	Effect of Change
Accounts receivable, net	$ 24,706	$ 19,504	$ (5,202)
Price adjustments and other revenue reserves	$ 5,202	$ —	$ 5,202

Revenue Recognition.

Revenue is recognized when control of the promised goods or services is transferred to customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services. Sales of products with alternative use account for the majority of our revenue and are recognized at a point in time, the timing of such recognition remained the same under Topic 606.

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction, that are collected by us from a customer and deposited with the relevant government authority, are excluded from revenue. Our revenue arrangements do not contain significant financing components.

Revenue is recognized over a period of time when it is assessed that performance obligations are satisfied over a period rather than at a point in time. When any of the following criteria is fulfilled, revenue is recognized over a period of time:

(a) The customer simultaneously receives and consumes the benefits provided by the performance as Adesto performs.

(b) Adesto's performance creates or enhances an asset (for example, work in process) that the customer controls as the asset is created or enhanced.

(c) Adesto's performance does not create an asset with an alternative use, and Adesto has an enforceable right to payment for performance completed to date.

If revenue is recognized over a period of time, we would then select an appropriate method for measuring progress toward complete satisfaction of the performance obligation, usually costs incurred to date relative to the total expected costs to the satisfaction of that performance obligation. Typically, our revenue is recognized at a point in time.

Sales to certain distributors are made under arrangements which provide the distributors with price adjustments, price protection, stock rotation and other allowances under certain circumstances. These adjustments and allowances are accounted for as variable consideration. We estimate these amounts based on the expected amount to be provided to customers and reduce revenue recognized. We believe that there will not be significant changes to our estimates of variable consideration.

If a customer pays consideration, or Adesto has a right to an amount of consideration that is unconditional before we transfer a good or service to the customer, those amounts are classified as deferred income/ advances received from customers which are included in other current liabilities or other long-term liabilities when the payment is made or it is due, whichever is earlier.

If the arrangement includes variable contingent consideration, we recognize revenue over time if we can reasonably measure its progress, or we are capable of providing reliable information that would be required to apply an appropriate method of measuring progress. To date, we have not had any arrangements incorporating contingent consideration.

Practical Expedients and Elections.

Sales commissions are owed and are recorded at the time of sell through of our products to end customers. These costs are recorded within sales and marketing expenses.

We do not disclose the value of unsatisfied performance obligations for (i) contracts with an original expected length of one year or less and (ii) contracts for which we recognize revenue at the amount to which we have the right to invoice for services performed.

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

We have elected to account for shipping and handling costs as fulfillment costs after the customer obtains control of the goods. These costs are recorded in cost of revenue.

Reclassifications.

Certain reclassifications have been made to prior periods' condensed consolidated financial statements to conform to the current period presentation. These reclassifications did not result in any change in previously reported total assets, stockholders' equity or net loss.

Use of Estimates.

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions that affect the reported amount of assets, liabilities, revenue and expenses and related disclosures of contingent assets and liabilities. On an on-going basis, we evaluate those estimates, including those related to allowances for doubtful accounts, price adjustments and other revenue reserves, warranty accrual, inventory write-downs, valuation of long-lived assets, including property and equipment and identifiable intangible assets and goodwill, loss on purchase commitments, valuation of deferred taxes and contingencies. In addition, we use assumptions when employing the Black-Scholes option-pricing model to calculate the fair value of stock options granted and Monte Carlo simulation techniques to value certain restricted stock units with market-based vesting conditions. We base our estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, when these carrying values are not readily available from other sources. Actual results could differ from these estimates.

Product Warranty.

Our products are sold with a limited warranty for a period of one year, warranting that the product conforms to specifications and is free from material defects in design, materials and workmanship. To date, we have had insignificant returns of any defective production parts. During the year ended December 31, 2015, we recorded $250,000 for a specific potential warranty claim. During the years ended December 31, 2017 and 2016, $185,000 and $41,000, respectively, has been incurred relating to this potential warranty claim and during the year ended December 31, 2017 we recorded $27,000 for an additional potential warranty claim. As of September 30, 2018 and December 31, 2017, the warranty accrual was $51,000 and is included in accrued expenses and other current liabilities on the condensed consolidated balance sheets.

Foreign Currency Translation.

The functional currency of our foreign subsidiaries is the local currency. In consolidation, we translate assets and liabilities at exchange rates in effect at the consolidated balance sheet date. We translate revenue and expense accounts at the average exchange rates during the period in which the transaction takes place. Net losses from foreign currency translation of assets and liabilities were $148,000 and $20,000 for the three months ended September 30, 2018 and 2017, respectively, and $65,000 and $71,000 for the nine months ended September 30, 2018 and 2017, respectively, and are included in the cumulative translation adjustment component of accumulated other comprehensive loss, net of tax, a component of stockholders' equity. Net gains and losses arising from transactions denominated in currencies other than the functional currency were a gain of $9,000 and a loss of $7,000 for the three months ended September 30, 2018 and 2017, respectively, and a loss of $1,000 and a gain of $1,000 for the nine months ended September 30, 2018 and 2017, respectively, and are included in other income (expense), net in the condensed consolidated statements of operations.

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Concentration of Risk.

Our products are primarily manufactured, assembled and tested by third-party foundries and other contractors in Asia and we are heavily dependent on a single foundry in Taiwan for the manufacture of wafers and a single contractor in the Philippines for assembly and testing of our products. We do not have long-term agreements with either of these suppliers. A significant disruption in the operations of these parties would adversely impact the production of our products for a substantial period of time, which could have a material adverse effect on our business, financial condition, operating results and cash flows.

Financial instruments that potentially subject us to significant concentrations of credit risk consist principally of cash and cash equivalents, investments and accounts receivables. We place substantially all of our cash and cash equivalents and investments on deposit with a reputable, high credit quality financial institution in the United States of America. We believe that the bank that holds substantially all of our cash and cash equivalents and investments is financially sound and, accordingly, subject to minimal credit risk. Deposits held with the bank may exceed the amount of insurance provided on such deposits.

We generally do not require collateral or other security in support of accounts receivable. We periodically review the need for an allowance for doubtful accounts by considering factors such as historical experience, credit quality, the age of the accounts receivable balances and current economic conditions that may affect a customer’s ability to pay. The allowance for doubtful accounts as of September 30, 2018 and December 31, 2017 was $30,000 and zero, respectively.

Customer concentrations as a percentage of revenue, net were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Customer A	20 %	13 %	21 %	16 %
Customer B	*	12 %	*	10 %
Customer C	*	13 %	*	12 %

*less than 10%

Customer concentrations as a percentage of gross accounts receivable were as follows:

	September 30, 2018	December 31, 2017
Customer A	22 %	31 %
Customer B	13 %	*

*less than 10%

Note 2. Acquisitions.

Echelon Corporation

On September 14, 2018, we acquired 100% of the issued capital of Echelon Corporation, a Delaware corporation ("Echelon"), pursuant to the terms of an Agreement and Plan of Merger (the "Merger Agreement") dated as of June 28, 2018. The purchase price was approximately $44.1 million paid in cash.

Table of Contents

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

The assets and liabilities of Echelon were recorded in our condensed consolidated balance sheet as of the acquisition date, at their respective fair values. Fair value is estimated based on one or a combination of income, cost and/or market approaches, as determined based on the nature of the asset or liability, and the level of inputs available. With respect to assets and liabilities, the determination of fair value requires management to make subjective judgments as to projections of future operating performance, the appropriate discount rate to apply, long-term growth rates, and other factors, which affect the amounts recorded in the purchase price allocation. The excess of the consideration transferred over the fair value of the identifiable assets, net of liabilities, is recorded as goodwill, which is indicative of the expected continued growth and development of Echelon. The purchase price allocation that follows is based on these estimated fair values of assets acquired and liabilities assumed. We will continue to evaluate certain assets, liabilities and tax estimates that are subject to change within the measurement period (up to one year from the acquisition date).

The following table summarizes the fair values of assets acquired and liabilities assumed (in thousands):

Cash	$ 15,270
Short term investments	1,274
Accounts receivable	3,020
Inventories	5,710
Other current assets	2,845
Property and equipment, net	614
Intangible assets	17,690
Goodwill	4,266
Other non-current assets	252
Accounts payable	(3,630)
Other current liabilities	(2,642)
Other non-current liabilities	(222)
Deferred tax liability	(341)
Fair value net assets acquired	$ 44,106

Intangible assets reflect the following:

	Fair Value	Useful Life (in Years)
Customer relationships	$ 6,520	7
Developed technology	10,670	4
Trademarks	500	8
Total acquired intangible assets	$ 17,690	

Pro forma financial information

The following table presents the unaudited pro forma financial information for the combined entity of Adesto and Echelon for the three and nine month periods ended September 30, 2018, as if the acquisition had occurred at the beginning of the periods presented after giving effect to certain purchase accounting adjustments. Echelon was acquired on September 14, 2018.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands except per share amounts)			
Net revenue	$ 27,541	$ 23,157	$ 76,780	$ 63,916

14

Table of Contents

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Net loss	$ (8,124)	$ (1,842)	$ (17,087)	$ (8,737)
Basic and diluted net loss per share	$ (0.29)	$ (0.06)	$ (0.72)	$ (0.34)

S3 Asic Semiconductors Limited

On May 9, 2018, we acquired 100% of the issued capital of S3 Asic Semiconductors Limited, a private company limited by shares and incorporated in Ireland (“S3”), pursuant to the Share Purchase Agreement dated May 9, 2018 (the “Agreement”). S3 is headquartered in Ireland and its subsidiaries are in the United States, Portugal and the Czech Republic. S3 and its subsidiaries are engaged in the business of providing advanced mixed signal semiconductor devices and intellectual property to customers in the industrial and communications markets. The aggregate consideration was approximately $35.0 million in cash and contingent consideration in the form of a $15.0 million earn-out. The earn-out is based on achievement of certain milestones through 2019, including minimum total revenue targets, revenue derived from sales of semiconductor devices and new customer engagements with minimum value thresholds.

The assets and liabilities of S3 were recorded in our condensed consolidated balance sheet as of the acquisition date, at their respective fair values. Fair value is estimated based on one or a combination of income, cost and/or market approaches, as determined based on the nature of the asset or liability, and the level of inputs available. With respect to assets and liabilities, the determination of fair value requires management to make subjective judgments as to projections of future operating performance, the appropriate discount rate to apply, long-term growth rates, and other factors, which affect the amounts recorded in the purchase price allocation. The excess of the consideration transferred over the fair value of the identifiable assets, net of liabilities, is recorded as goodwill, which is indicative of the expected continued growth and development of S3. The purchase price allocation that follows is based on these estimated fair values of assets acquired and liabilities assumed. We will continue to evaluate certain assets, liabilities and tax estimates that are subject to change within the measurement period (up to one year from the acquisition date).

The following table summarizes the fair values of assets acquired and liabilities assumed (in thousands):

Cash	$ 267
Accounts receivable	192
Other current assets	883
Property and equipment, net	191
Intangible assets	15,340
Goodwill	34,352
Accounts payable	(37)
Deferred revenue	(129)
Earn-out liability, current	(10,218)
Other current liabilities	(761)
Deferred tax liability	(1,918)

Earn-out liability, non-current	(3,279)
Fair value of net assets acquired	$ 34,883

Intangible assets reflect the following:

	Fair Value	Useful Life (in Years)
Customer relationships	$ 12,880	7
Contract backlog	210	0.5
Developed technology	1,080	5
Non-compete agreements	380	2

Table of Contents

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Trademarks	790	12
Total	$ 15,340	

Note 3. Balance Sheet Components.

Accounts Receivable, Net.

Accounts receivable, net consisted of the following (in thousands):

	September 30, 2018	December 31, 2017
Accounts receivable	$ 24,736	$ 12,500
Allowance for SSDs, price protection, rights of return and other activities	—	(3,832)
Allowance for doubtful accounts	(30)	—
Total accounts receivable, net	$ 24,706	$ 8,668

Inventories.

Inventories consisted of the following (in thousands):

	September 30, 2018	December 31, 2017
Raw materials	$ 2,298	$ 2,213
Work-in-process	8,430	2,408
Finished goods	6,813	1,193
Total inventories	$ 17,541	$ 5,814

For the three months ended September 30, 2018, we recorded a write-down of $16,000 related to excess inventory. For the three months ended September 30, 2017, we realized a benefit of $0.4 million from the sales of previously reserved products.

For the nine months ended September 30, 2018 and 2017, we realized a benefit of $0.9 million and $1.0 million, respectively, from the sales of previously reserved products.

Inventory write-downs are primarily associated with products built in excess of customer demand which resulted in excess inventory levels, legacy products for which no demand exists and lower of cost or net realizable value write-downs associated with products for which costs exceeded net realizable value.

Table of Contents

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Property and Equipment, Net.

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

	September 30, 2018	December 31, 2017
Machinery and equipment	$ 14,936	$ 9,457
Leasehold improvements	4,463	4,252
Computer software	3,765	675
TowerJazz license	350	350
Furniture and fixtures	246	83
Construction in progress	1,301	1,301
Property and equipment, at cost	25,061	16,118
Accumulated depreciation and amortization	(16,332)	(8,935)
Property and equipment, net	$ 8,729	$ 7,183

The Company incurs costs for the fabrication of masks used by its foundry partners to manufacture its products. Beginning the first fiscal quarter of 2017, the Company capitalizes mask costs that are expected to be utilized in production manufacturing as the Company's product development process has become more predictable and thus supports capitalization of the mask. The capitalized mask costs begin depreciating to cost of revenue once the products go into production. Depreciation is computed using the straight-line method over a three year period which is the expected useful life of the mask. Previously mask sets were expensed to research and development.

Depreciation and amortization expense of property and equipment for the three and nine months ended September 30, 2018 was $0.6 million and $1.7 million, respectively.

Depreciation and amortization expense of property and equipment for the three and nine months ended September 30, 2017 was $0.4 million and $1.0 million, respectively

Accrued Expenses and Other Current Liabilities.

Accrued expenses and other current liabilities consisted of the following (in thousands):

	September 30, 2018	December 31, 2017
Accrued sales commission payable	$ 318	$ 310
Accrued manufacturing expenses	537	265
Deferred rent, current portion	527	422
Liabilities to certain customers	812	468
Deferred revenue, current portion	1,454	262

Accrued professional services	1,903	94
Other accrued liabilities	1,418	538
Total accrued expenses and other current liabilities	$ 6,969	$ 2,359

Table of Contents

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 4. Fair Value Measurements.

Fair value is defined as the exchange price that would be received from selling an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. We measure financial assets and liabilities at fair value at each reporting period using a fair value hierarchy which requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's classification 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. Quoted prices in active markets for identical assets or liabilities.

Level 2. Quoted prices for similar assets and liabilities in active markets or inputs other than quoted prices which are observable for the assets or liabilities, either directly or indirectly through market corroboration, for substantially the full term of the financial instruments.

Level 3. Unobservable inputs which are supported by little or no market activity and which are significant to the fair value of the assets or liabilities.

Financial assets measured at fair value on a recurring basis were as follows:

	Fair Value Measurement at Reporting Date Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
	(in thousands)			
As of September 30, 2018				
Assets:				
Money market funds	$ 6	$ —	$ —	$ 6
U.S. government securities	—	1,275	—	1,275
	$ 6	$ 1,275	$ —	$ 1,281
As of December 31, 2017				
Assets:				
Money market funds	$ 11,501	$ —	$ —	$ 11,501

As of September 30, 2018 and December 31, 2017, we had no financial liabilities measured at fair value on a recurring basis.

The Company’s available-for-sale securities consist of U.S. government securities with a minimum and weighted average credit rating of A-1+. The Company values these securities based on pricing from pricing vendors, who may use quoted prices in active markets for identical assets (Level 1 inputs) or inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs) in determining fair value. However, the Company classifies all of its fixed income available-for-sale securities as having Level 2 inputs. The valuation techniques used to measure the fair value of the Company’s financial instruments having Level 2 inputs were derived from non-binding market consensus prices that are corroborated by observable market data, quoted market prices for similar instruments, or pricing models, such as discounted cash flow techniques. The Company's procedures include controls to ensure that appropriate fair values are recorded by comparing prices obtained from a third party independent source.

Table of Contents

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

The Company's available-for-sale securities had contractual maturities of six months and an average remaining term to maturity of three months. The amortized cost basis, aggregate fair value, and gross unrealized holding gains and losses of the Company's short-term investments by major security type were as follows (in thousands):

	Amortized Cost	Aggregate Fair Value	Unrealized Holding Gain	Unrealized Holding Losses
As of September 30, 2018				
U.S. government securities	$ 1,275	$ 1,275	$ —	$ —

Market values were determined for each individual security in the investment portfolio. The Company reviews its investments on a regular basis to evaluate whether or not any have experienced an other-than-temporary decline in fair value.

Note 5. Intangible Assets, net.

In 2012, in connection with our purchase of the serial flash memory product line assets from Atmel Corporation, we recorded $16.4 million of intangible assets.

In connection with the acquisition of S3 (Note 2), we recorded $15.3 million of intangible assets.

In connection with the acquisition of Echelon (Note 2), we recorded $17.7 million of intangible assets.

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Intangible assets, net were as follows (in thousands):

	September 30, 2018			
	Estimated Useful Life (in Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	10	$ 4,282	$ 2,570	$ 1,712
Developed technology	5	1,080	85	995
Developed technology	4	10,670	119	10,551
Customer relationships	12	9,011	4,505	4,506
Customer relationships	7	19,400	763	18,637
Customer backlog	1	2,779	2,779	—
Contract backlog	0.5	210	165	45
Non-compete agreement	5	282	282	—
Non-compete agreement	2	380	74	306
Trademarks	8	500	3	497
Trademarks	12	790	26	764
Total intangible assets subject to amortization		$ 49,384	$ 11,371	$ 38,013

	December 31, 2017			
	Estimated Useful Life (in Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	10	$ 4,282	$ 2,249	$ 2,033
Customer relationships	12	9,011	3,942	5,069
Customer backlog	1	2,779	2,779	—
Non-compete agreement	5	282	282	—
Total intangible assets subject to amortization		$ 16,354	$ 9,252	$ 7,102

We recorded amortization expense related to the acquisition-related intangible assets as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Operating expense category:				
Research and development	$ 323	$ 121	$ 567	$ 364
Sales and marketing	763	188	1,472	563

General and administrative	52	—	80	—
Total	$ 1,138	$ 309	$ 2,119	$ 927

Table of Contents

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

The estimated future amortization expense of acquisition-related intangible assets subject to amortization after September 30, 2018 is as follows (in thousands):

Year Ended December 31,	
2018 (remaining 3 months)	$ 1,833
2019	7,152
2020	7,030
2021	6,962
2022	6,070
Thereafter	8,966
Total	$ 38,013

Note 6. Investment in Unconsolidated Affiliates.

During 2017 and 2016, we made investments in Semitech Semiconductor Pty. Ltd., an Australian corporation (“Semitech”), as part of a license and development agreement dated April 16, 2016. Semitech has developed Narrowband-Power Line Communications (“N-PLC”) products and market knowledge in the N-PLC devices space and plans to sell its products into the smart grid, solar, smart lighting and industrial space. Investments during 2016 through June 14, 2017 were recorded as notes receivable. On June 15, 2017, $0.4 million of notes receivable and accrued interest were converted into 233,335 shares of preferred stock in Semitech. In June 2018, we converted $0.5 million of notes receivable and accrued interest into 312,076 shares of preferred stock in Semitech. This investment is recorded at cost in other non-current assets on the condensed consolidated balance sheets as of September 30, 2018 and December 31, 2017. As of September 30, 2018 and December 31, 2017, we held investments in notes receivable in Semitech in the amount of $0.1 million and $0.2 million, respectively, which were classified in other non-current assets on the condensed consolidated balance sheets.

Note 7. Borrowings.

Western Alliance Bank Term Loan.

The Company was a party to that certain Business Financing Agreement dated July 7, 2016 and that certain Second Business Financing Modification Agreement, dated September 29, 2017, by and between Western Alliance Bank and the Company (“Credit Facility”). The Credit Facility provided for (i) a term loan of up to $18.0 million (the “Term Loan”) and (ii) a revolving credit line advance (the “Line of Credit”) in the aggregate amount of the lower of (x) $5.0 million and (y) 80% of certain of the Company’s receivables. The Term Loan bore interest at a rate per annum equal to the greater of the prime rate or 3.5%, plus 0.75% and was scheduled to mature in June 2019. The Line of Credit bore interest at a rate per annum equal to the greater of the prime rate or 3.5% plus 0.50%), and was scheduled to mature in

July 2018. We made interest-only payments on the Term Loan from July 2016 through September 2016 and began making interest payments and principal payments in 33 equal monthly installments starting October 2016. Prior to the Amendment, the Credit Facility provided that any indebtedness we incurred thereunder was collateralized by substantially all assets of the Company and any domestic subsidiaries, subject to certain customary exceptions. We paid a facility fee of $150,000 as well as a $25,000 diligence fee upon entry into the Credit Facility and an additional $10,000 on July 7, 2017. Additional fees of $25,000 were incurred in connection with the amendment. These fees were recorded as a debt discount and were amortized over the life of the agreement.

Borrowings of $12.0 million under this facility were repaid in full in May 2018. In connection with the repayment of this facility, the remaining unamortized debt discount of $66,000 was recorded as interest expense in the condensed consolidated statements of operations.

Table of Contents

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Cortland Capital Market Services LLC Term Loan.

One May 8, 2018, we entered into a credit agreement with Cortland Capital Market Services LLC ("Cortland") ("Credit Agreement"). The Credit Agreement provides for a 1st lien senior secured term loan of $35.0 million ("Term Loan"). The Term Loan bears interest at a rate per annum equal to the sum of the Libor Rate (2.4375% on September 30, 2018) plus 8.75% and is payable in consecutive quarterly installments starting December 31, 2018. The Term Loan is scheduled to mature on May 8, 2022. The Credit Agreement provided that any indebtedness we incurred thereunder was collateralized by substantially all assets of the Company and any domestic subsidiaries, subject to certain customary exceptions.

The Credit Agreement contains customary representations and warranties and affirmative and negative covenants, including maximum consolidated leverage ratios and minimum liquidity. Upon an occurrence of an event of default, under the Credit Facility we could be required to pay interest on all outstanding obligations under the agreement at a rate of 2% above the otherwise applicable interest rate, and the lender may accelerate our obligations under the agreement.

In connection with the Credit Agreement, Cortland received a warrant to purchase 850,000 shares of common stock at an exercise price of $8.30 and a term of six years. In addition, we paid financing costs of $1.4 million. The financing costs and the value of the warrant, $4.8 million, were recorded as a debt discount and are being amortized over the life of the Credit Agreement. Amortization of debt discount was $0.4 million and $0.7 million for the three and nine months ended in September 30, 2018, respectively.

Outstanding borrowings consisted of the following (in thousands):

	September 30, 2018	December 31, 2017
Term loan, current	$ —	$ 926
Term loan, non-current	29,433	10,908
Line of credit	—	1,500
Total	$ 29,433	$ 13,334

Future repayments on outstanding borrowings (excluding unamortized discount of $5.6 million as of September 30, 2018) are as follows (in thousands):

Year Ended December 31,	
2018 (remaining 3 months)	$ 292
2019	1,750
2020	1,750
2021	1,750

2022	29,458
	$ 35,000

Interest expense incurred under our borrowings was $1.1 million and $2.4 million for the three and nine months ended September 30, 2018, respectively.

Interest expense incurred under our borrowings was $0.2 million and $0.6 million for the three and nine months ended September 30, 2017, respectively.

Table of Contents

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 8. Segment Information.

We operate in one business segment, application-specific, semiconductors and systems. Our chief decision-maker, the President and Chief Executive Officer, evaluates our performance based on company-wide consolidated results. Revenue is evaluated based on product category and by geographic region. All of our revenue results from contracts with customers; we have no additional sources of revenue.

Product revenue from customers is disaggregated based on the geographic region to which the product is delivered. Revenue by geographic region was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
United States	$ 7,253	$ 3,331	$ 15,472	$ 8,853
Rest of Americas	583	58	868	189
Europe	5,087	2,044	11,708	6,054
Asia Pacific	8,865	9,729	27,078	24,540
Rest of world	139	77	286	322
Total	$ 21,927	$ 15,239	$ 55,412	$ 39,958

Long-lived assets are attributed to the geographic region were they are located. Long-lived assets by geographic region were as follows (in thousands):

	September 30, 2018	December 31, 2017
United States	$ 5,511	$ 5,424
Asia Pacific	2,325	1,759
Europe	893	—
Total property and equipment, net	$ 8,729	$ 7,183

Note 9. Commitments and Contingencies.

Operating Leases.

The Company leases office facilities under various non-cancelable operating lease agreements. Certain lease agreements contain free or escalating rent payment provisions. The Company recognizes rent expense under such leases on a straight-line basis over the term of the lease with the difference between the expense and the payments recorded as deferred rent on the consolidated balance sheets. Any reimbursements by the landlord for tenant improvements are considered lease incentives, the balance of which is recorded as a lease incentive obligation within deferred rent on the consolidated balance sheets, and amortized as a reduction of rent expense over the life of the lease. Lease renewal periods are considered on a lease-by-lease basis in determining the lease term.

On November 2, 2015, the Company entered into a lease with Peterson Ridge LLC pursuant to which the Company leased a new headquarters facility, consisting of an aggregate of approximately 34,000 square feet of space in Santa Clara, California. The initial term of the lease commenced on November 2, 2015 and is scheduled to end on July 31, 2023 and may be extended, at the Company’s option, for an additional five-year period following the initial lease term.

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Pursuant to the lease, monthly base rental payments due under the lease were approximately $93,000 per month between August 1, 2016 and February 27, 2017, with annual increases of approximately 3% thereafter. The Company must also pay for certain other operating costs under the lease, including operating expenses, taxes, assessments, insurance, utilities, securities and property management fees. Peterson Ridge LLC is obligated to reimburse the Company for up to approximately $2.5 million of the Company's out-of-pocket costs associated with any tenant improvements, as defined in the lease. The Company was reimbursed for this amount during the year ended December 31, 2016. As of September 30, 2018 and December 31, 2017, the Company recorded a lease incentive obligation of $1.7 million and $2.0 million, respectively, in deferred rent on the condensed consolidated balance sheets.

Rent expense under operating leases was $0.5 million and $1.2 million for the three and nine months ended September 30, 2018, respectively.

Rent expense under operating leases was $0.3 million and $0.8 million for the three and nine months ended September 30, 2017, respectively

				3			
	Total	2018	2019	2020	2021	2022	Thereafter
	(in thousands)						
Operating leases	$ 7,994	$ 674	$ 2,148	$ 1,588	$ 1,466	$ 1,325	$ 793

Purchase Commitments.

As of September 30, 2018, we had purchase commitments with our third-party foundries of $3.3 million, $0.1 million for a licensing and development agreement, and $0.4 million in conjunction with an agreement with TowerJazz Panasonic Semiconductor Company all due within one year.

Litigation.

We are subject to legal proceedings, claims and litigation, including intellectual property litigation, arising in the ordinary course of business. Such matters are subject to many uncertainties and outcomes and are not predictable with assurance. We accrue amounts that we believe are adequate to address any liabilities related to legal proceedings and other loss contingencies that we believe will result in a probable loss that is reasonably estimable.

Indemnification.

During the normal course of business, we may make certain indemnities, commitments and guarantees which may include intellectual property indemnities to certain of our customers in connection with the sales of our products and indemnities for liabilities associated with the infringement of other parties' technology based upon our products. Our exposure under these indemnification provisions is generally limited to the total amount paid by a customer under the agreement. However, certain agreements include indemnification provisions that could potentially expose us to losses in excess of the amount received under the agreement. In addition, we indemnify our officers, directors and certain key employees while they are serving in good faith in such capacities.

We have not recorded any liability for these indemnities, commitments and guarantees in the accompanying condensed consolidated balance sheets. Where necessary, we accrue for losses for any known contingent liabilities, including those that may arise from indemnification provisions, when future payment is probable.

Table of Contents

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 10. Common Stock, Common Stock Warrants and Stock Option Plan.

Common Stock.

We are authorized to issue 100,000,000 shares of common stock with $0.0001 par value per share as of September 30, 2018 and December 31, 2017. Each holder of common stock is entitled to one vote per share. As of September 30, 2018, no dividends have been declared by the Board of Directors, however, the holders of common stock are also entitled to receive dividends, when and if declared by our Board of Directors.

We completed a follow-on offering of our common stock in June 2017. We sold 5,000,000 shares, including 625,000 shares upon exercise of the underwriters' option to purchase additional shares. The shares were sold at a public offering price of $4.00 per share for net proceeds of $18.4 million to us, after deducting underwriting discounts, commissions and offering expenses.

We completed another follow-on offering of our common stock in July 2018. We sold 7,705,000 shares, including 1,005,000 shares upon exercise of the underwriters' option to purchase additional shares. The shares were sold at a public offering price of $6.00 per share for net proceeds of $42.7 million to us, after deducting underwriting discounts, commissions and offering expenses.

Common Stock Reserved for Future Issuance.

As of September 30, 2018 and December 31, 2017, we had reserved shares of common stock for future issuances as follows:

	September 30, 2018	December 31, 2017
Warrants to purchase common stock	1,239,423	389,423
Stock option plan:		
Options outstanding	1,844,030	1,560,453
Restricted stock units outstanding	1,074,193	509,894
Shares available for future grants	289,258	580,827
Shares available for ESPP	362,938	275,587
Total	4,809,842	3,316,184

Common Stock Warrants.

In connection with the Credit Agreement (Note 7), the Company issued Cortland a warrant to purchase 850,000 shares of common stock at an exercise price of $8.30 per share with a term of six years. The grant date fair value of the warrant was approximately $4.8 million which was recorded as a debt discount and is being amortized over the life of the Credit Agreement. The fair value of the warrant was determined using the Black-Scholes Model based on the following assumptions: common stock price on date of grant of $8.70, dividend yield of 0%, volatility of 69.73%, a risk-free interest rate 2.87% and a term of 6 years.

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

The following common stock warrants were outstanding:

As of September 30, 2018

Total amount of securities issuable under the outstanding warrants	Exercise Price	Issuance Date	Expiration Date
74,141	$ 30.35	2012-2013	2019
315,282	$ 2.38	2014-2015	2022-2024
850,000	$ 8.30	2018	2024
1,239,423	$ 8.11		

As of December 31, 2017

Total amount of securities issuable under the outstanding warrants	Exercise Price	Issuance Date	Expiration Date
74,141	$ 30.35	2012-2013	2019
315,282	$ 2.38	2014-2015	2022-2024
389,423	$ 7.71		

Common stock warrants are exercisable at the option of the holder any time after the date of issuance into shares of our common stock. During 2017, common stock warrants with an aggregate 7,378 shares of issuable common stock expired and common stock warrants with an aggregate 14,713 shares of issuable common stock were cashless exercised resulting in the issuance of 10,223 shares of common stock.

Employee Benefit Plans.

2007 Equity Incentive Plan.

In 2007, our Board of Directors and shareholders approved the 2007 Equity Incentive Plan (the “2007 Plan”) under which 272,727 shares of common stock were reserved and available for the issuance of stock options and restricted stock to eligible participants. The 2007 Plan was subsequently amended to increase the number of shares of common stock reserved for issuance under the 2007 Plan to 787,878 and during the year ended December 31, 2015, the number of shares reserved for issuance under the 2007 Plan was increased to 2,651,515. Options and restricted stock awards were granted at a price per share not less than the 85% of the fair value at the date of grant or award, respectively. Restricted stock awarded to persons controlling more than 10% of our stock were granted at a price per share not less than the 100% of the fair value at the date of the award. Options that were granted to new employees generally vest over a four-year period with 25% vesting at the end of one year and the remaining to vest monthly thereafter, while options that were granted to existing employees generally vest over a four-year period. Options granted generally are exercisable up to 10 years from the date of grant. As of October 26, 2015, no shares were available for grant under the 2007 Plan and all outstanding options would continue to be governed and remain outstanding in accordance with their existing terms. In addition, any shares subject to outstanding awards under the 2007 Plan that are issuable upon the exercise of options that expire or become unexercisable for any reason without having been exercised in full will be available for future grant and issuance under the 2015 Plan (as defined below).

2015 Equity Incentive Plan.

In September 2015, our Board of Directors adopted, and in October 2015 our stockholders approved, our 2015 Equity Incentive Plan. The 2015 Equity Incentive Plan became effective on the date immediately prior to the date of our initial public offering (“IPO”). As a result, 1,813,272 shares of common stock previously reserved but unissued under the 2007 Plan on the effective date of the 2015 Equity Incentive Plan became reserved for issuance under our 2015 Equity Incentive Plan, and we ceased granting awards under our 2007 Plan. The number of shares reserved for issuance under our 2015 Equity Incentive Plan will increase automatically on the first day of January of each of 2016 through 2025 by the number of shares equal to 4% of the total outstanding shares of our common stock as of the immediately preceding December 31. However, our Board of Directors may reduce the amount of the increase in any particular year.

Our 2015 Equity Incentive Plan authorizes the award of stock options, restricted stock awards, stock appreciation rights, restricted stock units (“RSUs”), performance awards and stock bonuses. No person will be eligible to receive more than 2,000,000 shares in any calendar year under our 2015 Equity Incentive Plan other than a new employee of ours, who will be eligible to receive no more than 4,000,000 shares under the plan in the calendar year in which the employee commences employment. The aggregate number of shares of our common stock that may be subject to awards granted to any one non-employee director pursuant to the 2015 Equity Incentive Plan in any calendar year shall not exceed 300,000. Our 2015 Equity Incentive Plan provides that no more than 25,000,000 shares will be issued as incentive stock options.

2015 Employee Stock Purchase Plan.

In September 2015, our Board of Directors adopted, and in October 2015 our stockholders approved, our 2015 Employee Stock Purchase Plan (“ESPP”). The 2015 Employee Stock Purchase Plan became effective on the date of our IPO. We reserved 150,000 shares of our common stock for issuance under our 2015 Employee Stock Purchase Plan. The number of shares reserved for issuance under our 2015 Employee Stock Purchase Plan will increase automatically on the first day of January following the first offering date by the number of shares equal to 1% of the total outstanding shares of our common stock as of the immediately preceding December 31 (rounded to the nearest whole share). However, our Board of Directors may reduce the amount of the increase in any particular year. The aggregate number of shares issued over the term of our 2015 Employee Stock Purchase Plan will not exceed 2,250,000 shares of our common stock.

Under our 2015 Employee Stock Purchase Plan, eligible employees will be able to acquire shares of our common stock by accumulating funds through payroll deductions. Eligible employees will be able to select a rate of payroll deduction up to 15% of their base cash compensation. The purchase price for shares of our common stock purchased under our 2015 Employee Stock Purchase Plan will be 85% of the lesser of the fair market value of our common stock on (i) the first trading day of the applicable offering period and (ii) the last trading day of each purchase period in the applicable offering period. Except for the first offering period, each offering period will run for no more than nine months, with purchases occurring every nine months. The first offering period began upon the effective date of our IPO and was originally set to end on June 30, 2016. On May 25, 2016, the Board of Directors extended the initial offering period to July 31, 2016. Subsequent purchase periods will be 6 months in duration beginning on August 1, 2016. On July 29, 2016, we issued 68,392 shares of common stock in conjunction with the end date of the initial purchase window. During 2017, we issued 110,711 shares of common stock pursuant to the ESPP. On January 31, 2018 we issued 55,806 shares of common stock pursuant to the ESPP. On July 31, 2018 we issued 69,761 shares of common stock in conjunction with the end date of the latest purchase window.

No participant will have the right to purchase shares of our common stock in an amount that has a fair market value greater than $25,000, determined as of the first day of the applicable purchase period, for each calendar year in which that right is outstanding. In addition, no participant will be permitted to purchase more than 2,500 shares during any one purchase period or a lesser amount as determined by our compensation committee.

Our 2015 Employee Stock Purchase Plan will continue until the earlier to occur of its termination by our Board of Directors, the issuance of all shares reserved for issuance under it or the tenth anniversary of its effective date.

Table of Contents

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

A summary of stock option and RSUs (including performance-based RSU) activity under the 2007 Plan and the 2015 Equity Incentive Plan is as follows:

	Stock Options			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
	(aggregate intrinsic value in thousands)			
Outstanding as of December 31, 2015	796,356	2.49	6.5	$ 4,157
Granted	230,200	3.38		
Exercised	(13,112)	1.80		
Canceled	(21,549)	3.73		
Outstanding as of December 31, 2016	991,895	2.68	6.3	$ 161
Granted	835,480	4.30		
Exercised	(230,123)	1.92		
Canceled	(36,799)	4.16		
Outstanding as of December 31, 2017	1,560,453	3.63	7.6	$ 4,632
Granted	448,200	7.45		
Exercised	(108,222)	2.43		
Canceled	(56,401)	3.49		
Outstanding as of September 30, 2018	1,844,030	$ 4.63	7.8	$ 3,397
Options vested and expected to vest as of September 30, 2018	1,750,842	$ 4.56	7.7	$ 3,321
Options vested and exercisable as of September 30, 2018	892,281	$ 3.47	6.5	$ 2,451

	Restricted Stock Units			
	Shares	Weighted-Average Grant Date Fair Value	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
	(aggregate intrinsic value in thousands)			
Outstanding as of December 31, 2015	874,508	$ 5.95	1.8	$ 6,742
Granted	69,414	4.82		
Released	(438,086)	5.95		
Forfeited/expired	(14,882)	5.70		
Outstanding as of December 31, 2016	490,954	5.80	0.5	$ 908

Granted	541,513	2.88		
Released	(497,009)	5.64		
Forfeited/expired	(25,564)	5.98		
Outstanding as of December 31, 2017	509,894	2.84	1.4	$ 3,288
Granted	758,165	7.12		
Released	(178,380)	3.65		
Forfeited/expired	(15,486)	8.53		
Outstanding as of September 30, 2018	1,074,193	$ 5.68	1.5	$ 6,391

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 11. Stock-based Compensation.

We record stock-based compensation based on fair value as of the grant date using the Black-Scholes option-pricing model for stock options granted and Monte Carlo simulation techniques for certain RSUs with performance-based vesting conditions. We recognize such costs as compensation expense on a straight-line basis over the employee's requisite service period, which is generally four years. Our valuation assumptions for stock options are as follows:

Fair value of common stock. Prior to our IPO in October 2015, we estimated the fair value of our common stock using various valuation methodologies, including valuation analyses performed by third-party valuation firms. After the IPO, we used the publicly quoted price as the fair value of our common stock.

Risk-free interest rate. We base the risk-free interest rate used in the Black-Scholes option-pricing model on the implied yield available on U.S. Treasury zero-coupon issues with an equivalent expected term of the options for each option group.

Expected term. The expected term represents the period that our stock-based awards are expected to be outstanding. The expected term assumption is based on the simplified method in which the expected term is equal to the average of the stock-based award's weighted-average vesting period and its contractual term. We expect to continue using the simplified method until sufficient information about historical behavior is available.

Volatility. We determine volatility based on the historical stock volatility of our publicly traded stock.

Dividend yield. We have never declared or paid any cash dividend and do not currently plan to pay a cash dividend in the foreseeable future. Consequently, we used an expected dividend yield of zero.

The following table summarizes the weighted-average assumptions used in the Black-Scholes option-pricing model to determine fair value of stock options:

	Three Months Ended September 30,			Nine Months Ended September 30,			
	2018		2017	2018		2017	
Volatility	77	%	—	72	%	86	%
Expected dividend yield	—		—	—		—	
Risk-free rate	2.80	%	—	2.84	%	2.15	%
Expected term (in years)	5		—	6		6	

The weighted-average grant date fair value of the options granted under the 2015 Equity Incentive Plan as calculated using the Black-Scholes option-pricing model was $3.62 and $4.69 per share for the three and nine months ended September 30, 2018, respectively.

On April 1, 2017, our compensation committee granted 204,220 RSUs that do not begin vesting unless certain performance goals are met. All performance goals must be met in order for the shares to begin vesting. Vesting would begin on the one-year anniversary of the grant date. These performance goals relate to a) the price performance of our common stock one year from the grant date as compared to a threshold established by our compensation committee and b) revenue, gross profit and EBITDA performance relative to plan targets for fiscal 2017 established by our compensation committee. As a result of these performance-based vesting conditions we valued these RSUs using Monte Carlo simulation techniques to establish a fair value per share of $0.81 at the time of grant.

On April 1, 2018, our compensation committee granted 102,283 RSUs that do not begin vesting unless certain performance goals are met. Vesting will not begin unless the stock performance goals are met and the number of shares

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

eligible to begin vesting are based on Adesto's share performance as compared to the Russell 2000 stock index which is the performance threshold established by the compensation committee. The evaluation period for the stock performance is from April 2, 2018 through March 31, 2019. Vesting would begin on the one-year anniversary of the grant date with 20% of the shares vesting immediately and the remaining 80% of the shares vesting over the next eight quarters. As a result of these performance-based vesting conditions we valued these RSUs using Monte Carlo simulation techniques to establish a fair value per share of $4.92 at the time of grant.

The following table presents the effects of stock-based compensation for stock options, RSUs (including performance-based RSUs), and ESPP purchase rights (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Cost of revenue	$ 56	$ 35	$ 129	$ 86
Research and development	356	373	786	937
Sales and marketing	180	239	456	621
General and administrative	348	420	732	1,229
Total	$ 940	$ 1,067	$ 2,103	$ 2,873

Stock-based compensation expense capitalized to inventories was not material during the three and nine months ended September 30, 2018 and 2017.

We did not realize any income tax benefit from stock option exercises in any of the periods presented due to recurring losses and valuation allowances.

As of September 30, 2018, the total unrecognized compensation cost related to stock options, net of estimated forfeitures, was approximately $3.0 million, and this amount is expected to be recognized over a weighted-average period of approximately 2.8 years.

As of September 30, 2018, the total unrecognized compensation cost related to RSUs (including performance-based RSUs) and ESPP purchase rights was $4.8 million and $0.1 million, respectively, and these amounts are expected to be recognized over 2.5 years and 0.3 years, respectively.

Note 12. Income Taxes.

We recorded a benefit from and provision for income tax of $64,000 and $17,000, respectively, for the three months ended September 30, 2018 and 2017, respectively, and a benefit from and provision for income tax of $80,000 and $57,000, respectively, for the nine months ended September 30, 2018 and 2017, respectively. The income tax provision is comprised of estimates of current and deferred taxes in domestic and foreign jurisdictions. The income tax provision reflects tax expense associated with foreign taxes, state income tax, uncertain tax positions and tax expense related to the recording of a deferred tax liability that results from the amortization for income tax purposes of acquisition-related goodwill. The decrease in the tax provision between 2018 and 2017 is primarily due to a deferred tax benefit associated with our foreign deferred tax liability.

In December 2017, the Tax Cuts and Jobs Act (the “2017 Tax Act”) was enacted. The 2017 Tax Act includes a number of changes to existing U.S. tax laws that impact us, most notably a reduction of the U.S. corporate income tax rate from 35 percent to 21 percent for tax years beginning after December 31, 2017.

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

On December 22, 2017, Staff Accounting Bulletin No. 118 ("SAB 118") was issued to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the 2017 Tax Act. In accordance with SAB 118, we have determined that the provisional amount related to the mandatory deemed repatriation of deferred foreign income was $0.1 million based on cumulative foreign earnings of $0.6 million. Additional work is necessary to do a more detailed analysis of historical foreign earnings as well as potential correlative adjustments. We are continuing to gather additional information to more precisely compute the amount of deferred foreign income to be included in U.S. taxable income. Any subsequent adjustment to these amounts will be recorded in the quarter of 2018 when the analysis is complete.

In January 2018, the FASB released guidance on the accounting for tax on the global intangible low-taxed income ("GILTI") provisions of the 2017 Tax Act. The GILTI provisions impose a tax on foreign income in excess of a deemed return on tangible assets of foreign corporations. The guidance indicates that either accounting for deferred taxes related to GILTI inclusions or to treat any taxes on GILTI inclusions as period cost are both acceptable methods subject to an accounting policy election. Effective January 1, 2018, we elected to treat any potential GILTI inclusions as a period cost as we are not projecting any material impact from GILTI inclusions and any deferred taxes related to any inclusion would be immaterial.

As of September 30, 2018, our deferred tax assets are fully offset by a valuation allowance except in those jurisdictions where it is determined that a valuation allowance is not required. Accounting for income taxes provides for the recognition of deferred tax assets if realization of such assets is more likely than not. Based on the weight of available evidence, which includes historical operating performance, reported cumulative net losses since inception and difficulty in accurately forecasting our future results, we provided a full valuation allowance against our net U.S. deferred tax assets. We reassess the need for our valuation allowance on a quarterly basis. If it is later determined that a portion or all of the valuation allowance is not required, it generally will be a benefit to the income tax provision in the period that such determination is made.

We evaluate tax positions for recognition using a more-likely-than-not recognition threshold, and those tax positions eligible for recognition are measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon the effective settlement with a taxing authority that has full knowledge of all relevant information. We believe that we have provided adequate reserves for our income tax uncertainties in all open tax years. We do not anticipate a material change in the total amount or composition of its unrecognized tax benefits within 12 months of September 30, 2018.

We file federal, state and foreign income tax returns in jurisdictions with varying statutes of limitations. Due to our net operating loss and credit carryforwards, our income tax returns generally remain subject to examination by federal, state and international authorities.

Table of Contents

ADESTO TECHNOLOGIES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 13. Net Loss Per Share.

The following outstanding common stock equivalents were excluded from the computation of diluted net loss per share for the periods presented because including them would have been antidilutive:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Stock options	1,844,030	1,592,551	1,844,030	1,592,551
Restricted stock units	1,074,193	635,161	1,074,193	635,161
Common stock warrants	1,239,423	404,136	1,239,423	404,136
	4,157,646	2,631,848	4,157,646	2,631,848

Note 14. Related Party Transactions.

The Company purchases certain wafers from Altis Semiconductor S.N.C., which was acquired by X-FAB Silicon Foundries, a stockholder of the Company, in 2016. We made no payments to X-Fab Silicon Foundries during the three and nine months ended September 30, 2018. We made payments of $45,000 and $82,000 to X-FAB during the three and nine months ended September 30, 2017. As of September 30, 2018 and December 31, 2017, there were no invoices included within accounts payable on the condensed consolidated balance sheets.

Table of Contents

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

Forward-looking statements and factors that may affect future results

The discussion below contains forward-looking statements, which are subject to safe harbors under the Securities Act of 1933, as amended (the “Securities Act”) and the Exchange Act of 1934, as amended (the “Exchange Act”). Forward-looking statements generally relate to future events or to our future financial or operating performance. You can generally identify forward-looking statements because they contain words such as “may,” “might,” “will,” “should,” “expects,” “plans,” “anticipates,” “could,” “intend,” “target,” “projects,” “contemplates,” “believes,” “estimates,” “predicts,” “
“continue” or the negative of these terms or other similar expressions that concern our expectations, strategy, plans or intentions. We have based these forward-looking statements primarily on our current expectations and projections about future events and trends that we believe may affect our business, financial condition, results of operations and prospects. Except as required by law, we do not undertake any obligation to update these forward-looking statements to reflect events occurring or circumstances arising after the date of this report. You should not rely upon forward-looking statements as predictions of future events. We cannot assure you that the results, events and circumstances reflected in the forward-looking statements will be achieved or occur, and actual results, events or circumstances could differ materially from those projected in the forward-looking statements. These forward-looking statements involve risks and uncertainties, and our actual results, performance, or achievements could differ materially from those expressed or implied by the forward-looking statements on the basis of several factors, including those that we discuss in Risk Factors, set forth in Part II, Item 1A, of this Quarterly Report on Form 10 Q. We encourage you to read that section carefully.

The following is a discussion and analysis of our financial condition and results of operations and should be read together with our condensed consolidated financial statements and related notes to condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10 Q and our audited consolidated financial statements and related notes to audited consolidated financial statements included in our Annual Report on Form 10 K for the year ended December 31, 2017. In this Quarterly Report, unless otherwise specified or the context otherwise requires, “Adesto,” “we,” “us,” and “our” refer to Adesto Technologies Corporation and its consolidated subsidiaries.

Overview

We are a leading provider of innovative, application-specific semiconductors and systems that provide the key building blocks of Internet of Things, or IoT, edge devices operating on networks worldwide. Our broad portfolio of semiconductor and embedded technologies are optimized for connected IoT devices used in industrial, consumer, communications and medical applications. Through expert design, systems expertise and proprietary intellectual property, we enable our customers to differentiate their systems where it matters most for IoT: longer battery life, greater reliability, integrated intelligence and lower cost. Our product portfolio includes analog, digital and non-volatile memory, or NVM, technologies delivered in the form of standard products, application-specific integrated circuits, or ASICs, and intellectual property, or IP, cores.

Our revenue is primarily derived from the sale of our NVM products, specifically our serial flash memory products, which represented substantially all of our revenue for the nine months ended September 30, 2018. In recent years, we have invested in developing and commercializing new flash memory products that are well suited for low-power, high-growth applications. In 2013, we introduced the first of our next-generation DataFlash and Fusion Serial Flash products. Revenue from our next-generation NVM products were $16.3 million and $15.2 million for the three months ended September 30, 2018 and 2017, respectively. With the acquisition of S3 Asic Semiconductors Limited, or S3, in May 2018, we expanded our product offering and began selling analog, mixed-signal and radio frequency ASICs and IP blocks, and managing the supply of high-quality devices to our customers. We acquired 100% of the issued capital of Echelon Corporation on September 14, 2018. During the three months ended September 30, 2018, S3 and Echelon revenues were approximately $5.6 million.

For the nine months ended September 30, 2018, our products were sold to more than 2,000 end customers. In general, we work directly with our customers to have our NVM devices designed into and qualified for their products. Although we maintain direct sales, support and development relationships with our customers, once our products are

Table of Contents

designed into a customer's product, we sell a majority of our products to those customers through distributors. We generated 59% and 74% of our revenue from distributors in each of the nine months ended September 30, 2018 and 2017, respectively. Sales to three distributors generated approximately 32% and 38% of our revenue during the nine months ended September 30, 2018 and 2017, respectively. Additionally, we derived approximately 72% and 78% of our revenue internationally during the nine months ended September 30, 2018 and 2017, respectively, the majority of which was recognized in the Asia Pacific, or APAC, region. Revenue by geography is recognized based on the region to which our products are sold, and not to where the end products are shipped.

We employ a fabless manufacturing strategy and use market-leading suppliers for all phases of the manufacturing process, including wafer fabrication, assembly, testing and packaging. This strategy significantly reduces the capital investment that would otherwise by required to operate manufacturing facilities of our own.

Recent Developments

Acquisition of Echelon Corporation

On June 28, 2018, we entered into an agreement and plan of merger with Echelon Corporation, or Echelon, under which we agreed to acquire Echelon through a merger of a wholly owned subsidiary of ours with Echelon. Following the completion of the merger on September 14, 2018, Echelon became our wholly owned subsidiary. Under the merger agreement, at the closing of the acquisition, September 14, 2018, all outstanding equity securities of Echelon were converted into the right to receive an aggregate amount of approximately $44.1 million in cash.

Follow-On Offering

We completed a follow-on offering of our common stock in July 2018. We sold 7,705,000 shares, including 1,005,000 shares upon exercise of the underwriters' option to purchase additional shares. The shares were sold at a public offering price of $6.00 per share for net proceeds of approximately $42.7 million to us, after deducting underwriting discounts, commissions and offering expenses.

Factors Affecting Our Performance

Product adoption in new markets and applications. We optimize our products to meet the technical requirements of the emerging IoT market. The growth in the IoT market is dependent on many factors, most of which are outside of our control. Should the IoT market not develop or develop more slowly, our financial results could be adversely affected.

Ability to attract and retain customers that make large orders. In 2017, our products were sold to more than 2,000 end customers, of which approximately 50 generated more than half our revenue. One end customer accounted for 10% or more of our revenue in 2016. No end customer accounted for 10% or more of our revenue in 2017 or the first nine months of 2018. While we expect the composition of our customers to change over time, our business and operating results will depend on our ability to continually target new and retain existing customers that make large orders, particularly those in growth markets which are less dependent on macroeconomic conditions.

Design wins with new and existing customers. We believe our solutions significantly improve the performance and potentially lower the system cost of our customers' designs, particularly if we are part of the early design phase. Accordingly, we work closely with our customers and targeted prospects to understand their product roadmaps and strategies. We consider design wins to be critical to our future success. We define a design win as the successful completion of the evaluation stage, where a customer has tested our product, verified that our product meets its requirements and qualified our NVM device for their products. The number of our design wins has grown from 135 in 2015 to 296 in 2016 and to 417 in 2017. The revenue that we generate, if any, from each design win can vary significantly. Our long-term sales expectations are based on forecasts from customers, internal estimates of customer demand factoring in expected time to market for end customer products incorporating our solutions and associated

Table of Contents

revenue potential and internal estimates of overall demand based on historical trends. We had 423 new design wins during the first nine months of 2018.

Pricing, product cost and gross margins of our products. Our gross margin has been and will continue to be affected by a variety of factors, including the timing of changes in pricing, shipment volumes, new product introductions, changes in product mixes, changes in our purchase price of fabricated wafers and assembly and test service costs, manufacturing yields and inventory write downs, if any. In general, newly introduced products and products with higher performance and more features tend to be priced higher than older, more mature products. Average selling prices in the semiconductor industry typically decline as products mature. Consistent with this historical trend, we expect that the average selling prices of our products will decline as they mature. In the normal course of business, we will seek to offset the effect of declining average selling prices on existing products by reducing manufacturing costs and introducing new and higher value-added products. More recently, certain of our suppliers have increased costs although such increase did not have a material impact on our results of operations for the nine months ended September 30, 2018. If we are unable to maintain overall average selling prices or offset any declines in average selling prices with realized savings on product costs, our gross margin will decline.

Investment in growth. We have invested, and intend to continue to invest, in expanding our operations, increasing our headcount, developing our products and differentiated technologies to support our growth and expanding our infrastructure. We expect our total operating expenses to increase in the foreseeable future to meet our growth objectives. We plan to continue to invest in our sales and support operations throughout the world, with a particular focus in adding additional sales and field applications personnel to further broaden our support and coverage of our existing customer base, in addition to developing new customer relationships and generating design wins. We also intend to continue to invest additional resources in research and development to support the development of our products and differentiated technologies. Any investments we make in our sales and marketing organization or research and development will occur in advance of experiencing any benefits from such investments, and the return on these investments may be lower than we expect. In addition, as we invest in expanding our operations internationally, our business and results will become further subject to the risks and challenges of international operations, including higher operating expenses and the impact of legal and regulatory developments outside the United States.

Components of Our Results of Operations

Revenue

During the first nine months of 2018 we derived more than 86% of our revenue through the sale of our NVM products to OEMs and ODMs, primarily through distributors. We generated 59% and 74% of our revenue from distributors in each of the nine months ended September 30, 2018 and 2017, respectively. We derived approximately 13% of our revenue from the operations of S3 and Echelon during the first nine months of 2018. Revenue is recognized when control of the promised goods or services is transferred to customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services. We sell the majority of our products to distributors and generally recognize revenue when we ship the product directly to the distributors since title and risk of loss transfers at that time.

Because our distributors market and sell their products worldwide, our revenue by geographic location is not necessarily indicative of where our customers’ product sales and design win activity occur, but rather of where their manufacturing operations occur.

Cost of Revenue and Gross Margin

Cost of revenue primarily consists of costs paid to our third-party manufacturers for wafer fabrication, assembly and testing of our NVM products, write-downs of inventory for excess and obsolete inventories including write-downs of inventory for products based on CBRAM technology and accruals for future losses on CBRAM wafer purchase commitments to the extent our costs exceed the market price for such products. To a lesser extent, cost of revenue also includes depreciation of test equipment and expenses relating to manufacturing support activities, including personnel-

Table of Contents

related costs, logistics and quality assurance and shipping. Cost of revenue for S3 is driven primarily by personnel-related costs.

Our gross margin has been and will continue to be affected by a variety of factors, including the timing of changes in pricing, shipment volumes, new product introductions, changes in product mix, changes in our purchase price of fabricated wafers and assembly and test service costs, manufacturing yields and inventory write downs, if any. We expect our gross margin to fluctuate over time depending on the factors described above.

Operating Expenses

Our operating expenses consist of research and development, sales and marketing and general and administrative expense. Personnel-related costs, including salaries, benefits, bonuses and stock-based compensation, are the most significant component of each of our operating expense categories. In addition, in the near term we expect to hire additional personnel, primarily in our selling and marketing functions, and increase research and development expenditures. Accordingly, we expect our operating expenses to increase in absolute dollars as we invest in these initiatives.

Research and Development. Our research and development expenses consist primarily of personnel-related costs for the design and development of our products and technologies. Additional research and development expenses include product prototype costs, amortization of mask costs and other materials costs, external test and characterization expenses, depreciation, amortization of design tool software licenses, amortization of acquisition-related intangible assets and allocated overhead expenses. We also incur costs related to outsourced research and development activities and joint venture activities. We expect research and development expenses to increase in absolute dollars for the foreseeable future as we continue to improve our product features and increase our portfolio of solutions.

Sales and Marketing. Sales and marketing expenses consist primarily of personnel-related costs for our sales, business development, marketing, and applications engineering activities, third-party sales representative commissions, promotional and other marketing expenses, amortization of acquisition-related intangible assets and travel expenses. We expect sales and marketing expenses to increase in absolute dollars for the foreseeable future as we continue to expand our direct sales teams and increase our marketing activities.

General and Administrative. General and administrative expenses consist primarily of personnel-related costs, consulting expenses and professional fees. Professional fees principally consist of legal, audit, tax and accounting services. We expect general and administrative expenses to increase in absolute dollars for the foreseeable future as we hire additional personnel, make improvements to our infrastructure and incur significant additional costs for the compliance requirements of operating as a public company, including higher legal, insurance and accounting expenses.

Other Income (Expense), Net

Other income (expense), net is comprised of interest income (expense) and other income (expense). Interest expense consists of interest on our outstanding debt. Other expense, net consists primarily of the foreign exchange gains or losses. Our foreign currency exchange gains and losses relate to transactions and asset and liability balances denominated in currencies other than the U.S. dollar. We expect our foreign currency gains and losses to continue to fluctuate in the future due to changes in foreign currency exchange rates.

Provision for (benefit from) Income Taxes

Provision for (benefit from) income taxes consists primarily of U.S. federal and state income taxes in the United States and income taxes in certain foreign jurisdictions in which we conduct business. We have a full valuation allowance for deferred tax assets, including net operating loss carryforwards, and tax credits related primarily to research and development. We expect to maintain this full valuation allowance for the foreseeable future.

Table of Contents

Comparison of the Three and Nine months ended September 30, 2018 and 2017 (in thousands, except percentage data):

Revenue

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Change $	Change %	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017	Change $	Change %
Revenue, net	$ 21,927	$ 15,239	6,688	44 %	$ 55,412	$ 39,958	15,454	39 %

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Revenue by geography:				
United States	32 %	22 %	28 %	22 %
Europe	23 %	13 %	21 %	15 %
Asia Pacific	41 %	64 %	49 %	61 %
Rest of world	4 %	1 %	2 %	2 %

Revenue increased by $6.7 million, or 44%, during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017. This increase was due primarily to higher sales of standard memory products to Tier 1 OEM customers and the contribution of revenues of approximately $5.6 million from S3 and Echelon products.

Revenue increased by $15.5 million, or 39%, during the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017. This increase was due primarily to an 18% increase in unit shipments from our FusionFlash, Standard Flash and DataFlash products along with the contribution of revenue of approximately $7.6 million from S3 and Echelon products.

Cost of Revenue and Gross Margin

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Change $	Change %	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017	Change $	Change %
Cost of revenue	$ 12,344	$ 7,773	$ 4,571	59 %	$ 30,885	$ 20,215	$ 10,670	53 %
Gross profit	9,583	7,466	2,117	28 %	24,527	19,743	4,784	24 %
Gross margin	44 %	49 %			44 %	49 %		

Cost of revenue increased by $4.6 million, or 59%, during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017. This increase was due primarily to a mix shift to products with a higher product cost, additional expenses associated with our operations organization, and a reduction in sales of previously written down products along with incremental cost of revenue incurred as a result of our May 2018 acquisition of S3 and our September 2018 acquisition of Echelon.

Cost of revenue increased by $10.7 million, or 53%, during the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017. This increase was due primarily to an 18% increase in unit shipments and additional expenses associated with our operations organization along with incremental cost of revenue incurred as a result of our May 2018 acquisition of S3 and our September 2018 acquisition of Echelon.

Our gross margin percentage decreased from 49% to 44% for the three months ended September 30, 2018 and for the nine months ended September 30, 2018 primarily due to product mix impacts as we generated a higher proportion of our revenues from sales to Tier 1 OEM customers of Standard Flash memory products which generally carry lower gross margins than our other memory products.

Table of Contents

Gross profit increased by $2.1 million during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017 due to gross profit generated from our S3 and Echelon businesses offset by a decrease driven by sales to Tier 1 OEM customers of Standard Flash memory products which generally carry lower gross margins.

Gross profit increased by $4.8 million during the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017 due primarily to an increase in unit shipments along with gross profit generated from our S3 and Echelon businesses.

Operating Expenses

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2018	2017	$	%	2018	2017	$	%
Operating expenses:								
Research and development	$ 5,620	$ 3,606	$ 2,014	56 %	$ 13,706	$ 10,653	$ 3,053	29 %
Sales and marketing	4,256	2,897	1,359	47	10,623	8,408	2,215	26
General and administrative	7,130	1,761	5,369	305	12,484	5,569	6,915	124
Total operating expenses	$ 17,006	$ 8,264	$ 8,742	106%	$ 36,813	$ 24,630	$ 12,183	49 %

Research and Development. Research and development expense increased by $2.0 million, or 56%, during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017. This increase was due primarily to a $1.1 million increase in outside services, a $0.4 million increase in depreciation and amortization expense, and a $1.7 million increase in personnel-related costs, partially offset by a $1.2 million decrease in facilities related costs.

Research and development expense increased by $3.1 million, or 29%, during the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017. This increase was due primarily to a $1.9 million increase in personnel-related costs, a $1.4 million increase in outsourced research and development activities, a $0.6 million increase in depreciation and amortization expense, and a $0.2 million increase in research and development materials and supplies partially offset by a $1.1 million decrease in facilities related costs.

Sales and Marketing. Sales and marketing expense increased by $1.4 million, or 47% for the three months ended September 30, 2018 as compared to the three months ended September 30, 2017. This increase was due primarily to a $0.5 million increase in personnel-related costs, a $0.6 million increase in acquisition-related amortization expense, a $0.1 million increase in outside service, and a $0.1 million increase in travel costs and tradeshows.

Sales and marketing expense increased by $2.2 million, or 26% for the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017. This increase was due primarily to a $0.7 million increase in personnel-related costs, a $0.3 million increase in outsourced sales and marketing, a $0.9 million increase in acquisition-related amortization expense, and a $0.2 million increase in travel costs.

General and Administrative. General and administrative expenses increased by $5.4 million, or 305%, during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017. This increase was due primarily to acquisition-related legal and accounting costs of $2.9 million, separation pay of $1.9 million, personnel-related costs of $0.1 million, outside services of $0.2 million, facilities-related costs of $0.1 million, public company expenses of $0.1 million and $0.1 million in travel costs.

General and administrative expenses increased by $6.9 million, or 124%, during the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017. This increase was due primarily to acquisition-related legal and accounting costs of $4.9 million, separation pay of $1.9 million, an increase in outside services of $0.3 million, an increase in facilities-related costs of $0.3 million and an increase of travel expenses of $0.1 million, partially offset by a decrease in personnel-related costs of $0.4 million, mostly due to 2015 RSUs becoming fully vested, and a decrease of public company expenses of $0.2 million.

Table of Contents

Other Income (Expense), Net

	Three Months Ended September 30,		Change		Nine months ended September 30,		Change	
	2018	2017	$	%	2018	2017	$	%
Interest expense, net	$ (1,046)	(170)	$ (876)	(515) %	$ (2,368)	(581)	$ (1,787)	(308) %
Other income (expense), net	8	(12)	20	167	17	2	15	750
Total other income (expense), net	$ (1,038)	$ (182)	$ (856)	(470) %	$ (2,351)	$ (579)	$ (1,772)	(306) %

Interest expense, net increased by approximately $0.9 million during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017, primarily due to additional interest on the term loan of $0.6 million and amortization of debt discount $0.4 million as we increased our level of indebtedness during the three months ended September 30, 2018 in connection with the S3 acquisition.

Interest expense, net increased by approximately $1.8 million during the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017, primarily due to additional interest of $1.2 million and amortization of debt discount of $0.5 million as we increased our level of indebtedness during the nine months ended September 30, 2018 in connection with the S3 acquisition.

Other income (expense), net increased by approximately $20,000 during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017 due primarily to a decrease in foreign currency transaction charges.

Other income (expense), net increased by approximately $15,000 during the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017 due primarily to a decrease in foreign currency transaction charges.

Provision for (benefit from) Income Taxes

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2018	2017	$	%	2018	2017	$	%
Provision for (benefit from) income taxes	$ (64)	$ 17	$ (81)	(476) %	$ (80)	$ 57	$ (137)	(240) %

Provision for income taxes decreased by $81,000 during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017. The decrease was due primarily to a reduction in tax expense related to our foreign subsidiaries as well as an increase in benefits related to deferred taxes in the United States.

Provision for income taxes decreased by $137,000 during the nine months ended September 30, 2018 as compared to the nine months ended September 30, 2017. The decrease was due primarily to a reduction in tax expense related to our foreign subsidiaries as well as an increase in benefits related to deferred taxes in the United States.

Liquidity and Capital Resources

Our principal source of liquidity as of September 30, 2018 consisted of cash and cash equivalents of $13.3 million and short-term investments of $1.3 million. Our outstanding borrowings under our new credit facility as of September 30, 2018 were $35.0 million. Substantially all of our cash and cash equivalents are held in the United States.

We believe our existing cash and cash equivalents and short-term investments will be sufficient to meet our anticipated cash needs over the next 12 months. Our future capital requirements will depend on many factors, including our growth rate, the timing and extent of our spending to support research and development activities, the timing and cost of establishing additional sales and marketing capabilities, the introduction of new and enhanced products and our costs to implement new manufacturing technologies. In the event that additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us or at all. Any additional debt financing obtained by us in

Table of Contents

the future could also involve restrictive covenants relating to our capital-raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. Additionally, if we raise additional funds through further issuances of equity, convertible debt securities or other securities convertible into equity, our existing stockholders could suffer significant dilution in their percentage ownership of our company, and any new equity securities we issue could have rights, preferences and privileges senior to those of holders of our common stock. If we are unable to obtain adequate financing or financing on terms satisfactory to us, when we require it, our ability to continue to grow or support our business and to respond to business challenges could be significantly limited.

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

	Nine Months Ended September 30,	
	2018	2017
Cash flows used in operating activities	$ (13,082)	$ (1,216)
Cash flows used in investing activities	(66,517)	(2,054)
Cash flows provided by financing activities	63,190	14,129

Cash Flows from Operating Activities

Our primary source of cash from operating activities has been from cash collections from our customers. We expect cash inflows from operating activities to be affected by increases in sales and timing of collections. Our primary uses of cash from operating activities have been for personnel costs, investments in research and development and sales and marketing, and procurement of inventory. Net cash used in operating activities for the periods presented consisted of net losses adjusted for certain noncash items and changes in working capital. Within changes in working capital, changes in accounts receivable, inventory and accounts payable generally account for the largest adjustments, as we typically use more cash to fund accounts receivable and build inventory as our business grows. Increases in accounts payable typically provides more cash as we do more business with our contract foundries and other third parties, depending on the timing of payments.

During the nine months ended September 30, 2018, cash used in operating activities was approximately $13.1 million and was due primarily to a net loss of $14.6 million, partially offset by non-cash charges of $2.1 million related to stock-based compensation expense, $1.7 million related to depreciation and amortization, $2.1 million related to the amortization of intangible assets, $0.7 million related to amortization of debt discount, and a decrease in our net assets and liabilities of $4.7 million. The decrease in net assets and liabilities is due primarily to an increase in accounts receivable of $12.8 million, an increase in inventories of $6.0 million, a decrease in deferred rent of $0.3 million, partially offset by an increase in price adjustments and other revenue reserves of $5.2 million, an increase in accounts payable, accrued compensation and other accrued expenses of $8.1 million, and a decrease in prepaid expenses and other current assets of $0.9 million.

During the nine months ended September 30, 2017, cash used in operating activities was approximately $1.2 million and was due primarily to a net loss of $5.5 million, partially offset by non-cash charges of $2.9 million related to stock-based compensation expense, $1.0 million related to depreciation and amortization, $0.9 million related to amortization of intangible assets, and an increase in our net assets and liabilities of $0.6 million. The increase in assets and liabilities is due primarily to an increase in accounts receivable of $2.7 million, an increase in prepaid expenses and other assets of $0.2 million, a decrease in deferred rent of $0.3 million, partially offset by an increase in accounts payable and accrued compensation of $2.0 million, and a decrease in inventories of $0.9 million.

Cash Flows from Investing Activities

During the nine months ended September 30, 2018, cash used in investing activities was $66.5 million and was due to our purchase of all the assets of S3, net of cash acquired, for $34.6 million, the acquisition of Echelon, net of cash acquired, of $28.8 million, purchases of property and equipment of $2.6 million and an investment in the notes receivable of Semitech for $0.4 million.

Table of Contents

During the nine months ended September 30, 2017, cash used in investing activities was $2.1 million and was due primarily to purchases of equipment and investments in leasehold improvements related to our headquarters facility in Santa Clara.

Cash Flows from Financing Activities

During the nine months ended September 30, 2018, cash provided by financing activities was $63.2 million and was due primarily to proceeds from a term loan, net of fees, of $33.6 million, net proceeds from a public equity offering to finance the Echelon acquisition of $42.7 million, and proceeds from the exercise of stock options and our employee stock purchase plan of $0.8 million offset in part by repayment of our line of credit and term loan with Western Alliance Bank of $13.5 million.

During the nine months ended September 30, 2017, cash provided by financing activities was $14.1 million and was due primarily to proceeds from a follow-on offering of our common stock of $18.4 million, net of fees, net proceeds from our line of credit of $0.2 million, and net proceeds from the exercise of stock options of $0.6 million, partially offset by repayments on our term loan of $4.9 million and tax withholdings related to settlement of RSUs of $0.2 million.

Off Balance Sheet Arrangements

During the periods presented, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off balance sheet arrangements or other contractually narrow or limited purpose.

Credit Facility

Western Alliance Bank Term Loan.

The Company was a party to that certain Business Financing Agreement dated July 7, 2016 and that certain Second Business Financing Modification Agreement, dated September 29, 2017, by and between Western Alliance Bank and the Company (“Credit Facility”). The Credit Facility provided for (i) a term loan of up to $18.0 million (the “Term Loan”) and (ii) a revolving credit line advance (the “Line of Credit”) in the aggregate amount of the lower of (x) $5.0 million and (y) 80% of certain of the Company’s receivables. The Term Loan bore interest at a rate per annum equal to the greater of the prime rate or 3.5%, plus 0.75% and was scheduled to mature in June 2019. The Line of Credit bore interest at a rate per annum equal to the greater of the prime rate or 3.5% plus 0.50%), and was scheduled to mature in July 2018. We made interest-only payments on the Term Loan from July 2016 through September 2016 and began making interest payments and principal payments in 33 equal monthly installments starting October 2016. Prior to the Amendment, the Credit Facility provided that any indebtedness we incurred thereunder was collateralized by substantially all assets of the Company and any domestic subsidiaries, subject to certain customary exceptions. We paid a facility fee of $150,000 as well as a $25,000 diligence fee upon entry into the Credit Facility and an additional $10,000 on July 7, 2017. Additional fees of $25,000 were incurred in connection with the amendment. These fees were recorded as a debt discount and were amortized over the life of the agreement.

Borrowings of $12.0 million under this facility were repaid in full in May 2018. In connection with the repayment of this facility, the remaining unamortized debt discount of $66,000 was recorded as interest expense in the condensed consolidated statements of operations.

Cortland Capital Market Services LLC Term Loan.

One May 8, 2018, we entered into a credit agreement with Cortland Capital Market Services LLC (“Cortland”) (“Credit Agreement”). The Credit Agreement provides for a 1st lien senior secured term loan of $35.0 million (“Term Loan”). The Term Loan bears interest at a rate per annum equal to the sum of the Libor Rate (2.4375% on September 30, 2018) plus 8.75% and is payable in consecutive quarterly installments starting December 31, 2018. The Term Loan is

Table of Contents

scheduled to mature May 8, 2022. The Credit Agreement provided that any indebtedness we incurred thereunder was collateralized by substantially all assets of the Company and any domestic subsidiaries, subject to certain customary exceptions.

The Credit Agreement contains customary representations and warranties and affirmative and negative covenants, including maximum consolidated leverage ratios and minimum liquidity. Upon an occurrence of an event of default, under the Credit Facility we could be required to pay interest on all outstanding obligations under the agreement at a rate of 2% above the otherwise applicable interest rate, and the lender may accelerate our obligations under the agreement. As of September 30, 2018, we were in compliance with all financial covenants and restrictions.

In connection with the Credit Agreement, Cortland received a warrant to purchase 850,000 shares of common stock at an exercise price of $8.30 and a term of six years. In addition, we paid financing costs of $1.4 million. The financing costs and the value of the warrant, $4.8 million, were recorded as a debt discount and are being amortized over the life of the agreement. Amortization of debt discount was $0.4 million and $0.7 million for the three and nine months ended in September 30, 2018, respectively.

Contractual Obligations and Commitments

The following is a summary of our contractual obligations and commitments as of September 30, 2018:

		Payments due by period			
Contractual Obligations	Total	Less than 1 year	1 – 3 Years	4 – 5 Years	More than 5 Years
	(in thousands)				
Operating leases (1)	$ 7,994	$ 2,425	$ 3,094	$ 2,475	$ —
Inventory-related commitments (2)	3,291	3,291	—	—	—
Financing arrangements (3)	35,000	1,605	3,500	29,895	—
Joint Development and Manufacturing Agreement (4)	400	400	—	—	—
Licensing and Development Agreement (5)	75	75	—	—	—
Total contractual cash obligations	$ 46,760	$ 7,796	$ 6,594	$ 32,370	$ —

(1) Operating leases primarily relate to our leases of office space with terms expiring through July 31, 2023.
(2) Represents outstanding purchase orders for wafer commitments that we have placed with our suppliers as of September 30, 2018.
(3) Financing arrangements represent debt maturities under our term loan.
(4) Represents our commitments under the third amendment of the CBRAM Joint Development and Manufacturing Agreement executed on November 22, 2017 with TowerJazz Panasonic Semiconductor Company.
(5) Represents our commitments under the Licensing and Development Agreement executed on April 21, 2016 with Semitech Semiconductor Pty, Ltd. or Semitech.

As of September 30, 2018, we had a liability of $41,000 for uncertain tax positions.

In May 2018, we entered into a new $35.0 million credit facility and terminated of our existing credit facility, which included paying off the outstanding term loan thereunder.

Item 3.Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risks in the ordinary course of our business. These risks primarily include foreign exchange rate and interest rate sensitivities as follows:

Foreign Currency Risk

Our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates.

The majority of our revenue is denominated in U.S. dollars. Our expenses are generally denominated in the currencies in which our operations are located, which is primarily in the United States and to a lesser extent in Europe, Middle East and Africa, or EMEA, and APAC. Our results of operations and cash flows are, therefore, subject to fluctuations due to changes in foreign currency exchange rates and may be adversely affected in the future due to changes in foreign exchange rates. The effect of a hypothetical 10% change in foreign currency exchanges rates applicable to our business would not have a material impact on our historical consolidated financial statements.

We have not hedged exposures denominated in foreign currencies or used any other derivative financial instruments. Although we transact the substantial majority of our business in U.S. dollars, future fluctuations in the value of the U.S. dollar may affect the competitiveness of our products and thus may impact our results of operations and cash flows.

Interest Rate Sensitivity

We had cash and cash equivalents of $13.3 million and short-term investments of $1.3 million as of September 30, 2018, consisting of bank deposits, money market funds and U.S. government securities. Such interest-earning instruments carry a degree of interest rate risk. To date, fluctuations in interest income have not been significant. We also had total outstanding gross debt of $35.0 million offset by an unamortized debt discount of approximately $5.6 million as of September 30, 2018. The outstanding debt relates to a term loan described in section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Credit Facility”.

We do not enter into investments for trading or speculative purposes and have not used any derivative financial instruments to manage our interest rate risk exposure. We have not been exposed to, nor do we anticipate being exposed to, material risks due to changes in interest rates. Our exposure to interest rates relates to the change in the amounts of interest we must pay on our variable rate borrowings. A hypothetical 10% increase in our borrowing rates would not have a material impact on interest expense on our principal balances as of September 30, 2018.

Item 4.Controls and Procedures.

(a) Disclosure Controls and Procedures

We maintain “disclosure controls and procedures,” as such term is defined in Rule 13a 15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), as appropriate, to allow timely decisions regarding required disclosure.

Our management is responsible for establishing and maintaining our disclosure controls and procedures. Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of the effectiveness of our disclosure controls and procedures as of September 30, 2018. Based on this evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of September 30, 2018.

(b) Changes in Internal Control over Financial Reporting

Table of Contents

There were no changes in our internal control over financial reporting that occurred during the nine months ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting (as defined in Rules 13a 15(f) and 15d 15(f) under the Exchange Act). Internal control over financial reporting means a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

PART II: OTHER INFORMATION

ITEM 1.Legal Proceedings

We are not currently a party to any legal proceedings which, if determined adversely to us, would individually or in the aggregate have a material adverse effect on our business, operating results, financial condition or cash flows. We may, from time to time, become involved in legal proceedings arising in the ordinary course of our business and as our business grows, we may become a party to an increasing number of legal proceedings.

ITEM 1A.Risk Factors

An investment in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below, together with all of the other information in this Quarterly Report on Form 10 Q, including the section titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our condensed consolidated financial statements and related notes, before making a decision to invest in our common stock. Our business, operating results, financial condition, or prospects could be materially and adversely affected by any of these risks and uncertainties. If any of these risks actually occurs, the trading price of our common stock could decline and you might lose all or part of your investment. Our business, operating results, financial performance, or prospects could also be harmed by risks and uncertainties not currently known to us or that we currently do not believe are material.

Risks Related to Our Business and Our Industry

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 since our inception. We incurred net losses of $5.7 million, $11.6 million, and $8.4 million for the years ended December 31, 2017, 2016 and 2015, respectively, and $14.6 million during the first nine months of 2018. As of September 30, 2018, we had an accumulated deficit of $114.4 million. We expect to incur significant expenses related to the continued development and expansion of our business, including in connection with our efforts to pursue opportunities in emerging IoT markets, develop and improve upon our products and technology, maintain and enhance our research and development and sales and marketing activities and hire additional personnel. Further, revenue may not grow or revenue may decline for a number of possible reasons, many of which are outside our control, including a decline in demand for our products, increased competition, business conditions that adversely affect the semiconductor industry, including reduced demand for products in the end markets that we serve, or our failure to capitalize on growth opportunities. If we fail to generate sufficient revenue to support our operations, we may not be able to achieve or sustain profitability.

We rely on third parties to manufacture, package, assemble and test the semiconductor components comprising our products, which exposes us to a number of risks, including reduced control over manufacturing and delivery timing and potential exposure to price fluctuations, which could result in a loss of revenue or reduced profitability.

As a fabless semiconductor company, we outsource the manufacturing, packaging, assembly and testing of our semiconductor components to, and rely on a limited number of, third-party foundries and assembly and testing service providers. For example, we use two foundries, United Microelectronics Corporation in Taiwan and XMC in Wuhan, China, for the production of our flash memory products and a single foundry, Altis Semiconductor S.N.C. in France (acquired by X-FAB Silicon Foundries in 2016), for our Mavriq and Moneta products. Our primary assembly and testing

Table of Contents

contractor is Amkor Technology, Inc. in Taiwan, Korea and the Philippines. Our wafer probing is performed by King Yuan Electronics Co., Ltd. in Taiwan.

Relying on third-party manufacturing, assembly and testing presents a number of risks, including but not limited to:

- capacity and materials shortages during periods of high demand;
- reduced control over delivery schedules, inventories and quality;
- the unavailability of, or potential delays in obtaining access to, key process technologies;
- the inability to achieve required production or test capacity and acceptable yields on a timely basis;
- misappropriation of our intellectual property;
- the third parties' ability to perform its obligations due to bankruptcy or other financial constraints;
- limited warranties on wafers or products supplied to us; and
- potential increases in prices.

We currently do not have long-term supply contracts with our third-party contract manufacturers for the products we sell to generate the bulk of our revenue, our NVM products, including United Microelectronics Corporation and Amkor Technology, Inc. Therefore, they are not obligated to perform services or supply components to us for any specific period, in any specific quantities, or at any specific price, except as may be provided in a particular purchase order. During periods of high demand and tight inventories, our third-party foundries and assembly and testing contractors may allocate capacity to the production of other companies' components while reducing deliveries to us, or significantly raise their prices. In particular, they may allocate capacity to other customers that are larger and better financed than us or that have long-term agreements, decreasing the capacity available to us. Shortages of capacity available to us may be caused by the actions of their other, large customers that may be difficult to predict, such as major product launches. If we need other foundries or assembly and test contractors because of increased demand, or if we are unable to obtain timely and adequate deliveries from our providers, we might not be able to cost-effectively and quickly retain other vendors to satisfy our requirements. Because the lead-time needed to establish a relationship with a new third-party supplier could be several quarters, there is no readily available alternative source of supply for any specific component. In addition, the time and expense to qualify a new foundry could result in additional expense, diversion of resources or lost sales, any of which would negatively impact our financial results.

In the event that we expand production of a component to include a new contract manufacturer, it may take approximately 18 to 24 months to allow a transition from our current foundry or assembly services provider to the new provider. We may experience difficulty migrating production to a new contract manufacturer and, consequently, may experience reduced yields, delays in component deliveries and increased research and development expense. The inability by us or our third-party manufacturers to effectively and efficiently transition our technology to their infrastructure may adversely affect our operating results and our gross margin. There can be no assurance that we will be able to find suitable replacements for our third-party contract manufacturers.

If any of our current or future foundry partners or assembly and test subcontractors significantly increases the costs of wafers or other materials, interrupts or reduces our supply, including for reasons outside of their control, or if any of our relationships with our suppliers is terminated, our operating results could be adversely affected. During 2017, one of our foundry partners increased the costs of wafers to us. Although such increase did not have a material impact on our results of operations for the nine months ended September 30, 2018 and is not expected to have a material impact in the near term, there can be no assurances that such additional increases will not have a material adverse impact on our future operating results. Such increases could also damage our customer relationships, result in lost revenue, cause a loss in market share or damage our reputation

We may be unable to match production with customer demand for a variety of reasons including our inability to accurately forecast customer demand or the capacity constraints of contract manufacturers, which could adversely affect our operating results.

We make planning and spending decisions, including determining production levels, production schedules, component procurement commitments, personnel needs and other resource requirements, based on our estimates of

Table of Contents

product demand and customer requirements. Our products are typically purchased pursuant to individual purchase orders. While our customers may provide us with their demand forecasts, they are not contractually committed to buy any quantity of products beyond purchase orders. Furthermore, many of our customers may increase, decrease, cancel or delay purchase orders already in place without significant penalty. The short-term nature of commitments by our customers and the possibility of unexpected changes in demand for their products reduce our ability to accurately estimate future customer requirements. On occasion, customers may require rapid increases in production, which can strain our resources, necessitate more onerous procurement commitments and reduce our gross margin. If we overestimate customer demand, we may purchase products that we may not be able to sell, which could result in decreases in our prices or write-downs of unsold inventory. Conversely, if we underestimate customer demand or if sufficient manufacturing capacity was unavailable, we would lose sales opportunities and could lose market share or damage our customer relationships. The rapid pace of innovation in our industry could also render significant portions of our inventory obsolete. Excess or obsolete inventory levels could result in unexpected expenses or write-downs of inventory values that could adversely affect our business, operating results and financial condition.

Our quarterly operating results or other operating metrics may fluctuate significantly, which could cause the trading price of our common stock to decline.

Our quarterly operating results and other operating metrics have fluctuated in the past and may continue to fluctuate from quarter to quarter. We expect that this trend will continue as a result of a number of factors, many of which are outside of our control and may be difficult to predict, including:

- the receipt, reduction, delay or cancellation of orders by large customers;
- the gain or loss of significant customers and distributors;
- the timing and success of our launch of new or enhanced products and those of our competitors;
- market acceptance of our products and our customers’ products;
- the level of growth or decline in the IoT market;
- the timing and extent of research and development and sales and marketing expenditures;
- the amount and timing of operating expenses related to the maintenance and expansion of our business, operations and infrastructure;
- changes in our product mix;
- our ability to reduce the manufacturing costs of our products;
- competitive pressures resulting in lower than expected average selling prices;

- fluctuations in sales by and inventory levels of original equipment manufacturers and original design manufacturers, OEMs and ODMs, respectively, who incorporate our products in their products;
- cyclical and seasonal fluctuations in our markets;
- fluctuations in the manufacturing yields of our third-party contract manufacturers;
- events that impact the availability of production capacity at our third-party subcontractors and other interruptions in the supply chain including due to geopolitical events, natural disasters, materials shortages, bankruptcy or other causes;
- supply constraints for and changes in the cost of the other components incorporated into our customers' products;
- the timing of expenses related to the acquisition and integration of technologies or businesses;
- product rates of return or price concessions in excess of those expected or forecasted;
- costs associated with the repair and replacement of defective products;
- unexpected inventory write-downs or write-offs;
- costs associated with litigation over intellectual property rights and other litigation;
- the length and unpredictability of the purchasing and budgeting cycles of our customers;
- loss of key personnel or the inability to attract qualified engineers; and
- geopolitical events, such as war, threat of war or terrorist actions, or the occurrence of natural disasters.

Any one of the factors above or the cumulative effect of some of the factors above may result in significant fluctuations in our operating results.

Table of Contents

The semiconductor industry is highly cyclical and our markets may experience significant cyclical fluctuations in demand as a result of changing economic conditions, budgeting and buying patterns of customers and others factors. As a result of these and other factors affecting demand for our products and our results of operations in any given period, the results of any prior quarterly or annual periods should not be relied upon as indicative of our future revenue or operating performance. Fluctuations in our revenue and operating results could also cause our stock price to decline.

We may experience difficulties in realizing the expected benefits of the acquisitions of S3 Semiconductors and Echelon Corporation and may continue to incur significant acquisition-related costs and transition costs in connection with these completed acquisitions.

We completed the acquisitions of S3 Semiconductors on May 9, 2018 and the acquisition of Echelon on September 14, 2018. The integration of these businesses has resulted in and continues to result in substantial financial costs and the investment of personnel time and attention and other resources. The success of each acquisition depends in part on our ability to realize the anticipated business opportunities, including certain cost savings and operational efficiencies or synergies, and growth prospects from combining the respective companies with Adesto in an efficient and effective manner. We may never realize these business opportunities and growth prospects and, we may incur additional costs to maintain employee morale and to retain key employees. Management cannot ensure that the elimination of duplicative costs or the realization of other efficiencies will offset the transaction and integration costs in the near term or at all.

Additionally, we may encounter difficulties surrounding the integration of these companies following acquisition, which could delay or prevent our achievement of the expected benefits from the respective acquisition. Moreover, risks specific to the acquired businesses and the sectors of the semiconductor market in which they compete could also delay or prevent our achievement of the expected benefits from the respective acquisition.

The market for semiconductor products is characterized by declines in average selling prices, which we expect to continue, and which could negatively affect our revenue and margins.

Our customers expect the average selling price of our products to decrease year-over-year and we expect this trend to continue. When such pricing declines occur, we may not be able to mitigate the effects by selling more or higher margin units, or by reducing our manufacturing costs. In such circumstances, our operating results could be materially and adversely affected. Our flash memory products have experienced declining average selling prices over their life cycle. The rate of decline may be affected by a number of factors, including relative supply and demand, the level of competition, production costs and technological changes. As a result of the decreasing average selling prices of our products following their launch, our ability to increase or maintain our margins depends on our ability to introduce new or enhanced products with higher average selling prices and to reduce our per-unit cost of sales and our operating costs. We may not be able to reduce our costs as rapidly as companies that operate their own manufacturing, assembly and testing facilities, and our costs may even increase because we do not operate our own manufacturing, assembly or testing facilities, which could also reduce our gross margins. In addition, our new or enhanced products may not be as successful or enjoy as high margins as we expect. If we are unable to offset any reductions in average selling prices by introducing new products with higher average selling prices or reducing our costs, our revenue and margins will be negatively affected and may decrease.

The semiconductor market is highly cyclical and has experienced severe downturns in the past, generally as a result of wide fluctuations in supply and demand, constant and rapid technological change, continuous new product introductions and price erosion. During downturns, periods of intense competition, or the presence of oversupply in the industry, the selling prices for our products may decline at a high rate over relatively short time periods as compared to historical rates of decline. We are unable to predict selling prices for any future periods and may experience unanticipated, sharp declines in selling prices for our products.

Our prospects for growth depends on the growth and development of the emerging IoT industry, and if the market does not develop as we expect, our business prospects may be harmed.

Our products are increasingly being utilized in IoT edge devices. The IoT industry is nascent and is characterized by rapidly changing technologies, devices and connectivity requirements, evolving industry standards and changing

Table of Contents

customer demands. The continued development of IoT depends in part on significant growth in the number of connected devices. Such growth is affected by various factors, including the continued growth in the use of mobile operator networks and the Internet to connect an increasing number and variety of devices, price reductions for key hardware and software components, innovation of other components of the IoT nodes toward low-power formats, and the continued development of IoT standards and protocols. Without these continued developments, IoT might not gain widespread market acceptance and our business could suffer. Security and privacy concerns, evolving business practices and consumer preferences may also slow the growth and development of IoT. Because our revenue growth ultimately depends upon the success of IoT, our business may suffer as a result of slowing or declining growth in IoT adoption. Even if the IoT industry does develop, we may not be well positioned or able to penetrate and capitalize on this new market. As a result of these factors, the future revenue and income potential of our business is uncertain.

The markets for our products are evolving, and changing market conditions, such as the introduction of new technologies or changes in customer preferences, may negatively affect demand for our products. If we fail to properly anticipate or respond to changing market conditions, our business prospects and results of operations will suffer.

The semiconductor industry is subject to constant and rapid changes in technology, frequent new product introductions, short product life cycles, rapid product obsolescence and evolving technical standards. New technologies may be introduced that make the current technologies on which our products are based less competitive or obsolete or require us to make changes to our technology that could be expensive and time consuming to implement. Due to the evolving nature of our markets, our future success depends on our ability to accurately anticipate and respond to changes in industry standards, technological requirements, customer and consumer preferences and other market conditions. Our technologies could become obsolete sooner than we expect because of faster than anticipated, or unanticipated, changes in one or more of the industry standards and technological requirements. We may be unable to develop and introduce new or enhanced technologies that satisfy customer requirements and achieve market acceptance in a timely manner or at all, succeed in commercializing the technologies on which we have focused our research and development expenditures to develop or otherwise made significant investments to acquire, and anticipate new industry standards and technological changes. If we fail to adapt successfully to technological changes or fail to obtain access to important new technologies, we may be unable to retain customers or attract new customers. Any decrease in demand for our products, or the need for low-power products in general, due to the emergence of competing technologies, changes in customer preferences and requirements or other factors, could adversely affect our business, results of operations and prospects.

We must continuously develop new and enhanced products, and if we are unable to successfully market our new and enhanced products for which we incur significant expenses to develop, our results of operations and financial condition will be materially adversely affected.

In order to compete effectively in our markets, we must continually design, develop and introduce new and improved products with improved features in a cost-effective manner in response to changing technologies and market demand. This requires us to devote substantial financial and other resources to research and development. We have developed and are continuing to develop next-generation products, such as our Moneta and EcoXiP products, which we expect to be one of the drivers of our future revenue growth. However, we may not succeed in developing and marketing these new and enhanced products. We also face the risk that customers may not value or be willing to bear the cost of incorporating our new and enhanced products into their products, particularly if they believe their customers are satisfied with current solutions. Regardless of the improved features or superior performance of our new and enhanced products, customers may be unwilling to adopt our solutions due to design or pricing constraints, or because they do not want to rely on a single or limited supply source. Because of the extensive time and resources that we invest in developing new and enhanced products, if we are unable to sell customers new generations of our products, our revenue could decline and our business, financial condition, results of operations and cash flows would be negatively affected. For example, we generated limited revenue from sales of our Mavriq products to date. While we expect revenue from our Mavriq products to grow, we may not be able to materially increase our revenue from this product family. Similarly, any of our more recently-introduced products or product families, such as Moneta and EcoXiP, may not achieve market acceptance and contribute significantly to our revenue. If we are unable to successfully develop and market our new and enhanced products that we have incurred significant expenses developing, our results of operations and financial condition will be materially and adversely affected.

Our success and future revenue depend on our ability to secure design wins and on our customers' ability to successfully sell the products that incorporate our solutions. Securing design wins is a lengthy, expensive and competitive process, and may not result in actual orders and sales, which could cause our revenue to decline.

We sell to customers that incorporate our products into their products. A design win occurs after a customer has tested our product, verified that it meets the customer's requirements, qualified our solutions for their products and placed an order for the purchase of our products. Our customers may need several months to years to test, evaluate and adopt our product and additional time to begin volume production of the product that incorporates our solution. Due to this generally lengthy design cycle, we may experience significant delays from the time we increase our operating expenses and make investments in our products to the time that we generate revenue from sales of these products. Moreover, even if a customer selects our solution, we cannot guarantee that this will result in any sales of our products, as the customer may ultimately change or cancel its product plans, or efforts by our customer to market and sell its product may not be successful. We may not generate any revenue from design wins after incurring the associated costs, which would cause our business and operating results to suffer.

If a current or prospective customer designs a competitor's solution into its product, it becomes significantly more difficult for us to sell our solutions to that customer because changing suppliers involves significant time, cost, effort and risk for the customer even if our solutions remain compatible with their product design. If current or prospective customers do not include our solutions in their products and we fail to achieve a sufficient number of design wins, our results of operations and business may be harmed.

We rely on our relationships with OEMs and ODMs to enhance our solutions and market position, and our failure to continue to develop or maintain such relationships in the future would harm our ability to remain competitive.

We develop our products for leading OEMs and ODMs that serve a variety of end markets and are developing devices for wearables, sensors, Bluetooth 4.0 and other IoT applications. For each application, manufacturers create products that incorporate specialized semiconductor technology, which makers of semiconductor products use as the basis for their products. These manufacturers set the specifications for many of the key components to be used on each generation of their products and, in the case of memory components, generally qualify only a few vendors to provide memory components for their products. As each new generation of their products is released, vendors are validated in a similar fashion. We must work closely with semiconductor manufacturers to ensure our products become qualified for use in their products. As a result, maintaining close relationships with leading product manufacturers that are developing devices for wearables, Bluetooth 4.0 and other IoT applications is crucial to the long-term success of our business. We could lose these relationships for a variety of reasons, including our failure to qualify as a vendor, our failure to demonstrate the value of our new solutions, declines in product quality, or if OEMs or ODMs seek to work with vendors with broader product suites, greater production capacity or greater financial resources. If our relationships with key industry participants were to deteriorate or if our solutions were not qualified by our customers, our market position and revenue could be materially and adversely affected.

Our business is dependent on selling through distributors.

Sales through distributors accounted for approximately 59% and 74% of our revenues during the first nine months of 2018 and 2017, respectively. We do not have long-term agreements with our distributors, and we and our distributors may each terminate our relationship with little or no advance notice.

Any future adverse conditions in the U.S. or global economies or in the U.S. or global credit markets could materially impact the operations of our distributors. Any deterioration in the financial condition of our distributors or any disruption in the operations of our distributors could adversely impact the flow of our products to our end customers and adversely impact our results of operation. In addition, during an industry or economic downturn, it is possible there will be an oversupply of products and a decrease in demand for our products from our distributors, which could reduce our revenues in a given period. Violations of the Foreign Corrupt Practices Act and similar regulations, or similar laws, by our distributors could have a material adverse impact on our business.

Table of Contents

Changes to industry standards and technical requirements relevant to our products and markets could adversely affect our business, results of operations and prospects.

Our products are only a part of larger electronic systems. All products incorporated into these systems must comply with various industry standards and technical requirements created by regulatory bodies or industry participants in order to operate efficiently together. Industry standards and technical requirements in our markets are evolving and may change significantly over time. For our products, the industry standards are developed by the Joint Electron Device Engineering Council, an industry trade organization. In addition, large industry-leading semiconductor and electronics companies play a significant role in developing standards and technical requirements for the product ecosystems within which our products can be used. Our customers also may design certain specifications and other technical requirements specific to their products and solutions. These technical requirements may change as the customer introduces new or enhanced products and solutions.

Our ability to compete in the future will depend on our ability to identify and comply with evolving industry standards and technical requirements. The emergence of new industry standards and technical requirements could render our products incompatible with products developed by other suppliers or make it difficult for our products to meet the requirements of certain of our customers in consumer, industrial, IoT and other markets. As a result, we could be required to invest significant time and effort and to incur significant expense to redesign our products to ensure compliance with relevant standards and requirements. If our products are not in compliance with prevailing industry standards and technical requirements for a significant period of time, we could miss opportunities to achieve crucial design wins, our revenue may decline and we may incur significant expenses to redesign our products to meet the relevant standards, which could adversely affect our business, results of operations and prospects.

If sales of our customers’ products decline or if their products do not achieve market acceptance, our business and operating results could be adversely affected.

Our revenue depends on our customers’ ability to commercialize their products successfully. The markets for our customers’ products are extremely competitive and are characterized by rapid technological change. Competition in our customers’ markets is based on a variety of factors including price, performance, product quality, marketing and distribution capability, customer support, name recognition and financial strength. As a result of rapid technological change, the markets for our customers’ products are characterized by frequent product introductions, short product life cycles, fluctuating demand and increasing product capabilities. As a result, our customers’ products may not achieve market success or may become obsolete. We cannot assure you that our customers will dedicate the resources necessary to promote and commercialize their products, successfully execute their business strategies for such products, or be able to manufacture such products in quantities sufficient to meet demand or cost-effectively manufacture products at a high volume. Our customers do not have contracts with us that require them to manufacture, distribute or sell any products. Moreover, our customers may develop internally, or in collaboration with our competitors, technology that they may utilize instead of the technology available to them through us. Our customers’ failure to achieve market success for their products, including as a result of general declines in our customers’ markets or industries, could negatively affect their willingness to utilize our products, which may result in a decrease in our revenue and negatively affect our business and operating results.

Our revenue also depends on the timely introduction, quality and market acceptance of our customers' products that incorporate our solutions. Our customers' products are often very complex and subject to design complexities that may result in design flaws, as well as potential defects, errors and bugs. We have in the past been subject to delays and project cancellations as a result of design flaws in the products developed by our customers. For example, in 2014, flaws in one of our customer's products that were unrelated to our solutions generated negative publicity for our customer and delayed the product's release until it could be redesigned. In the past, we have also been subject to delays and project cancellations as a result of changing market requirements, such as the customer adding a new feature, or because a customer's product fails their end customer's evaluation or field trial. Customer products may also be delayed due to issues with other vendors of theirs. We incur significant design and development costs in connection with designing our solutions for customers' products. If our customers discover design flaws, defects, errors or bugs in their products, or if they experience changing market requirements, failed evaluations or field trials, or issues with other vendors, they may

Table of Contents

delay, change or cancel a project. If we have already incurred significant development costs, we may not be able to recoup those costs, which in turn would adversely affect our business and financial results.

We face competition and expect competition to increase in the future. If we fail to compete effectively, our revenue growth and results of operations will be materially and adversely affected.

The global semiconductor market in general, and the IoT semiconductor market in particular, are highly competitive. We expect competition to increase and intensify as other semiconductor companies enter our markets, many of which have greater financial and other resources with which to pursue technology development, product design, manufacturing, marketing and sales and distribution of their products. Increased competition could result in price pressure, reduced profitability and loss of market share, any of which could materially and adversely affect our business, revenue and operating results. Currently, our competitors range from large, international companies offering a wide range of semiconductor products or systems to companies specializing in other alternative, specialized emerging memory technologies. Our primary competitors include GigaDevice Semiconductor, Macronix International Co. Ltd., Microchip Technology Inc., Micron Technology, Inc., Cypress Semiconductor Corporation, Winbond Electronics Corp., Cree Inc., Digi International, General Electric, Maxim Integrated Products, Philips, Siemens, Silver Spring Networks, STMicroelectronics, Telensa, Texas Instruments, Tridium, On Semiconductor, Socionext, Ansem, IC Sense and Verisilicon. Key industry standard and trade group competitors include BACnet, DALI, DeviceNet, HART, Konnex, Profibus, ZigBee, and the ZWave Alliance in the IoT market. Each of these standards and/or alliances is backed by one or more competitors. In addition, as the IoT market opportunity grows, we expect new entrants will enter these markets and existing competitors, including leading semiconductor companies, may make significant investments to compete more effectively against our products. These competitors could develop technologies or architectures that make our products or technologies obsolete.

Our ability to compete successfully depends on factors both within and outside of our control, including:

- the functionality and performance of our products and those of our competitors;
- our relationships with our customers and other industry participants;
- prices of our products and prices of our competitors’ products;
- our ability to develop innovative products;
- our ability to retain high-level talent, including our management team and engineers; and
- the actions of our competitors, including merger and acquisition activity, launches of new products and other actions that could change the competitive landscape.

Competition could result in pricing pressure, reduced revenue and profitability and loss of market share, any of which could materially and adversely affect our business, results of operations and prospects. In the event of a market downturn, competition in the markets in which we operate may intensify as our customers reduce their purchase orders. Our competitors that are significantly larger and have greater financial, technical, marketing, distribution, customer support and other resources or more established market recognition than us may be better positioned to accept lower prices and withstand adverse economic or market conditions.

Our customers require our products and our third-party contractors to undergo a lengthy and expensive qualification process. If we are unsuccessful or delayed in qualifying any of our products with a customer, our business and operating results would suffer.

Prior to selecting and purchasing our products, our customers typically require that our products undergo extensive qualification processes, which involve testing of our products in the customers’ systems, as well as testing for reliability. This qualification process may continue for several months or years. However, obtaining the requisite qualifications for a product does not assure any sales of the product. Even after successful qualification and sales of a product to a customer, a subsequent revision in our third-party contractors’ manufacturing process or our selection of a new contract manufacturer may require a new qualification process, which may result in delays and excess or obsolete inventory. After our products are qualified and selected, it can and often does take several months or more before the customer commences volume production of systems that incorporate our products. Despite these uncertainties, we devote substantial resources, including design, engineering, sales, marketing and management efforts, to qualify our products with customers in anticipation of sales. If we are unsuccessful or delayed in qualifying any of our products with a customer, sales of those products may be precluded or delayed, which may impede our growth and harm our business.

Our costs may increase substantially if our third-party manufacturing contractors do not achieve satisfactory product yields or quality.

The fabrication process is extremely complicated and small changes in design, specifications or materials can result in material decreases in product yields or even the suspension of production. From time to time, the third-party foundries that we contract to manufacture our products may experience manufacturing defects and reduced manufacturing yields related to errors or problems in their manufacturing processes or the interrelationship of their processes with our designs. In some cases, our third-party foundries may not be able to detect these defects early in the fabrication process or determine the cause of such defects in a timely manner.

Generally, in pricing our products, we assume that manufacturing yields will continue to improve, even as the complexity of our products increases. Once our products are initially qualified with our third-party foundries, minimum acceptable yields are established. We are responsible for the costs of the units if the actual yield is above the minimum. If actual yields are below the minimum we are not required to purchase the units. Typically, minimum acceptable yields for our new products are generally lower at first and gradually improve as we achieve full production. Unacceptably low product yields or other product manufacturing problems could substantially increase overall production time and costs and adversely impact our operating results. Product yield losses will increase our costs and reduce our gross margin. In addition to significantly harming our results of operations and cash flow, poor yields may delay shipment of our products and harm our relationships with existing and potential customers

The complexity of our products may lead to errors, defects and bugs, which could negatively impact our reputation with customers and result in liability.

Products as complex as ours may contain errors, defects and bugs when first introduced to customers or as new versions are released. Our products have in the past experienced such errors, defects and bugs. Delivery of products with production defects or reliability, quality or compatibility problems could significantly delay or hinder market acceptance of the products or result in a costly recall and could damage our reputation and adversely affect our ability to retain existing customers and attract new customers. Errors, defects or bugs could cause problems with the functionality of our products, resulting in interruptions, delays or cessation of sales of these products to our customers. We may also be required to make significant expenditures of capital and resources to resolve such problems. We cannot assure you that problems will not be found in new products, both before and after commencement of commercial production, despite testing by us, our suppliers or our customers. Any such problems could result in:

- delays in development, manufacture and roll-out of new products;

- additional development costs;
- loss of, or delays in, market acceptance;
- diversion of technical and other resources from our other development efforts;
- claims for damages by our customers or others against us; and
- loss of credibility with our current and prospective customers.

Any such event could have a material adverse effect on our business, financial condition and results of operations.

If our IoT solutions become subject to cyber-attacks, or if public perception is that they are vulnerable to cyber-attacks, our reputation and business would suffer.

We have designed our IoT products, including our outdoor lighting solutions products acquired from Echelon, to interoperate with other third-party products and systems. Although we attempt to safeguard our products and solutions from cybersecurity threats, the potential for cyber security attacks and other incidents continues to evolve in scope and frequency.

Advances in and expanding availability of technical tools to enable cybersecurity attacks, and increasing sophistication of the threats, deepen the risk of potential security incidents. This risk expands as new protocols and devices are implemented into our products and systems, and as customer requirements evolve. Should our products, or the combination of our products into third party systems, fail to prevent or be unable to withstand any such threats or cyber-attacks, or if our partners or customers fail to safeguard applicable technologies, products or the systems with adequate security policies and measures or otherwise, our business and reputation may be harmed.

We have attempted to design certain of our products to prevent and monitor unauthorized access, misuse, modification or other activities related to those products and the systems into which the products are intended to be placed. Despite our security measures, our products or systems may be subject to unauthorized break ins, viruses, disruptions, high-jacking, cyber terrorism, misuse, tampering, other unauthorized access or modification, or unauthorized access to, or acquisition, loss, or alteration of, data. Should our products fail to perform, be unable to withstand a cyber-attack, or otherwise suffer a security incident, or be perceived to have suffered any kind of security vulnerability or cyber incidents, we could face legal liability, and encounter material adverse financial and reputational harm.

In addition, we believe that there could be incidents of security breaches in the future which could receive significant publicity and visibility. Any such publicity or visibility, regardless of whether the problem is due or related to the performance or security measures of our products or systems, could have a negative effect on public confidence, or cause a perception that our solutions are or could be subject to similar attacks or breaches, and our business, results of operations and financial condition may be materially and adversely affected. Such an event could also result in a material adverse effect on the market price of our common stock, independent of the direct effects on our business.

Furthermore, because some of the information collected by some of our solutions is or may be considered personal data or otherwise may be alleged to be confidential or proprietary to our customers or third parties, a cyber-attack or other data security incident, including any unauthorized access to, loss of, or acquisition of data collected or maintained by our solutions, could violate, or be alleged to violate, applicable privacy, consumer or information security laws, regulations or other obligations. Any of the foregoing could cause us to face regulatory investigations and enforcement actions, private litigation, and other financial or legal liability, as well as harm to our reputation and business, any of which could have a material adverse effect on our business and financial performance.

We may experience difficulties in transitioning to new wafer fabrication process technologies or in achieving higher levels of design integration, which may result in reduced manufacturing yields, delays in product deliveries and increased expenses.

We aim to use the most advanced manufacturing process technology appropriate for our solutions that is available from our third-party foundries. As a result, we periodically evaluate the benefits of migrating our solutions to other technologies in order to improve performance and reduce costs. These ongoing efforts require us from time to time to modify the manufacturing processes for our products and to redesign some products, which in turn may result in delays in product deliveries. We may face difficulties, delays and increased expense as we transition our products to new processes, and potentially to new foundries. We will depend on our third-party foundries as we transition to new processes. We cannot assure you that our third-party foundries will be able to effectively manage such transitions or that we will be able to maintain our relationship with our third-party foundries or develop relationships with new third-party foundries. If we or any of our third-party foundries experience significant delays in transitioning to new processes or fail to efficiently implement transitions, we could experience reduced manufacturing yields, delays in product deliveries and increased expenses, any of which could harm our relationships with our customers and our operating results.

As smaller line width geometry manufacturing processes become more prevalent, we intend to move our future products to increasingly smaller geometries in order to reduce costs while integrating greater levels of functionality into our products. This transition will require us and our third-party foundries to migrate to new designs and manufacturing processes for smaller geometry products. We may not be able to achieve smaller geometries with higher levels of design integration or to deliver new integrated products on a timely basis. We periodically evaluate the benefits, on a product-by-product basis, of migrating to smaller geometry process technologies to reduce our costs and increase performance. We are dependent on our relationships with our third-party foundries to transition to smaller geometry processes successfully. We cannot assure you that our third-party foundries will be able to effectively manage any such transition. If we or our third-party foundries experience significant delays in any such transition or fail to implement a transition, our business, financial condition and results of operations could be materially harmed.

If we fail to retain qualified finance personnel and strengthen our financial reporting systems and infrastructure, we may not be able to timely and accurately report our financial results or comply with the requirements of being a public company, including compliance with the Sarbanes-Oxley Act and SEC reporting requirements.

Our ability to timely and accurately report our financial results or comply with the requirements of being a public company depends on our maintaining adequate numbers of accounting and finance staff with technical accounting, SEC reporting and Sarbanes-Oxley Act compliance expertise. Any inability to recruit or retain qualified accounting and finance staff would have an adverse impact on our ability to accurately and timely prepare our financial statements. We may be unable to hire qualified professionals with requisite technical and public company experience when and as needed. In addition, new employees will require time and training to learn our business and operating processes and procedures. If our finance and accounting organization is unable for any reason to meet the demands of being a public company, the quality and timeliness of our financial reporting may suffer, which could result in the identification of material weaknesses in our internal controls. Any consequences resulting from inaccuracies or delays in our reported financial statements could cause the trading price of our common stock to decline and could harm our business, operating results and financial condition.

If we fail to strengthen our financial reporting systems, infrastructure and internal control over financial reporting to meet the demands placed upon us as a public company, including the requirements of the Sarbanes-Oxley Act, we may be unable to report our financial results timely and accurately and prevent fraud. We expect to incur significant expense and devote substantial management effort toward ensuring compliance with Section 404.

A breach of our security systems may damage our reputation and adversely affect our business.

Our security systems are designed to protect our customers', suppliers' and employees' confidential information, as well as maintain the physical security of our facilities. We also rely on a number of third-party "cloud-based" service providers of corporate infrastructure services relating to, among other things, human resources, electronic communication services and some finance functions, and we are, of necessity, dependent on the security systems of these providers. Any security breaches or other unauthorized access by third parties to the systems of our cloud-based service providers or the existence of computer viruses in their data or software could expose us to a risk of information loss and misappropriation of confidential information. Accidental or willful security breaches or other unauthorized access by third parties to our information systems or facilities, or the existence of computer viruses in our data or software, could expose us to a risk of information loss and misappropriation of proprietary and confidential information belonging to us, our customers or our suppliers. Any theft or misuse of this information could result in, among other things, unfavorable publicity, damage to our reputation, difficulty in marketing our products, allegations by our customers that we have not performed our contractual obligations, litigation by affected parties and possible financial obligations for liabilities and damages related to the theft or misuse of this information, any of which could have a material adverse effect on our business, financial condition, our reputation, and our relationships with our customers and partners. Since the techniques used to obtain unauthorized access or to sabotage systems change frequently and are often not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures.

Failure to protect our intellectual property could substantially harm our business.

Our success and ability to compete depend in part upon our ability to protect our intellectual property. We rely on a combination of intellectual property rights, including patents, mask work protection, copyrights, trademarks, trade secrets and know-how, in the United States and other jurisdictions. The steps we take to protect our intellectual property rights may not be adequate, particularly in foreign jurisdictions such as China. Any patents we hold may not adequately protect our intellectual property rights or our products against competitors, and third parties may challenge the scope, validity or enforceability of our issued patents. In addition, other parties may independently develop similar or competing technologies designed around any patents or patent applications that we hold. Some of our products and

Table of Contents

technologies are not covered by any patent or patent application, as we do not believe patent protection of these products and technologies is critical to our business strategy at this time. A failure to timely seek patent protection on products or technologies generally precludes us from seeking future patent protection on these products or technologies.

In addition to patents, we also rely on contractual protections with our customers, suppliers, distributors, employees and consultants, and we implement security measures designed to protect our trade secrets and know-how. However, we cannot assure you that these contractual protections and security measures will not be breached, that we will have adequate remedies for any such breach or that our customers, suppliers, distributors, employees or consultants will not assert rights to intellectual property or damages arising out of such contracts.

We may initiate claims against third parties to protect our intellectual property rights if we are unable to resolve matters satisfactorily through negotiation. Litigation brought to protect and enforce our intellectual property rights could be costly, time-consuming and distracting to management. It could also result in the impairment or loss of portions of our intellectual property, as an adverse decision could limit our ability to assert our intellectual property rights, limit the value of our technology or otherwise negatively impact our business, financial condition and results of operations. Additionally, any enforcement of our patents or other intellectual property may provoke third parties to assert counterclaims against us. Our failure to secure, protect and enforce our intellectual property rights could materially harm our business.

We may face claims of intellectual property infringement, which could be time-consuming, costly to defend or settle, result in the loss of significant rights, harm our relationships with our customers and distributors, or otherwise materially adversely affect our business, financial condition and results of operations.

The semiconductor industry is characterized by companies that hold patents and other intellectual property rights and that vigorously pursue, protect and enforce intellectual property rights. These companies include patent holding companies or other adverse patent owners who have no relevant product revenue and against whom our own patents may provide little or no deterrence. From time to time, third parties may assert against us and our customers’ patent and other intellectual property rights to technologies that are important to our business.

Claims that our products, processes or technology infringe third-party intellectual property rights, regardless of their merit or resolution, could be costly to defend or settle and could divert the efforts and attention of our management and technical personnel. We may also be obligated to indemnify our customers or business partners in connection with any such litigation, which could result in increased costs. Infringement claims also could harm our relationships with our customers or distributors and might deter future customers from doing business with us. If any such proceedings result in an adverse outcome, we could be required to:

- cease the manufacture, use or sale of the infringing products, processes or technology;
- pay substantial damages for infringement;
- expend significant resources to develop non-infringing products, processes or technology, which may not be successful;
- license technology from the third-party claiming infringement, which license may not be available on commercially reasonable terms, or at all;
- cross-license our technology to a competitor to resolve an infringement claim, which could weaken our ability to compete with that competitor; or
- pay substantial damages to our customers to discontinue their use of or to replace infringing technology sold to them with non-infringing technology, if available.

Any of the foregoing results could have a material adverse effect on our business, financial condition and results of operations. Furthermore, our exposure to the foregoing risks may also be increased as a result of acquisitions of other companies or technologies. For example, we may have a lower level of visibility into the development process with respect to intellectual property or the care taken to safeguard against infringement risks with respect to the acquired company or technology. In addition, third parties may make infringement and similar or related claims after we have acquired technology that had not been asserted prior to the acquisition.

We rely upon third-party licensed technology to develop our products. If licenses of third-party technology are inadequate, our ability to develop and commercialize our products or product enhancements could be negatively impacted.

Our products incorporate technology licensed from third parties. In connection with our acquisition of certain flash memory assets from Atmel Corporation in 2012, we obtained a perpetual license to Atmel's flash memory technology. In addition, a component of our CBRAM technology is licensed from Axon Technology Corp. While we believe these licenses enable us to develop our products and pursue our current product strategies, these licenses may not provide us with the benefits we expect from them. From time to time, we may be required to license additional technology from third parties to develop our products or product enhancements. However, these third-party licenses may not be available to us on commercially reasonable terms or at all. Our inability to obtain third-party licenses necessary to develop products and product enhancements could require us to obtain substitute technology at a greater cost or of lower quality or performance standards or delay product development. Any of these results may limit our ability to develop new products, which could harm our business, financial condition and results of operations.

We have expanded in the past and expect to continue to expand in the future through acquisitions of, or investments in, other companies, each of which may divert our management's attention, result in additional dilution to stockholders or use resources that are necessary to operate our business.

We have grown our business through acquisitions and we expect to continue to evaluate and enter into discussions regarding potential strategic transactions. We completed the acquisition of S3 in May 2018 and acquisition of Echelon in September 2018. These transactions are and any new acquisitions or investments could be material to our financial condition and results of operations. The process of integrating businesses and technology can create unforeseen operating difficulties and expenditures as could the integration of any future acquisitions. Such transactions could create risks for us, including:

- difficulties in assimilating acquired personnel, operations and technologies or realizing synergies expected in connection with an acquisition, particularly with acquisitions of companies with large and widespread operations, complex products or that operate in markets in which we historically have had limited experience;
- unanticipated costs or liabilities, including possible litigation associated with the acquisition;
- failure to realize expected revenue growth and higher than expected operating, transaction and integration costs;
- incurrence of acquisition-related costs;

- inability to maintain, develop and deepen relationships with end customers of newly acquired businesses and otherwise expand our sales channels;
- diversion of management's attention from other business concerns;
- use of resources that are needed in other parts of our business; and
- use of substantial portions of our available cash to consummate an acquisition.

Our failure to address these risks or other problems encountered in connection with our past or future acquisitions and investments could cause us to fail to realize the anticipated benefits of these acquisitions or investments, cause us to incur unanticipated liabilities and harm our business generally. Future acquisitions could also result in the use of substantial amounts of our cash and cash equivalents, dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities, amortization expenses or the write-off of goodwill, any of which could harm our financial condition. We do not have an extensive history of acquiring other companies and managing integrations, and the risk of failing to achieve the anticipated benefits and synergies of our acquisitions of S3 Semiconductors and Echelon may be increased by the risks inherent to managing concurrent integrations. Also, the anticipated benefits of any acquisitions may not materialize, may be less beneficial, or may develop more slowly, than we expect. If we do not receive the benefits anticipated from these acquisitions and investments, or if the achievement of these benefits is delayed, our operating results may be adversely affected and our stock price could decline.

Table of Contents

Our success depends on our ability to attract and retain key employees, and our failure to do so could harm our ability to grow our business and execute our business strategies.

Our success depends on our ability to attract and retain our key employees, including our management team and experienced engineers. Competition for personnel in the semiconductor technology field is intense, and the availability of suitable and qualified candidates is limited. We compete to attract and retain qualified research and development personnel with other semiconductor companies, universities and research institutions, particularly those in the San Francisco Bay Area where our headquarters is located. The members of our management and key employees are at-will employees. In addition, our management and employees, including those recently added from S3 Semiconductor and Echelon, may experience uncertainly about their future roles with us as we integrate the acquired businesses into our existing organizational structure. We must continue to attract and motivate all our employees and keep them focused on our strategies and goals following the acquisitions. If we lose the services of any key senior management member or employee, we may not be able to locate suitable or qualified replacements, and may incur additional expenses to recruit and train new personnel, which could severely impact our business and prospects. The loss of the services of one or more of our key employees, especially our key engineers, or our inability to attract and retain qualified engineers, could harm our business, financial condition and results of operations.

We may not be able to effectively manage our growth, and we may need to incur significant expenditures to address the additional operational and control requirements of our growth, either of which could harm our business and operating results.

We expect to increase headcount and the overall size of our operations to support our growth. To effectively manage our growth, we must continue to expand our operational, engineering and financial systems, procedures and controls and to improve our accounting and other internal management systems. This may require substantial managerial and financial resources, and our efforts in this regard may not be successful. Our current systems, procedures and controls may not be adequate to support our future operations. If we fail to adequately manage our growth, or to improve our operational, financial and management information systems, or fail to effectively motivate or manage our new and future employees, the quality of our products and the management of our operations could suffer, which could adversely affect our operating results.

We have operations outside of the United States and intend to expand our international operations, which exposes us to significant risks.

With the acquisitions of S3 Semiconductors and Echelon, we expanded our global footprint beyond the limited operations we once had in Europe and Asia. We intend to expand our operations in Asia and, the acquisitions significantly expand our global operations. The success of our business depends, in large part, on our ability to operate successfully from geographically disparate locations and to further expand our international operations and sales. Operating in international markets requires significant resources and management attention and subjects us to regulatory, economic and political risks that are different from those we face in the United States. We cannot be sure that further international expansion will be successful. In addition, we face risks in doing business internationally that could expose us to reduced demand for our products, lower prices for our products or other adverse effects on our operating results. Among the risks we believe are most likely to affect us are:

difficulties, inefficiencies and costs associated with staffing and managing foreign operations;

longer and more difficult customer qualification and credit checks;

greater difficulty collecting accounts receivable and longer payment cycles;

the need for various local approvals to operate in some countries;

difficulties in entering some foreign markets without larger-scale local operations;

compliance with local laws and regulations;

unexpected changes in regulatory requirements, including the elimination of tax holidays;

reduced protection for intellectual property rights in some countries;

adverse tax consequences as a result of repatriating cash generated from foreign operations to the United States;

Table of Contents

adverse tax consequences, including potential additional tax exposure if we are deemed to have established a permanent establishment outside of the United States;

adverse tax consequences, including potential additional tax costs, resulting from the new tax legislation signed into law on December 22, 2017, that imposes a minimum domestic tax on the earnings of foreign subsidiaries;

· the effectiveness of our policies and procedures designed to ensure compliance with the Foreign Corrupt Practices Act of 1977 and similar regulations;
· the imposition of tariffs or other trade barriers on the importation of our products;

fluctuations in currency exchange rates, which could increase the prices of our products to customers outside of the United States, increase the expenses of our international operations by reducing the purchasing power of the U.S. dollar and expose us to foreign currency exchange rate risk if, in the future, we denominate our international sales in currencies other than the U.S. dollar;

new and different sources of competition; and

political and economic instability, and terrorism.

Our failure to manage any of these risks successfully could harm our operations and reduce our revenue.

Because our business is highly dependent on growth in the electronics manufacturing supply chain in China, any slowdown in this growth could adversely affect our business and operating results.

Our business is highly dependent upon the economy and the business environment in China. In particular, our growth strategy is based upon the assumption that demand in China for devices that use semiconductors will continue to grow. Therefore, any slowdown in the growth of consumer demand in China for products that use semiconductors, such as computers, mobile phones or other consumer electronics, could have a serious adverse effect on our business. In addition, our business plan assumes that an increasing number of non-Chinese integrated device manufacturers, or IDMs, fabless semiconductor companies and systems companies will establish operations in China. Any decline in the rate of migration to China of semiconductor design companies or companies that require semiconductors as components for their products could adversely affect our business and operating results.

If significant tariffs or other restrictions are placed on Chinese imports or any related counter-measures are taken by China, our revenue and results of operations may be materially harmed. The Trump Administration has signaled that it may alter trade agreements and terms between China and the United States, including limiting trade with China and/or imposing a tariff on imports from China. In March 2018, President Trump imposed a 25% tariff on steel imports and a 10% tariff on aluminum imports and announced additional tariffs on goods imported from China specifically, as well as certain other countries. The materials subject to these tariffs to date do not constitute a significant percentage of our raw material costs. However, if retaliatory trade measures taken by China or other countries in response to the tariffs cause the cost of our products to increase, we may be required to raise our prices, which may result in the loss of customers and harm to our reputation and operating performance.

In order to comply with environmental laws and regulations, we may need to modify our activities or incur substantial costs, and if we fail to comply with environmental regulations we could be subject to substantial fines or be required to have our suppliers alter their processes.

The semiconductor industry is subject to a variety of international, federal, state and local governmental regulations directed at preventing or mitigating environmental harm, as well as to the storage, discharge, handling, generation, disposal and labeling of toxic or other hazardous substances. Failure to comply with environmental regulations could subject us to civil or criminal sanctions and property damage or personal injury claims. Compliance with current or future environmental laws and regulations could restrict our ability to expand our business or require us to modify processes or incur other substantial expenses which could harm our business. In response to environmental concerns, some customers and government agencies impose requirements for the elimination of hazardous substances, such as lead (which is widely used in soldering connections in the process of semiconductor packaging and assembly), from electronic equipment. For example, the European Union, or EU, adopted its Restriction on Hazardous Substance Directive which prohibits, with specified exceptions, the sale in the EU market of new electrical and electronic equipment containing more than agreed levels of lead or other hazardous materials and China has enacted similar

Table of Contents

regulations. Environmental laws and regulations such as these could become more stringent over time, causing a need to redesign technologies, imposing greater compliance costs and increasing risks and penalties associated with violations, which could seriously harm our business.

The issuance of new accounting standards or future interpretations of existing accounting standards could adversely affect our operating results.

We prepare our financial statements in accordance with accounting principles generally accepted in the United States of America, or GAAP. A change in those principles could have a significant effect on our reported results and might affect our reporting of transactions completed before a change is announced. GAAP is issued and subject to interpretation by the Financial Accounting Standards Board, the SEC and various other bodies formed to promulgate and interpret accounting principles. A change in these principles or interpretations could have a significant effect on our reported financial results, and could affect the reporting of transactions completed before the announcement of a change. The issuance of new accounting standards or future interpretations of existing accounting standards, or changes in our business practices or estimates, could result in future changes in our revenue recognition or other accounting policies that could have a material adverse effect on our results of operations.

Some of our facilities and the facilities of our suppliers are located near known earthquake fault zones, and the occurrence of an earthquake or other catastrophic disaster could damage our facilities, which could cause us to curtail our operations.

Our principal offices, and our contract manufacturers' and suppliers' facilities in Asia, are located near known earthquake fault zones and, therefore, are vulnerable to damage from earthquakes. We are also vulnerable to damage from other types of disasters, such as power loss, fire, floods and similar events. If any such disaster were to occur, our ability to operate our business could be seriously impaired. In addition, we may not have adequate insurance to cover our losses resulting from disasters or other similar significant business interruptions. Any significant losses that are not recoverable under our insurance policies could seriously impair our business and financial condition.

Our substantial level of indebtedness could adversely affect our financial condition.

We have a substantial amount of indebtedness, which will require significant interest payments. After giving effect to the term loan we received in May 2018, we have had approximately $35 million aggregate principal amount of indebtedness outstanding as of September 30, 2018. Our substantial level of indebtedness could have important consequences, including the following:

- we must use a substantial portion of our cash flow from operations to pay interest and principal on the term loan, which will reduce funds available to us for other purposes such as working capital, capital expenditures, other general corporate purposes and potential acquisitions;
- our ability to refinance such indebtedness or to obtain additional financing for working capital, capital expenditures, acquisitions or general corporate purposes may be impaired;
- we will be exposed to fluctuations in interest rates;

- our leverage may be greater than that of some of our competitors, which may put us at a competitive disadvantage and reduce our flexibility in responding to current and changing industry and financial market conditions;
- we may be more vulnerable to the current economic downturn and adverse developments in our business;
- we may be unable to comply with financial and other restrictive covenants in our debt agreements, which could result in an event of default that, if not cured or waived, may result in acceleration of certain of our debt and would have an adverse effect on our business and prospects and could force us into bankruptcy or liquidation; and
- in the event of the insolvency, liquidation, reorganization, dissolution or other winding up of our business, if there are not sufficient assets remaining to pay all creditors, then all or a portion of the amounts due on the notes then outstanding would remain unpaid.

Table of Contents

We may be able to incur substantial additional indebtedness in the future, subject to the restrictions contained in our existing credit facility and the terms of any of our other indebtedness. For example, we may incur additional debt to fund our business and strategic initiatives, and may utilize additional debt to fund a portion of the purchase price for the Echelon acquisition. If we incur additional debt and other obligations, the risks associated with our substantial leverage and the ability to service such debt would increase.

Our ability to meet expenses, to remain in compliance with our covenants under our debt arrangements and to make future principal and interest payments in respect of our debt arrangements depends on, among other things, our operating performance, competitive developments and financial market conditions, all of which are significantly affected by financial, business, economic and other factors. We are not able to control many of these factors. Accordingly, our cash flow may not be sufficient to allow us to pay principal and interest on our debt and meet our other obligations.

We may not be able to secure additional financing on favorable terms, or at all, to meet our future capital needs.

We have funded our operations since inception through equity financings, our borrowing arrangements, and our public offerings in October 2015, June 2017, and July 2018. We have incurred net losses and negative cash flows from operating activities since our inception, and we expect we will continue to incur operating and net losses and negative cash flows from operations for the foreseeable future. We do not know when or if our operations will generate sufficient cash to fund our ongoing operations. In the future, we may require additional capital to fund our ongoing operations, respond to business opportunities, challenges, acquisitions or unforeseen circumstances and may determine to engage in equity or debt financings or enter into credit facilities, but we may not be able to timely secure additional debt or equity financing or raise additional capital in the public market on favorable terms or at all.

Our current credit facility limits our ability to incur indebtedness, and these restrictions are subject to a number of qualifications and exceptions subject to the consent of our lender. Any additional debt financing obtained by us in the future could also involve restrictive covenants relating to our capital-raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions.

If we raise additional funds through issuances of equity, convertible debt securities or other securities convertible into equity, our existing stockholders could suffer significant dilution in their percentage ownership of our company, and any new equity securities we issue could have rights, preferences and privileges senior to those of holders of our common stock. If we are unable to obtain adequate financing or financing on terms satisfactory to us, when we require it, our ability to continue to grow or support our business and to respond to business challenges could be significantly limited.

Provisions of our debt agreements may restrict our ability to pursue our business strategies.

Borrowings under our new $35 million credit facility are collateralized by substantially all of our assets excluding our intellectual property. Our credit facility restricts our ability to, among other things:

- dispose of or sell assets;
- consolidate or merge with other entities;
- incur additional indebtedness;
- create liens on our assets;
- pay dividends;
- make investments;
- enter into transactions with affiliates; and
- redeem subordinated indebtedness.

These restrictions are subject to certain exceptions. In addition, our credit facility, requires us to comply with certain financial covenants. The operating and financial restrictions and covenants in the credit facility, as well as any future financing agreements that we may enter into, may restrict our ability to finance our operations, engage in business activities or expand or fully pursue our business strategies. Our ability to comply with these covenants may be affected

Table of Contents

by events beyond our control, and we may not be able to meet those covenants. A breach of any of these covenants could result in a default under the credit facility which could cause, among other things (unless such default is waived by the lender), all or a portion of the outstanding indebtedness thereunder to become immediately due and payable and subject to an increase by 2% of the interest rate charged during the period of the unremedied breach. In addition, the lender would be able to sell or lease our assets in satisfaction of our outstanding indebtedness.

Our ability to use net operating losses to offset future taxable income may be subject to certain limitations.

In general, under Section 382 of the U.S. Internal Revenue Code of 1986, as amended, or the Code, a corporation that undergoes an "ownership change" is subject to limitations on its ability to utilize its pre-change net operating losses, or NOLs, to offset future taxable income, and tax credits to offset tax. In addition, although we do not expect to undergo an ownership change, we may experience an ownership change in the future, and our ability to utilize our NOLs and tax credits could be further limited by Section 382 of the Code. Future changes in our stock ownership, many of which are outside of our control, could result in an ownership change under Section 382 of the Code. Our net operating losses and tax credits could also be impaired under state laws. As a result, we might not be able to utilize a material portion of our state NOLs and tax credits.

If we are unable to implement and maintain effective internal control over financial reporting in the future, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock may be negatively affected.

As a public company, we are required to maintain internal controls over financial reporting and to report any material weaknesses in such internal controls. If and when we no longer meet the definition of an "emerging growth company" as defined by the JOBS Act, we would be required under Section 404 of the Sarbanes-Oxley Act to evaluate and determine the effectiveness of our internal control over financial reporting and, beginning with our annual report for the applicable fiscal year, provide a management report on our internal control over financial reporting, which must be attested to by our independent registered public accounting firm. If we have one or more material weaknesses in our internal control over financial reporting, we may not detect errors on a timely basis and our financial statements may be materially misstated. We are in the process of designing and implementing our internal control over financial reporting required to comply with this obligation, which process will be time consuming, costly and complicated. If we identify material weaknesses in our internal control over financial reporting, if we are unable to comply with the requirements of Section 404 in a timely manner, if we are unable to determine that our internal control over financial reporting is effective, or if our independent registered public accounting firm is unable to express an opinion as to the effectiveness of our internal control over financial reporting, investors may lose confidence in the accuracy and completeness of our financial reports, the market price of our common stock could be negatively affected, and we could become subject to investigations by the NASDAQ Stock Market, the SEC or other regulatory authorities, which could require additional financial and management resources.

Regulations related to "conflict minerals" may force us to incur additional expenses, may make our supply chain more complex and may result in damage to our reputation with customers.

Pursuant to the Dodd-Frank Act, the SEC has adopted requirements for companies that use certain minerals and metals, known as conflict minerals, in their products, whether or not these products are manufactured by third parties.

These requirements will require companies to diligence, disclose and report whether or not such minerals originate from the Democratic Republic of Congo and adjoining countries. The implementation of these requirements could adversely affect the sourcing, availability and pricing of minerals used in the manufacture of our products, and affect our costs and relationships with customers, distributors and suppliers as we must obtain additional information from them to ensure our compliance with the disclosure requirement. In addition, we will incur additional costs to comply with the disclosure requirements, including costs related to determining the source of any of the relevant minerals and metals used in our products. Since our supply chain is complex, we may not be able to sufficiently verify the origins for these minerals and metals used in our products through the due diligence procedures that we implement, which may harm our reputation. In such event, we may also face difficulties in satisfying customers who require that all of the components of our products are certified as conflict mineral free and these customers may discontinue, or materially reduce, purchases of our products, which could result in a material adverse effect on our results of operations and our financial condition may be adversely affected.

Risks Related to Ownership of Our Common Stock

The market price of our common stock has been and will likely continue to be volatile, and you could lose all or part of your investment.

The market price of our common stock has been, and will likely continue to be, volatile. Since shares of our common stock were sold in our initial public offering in October 2015 at a price of $5.00 per share, our stock price has fluctuated significantly. In addition to the factors discussed in this Quarterly Report on Form 10 Q, the market price of our common stock may fluctuate significantly in response to numerous factors, many of which are beyond our control, including:

- overall performance of the equity markets in general, in our industry or in the markets we address;
- our operating performance and the performance of other similar companies;
- changes in the estimates of our results of operations that we provide to the public, our failure to meet these projected results or changes in recommendations by securities analysts that elect to follow our common stock;
- announcements of technological innovations, new products or enhancements to products, acquisitions, strategic alliances or significant agreements by us or by our competitors;
- announcements of new business partners, on the termination of existing business partner arrangements or changes to our relationships with such business partners;
- recruitment or departure of key personnel;
- announcements of litigation or claims against us;
- changes in legal requirements relating to our business;
- the economy as a whole, market conditions in our industry, and the industries of our customers and end customers;
- trading activity by our principal stockholders;
- the expiration of contractual lock-up or market standoff agreements; and
- sales of shares of our common stock by us or our stockholders.

In addition, the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many technology companies. Stock prices of many technology companies have fluctuated in a manner unrelated or disproportionate to the operating performance of those companies. In the past, stockholders have filed securities class action litigation following periods of market volatility. If we were to become involved in securities litigation, it could subject us to substantial costs, divert resources and the attention of management from our business, and adversely affect our business.

If securities analysts do not publish research or reports about our business or if they downgrade our stock, the price of our stock could decline.

The trading market for our common stock rely in part on the research and reports that industry or financial analysts publish about us or our business. We do not control these analysts. If few analysts cover our company, the price and trading volume of our stock could suffer. If one or more of the analysts who cover us downgrade our stock, or publish unfavorable research about our business, our stock price would likely decline rapidly. If one or more of these analysts cease coverage of our company or fail to publish regularly, we could lose visibility in the market, which in turn could cause our stock price to decline.

Table of Contents

We do not intend to pay dividends for the foreseeable future.

We have never declared nor paid cash dividends on our capital stock. We currently intend to retain any future earnings to finance the operation and expansion of our business, and we do not expect to declare or pay any dividends in the foreseeable future. In addition, our ability to pay cash dividends on our capital stock is restricted by the terms of our term loan facility and is likely to be restricted by any future debt financing arrangement. Any return to stockholders will therefore be limited to increases in the price of our common stock, if any.

Provisions in our amended and restated certificate of incorporation and bylaws or Delaware law might discourage, delay or prevent a change of control of our company or changes in our management.

Delaware corporate law and our amended and restated certificate of incorporation and bylaws contain provisions that could discourage, delay or prevent a change in control of our company or changes in our board of directors that the stockholders of our company may deem advantageous. Among other things, these provisions:

- establish a classified board of directors so that not all members of our board are elected at one time;
- provide that directors may be removed only “for cause” and only with the approval of stockholders representing 66 2/3 percent of our outstanding common stock;
- require super-majority voting to amend some provisions in our amended and restated certificate of incorporation and bylaws;
- authorize the issuance of “blank check” preferred stock that our board could issue to increase the number of outstanding shares and to discourage a takeover attempt;
- eliminate the ability of our stockholders to call special meetings of stockholders;
- prohibit stockholder action by written consent, which means that all stockholder actions will be required to be taken at a meeting of our stockholders;
- provide that our board of directors is expressly authorized to make, alter or repeal our bylaws; and
- establish advance notice requirements for nominations for election to our board or for proposing matters that can be acted upon by stockholders at stockholder meetings.

These provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management. In addition, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which generally prohibits a Delaware corporation from engaging in a broad range of business combinations with any “interested” stockholder for a period of three years following the date on which the stockholder became an “interested” stockholder. Any delay or prevention of a change of control transaction or changes in our management could cause the market price of our common stock to decline.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. UNREGISTERED SALES OF EQUITY AND USE OF PROCEEDS

(a) Sales of Unregistered Securities

None.

(b) Use of Proceeds from Public Offering of Common Stock

None.

Table of Contents

(c) Issuer Purchases of Equity Securities

None.

ITEM 3.DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4.MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5.OTHER INFORMATION

None.

ITEM 6.Exhibits

The exhibits filed or furnished as part of this Quarterly Report on Form 10-Q are set forth on the Exhibit Index below.

Number	Description
31.1	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a 14(c) and 15d 14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a 14(c) and 15d 14(a)-, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1+	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2+	Certification of 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 Linkbase Document

+This certification shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or Exchange Act, or otherwise subject to the liability of that Section, nor shall it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended or the Exchange Act of 1934.

64

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

		Adesto Technologies Corporation
Dated: November 9, 2018	By:	/s/ Ron Shelton
		Ron Shelton
		Chief Financial Officer
		(Principal Financial and Accounting Officer)