

ECHELON CORP
Form 10-K
March 27, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-K
(Mark One)

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

For the fiscal year ended December
31, 2017

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:

000-29748

ECHELON CORPORATION

(Exact name of registrant as
specified in its charter)

Delaware 77-0203595

(State or

other

jurisdiction

of

incorporation

or

organization)

2901 Patrick Henry Drive

Santa Clara, California 95054

(Address of principal executive
office and zip code)

(408) 938-5200

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(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|--|---|
| Common Stock, par value \$0.01 (The Nasdaq Global Market) | The NASDAQ Stock Market LLC |

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

(do not check if a 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

As of June 30, 2017, the last business day of the registrant's most recently completed second fiscal quarter, there were 4,453,811 shares of the registrant's common stock outstanding, and the aggregate market value of such shares held by non-affiliates of the registrant (based on the per share closing sale price of \$5.16 of such shares on the Nasdaq Global Market on June 30, 2017) was approximately \$16.9 million. Shares of the registrant's common stock held by each executive officer and director and by each entity that owns 5% or more of the registrant's outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

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As of February 28, 2018, 4,524,021 shares of the registrant's common stock, \$0.01 par value per share, were issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

| Document | Parts Into Which Incorporated |
|---|-------------------------------|
| Proxy Statement for the 2018 Annual Meeting of Stockholders to be held May 17, 2018 (Proxy Statement) | Part III |

ECHELON CORPORATION
 FORM 10 K
 FOR THE YEAR ENDED DECEMBER 31, 2017
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FORWARD-LOOKING INFORMATION

This report contains forward-looking statements within the meaning of the U.S. federal securities laws that involve risks and uncertainties. Certain statements contained in this report are not purely historical including, without limitation, statements regarding our expectations, beliefs, intentions, anticipations, commitments or strategies regarding the future, are forward-looking. These statements include those discussed in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, including "Critical Accounting Estimates," "Results of Operations," "Off-Balance-Sheet Arrangements and Other Critical Contractual Obligations," "Liquidity and Capital Resources," and "Recently Issued Accounting Standards," and elsewhere in this report.

In this report, the words "may," "could," "would," "might," "will," "should," "plan," "forecast," "anticipate," "believe," "expect," "estimate," "predict," "potential," "continue," "future," "moving toward" or the negative of these terms or other similar expressions also identify forward-looking statements. Our actual results could differ materially from those forward-looking statements contained in this report as a result of a number of risk factors including, but not limited to, those set forth in the section entitled "Risk Factors" and elsewhere in this report. You should carefully consider these risks, in addition to the other information in this report and in our other filings with the SEC. All forward-looking statements and reasons why results may differ included in this report are made as of the date of this report, and we assume no obligation to update any such forward-looking statement or reason why such results might differ.

PART I

ITEM 1. BUSINESS

General

Echelon was incorporated in California in 1988 and reincorporated in Delaware in 1989. With its Silicon Valley based global headquarters in Santa Clara, California, and regional sales offices throughout North America, Europe, and Asia, Echelon makes its products available throughout the world.

We are a pioneer in developing distributed intelligence, open-standard control networking platforms for Industrial Internet of Things ("IIoT") applications and delivering elements necessary to design, install, monitor and control highly reliable, scalable and secure communities of devices. Echelon's vision is one of low-cost monitoring and control technology in every industrial electrical device in the world and complete vertical solutions in the fastest growing market segments. With more than 140 million Echelon-powered devices shipped worldwide, Echelon helps its customers migrate existing legacy devices, and bring new devices and applications into a growing global Industrial Internet.

In 2014 the Internet of Things ("IoT") market opportunity became increasingly apparent. The IoT refers to a network of physical objects, each containing a unique network address, which interact with each other to share information and to take action. IoT networks can run a variety of languages, or protocols, and be connected via wired or wireless links. The IoT can be further segmented into the Human Internet of Things (HIIoT) and the Industrial Internet of Things (IIoT); the latter is Echelon's market focus.

The IIoT refers to communities of rules-based, self-directed devices that reside in commercial or industrial environments and operate with little to no human interaction. Because of the harsh nature of these environments (e.g., extreme temperature, vibration, noise, humidity, dust) where connectivity can be intermittent, and because industrial applications demand high reliability, IIoT devices need to be more robust than consumer-oriented HIIoT devices. Specialized requirements of the IIoT include no-compromise control capability, proven reliability, and hardened security. In addition, IIoT devices must be able to interact autonomously and function when disconnected from the Internet or a local access point. The IIoT will incorporate decades of existing and in-service infrastructure - deployed mechanical and digital vertical solutions ready to be connected. When these solutions are connected, they generally communicate with protocols developed many years ago, and often dedicated to specific applications.

Just as mainframe networking evolved to workgroup networking, which gave way to the corporate and consumer Internet, the IIoT represents a next big wave in technology. This market opportunity is driven by the convergence of control systems for lighting, HVAC, security, manufacturing, transportation, and more. The customers for IIoT products are themselves participating in highly fluid and competitive environments that prize lower costs, differentiated offerings,

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improved customer service, ubiquitous connectivity, and near-infinite analytic capabilities. The IIoT will unlock improvements in life quality, efficiency, safety, and more. Market analysts, such as those at IHS, Inc., project that the world market for Internet-connected devices could reach 50 billion by 2025, with the industrial segment representing the majority share of these devices.

IIoT products have long lifecycles and must operate under extreme conditions. They must also be secure to prevent unauthorized access and abuse that could cause environmental hazards or life-threatening situations. New systems running modern Information Technology protocols, such as IP, must interoperate with systems running mature Operational Technology protocols such as LONWORKS, BacNet and Modbus. Echelon's control networking technology is purpose-built for industrial environments such as building automation, lighting and transportation.

Strategy

Today Echelon has two areas of business focus. Our original product lines are focused on developing, marketing, selling and supporting embedded components, modules, edge servers, and software that enable OEMs and other 3rd parties to quickly develop IIoT devices for their end users. Applications span a broad range of markets and products from HVAC systems to manufacturing equipment control, elevator control, transportation, and much more.

Starting in late 2014, through the acquisition of Lumewave Inc., a wireless outdoor lighting control system provider with a track record of selling its solution to U.S. municipalities, universities, medical facilities and enterprises, we began developing and introducing a connected lighting platform geared primarily for outdoor applications. Targeting the fast-growing market for LED light sources, our Lumewave by Echelon connected lighting solution supports a range of applications for smart cities and smart enterprises. These applications can reduce energy consumption, enhance citizen and employee safety, improve livability in cities and make maintenance dollars go farther.

The Lumewave by Echelon products, which include individual lighting controllers, motion sensors, edge servers, and management and maintenance software, have since been incorporated into Echelon's product portfolio along with the established Lumewave sales channels in North America.

Embedded Components & Modules

Our IIoT embedded components and modules are utilized by a wide array of original equipment manufacturers (OEMs) and system integrators covering a broad spectrum of markets. Among the more significant of these markets are building automation systems, industrial and manufacturing equipment, lighting, and energy management systems. Sales levels track closely with new construction starts and tenant improvement cycles in the commercial buildings market. Consequently, industrial and manufacturing equipment is upgraded infrequently - approximately every 10 years or so. As with other areas of the IoT, numerous technical transitions are taking place that are impacting the market and our business. Most notably, legacy systems are becoming connected to the Internet so that 'big data analytics' can be performed and operational systems optimized in near real time. In addition, legacy 'operational technologies' such as RS485, BacNet and LonWorks are being augmented and in some cases supplanted by newer technologies such as Ethernet, Wi-Fi, Bluetooth, and TCP/IP. Standards are very much in flux which can slow the adoption of these new connectivity technologies.

In keeping with these trends, in October 2013, we introduced our IzoT™ embedded platform - purpose-built for the IIoT. The IzoT platform allows control networking to be done using Internet Protocol ("IP") all the way to the end device. IzoT software can run on any processor in an environment providing UDP/IP socket connectivity; it allows a single device to be brought to market as a LONWORKS®, BACnet®, or other protocol-supporting device; and it can be used with an underlying wired or wireless communications link, such as Ethernet, RS-485, Wi-Fi, 15.4, or Echelon's free topology (FT) standard. The IzoT platform allows customers to easily embrace their current installed solutions, extend those solutions with newer technologies if they choose, and enhance both existing and new

connectivity systems with cloud-based analytics. In June 2014 Echelon began sampling the IzoT platform with evaluation kits, software, chips, modules, and routers.

Both LONWORKS and the IzoT control networking platform consist of a three-tier architecture: a device tier, an edge server tier, and an enterprise software tier. At the device tier, industrial devices such as load controllers, lighting ballasts, meters, and thermostats, embed Echelon or third-party free topology (FT) or power line (PL) smart transceivers, enabling them to act as peers working together to collect data and take cooperative action. These individual devices are managed by edge servers, such as Echelon's Smart Servers. For example, when an edge server receives information from the local utility, such as a signal to shed electrical load, this information is transmitted across the twisted-pair network. The network

devices then execute the control signal, resulting in a reduction of energy consumption while preserving a safe and comfortable work environment.

At the edge server tier, various control technologies and protocols are unified and supervised so that local decisions can be made at the device tier levels. An example of an edge server is the Echelon SmartServer. In general, the devices and control node tiers communicate using control protocols such as LONWORKS technology (ISO/EN 14908), BACnet, and Open Smart Grid Protocol (OSGP). OSGP is a family of standards published by the European Telecommunications Standards Institute (ETSI) that is optimized for smart grid applications used in conjunction with LONWORKS technology.

At the enterprise software tier, Echelon technology connects the edge server tiers to an enterprise software tier, commonly an information technology (IT) solution, so business rules can be established for the control system and operational data can be archived for later analysis. Our LONWORKS Control Network Software (LNS) is an example of an enterprise software tier product. Edge servers communicate with enterprise tier solutions using Internet protocols such as TCP/IP and web services.

Lumewave by Echelon Connected Lighting Platform

Lighting, especially outdoor lighting, has been a key application for Echelon products and has been identified as potentially being one of the fastest growing market segments in the IIoT. Street, campus and commercial outdoor lights are important assets, providing safety and aesthetic value to their community. They also consume a significant amount of electricity - as much as 40% of a city's overall electricity budget. As a result, cities, campuses and commercial enterprises are responsible for a substantial portion of worldwide energy consumption and greenhouse gas production. Therefore, these entities are looking for ways to improve infrastructure to become more environmentally friendly, increase the quality of life for their residents and occupants, and reduce costs.

Market research suggests that the transition from 'analog' to 'solid state' lighting is happening at an accelerating pace. In 2015, 19% of outdoor lights used LED light sources, which is expected to increase to 79% by 2025 according to the United States Department of Energy.

The Lumewave by Echelon connected lighting platform is a multi-application solution. The growing list of applications that Lumewave supports bring benefits in the areas of energy savings and sustainability, safety enhancement, livability and improved maintenance efficiencies. Example applications in each area include:

Sustainability/Energy savings. At the most basic level, Echelon's platform offers scheduling of lights on or off, the setting of dimming levels for individual or groups of lights, and intelligent lighting according to time of day, season, or weather conditions. Our systems include energy metering functions which allow a city to consider energy cost when optimizing system variables, and work with local utilities to minimize electricity charges

Safety. With our system lamp outages can be quickly spotted and repaired, and often predicted and repaired before they fail. Our adaptive lighting solutions can brighten lights in response to motion, direction of travel, traffic volumes and more. Our new white tuning concept allows cities to control the color of outdoor lights from soothing yellow to bright blue/white depending upon comfort and safety requirements. Our weather adaptive lighting concept adjusts schedules, brightness and color temperature based on weather conditions for optimal safety.

Livability. Selective dimming, adaptive lighting, white tuning and fault identification all help ensure a more livable and attractive city, which is good for business and good for the citizenry.

Maintenance efficiency. Our platform is fixture-agnostic so our customers are free to choose and connect virtually any light fixture from any catalog. We have both RF and powerline communication options to maximize aesthetics and performance. The platform allows for GPS options, automated topology optimization, and includes a powerful Central Management System (CMS) configuration and management features to make startup commissioning and management easy. Powerful reporting helps optimize and predict maintenance needs, monitor energy consumption and identify

communication problems. Separate 'application widgets' support the needs of the specific applications described above.

Echelon's outdoor lighting control product portfolio includes:

Smart Transceivers: Outdoor lighting manufacturers can embed our power line smart transceivers into their outdoor light ballasts, drivers, and generators; or can use these transceivers to develop outdoor lighting controllers that serve as add-on products for existing dimmable ballasts and drivers within a luminaire. These components

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enable command, control, and monitoring of each light. They communicate with the Echelon SmartServer edge server over existing power lines.

Outdoor Lighting Controllers: In order to address the retrofit market and to reduce the time needed to develop and deploy intelligent luminaires, Echelon provides its own brand of outdoor lighting controllers. Echelon outdoor lighting controllers support RF and power line (PL) based communications.

Motion Sensors: Echelon motion sensors work with outdoor lighting controllers to adjust light levels based on motion (ON/OFF or dimming).

SmartServer Edge Server: The Echelon SmartServer is a programmable gateway for connecting outdoor lighting segments to a centralized management system. The SmartServer provides rules for operation, invoking on/off time and sequencing, dimming time and percentage, and other functions.

PL/RF Bridge: Our PL/RF Bridge can be used to connect segments (groups) of outdoor lights to a SmartServer. The PL/RF Bridge uses a plug-and-play RF connection for simple, low-cost installation. Each virtual segment communicates with the SmartServer over existing power lines.

LumInsight Central Management Software ("CMS"): Our LumInsight CMS is used to manage the outdoor lighting network. Customers can choose to run an enterprise version of LumInsight or they can opt to access it as an Echelon hosted, cloud-based application.

Third-Party Software: Third-party system software integrates with a city's enterprise applications and manages the outdoor lighting network using the SmartServer for control and communication. System software is available in hosted or server-based configurations.

Go-To-Market (Sales) Strategy

We sell our IIoT platform to OEMs in the building, lighting, and industrial controls markets directly and through distribution worldwide. These efforts are supported with application engineering, technical support, and industry experts working out of the U.S. as well as China, Japan, South Korea, India, the Netherlands, and the United Kingdom. In outdoor lighting, in addition to selling our platform to lighting OEMs worldwide, in some geographies we also offer the complete Lumewave by Echelon platform solution to end customers such as municipalities, cities, campuses and commercial enterprises through local system integration partners and channel representatives.

Echelon organizes its sales resources by region. Within a region, sales personnel selling our embedded solutions work directly with large OEM customers such as Honeywell, Schneider, Siemens, Trane, and others. Sales personnel focused on our lighting platform work with distribution partners, regional manufacturers' representatives, and regional system integrators. We will often "sell with" these partners by calling on end users such as municipalities and enterprises at their side.

Product Development

Our future success depends in large part on our ability to enhance existing products, reduce product cost, and develop new products that offer technological competitiveness. We have made and intend to continue to make substantial investments in product development, while implementing strategies for overall product development cost reduction where appropriate.

Our strategy is to focus our product innovation efforts on enabling a platform that is versatile and capable of deployment in embedded and connected lighting markets. The platform is comprised of 3 tiers:

- The enterprise management and cloud tier,
- The edge server tier,
- and the device tier.

The platform is extensible to incorporate different types of end devices, protocols, services and business logic to drive sustainability/energy savings, enhance safety, increase efficiency, and manage livability. Key to the extensibility lies in the ability to incorporate selected new functionality and partner products. As an example, our recent proof of concept quickly incorporated weather data from the IBM Watson IoT platform and enabled us to study the balance of managing sustainability while enhancing safety for residents in a city. Also key to the extensibility lies in the ability to standardize at the appropriate layers, with hardware, operating systems, web capabilities, different physical and network protocols, new IoT messaging systems (like MQTT), data driven functionality, etc. Another key part of our product development strategy is balancing standardization with innovation, to optimize functionality, and intellectual property. As we build out this platform, we will aggressively file the appropriate patent disclosures to protect our innovation and intellectual property.

Our total expenses for product development were \$9.3 million for 2017, and \$8.3 million for 2016. Included in these totals were stock-based compensation expenses of \$475,000 and \$173,000 for the years ended December 31, 2017, and 2016, respectively.

To date, we have not capitalized any software development costs from our development efforts.

Marketing

Our marketing efforts focus on two key elements: awareness and demand generation/sales enablement. From an awareness perspective, we seek to generate visibility and credibility of our brand, the products and solutions that we offer, and the capabilities and benefits that they bring. Our marketing program comprises press releases, advertising, collateral, published technical and thought-leadership papers, newsletters, and customer case studies describing the benefits our customers are seeing from implementing our solutions. We also participate in industry events and trade shows, speak at relevant industry conferences, and are continually enhancing our global websites.

Marketing also focuses on making it easier for our sales teams and our partners to sell our solutions. We do this through a variety of demand generation and sales enablement activities such as webinars/seminars, lead-generation from our participation at industry exhibitions and conferences, and the production of focused selling tools such as sales playbooks, competitive analyses, and sales presentations and training. We also actively participate in LONMARK® International, an association directly focused on the adoption of our products.

We focus our sales teams using a systematic pipeline management process, whereby prospects are identified, qualified, and tracked, with the expectation that a portion of these opportunities are ultimately closed.

Principal Customers

During the years ended December 31, 2017 and 2016, we had one customer that accounted for a significant portion of our revenues: Avnet Europe Comm VA (“Avnet”), the primary distributor of our IIoT products in Europe and Japan. For the years ended December 31, 2017, and 2016, the percentages of our revenues attributable to sales made to Avnet was follows:

| Year ended | |
|--------------|-------|
| December 31, | |
| 2017 | 2016 |
| Avnet 28.0% | 28.7% |

Geographic Information

We operate in three main geographic areas: the Americas; Europe, Middle East and Africa (“EMEA”); and Asia Pacific / Japan (“APJ”). Each geographic area provides products and services to our customers located in the respective region. Our long-lived assets include property and equipment, goodwill, purchased intangible assets such as purchased technology and customer and channel relationships, and deposits on our leased facilities. Long-lived assets are attributed to geographic areas based on the country where the assets are located. As of December 31, 2017 and 2016, long-lived assets of approximately \$2.1 million and \$2.2 million, respectively, were domiciled in the United States. Long-lived assets for all other locations are not material to the consolidated financial statements.

We sell our products primarily in U.S. dollars to customers throughout the world. Revenues are attributed to geographic areas based on the country where the customer is domiciled. Our international sales include both export sales and sales by international subsidiaries and accounted for 60.9% of our total revenues for 2017 and 68.2% of our total revenues for 2016. Summary revenue information by geography for the years ended December 31, 2017 and 2016, is as follows (in thousands):

| | Year ended | |
|----------|--------------|----------|
| | December 31, | |
| | 2017 | 2016 |
| Americas | \$13,316 | \$11,402 |
| EMEA | 10,765 | 14,115 |
| APJ | 7,586 | 6,868 |
| Total | \$31,667 | \$32,385 |

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Supply Chain

Our supply chain strategy uses design and manufacturing services from third parties where it reduces our costs and takes advantage of consolidated purchasing power. We limit our internal supply chain activities to quality inspection, system integration, custom configuration, testing, and order fulfillment.

We maintain manufacturing agreements with Cypress Semiconductor related to the FT 3100 family of free topology transceivers. We also maintain manufacturing agreements with STMicroelectronics for production of our PL 3100 power line transceivers, and with Open-Silicon, Inc. for production of our Neuron 5000 microcontroller and the FT 5000 free topology receiver (which are manufactured at Taiwan Semiconductor Manufacturing Company).

For products requiring assembly, we utilize both third-party original design manufacturers (ODMs) and contract electronic manufacturers (CEMs). CEMs procure material and assemble, test, and inspect the final products to our design specifications. Our ODM partners perform the same services as CEMs but also provide design services to our product requirements.

Working Capital

As of December 31, 2017, we had working capital, defined as current assets less current liabilities, of \$20.4 million, which was a decrease of approximately \$2.7 million compared to working capital of \$23.1 million as of December 31, 2016.

Competition

We believe the markets for our products are competitive and becoming more competitive in terms of pricing, product features, and distribution. In each of our markets, our competitors include both small companies as well as some of the largest companies in the electronics industry, operating either alone or together with trade associations and partners.

Our key competitors include established companies such as Cimcon Lighting, Inc., Cree Inc., Digi International, General Electric, LED Roadway Lighting, Maxim Integrated Products, Phillips, Siemens, Silver Springs Networks, STMicroelectronics, Telensa, Texas Instruments, and Tridium. We also see competition from embedded control companies like Freescale Semiconductor and Intel Corporation. In addition, the market has attracted and will continue to attract well-funded, venture-backed start-up companies. Key industry standard and trade group competitors include BACnet, Konnex, DALI, DeviceNet, HART, Profibus, ZigBee, and the ZWave Alliance.

To maintain and improve our competitive position, we must keep pace with the evolving needs of our customers and continue to develop and introduce new products, features, and services in a timely and efficient manner. The principal competitive factors that affect the markets for our products include:

- the price and features of our products such as adaptability, scalability, functionality, ease of use, and the ability to integrate with other products;
- our ability to anticipate changes in customer requirements and to develop new or improved products that meet these requirements in a timely manner;
- our product reputation, quality, performance, and conformance with established industry standards;
- our customer service and support;
- warranties, indemnities, and other contractual terms; and
- customer relationships and market awareness.

Additionally, while our product implementations are proprietary to Echelon and are often protected by unique, patented processes, key technologies such as LONWORKS and IzoT are open, meaning that many of our basic control networking patents are broadly licensed without royalties or license fees. For instance, all of the network management commands required to develop software that competes with our LNS software are published. As a result, our customers are capable of developing hardware and software solutions that compete with many of our products.

Government Regulation

Many of our products and the markets and industries in which they are used are subject to U.S. and foreign regulation as well as local, industry-specific codes and requirements. For example, the power line medium, which is the

communications medium used by some of our products, is subject to special regulations in North America, Europe, and Japan. In general, these regulations limit the ability of companies to use power lines as a communication medium. In addition, some of our competitors have attempted to use regulatory actions to reduce the market opportunity for our products or to increase the market opportunity for their own products. We have resisted these efforts and will continue to oppose competitors' efforts to use regulation to impede competition in the markets for our products. Our business might also be affected by other regulatory factors, including public utility commission or similar approvals and government mandates. This could lead to an extension of the sales cycle or even cancellation of a customer's order.

In addition, the market for our products might experience a movement toward standards-based protocols driven by governmental action. To the extent that we do not adopt such protocols or do not succeed in achieving adoption of other protocols we use as standards or de facto standards, sales of our products might be adversely affected. The adoption of voluntary standards or the passage of governmental regulations that are incompatible with our products or technology could limit the market opportunity for our products, which could harm our revenues, results of operations, and financial condition.

Proprietary Rights

We own registered patents in the United States and in selected foreign countries. Many of the specific patents that are fundamental to LONWORKS technology have been licensed to our customers with no license fee or royalties.

We also hold several trademarks in the United States and select foreign countries, many of which are registered, including Echelon, Lumewave by Echelon, LumInsight, LonBuilder, LonTalk, LONWORKS, Neuron, LON, LonPoint, LonMaker, IzoT, LNS, LonManager, Digital Home, and NodeBuilder.

Employees

As of February 28, 2018, we had 74 employees worldwide. About 49 employees are located at our headquarters in California and 12 employees are located in other offices throughout the United States. Our remaining employees are located in five countries worldwide, with the largest concentrations in China, Hong Kong, the Netherlands, and the United Kingdom. None of our employees are represented by a labor union. We have not experienced any work stoppages and we believe relations with our employees are good.

Where to Find More Information

We make our public filings with the Securities and Exchange Commission, or SEC, including our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all exhibits and amendments to these reports, available free of charge at our website, www.echelon.com, as soon as reasonably practicable after we file such material with the SEC. These materials are located in the "Investor Relations" portion of our Web site under the link "SEC Filings." The inclusion of our Web site address in this report does not include or incorporate by reference into this report any information on our Web site. Copies of our public filings may also be obtained from the SEC Web site at www.sec.gov.

Executive Officers of the Registrant

Ronald Sege, age 60, has been our President and Chief Executive Officer and a member of our board of directors since August 2010. He has been Chairman of the Board of Directors since October 2011. Prior to joining Echelon, he was President and Chief Operating Officer of 3Com Corporation from 2008 to 2010. He held the position of President and CEO of Tropos Networks from 2004 to 2008, and was the President and CEO of Ellacoya Networks from 2001 to 2004. Earlier in Mr. Sege's career, he was Executive Vice President at Lycos from 1998 to 2001 and he spent 10 years at 3Com holding various Executive Vice President and Vice President positions. Mr. Sege received his B.A. in Economics from Pomona College and earned an M.B.A. from the Harvard Business School.

Christopher Jodoin, age 52, was appointed Senior Vice President of Operations and Planning in January 2016 and served as Vice President of Operations and Planning from January 2015 to January 2016. Prior to that, he held various financial and operational positions at Echelon and played a key role in the divestiture of our Grid division in 2014.

Prior to joining Echelon in 2012, Mr. Jodoin was Vice President of Integration at InVentiv Health. He also held a variety of senior financial and operational positions at Hewlett Packard and 3Com Corporation. Mr. Jodoin received a B.A in Economics from Boston College and an M.B.A from Northeastern University.

Andrew Lovit, age 57, has been our Senior Vice President of Worldwide Sales since September 2017. He joined Echelon from Procera Networks, where he served as Senior Vice President of Global Sales and Services from 2014 to 2017. Prior to that, Mr. Lovit served as Senior Vice President of Global Field Operations for Fortress Solutions. He has also held Vice President of Sales and Field Operations roles at Bivio Networks, Ericsson, SkyStream Networks, Paradyne Corporation, and 3Com. Mr. Lovit holds a Bachelor of Science degree in Business Administration from The Ohio State University.

C. Michael Marszewski, age 50, has been our Vice President and Chief Financial Officer since April 2015. Since joining Echelon in 1999, Mr. Marszewski has served in a variety of financial positions, including most recently Vice President Corporate Controller and Chief Accounting Officer, and has played important roles in strategic projects including acquisitions, divestitures, and private placement of securities. Prior to joining Echelon, Mr. Marszewski held positions at Stanford Telecommunications, National Semiconductor, and Arthur Andersen LLP. He earned his Bachelor's Degree in Accounting at Santa Clara University.

Sohrab Modi, age 57, was appointed Senior Vice President, Engineering and Chief Technology Officer in March 2017 and has served as Vice President and CTO since February 2015 and CTO since joining Echelon in September 2014. Prior to joining our company Mr. Modi was Vice President and Chief Technology Officer at Futurewei, a division of Huawei. From 1999 to 2008, Mr. Modi held senior Engineering and General Management positions at Sun Microsystems, including Vice President in the Chief Technology Office. Previously, Mr. Modi held engineering management roles at Novell. Mr. Modi holds a B.S. degree in Physics from the University of Mumbai and an M.S. degree in Computer Science from the Rochester Institute of Technology.

Alicia Jayne Moore, age 58, our Senior Vice President, Chief Legal and Administration Officer and Secretary to the Board of Directors, joined Echelon on July 15, 2013. Prior to joining our company, Ms. Moore provided strategic legal and business consulting services to several public and private companies and foundations from 2008 to 2013. Prior to that, Ms. Moore was the Vice President, Corporate Business Development, General Counsel and Secretary for Extreme Networks, Inc. She also served as General Counsel for AristaSoft, Inc. and Adaptec, Inc. Ms. Moore practiced law as an associate in the law firms of Coudert Brothers, LLP and Ware & Friedenrich, LLP (now DLA Piper). Ms. Moore received an A.B degree in International Relations from Stanford University, and her law degree from U.C.L.A. School of Law.

ITEM 1A. RISK FACTORS

Investing in our common stock involves a high degree of risk. Interested persons should carefully consider the risks described below in evaluating our company. Additional risks and uncertainties not presently known to us, or that we currently consider immaterial, may also impair our business operations. If any of the following risks actually occur, our business, financial condition or results of operations could be materially adversely affected. In that case, the trading price of our common stock could decline. Before deciding to purchase, hold or sell our common stock, you should carefully consider the risks described in this section. This section should be read in conjunction with the condensed consolidated financial statements and accompanying notes thereto, and Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are included in this Annual Report on Form 10-K.

There can be no guarantee that the IIoT market in general, and the lighting market segment in particular, will develop as expected, or that we will be successful in pursuing these market opportunities.

We have devoted and will continue to devote significant effort and resources to leverage our technology and develop and launch our platform to customers within the IIoT market. However, to date, the market for our products has not developed as quickly as anticipated, and our efforts to capitalize on these opportunities have not produced the results we anticipated. Our efforts to capitalize on these opportunities may not be successful in the near term, or at all.

Although revenues from our legacy embedded systems products have been increasing in recent quarters, prior to 2017 they had been declining annually for several years. We cannot guarantee that the recent improvement in sales of these

products will continue.

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We have decided to focus heavily on lighting controls within the IIoT as our targeted market. As we have a limited operating history in this market segment, we are subject to a number of risks and uncertainties that may impact our ability to gain market acceptance for our lighting control products.

In recent years, we have invested substantial resources in the development and commercialization of control networking solutions for the lighting market. However, we have a limited operating history in this market segment, and we may not recognize a meaningful amount of revenues from these efforts in the near future, or at all. Our efforts to gain market acceptance for our lighting control products and solutions are subject to considerable risk and uncertainty, including:

- the risk of competition and emerging technologies (see “If we do not develop and maintain adequate distribution channels, our revenues will be harmed” for additional information on the risks associated with competing for market share);
- the risk that we will not be able to develop adequate sales channels for these new products and services (see “Our IIoT revenues may not meet expectations, which could cause volatility in the price of our stock” for additional information on the risks associated with establishing new sales channels);
- the risk that we misjudge the market and fail to develop solutions that meet the requirements of our existing or potential customers;
- the risk that our solutions will suffer security breaches or otherwise allow unauthorized access to, or acquisition of, data;
- the risk that our products will not perform adequately due to defect or misuse by customers (see “Liabilities resulting from defects in or misuse of our products, whether or not covered by insurance, may delay our revenues and increase our liabilities and expenses” for additional information on the risks associated with defective or misused products); and
- the risk that our supply chain for components is unable to meet our demand (see “Because we depend on a limited number of key suppliers and in certain cases, a sole supplier, the failure of any key supplier to produce timely and compliant products could result in a failure to ship products, or could subject us to higher prices, which would harm our results of operations and financial position” for additional information on the risks associated with manufacturing).

We have changed our business model significantly in recent years, which makes it difficult to evaluate our prospects and forecast our future results of operations.

Although we commenced our business in 1988, we have made significant changes to our business model in recent years. Historically, we derived all of our revenues from our embedded systems and Grid businesses. However, in 2014, we sold our Grid business, and prior to 2017, we had been experiencing a decline in revenues from our legacy embedded systems products and services, including a cessation in our shipments to Enel.

In recent years, we have shifted our focus to networking solutions for the outdoor lighting market. Unlike our legacy embedded systems products, which are typically sold to OEMs for incorporation into their products, which are then sold to their commercial and industrial customers, our lighting solutions products are more project based, being sold through energy services companies and distributors to municipalities, enterprise and educational campuses, retailers, and other end users. In addition, our outdoor lighting solutions typically generate lower overall gross margins than do our embedded systems products.

As we have a limited operating history with our lighting solutions, our ability to evaluate our current business and forecast our future results of operations and effectively assess our future prospects is subject to a number of uncertainties that may impact our ability to plan for and model future growth. Our historical revenue growth should not be considered indicative of our future performance and such growth may stagnate or decline over time. Further, in future periods, our revenues could decline for a number of reasons, including the failure to offset the expected decline in revenues from our embedded systems products by an increase in sales of our lighting solutions, changes in our pricing structure, increased competition in the IIoT market generally or in the lighting market in particular, or our failure, for any reason, to capitalize on growth opportunities. We have encountered and will continue to encounter risks and uncertainties frequently experienced by companies in rapidly changing industries. If our assumptions regarding these risks and uncertainties, which we use to plan our business, are incorrect or change, or if we do not

address these risks successfully, our operating and financial results could differ materially from our expectations, and our business could suffer.

Our revenues may not meet expectations, and our operating expenses may be higher than we anticipate, which could cause volatility in the price of our stock.

As we attempt to grow our IIoT business, we expect to commit significant resources developing new products in emerging markets. In addition, our IIoT business operates in nascent markets, such as outdoor lighting and controls, in which we have yet to build a reliable customer base. As a result, sales of our products are unpredictable and yet to be proven, and sales and marketing costs related to our products may be significant. These factors could have a negative impact on our revenues and make it difficult to project our financial results, which could cause declines and volatility in our stock price. Additionally, because we are operating

in an emerging market, risks that we are not currently able to identify are likely to materialize and could negatively impact our operations and financial condition.

Emerging markets are particularly dynamic and highly competitive, and we may lose sales to our competitors, which would harm our revenues and results of operations.

Competition in the IIoT market is intense and involves rapidly changing technologies, evolving industry standards, frequent new product introductions, industry consolidations, effective management of distribution channels, rapid changes in customer or regulatory requirements, and localized market requirements. In each of our existing and target markets, we compete with a wide array of manufacturers, vendors, strategic alliances, systems developers and other businesses. The future of our IIoT business depends significantly on our ability to react to changing customer needs by enhancing our existing products and developing new products. There can be no guarantee, however, that new products and product enhancements will be accepted by businesses and consumers. If we make investments in technologies that do not gain market acceptance, our business may not grow as anticipated. In addition, future product offerings by our competitors can render our products obsolete. Any failure to evolve with emerging technologies and our competitors could cause a loss of market share and result in declining revenues.

The principal competitive factors that affect the markets for our products include the following:

- our ability to anticipate changes in customer or regulatory requirements and to develop, or improve, our products to meet these requirements in a timely manner;
- the price and features of our products such as adaptability, scalability, functionality, ease of use, and the ability to integrate with other products;
- our product reputation, quality, performance, and conformance with established industry standards;
- our ability to expand our product line to address our customers' requirements;
- our ability to effectively manage and expand our distribution channels to address new markets for current and future products;
- our ability to meet a customer's required delivery schedules;
- a customer's willingness to do business with us because of our size and perceived concerns regarding our liquidity and financial strength relative to our competitors;
- the risk of industry consolidation, which is particularly high in emerging markets such as the IIoT;
- our customer service and support;
- warranties, indemnities, and other contractual terms; and
- customer relationships and market awareness.

Competitors for our IIoT products include some of the largest companies in the electronics industry, operating either alone or together with trade associations and partners. Key company competitors include companies such as Cimcon Lighting, Inc., Cree Inc., Digi International, General Electric, LED Roadway Lighting, Maxim Integrated Products, Philips, Siemens, Silver Spring Networks, STMicroelectronics, Telensa, Texas Instruments, and Tridium. Key industry standard and trade group competitors include BACnet, DALI, DeviceNet, HART, Konnex, Profibus, ZigBee, and the ZWave Alliance in the IIoT market. Each of these standards and/or alliances is backed by one or more competitors. For example, the ZigBee alliance includes over 300 member companies with promoter members, such as Ember, Emerson, Freescale, Kroger, Landis+Gyr (a subsidiary of Toshiba), Philips, Reliant Energy, Schneider Electric, STMicroelectronics, Tendril, and Texas Instruments. Additionally, because we are operating in an emerging market, it is likely that additional competitors could surface and rapidly gain market share.

Many of our competitors, alone or together with their trade associations and partners, have significantly greater financial, technical, marketing, service and other resources, significantly greater name recognition, and broader product offerings, all of which may impact the willingness of customers and potential customers to do business with us. Our future success will depend on our ability to enhance our existing products, to introduce new products to meet changing customer requirements and emerging technologies, and to demonstrate the performance advantages and cost-effectiveness of our products over competing products. If we are unable to do so and thus are unable to compete effectively in any of the markets we serve, our revenues, results of operations, and financial position would be harmed.

Fluctuations in our results of operations may cause our stock price to decline.

Our quarterly and annual results of operation have varied significantly from period to period, and we have sometimes failed to meet market expectations. Moreover, we have a history of losses and negative cash flow and cannot assure you that we will achieve sustained profitability in the future. We expect that our results of operations will continue to vary as a result of a number of factors, many of which are outside of our control, including the following:

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- orders may be cancelled;
- the mix of products and services that we sell may change to a less profitable mix;
- shipment, payment schedules, and product acceptance may be delayed;
- our products may not be purchased by OEMs, systems integrators, service providers and end-users at the levels we project;
- our ability to develop products that comply with future regulations and trade association guidelines;
- the revenue recognition rules relating to certain of our products could require us to defer some or all of the revenue associated with product shipments until certain conditions, such as delivery and acceptance criteria for our software and/or hardware products, are met in a future period;
- our CEMs may not be able to provide quality products on a timely basis, especially during periods where capacity in the CEM market is limited;
- our products may not be manufactured in accordance with specifications or our established quality standards, or may not perform as designed;
- downturns in any customer's or potential customer's business, or declines in general economic conditions, could cause significant reductions in capital spending, thereby reducing the levels of orders from our customers;
- we may incur costs associated with any future business acquisitions; and
- any future impairment charges related to our intangible assets that are required to be recorded under generally accepted accounting principles in the United States may negatively affect our earnings and financial condition.

Any of the above factors could, individually or in the aggregate, have a material adverse effect on our results of operations and our financial condition, which could cause our stock price to decline

If we are not able to develop or enhance our products in a timely manner, our revenues will suffer.

Due to the nature of development efforts in general, we can experience delays in the introduction of new or improved products beyond our original projected shipping date for such products. Historically, when these delays have occurred, we experienced an increase in our development costs and a delay in our ability to generate revenues from these new products. In addition, such delays could cause us to incur penalties if our deliveries are delayed, could otherwise impair our relationship with any of our customers that were relying on the timely delivery of our products in order to complete their own products or projects, or could cause the customer to cancel orders or to seek alternate sources of supply or other remedies. Any delay in the introduction of new products could impact future revenue targets or forecasts.

We are sometimes required to modify our products to meet local rules and regulations. Given the competitive nature of these markets, we may not be able to increase the price of such products to reflect the costs of such modifications. In addition, given the long-term nature of development activities, we may be required to undertake such modifications prior to receiving firm commitments or orders from our customers. In either of these or other similar scenarios, we may not be able to recover our costs attributable to required product modifications.

When we develop new products, there is no guarantee that these new products will meet our customers' requirements or will otherwise be acceptable to them, which could cause them to discontinue buying our products. This could have a material adverse effect on our revenues and results of operations.

We intend to continue investing resources in our development activities, which could expose us to risks, such as protection of intellectual property, investment risk, and labor costs and other matters. We could also be adversely affected by delays or cost increases experienced by third parties that are developing products on our behalf.

The sales cycle for our products is often lengthy and unpredictable.

The sales cycle between initial customer contact and execution of a contract or license agreement with a customer or purchaser of our products can vary widely. Initially, we must educate our customers about the potential applications of and cost savings associated with our products.

If we are successful in this effort for our embedded systems products, OEMs will typically conduct extensive and lengthy product evaluations before making a decision to design our products into their offerings. Once the OEM decides to incorporate our products, volume purchases of our products are generally delayed until the OEM's product development, system integration, and product introduction periods have been completed. In addition, changes in our customers' budgets, or the priority they assign to control network development, could also affect the sales cycle.

For our outdoor lighting controls products, the sales cycle can also be extended. As a nascent market, many of our sales channel partners, as well as end use customers, are not aware of the benefits our controls technology can bring to their lighting systems. This requires extensive educational efforts on our part and these efforts may not be successful or meet our objectives. Even with the benefit of this education, when dealing with larger projects such as to municipalities, the post-education sales cycle typically commences with a trial deployment of relatively low value to us. If the trial is successful, the end use customer may commence a full scale deployment that could take months or years to complete, if at all.

In addition, potential customers for our products, both embedded systems and outdoor lighting controls, include local, state and federal government authorities. Sales to government authorities can be extended and unpredictable.

Government authorities generally have complex budgeting, purchasing, and regulatory processes that govern their capital spending, and their spending is likely to be adversely impacted by economic conditions. In addition, in many instances, sales to government authorities may require field trials and may be delayed by the time it takes for government officials to evaluate multiple competing bids, negotiate terms, and award contracts. We further face the risk of cancellation during development and production due to regulatory, government and geopolitical changes, and delays in installing, operating, and evaluating the results of any field trials before full implementation of our products. For these reasons, the sales cycle associated with our IIoT products is subject to a number of significant risks that are beyond our control. Consequently, if our forecasted customer orders are not realized, or are delayed, our revenues and results of operations could be materially and adversely affected. In addition, an extended sales cycle may result in our inability to recognize revenue from existing or new projects until the end of several fiscal quarters. This may also make it difficult to predict our financial results and increase the volatility of our stock price.

If we do not develop and maintain adequate distribution channels, our revenues will be harmed.

The market for our products is new and unproven, and we cannot rely solely on our existing distributors to sell our products. Therefore, we are focused on expanding our distribution channel to include new distributors in order to generate revenue from product sales. We expect that the distribution channel for our products will be dispersed and it is difficult to predict how long it will take and how costly it will be to develop. We may not be successful in developing and maintaining an adequate distribution channels within our expected timeframe and cost expectations, if at all. In addition, if any of our new or existing distributor partners fail to dedicate sufficient resources to market and sell our products, our revenues could suffer. Furthermore, if our existing distributor partners were to significantly reduce their inventory levels for our products, we could expect a decrease in service levels to our end-use customers. Sales of our products may fail to meet our financial targets, which would negatively impact our results of operations and expected return on investment in the IIoT market.

We have invested and intend to continue to invest significant resources in the development and sales of products in the emerging IIoT market, particularly in the outdoor lighting market segment. If we are unable to receive orders for, ship, and recognize revenue for our products in a timely manner, and in the quantities and at prices in line with our targets, our financial results will be harmed. Our long-term financial goals include expectations for a return on these investments, but we may or may not ever realize any return whatsoever on this investment of resources.

Over the last several years, our market share in our existing embedded systems business has declined due to increased competition, reduced levels of investment in our LONWORKS product line, and pricing pressures faced around the world. However, during 2017, our embedded systems revenues grew across a broad base of customer applications, ranging from semiconductor manufacturing monitoring, to building automation, HVAC controls, and more. We believe this trend may be taking hold and working to Echelon's benefit, as companies expand into IIoT deployments and leverage LONWorks' capability.

Prior to 2017, annual revenues generated from our embedded systems business failed to meet our expectations. If this revenue decline were to return, our ability to continue funding our entry into the outdoor lighting segment could be harmed.

In order to achieve our financial targets, we believe that we must meet the following objectives:

- achieve acceptance of our products in the IIoT market, particularly the outdoor lighting market, in order to increase our revenues;

- manage our operating expenses to a reasonable percentage of revenues; and
- manage our cash resources prudently.

Even if we meet these objectives, there can be no assurance that we will meet our overall financial targets and objectives.

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A significant portion of our operating expenses are fixed. Therefore, if we cannot achieve our revenue targets, our use of cash balances would increase, our losses would increase, and/or we would be required to take additional actions necessary to reduce expenses. We cannot assure you that we will meet any or all of these objectives to the extent necessary to achieve our financial goals and, if we fail to achieve our goals, our results of operations are likely to be harmed.

In our legacy embedded systems business, we may be unable to promote and expand acceptance of our open, interoperable control systems over competing protocols, standards, or technologies.

LONWORKS and IzoT technology are open, meaning that many of our technology patents are broadly licensed without royalties or license fees. As a result, our IIoT customers are able to develop hardware and software solutions that compete with some of our products. Because some of our customers are OEMs that develop and market their own control systems, these customers, in particular, could develop competing products based on our open technology. For instance, we have published all of the network management commands required to develop software that competes with our LNS software.

In addition, many of our IIoT competitors are dedicated to promoting closed or proprietary systems, technologies, software and network protocols or product standards that differ from or are incompatible with ours. We also face strong competition from large trade associations that promote alternative technologies and standards for particular vertical applications or for use in specific countries. These include BACnet, DALI, and KNX in the buildings market; DeviceNet, HART, and ProfiBus in the industrial controls market; TCN in the rail transportation market; and Echonet, ZigBee, and Z-Wave in the home control markets.

The ability of our IIoT products to interoperate with multiple standards is important to our success. Our technologies, protocols, or standards may not be successful or we may decide not to invest our resources at the levels required in order to compete with new or enhanced products or standards introduced by our IIoT product line competitors, which would have a material adverse effect on our revenues, results of operations, and financial condition.

We are increasingly dependent on third-party developers.

We are increasingly reliant on various third parties for the development of software used in our products. There is a risk that the software provided by these third parties could contain errors or defects that could adversely impact the quality of our products. In addition, these third parties may use open source or other code that contains security flaws, which may cause our products to be more prone to hacking or other security incidents. We may also be negatively impacted by employee turnover or other challenges that these third-party developers face in their own businesses. Third parties may also choose not to develop software for our products if we do not have adequate market share or sufficient perception of future success. The materialization of any of these risks would impact our ability to deliver quality products on a timely basis, which could adversely impact our reputation and brand and harm our business and results of operations.

In addition, many of these third-party developers are located in markets that are subject to political risk, intellectual property misappropriation, corruption, infrastructure problems and natural disasters, in addition to country specific privacy and data security risks, given current legal and regulatory environments. The failure of these third parties to meet their obligations and adequately deploy business continuity plans in the event of a crisis and/or the development of significant disagreements, natural or man-made disasters or other factors that materially disrupt our ongoing relationship with these developers could negatively affect our operations.

Because we depend on a limited number of key suppliers and, in certain cases, a sole supplier, the failure of any key supplier to produce timely and compliant products could result in a failure to ship products, or could subject us to higher prices, which would harm our results of operations and financial position.

Our future success will depend significantly on our ability to timely manufacture our products cost effectively, in sufficient volumes, and in accordance with quality standards. For most of our products requiring assembly, we rely on a limited number of contract electronic manufacturers (CEMs), principally Bel-Fuse. These CEMs procure material and assemble, test, and inspect the final products to our specifications. This strategy involves certain risks, including reduced control over quality, costs, delivery schedules, availability of materials, components, finished products, and manufacturing yields. For example, an extended delay in the supply of a key component could disrupt the

manufacturing of our products. Any such interruption in the supply of key components could therefore have a material adverse effect on our customer relationships and revenues. As a result of these and other risks, our CEMs could demand price increases for manufacturing our products. The Bel-Fuse factories, where our products are manufactured, are located in China. The Chinese government maintains programs, whereby labor rates for the manufacture of our products will increase over time. In addition, our agreements with our CEMs make us responsible for components and subassemblies purchased by the CEMs when based on our forecasts or purchase orders. Accordingly, we will be at risk for any

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excess and obsolete inventory purchased by our CEMs. Lastly, CEMs can experience turnover, instability, and lapses in manufacturing or component quality, exposing us to additional risks as well as missed commitments to our customers.

We also maintain manufacturing agreements with a limited number of semiconductor manufacturers for the production of key products. Cypress Semiconductor is the sole licensee, manufacturer and distributor for the Cypress Neuron, which is an important part of the LONWORKS portfolio. As a result, we or our customers may experience longer lead times and higher pricing for these parts, which could result in reduced orders for our products from these same customers. In addition, Cypress Semiconductor could decide to reduce or cease production of the Neuron chip in the future, at any time, with or without advance notice to us.

The FT 5000 free topology transceiver and the Neuron 5000 are sole sourced from the Taiwan Semiconductor Manufacturing Company (TSMC) foundry through our aggregator Open Silicon. In addition, we currently purchase several key products and components from sole or limited source suppliers with which we do not maintain signed agreements that would obligate them to supply to us on negotiated terms. Any sole source relationship could make us vulnerable to price increases, particularly where we do not maintain long-term supply agreements with the supplier, or to supply disruptions that would result if the supplier issued an end of life notice with respect to a key product.

We are continuing to review the impact that economic factors are having on our suppliers. Some of these suppliers are large, well-capitalized companies, while others are smaller and more highly leveraged. In order to mitigate these risks, we may take actions such as increasing our inventory levels and/or adding additional sources of supply. Such actions may increase our costs and increase the risk of excess and obsolete inventories. Even if we undertake such actions, there can be no assurance that we will be able to prevent any disruption in the supply of goods and services we receive from these suppliers.

We may also elect to change any of these key suppliers. As part of such a transition, we may be required to purchase certain raw material and in-process inventory from the existing supplier and resell it to the new source. In addition, if any of our key suppliers were to stop manufacturing our products or supplying us with our key components, it could be expensive and time consuming to find a replacement. Also, as our business grows, we will be required to expand our business with our key suppliers or find additional sources of supply. There is no guarantee that we would be able to find acceptable alternative or additional sources. Additional risks that we face if we must transition between CEMs include:

- moving raw material, in-process inventory, and capital equipment between locations, some of which may be in different parts of the world;

- reestablishing acceptable manufacturing processes with a new work force; and

- exposure to excess or obsolete inventory held by contract manufacturers for use in our products.

The failure of any key manufacturer to produce a sufficient number of products on time, at agreed quality levels, and fully compliant with our product, assembly and test specifications could result in our failure to ship products in a timely manner or at all, which would adversely affect our revenues and gross profit, and could result in claims against us by our customers, which could harm our results of operations and financial position. Any such failures could also have a negative impact on our ability to project our financial results, which could result in volatility in our stock price. Because our products use components or materials that may be subject to price fluctuations, shortages, interruptions of supply, or discontinuation, we may be unable to ship our products in a timely fashion, which would adversely affect our revenues, harm our reputation, and negatively impact our results of operations.

We may be vulnerable to price increases for products, components, or materials, such as silver, copper, and cobalt. We generally do not enter into forward contracts or other methods of hedging against supply risk for these items. In addition, we have in the past and may in the future experience shortages or interruptions in supply for certain of these items, including products or components that have been or will be discontinued, which can cause us to delay shipments beyond targeted or announced dates. We have also reduced our inventory levels from historical levels, which could impact our ability to supply our customers with products in a timely manner if there was an unexpected increase in demand. Such shortages or interruptions could result from events outside our control, as was the case with

the earthquake and tsunami in Japan in March 2011. To help address these issues, we may decide from time to time to purchase quantities of these items that are in excess of our estimated requirements. As a result, we could be forced to increase our excess and obsolete inventory reserves to provide for these excess quantities, which could harm our results of operations. In addition, if a component or other product goes out of production, we may be required to requalify substitute components or products, or even redesign our products to incorporate an alternative component or product.

If we experience any shortage of products or components of acceptable quality, or any interruption in the supply of these products or components, or if we are not able to procure them from alternate sources at acceptable prices and within a reasonable

period of time, our revenues, gross profits or both could decrease. In addition, under the terms of some of our contracts with our customers, we may also be subject to penalties if we fail to deliver our products on time.

Our business depends on the Internet and its continued and unimpeded access and development.

The Internet is crucial to the operations of many of our IIoT products and is a key component of the IIoT market as a whole. Our reliance on the Internet exposes us to a number of risks and uncertainties that are beyond our control, including risks related to privacy and data security. It is difficult to quantify the impact that any future security or performance problems associated with the Internet may have on our products and revenues.

In addition, state, federal and foreign regulators could adopt laws and regulations that impose additional burdens on companies that conduct business over the Internet. The growth and development of the market for online services may prompt calls for more stringent consumer protection laws or laws that may inhibit the use of Internet-based communications or the information contained in these communications. The adoption of any additional laws or regulations may impact the growth of the IIoT market. Any new legislation or regulations, application of laws and regulations from jurisdictions whose laws do not currently apply to our business, or application of existing laws and regulations to the IIoT and other related services could increase our costs and harm our growth.

In particular, there is increasing focus on privacy and data security laws and regulations applicable to the IoT. A wide variety of provincial, state, national, and international laws and regulations apply to the collection, use, retention, protection, disclosure, transfer and other processing of personal data. Regulatory authorities have increased their privacy- and data security-related activity in the IoT domain in recent years. For example, the Federal Trade Commission released a report on January 27, 2015 with recommendations for privacy and data security applicable to connected devices, objects and sensors. We also may become obligated to comply with, or may choose to comply with, self-regulatory or other requirements applicable to privacy or data security.

The privacy- and data security-related laws and regulations that may apply to us are evolving and subject to differing interpretation and enforcement, and may result in ever-increasing regulatory and public scrutiny and escalating levels of enforcement and sanctions. For example, the European Union General Data Protection Regulation, which becomes fully effective in May 2018, imposes more stringent data protection requirements and provides for greater penalties for noncompliance. Our actual or perceived failure to comply with applicable laws and regulations or other actual or alleged obligations relating to privacy or data security, or to protect personal data, could result in regulatory investigations or regulatory enforcement actions and remedies against us, including fines, imprisonment of company officials and public censure, private litigations, claims for damages, damage to our reputation and loss of goodwill (both in relation to existing end use customers and prospective end use customers), any of which could have a material adverse effect on our operations, financial performance, and business.

If our IIoT 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 IIoT products, including our outdoor lighting solutions products, 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 are dependent on technology systems and third-party content that are beyond our control.

Our success in the IIoT market will depend in part on the availability of online services and Internet connections to facilitate data transmission. In most instances, these services will be provided by third parties and will be outside of our control. Even when we are not responsible for connectivity or other problems, users of our products may attribute the problem to us. For example, many of our customers rely on the capacity, reliability and security of wireless networks owned and controlled by third parties to use our IIoT products. However, the price of access and operational integrity of online services, wireless networks and Internet connections are beyond our control. As a result, it may be difficult to identify the source of problems if they occur. This could diminish our brand and harm our business, divert the attention of our technical personnel from our product development efforts or cause significant customer relations problems.

Information Technology system security failures, cyber-attacks, and other technological breaches could cause harms to our business.

We also rely on the security of our third party providers to protect our proprietary information and information of our customers. Information technology system failures, including a breach of our or our third party providers' data security, could disrupt our ability to function in the normal course of business by potentially causing, among other things, an unintentional disclosure of customer information. Despite our implementation of security measures or those of our third party providers, information systems may be vulnerable to threats such as computer hacking, cyber-terrorism or other unauthorized attempts by third parties to access, modify or delete our or our customers' data or otherwise disrupt our systems. Any such breach could have a material adverse effect on our business, results of operations, and our reputation as a provider of data collection, and secure and reliable device connection, collaboration and communications solutions, including legal claims for damages or injunctive relief under state, federal and foreign laws, reputational damage, and decreased revenues.

We have designed our IIoT products and solutions products 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 continues to evolve in scope and frequency.

We face operational and other risks associated with our international operations, which may adversely affect our revenues, results of operations, and financial condition.

We have operations located in seven countries and our products are sold in many more countries around the world. Revenues from international sales, which include both export sales and sales by international subsidiaries, accounted for about 60.9% and 68.2% of our total revenues for the years ended December 31, 2017 and 2016, respectively. We expect that international sales will continue to constitute a significant portion of our total revenues. Given our high dependency on sales of our products into Europe, the ongoing financial crisis in that region, which may be adversely impacted by the "Brexit" vote in the United Kingdom, could adversely affect our financial results.

Other risks inherent in our international business activities include, but are not limited to, the following:

• timing of and costs associated with localizing products for foreign countries and lack of acceptance of non-local products in foreign countries;

• that the nature and composition of our products may subject us to any number of additional legal requirements, which might include, but are not limited to, data privacy regulations, import/export regulations and other similar requirements;

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challenges in managing international operations;
the burdens of complying with a wide variety of foreign laws and any related implementation costs;
the applicability of foreign laws that could affect our business or revenues, such as laws that purport to require that we return payments that we received from insolvent customers in certain circumstances; and unexpected changes in regulatory requirements, tariffs, and other trade barriers;
cultural differences that could make it more difficult to sell our products or could result in allegations that sales activities have violated the U.S. Foreign Corrupt Practices Act or similar laws that prohibit improper payments in connection with efforts to obtain business;
exchange rate fluctuations;
the imposition of tariffs or other trade barriers on the importation of our products;
potentially adverse tax consequences, including restrictions on repatriation of earnings;
economic and political conditions in the countries where we do business;
differing vacation and holiday patterns in other countries, particularly in Europe;
increased costs of labor, particularly in China;
labor actions generally affecting individual countries, regions, or any of our customers, which could result in reduced demand for, or could delay delivery or acceptance of, our products; and
international terrorism.

Any of these factors could have a material adverse effect on our revenues, results of operations, and our financial condition.

Our executive officers and technical personnel are critical to our business and the loss of one or more key employees or our inability to attract and retain qualified personnel could harm our business.

Our success depends substantially on the performance of our executive officers and key employees. Due to the specialized technical nature of our business and limited staff, we are particularly dependent on our Chief Executive Officer and other executive officers, as well as our technical personnel. Our future success will depend on our ability to attract, integrate, motivate and retain qualified executive, managerial, technical, sales, and operations personnel, particularly given the overall economic climate and the emphasis on reducing expenses at our company.

Competition for qualified personnel in our business areas is intense, and we may not be able to continue to retain qualified executive officers and key personnel and attract new officers and personnel when necessary. Our product development and marketing functions are largely based in Silicon Valley, which is a highly competitive marketplace. It may be particularly difficult to recruit, relocate and retain qualified personnel in this geographic area. Moreover, the cost of living, including the cost of housing, in Silicon Valley is known to be high. Because we are legally prohibited from making loans to executive officers, we will not be able to assist potential key personnel as they acquire housing or incur other costs that might be associated with joining our company. We may need to invest significant amounts of cash and equity to attract and retain new employees and expend significant time and resources to identify, recruit, train, and integrate such employees, and we may never realize returns on these investments. In addition, if we lose the services of any of our key personnel and are not able to find suitable replacements in a timely manner or fail to adequately plan for the succession of key personnel, our business could be disrupted, other key personnel may decide to leave, and we may incur increased operating expenses in finding and compensating their replacements. If we are unable to obtain additional funds when needed, our business could suffer.

For the last several years, our combined cash, cash equivalent, and short-term investment balance has declined. As we continue to implement our long-term strategic focus on the IIoT business, including the outdoor lighting controls market, this trend may continue.

As our cash balances decline, customers or potential customers may become less interested in doing business with us, or we may not satisfy the financial criteria they have established for their suppliers. In addition, from time to time we may also decide to use a portion of our cash balances to settle alleged warranty issues that may arise with our customers or, as noted under the heading "Legal Proceedings," in connection with litigation. We may do so even if we do not believe we have liability to our customers or in connection with such litigation, in order to limit our risk, reduce outlays to third party providers, and for administrative convenience. In the future, to the extent that our revenues grow or as we may determine necessary to maintain adequate supply levels, we may experience higher levels of inventory

and accounts receivable, which will also use our cash balances. In addition, to the extent we plan to make alternate uses of our facilities, we may incur additional cash expenditures. We may also use our cash reserves to strategically acquire or invest in other companies, products, or technologies that are complementary to our business. Lastly, our combined cash, cash equivalents, and short-term investment balances could be negatively affected by the various risks and uncertainties that we face, especially in light of our focus on the nascent and emerging IIoT things market, and any changes in our planned cash outlay could negatively affect our existing cash reserves.

There can be no assurance that we will be able to obtain financing on terms acceptable to us, or at all, in the future. In addition, if we do not meet our revenue targets, our use of our cash balances would increase due to the fact that a significant portion of our operating expenses are fixed. If we are not able to obtain additional financing when needed, or on acceptable terms, our ability to support our business growth, invest in additional research and development and sales and marketing, or respond to business opportunities, challenges, or other circumstances could be adversely affected, and our business may be harmed.

Our current stock price and corresponding market valuation could give rise to stockholder activism or hostile takeover attempts, which could be harmful to our business.

Because the current trading price of our common stock and aggregate market capitalization are low, there is a risk that we could face stockholder activism or hostile takeover attempts, which could divert management's attention from its strategic plan to build stockholder value through the expansion of our lighting solutions business. If the IIoT market in general, and the outdoor lighting market segment in particular, do not materialize as anticipated, if our control networking solutions and other product offerings are not accepted and utilized, or if we are subject to a hostile takeover at a depressed valuation, we may have to devote a significant amount of time and resources to address these matters without any return on our investment. This could cause us to suffer significant financial losses and could also have a negative impact on our reputation and results of operations, any of which would likely cause our stock price to decline.

Voluntary and/or industry standards and governmental regulatory actions in our markets could limit our ability to sell our products.

Standards bodies, which are formal and informal associations that attempt to set voluntary, non-governmental product standards, are influential in many of our target markets. We participate in many voluntary and/or industry standards organizations around the world in order to help prevent the adoption of exclusionary standards as well as to promote standards for our products. However, we do not have the resources to participate in all standards processes that may affect our markets, and our efforts to influence the direction of those standards bodies in which we do participate may not be successful. Many of our competitors have significantly more resources focused on standards activities and may influence those standards in a way that would be disadvantageous to our products and thereby make it difficult for us to achieve our business and financial objectives.

Many of our products and the industries in which they are used are subject to U.S. and foreign regulation. In addition, the markets for our IIoT products may experience a movement towards standards based protocols driven by governmental action, such as those being considered in the U.S. by the National Institute of Standards and Technology. To the extent that we do not adopt such protocols or do not succeed in achieving adoption of our own protocols as standards or de facto standards, sales of our IIoT products may be adversely affected. Moreover, even if our own protocols are adopted as standards, we run the risk that we could lose business to competing implementations.

The adoption of voluntary and/or industry standards or the passage of governmental regulations, for example by state utility commissions or national regulatory bodies such as Federal Energy Regulatory Commissions in the United States and PTB or BSI in Germany, that are incompatible with our products or technology could limit the market opportunity for our products or result in increased costs, which could harm our revenues, results of operations, and financial condition.

We are subject to numerous governmental regulations concerning the manufacturing and use of our products. We must stay in compliance with all such regulations and any future regulations. Any failure to comply with such regulations, and the unanticipated costs of complying with future regulations, may adversely affect our business, financial condition, and results of operations.

We manufacture and sell products incorporating electronic components that may contain materials that are subject to government regulation in the locations in which our products are manufactured and assembled, as well as the locations where we sell our products. Since we operate on a global basis, maintaining compliance with regulations concerning

the materials used in our products is a complex process that requires continual monitoring of regulations and ongoing compliance procedures. For example, in 2012 the European Union issued recast regulations regarding the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment ("RoHS"), and in 2014, the SEC rules requiring companies to publicly disclose their use of "conflict minerals" that originated in the Democratic Republic of the Congo (DRC) or an adjoining country also become effective. The adoption of any unanticipated new regulations that significantly impact the various components we use or require that we use more expensive components would have a material adverse impact on our business, financial condition and results of operations.

Our reliance on third-party manufacturers exposes us to the risk that conflict minerals that are contained in our products have originated in the DRC or an adjoining country. We have incurred and expect to incur additional costs to comply with the disclosure

requirements. Moreover, the implementation of these requirements could adversely affect the sourcing, availability and pricing of materials used in the manufacture of our products to the extent that there may be only a limited number of suppliers offering “conflict free” minerals that can be used in our products. There can be no assurance that we will be able to obtain such minerals in sufficient quantities or at competitive prices. We may also encounter customers who require that all of the components of our products be certified as conflict free. If we are not able to meet customer requirements, such customers may choose to not purchase our products, which could impact our sales.

Our manufacturing processes, including the processes used by our suppliers, are also subject to numerous governmental regulations that cover both the use of various materials as well as environmental concerns. Since we and our suppliers operate on a global basis, maintaining compliance with regulations concerning our production processes is also a complex process that requires continual monitoring of regulations and ongoing compliance procedures. For example, environmental issues such as pollution and climate change have seen significant legislative and regulatory interest on a global basis. Changes in these areas could directly increase the cost of energy, which may have an impact on the way we or our suppliers manufacture products or use energy to produce our products. In addition, any new regulations or laws in the environmental area might increase the cost of raw materials we use in our products. We are currently unable to predict how any such changes will impact us and if any such impact could be material to our business. Any new law or regulation that significantly increases our costs of manufacturing or causes us or our suppliers to significantly alter the way that our products are manufactured would have a material adverse effect on our business, financial condition and results of operations.

Liabilities resulting from defects in or misuse of our products, whether or not covered by insurance, may delay our revenues and increase our liabilities and expenses.

Our products are manufactured with highly complex electronic components and may, as a result, contain or may be alleged to contain errors or failures, including those relating to actual or potential security breaches. In addition, our customers or their installation partners may improperly install or implement our products, which could delay completion of a deployment or hinder our ability to win a subsequent award. Furthermore, because of the low cost and interoperable nature of our IIoT products, LONWORKS technology could be used in a manner for which it was not intended.

Even if we determine that an alleged error or failure in our products does not exist, we may incur significant expense and shipments and revenues may be delayed while we analyze the alleged error or failure. If errors or failures are found in our products, we may not be able to successfully correct them in a timely manner, or at all, and our reputation may suffer. Such errors or failures could delay our product shipments and divert our engineering resources while we attempt to correct them. In addition, we could decide to extend the warranty period, or incur other costs outside of our normal warranty coverage, to help address any known errors or failures in our products and mitigate the impact on our customers. For example, we could decide to replace defective products at a cost that is significantly higher than the value of the original products. This could delay our revenues and increase our expenses.

To address these issues, the agreements we maintain with our customers may contain provisions intended to limit our exposure to potential errors and omissions claims as well as any liabilities arising from them. However, our customer contracts may not effectively protect us against the liabilities and expenses associated with errors or failures attributable to our products.

Defects in our products may also cause us to be liable for losses in the event of property damage, harm or death to persons, claims against our directors or officers, and the like. For example, our outdoor lighting control products operate in a variety of settings under diverse conditions that may present the risk of product failure, which could subject us to liability. For instance, a failure of our automated smart lighting product used by a customer to enhance security could subject us to liability in the event of unlawful activity by third parties. Moreover, our IIoT products may present risks beyond our control such as operational misuse that could ultimately subject us to liability. Such liabilities could harm our reputation, expose our company to liability, and adversely affect our operating results and financial position.

To help reduce our exposure to these types of liabilities, we currently maintain property, general commercial liability, errors and omissions, directors and officers, and other lines of insurance. However, it is possible that such insurance may not be available in the future or, if available, may be insufficient in amount to cover any particular claim, or we might not carry insurance that covers a specific claim. In addition, we believe that the premiums for the types of

insurance we carry will continue to fluctuate from period to period. Significant cost increases could also result in increased premiums or reduced coverage limits. Consequently, if we elect to reduce our coverage, or if we do not carry insurance for a particular type of claim, we will face increased exposure to these types of claims.

We may be unable to realize the benefits of our net operating loss carry-forwards (“NOLs”).

NOLs may be carried forward to offset federal and state taxable income in future years and eliminate income taxes otherwise payable on such taxable income, subject to certain adjustments. Based on current federal and state corporate income tax rates, our NOLs and other carry-forwards could provide a benefit to us, if fully utilized, of significant future tax savings. However, our ability to use these tax benefits in future years will depend upon the amount of our otherwise federal and state taxable income. If we do not have sufficient federal and state taxable income in future years to use the tax benefits before they expire, we will lose the benefit of these NOLs permanently. Consequently, in addition to dependence on the generation of future business profits, our ability to use the tax benefits associated with our substantial NOLs will depend significantly on our success in identifying suitable acquisition or investment candidates, and once identified, successfully consummating an acquisition of or investment in these candidates.

Additionally, federal NOLs are subject to annual limitations under the change of ownership rules within Section 382 of the Internal Revenue Code. In general, an ownership change occurs when the percentage of stock held by one or more 5-percent shareholders increases by more than 50 percentage points over the lowest stock ownership held by such shareholders at any time within a prescribed period, usually three years. If an ownership change were to occur, we may be unable to use a significant portion of our NOLs to offset taxable income. As discussed in Note 7 to our consolidated financial statements included in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission in March 2017, on April 22, 2016, the Company's Board of Directors adopted a Tax Benefit Preservation Plan ("Tax Plan") intended to reduce the likelihood that changes in the Company's investor base have the unintended effect of limiting the Company's use of its tax benefits. The Tax Plan is intended to require any person acquiring shares of the Company's securities equal to or exceeding 4.99% of the Company's outstanding shares to obtain the approval of the Board of Directors. This would protect the tax benefits because changes in ownership by a person owning less than 4.99% of the Company's stock are considered and included in one or more public groups in the calculation of "ownership change" for purposes of Section 382 of the Code. However, there can be no assurance that the Tax Plan would be effective under all circumstances. Moreover, the Tax Plan, as amended on April 17, 2017, will expire on April 25, 2019, unless renewed by our Board of Directors.

The amount of NOLs that we have claimed has not been audited or otherwise validated by the U.S. Internal Revenue Service ("IRS"). The IRS could challenge our calculation of the amount of our NOLs or our determinations as to when a prior change in ownership occurred, and other provisions of the Internal Revenue Code may limit our ability to carry forward our NOLs to offset taxable income in future years. If the IRS was successful with respect to any such challenge, the potential tax benefit of the NOLs to us could be substantially reduced.

Lastly, in December 2017, the Tax Cuts and Jobs Act ("the Act") was signed into law. Among other changes is a permanent reduction in the federal U.S. corporate income tax rate from 35% to 21%, effective January 1, 2018. As a result of the change in the corporate income tax rate, the value of our NOLs has decreased.

We have limited ability to protect our intellectual property rights.

Our success depends significantly upon our intellectual property rights, which can vary significantly from jurisdiction to jurisdiction. We rely on a combination of patent, copyright, trademark and trade secret laws, non-disclosure agreements and other contractual provisions to establish, maintain and protect these intellectual property rights, all of which afford only limited protection, particularly in those countries that lack robust or accessible enforcement mechanisms. For example, we have in the past and may in the future form joint ventures with foreign companies, including those in China, where intellectual property mechanisms are generally less stringent than those found in the U.S. We have also outsourced certain development activities to third parties. If any of our patents fail to protect our technology, or if we do not obtain patents in certain countries, our competitors may find it easier to offer equivalent or superior technology. In addition, our trade secrets or other intellectual property that we license to third parties could be used improperly or otherwise in violation of the license terms.

We have also registered or applied for registration for certain trademarks, and will continue to evaluate the registration of additional trademarks as appropriate. If we fail to properly register or maintain our trademarks, or to otherwise take all necessary steps to protect our trademarks, the value associated with the trademarks may diminish. In addition, if we fail to protect our trade secrets or other intellectual property rights, we may not be able to compete as effectively in

our markets.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or services or use information that we regard as proprietary, or it may not be economically feasible to enforce them. Any of our patents, trademarks, copyrights, trade secrets, or intellectual property rights could be challenged, invalidated or circumvented. In addition, we cannot assure you that we have taken or will take all necessary steps to protect our intellectual property rights. Third parties may also independently develop similar technology without breach of our trade secrets or other proprietary rights. In addition, the laws of some foreign countries, including several in which we operate or sell our products, do not protect proprietary rights to as great an extent as do the laws of the United States, and it may take longer to receive a remedy from a court outside of

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the United States. Also, some of our products are licensed under shrink-wrap license agreements that are not signed by licensees and therefore may not be binding under the laws of certain jurisdictions.

From time to time, litigation may be necessary to defend and enforce our proprietary rights. As a result, we could incur substantial costs and divert management resources, which could harm our business, regardless of the final outcome. Despite our efforts to safeguard and maintain our proprietary rights both in the United States and abroad, we may be unsuccessful in doing so. Also, the steps that we take to safeguard and maintain our proprietary rights may be inadequate to deter third parties from infringing, misusing, misappropriating, or independently developing our technology or intellectual property rights, or to prevent an unauthorized third party from misappropriating our products or technology.

Our business may suffer if it is alleged or found that our products infringe the intellectual property rights of others, or if we are unable to secure rights to use the intellectual property rights of others on reasonable terms.

We may be contractually obligated to indemnify our customers or other third parties that use our products in the event our products are alleged to infringe a third party's intellectual property rights. From time to time, we may also receive notice that a third party believes that our products may be infringing patents or other intellectual property rights of that third party. Responding to those claims, regardless of their merit, can be time consuming, result in costly litigation, divert management's attention and resources, and cause us to incur significant expenses. We do not insure against infringement of a third party's intellectual property rights.

As the result of such a claim, we may elect or be required to redesign our products that are alleged to infringe the third party's patents or other intellectual property rights, which could cause those product offerings to be delayed. Or we could be required to cease distributing those products altogether. In the alternative, we could seek a license to the third party's intellectual property. Even if our products do not infringe, we may elect to take a license or settle to avoid incurring litigation costs. However, it is possible that we would not be able to obtain such a license or settle on reasonable terms, or at all.

In some cases, even though no infringement has been alleged, we may attempt to secure rights to use the intellectual property rights of others that would be useful to us. We cannot guarantee that we would be able to secure such rights on reasonable terms, or at all.

Lastly, our customers may not purchase our products if they are concerned our products may infringe third party intellectual property rights. This could reduce the market opportunity for the sale of our products and services.

Any of the foregoing risks could have a material adverse effect on our revenues, results of operations, and financial condition.

We may be unable to anticipate or fail to adequately mitigate against increasingly sophisticated methods to engage in illegal or fraudulent activities against us.

Despite any defensive measures we take to manage threats to our business, our risk and exposure to these matters remain heightened because of, among other things, the evolving nature of such threats in light of advances in computer capabilities, new discoveries in the field of cryptography, new and sophisticated methods used by criminals including phishing, social engineering or other illicit acts, or other events or developments that we may be unable to anticipate or fail to adequately mitigate. These threats, events, and developments could lead to, for example, unauthorized access to or acquisition of our sensitive business information or intellectual property, or the personal data of our employees. If any such efforts against us were to be successful, we could face financial and legal liability and suffer damage to our business and reputation, any of which could have a material adverse effect on our results of operations and financial condition.

Future acquisitions, strategic investments, partnerships or alliances could be difficult to identify and integrate, divert the attention of management, disrupt our business, dilute stockholder value and adversely affect our results of operations and financial condition.

As opportunities present themselves, we may from time to time evaluate and enter into strategic partnerships or transactions involving acquisitions of or investments in other businesses, products or technologies that we believe could complement or expand our services, enhance our technical capabilities or otherwise offer growth opportunities. The pursuit of potential transactions may divert the attention of management and cause us to incur various expenses in

identifying, investigating, and pursuing suitable opportunities, whether or not transactions are ultimately completed. If we acquire businesses, we may not be able to integrate successfully the acquired personnel, operations and technologies, or effectively manage the combined business following the acquisition. We may not be able to find and identify desirable opportunities or be successful in entering into an agreement with respect to the opportunities that we do identify. Acquisitions and other transactions could also result in dilutive issuances of equity

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securities, use of our existing cash reserves or the incurrence of debt. In addition, a transaction may fail to meet our expectations. The occurrence of any of these risks could harm our results of operations, business and financial condition.

Natural disasters, power outages, and other factors outside of our control such as widespread pandemics could disrupt our business.

We must protect our business and our network infrastructure against damage from earthquake, flood, hurricane and similar events, as well as from power outages. Our corporate headquarters is located in the San Francisco Bay Area, a region known for earthquakes. A natural disaster, power outage, or other unanticipated problem could also adversely affect our business by, among other things, harming our primary data center or other internal operations, limiting our ability to communicate with our customers, limiting our ability or our partners' or customers' ability to sell or use our products, affecting our third party developer's ability to complete developments on schedule or at all, or affecting our suppliers' ability to provide us with components or products. These risks may be further increased if the disaster recovery plans for us and our suppliers prove to be inadequate. For example, the 2011 earthquake and tsunami in Japan adversely impacted our revenues from customers located in Japan and/or our ability to source parts from companies located in Japan. Shortly after the earthquake, we received notice from Toshiba (one of two manufacturers of the Neuron Chip - an important component that we and our customers use in control network devices), that they would no longer be able to manufacture Neuron Chips due to earthquake damage suffered at the semiconductor manufacturing facility that produced the Neuron Chips. However, the abrupt termination of Toshiba's Neuron Chip manufacturing capability caused a disruption in supply and an increase in prices from the remaining supplier, Cypress Semiconductor. We do not insure against several natural disasters, including earthquakes.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

At our corporate headquarters in Santa Clara, California, we sublease approximately 32,000 square feet of usable space. We moved to this location in December 2015. The sublease for this space is scheduled to expire in July 2019. We also lease office space for our employees and consultants in Florida, China, Hong Kong, Japan, the Netherlands, South Korea, and the United Kingdom. The leases for these offices expire at various dates through 2018.

As of December 31, 2017, the future minimum rental payments for all of our leased office space, including those for our corporate headquarters facilities, totaled approximately \$1.4 million. For the year ended December 31, 2017, the aggregate rental expense for all leased office space was approximately \$929,000.

We believe that our facilities will be adequate for at least the next 12 months. For additional information regarding our obligations under property leases, please see Note 10 - Commitments and Contingencies, in the Notes to Consolidated Financial Statements included in Item 15 of Part IV of this Report.

ITEM 3. LEGAL PROCEEDINGS

For a discussion regarding our legal proceedings and matters, please refer to the "Legal Actions" section of Note 10 - Commitments and Contingencies, in the Notes to the Consolidated Financial Statements in Item 15 of Part IV of this Annual Report on Form 10-K, which is incorporated herein by reference.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND
5. ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the Nasdaq Global Market under the symbol "ELON." We began trading on NASDAQ on July 28, 1998, the date of our initial public offering. The following table sets forth, for the quarter indicated, the high and low sales price per share of our common stock as reported on the Nasdaq Global Market. On December 7, 2015, we effected a one-for-ten reverse stock split. All share and per share information has been retroactively adjusted to reflect the stock split.

| | Price Range | |
|------------------------------|-------------|--------|
| | High | Low |
| Year ended December 31, 2017 | | |
| Fourth quarter | \$5.81 | \$4.40 |
| Third quarter | 5.46 | 4.26 |
| Second quarter | 7.20 | 5.12 |
| First quarter | 6.42 | 4.38 |

Year ended December 31, 2016

| | | |
|----------------|--------|--------|
| Fourth quarter | \$5.50 | \$4.17 |
| Third quarter | 5.75 | 4.73 |
| Second quarter | 5.74 | 4.41 |
| First quarter | 6.70 | 4.71 |

As of February 28, 2018, there were approximately 119 stockholders of record. Because brokers and other institutions hold many shares on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

Dividend Policy

We have never paid dividends on our capital stock and do not currently expect to pay any dividends in the foreseeable future. We intend to retain future earnings, if any, for use in our business.

Equity Compensation Plan Summary Information

For information on our equity compensation plans, please refer to Note 6 - Stockholders' Equity and Employee Stock Option Plans, in the Notes to the Consolidated Financial Statements in Item 15 of Part IV of this Annual Report on Form 10-K.

Recent Sales of Unregistered Securities

There were no sales of unregistered securities during the fourth quarter of our fiscal year ended December 31, 2017.

Repurchase of Equity Securities by the Company

The following table provides information about the repurchase of our common stock during the quarter ended December 31, 2017:

| Period | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|--------------------------|--|---------------------------------------|--|---|
| October 1 – October 31 | — | \$ — | — | — |
| November 1 – November 30 | — | \$ — | — | — |
| December 1 – December 31 | 21 | \$ 5.19 | — | — |
| Total | 21 | \$ 5.19 | — | — |

(1) Represents shares surrendered to us by employees in order to satisfy stock-for-stock option exercises and/or withholding tax obligations related to stock-based compensation.

ITEM 6. SELECTED FINANCIAL DATA

As a smaller reporting company, we are not required to provide the information under this item, pursuant to Regulation S-K Item 301(c).

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included elsewhere in this Annual Report. The following discussion contains predictions, estimates, and other forward-looking statements that involve a number of risks and uncertainties about our business. These statements may be identified by the use of words such as "we believe," "expect," "anticipate," "intend," "plan," "goal," "continues," "may" and expressions. Forward-looking statements include statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characterizations of future events or circumstances. In particular, these statements include statements such as: our projections of revenues; estimates of our future gross margins and restructuring charges; statements regarding reinvesting a portion of our earnings from foreign operations; plans to use our cash reserves to strategically acquire other companies, products, or technologies; our projections of our combined cash, cash equivalent and short term investment balance; the sufficiency of our cash reserves to meet cash requirements; our expectations that our revenues will not fluctuate significantly due to a fluctuation in foreign currency sales; our forecasts regarding our sales and marketing expenses; and estimates of our interest income and tax exposure. Such statements are based on our current expectations and could be affected by the uncertainties and risk factors described throughout this filing and particularly in the "Risk Factors" section. Therefore, our actual results may differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to review or update publicly any forward-looking statements for any reason.

EXECUTIVE OVERVIEW

Echelon Corporation was incorporated in California in February 1988 and reincorporated in Delaware in January 1989. We went public on the NASDAQ market under the symbol "ELON" in July, 1998. We are based in Santa Clara, California, and maintain offices in several foreign countries throughout Europe and Asia. Our products enable "things" in commercial and industrial applications — such as air conditioners, lighting, manufacturing equipment, electricity meters, light switches, thermostats, and valves — to be made "smart" and inter-connected, part of an emerging market known as the Industrial Internet of Things ("IIoT").

Our widely deployed, open standard, multi-vendor energy control networking platform powers applications for smart cities, smart buildings, and smart campuses that help customers save on their energy usage; prevent failure or reduce failure duration; reduce carbon footprint; improve safety, comfort, and convenience; and more. Our solutions, which feature a programmable, distributed intelligence architecture that is designed for both high reliability and fast action, are implemented over the powerline or through wireless communication systems for flexibility in installation and operation.

We offer two product lines, the first of which is comprised of chips, modules, gateways, and design and management software that enables Original Equipment Manufacturers ("OEMs") to quickly design and bring to market interoperable smart systems for their commercial and industrial customers. These products are generally marketed under the LONWORKS and IzoT brand names. We refer to revenues from these products as "embedded systems" revenues.

Our second product line is a range of control networking solutions designed specifically for the lighting market within the IIoT. As this market continues its transition to solid state lighting, or LEDs, we have focused our initial offerings on outdoor lighting control solutions, as we believe that the incremental energy savings, maintenance benefits, and safety improvements resulting from the implementation of controls offers a compelling return on investment. In addition, due to the abundance of lighting fixtures in most locations, the lighting control system can host a variety of "smart" applications that can further improve safety and comfort on roadways, in parking lots and garages, on

campuses, in tunnels, and more. Our lighting control solutions consist of wired and wireless control nodes placed at the lighting fixtures of a wide variety of manufacturers, “smart” gateways for interconnecting the control nodes, and a software-based Central Management System, or CMS, which is used for startup, commissioning, management, and monitoring of the lighting network. These solutions are sold to end users typically through manufacturers' representatives, energy services companies, and distributors, and are generally marketed under the LumInsight and Lumewave by Echelon brand names. We refer to revenues from these products as "outdoor lighting" revenues.

The following tables provide an overview of key financial metrics for the years ended December 31, 2017 and 2016 that our management team focuses on in evaluating our financial condition and operating performance (in thousands, except percentages).

| | Year ended December 31, | | | |
|--|-------------------------|------------|-----------|-----------|
| | 2017 | 2016 | \$ Change | % Change |
| Net revenues | \$31,667 | \$32,385 | \$(718) | (2.2)% |
| Gross margin | 55.7 % | 55.8 % | --- | (0.1) ppt |
| Operating expenses | \$21,804 | \$22,812 | \$(1,008) | (4.4)% |
| Net loss attributable to Echelon Corporation Stockholders | \$(4,623) | \$(4,103) | \$(520) | 12.7 % |
| Cash, cash equivalents, restricted investments, and short-term investments | \$20,478 | \$23,036 | \$(2,558) | (11.1)% |

Net revenues: Our total revenues decreased by 2.2% during 2017 as compared to 2016. Excluding component sales to Enel, which decreased from \$1.3 million in 2016 to \$0 in 2017, our revenues increased by 1.9% during 2017 as compared to 2016. This increase was primarily due to an increase in sales made to customers in the Americas and APJ regions, partially offset by a reduction in sales made to customers in the EMEA region.

Gross margin: Our gross margins remained relatively unchanged during 2017 as compared to 2016.

Operating expenses: Our operating expenses decreased by 4.4% during 2017 as compared to 2016. This continues a trend we began several years ago and is primarily due to reduced compensation related expenses resulting from the restructuring actions we have undertaken as well as a reduction in fees paid to some of our third party service providers.

Net loss: We generated a net loss of \$4.6 million during 2017, which was an increase from the net loss of \$4.1 million in 2016. This increase was primarily the result of an increase in our foreign exchange translation losses, and was partially offset by an overall decrease in our operating expenses.

Cash, cash equivalents, restricted investments, and short-term investments: During 2017, our cash, cash equivalents, restricted investments, and short-term investment balance decreased by 11.1%, from \$23.0 million at December 31, 2016 to \$20.5 million at December 31, 2017. This decrease was primarily the result of cash used in operations of \$2.2 million (driven primarily by our net loss of \$4.6 million less non-cash charges for depreciation and amortization, and stock based compensation).

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. Note 1, "Significant Accounting Policies" of Notes to Consolidated Financial Statements in this Annual Report on Form 10-K describes the significant accounting policies and methods used in the preparation of our consolidated financial statements. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to our stock-based compensation, allowance for doubtful accounts, inventories, and commitments and contingencies. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies and estimates relate to those policies that are most important to the presentation of our consolidated financial statements and require the most difficult, subjective, and complex judgments.

Revenue Recognition. Our revenues are derived from the sale and license of our products and to a lesser extent, from fees associated with training, technical support, and custom software design services offered to our customers. Product

revenues consist of revenues from hardware sales and software licensing arrangements. Service revenues consist of product technical support (including software post-contract support services), training, and custom software development services.

We recognize revenue when persuasive evidence of an arrangement exists, delivery to the customer's carrier (and acceptance, as applicable) has occurred, the sales price is fixed or determinable, collectability is probable, and there are no post-delivery obligations. For non-distributor hardware sales, including sales to third party manufacturers, these criteria are generally met at the time of delivery to the customer's carrier. However, for arrangements that contain contractual acceptance provisions, revenue recognition may be delayed until acceptance by the customer or the acceptance provisions lapse unless we can objectively demonstrate that the contractual acceptance criteria have been satisfied, which is generally accomplished by establishing a history of acceptance for the same or similar products. For sales made to our distributor partners, revenue recognition criteria are generally met at the time the distributor sells the products through to its end-use customer. Service revenue is recognized as the training services are performed, or ratably over the term of the support period.

We account for the rights of return, price protection, rebates, and other sales incentives offered to distributors of our products as a reduction in revenue. With the exception of sales to distributors, the Company's customers are generally not entitled to return products for a refund. For sales to distributors, due to contractual rights of return and other factors that impact our ability to make a reasonable estimate of future returns and other sales incentives, revenues are not recognized until the distributor has shipped our products to the end customer.

Inventory Valuation. At each balance sheet date, we evaluate our ending inventories for excess quantities and obsolescence. In general, the evaluation for excess quantities includes analyses of historical sales levels by product and projections of future demand. In general, inventories on hand in excess of one year's forecasted demand are deemed to be excess. However, in certain instances when the facts and circumstances for a particular item warrant an extended view, periods of longer than one year are used to determine excess supplies. In performing these analyses, management must make significant judgments in determining the appropriate time horizon over which to analyze for excess inventories.

For most of our products, our customers generally buy from a portfolio of "off-the-shelf" or standard products. In addition, our revenues are generally composed of a larger volume of smaller dollar transactions. Accordingly, while any single customer's demand for a given product may fluctuate from quarter to quarter, the fact that there are so many IIoT customers buying a standard product tends to average out increases or decreases in any individual customer's demand. This has historically resulted in a relatively stable future demand forecast for our IIoT products, which, absent outside forces such as worsening general economic conditions, management evaluates in determining its requirement for an excess inventory reserve.

In addition to providing a reserve for excess inventories, we do not value inventories that we consider obsolete. We consider a product to be obsolete when one of several factors exists. These factors include, but are not limited to, our decision to discontinue selling an existing product, the product has been re-designed and we are unable to rework our existing inventory to update it to the new version, or our competitors introduce new products that make our products obsolete.

We adjust remaining inventory balances to approximate the lower of our cost or net realizable value. If future demand or market conditions are less favorable than our projections, additional inventory write-downs may be required and would be reflected in cost of sales in the period the revision is made.

RESULTS OF OPERATIONS

The following discussion covers our results of operations for the two years ended December 31, 2017.

The following table reflects the percentage of total revenues represented by each item in our Consolidated Statements of Operations for the years ended December 31, 2017 and 2016:

| | Year ended | |
|--|--------------|---------|
| | December 31, | |
| | 2017 | 2016 |
| Revenues | 100.0 % | 100.0 % |
| Cost of revenues | 44.3 | 44.2 |
| Gross profit | 55.7 | 55.8 |
| Operating expenses: | | |
| Product development | 29.4 | 25.5 |
| Sales and marketing | 17.5 | 19.1 |
| General and administrative | 22.0 | 24.9 |
| Restructuring charges | — | 0.9 |
| Total operating expenses | 68.9 | 70.4 |
| Loss from operations | (13.1) | (14.6) |
| Interest and other income (expense), net | (1.6) | 2.5 |
| Loss before provision for income taxes | (14.7) | (12.1) |
| Income tax expense (benefit) | (0.1) | 0.6 |
| Net loss | (14.6) | (12.7) |

Revenues
Total revenues

| | Year ended | | 2017 over 2016 | 2017 over 2016 |
|------------------------|--------------|----------|----------------------|----------------------|
| | December 31, | | | |
| (Dollars in thousands) | 2017 | 2016 | \$ | % |
| Total revenues | \$31,667 | \$32,385 | (718) | (2.2)% |

Total revenues

Our revenues are primarily comprised of sales of our hardware products, and to a lesser extent, revenues we generate from sales of our software products and from our customer support and training offerings. Included in these totals are components we sell to Enel.

Excluding sales to Enel, a related party, which are discussed more fully below, our revenues increased by 1.9%, or \$595,000, during 2017 as compared to 2016. Partially offsetting this increase was a reduction in the amount of component sales we made to our former Grid division. Excluding these sales as well, our revenues grew by 6.4%, or \$1.9 million, during 2017 as compared to 2016. This increase was primarily due to increases in sales made to customers in the Americas and APJ regions, which were partially offset by a reduction in sales to our customers in the EMEA region. During 2017, our embedded systems revenues grew across a broad base of customer applications, ranging from semiconductor manufacturing monitoring, to building automation, HVAC controls, and more. We believe this trend may be taking hold and working to Echelon's benefit, as companies expand into IIoT deployments and leverage LONWorks' capability.

The portion of our revenues denominated in currencies other than the United States dollar, principally the Japanese Yen, was about 4.1% in 2017 and 3.9% in 2016. Our revenues will be subject to fluctuations in the exchange rates between the United States dollar and the foreign currencies in which we sell our products and services. In general, if the dollar were to weaken against these currencies, our revenues from those foreign currency sales, when converted

into United States dollars, would increase. Conversely, if the dollar were to strengthen against these currencies, our revenues from those foreign currency sales, when converted into United States dollars, would decrease. The extent of this exchange rate fluctuation increase or decrease will depend on the amount of sales conducted in these currencies and the magnitude of the exchange rate fluctuation from year to year. To date, we have not hedged any of these foreign currency risks. We do not currently expect that, during 2018, the amount of our revenues conducted in these foreign currencies will fluctuate significantly from prior year levels. Given the historical and expected future level of sales made in foreign currencies, we do not currently plan to hedge against

these currency rate fluctuations. However, if the portion of our revenues denominated in foreign currencies were to grow significantly, we would re-evaluate these exposures and, if necessary, enter into hedging arrangements to help minimize these risks.

Enel project revenues (included in Total Revenues and Discontinued Operations)

| | Year ended December 31, | |
|-----------------------------|-------------------------|--------|
| | 2017 | 2017 |
| | over | over |
| (Dollars in thousands) 2016 | 2016 | 2016 |
| | \$ | % |
| | Change | Change |

Enel revenues —\$ 1,313 (1,313) (100.0)%

In October 2006, we entered into a development and supply agreement with Enel. The development and supply agreement expired in March 2016. Under the development and supply agreement, Enel purchased metering kit products from us. Enel Project revenues recognized during the year ended December 31, 2016 related primarily to shipments under the development and supply agreement.

We sold our products to Enel and its designated manufacturers in U.S. dollars. Therefore, the associated revenues are not subject to foreign currency risks. We do not currently expect that there will be any additional significant shipments to Enel in 2018 and beyond.

Gross Profit and Gross Margin

| | Year ended December 31, | | | |
|-----------------------------|-------------------------|-----------|--------|---------|
| | 2017 | 2017 | 2017 | 2017 |
| | over | over | over | over |
| (Dollars in thousands) 2017 | 2016 | 2016 | 2016 | 2016 |
| | \$ | % | \$ | % |
| | Change | Change | Change | Change |
| Gross Profit | \$ 17,651 | \$ 18,083 | (432) | (2.4)% |
| Gross Margin | 55.7 % | 55.8 % | — | (0.1) |

Gross profit is equal to revenues less cost of revenues. Cost of revenues associated with sales of our IIoT products includes direct costs associated with the purchase of components, sub-assemblies, and finished goods, as well as indirect costs such as allocated labor and overhead; costs associated with the packaging, preparation, and shipment of products; and charges related to warranty and excess and obsolete inventory reserves. Cost of revenues associated with our IIoT services consists of employee-related costs such as salaries and fringe benefits as well as other direct and indirect costs incurred in providing training, customer support, and custom software development services. Gross margin is equal to gross profit divided by revenues.

Gross margins remained relatively unchanged during the year ended December 31, 2017 as compared to 2016. Our future gross margins will continue to be affected by several factors, including, but not limited to: overall revenue levels, changes in the mix of products sold, changes in our distribution strategy and use of distributors, changes in the prices charged by our suppliers, periodic charges related to excess and obsolete inventories, warranty expenses, introductions of cost reduced versions of our products, changes in the average selling prices of the products we sell, purchase price variances, and fluctuations in the level of indirect overhead spending. In addition, the impact of foreign

exchange rate fluctuations and labor rates may affect our gross margins in the future. We currently outsource the manufacturing of most of our products requiring assembly to CEMs located primarily in China. To the extent labor rates were to rise further, or to the extent the U.S. dollar were to weaken against the Chinese currency, or other currencies used by our CEMs, our costs for the products they manufacture could rise, which would negatively affect our gross margins.

Operating Expenses
Product Development

| | | Year ended December 31, | | | |
|------------------------|------|----------------------------|--------|--------|--------|
| | | 2017 | 2017 | 2017 | 2017 |
| | | over | over | over | over |
| (Dollars in thousands) | 2017 | 2016 | 2016 | 2016 | 2016 |
| | | \$ | % | \$ | % |
| | | Change | Change | Change | Change |

Product Development \$9,313 \$8,260 1,053 12.7 %

Product development expenses consist primarily of payroll and related expenses for development personnel, facility costs, expensed material, fees paid to third party service providers, depreciation and amortization, and other costs associated with the development of new technologies and products.

Our product development expenses increased during 2017 as compared to 2016, driven primarily by increases in fees paid to third party product development service providers.

We currently expect that our product development expenses will continue to increase during the first half of 2018 as compared to 2017 as we continue to incur near-term costs associated with the roll-out of new products. We expect our product development expenses will return to more recent historical levels during the second half of 2018.

Sales and Marketing

| | | Year ended December 31, | | | |
|------------------------|------|----------------------------|--------|--------|--------|
| | | 2017 | 2017 | 2017 | 2017 |
| | | over | over | over | over |
| (Dollars in thousands) | 2017 | 2016 | 2016 | 2016 | 2016 |
| | | \$ | % | \$ | % |
| | | Change | Change | Change | Change |

Sales and Marketing \$5,532 \$6,189 (657) (10.6)%

Sales and marketing expenses consist primarily of payroll, commissions, and related expenses for sales and marketing personnel, travel and entertainment, facilities costs, advertising and product promotion, and other costs associated with our sales and marketing activities.

Our sales and marketing expenses decreased in 2017 as compared to 2016, driven primarily by reductions in compensation related expenses for our sales and marketing personnel.

General and Administrative

| | | Year ended December 31, | | | |
|------------------------|------|----------------------------|--------|--------|--------|
| | | 2017 | 2017 | 2017 | 2017 |
| | | over | over | over | over |
| (Dollars in thousands) | 2017 | 2016 | 2016 | 2016 | 2016 |
| | | \$ | % | \$ | % |
| | | Change | Change | Change | Change |

General and Administrative \$6,959 \$8,077 (1,118) (13.8)%

General and administrative expenses consist primarily of payroll and related expenses for executive, finance, and administrative personnel, professional fees for legal and accounting services rendered to the company, facility costs, insurance, and other general corporate expenses.

General and administrative expenses decreased in 2017 as compared to 2016 due primarily to a decrease in fees paid to third party general and administrative service providers.

Restructuring Charges

| | Year ended December 31, | 2017 over 2016 \$ Change | 2017 over 2016 % Change |
|------------------------|-------------------------------|--------------------------------------|----------------------------|
| (Dollars in thousands) | 2017 | 2016 | |

Restructuring Charges \$ —\$ 286 (286) (100.0)%

During the fourth quarter of 2016, we undertook restructuring actions affecting approximately 7 employees to be terminated between October 2016 and November 2018, as part of an overall plan to reshape our Company for the future. In connection with this restructuring, we recorded restructuring charges of approximately \$286,000 related to termination benefits for these personnel during the quarter ended December 31, 2016.

Interest and Other Income (Expense), Net

| | Year ended December 31, | | | |
|------------------------|-------------------------------|------|--------------------------------------|-------------------------------------|
| | 2017 | 2016 | 2017 over 2016 \$ Change | 2017 over 2016 % Change |
| (Dollars in thousands) | 2017 | 2016 | | |

Interest and Other Income (Expense), Net \$(498) \$808 (1,306) (161.6)%

Interest and other income (expense), net primarily reflects interest earned by our company on cash and short-term investment balances as well as foreign exchange translation gains and losses related to short-term intercompany balances.

Interest and other expense, net increased by \$1.3 million during 2017 as compared to the same period in 2016. This increase was primarily attributable to a \$1.4M increase in foreign currency remeasurement losses during 2017 as compared to 2016. These foreign currency fluctuations are attributable to our foreign currency denominated short-term intercompany balances. We account for translation gains and losses associated with these balances by reflecting these amounts as either other income or loss in our consolidated statements of operations. During periods when the U.S. dollar weakens in value against these foreign currencies the associated translation losses negatively impact other income. Conversely, when the U.S. dollar strengthens, the resulting translation gains favorably impact other income.

We do not currently anticipate interest income on our investment portfolio will improve during 2018 as we expect interest rates to remain historically low. Future gains or losses associated with remeasuring our foreign currency denominated short-term intercompany balances will depend on the intercompany account balances as well as exchange rates in effect at the time of translation.

Income Tax Expense / Benefit

| | Year ended December 31, | | | |
|------------------------|-------------------------------|------|----------------------|----------------------|
| | 2017 | 2016 | 2017 over 2016 | 2017 over 2016 |
| (Dollars in thousands) | 2017 | 2016 | | |

| | \$ | % |
|--------|----|--------|
| Change | | Change |

Income Tax Expense / (Benefit) \$(28) \$182 (210) (115.4)%

The income tax expense (benefit) for the years ended December 31, 2017 and 2016 was \$(28,000) and \$182,000, respectively. The difference between the statutory rate and our effective tax rate is primarily due to the impact of foreign taxes, changes in the valuation allowance on deferred tax assets, and changes in the accruals related to unrecognized tax benefits.

OFF-BALANCE-SHEET ARRANGEMENTS AND OTHER CONTRACTUAL OBLIGATIONS

Off-Balance-Sheet Arrangements. We have not entered into any transactions with unconsolidated entities whereby we have financial guarantees, subordinated retained interests, derivative instruments, or other contingent arrangements that expose our

company to material continuing risks, contingent liabilities, or any other obligation under a variable interest in an unconsolidated entity that provides financing, liquidity, market risk, or credit risk support to us.

Lease Commitments. In September 2015, we entered into a lease agreement for our corporate headquarters facility in Santa Clara, California. This lease commenced in November 2015 and will expire in July 2019. In addition, we lease facilities under operating leases for our sales, marketing, and product development personnel located elsewhere within the United States and in several foreign countries throughout Europe and Asia. These operating leases expire on various dates through 2019, and in some instances are cancelable with advance notice. Lastly, we also lease certain equipment and, for some of our sales personnel, automobiles. These operating leases are generally less than five years in duration.

Purchase Commitments. We utilize several contract manufacturers who manufacture and test our products requiring assembly. These contract manufacturers acquire components and build product based on demand information supplied by us in the form of purchase orders and demand forecasts. These purchase orders and demand forecasts generally cover periods up to twelve months, and in rare cases, up to eighteen months. We also obtain individual components for our products from a wide variety of individual suppliers. We generally acquire these components through the issuance of purchase orders, and in some cases through demand forecasts, both of which cover periods up to twelve months.

We also utilize purchase orders when procuring capital equipment, supplies, and services necessary for our day-to-day operations. These purchase orders generally cover periods ranging up to twelve months, but in some instances cover a longer duration.

Indemnifications. In the normal course of business, we provide indemnifications of varying scope to customers against claims of intellectual property infringement made by third parties arising from the use of our products. Historically, costs related to these indemnification provisions have not been significant. However, we are unable to estimate the maximum potential impact of these indemnification provisions on our future results of operations. As permitted under Delaware law, we have agreements whereby we indemnify our officers and directors for certain events or occurrences while the officer or director is, or was, serving at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the officer's or director's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that would enable us to recover a portion of any future amounts paid. We believe the estimated fair value of these indemnification agreements in excess of the applicable insurance coverage is minimal.

Royalties. We have certain royalty commitments associated with the shipment and licensing of certain products. Royalty expense is generally based on a U.S. dollar amount per unit shipped or a percentage of the underlying revenue. Royalty expense, which is recorded as a component of cost of revenues in our Consolidated Statements of Operations, was approximately \$260,000 and \$264,000 for the years ended December 31, 2017 and 2016, respectively.

We will continue to be obligated for royalty payments in the future associated with the shipment and licensing of certain of our products. While we are currently unable to estimate the maximum amount of these future royalties, such amounts will continue to be dependent on the number of units shipped or the amount of revenue generated from these products.

Taxes. We conduct our operations in many tax jurisdictions throughout the world. In many of these jurisdictions, non-income based taxes such as property taxes, sales and use taxes, and value-added taxes are assessed on Echelon's operations in that particular location. While we strive to ensure compliance with these various non-income based tax filing requirements, there have been instances where potential non-compliance exposures have been identified. In accordance with generally accepted accounting principles, we make a provision for these exposures when it is both probable that a liability has been incurred and the amount of the exposure can be reasonably estimated. To date, such provisions have been immaterial, and we believe that, as of December 31, 2017, we have adequately provided for such contingencies. However, it is possible that our results of operations, cash flows, and financial position could be harmed if one or more non-compliance tax exposures are asserted by any of the jurisdictions where we conduct our operations.

Legal Actions. From time to time, in the ordinary course of business, we may be subject to other legal proceedings, claims, investigations, and other proceedings, including claims of alleged infringement of third-party patents and other intellectual property rights, and commercial, employment, and other matters. In accordance with generally accepted accounting principles, we make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case. While we believe

we have adequately provided for such contingencies as of December 31, 2017, the amounts of which were immaterial, it is possible that our results of operations, cash flows, and financial position could be harmed by the resolution of any such outstanding claims.

LIQUIDITY AND CAPITAL RESOURCES

Since our inception, we have financed our operations and met our capital expenditure requirements primarily from the sale of preferred stock and common stock, although during 2012 and certain earlier years, we were also able to finance our operations through operating cash flow.

The following table presents selected financial information as of December 31, 2017 and 2016 (dollars in thousands):

| | December 31, | |
|--|--------------|----------|
| | 2017 | 2016 |
| Cash, cash equivalents, restricted investments, and short-term investments | \$20,478 | \$23,036 |
| Trade accounts receivable, net | 2,721 | 3,015 |
| Working capital | 20,369 | 23,083 |
| Stockholders' equity | \$21,887 | \$24,678 |

As of December 31, 2017, we had \$20.5 million in cash, cash equivalents, restricted investments, and short-term investments, a decrease of \$2.6 million as compared to December 31, 2016. Historically, our primary source of cash, other than stock sales, has been receipts from revenue, and to a lesser extent, proceeds from the exercise of stock options and warrants by our employees and directors. Our primary uses of cash have been cost of product revenue, payroll (salaries, commissions, bonuses, and benefits), general operating expenses (costs associated with our offices such as rent, utilities, and maintenance; fees paid to third party service providers such as consultants, accountants, and attorneys; travel and entertainment; equipment and supplies; advertising; and other miscellaneous expenses), acquisitions, capital expenditures, payment of taxes associated with certain equity compensation awards, purchases under our stock repurchase programs, and early termination charges associated with our operating leases.

Cash flows from operating activities. Cash flows from operating activities have historically been driven by net income (loss) levels; adjustments for non-cash charges such as impairment charges, write-downs of property, plant, and equipment, stock-based compensation, depreciation and amortization, and changes in accrued investment income; and fluctuations in operating asset and liability balances. Net cash used in operating activities was \$2.2 million for the year ended December 31, 2017, a decrease in cash outflows of approximately \$798,000 as compared to 2016. During the year ended December 31, 2017, net cash used in operating activities was primarily the result of our net loss of \$4.6 million, which was partially offset by stock-based compensation expenses of \$1.5 million, depreciation and amortization expense of \$454,000, and changes in our operating assets and liabilities of \$600,000. The primary components of the \$600,000 net change in our operating assets and liabilities were a \$1.0 million increase in deferred revenues, a \$586,000 increase in accounts payable, and a \$367,000 decrease in accounts receivable; all of which was partially offset by a \$681,000 increase in inventories and a \$628,000 increase in deferred cost of goods sold. Deferred revenue and deferred cost of goods sold increased due to the fact that, as of December 31, 2017, not all of the required revenue recognition criteria had been met for certain of our outdoor lighting projects, and to a lesser extent, due to the timing of sales made to our distributor partners. Account payable increased due to the timing of expenditures during the latter part of 2017. Accounts receivable decreased based on the timing of shipments in the fourth quarter of 2017. Inventories increased in anticipation of shipments we were required to make in early 2018.

Net cash used in operating activities was \$3.0 million for the year ended December 31, 2016, a decrease in cash outflows of approximately \$1.9 million as compared to 2015. During the year ended December 31, 2016, net cash used in operating activities was primarily the result of our net loss of \$4.1 million and a reduction in the amount of contingent consideration we owed the former Lumewave shareholders; all of which was partially offset by stock-based compensation expenses of \$746,000, depreciation and amortization expense of \$489,000, and changes in our operating assets and liabilities of \$199,000. The primary components of the \$199,000 net change in our operating assets and liabilities were a \$1.0 million increase in accounts receivable, a \$340,000 increase in deferred revenues, a \$323,000 decrease in inventories, and a \$200,000 decrease in other current assets; all of which was partially offset by a \$1.2 million decrease in accrued liabilities and an \$558,000 decrease in accounts payable. Accounts receivable

increased based on the timing of shipments in the fourth quarter of 2016. Deferred revenues and deferred cost of goods sold increased due primarily to the timing of sales to our distributors. Inventories decreased as part of an ongoing effort to reduce inventory levels. Other current assets decreased primarily as a result of a reduction in prepaid expenses and the refund of the deposit on our old headquarters building in San Jose. Accrued liabilities decreased primarily due to the payment of bonuses that were accrued as of December 31, 2015 and the reversal of contingent

consideration owed to the former Lumewave shareholders. Accounts payable decreased due to the timing of expenditures during the latter part of 2016.

Cash flows from investing activities. Cash flows from investing activities have historically been driven by transactions involving our short-term investment portfolio, capital expenditures, changes in our long-term assets, and acquisitions and divestitures. Net cash used in investing activities was \$182,000 for the year ended December 31, 2017, an increase of \$5.4 million in cash outflows compared to 2016. During the year ended December 31, 2017, net cash used investing activities was primarily the result of purchases of available-for-sale short-term investments of \$23.9 million, capital expenditures of \$209,000, and changes in other long-term assets of \$98,000; all of which was partially offset by proceeds from the maturities of available-for-sale short-term investments of \$24.0 million. Net cash provided by investing activities was \$5.2 million for the year ended December 31, 2016, a decrease of \$5.5 million in cash inflows compared to 2015. During the year ended December 31, 2016, net cash provided by investing activities was primarily the result of proceeds from the maturities of available-for-sale short-term investments of \$29.2 million; partially offset by purchases of available-for-sale short-term investments of \$24.0 million, changes in other long-term assets of \$160,000, and capital expenditures of \$117,000. Other long-term assets decreased primarily due to the refund of a deposit associated with a performance bond we maintained for European VAT purposes.

Cash flows from financing activities. Cash flows from financing activities have historically been driven by the proceeds from issuance of common and preferred stock offset by transactions under our stock repurchase programs, principal payments on our lease financing obligations, and the acquisition of restricted investments. Net cash used in financing activities was \$240,000 for the year ended December 31, 2017, a increase in outflows of \$197,000 as compared to the same period in 2016. During the year ended December 31, 2017, net cash used in financing activities was primarily the result of \$240,000 worth of shares repurchased from employees for payment of employee taxes on vesting of restricted stock units and upon exercise of stock options.

Net cash used in financing activities was \$43,000 for the year ended December 31, 2016, a decrease in outflows of \$11.4 million as compared to the same period in 2015. During the year ended December 31, 2016, net cash used in financing activities was primarily the result of \$43,000 worth of shares repurchased from employees for payment of employee taxes on vesting of restricted stock units and upon exercise of stock options.

As noted above, our cash and investments totaled \$20.5 million as of December 31, 2017. Of this amount, approximately 5% was held by our foreign subsidiaries. Our intent is to permanently reinvest a significant portion of our earnings from foreign operations, and current plans do not anticipate that we will need funds generated from foreign operations to fund our domestic operations. In the event funds from foreign operations are needed to fund operations in the United States and if U.S. tax has not already been previously provided, we would provide for and pay any additional U.S. taxes due in connection with repatriating these funds.

Of our cash and investment balance of \$20.5 million as of December 31, 2017, approximately \$864,000 was held at Zhejiang Echelon-Holley Technology Co., Ltd., our Chinese joint venture with Holley Metering Limited ("Holley Metering"). We are currently working with Holley Metering to shut the joint venture down and expect that process to be finished within the next six months. At such time as the shut down process is completed, we expect the remaining cash balance will be distributed between Echelon and Holley Metering in relation to their respective ownership percentages (51% to Echelon and 49% to Holley Metering).

We use well-regarded investment managers to manage our invested cash. Our portfolio of investments managed by these investment managers is primarily composed of highly rated U.S. government securities, and to a lesser extent, money market funds. All investments are made according to guidelines and within compliance of policies approved by the Audit Committee of our Board of Directors.

We currently maintain an operating credit line of \$1.0 million with our primary bank for company credit card purchases. This line of credit continues to be secured by a collateral of the first priority on \$1.3 million of our investments (presented as restricted investments in the Consolidated Balance Sheets).

In the future, our cash reserves may be used to strategically acquire other companies, products, or technologies that are complementary to our business or for settlements of customer disputes or litigation. In addition, our combined cash, cash equivalents, and short-term investments balances could be negatively affected by various risks and uncertainties, including, but not limited to, the risks detailed in this Annual Report in Part I, Item 1A - Risk Factors.

For example, any continued weakening of economic conditions or changes in our planned cash outlay could negatively affect our existing cash reserves.

Based on our current business plan and revenue prospects, we believe that our existing cash reserves will be sufficient to meet our projected working capital and other cash requirements for at least the next twelve months. However, we currently expect that our combined cash, cash equivalent, restricted investments, and short-term investment balance will decline during 2018. In the event that we require additional financing, such financing may not be available to us in the amounts or at the times that we require, or on acceptable terms. If we fail to obtain additional financing, when and if necessary, our business would be harmed.

RELATED PARTY TRANSACTIONS

In June 2000, we entered into a stock purchase agreement with Enel pursuant to which Enel purchased 300,000 newly issued shares of our common stock for \$130.7 million. The closing of this stock purchase occurred on September 11, 2000. At the closing, Enel had agreed that it would not, except under limited circumstances, sell or otherwise transfer any of those shares for a specified time period. That time period expired September 11, 2003. To our knowledge, Enel has not disposed of any of its 300,000 shares. Under the terms of the stock purchase agreement, Enel has the right to nominate a member of our board of directors. A representative of Enel served on our board until March 14, 2012; no Enel representative is presently serving on our board.

At the time the company entered into the stock purchase agreement with Enel, it also entered into a research and development agreement with an affiliate of Enel (the "R&D Agreement"). Under the terms of the R&D Agreement, the company cooperated with Enel to integrate its LONWORKS technology into Enel's remote metering management project in Italy, the Contatore Elettronico. The company completed the sale of its components and products for the deployment phase of the Contatore Elettronico project during 2005. During 2006, the company supplied Enel and its designated manufacturers with limited spare parts for the Contatore Elettronico system. In October 2006, the company entered into a new development and supply agreement and a software enhancement agreement with Enel. Under the development and supply agreement, Enel and its contract manufacturers purchase additional electronic components and finished goods from the company. Under the software enhancement agreement, the company provided software enhancements to Enel for use in its Contatore Elettronico system. The software enhancement was assigned to S&T as part of the sale of our Grid division in September 2014. The development and supply agreement expired in March 2016, although delivery of products can extend beyond then and the agreement may be extended under certain circumstances.

We recognized no revenue from Enel during the year ended December 31, 2017. During the year ended December 31, 2016, we recognized revenue from products and services sold to Enel and its designated manufacturers of approximately \$1.3 million. As of December 31, 2017 and 2016, none of the Company's total accounts receivable balance related to amounts owed by Enel and its designated manufacturers.

RECENTLY ISSUED ACCOUNTING STANDARDS

During 2017, there have been no new recent accounting pronouncements or changes in accounting pronouncements, other than those noted in Note 1 in the Notes to Consolidated Financial Statements in Part IV, Item 15 of this report, that are of significance, or potential significance, to our company.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

Market Risk Disclosures. The following discussion about our market risk disclosures involves forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements. We are exposed to market risk related to changes in interest rates and foreign currency exchange rates. We do not use derivative financial instruments to hedge these exposures.

Interest Rate Sensitivity. We maintain a short-term investment portfolio consisting mainly of fixed income securities with a weighted average maturity of less than one year. These available-for-sale securities are subject to interest rate risk and will fall in value if market interest rates increase. If market rates were to increase immediately and uniformly by 10% from levels at December 31, 2017 and December 31, 2016, the fair value of the portfolio would decline by an immaterial amount. We currently intend to hold our fixed income investments until maturity, and therefore we would not expect our operating results or cash flows to be affected to any significant degree by a sudden change in market interest rates. However, if necessary, we may sell short-term investments prior to maturity to meet the liquidity needs of the company.

Foreign Currency Exchange Risk. We have international subsidiaries and operations and are, therefore, subject to foreign currency rate exposure. To date, our exposure to exchange rate volatility has not been significant. If foreign

exchange rates

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were to fluctuate by 10% from rates at December 31, 2017, and December 31, 2016, our financial position and results of operations would not be materially affected. However, we could experience a material impact in the future.

In addition, for our cost of goods sold, our products are generally assembled by CEMs in China, although our transactions with these vendors have historically been denominated in U.S. dollars. These vendors may require us to pay in their local currency, or demand a U.S. dollar price adjustment or other payment to address a change in exchange rates, which would increase our cost to procure our products. This is particularly a risk in China, where any future revaluations of the Chinese currency against the U.S. dollar could result in significant cost increases.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Financial Statements and Supplementary Data required by this item are set forth in Item 15(a).

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

a. Evaluation of Effectiveness of Disclosure Controls and Procedures

We have designed our disclosure controls and procedures to ensure that information we are required to disclose in reports that we file or submit under the Securities and Exchange Act of 1934 is accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure, and that such information is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. As of the end of the period covered by this Annual Report on Form 10-K, under the supervision of our Chief Executive Officer and our Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures, as such terms are defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities and Exchange Act of 1934. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of December 31, 2017.

b. Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934). Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Our internal control over financial reporting is 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.

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2017. This evaluation was based on the framework in Internal Control - Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control - Integrated Framework (1992), our management concluded that our internal control over financial reporting is effective at this reasonable assurance level as of December 31, 2017.

c. Changes in Internal Control Over Financial Reporting

There were no changes in our internal controls over financial reporting (as defined in Rule 13a-15(e) of the Exchange Act) that occurred during the quarter ended December 31, 2017, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

Not applicable.

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information regarding our executive officers required by this Item is incorporated herein by reference from the section titled “Executive Officers of Registrant” in Part I of this annual report on Form 10-K. The remaining information required by this Item is incorporated herein by reference from our Proxy Statement for the 2018 Annual Meeting of Stockholders (the “2018 Proxy Statement”), which will be filed with the Securities and Exchange Commission no later than 120 days after the end of our fiscal year ended December 31, 2017.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated herein by reference from our 2018 Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item is incorporated herein by reference from our 2018 Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated herein by reference from our 2018 Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item is incorporated herein by reference from our 2018 Proxy Statement.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) The following documents are filed as part of this Form:

1. Financial Statements

| | Page |
|---|-----------|
| Reports of Independent Registered Public Accounting Firms | <u>44</u> |
| Consolidated Balance Sheets | <u>45</u> |
| Consolidated Statements of Operations | <u>46</u> |
| Consolidated Statements of Comprehensive Loss | <u>47</u> |
| Consolidated Statements of Stockholders' Equity | <u>48</u> |
| Consolidated Statements of Cash Flows | <u>49</u> |
| Notes to Consolidated Financial Statements | <u>49</u> |

2. Financial Statement Schedule

See Note 15 in Notes to Consolidated Financial Statements 71

All other schedules have been omitted because they are not applicable or the required information is included in the Consolidated Financial Statements or the Notes thereto.

3. Exhibits

Item 601 of Regulation S-K requires the following exhibits listed below. Each management contract or compensatory plan or arrangement required to be filed as an exhibit to this Form 10-K has been identified.

Exhibit No. Description of Document

| | |
|--------------------------|---|
| 3.2 ⁽¹⁾ | <u>Amended and Restated Certificate of Incorporation of Registrant, as amended December 7, 2015.</u> |
| 3.3 ⁽²⁾ | <u>Amended and Restated Bylaws of Registrant.</u> |
| 4.1 ⁽³⁾ | <u>Form of Registrant's Common Stock Certificate.</u> |
| 4.2 ⁽¹⁷⁾ | <u>Tax Benefit Preservation Plan, dated as of April 22, 2016, by and between Echelon Corporation and Computershare Inc., as rights agent.</u> |
| 10.1 ⁽⁴⁾ | <u>Form of Indemnification Agreement entered into by Registrant with each of its directors and executive officers.</u> |
| 10.2 ⁽¹⁰⁾ | <u>1997 Stock Plan (as amended and restated March 26, 2004)</u> |
| 10.2 ⁽¹⁶⁾⁺ | <u>1997 Stock Plan (as amended and restated April 3, 2013)</u> |
| 10.2(a) ⁽⁵⁾⁺ | <u>Form of 1997 Stock Plan Stock Option Agreement with early exercise feature</u> |
| 10.2(b) ⁽⁵⁾⁺ | <u>Form of 1997 Stock Plan Nonqualified Stock Option Agreement with early exercise feature</u> |
| 10.2(c) ⁽⁵⁾⁺ | <u>Form of 1997 Stock Plan Nonqualified Stock Option Agreement</u> |
| 10.2(d) ⁽⁵⁾⁺ | <u>Form of 1997 Stock Plan Performance Share Agreement (re: non-standard vesting schedule)</u> |
| 10.2(e) ⁽⁵⁾⁺ | <u>Form of 1997 Stock Plan Performance Share Agreement for non-US employees</u> |
| 10.2(f) ⁽⁵⁾⁺ | <u>Form of 1997 Stock Plan Performance Share Agreement with performance based vesting criteria for non-US employees</u> |
| 10.2(g) ⁽⁵⁾⁺ | <u>Form of 1997 Stock Plan Stock Appreciation Right Agreement for non-US employees</u> |
| 10.2(h) ⁽⁵⁾⁺ | <u>Form of 1997 Stock Plan Performance Share Agreement with performance based vesting criteria</u> |
| 10.2(i) ⁽⁵⁾⁺ | <u>Form of 1997 Stock Plan Performance Share Agreement</u> |
| 10.2(j) ⁽¹³⁾⁺ | <u>Form of 1997 Stock Plan Stock Appreciation Right Agreement</u> |
| 10.2(k) ⁽⁷⁾⁺ | <u>Form of 1997 Stock Plan Performance Share Agreement for US-based corporate officers</u> |
| 10.2(l) ⁽⁷⁾⁺ | <u>Form of 1997 Stock Plan Performance Share Agreement for non US-based corporate officers</u> |
| 10.2(m) ⁽⁷⁾⁺ | <u>Form of 1997 Stock Plan Stock Appreciation Right Agreement for US-based corporate officers</u> |
| 10.2(n) ⁽⁷⁾⁺ | <u>Form of 1997 Stock Plan Stock Appreciation Right Agreement for non US-based corporate officers</u> |
| 10.2(o) ⁽¹²⁾⁺ | <u>Form of 1997 Stock Plan Restricted Stock Award Agreement</u> |

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- 10.2(p)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Stock Option Agreement for U.S. Optionees (2012)
 10.2(q)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Stock Option Agreement for U.S. Corporate Officers (2012)
 10.2(r)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Stock Option Agreement for Optionees Outside the U.S. (2012)
 10.2(s)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Stock Option Agreement for Corporate Officers Outside the U.S. (2012)
 10.2(t)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Stock Option Agreement Appendix A for Optionees Outside the U.S. (2012)
 10.2(u)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Performance Share Agreement for Participants Outside the U.S. (2012)
 10.2(v)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Performance Share Agreement for Corporate Officers Outside the U.S. (2012)
 10.2(w)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Performance Share Agreement Appendix A for Participants Outside the U.S. (2012)
 10.2⁽¹⁵⁾⁺ 1997 Stock Plan (as amended and restated August 18, 2010)
 10.3⁽¹⁸⁾ 2016 Equity Incentive Plan and form agreements
 10.4⁽¹⁹⁾ 2016 Inducement Equity Incentive Plan and form agreements
 10.5⁽⁴⁾ Form of International Distributor Agreement.
 10.6⁽⁴⁾ Form of OEM License Agreement.
 10.7⁽⁴⁾ Form of Software License Agreement.
 10.8⁽⁴⁾ International Distributor Agreement between the Company and EBV Elektronik GmbH as of December 1, 1997.
 10.9⁽⁹⁾ Building 1 Lease Agreement dated December 30, 1999
 10.10⁽⁹⁾ First Amendment to Building 1 Lease Agreement dated May 10, 2000
 10.11⁽⁹⁾ Echelon Corporation Common Stock Purchase Agreement with ENEL S.p.A. dated June 30, 2000
 10.12⁽⁹⁾ Second Amendment to Building 1 Lease Agreement dated September 22, 2000
 10.13⁽⁹⁾ Building 2 Lease Agreement dated November 15, 2001
 10.14⁽⁹⁾ Third Amendment to Building 1 Lease Agreement dated April 10, 2008
 10.15⁽⁹⁾ First Amendment to Building 2 Lease Agreement dated April 10, 2008
 10.16⁽¹⁴⁾ Form of Value Added Reseller Agreement
 10.17⁽²¹⁾ Assignment and Amendment dated April 29, 2011 between the Company and Avnet Europe Comm VA (assigning and modifying the International Distributor Agreement filed as Exhibit 10.8 to the Registration Statement on Form S-1 filed on June 1, 1998)
 10.18⁽²²⁾⁺ Echelon Corporation Employment Agreement by and between Echelon Corporation and Ronald A. Sege dated August 18, 2010
 10.19⁽¹⁶⁾⁺ Form of Executive Change in Control and Severance Agreement (2013)
 10.20⁽²⁰⁾⁺ Echelon Corporation Employment letter with Alicia Jayne Moore dated June 27, 2013
 21.1⁽³⁾ Subsidiaries of the Registrant.
 23.1 Consent of Armanino LLP, Independent Registered Public Accounting Firm.
 24.1⁽⁴⁾ Power of Attorney (see signature page).
 31.1 Certificate of Echelon Corporation Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
 31.2 Certificate of Echelon Corporation Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
 32 Certification by the Chief Executive Officer and the 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
 101.CAL* XBRL Taxonomy Extension Calculation Linkbase
 101.DEF* XBRL Taxonomy Extension Definition Linkbase
 101.LAB* XBRL Taxonomy Extension Label Linkbase
 101.PRE* XBRL Taxonomy Extension Presentation Linkbase

*The financial information contained in these XBRL documents is unaudited and is furnished, not filed with the Securities and Exchange Commission.

⁺ Indicates management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 14(c) of Form 10-K.

- (1) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2000, filed on November 14, 2000, and Current Report on Form 8-K filed on December 10, 2015.
- (2) Incorporated herein by reference to the Registrant's Current Report on Form 8-K dated August 16, 2007, filed on August 17, 2007.
- (3) Incorporated herein by reference to the Registrant's Registration Statement on Form S-1/A filed on July 9, 1998.
- (4) Incorporated herein by reference to the Registrant's Registration Statement on Form S-1 filed on June 1, 1998.
- (5) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2006, filed on March 16, 2007.
- (6) Incorporated herein by reference to the Registrant's Current Report Form 8-K dated April 12, 2007, filed on April 18, 2007.
- (7) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2008, filed on August 11, 2008.
- (8) Incorporated herein by reference to the Registrant's Registration Statement on Form S-8 filed on August 21, 2000.
- (9) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2008, filed on March 11, 2010.
- (10) Incorporated herein by reference to the Registrant's Registration Statement on Form S-8 filed on June 1, 2005.
- (11) Incorporated herein by reference to the Registrant's Registration Statement on Form S-8 filed on August 6, 2010.
- (12) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2010, filed on November 3, 2010
- (13) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2007, filed on March 17, 2008
- (14) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2009, filed on March 16, 2010
- (15) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2012, filed on August 8, 2012
- (16) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2013, filed on August 9, 2013
- (17) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed on April 26, 2016
- (18) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2016, filed on November 9, 2016
- (19) Incorporated herein by reference to the Registrant's Registration Statement on Form S-8 filed on April 21, 2016
- (20) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2013, filed on November 8, 2013
- (21) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2011, filed on May 6, 2011
- (22) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2011, filed on March 15, 2012.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Stockholders of Echelon Corporation and subsidiaries

Opinion on the Financial Statements

We have audited the accompanying balance sheets of Echelon Corporation and subsidiaries (collectively the "Company") as of December 31, 2017 and 2016, the related consolidated statements of operations, stockholders' equity, and cash flows, for each of the two years in the period ended December 31, 2017, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2017, in conformity with U.S. generally accepted accounting principles.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as the Company's auditor since 2016.

/s/ ARMANINO LLP
San Jose, California
March 27, 2018

ECHELON CORPORATION
CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share amounts)

| | December 31, 2017 | December 31, 2016 |
|--|----------------------|----------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 7,261 | \$ 9,803 |
| Restricted investments | 1,250 | 1,250 |
| Short-term investments | 11,967 | 11,983 |
| Accounts receivable, net of allowances of \$282 and \$564 as of December 31, 2017 and 2016, respectively | 2,721 | 3,015 |
| Inventories | 3,251 | 2,570 |
| Deferred cost of goods sold | 1,767 | 1,104 |
| Other current assets | 1,152 | 900 |
| Total current assets | 29,369 | 30,625 |
| Property and equipment, net | 458 | 445 |
| Intangible assets, net | 725 | 953 |
| Other long-term assets | 987 | 885 |
| Total assets | \$ 31,539 | \$ 32,908 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 2,317 | \$ 1,697 |
| Accrued liabilities | 1,878 | 2,174 |
| Deferred revenues | 4,805 | 3,671 |
| Total current liabilities | 9,000 | 7,542 |
| LONG-TERM LIABILITIES: | | |
| Other long-term liabilities | 652 | 688 |
| Total liabilities | 9,652 | 8,230 |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock, \$0.01 par value: | | |
| Authorized - 5,000,000 shares; none outstanding | — | — |
| Common stock, \$0.01 par value: | | |
| Authorized - 10,000,000 shares | | |
| Issued - 4,842,294 and 4,753,654 shares as of December 31, 2017 and 2016, respectively. | | |
| Outstanding - 4,520,376 and 4,431,736 shares as of December 31, 2017 and 2016, respectively | 48 | 48 |
| Additional paid-in capital | 359,339 | 358,123 |
| Treasury stock (321,918 shares as of December 31, 2017 and 2016) | (28,130) | (28,130) |
| Accumulated other comprehensive loss | (1,821) | (2,437) |
| Accumulated deficit | (307,803) | (303,180) |
| Total Echelon Corporation stockholders' equity | 21,633 | 24,424 |
| Non controlling interest in subsidiary | 254 | 254 |
| Total stockholders' equity | 21,887 | 24,678 |
| Total liabilities and stockholders' equity | \$ 31,539 | \$ 32,908 |

See accompanying notes to consolidated financial statements.

ECHELON CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

| | Year ended | |
|--|--------------|-----------|
| | December 31, | |
| | 2017 | 2016 |
| Revenues ⁽¹⁾ | \$31,667 | \$32,385 |
| Cost of revenues ⁽²⁾ | 14,016 | 14,302 |
| Gross profit | 17,651 | 18,083 |
| Operating expenses: | | |
| Product development ⁽²⁾ | 9,313 | 8,260 |
| Sales and marketing ⁽²⁾ | 5,532 | 6,189 |
| General and administrative ⁽²⁾ | 6,959 | 8,077 |
| Restructuring charges | — | 286 |
| Total operating expenses | 21,804 | 22,812 |
| Loss from operations | (4,153) | (4,729) |
| Interest and other income (expense), net | (498) | 808 |
| Loss from operations before provision for income taxes | (4,651) | (3,921) |
| Income tax expense (benefit) | (28) | 182 |
| Net loss | (4,623) | (4,103) |
| Basic and diluted net loss per share | \$(1.04) | \$(0.93) |

Shares used in computing net loss per share:

| | | |
|---------|-------|-------|
| Basic | 4,465 | 4,425 |
| Diluted | 4,465 | 4,425 |

¹ Includes related party amounts of \$0 and \$1,313 in 2017 and 2016, respectively. See Note 13 for additional information on related party transactions.

² See Note 7 for summary of amounts included representing stock-based compensation expense. See accompanying notes to consolidated financial statements.

ECHELON CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

| | Year ended | |
|---|--------------|-----------|
| | December 31, | |
| | 2017 | 2016 |
| Net loss | \$(4,623) | \$(4,103) |
| Other comprehensive income (loss), net of tax: | | |
| Foreign currency translation adjustment | 617 | (853) |
| Unrealized holding gain (loss) on available-for-sale securities | (1) | 10 |
| Total other comprehensive income (loss) | 616 | (843) |
| Comprehensive loss | \$(4,007) | \$(4,946) |

See accompanying notes to consolidated financial statements.

ECHELON CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)

| | Echelon Corporation Shareholders | | | | Additional Paid-in- capital | Accu-mulated Other Compre-hensive Income (Loss) | Accumu-lated Deficit | Non Control-lif Interest | Total |
|--|----------------------------------|--------|-----------------------------|------------|-----------------------------------|---|-------------------------|--------------------------------|-----------|
| | Common Stock Shares | Amount | Treasury Stock Shares | Amount | | | | | |
| BALANCE AT DECEMBER 31, 2015 | 4,738 | \$ 47 | (322) | \$(28,130) | \$ 356,746 | \$ (1,594) | \$ (298,402) | \$ 254 | \$ 28,921 |
| Cumulative effect adjustment from adoption of accounting standard | — | — | — | — | 675 | — | (675) | — | — |
| Release of restricted stock units | 24 | 1 | — | — | (1) | — | — | — | — |
| Stock received for payment of employee taxes on vesting of restricted stock units and upon exercise of stock options | (8) | — | — | — | (43) | — | — | — | (43) |
| Stock-based compensation | — | — | — | — | 746 | — | — | — | 746 |
| Foreign currency translation adjustment | — | — | — | — | — | (853) | — | — | (853) |
| Unrealized holding gain on available-for-sale securities | — | — | — | — | — | 10 | — | — | 10 |
| Net loss | — | — | — | — | — | — | (4,103) | — | (4,103) |
| BALANCE AT DECEMBER 31, 2016 | 4,754 | \$ 48 | (322) | \$(28,130) | \$ 358,123 | \$ (2,437) | \$ (303,180) | \$ 254 | \$ 24,678 |
| Release of restricted stock units | 137 | 1 | — | — | (1) | — | — | — | — |
| Stock received for payment of employee taxes on vesting of restricted stock units and upon exercise of stock options | (49) | (1) | — | — | (240) | — | — | — | (241) |
| Stock-based compensation | — | — | — | — | 1,457 | — | — | — | 1,457 |
| Foreign currency translation adjustment | — | — | — | — | — | 617 | — | — | 617 |
| Unrealized holding loss on available-for-sale securities | — | — | — | — | — | (1) | — | — | (1) |
| Net loss | — | — | — | — | — | — | (4,623) | — | (4,623) |
| BALANCE AT DECEMBER 31, 2017 | 4,842 | \$ 48 | (322) | \$(28,130) | \$ 359,339 | \$ (1,821) | \$ (307,803) | \$ 254 | \$ 21,887 |

See accompanying notes to consolidated financial statements.

ECHELON CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

| | Year ended | |
|--|---------------|----------------|
| | December 31, | 2016 |
| | 2017 | 2016 |
| CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES: | | |
| Net loss | \$(4,623) | \$(4,103) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 454 | 489 |
| Increase (decrease) in allowance for doubtful accounts | (3 |) 6 |
| Loss on disposal and write-down of fixed assets | — | 1 |
| Increase in accrued investment income | (110 |) (43 |
| Stock-based compensation | 1,457 | 746 |
| Adjustment to contingent consideration | — | (318 |
| Change in operating assets and liabilities: | | |
| Accounts receivable | 367 | 1,009 |
| Inventories | (681 |) 323 |
| Deferred cost of goods sold | (628 |) (20 |
| Other current assets | (242 |) 200 |
| Accounts payable | 586 | (558 |
| Accrued liabilities | 259 | (1,176 |
| Deferred revenues | 1,004 | 340 |
| Deferred rent | (65 |) 81 |
| Net cash used in operating activities | (2,225 |) (3,023 |
| CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES: | | |
| Purchases of available-for-sale short-term investments | (23,875) | (23,955) |
| Proceeds from maturities and sales of available for sale short term investments | 24,000 | 29,155 |
| Change in other long-term assets | (98 |) 160 |
| Capital expenditures | (209 |) (117 |
| Net cash provided by (used in) investing activities | (182 |) 5,243 |
| CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES: | | |
| Repurchase of common stock from employees for payment of taxes on vesting of restricted stock units and upon exercise of stock options | (240 |) (43 |
| Net cash used in financing activities | (240 |) (43 |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH | 105 | (65 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (2,542 |) 2,112 |
| CASH AND CASH EQUIVALENTS: | | |
| Beginning of year | 9,803 | 7,691 |
| End of year | \$7,261 | \$9,803 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Cash paid for income taxes | \$151 | \$169 |
| Non-cash transfer of restricted investments to available-for-sale short-term investments | \$— | \$151 |

See accompanying notes to consolidated financial statements.

ECHELON CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Significant Accounting Policies

Operations

Echelon Corporation (the Company) was incorporated in California in February 1988 and reincorporated in Delaware in January 1989. The Company is based in Santa Clara, California, and maintains offices in six foreign countries throughout Europe and Asia. Its products enable everyday devices — such as air conditioners, appliances, elevators, electricity meters, light switches, thermostats, and valves — to be made “smart” and inter-connected, part of an emerging market known as the Industrial Internet of Things (“IIoT”).

Its proven, open standard, multi-application energy control networking platform powers applications for smart cities, smart buildings, and smart campuses that help customers save on their energy usage, reduce outage duration or prevent them from happening entirely, reduce carbon footprint and more. Today, the Company offers, directly and through its partners worldwide, a wide range of products and services.

Basis of Presentation

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries, and a subsidiary in which it has a controlling interest (collectively referred to as the “Company”). The Company reports noncontrolling interests in consolidated entities as a component of equity separate from the Company’s equity. All material inter-company transactions between and among the Company and its consolidated subsidiaries and other consolidated entities have been eliminated in consolidation.

Risks and Uncertainties

The Company’s operations and performance depend significantly on worldwide economic conditions and their impact on purchases of the Company’s products, as well as the ability of suppliers to provide the Company with products and services in a timely manner. The impact of any of the matters described below could have an adverse effect on the Company’s business, results of operations and financial condition.

The Company’s sales are currently concentrated, as approximately 28.0% of revenues for the year ended December 31, 2017, were derived from one customer, Avnet Europe Comm VA (“Avnet”), the Company’s primary distributor of its IIoT products in Europe and Japan. Customers in any of the Company’s target market sectors may experience unexpected reductions in demand for their products and consequently reduce their purchases from the Company, resulting in either the loss of a significant customer or a notable decrease in the level of sales to a significant customer. In addition, if any of these customers are unable to obtain the necessary capital to operate their business, they may be unable to satisfy their payment obligations to the Company.

The Company utilizes third-party contract electronic manufacturers to manufacture, assemble, and test its products. If any of these third-parties were unable to obtain the necessary capital to operate their business, they may be unable to provide the Company with timely services or to make timely deliveries of products.

From time to time, the Company has experienced shortages or interruptions in supply for certain products or components used in the manufacture of the Company’s products that have been or will be discontinued. In order to ensure an adequate supply of these items, the Company has occasionally purchased quantities of these items that are in excess of the Company’s then current estimate of short-term requirements. If the long-term requirements do not materialize as originally expected, or if the Company develops alternative solutions that no longer employ these items and the Company is not able to dispose of these excess products or components, the Company could be subject to increased levels of excess and obsolete inventories.

Use of Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions, and estimates that affect amounts reported in the Consolidated Financial Statements and accompanying notes. Significant estimates and judgments are used for revenue recognition, performance-based equity compensation, inventory valuation, intangible asset valuation, goodwill valuation, contingent consideration valuation, and other loss contingencies. In order to determine the carrying values of assets and liabilities that are not readily apparent from other sources, the Company bases its estimates and assumptions on current facts, historical experience, and various other factors that it believes to be reasonable under the circumstances. Actual results experienced by the Company may differ materially from management’s estimates.

Recently Issued Accounting Standards

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(i) New Accounting Standards Recently Adopted

In July 2015, the FASB issued an update to ASC 330, Inventory: Simplifying the Measurement of Inventory. Under this update, subsequent measurement of inventory is based on the lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated cost of completion and disposal. This update does not apply to inventory that is measured using last-in, first-out or the retail inventory method. This update was adopted by the Company in the first quarter of fiscal year 2017 and did not have a significant impact on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation – Stock Compensation (Topic 718), which simplifies the accounting for share-based payments, including income tax consequences, accounting for forfeitures, classification of awards as either equity or liabilities, and classification on the statements of cash flows. This guidance is effective for interim and annual periods beginning after December 15, 2016, with early adoption permitted. During the fourth quarter of 2016, the Company elected to early adopt ASU 2016-09, with retrospective application to January 1, 2016. The primary impact of adoption was to the Company's accounting policy for forfeited equity compensation awards. Prior to the adoption of ASU 2016-09, the Company's stock-based compensation expense was calculated using an estimated forfeiture rate. Following the adoption, the Company recognizes the impact of forfeitures on stock-based compensation expense as they occur. The net cumulative effect of this change was recognized as a \$675,000 reduction to retained earnings as of January 1, 2016.

(ii) New Accounting Standards Not Yet Effective

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which requires, among other things, the recognition of lease assets and lease liabilities on the balance sheet by lessees for certain leases classified as operating leases under previous GAAP. ASU 2016-02 is effective for annual and interim periods beginning after December 15, 2018. ASU 2016-02 mandates a modified retrospective transition method with early adoption permitted. The Company is currently evaluating the effect that ASU 2016-02 will have on its consolidated financial statements and related disclosures.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which superseded existing revenue recognition guidance under current U.S. GAAP. The standard is a comprehensive revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. In doing so, among other things, companies will generally need to use more judgment and make more estimates than under the current guidance. Recently, the FASB has issued guidance clarifying certain topics such as (i) gross versus net revenue reporting, (ii) identifying performance obligations and licensing, (iii) accounting for shipping and handling fees and costs, and (iv) accounting for consideration given by a vendor to a customer.

The standard will be effective for Echelon in the fiscal year beginning January 1, 2018. The standard permits two methods of adoption: (i) retrospectively to each prior reporting period presented (the full retrospective method), or (ii) retrospectively with the cumulative effect of initially applying the standard recognized at the date of initial application (the cumulative catch-up transition method). The Company will adopt the standard using the full retrospective method to restate each prior reporting period presented.

In preparation for the adoption, the Company has implemented internal controls to enable the preparation of financial information and has reached conclusions on key accounting assessments related to the standard. The Company currently believes the most significant impact of adopting the new standard will relate to its accounting for sales made to distributors under agreements that contain a limited right to return unsold products and price adjustment provisions. Under the existing revenue guidance, the Company has historically concluded that the price to these distributors is not fixed or determinable at the time it delivers products to them. Accordingly, revenue from sales to these distributors

has not historically been recognized until the distributor resells the product. By contrast, under the new standard, the Company will recognize revenue, including estimates for applicable variable consideration, predominately at the time of shipment to these distributors, thereby accelerating the timing of revenue for products sold through the distribution channel. The Company does not currently capitalize costs to obtain customer contracts such as commission expenses, nor does it expect to capitalize such costs under the new standard.

Adoption of the standard will result in the recognition of additional revenue of \$274,000 for the year ended December 31, 2017. In addition, adoption of the standard will result in a reduction of deferred revenues of \$3.0 million as of December 31, 2017, driven by the recognition of revenues associated with on-hand distributor inventory as of that date, the revenue for which was deferred under previous guidance; a decrease of deferred cost of goods sold of \$728,000 as of December 31, 2017, again driven by the recognition of revenue that was deferred under previous guidance; and a decrease in accounts receivable of \$395,000 as of December 31, 2017, driven by the incremental reserves required for estimated price adjustments that will be

issued to the distributors in the future based on the additional revenue recognized under the new guidance. See Expected Impacts to Reported Results below for the impact of adoption of the standard on our consolidated financial statements.

Expected Impacts to Reported Results

Adoption of the new revenue recognition guidance (discussed above) is expected to impact our reported results as follows (in thousands, except earnings per share amounts):

| | Year ended December 31, 2017 | | |
|----------------------------------|------------------------------|------------|----------|
| | New | | |
| | As | Revenue | As |
| | Reported | Standard | Adjusted |
| | | Adjustment | |
| Statement of Operations: | | | |
| Revenue | \$31,667 | \$ 274 | 31,941 |
| Net loss | (4,623) | 204 | (4,419) |
| Basic and diluted loss per share | (1.04) | 0.05 | (0.99) |
| | December 31, 2017 | | |
| | New | | |
| | As | Revenue | As |
| | Reported | Standard | Adjusted |
| | | Adjustment | |
| Balance Sheets: | | | |
| Accounts receivable, net | \$2,721 | \$ (395) | \$ 2,326 |
| Deferred cost of goods sold | 1,767 | (728) | 1,039 |
| Deferred revenues | 4,805 | (2,963) | 1,842 |
| Stockholders' equity | 21,887 | 1,840 | 23,727 |

Current Revenue Recognition

The Company's revenues are derived from the sale and license of its products and to a lesser extent, from fees associated with training, technical support, and custom software design services offered to its customers. Product revenues consist of revenues from hardware sales and software licensing arrangements. Service revenues consist of product technical support (including software post-contract support services), training, and custom software development services.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery to the customer's carrier (and acceptance, as applicable) has occurred, the sales price is fixed or determinable, collectability is probable, and there are no post-delivery obligations. For non-distributor hardware sales, including sales to third party manufacturers, these criteria are generally met at the time of delivery to the customer's carrier. However, for arrangements that contain contractual acceptance provisions, revenue recognition may be delayed until acceptance by the customer or the acceptance provisions lapse unless the Company can objectively demonstrate that the contractual acceptance criteria have been satisfied, which is generally accomplished by establishing a history of acceptance for the same or similar products. For sales made to the Company's distributor partners, revenue recognition criteria are generally met at the time the distributor sells the products through to its end-use customer. Service revenue is recognized as the training services are performed, or ratably over the term of the support period.

The Company accounts for the rights of return, price protection, rebates, and other sales incentives offered to distributors of its products as a reduction in revenue. With the exception of sales to distributors, the Company's customers are generally not entitled to return products for a refund. For sales to certain distributors, due to contractual rights of return and other factors that impact its ability to make a reasonable estimate of future returns and other sales incentives, revenues are not recognized until the distributor has shipped its products to the end customer.

Deferred Revenue and Deferred Cost of Goods Sold

Deferred revenue consists substantially of amounts billed or payments received in advance of revenue recognition. Deferred cost of goods sold related to deferred product revenues includes direct product costs and applied overhead. Once all revenue recognition criteria have been met, the deferred revenues and associated cost of goods sold are recognized.

Stock-Based Compensation

The Company accounts for employee stock-based payment transactions in which the Company receives employee services in exchange for equity instruments of the enterprise. Stock-based compensation cost for restricted stock units ("RSUs") granted to employees is measured based on the closing fair market value of the Company's common stock on the date of grant. Stock-based compensation cost for RSUs granted to non-employee consultants is measured based on the closing fair market value of the Company's common stock at the earlier of the date at which a commitment for performance by the consultant to earn the RSUs is reached, or the date at which the consultant's performance necessary for the RSUs to vest has been completed. Stock-based compensation cost for stock options granted to employees is estimated at the grant date based on each award's fair-value as calculated using the Black-Scholes-Merton ("BSM") option-pricing model. The Company recognizes stock-based compensation cost as expense using the accelerated multiple-option approach over the requisite service period. Further information regarding stock-based compensation can be found in Note 7 of these Notes to Consolidated Financial Statements.

Cash and Cash Equivalents

The Company considers bank deposits, money market investments and all debt and equity securities with remaining maturities of three months or less at the date of purchase to be cash and cash equivalents.

Short-Term Investments

The Company classifies its investments in marketable debt securities as available-for-sale. Securities classified as available-for-sale are reported at fair value with the related unrealized holding gains and losses, net of tax, being included in accumulated other comprehensive loss.

Fair Value Measurements

The Company measures at fair value its cash equivalents and available-for-sale investments using a valuation hierarchy based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's own assumptions. These two types of inputs have created the following fair value hierarchy:

Level 1 - Quoted prices for identical instruments in active markets;

Level 2 - Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

Level 3 - Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires the Company to minimize the use of unobservable inputs and to use observable market data, if available, when estimating fair value. Other than cash and money market funds, the Company's only financial assets or liabilities required to be measured at fair value on a recurring basis at December 31, 2017, are fixed income available-for-sale securities. See Note 2 of these Notes to Consolidated Financial Statements for a summary of the input levels used in determining the fair value of the Company's cash equivalents and short-term investments as of December 31, 2017 and 2016.

Inventories

Inventories are stated at the lower of cost (first in, first out) or net realizable value and include material, labor and manufacturing overhead. When required, provisions are made to reduce excess and obsolete inventories to their estimated net realizable value. Inventories consist of the following (in thousands):

December 31, December 31,
2017 2016

| | | |
|---------------------|----------|----------|
| Purchased materials | \$ 148 | \$ 148 |
| Finished goods | 3,103 | 2,422 |
| | \$ 3,251 | \$ 2,570 |

Impairment of Long-Lived Assets

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability is measured by comparing the asset's carrying value to the future undiscounted cash flows the asset is expected to generate. If long-lived assets are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the asset exceeds its fair value. For the years ended December 31, 2017 and December 31, 2016, the Company recognized no impairments of long-lived assets.

Software Development Costs

For software to be sold, leased, or otherwise marketed, the Company capitalizes eligible computer software development costs upon the establishment of technological feasibility, which the Company has defined as completion of a working model. For the two years ended December 31, 2017, costs that were eligible for capitalization were insignificant and, thus, the Company has charged all software development costs to product development expense in the accompanying consolidated statements of operations.

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

| | December 31, 2017 | December 31, 2016 |
|-----------------------------------|----------------------|----------------------|
| Accrued payroll and related costs | \$ 1,088 | \$ 1,299 |
| Warranty reserve | 142 | 118 |
| Restructuring charges | 185 | 273 |
| Other accrued liabilities | 463 | 484 |
| | \$ 1,878 | \$ 2,174 |

Foreign Currency Translation

The functional currency of the Company's subsidiaries is the local currency. Accordingly, all assets and liabilities are translated into U.S. dollars at the current exchange rate as of the applicable balance sheet date. Equity transactions are translated using historical exchange rates. Revenues and expenses are translated at the average exchange rate prevailing during the period. Gains and losses resulting from the translation of the financial statements are included in accumulated other comprehensive income (loss).

Remeasurement adjustments for non-functional currency monetary assets and liabilities, including short-term intercompany balances, are included in other income (expense) in the accompanying consolidated statements of operations. Currently, the Company does not employ a foreign currency hedge program utilizing foreign currency exchange contracts as the foreign currency transactions and risks to date have not been significant.

Concentrations of Credit Risk and Suppliers

The Company's financial instruments have historically consisted of cash equivalents, short-term investments, accounts receivable, accounts payable, and lease financing obligations. The carrying value of the Company's financial instruments approximates fair value. Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of investments, which are classified as either cash equivalents or short-term investments, and trade receivables. With respect to its investments, the Company has an investment policy that limits the amount of credit exposure to any one financial institution and restricts placement of the Company's investments to financial institutions independently evaluated as highly creditworthy. With respect to its trade receivables, the Company performs ongoing credit evaluations of each of its customers' financial condition. For a customer whose credit worthiness does not meet the Company's minimum criteria, the

Company may require partial or full payment prior to shipment. Alternatively, prior to shipment, customers may be required to provide the Company with an irrevocable letter of credit or arrange for some other form of coverage, such as a bank guarantee, to mitigate the risk of uncollectibility. Additionally, the Company establishes an allowance for doubtful accounts and sales return allowances based upon factors surrounding the credit risk of specific customers, historical trends, and other available information. With the exception of amounts owed to the Company on sales made to certain significant customers, concentrations of credit risk with respect to trade receivables are generally limited due to the Company's large number of customers and their dispersion across many different industries and geographies. As of December 31, 2017 and 2016, 0.0% and 26.9%, respectively, of the Company's total accounts receivable balance were due from Avnet Europe Comm VA (refer to Note 8 - Significant Customers for a discussion of revenues generated from the Company's significant customers).

For most of the Company's products requiring assembly, it relies on a limited number of contract electronic manufacturers, principally Bel-Fuse (formerly TYCO). The Company also maintains manufacturing agreements with a limited number of semiconductor manufacturers for the production of key products.

The Neuron Chip is an important component that the Company and its customers use in control network devices. In addition to those sold by the Company, the Neuron Chip is currently manufactured and distributed only by Cypress Semiconductor. Another semiconductor supplier, STMicroelectronics, manufactures the Company's power line smart transceiver products, for which the Company has no alternative source. In addition, the Company currently purchases several key products and components from sole or limited source suppliers with which it does not maintain signed agreements that would obligate them to supply to the Company on negotiated terms.

If any of the Company's key suppliers were to stop manufacturing the Company's products or cease supplying the Company with its key components, it could be expensive and time consuming to find a replacement. There is no guarantee that the Company would be able to find acceptable alternatives or additional sources.

The failure of any key manufacturer to produce a sufficient number of products on time, at agreed quality levels, and fully compliant with the Company's product, assembly and test specifications could adversely affect the Company's revenues and gross profit, and could result in claims against the Company by its customers, which could harm the Company's results of operations and financial position.

Computation of Basic and Diluted Net Loss Per Share

Basic net loss per share is calculated by dividing net loss attributable to Echelon Corporation Stockholders by the weighted average shares of common stock outstanding during the period. Diluted net loss per share attributable to Echelon Corporation Stockholders is calculated by adjusting the weighted average number of outstanding shares assuming conversion of all potentially dilutive stock options and warrants under the treasury stock method.

For the years ended December 31, 2017 and 2016, the diluted net loss per share calculation is equivalent to the basic net loss per share calculation as there were no potentially dilutive stock options or RSUs due to the Company's net loss position. The number of stock options, stock appreciation rights, restricted stock units ("RSUs"), and restricted stock awards ("RSAs") excluded from this calculation for the years ended December 31, 2017 and 2016 was 981,628 and 837,035, respectively.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company takes a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon effective settlement. The Company re-evaluates its income tax positions on a quarterly basis to consider factors such as changes in facts or circumstances, changes in or interpretations of tax law, effectively settled issues

under audit, and new audit activity. Such a change in recognition or measurement would result in recognition of a tax benefit or an additional charge to the tax provision. Interest and penalties on unrecognized tax benefits are classified as income tax expense.

Comprehensive Income (Loss)

Comprehensive income (loss) for the Company consists of net loss plus the effect of unrealized holding gains or losses on investments classified as available-for-sale and foreign currency translation adjustments.

2. Financial Instruments

Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis

On a recurring basis, the Company measures certain of its financial assets, namely its cash equivalents, and short-term investments, at fair value. The fair value of the Company's financial assets measured at fair value on a recurring basis was determined using the following inputs at December 31, 2017 (in thousands):

Fair Value Measurements at Reporting Date
Using

| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|----------|---|---|--|
| Assets: | | | | |
| Money market funds ⁽¹⁾ | \$4,515 | \$ 4,515 | \$ — | \$ — |
| U.S. government securities ⁽²⁾ | 13,217 | — | 13,217 | — |
| Total | \$17,732 | \$ 4,515 | \$ 13,217 | \$ — |

The fair value of the Company's financial assets and liabilities measured at fair value on a recurring basis was determined using the following inputs at December 31, 2016 (in thousands):

Fair Value Measurements at Reporting Date
Using

| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|----------|---|---|--|
| Assets: | | | | |
| Money market funds ⁽¹⁾ | \$4,513 | \$ 4,513 | \$ — | \$ — |
| U.S. government securities ⁽²⁾ | 13,233 | — | 13,233 | — |
| Total | \$17,746 | \$ 4,513 | \$ 13,233 | \$ — |

⁽¹⁾ Included in cash and cash equivalents in the Company's consolidated balance sheets

⁽²⁾ Represents the portfolio of available-for-sale securities and is included in restricted investments and short-term investments in the Company's consolidated balance sheets

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 such as comparing prices obtained from multiple independent sources. There were no transfers between Level 1 and 2 hierarchies for the years ended December 31, 2017 and 2016.

As of December 31, 2017, the Company's available-for-sale securities had contractual maturities of 6 months and an average remaining term to maturity of 3 months. Among the Company's available-for-sale securities, there have been no unrealized holding losses for a period of greater than 12 months as of December 31, 2017. As of December 31, 2017, 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):

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| | Amortized Cost | Aggregate Fair Value | Unrealized Holding Gains | Unrealized Holding Losses |
|----------------------------|-------------------|----------------------------|--------------------------------|---------------------------------|
| U.S. government securities | \$ 11,970 | \$ 11,967 | \$ | —\$ 3 |

The amortized cost basis, aggregate fair value and gross unrealized holding gains and losses for the Company's available-for-sale short-term investments, by major security type, were as follows as of December 31, 2016 (in thousands):

| | Amortized Cost | Aggregate Fair Value | Unrealized Holding Gains | Unrealized Holding Losses |
|----------------------------|-------------------|----------------------------|--------------------------------|---------------------------------|
| U.S. government securities | \$ 11,984 | \$ 11,983 | \$ | —\$ 1 |

Market values were determined for each individual security in the investment portfolio. Any decline in value of these investments is primarily related to changes in interest rates and is considered to be temporary in nature. 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. The cost of securities sold is based on the specific identification method and realized gains and losses are included in Interest and other income (expense), net in the Company's consolidated statements of operations.

Non-Financial Assets Measured at Fair Value on a Nonrecurring Basis

The majority of the Company's non-financial assets and liabilities, which have historically included goodwill, intangible assets, inventories, and property, plant and equipment, are not required to be measured at fair value on a recurring basis. However, if certain triggering events occur (or tested at least annually for goodwill) such that a non-financial instrument is required to be evaluated for impairment and an impairment is recorded to reduce the non-financial instrument's carrying value to the fair value as a result of such triggering events, the non-financial assets and liabilities are measured at fair value for the period such triggering events occur.

3. Property and Equipment

A summary of property and equipment, net as of December 31, 2017 and 2016 is as follows (in thousands):

| | December 31, 2017 | December 31, 2016 |
|---|----------------------|----------------------|
| Computer and other equipment | \$ 3,559 | \$ 3,370 |
| Software | 3,137 | 3,130 |
| Furniture and fixtures | 117 | 110 |
| Leasehold improvements | 200 | 194 |
| | 7,013 | 6,804 |
| Less: Accumulated depreciation and amortization | (6,555) | (6,359) |
| Property and equipment, net | \$ 458 | \$ 445 |

Property and equipment are stated at cost. Depreciation is provided using the straight-line method as follows:

• Computer equipment and related software, other equipment, and furniture and fixtures are depreciated over their estimated useful lives of two to five years;

• Leasehold improvements are depreciated over the shorter of the remaining lease term or estimated useful lives; and

• Certain telecommunications equipment is depreciated over its estimated useful life of 10 years.

4. Acquisitions

On August 15, 2014, the Company purchased 100% of the outstanding shares of Lumewave, Inc. ("Lumewave"). The acquisition was aimed at expanding the Company's outdoor lighting business. The assets acquired and liabilities assumed are reflected in the Company's consolidated balance sheet at December 31, 2017, and the results of operations of Lumewave are included in the consolidated statements of operations since August 16, 2014. The following table

summarizes the purchase price allocation based on estimated fair values of assets acquired and liabilities assumed at the acquisition date (amounts in thousands):

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| | Amount |
|--------------------------------|----------|
| Cash and cash equivalents | \$ 630 |
| Accounts receivable | 107 |
| Inventory | 31 |
| Other current assets | 259 |
| Property and equipment | 23 |
| Identifiable intangible assets | 1,500 |
| Goodwill | 1,257 |
| Accounts payable | (352) |
| Accrued liabilities | (255) |
| | \$ 3,200 |

Identifiable intangible assets include \$800,000 in developed technology, \$500,000 in customer relationships, and \$200,000 for trade names. The identifiable intangible assets are being amortized over a period of 6.5 years. Transaction costs associated with the acquisition were not material. The method used to value the identified intangibles was an income method approach which incorporated a discount rate ranging from 21% to 22%.

Pro forma information for this acquisition is not presented as the results of the acquired business are not material to the Company's consolidated financial statements.

The contingent consideration was measured at fair value based on management's estimate of achieving the specified targets and discounted to its then present value of \$925,000. The contingent consideration was payable in a combination of cash and the Company's common stock. Both the fair value of the cash and equity portions of the contingent consideration were recorded as a liability and were remeasured each reporting period, with any change in their fair values recorded to earnings. The equity component of the contingent consideration was ultimately intended to be settled by issuing additional equity upon final determination of the targets being achieved. The number of shares to be issued was to be based on the average closing price of the Company's stock during the six days prior to the acquisition date.

As of December 31, 2015, the fair value of the contingent consideration was \$318,000, and was recorded in accrued liabilities in the Company's consolidated balance sheets. During the quarter ended December 31, 2015, the Company determined that it was no longer probable that the targets specified in the purchase agreement would be met at a level requiring a full payout of the contingent consideration. Accordingly, the Company reduced the associated liability to management's best estimate of the fair value as of December 31, 2015. This resulted in a \$577,000 adjustment, which was recorded as a reduction to general and administrative expenses in the Company's consolidated statements of operations. The remaining change in contingent consideration was due to amortization of interest on the contingent consideration.

During the quarter ended March 31, 2016, the contingent consideration decreased by approximately \$318,000. This reduction was due to the Company's determination that it was no longer probable that the minimum targets specified in the purchase agreement would be met due to sales force transitions and scheduling delays for some of our larger lighting projects. Accordingly, the Company reduced the associated liability to \$0 as of March 31, 2016. This resulted in a \$318,000 adjustment, which was recorded as a reduction to general and administrative expenses in the Company's consolidated statements of operations.

5. Accumulated Other Comprehensive Loss

| | | |
|-------------|--------------------|---------------|
| Foreign | Unrealized gain | Accumulated |
| currency | (loss) on | Other |
| translation | available-for-sale | Comprehensive |
| adjustment | securities | Loss |

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| | (Amount in thousands) | (Amount in thousands) | (Amount in thousands) |
|--|--------------------------|--------------------------|--------------------------|
| Beginning balance at December 31, 2015 | \$ (1,582) | \$ (12) | \$ (1,594) |
| Change during the year | (853) | 10 | (843) |
| Ending balance at December 31, 2016 | \$ (2,435) | \$ (2) | \$ (2,437) |
| Change during the year | 617 | (1) | 616 |
| Ending balance at December 31, 2017 | \$ (1,818) | \$ (3) | \$ (1,821) |

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6. Stockholders' Equity and Employee Stock Option Plans

(a) Tax Benefit Preservation Plan

On April 22, 2016, the Company announced that its Board of Directors (the "Board") had adopted a Tax Benefit Preservation Plan (the "Tax Plan") pursuant to which the Board authorized and declared a dividend distribution of one right (a "Right") for each outstanding share of common stock of the Company to stockholders of record as of the close of business on May 6, 2016. Each Right entitles the registered holder to purchase from the Company one one-thousandth of a share of Series A Participating Preferred Stock, par value \$0.01 per share, exercisable, except in certain circumstances, in the event that a person or group of affiliated or associated persons obtain beneficial ownership of 4.99% or more of the outstanding shares of the Company's common stock. The complete terms of the Rights are set forth in the Tax Plan, dated as of April 22, 2016, between the Company and Computershare Inc., as rights agent, and filed with the Securities and Exchange Commission on April 26, 2016. By adopting the Plan, the Board is helping to preserve the value of certain deferred tax benefits, including those generated by net operating losses (collectively, the "Tax Benefits"), which could be lost in the event of an "ownership change" as defined under Section 382 of the Internal Revenue Code of 1986, as amended (the "Code"). The Plan reduces the likelihood that changes in the Company's investor base will have the unintended effect of limiting the Company's use of its Tax Benefits. The Board has established procedures to consider requests to exempt certain acquisitions of the Company's securities from the Plan if the Board determines that it is in the best interests of the Company. Until they become exercisable, the Rights are inseparable from and trade with the Company's shares of common stock. The Rights have a de minimus fair value. The Tax Plan expires April 25, 2019.

(b) Stock Option Programs

The Company grants equity compensation awards under the 2016 Equity Incentive Plan (the "2016 Plan") and the 2016 Inducement Equity Incentive Plan (the "2016 Inducement Plan"). Prior to adoption of these Plans in 2016, the Company granted equity compensation awards under the 1997 Stock Plan (the "1997 Plan"), which was terminated as of October 4, 2016. A more detailed description of each of the Plans can be found below.

Stock option and other equity compensation grants are designed to reward employees, officers, directors, and certain non-employee consultants for their long-term contribution to the Company, to align their interest with those of the Company's stockholders in creating stockholder value, and to provide incentives for them to remain with the Company. The number and frequency of equity compensation grants is based on competitive practices, operating results of the Company, and accounting regulations.

Historically, the Company has issued new shares upon the exercise of stock options. However, treasury shares are also available for issuance, although the Company does not currently intend to use treasury shares for this purpose.

2016 Equity Incentive Plan

In October 2016, the Company adopted the 2016 Equity Incentive Plan (the "2016 Plan") for employees, officers, directors, and non-employee consultants. In setting the initial share reserve under the 2016 Plan of 500,000 shares, the Company considered the number of outstanding awards and forecasted grants under the Plan. In addition to the initial share reserve of 500,000 shares, the 2016 Plan also includes any shares subject to awards under the 1997 Plan that, after the termination of the 1997 Plan, expire or otherwise terminate without having vested or without having been exercised in full and any shares issued pursuant to awards granted under the 1997 Plan that are forfeited to or repurchased by the Company.

As of December 31, 2017, there were a total of 1.1 million shares of Common Stock reserved for issuance under the 2016 Plan, of which 892,629 were subject to outstanding awards and 187,982 shares remained available for new awards under the Plan. Stock options granted under the 2016 Plan generally have a term of 10 years, and the exercise price of said stock options is determined by the Board of Directors (or a Committee of the Board of Directors), and, except for limited circumstances, will be at least equal to 100% of the fair market value per share of common stock on the date of grant (or at least 110% of such fair market value for an incentive stock option granted to a stockholder with greater than 10% voting power of all stock). RSUs, Performance Units, and Performance Shares issued by the Company under the 2016 Plan generally vest ratably over 2 to 3 years. In addition, certain of these awards have additional financial-based performance requirements that must be met before vesting can occur. Awards with

performance-based vesting conditions expire no later than the 5 year anniversary of the grant date if the performance criteria have not been met.

The 2016 Plan also allows for the issuance of stock purchase rights and options that are immediately exercisable through execution of a restricted stock purchase agreement. Shares purchased pursuant to a stock purchase agreement may (but are not required to) be subject to vesting conditions, and the shares acquired may not be transferred by the participant until the vesting conditions (if any) are satisfied. In the event of termination of employment, the Company, at its discretion, may repurchase unvested shares at a price equal to the original issuance price. In addition, the 2016 Plan allows for the issuance of stock appreciation rights (“SARs”), restricted stock units (“RSUs”), and Performance Units and Performance Shares. SARs are rights to receive, in cash or shares of the Company's common stock, as designated on the grant date, the appreciation in fair market value of common stock between the exercise date and the date of grant. SARs may be granted alone or in tandem with options. The exercise price of a SAR will be at least equal to 100% of the fair market value per share of common stock on the date of grant. RSUs, Performance Units, and Performance Shares are awards that result in a payment to a participant, generally in the form of an issuance of shares of the Company's common stock, at such time as specified performance goals or other vesting criteria are achieved or the awards otherwise vest.

2016 Inducement Equity Incentive Plan

On April 20, 2016, the Company filed a Registration Statement on Form S-8 with the Securities and Exchange Commission to register 250,000 shares of common stock to be issued pursuant to the 2016 Inducement Plan. The purpose of the Inducement Plan is to facilitate the Company's ability to attract and retain the best available new hires by providing an inducement to such individual entering into employment with the Company or subsidiary of the Company. The Inducement Plan permits the grant of nonstatutory stock options, restricted stock, restricted stock units, stock appreciation rights, performance units, and performance shares, each with terms similar to those governed by the previously discussed 2016 Plan. Each award under the Inducement Plan is intended to qualify as an employment inducement award under NASDAQ Listing Rule 5635(c)(4).

As of December 31, 2017, there were a total of 235,000 shares of Common Stock reserved for issuance under the 2016 Inducement Plan, of which 89,000 were subject to outstanding awards and 146,000 shares remained available for new awards under the Plan.

1997 Stock Plan (terminated October 4, 2016)

During 1997, the Company adopted the 1997 Stock Plan for employees, officers, directors, and non-employee consultants, which was amended and restated in May 2004, and further amended and restated in April 2013. During 2013, the Board determined that it was in the best interest of the Company and the stockholders to amend and restate the Plan. In setting the share reserve under the amended Plan, the Company considered the number of outstanding awards and forecasted grants under the Plan. As of March 31, 2013 a total of 2,097,283 shares of its Common Stock were reserved for issuance under the Plan, of which 550,540 shares were subject to outstanding awards and 1,546,743 shares remained available for new awards under the Plan. Upon approval of the amended Plan by the shareholders, the total number of shares issuable under the Plan after March 31, 2013, was reduced from 2,097,283 to 1,090,540, including the 550,540 shares subject to current outstanding awards plus an additional 540,000 shares for future new awards. In determining the size of the share reserve, the Company took into account historical grant practices and the rate of granting equity awards (“burn rate”). As discussed above, the 1997 Plan was terminated on October 4, 2016. As of the termination date, all outstanding awards granted under the 1997 Plan were transferred to the 2016 Plan.

However, they will continue to be governed by the terms of the 1997 Plan.

Under the 1997 Plan, incentive stock options to purchase shares of common stock were eligible to be granted at not less than 100% of the fair market value. Options granted from May 6, 2003 to March 31, 2013, generally have a term of 5 years from the date of grant. All other options granted generally have a term of 10 years. The exercise price of stock options granted under the 1997 Plan is determined by the Board of Directors (or a Committee of the Board of Directors), but were at least equal to 100% of the fair market value per share of common stock on the date of grant (or at least 110% of such fair market value for an incentive stock option granted to a stockholder with greater than 10% voting power of all stock). Options generally vested ratably over four years.

The 1997 Plan also allowed for the issuance of stock purchase rights and options that were immediately exercisable through execution of a restricted stock purchase agreement. Shares purchased pursuant to a stock purchase agreement generally vested ratably over 4 years. In the event of termination of employment, the Company, at its discretion, may repurchase unvested shares at a price equal to the original issuance price. In addition, the 1997 Plan allowed for the

issuance of stock appreciation rights (“SARs”), restricted stock awards (“RSAs”), and restricted stock units (“RSUs”). SARs are rights to receive, in cash or shares of the Company's common stock, as designated on the grant date, the appreciation in fair market value of common stock between the exercise date and the date of grant. To date, the Company has only issued SARs that can be settled in shares of the Company's common stock. SARs may be granted alone or in tandem with options. The exercise price of a SAR will be at least equal to 100% of the fair market value per share of common stock on the date of grant. SARs issued by the Company generally

vest in equal, annual installments over 4 years, and expire on the 5 year anniversary of the grant date. RSUs and RSAs are awards that result in a payment to a participant, generally in the form of an issuance of shares of the Company's common stock, at such time as specified performance goals or other vesting criteria are achieved or the awards otherwise vest. RSUs and RSAs issued by the Company generally vest in equal, annual installments over 4 years. In addition, certain of these RSU and RSA grants have additional financial-based performance requirements that must be met before vesting can occur. RSUs and RSAs with performance-based vesting conditions expire no later than the 5 year anniversary of the grant date if the performance criteria have not been met.

(c) Stock Award Activity

The following table summarizes stock award activity under all plans for the years ended December 31, 2017 and 2016:

| | Shares Available for Grant | Options Outstanding | |
|---|----------------------------|---------------------|---|
| | | Number Outstanding | Weighted-Average Exercise Price Per Share |
| BALANCE AT DECEMBER 31, 2015 | 517,505 | 285,536 | \$ 24.72 |
| New plan shares approved | 750,000 | — | — |
| Unissued shares eliminated from plan | (13,346) | — | — |
| Options granted | (275,250) | 275,250 | 5.07 |
| RSUs granted | (460,209) | — | — |
| Options and stock appreciation rights cancelled | 54,914 | (54,914) | 25.50 |
| RSUs cancelled | 29,211 | — | — |
| BALANCE AT DECEMBER 31, 2016 | 602,825 | 505,872 | \$ 13.94 |
| Options granted | (20,000) | 20,000 | 7.18 |
| RSUs granted | (454,783) | — | — |
| Options and stock appreciation rights cancelled | 100,150 | (100,150) | 23.92 |
| RSUs cancelled | 105,790 | — | — |
| Balance at DECEMBER 31, 2017 | 333,982 | 425,722 | \$ 11.28 |

The total intrinsic value of options and SARs exercised during the years ended December 31, 2017 and 2016 was approximately \$0 and \$0, respectively, as no options or SARs were exercised during this time. The intrinsic value is calculated as the difference between the market value on the date of exercise and the exercise price of the shares. The following table provides additional information regarding RSU and RSA activity for the years ended December 31, 2017 and 2016:

| | Number of Shares Nonvested and Outstanding | Weighted-Average Grant Date Fair-Value |
|------------------------------|--|--|
| | | |
| BALANCE AT DECEMBER 31, 2015 | 64,714 | \$ 14.45 |
| RSUs granted | 307,770 | 5.21 |
| RSUs vested and released | (23,993) | 14.31 |
| RSUs cancelled | (17,328) | 17.06 |
| BALANCE AT DECEMBER 31, 2016 | 331,163 | \$ 5.74 |
| RSUs granted | 454,783 | 4.88 |
| RSUs vested and released | (136,928) | 6.22 |
| RSUs cancelled | (93,112) | 5.31 |
| BALANCE AT DECEMBER 31, 2017 | 555,906 | \$ 4.99 |

The fair value of each RSU and RSA granted to employees was estimated on the date of grant by multiplying the number of shares granted times the fair market value of the Company's stock on the grant date.

The total intrinsic value of RSUs and RSAs vested and released during the years ended December 31, 2017 and 2016 was approximately \$685,400 and \$118,000, respectively. The intrinsic value of vested and released RSUs and RSAs is calculated by multiplying the fair market value of the Company's stock on the vesting date by the number of shares vested. As of December 31, 2017, the number of RSUs and RSAs outstanding was 555,906, with a total intrinsic value of \$3.1 million. The intrinsic value of the outstanding RSUs and RSAs is calculated based on the market value of the Company's closing stock price of \$5.54 as of December 29, 2017, the last market trading day of 2017.

The following table provides additional information for significant ranges of outstanding and exercisable stock options and SARs as of December 31, 2017:

| Exercise Price Range | Number Outstanding | Weighted | Weighted | Aggregate Intrinsic Value |
|-----------------------------|--------------------|---|----------------------------------|---------------------------|
| | | Average Remaining Contractual Life (in years) | Average Exercise Price per Share | |
| \$4.51 | 20,000 | 8.38 | \$ 4.51 | \$ 20,600 |
| 5.22 | 182,000 | 8.74 | 5.22 | 58,240 |
| 5.45 - 9.10 | 31,500 | 8.81 | 7.01 | 675 |
| 9.11 | 73,000 | 7.45 | 9.11 | — |
| 9.15 - 23.70 | 81,590 | 6.03 | 21.29 | — |
| \$24.20 - \$32.50 | 37,632 | 4.77 | 30.24 | — |
| Outstanding | 425,722 | 7.64 | \$ 11.28 | \$ 79,515 |
| Vested and expected to vest | 418,607 | 7.64 | \$ 11.35 | \$ 77,790 |
| Exercisable | 345,103 | 7.43 | \$ 12.41 | \$ 57,168 |

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on the Company's closing stock price of \$5.54 as of December 29, 2017, which would have been received by the option holders had all option holders exercised their options as of that date.

7. Stock-based Compensation

(a) Valuation of Options, SARs, and RSUs Granted

The Company has elected to use the Black-Scholes-Merton ("BSM") option-pricing model to estimate the fair value of stock options and SARs that it grants. The BSM model incorporates various assumptions including volatility, expected term of the option from the date of grant to the time of exercise, risk-free interest rates, and dividend yields. The weighted average fair value of options granted during the years ended December 31, 2017 and 2016 was \$3.09 and \$2.55, respectively, and was determined using the following weighted average assumptions:

| | Year ended December 31, | |
|--------------------------|-------------------------------|-------|
| | 2017 | 2016 |
| Expected dividend yield | —% | —% |
| Risk-free interest rate | 1.7% | 1.2% |
| Expected volatility | 55.9% | 58.1% |
| Expected term (in years) | 3.75 | 5.12 |

The expected dividend yield reflects the fact that the Company has not paid any dividends in the past and does not currently intend to pay dividends in the foreseeable future. The risk-free interest rate assumption is based on U.S. Treasury yields in effect at the time of grant for the expected term of the option. The expected volatility is based on both the historical volatility of the Company's common stock over the most recent period commensurate with the expected life of the option as well as on implied volatility calculated from the market traded options on the Company's stock. The expected term has been calculated by applying the simplified method calculation to the 10-year term option grants made during 2016 and 2017, as the Company does not have relevant and adequate exercise history for such

options.

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The grant date fair value of RSUs and RSAs granted to employees is determined by multiplying the fair market value of the Company's stock on the grant date times the number of RSUs and RSAs awarded. During the years ended December 31, 2017 and 2016, the Company issued a limited number of RSUs to non-employee consultants. The final measurement date for these awards is determined at the earlier of the date at which a commitment for performance by the consultant to earn the RSUs is reached, or the date at which the consultant's performance necessary for the RSUs to vest has been completed. Between the date of issuance and the final measurement date, which is expected to be the date the consultants' performance is complete and the awards vest, the awards are remeasured based on the fair market value of the Company's stock at each reporting date. During the year ended December 31, 2017, awards granted to non-employee consultants and the related share-based payment expense were not significant.

(b) Equity Compensation Expense for RSUs and RSAs with Financial or other Performance-Based Vesting Requirements

As of December 31, 2017, there were 143,283 non-vested RSUs that were granted in 2017 that were subject to service-based vesting conditions as well as certain financial or other performance-based vesting requirements that must be achieved before vesting can occur. The following table contains pertinent information regarding these outstanding awards as of December 31, 2017 (in thousands except for number of awards granted):

| Grant Date | # of Awards Granted and Outstanding | Fair Value on Grant Date | Cumulative Expense Recognized | Unearned Compensation Expense | Latest Date Performance Condition Could be Met |
|--------------|-------------------------------------|--------------------------|-------------------------------|-------------------------------|--|
| January 2017 | 143,283 | \$ 721 | \$ 132 | \$ 589 | December 2017 |

Through December 31, 2017, cumulative compensation expense of \$132,000 associated with the 143,283 unvested RSUs granted in January 2017 had been recognized. From the date of grant through December 31, 2017, the Company believed it was probable that the performance requirements associated with certain of these awards would be achieved and therefore recognized expense on those specific awards. However, as of March 31, June 30, and September 30, 2017, the Company determined that separate performance conditions related to the remainder of the awards granted in January 2017 was improbable of achievement. Accordingly, no compensation expense has been recognized on these additional awards. As the performance conditions required for the vesting of these additional awards were not met as of December 31, 2017, the final date that the performance conditions could be met, the Company expects approximately 114,379 awards will expire unvested in March 2018 and will be returned to the Plan.

c) Expense Allocation

As of December 31, 2017, total compensation cost related to non-vested stock options and other equity based awards not yet recognized was \$1.6 million, which is expected to be recognized over the next 0.9 years on a weighted-average basis.

The following table summarizes stock-based compensation expense for the years ended December 31, 2017 and 2016 and its allocation within the consolidated statements of operations (in thousands):

| | Year ended 31 December, | |
|----------------------------|-------------------------|------|
| | 2017 | 2016 |
| Cost of revenues | \$158 | \$48 |
| Product development | 475 | 173 |
| Sales and marketing | (20) | 57 |
| General and administrative | 844 | 468 |

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| | | |
|--|---------|-------|
| Total stock based compensation expense related to stock options and share awards | 1,457 | 746 |
| Tax benefit | — | — |
| Stock-based compensation expense related to stock options and share awards, net of tax | \$1,457 | \$746 |

As of December 31, 2017, and 2016, stock-based compensation expense capitalized as part of the cost of inventory and deferred cost of goods sold was immaterial.

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8. Significant Customers

The Company markets its products and services throughout the world to original equipment manufacturers (OEMs) and systems integrators in the building, industrial, transportation, utility/home, and other automation markets. During the years ended December 31, 2017 and 2016, the Company had one customer that accounted for a significant portion of its revenues, Avnet Europe Comm VA ("Avnet"), the Company's primary distributor of its IIoT products in Europe and Japan. For the years ended December 31, 2017 and 2016, the percentage of the Company's revenues attributable to sales made to this customer was as follows:

| | Year ended | |
|-------|--------------|-------|
| | December 31, | |
| | 2017 | 2016 |
| Avnet | 28.0% | 28.7% |

Avnet is an indirect subsidiary of Avnet, Inc., a New York corporation, which is a distributor of electronic parts, enterprise computing and storage products, and embedded subsystems. Our agreement with Avnet renews automatically on May 31 of each year unless either party, in its sole discretion, gives notice of its desire not to renew at least 90 days before the expiration of the then current term.

9. Intangible Assets

The Company's identifiable intangible assets as of December 31, 2017, relate to the acquisition of Lumewave, Inc. in August 2014. The identifiable intangible assets include \$800,000 in developed technology, \$500,000 in customer relationships, and \$200,000 for trade names.

The changes in the carrying amount of identifiable intangible assets, net for the years ended December 31, 2017 and 2016 are as follows (in thousands):

| | Amount |
|---------------------------------|----------|
| Balance as of December 31, 2015 | \$ 1,183 |
| Amortization | (230) |
| Balance as of December 31, 2016 | 953 |
| Amortization | (228) |
| Balance as of December 31, 2017 | 725 |

Intangible assets other than goodwill are amortized on a straight-line basis over the following estimated remaining useful lives. The following table presents the details of the Company's finite-lived intangible assets as of December 31, 2017 (in thousands, except for weighted-average remaining useful life):

| | Gross Carrying Value | Accumulated Amortization | Net Carrying Value | Weighted-Average Remaining Useful Life (in years) |
|------------------------|----------------------|--------------------------|--------------------|---|
| Developed technology | \$ 800 | \$ (414) | \$ 386 | 3.13 |
| Customer relationships | 500 | (258) | 242 | 3.13 |
| Trade names | 200 | (103) | 97 | 3.13 |
| Total | \$ 1,500 | \$ (775) | \$ 725 | 3.13 |

The following table presents the amortization of finite-lived intangible assets included in the consolidated statements of operations for the years ended December 31, 2017 and 2016 (in thousands):

| Year ended | |
|------------|------|
| December | |
| 31, | |
| 2017 | 2016 |

| | | |
|--------------------|-------|-------|
| Cost of revenues | \$121 | \$123 |
| Operating expenses | 107 | 107 |
| Total | \$228 | \$230 |

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The following table presents the estimated future amortization of finite-lived intangible assets as of December 31, 2017 (in thousands):

| | Estimated Future Amortization |
|----------|-------------------------------------|
| 2018 | 229 |
| 2019 | 229 |
| 2020 | 229 |
| 2021 | 38 |
| Total \$ | 725 |

10. Commitments and Contingencies

(a) Lease Commitments

The Company leases facilities under operating leases for its personnel located within the United States and in several foreign countries throughout Europe and Asia. These operating leases expire on various dates through 2019, and in some instances are cancelable with advance notice. Lastly, the Company also leases certain equipment and, for some of its sales personnel, automobiles. These operating leases are generally less than five years in duration.

As of December 31, 2017, future minimum lease payments under all operating leases were as follows (in thousands):

| | |
|----------------|---------|
| 2018 | \$950 |
| 2019 | 483 |
| 2020 | \$16 |
| 2021 | \$12 |
| Total payments | \$1,461 |

Rent expense for all operating leases was approximately \$964,000 for 2017 and \$994,000 for 2016. Although certain of the operating lease agreements provide for escalating rent payments over the term of the lease, rent expense under these agreements is recognized on a straight-line basis. As of December 31, 2017, the Company has accrued approximately \$135,000 of deferred rent related to these agreements, of which approximately \$72,000 is reflected in accrued liabilities while the remainder is reflected in other long-term liabilities in the accompanying consolidated balance sheets. As of December 31, 2016, the Company had accrued approximately \$193,000 of deferred rent related to its lease agreements, of which approximately \$59,000 is reflected in current liabilities while the remainder is reflected in other long-term liabilities in the accompanying consolidated balance sheets.

(b) Royalties

The Company has certain royalty commitments associated with the shipment and licensing of certain of its products. Royalty expense is generally based on a dollar amount per unit shipped or a percentage of the underlying revenue. Royalty expense, which is recorded as a component of cost of revenues in the Company's consolidated statements of operations, was approximately \$260,000 and \$264,000 for the years ended December 31, 2017 and 2016, respectively.

The Company will continue to be obligated for royalty payments in the future associated with the shipment and licensing of certain of its products. The Company is currently unable to estimate the maximum amount of these future royalties. However, such amounts will continue to be dependent on the number of units shipped or the amount of revenue generated from these products.

(c) Guarantees

In the normal course of business, the Company provides indemnifications of varying scope to its customers against claims of intellectual property infringement made by third parties arising from the use of its products. Historically, costs related to these indemnification provisions have not been significant. However, the Company is unable to estimate the maximum potential impact of these indemnification provisions on its future results of operations.

As permitted under Delaware law, the Company has entered into agreements whereby it indemnifies its officers and directors for certain events or occurrences while the officer or director is, or was serving, at the Company's request in such capacity. The indemnification period covers all pertinent events and occurrences during the officer's or director's lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. However, the Company has directors and officers insurance coverage that would enable it to recover a portion of any future amounts paid. The Company believes the estimated fair value of these indemnification agreements in excess of the applicable insurance coverage is minimal, if any.

(d) Taxes

The Company conducts operations in many tax jurisdictions throughout the world. In many of these jurisdictions, non-income based taxes such as property taxes, sales and use taxes, and value-added taxes are assessed on the Company's operations in that particular location. While the Company strives to ensure compliance with these various non-income based tax filing requirements, there have been instances where potential non-compliance exposures have been identified. In accordance with accounting principles generally accepted in the United States of America, the Company makes a provision for these exposures when it is both probable that a liability has been incurred and the amount of the exposure can be reasonably estimated. To date, such provisions have been immaterial, and the Company believes that, as of December 31, 2017, it has adequately provided for such contingencies. However, it is possible that the Company's results of operations, cash flows, and financial position could be harmed if one or more non-compliance tax exposures are asserted by any of the jurisdictions where the Company conducts its operations.

(e) Legal Actions

From time to time, in the ordinary course of business, the Company may be subject to other legal proceedings, claims, investigations, and other proceedings, including claims of alleged infringement of third-party patents and other intellectual property rights, and commercial, employment, and other matters. In accordance with generally accepted accounting principles, the Company makes a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case. While the Company believes it has adequately provided for such contingencies as of December 31, 2017, the amounts of which were immaterial, it is possible that the Company's results of operations, cash flows, and financial position could be harmed by the resolution of any such outstanding claims.

Line of Credit

The Company maintains an operating credit line of \$1.0 million with its primary bank for company credit card purchases. This line of credit is secured by a collateral of the first priority on \$1.3 million of the Company's investments (presented as restricted investments in the consolidated balance sheets). The restricted investments are classified as current assets due to the contractual duration of the underlying credit agreement.

11. Income Taxes

The provision for (benefit from) income taxes attributable to continuing operations is based upon loss from operations before provision for income taxes as follows (in thousands):

| | Year ended | |
|----------|--------------|-----------|
| | December 31, | |
| | 2017 | 2016 |
| Domestic | \$(5,106) | \$(4,632) |
| Foreign | 455 | 711 |
| | \$(4,651) | \$(3,921) |

The provision for (benefit from) income taxes consists of the following (in thousands):

| | Year ended | |
|------------------------------------|------------|-------|
| | December | |
| | 31, | |
| | 2017 | 2016 |
| Federal: | | |
| Current | \$(82) | \$— |
| Deferred | — | — |
| Total federal benefit | (82) | — |
| State: | | |
| Current | 1 | 18 |
| Deferred | — | — |
| Total state provision | 1 | 18 |
| Foreign: | | |
| Current | 53 | 164 |
| Deferred | — | — |
| Total foreign provision | 53 | 164 |
| Total income tax expense (benefit) | \$(28) | \$182 |

The provision for (benefit from) income taxes differs from the amount estimated by applying the statutory Federal income tax rate to loss before taxes as follows (in thousands):

| | Year ended | |
|--|--------------|-----------|
| | December 31, | |
| | 2017 | 2016 |
| U.S. Federal tax benefit at statutory rate | \$(1,629) | \$(1,372) |
| State tax benefit, net of federal benefit | (187) | (171) |
| U.S.-Foreign rate differential | (113) | (96) |
| Change in valuation allowance | (33,001) | 939 |
| Rate differential impact - Tax Cuts and Jobs Act | 34,679 | — |
| Research and development credits | 281 | 233 |
| Permanent items | 30 | 657 |
| Others | (88) | (8) |
| Total income tax expense (benefit) | \$(28) | \$182 |

As of December 31, 2017 and 2016, a valuation allowance has been recorded against 100% of the net deferred tax asset. A valuation allowance is recognized if, based on the weight of the available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realizable in a particular tax jurisdiction. All available evidence, both positive and negative, is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed for some portion or all of a deferred tax asset. The Company determined that it is more likely than not that it will not realize a benefit from its United States deferred tax assets based on historical cumulative losses incurred in the United States. Therefore, a valuation allowance has been maintained on all deferred tax assets. The components of the net deferred income tax asset are as follows (in thousands):

| | Year ended | |
|--|--------------|------------|
| | December 31, | |
| | 2017 | 2016 |
| Deferred tax assets: | | |
| Net operating loss carry forwards | \$62,635 | \$100,378 |
| Tax credit carry forwards | 17,078 | 19,248 |
| Fixed and intangible assets | 266 | 597 |
| Capitalized research and development costs | 70 | 58 |
| Stock based compensation and other reserves and allowances | 2,131 | 3,445 |
| Gross deferred income tax assets | 82,180 | 123,726 |
| Valuation allowance | (82,180) | (123,726) |
| Net deferred income tax assets | \$— | \$— |

As of December 31, 2017, part of the Company's valuation allowance on deferred tax assets pertains to certain tax credits and net operating loss carry forwards. In the future, it will reduce the valuation allowance associated with these credits and losses upon the earlier of the period in which it utilizes them to reduce the amount of income tax it would otherwise be required to pay on its income tax returns, or when it becomes more likely than not that the deferred tax assets are realizable. In addition, the Internal Revenue Code of 1986, as amended, contains provisions that limit the net operating loss and credit carry forwards available for use in any given period upon the occurrence of certain events, including a significant change in ownership interests. The Company performed an analysis of the ownership changes in 2016. Through the date of the analysis, the Company did not experience any ownership change that would limit its net operating loss and credit carry forwards. The Company's net operating loss and credit carry forwards may be limited if an ownership change has occurred since the analysis was performed or if one were to occur in future periods.

In general, a corporation that undergoes an "ownership change" under Section 382 of the Internal Revenue Code is subject to limitations on its ability to utilize its pre-change net operating loss carry forwards (NOLs) to offset future taxable income and its ability to utilize tax credit carry forwards. As of December 31, 2017, the Company had net operating loss carry forwards of \$261.2 million for federal income tax reporting purposes and \$107.3 million for state income tax reporting purposes, which expire at various dates through 2037. In addition, as of December 31, 2017, the Company had approximately \$11.4 million and \$16.5 million of tax credit carry forwards for increased research expenditures for federal and California purposes, respectively. The federal research tax credits will expire at various dates if not utilized by 2037 and the state tax credit can be carried over indefinitely. In accordance with current Internal Revenue Code rules, federal net operating loss carry forwards must be utilized in full before federal research and development tax credits can be used to offset current tax liabilities. As a result, depending on the Company's future taxable income in any given year, some or all of the federal research tax credits, as well as portions of the Company's federal and state net operating loss carry forwards, may expire before being utilized.

On December 22, 2017, the Tax Cuts and Jobs Act ("the Act") was signed into law. Among other changes is a permanent reduction in the federal corporate income tax rate from 35% to 21%, effective January 1, 2018. As a result of the change in the corporate income tax rate, the Company revalued its net deferred tax asset at December 31, 2017, which resulted in a reduction of the value of the Company's net deferred tax asset of approximately \$34.7 million. This reduction was offset by a change in the Company's valuation allowance, thus resulting in no impact to the Company's tax expense for the year ended December 31, 2017.

Amounts held by foreign subsidiaries are generally subject to United States income taxation on repatriation to the United States. The Company currently intends to permanently reinvest its undistributed earnings from its foreign subsidiaries outside the United States. The Act provides for a one-time "deemed repatriation" of accumulated foreign earnings for the year ended December 31, 2017. The Company does not expect that the future foreign earnings will be subject to U.S. federal income tax since the Company is in a net earnings and profits deficit position and, as noted earlier, intends to permanently reinvest such earnings outside the U.S. indefinitely.

The following is a rollforward of the Company's unrecognized tax benefits related to uncertain tax positions for the years ended December 31, 2017 and 2016 (in thousands):

| | Year ended | |
|---|--------------|---------|
| | December 31, | |
| | 2017 | 2016 |
| Balance as of the beginning of the year | \$9,216 | \$9,066 |
| Tax positions related to current year: | | |
| Additions | 165 | 152 |
| Reductions | (9) | (14) |
| Tax positions related to prior years: | | |
| Additions | 26 | 80 |
| Reductions | (6) | (4) |
| Settlements | — | — |
| Lapses in statute of limitations | (48) | (64) |
| Balance as of the end of the year | \$9,344 | \$9,216 |

Included in the balance of total unrecognized tax benefits at December 31, 2017 are potential benefits of \$332,000, which if recognized, would affect the effective rate on income from continuing operations.

As of December 31, 2017, the Company had accrued interest and penalties related to the uncertain tax benefits of approximately \$56,000. During 2017, the Company decreased the prior year balance by \$6,000 due to lapses in statutes of limitations in certain foreign jurisdictions. During 2016, the Company decreased the prior year balance by \$12,000, again due to lapses in statutes of limitations. The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense.

The Company is subject to taxation in the United States and various state and foreign jurisdictions. In the United States, the tax years from 1998 remain open to examination by federal and most state tax authorities due to certain net operating loss and credit carryforward positions. In the foreign jurisdictions, the number of tax years open to examination by local tax authorities ranges from three to six years.

12. Warranty Reserves

When evaluating the reserve for warranty costs, management takes into consideration the term of the warranty coverage, the quantity of product in the field that is currently under warranty, historical return rates, and historical costs of repair. In addition, certain other applicable factors, such as technical complexity, may also be taken into consideration when historical information is not yet available for recently introduced products. Estimated reserves for warranty costs are generally provided for when the associated revenue is recognized. In addition, additional warranty reserves may be established when the Company becomes aware of a specific warranty related problem, such as a product recall. Such additional warranty reserves are based on the Company's current estimate of the total out-of-pocket costs expected to be incurred to resolve the problem, including, but not limited to, costs to replace or repair the defective items and shipping costs. The reserve for warranty costs was \$350,000 as of December 31, 2017 and \$245,000 as of December 31, 2016. Of the \$350,000 balance as of December 31, 2017, \$142,000 was included in accrued liabilities in the Company's consolidated balance sheet, with the remainder being included in other long-term liabilities. Of the \$245,000 balance as of December 31, 2016, \$118,000 was included in accrued liabilities with the remainder being included in other long-term liabilities.

13. Related Parties

In June 2000, the Company entered into a stock purchase agreement with Enel pursuant to which Enel purchased 300,000 newly issued shares of its common stock for \$130.7 million. To the Company's knowledge, Enel has disposed of none of its 300,000 shares. Under the terms of the stock purchase agreement, Enel has the right to nominate one member of the Company's board of directors. A representative of Enel served on the board until March 14, 2012; no Enel representative is presently on the board.

At the time the Company entered into the stock purchase agreement with Enel, it also entered into a research and development agreement with an affiliate of Enel (the "R&D Agreement"). Under the terms of the R&D Agreement, the Company cooperated with Enel to integrate its LONWORKS technology into Enel's remote metering management project in Italy, the Contatore Elettronico. The Company completed the sale of its components and products for the deployment phase of the Contatore Elettronico project during 2005. During 2006, the Company supplied Enel and its designated manufacturers with limited spare parts for the Contatore Elettronico system. In October 2006, the Company entered into a new development and supply agreement and a software enhancement agreement with Enel. Under the development and supply agreement, Enel and its contract manufacturers purchase additional electronic components and finished goods from the Company. Under the software enhancement agreement, the Company provided software enhancements to Enel for use in its Contatore Elettronico system. The software enhancement was assigned to S&T as part of the sale of our Grid division in September 2014. The development and supply agreement expired in March 2016.

During the year ended December 31, 2017, the Company generated no revenue from products and services sold to Enel and its designated manufacturers. For the year ended December 31, 2016, the Company recognized revenue from products and services sold to Enel and its designated manufacturers of approximately \$1.3 million. As of December 31, 2017 and 2016, none of the Company's total accounts receivable balance related to amounts owed by Enel and its designated manufacturers.

14. Restructuring

During the fourth quarter of 2016, the Company undertook restructuring actions affecting approximately 7 employees to be terminated between October 2016 and November 2018, as part of an overall plan to reshape the Company for the future. In connection with this restructuring, the Company recorded restructuring charges of approximately \$286,000 related to termination benefits for these personnel during the year ended December 31, 2016.

The following table sets forth a summary of restructuring activities related to the Company's 2016 restructuring program in 2017 (in thousands):

| | December 31, 2016 | Costs Incurred | Cash Payments | December 31, 2017 |
|----------------------|-------------------|----------------|---------------|-------------------|
| Termination benefits | \$ 273 | \$ | —\$ (88) | \$ 185 |

The following table sets forth a summary of restructuring activities related to the Company's 2016 restructuring program in 2016 (in thousands):

| | December 31, 2015 | Costs Incurred | Cash Payments | December 31, 2016 |
|----------------------|-------------------|----------------|---------------|-------------------|
| Termination benefits | \$ | —\$ 286 | \$ (13) | \$ 273 |

Accrued restructuring charges as of December 31, 2017 comprise the remaining liability balance from the 2016 restructuring and are reflected in accrued liabilities on the Company's consolidated balance sheet as of December 31, 2017.

15. Valuation and Qualifying Accounts (in thousands)

| | Balance at Beginning of Period | Charged/ (Credited) to Revenues and Expenses | Write-Off of Previously Provided Accounts | Balance at End of Period |
|--|--------------------------------------|---|---|-----------------------------------|
| Year Ended December 31, 2017: | | | | |
| Allowance for Doubtful Accounts | \$ 36 | \$ (6) | \$ — | \$ 30 |
| Allowance for Customer Returns and Sales Credits | \$ 528 | \$ 2,845 | \$ (3,121) | \$ 252 |
| Year Ended December 31, 2016: | | | | |
| Allowance for Doubtful Accounts | \$ 31 | \$ 5 | \$ — | \$ 36 |
| Allowance for Customer Returns and Sales Credits | \$ 490 | \$ 3,713 | \$ (3,675) | \$ 528 |

16. Segment Disclosure

ASC Topic 280, Segment Reporting, establishes standards for reporting information about operating segments, products and services, geographic areas of operations and major customers. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing business performance. The Company's chief operating decision-making group is the Executive Staff, which is comprised of the Chief Executive Officer and his direct reports (CODM).

The Company operates in one principal industry segment - the IIoT segment, which is its reportable segment. The IIoT segment sells products and services aimed at Embedded Control Platforms, such as LONWORKS and IzoT, which include components, control nodes, and development software, and which are sold typically to Original Equipment Manufacturers (OEMs) to build into their industrial application solutions. These platforms allow a single device to be brought to market as a LONWORKS®, BACnet®, or other protocol-supporting device; and it can be used with any underlying wired or wireless communications link, such as Ethernet, RS-485, Wi-Fi, 15.4, or Echelon's free topology (FT) standard. The IzoT platform provides a smooth migration path for legacy devices to the IIoT. The product portfolio includes Smart Transceivers, SmartServer Controllers, LNS and OpenLNS Operating Systems, Outdoor Lighting Controllers, SmartServer Segment Controllers and PL/RF Bridges.

The Company operates in three main geographic areas: the Americas; Europe, Middle East and Africa ("EMEA"); and Asia Pacific / Japan ("APJ"). Each geographic area provides products and services to the Company's customers located in the respective region. The Company's long-lived assets include property and equipment, goodwill, purchased technology, and deposits on its leased facilities. Long-lived assets are attributed to geographic areas based on the country where the assets are located. As of December 31, 2017 and December 31, 2016, long-lived assets of approximately \$2.1 million and \$2.2 million, respectively, were domiciled in the United States. Long-lived assets for all other locations are not material to the consolidated financial statements.

In North America, the Company sells its products primarily through a direct sales organization and select third-party electronics representatives. Outside North America, the Company sells its products through direct sales organizations in EMEA and APJ, value-added resellers, and local distributors. Revenues are attributed to geographic areas based on the country where the products are shipped to or the services are delivered. Summary revenue information by geography for the years ended December 31, 2017 and 2016 is as follows (in thousands):

| | Year ended | |
|----------------|--------------|----------|
| | December 31, | |
| | 2017 | 2016 |
| Americas | | |
| United States | \$12,395 | \$10,309 |
| Other Americas | 921 | 1,093 |
| Total Americas | 13,316 | 11,402 |
| EMEA | | |
| Germany | 8,034 | 8,749 |
| Other EMEA | 2,731 | 5,366 |
| Total EMEA | 10,765 | 14,115 |
| APJ | | |
| China | 2,443 | 2,209 |
| Other APJ | 5,143 | 4,659 |
| Total APJ | 7,586 | 6,868 |
| Total | \$31,667 | \$32,385 |

For information regarding the Company's major customers, please refer to Note 8, Significant Customers.

17. Joint Venture

On March 23, 2012, the Company entered into an agreement with Holley Metering Limited ("Holley Metering"), a designer and manufacturer of energy meters in China, to create a joint venture, Zhejiang Echelon-Holley Technology Co., Ltd. ("Echelon-Holley"). The joint venture's intended focus was on the development and sales of smart energy products for China and rest-of-world markets. The Company has a 51% ownership interest in the joint venture and exercises controlling influence. Therefore, Echelon-Holley's accounts are included in the Company's consolidated financial statements as of December 31, 2017, and for the two years then ended. Holley Metering's interests in Echelon-Holley's net assets are reported in the noncontrolling interest in subsidiary on the consolidated balance sheet as of December 31, 2017 and 2016. Net loss attributable to the noncontrolling interest in Echelon-Holley was \$0 during the years ended December 31, 2017 and 2016.

As of December 31, 2017, Echelon and Holley Metering had contributed in cash a total of approximately \$4,000,000 in Share Capital, as defined, to Echelon-Holley in proportion to their respective ownership interests.

In connection with the decision to sell its Grid business announced in the third quarter of 2014, the Company undertook a process to sell the remaining net assets of the joint venture and recorded the net assets and liabilities of the joint venture at the lower of their carrying amount or fair value less cost to sell, and classified them as held for sale in the Company's consolidated balance sheet at December 31, 2014. The major classes of assets and liabilities that were classified as held for sale were inventory, deferred revenues and the related deferred costs of sales, and accrued liabilities. In addition, the net loss attributable to the non-controlling interests were presented as part of discontinued operations in the consolidated statement of operations for the year ended December 31, 2014.

During the quarter ended September 30, 2015, the Company concluded that it would no longer pursue a sale, but would instead work with Holley Metering to shut the joint venture down. The remaining net assets of the joint venture were immaterial as of September 30, 2015.

18. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED):

The following tables set forth certain consolidated statements of operations data for each of the quarters in 2017 and 2016. This information has been derived from the Company's quarterly unaudited consolidated financial statements. The quarterly unaudited consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements included in this report and include all adjustments, consisting only of normal recurring adjustments that we consider necessary for a fair presentation of such information when read in conjunction with the annual audited consolidated financial statements and notes appearing in this report. The operating results for any quarter do not necessarily indicate the results for any subsequent period or for the entire fiscal year.

| | Three months ended | | | | | | | |
|--|--------------------|-------------------|--------------|---------------|------------------|-------------------|--------------|---------------|
| | December 2017 | September 2017 | June 2017 | March 2017 | December 2016 | September 2016 | June 2016 | March 2016 |
| Consolidated Statement of Operations Data: | | | | | | | | |
| Revenues | \$8,030 | \$7,817 | \$8,021 | \$7,799 | \$7,498 | \$8,179 | \$8,061 | \$8,647 |
| Cost of revenues | 3,858 | 3,337 | 3,495 | 3,326 | 3,375 | 3,707 | 3,415 | 3,805 |
| Gross profit | 4,172 | 4,480 | 4,526 | 4,473 | 4,123 | 4,472 | 4,646 | 4,842 |
| Operating expenses: | | | | | | | | |
| Product development | 2,551 | 2,280 | 2,255 | 2,227 | 2,119 | 1,963 | 1,985 | 2,193 |
| Sales and marketing | 1,368 | 1,239 | 1,463 | 1,462 | 1,638 | 1,570 | 1,679 | 1,302 |
| General and administrative | 1,450 | 1,656 | 1,929 | 1,924 | 1,782 | 2,087 | 2,197 | 2,011 |
| Restructuring charges | — | — | — | — | 286 | — | — | — |
| Total operating expenses | 5,369 | 5,175 | 5,647 | 5,613 | 5,825 | 5,620 | 5,861 | 5,506 |
| Loss from operations | (1,197) | (695) | (1,121) | (1,140) | (1,702) | (1,148) | (1,215) | (664) |
| Interest and other income (expense), net | (58) | (155) | (220) | (65) | 567 | (57) | 503 | (205) |
| Loss before provision for income taxes | (1,255) | (850) | (1,341) | (1,205) | (1,135) | (1,205) | (712) | (869) |
| Income tax expense (benefit) | (53) | 2 | 29 | (6) | 102 | 23 | 51 | 6 |
| Net loss | \$(1,202) | \$(852) | \$(1,370) | \$(1,199) | \$(1,237) | \$(1,228) | \$(763) | \$(875) |
| Basic and diluted net loss per share | \$(0.27) | \$(0.19) | \$(0.31) | \$(0.27) | \$(0.28) | \$(0.28) | \$(0.17) | \$(0.20) |
| Shares used in net loss per share calculation: | | | | | | | | |
| Basic | 4,520 | 4,460 | 4,445 | 4,434 | 4,432 | 4,431 | 4,420 | 4,417 |
| Diluted | 4,520 | 4,460 | 4,445 | 4,434 | 4,432 | 4,431 | 4,420 | 4,417 |

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.

ECHELON CORPORATION

Date: March 27,
2018

By: /s/ C. Michael Marszewski

C. Michael Marszewski

Vice President and Chief Financial Officer (Duly Authorized Officer and Principal Financial Officer)

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Ronald Sege and C. Michael Marszewski his true and lawful attorney-in-fact and agent, with full power of substitution and, for him and in his name, place and stead, in any and all capacities to sign any and all amendments to this Report on Form 10-K, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES EXCHANGE ACT OF 1934, THIS REPORT HAS BEEN SIGNED BY THE FOLLOWING PERSONS ON BEHALF OF THE REGISTRANT AND IN THE CAPACITIES AND ON THE DATES INDICATED.

| Signatures | Title | Date |
|--|---|-------------------|
| /s/ Ronald Sege Ronald Sege | Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer) | March 27, 2018 |
| /s/ C. Michael Marszewski C. Michael Marszewski | Vice President and Chief Financial Officer (Principal Financial and Principal Accounting Officer) | March 27, 2018 |
| /s/ Armas Clifford Markkula, Jr. Armas Clifford Markkula, Jr. | Vice Chairman | March 27, 2018 |
| /s/ Robert J. Finocchio, Jr. Robert J. Finocchio, Jr | Director | March 27, 2018 |
| /s/ Robert R. Maxfield Robert R. Maxfield | Director | March 27, 2018 |
| /s/ Betsy Rafael | Director | March 27, 2018 |

Betsy Rafael

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EXHIBIT INDEX

Exhibit No.

- 3.2⁽¹⁾ Amended and Restated Certificate of Incorporation of Registrant, as amended December 7, 2015.
- 3.3⁽²⁾ Amended and Restated Bylaws of Registrant.
- 4.1⁽³⁾ Form of Registrant's Common Stock Certificate.
- 4.2⁽¹⁷⁾ Tax Benefit Preservation Plan, dated as of April 22, 2016, by and between Echelon Corporation and Computershare Inc., as rights agent
- 10.1⁽⁴⁾ Form of Indemnification Agreement entered into by Registrant with each of its directors and executive officers.
- 10.2⁽¹⁰⁾ 1997 Stock Plan (as amended and restated March 26, 2004)
- 10.2⁽¹⁶⁾⁺ 1997 Stock Plan (as amended and restated April 3, 2013)
- 10.2(a)⁽⁵⁾⁺ Form of 1997 Stock Plan Stock Option Agreement with early exercise feature
- 10.2(b)⁽⁵⁾⁺ Form of 1997 Stock Plan Nonqualified Stock Option Agreement with early exercise feature
- 10.2(c)⁽⁵⁾⁺ Form of 1997 Stock Plan Nonqualified Stock Option Agreement
- 10.2(d)⁽⁵⁾⁺ Form of 1997 Stock Plan Performance Share Agreement (re: non-standard vesting schedule)
- 10.2(e)⁽⁵⁾⁺ Form of 1997 Stock Plan Performance Share Agreement for non-US employees
- 10.2(f)⁽⁵⁾⁺ Form of 1997 Stock Plan Performance Share Agreement with performance based vesting criteria for non-US employees
- 10.2(g)⁽⁵⁾⁺ Form of 1997 Stock Plan Stock Appreciation Right Agreement for non-US employees
- 10.2(h)⁽⁵⁾⁺ Form of 1997 Stock Plan Performance Share Agreement with performance based vesting criteria
- 10.2(i)⁽⁵⁾⁺ Form of 1997 Stock Plan Performance Share Agreement
- 10.2(j)⁽¹³⁾⁺ Form of 1997 Stock Plan Stock Appreciation Right Agreement
- 10.2(k)⁽⁷⁾⁺ Form of 1997 Stock Plan Performance Share Agreement for US-based corporate officers
- 10.2(l)⁽⁷⁾⁺ Form of 1997 Stock Plan Performance Share Agreement for non US-based corporate officers
- 10.2(m)⁽⁷⁾⁺ Form of 1997 Stock Plan Stock Appreciation Right Agreement for US-based corporate officers
- 10.2(n)⁽⁷⁾⁺ Form of 1997 Stock Plan Stock Appreciation Right Agreement for non US-based corporate officers
- 10.2(o)⁽¹²⁾⁺ Form of 1997 Stock Plan Restricted Stock Award Agreement
- 10.2(p)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Stock Option Agreement for U.S. Optionees (2012)
- 10.2(q)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Stock Option Agreement for U.S. Corporate Officers (2012)
- 10.2(r)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Stock Option Agreement for Optionees Outside the U.S. (2012)
- 10.2(s)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Stock Option Agreement for Corporate Officers Outside the U.S. (2012)
- 10.2(t)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Stock Option Agreement Appendix A for Optionees Outside the U.S. (2012)
- 10.2(u)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Performance Share Agreement for Participants Outside the U.S. (2012)
- 10.2(v)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Performance Share Agreement for Corporate Officers Outside the U.S. (2012)
- 10.2(w)⁽¹⁵⁾⁺ Form of 1997 Stock Plan Performance Share Agreement Appendix A for Participants Outside the U.S. (2012)
- 10.2⁽¹⁵⁾⁺ 1997 Stock Plan (as amended and restated August 18, 2010)
- 10.3⁽¹⁸⁾ 2016 Equity Incentive Plan and form agreements
- 10.4⁽¹⁹⁾ 2016 Inducement Equity Incentive Plan and form agreements
- 10.5⁽⁴⁾ Form of International Distributor Agreement.
- 10.6⁽⁴⁾ Form of OEM License Agreement.
- 10.7⁽⁴⁾ Form of Software License Agreement.
- 10.8⁽⁴⁾ International Distributor Agreement between the Company and EBV Elektronik GmbH as of December 1, 1997.
- 10.9⁽⁹⁾ Building 1 Lease Agreement dated December 30, 1999
- 10.10⁽⁹⁾ First Amendment to Building 1 Lease Agreement dated May 10, 2000

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- 10.11⁽⁹⁾ Echelon Corporation Common Stock Purchase Agreement with ENEL S.p.A. dated June 30, 2000
10.12⁽⁹⁾ Second Amendment to Building 1 Lease Agreement dated September 22, 2000
10.13⁽⁹⁾ Building 2 Lease Agreement dated November 15, 2001
10.14⁽⁹⁾ Third Amendment to Building 1 Lease Agreement dated April 10, 2008
10.15⁽⁹⁾ First Amendment to Building 2 Lease Agreement dated April 10, 2008
10.16⁽¹⁴⁾ Form of Value Added Reseller Agreement
Assignment and Amendment dated April 29, 2011 between the Company and Avnet Europe Comm VA
10.17⁽²¹⁾ (assigning and modifying the International Distributor Agreement filed as Exhibit 10.8 to the Registration
Statement on Form S-1 filed on June 1, 1998)
10.18⁽²²⁾⁺ Echelon Corporation Employment Agreement by and between Echelon Corporation and Ronald A. Sege
dated August 18, 2010
10.19⁽¹⁶⁾⁺ Form of Executive Change in Control and Severance Agreement (2013)
10.20⁽²⁰⁾⁺ Echelon Corporation Employment letter with Alicia Jayne Moore dated June 27, 2013
21.1⁽³⁾ Subsidiaries of the Registrant.
23.1 Consent of Armanino LLP, Independent Registered Public Accounting Firm.
24.1⁽⁴⁾ Power of Attorney (see signature page).
31.1 Certificate of Echelon Corporation Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley
Act of 2002.
31.2 Certificate of Echelon Corporation Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley
Act of 2002.
32 Certification by the Chief Executive Officer and the 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
101.CAL* XBRL Taxonomy Extension Calculation Linkbase
101.DEF* XBRL Taxonomy Extension Definition Linkbase
101.LAB* XBRL Taxonomy Extension Label Linkbase
101.PRE* XBRL Taxonomy Extension Presentation Linkbase

* The financial information contained in these XBRL documents is unaudited and is furnished, not filed with the Securities and Exchange Commission.

+ Indicates management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 14(c) of Form 10-K.

- (1) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2000, filed on November 14, 2000, and Current Report on Form 8-K filed on December 10, 2015.
(2) Incorporated herein by reference to the Registrant's Current Report on Form 8-K dated August 16, 2007, filed on August 17, 2007.
(3) Incorporated herein by reference to the Registrant's Registration Statement on Form S-1/A filed on July 9, 1998.
(4) Incorporated herein by reference to the Registrant's Registration Statement on Form S-1 filed on June 1, 1998.
(5) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2006, filed on March 16, 2007.
(6) Incorporated herein by reference to the Registrant's Current Report Form 8-K dated April 12, 2007, filed on April 18, 2007.
(7) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2008, filed on August 11, 2008.
(8) Incorporated herein by reference to the Registrant's Registration Statement on Form S-8 filed on August 21, 2000.
(9) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K/A for the fiscal year ended December 31, 2008, filed on March 11, 2010.
(10) Incorporated herein by reference to the Registrant's Registration Statement on Form S-8 filed on June 1, 2005.
(11) Incorporated herein by reference to the Registrant's Registration Statement on Form S-8 filed on August 6, 2010.

(12) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2010, filed on November 3, 2010

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- (13) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2007, filed on March 17, 2008
- (14) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2009, filed on March 16, 2010
- (15) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2012, filed on August 8, 2012
- (16) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2013, filed on August 9, 2013
- (17) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed on April 26, 2016
- (18) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2016, filed on November 9, 2016
- (19) Incorporated herein by reference to the Registrant's Registration Statement on Form S-8 filed on April 21, 2016
- (20) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2013, filed on November 8, 2013
- (21) Incorporated herein by reference to the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2011, filed on May 6, 2011
- (22) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2011, filed on March 15, 2012.