

Identiv, Inc.
Form 10-K
March 29, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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 0-29440

IDENTIV, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or other jurisdiction of
Incorporation or organization)

77-0444317
(I.R.S. Employer
Identification Number)

2201 Walnut Avenue, Suite 100, Fremont, California
(Address of Principal Executive Offices)

94538
(Zip Code)

Registrant's telephone number, including area code:

(949) 250-8888

Securities Registered Pursuant to Section 12(b) of the Act:

None

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Securities Registered Pursuant to Section 12(g) of the Act:

Common Stock, \$0.001 par value, and associated Preferred Share Purchase Rights

(Title of Class)

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

Indicated by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the 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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark 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 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a small reporting company) 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

Based on the closing sale price of the Registrant's Common Stock on the Nasdaq National Market System on June 30, 2017, the last business day of the Registrant's most recently completed second fiscal quarter, the aggregate market value of Common Stock held by non-affiliates of the Registrant was \$73,094,800.

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At March 15, 2018, the Registrant had outstanding 15,139,722 shares of Common Stock, excluding 947,168 shares held in treasury.

DOCUMENTS INCORPORATED BY REFERENCE

Designated portions of the Company's Proxy Statement to be filed within 120 days after the Registrant's fiscal year end of December 31, 2017 are incorporated by reference into Part II, Item 5 and Part III of this Report.

Identiv, Inc.

Form 10-K

For the Fiscal Year Ended December 31, 2017

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PART I

ITEM 1. BUSINESS

Statement Regarding Forward Looking Statements

This Annual Report on Form 10-K (“Annual Report”), including the documents incorporated by reference in this Annual Report, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. For example, statements, other than statements of historical facts regarding our strategy, future operations and growth, financial position, projected results, estimated revenues or losses, projected costs, prospects, plans, market trends, product attributes and benefits, competition, objectives of management, management judgements and estimates, and the expected impact of changes in laws or accounting pronouncements constitute forward-looking statements. In some cases, you can identify forward-looking statements by terms such as “will,” “believe,” “could,” “should,” “would,” “may,” “anticipate,” “intend,” “plan,” “estimate,” “expect,” “project” or the negative of these terms or other similar expressions. Although we believe that our expectations reflected in or suggested by the forward-looking statements that we make in this Annual Report are reasonable, we cannot guarantee future results, performance or achievements. You should not place undue reliance on these forward-looking statements. All forward-looking statements speak only as of the date of this Annual Report. While we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, even if our expectations change, whether as a result of new information, future events or otherwise. We also caution you that such forward-looking statements are subject to risks, uncertainties and other factors, not all of which are known to us or within our control, and that actual events or results may differ materially from those indicated by these forward-looking statements. We disclose some of the factors that could cause our actual results to differ materially from our expectations discussed elsewhere in this Annual Report. These cautionary statements qualify all of the forward-looking statements included in this Annual Report that are attributable to us or persons acting on our behalf.

Identiv and the Identiv logo are trademarks of Identiv, Inc., registered in many jurisdictions worldwide. Certain product and service brands are also trademarks or registered trademarks of the Company, including HIRSCH, ScramblePad, TouchSecure, and Velocity. Other product and brand names not belonging to Identiv that appear in this document may be trademarks or registered trademarks of their respective owners.

Each of the terms the “Company,” “Identiv,” “we” and “us” as used herein refers collectively to Identiv, Inc. and its wholly-owned subsidiaries, unless otherwise stated.

Overview

Identiv is a global security technology company that secures and manages access to physical places, things and information. Global organizations across government, education, retail, transportation, healthcare and other markets rely upon our solutions. We empower them to create secure and convenient experiences in schools, government offices, stores, banks, critical infrastructure, transportation, hospitals and virtually every type of facility and for a wide range of products.

Our operating segments focus on the following solutions:

- Physical security and customer insight solutions, securing buildings via an integrated access control system, included in our Premises (formerly referred to as “PACS”) segment.
- Information security solutions, securing enterprise information access and secure transactions across PCs, networks, email, login, secure payments, and printers via delivery of smart card reader products, included in our Identity

segment.

Radio frequency identification (“RFID”) based solutions for use in a wide range of applications from access control to asset tracking, product authenticity, brand protection, customer engagement, tamper detection, product instrumentation, transportation access and other applications sometimes included in the Internet of Things (“IoT”). The RFID devices are embedded into access cards, transponders and other embedded devices that enable frictionless access to and interaction with the physical world.

The foundation of our business is our deep technical expertise across RFID, smart card technology, and physical security technologies. Our close customer relationships and analytics platforms allow us to develop customer-relevant products and applications. This is all underpinned by our core value of uncompromising quality.

To deliver these solutions, we have organized our operations into four reportable business segments, principally by product families: Premises, Identity, Credentials, and All Other.

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Premises

The Premises segment includes our products and solutions to address the premises security and building intelligence market for government and enterprise, including access control, video surveillance, analytics and intelligence solutions.

The foundation of our physical security platform has been the Hirsch line of controllers including the advanced MX line, Hirsch's Velocity management software and a wide range of integrations that provide Velocity/MX's unique flexibility across a wide range of industries and implementations. We have further extended our physical access platform with our Identiv Connected Physical Access Manager ("ICPAM") software, derived from Cisco's Physical Access Manager ("CPAM") system and available in partnership with Cisco.

In February 2018, we acquired 3VR Security, Inc. ("3VR"), a video technology and analytics company. With the acquisition, we have added the 3VR video security and analytics platform, which is a natural complement to our Hirsch line. Nearly all customers for access control are customers for video security, and vice versa. Additionally, the events and data generated by both platforms combine to create what we believe to be uniquely valuable information for our customers to provide frictionless yet robust security. 3VR's platform is architected as an analytics system, proven across applications in the retail, banking, and other vertical markets, and valuable to our traditional Hirsch and ICPAM markets in government, education, critical infrastructure, transportation and others. Additionally, we sell either individual components or complete bundled solutions which can include any or all among software, edge controllers, multi-door panels, access readers, access cards, 3VR appliances and other components.

Our modular Hirsch MX controllers are designed to be scalable, allowing customers to start with a small system and expand over time. Hirsch MX controllers can operate autonomously, whether as a single controller or as part of a networked system with Velocity software. The Hirsch Velocity software platform enables centralized management of access and security operations across an organization, including control of doors, gates, turnstiles, elevators and other building equipment, monitoring users as they move around a facility, preventing unwanted access, maintaining compliance and providing a robust audit trail.

To our price/performance/quality-leading commercial offerings, we have added what we believe to be the highest performance, lowest per-door cost access control system for the U.S. federal government security mandate known as the Federal Identity, Credential and Access Management ("FICAM") architecture. This brings all of the advantages above into the next generation of physical security for the U.S. government departments and agencies to achieve Federal Information Processing Standard ("FIPS") 201 compliance.

Our TouchSecure ("TS") door readers provide unique features to support a wide range of security standards. We support the majority of legacy card credentials with a robust next-generation platform that can help companies migrate to more secure credentials and technologies, including smart cards, near field communication ("NFC") and government-issued credentials including Common Access Card ("CAC"), Personal Identification Verification ("PIV"), Personal Identification Verification – Interoperable ("PIV-I") and others. Additionally, our Scramblepad readers employ numerical scrambling on the keypad to protect access codes from being stolen as they are entered, and providing both secure two-factor authentication and convenient alternative-factor access.

In addition to this solution offering, in 2017, we launched Identiv Global Services ("IGS"), a service offering with a comprehensive catalog of end-to-end services that facilitates customer success and drives deeper adoption of the Identiv product portfolio. IGS supports customers throughout their premises security lifecycle from system design, to deployment to managed services. IGS experts enable customers to address today's complex security and IT systems interoperability requirements, and helps them achieve a tailor-made set-up.

Identity

Our Identity products include smart card readers, which includes a broad range of contact, contactless, portable and mobile smart card readers, tokens and terminals that are utilized around the world to enable logical access (i.e., PC, network or data access) and security and identification applications, such as national ID, payment, e-Health and e-Government.

With over 20 years of smart card reader, application and token experience as Identiv and previously as SCM Microsystems, we are known for our expertise in this complex ecosystem. We combine our deep technical expertise with an optimized supply chain, to provide what we believe to be the most optimal, cost-effective and high-quality smart card-based products. Whether Identiv branded products, original equipment manufacturers (“OEM”) branded, or embedded chips or modules, our position is as the trusted business solution provider for all users and issuers of smart cards and embedded-chip applications.

Credentials

Our Credentials segment include NFC and RFID products, including inlays and inlay-based and other cards, labels, tags and stickers, as well as other radio frequency (“RF”) and integrated circuits (“IC”) components and are generally grouped into access cards and transponders. Our TS Cards product line, we believe, is the first complete solution to allow customers to pay only for the most basic low-frequency proximity access technology while having the ability to evolve to the higher-security high-frequency and highest-security public key infrastructure (“PKI”) based access credentials. This product line exemplifies our values: we place no burden on our customers, instead providing what we believe to be the most cost-effective solution to their basic needs; and then delivering within this platform the ability for them to move to higher-level needs and capabilities, when they want, when they are ready and when they will realize economic and experience benefits.

Our transponder products span the full range of high frequency (“HF”) and ultra-high frequency (“UHF”) technologies. Our differentiation is analogous to application-specific integrated circuits (“ASICS”) in the semiconductor market. We leverage our flexible platform, our deep technical expertise and our infrastructure and supply chain to deliver solutions optimized for our customers’ business goals. We believe we are more responsive, more flexible, more experienced in business-optimized solutions and have a better track record of sustained delivery of solution-specific, high-quality RFID devices than our competitors. These products are manufactured in our state-of-the-art facility in Singapore and are used in a diverse range of physical applications, including electronic entertainment such as virtual reality (“VR”), games, loyalty cards, mobile payment systems, transit and event ticketing, brand authenticity from pharmaceuticals to consumer goods, hospital resource management, cold-chain management and many others.

Leveraging our expertise in RFID, physical access and physical authentication, we are developing new solutions to extend our platforms across a wide variety of physical use cases. The next major opportunity in our connected world is the IoT, which fundamentally is about physical things. We believe our core strength in physical access and physical instrumentation markets, our well-established platforms and our deep knowledge of the relevant technologies, position us well in this growth market.

All Other

The All Other segment included legacy product lines, such as Chipdrive and Digital Media readers. No revenues from this segment were generated in 2017 and no revenues are expected to be generated in future periods. In the fourth quarter of 2016, we phased out our Digital Media product lines and discontinued our Chipdrive product line.

For a discussion of our net revenue by segment and geographic location, see Note 9, Segment Reporting and Geographic Information, in the accompanying notes to our consolidated financial statements.

Market Strategy

Our corporate priority is to drive revenue growth by leveraging our core technology expertise and our enduring customer relationships, as well as our significant experience addressing solutions across multiple markets, including government, transportation, healthcare, education, banking, retail, critical infrastructure and others. Our common advantages across all of our segments, in addition to a shared set of technologies and supply chain, is our more than 20 years of expertise and sustained reputation as the go-to source for what we believe to be the top-quality, most reliable, most cost-effective solution. We drive an intense commitment to our customers, to ensure we are delivering business-supporting solutions to them and honoring a straightforward, respectful, trustworthy and business-based relationship at all times, and for a long time. In all of our segments we have a long track-record within the industry, and this position as a trusted advisor, supplier and business partner.

In our Premises segment, we believe that our more than 20 years' experience delivering physical security solutions to U.S. Government customers has provided us with significant expertise and a quality reputation. Our products enable compliance with federal directives and standards implemented over the past decade, including Homeland Security Presidential Directive ("HSPD") 12 and FIPS 201, which defines a common standard known as the PIV credential, used by all U.S. Government employees and contractors. We are a leading supplier of physical access control solutions to both federal and state government customers, including agencies within the Department of Justice, Department of the Treasury, the FBI, U.S. Marshall and many others. As a pioneering adopter of physical security technologies and protocols employed on a large scale, the U.S. Government continues to demand the best of breed, which we have been delivering to an increasing range of agencies and departments.

We develop and sell integrated physical security solutions to government and enterprise customers worldwide. Our systems integrate access control, video surveillance, intrusion detection, building management and other network-based systems using a wide range of access cards, including PIV cards, smart cards, RFID cards and biometrics in order to successfully secure facilities and resources.

Our offerings include Hirsch MX controllers, Velocity management software, ICPAM software edge controller systems. These combined with door readers and access cards provide scalable systems, allowing customers to start with a small system and expand over time. Hirsch and ICPAM controllers can operate autonomously, whether as a single controller or as part of a networked system with Velocity or ICPAM software. The Hirsch Velocity software platform enables centralized management of access and security operations across an organization, including control of doors, gates, turnstiles, elevators and other building equipment, monitoring users as they move around a facility, preventing unwanted access, maintaining compliance and providing a robust audit trail. Our door readers provide unique features to support a number of security environments and standards. For example, our ScramblePad readers employ numerical scrambling on the keypad to protect access codes from being stolen as they are entered. Our TS readers support the majority of card credentials with a robust platform that can help companies expand to encompass other credentials and technologies, including smart cards, NFC, and mobile government-issued cards.

With our recent acquisition of 3VR, our new offerings include video intelligence solutions which provide a single platform for real-time security and customer insights, enabling organizations to protect employees, customers and assets as well as improve store operations and shopping experiences. Our new open, pluggable platform leverages existing customer infrastructure and allows customers to expand their systems' capabilities seamlessly.

Physical Security and Analytics

As mentioned above, in February 2018, we acquired 3VR. Our new offerings include video intelligence solutions which provide a single platform for real-time security and customer insights, enabling organizations to protect employees, customers and assets as well as improve store operations and shopping experiences. Our new open, pluggable platform leverages existing customer infrastructure and allows customers to expand their systems' capabilities seamlessly. In addition, our analytics platform is core to our overall strategy. Security technologies are generating vast amounts of real-time data, which in practice has often been unmanageable. That has meant a limited capability to show risks in advance, and that manual processing of vast amounts of data has relegated responses to post-facto, forensic uses. Even those uses have been limited because of the scale of the security data and the limitations of the existing platforms to effectively manage and turn it into useful, actionable information.

Our systems have already been demonstrated to solve these problems for specific security applications, retail loss prevention, ATM fraud, loitering and other security risks. The same analytics are being used to turn this security data into business improvement applications. Since the infrastructure investment has been made for security purposes, costs for incremental systems to apply the data can be limited. We are doing this in such applications as queue line management, heat mapping, customer service, personnel training and other areas, which we believe will expand both within vertical applications and horizontally.

Since virtually all access control customers deploy video security, we believe the opportunity for a combined product with robust feature sets represents a substantial portion of the overall market, and makes the system more effective. Access control systems manage the most critical event in a security system: Access granted or access denied. Access control systems are based on rigorous identification of trusted people within an organization or a community. This provides the two critical ingredients for successful video security: A list of already-trusted people, as well as alarms and events to focus video attention and analytics where they are most relevant. Without this leverage, video is a massive data stream that is often unmanageable in real-time and cumbersome to sort through forensically.

As the market understands this need, some of the most progressive video companies have developed their own access control systems. And vice versa, some access control companies have developed video capabilities. We believe this approach of extending from one solution to the other has resulted in solutions with limited capabilities.

By combining access control and video security solutions, which are both strong on their own, we believe we are establishing a comprehensive solution for our customers. First, our 3VR platform has been architected from the beginning as an analytics platform, not just as a video streaming and viewing system. Second, by deeply combining

access authorization databases and events with video system events, a much narrower solution set is created, since authorized events and people are pre-known, and the remaining events are much easier to tag and respond to as possible security issues.

In addition to our core products, we have a range of product initiatives designed to leverage leading technology advances across mobile, biometric, machine-learning and other areas, to provide convenient, frictionless, low-cost yet highly secure physical access. We invest independently and in partnership with other leading technology companies in these emerging aspects of physical security and analytics platforms.

Leveraging Underlying Technologies across Smart Cards and RFID

In addition to providing secure and frictionless premises solutions, we are leveraging our underlying technology capabilities across a number of product and applications.

In our Identity segment, we have over 20 years' experience as a leading global supplier of smart card reader technologies. We offer a broad range of contact, contactless and mobile smart card readers, tokens and terminals that are utilized around the world to enable access and security applications, such as national ID cards, payment and eHealth and eGovernment. We have supplied millions of smart card readers to the Department of Defense and other federal agencies. To support the growing demand for solutions that provide secure access via mobile devices, sometimes known as "bring your own device" ("BYOD"), our mobile readers allow users to securely authenticate using iOS™ or Android™ devices, when they present standard credentials issued by the U.S. Government, including the PIV card and its predecessor, the CAC, as well as the PIV-I card issued by commercial contractors under a similar security standard.

In our Credentials segment, we design and manufacture a broad range of NFC and RFID products, including inlays and inlay-based cards, labels, tags and stickers, as well as other RF and IC components, across HF and UHF technologies, and from basic transactional devices to high-end microprocessor-based devices. We have expanded our solutions still further, incorporating advanced flexible, rechargeable battery technology to bring active-device capabilities to the Cold Chain market and opening the nearly-unlimited potential of active sensor-enabled applications. Our inlays and converted inlay products are used in a diverse range of applications, including electronic entertainment, loyalty schemes, mobile payment, transit and event ticketing, and others.

We believe that the know-how across RFID, NFC as well as smart card technology positions us well to benefit from the increasing importance of contactless technologies in a range of applications. On the Identity side, it is our strategy to closely align with innovative OEM partners who are looking to include a subset of these capabilities into their products, for example for secure printing, gaming, or unattended vending applications. Similarly, we aim to be the go-to provider for complex RFID and transponder applications utilizing NFC, HF, or UHF technology, or a combination thereof. We believe the capabilities we are developing in our engineering and research center in Germany provides a differentiator for product owners with specific and unique requirements. Often these relationships start with an agreement on shared non-recurring engineering ("NRE") related costs. Brand authenticity and consumer engagement applications especially demand compliance with a high level of technical requirements as well as specific expectations around the appearance of the product, user experience and reliability. We believe our ability to provide high-quality product pilots in small badges with rapid turnaround will provide us with a competitive advantage.

As across all our offerings, we are aiming to position ourselves as the preferred trusted advisor and development partner for our customers and partners.

Positioned for Growth in Growing Markets

Leveraging our expertise in RFID and NFC technology, and mobility, we are developing new solutions for a wide range of physical, connected items, or IoT. Market analysts estimate that by 2020 the number of physical things connected to the Internet will grow into the tens of billions. These will include household appliances, vehicles, medicines, home security systems, books, luggage, jewelry, toys and a host of other objects. We believe the growth of the IoT creates significant opportunities to provide physical access and authentication into nearly every industry, worldwide. We plan to leverage our physical access, video and analytics solutions as well as RFID-based physical device-management expertise to provide leading solutions as our customers, and our customers' customers, embrace the IoT.

Also underneath the umbrella of IoT, we are positioned in growing markets. Market analysts estimate the premises security market will continue to grow, with services and video being among the faster growing market segments, as well as the RFID and transponder markets. In addition, we believe that our markets are generally fragmented. As such, we believe we are positioned to grow in our core markets, and do so organically and inorganically. A first execution step on our inorganic growth strategy is evidenced by our acquisition of 3VR in February of 2018.

Customers

We sell to customers worldwide in a diverse range of markets, including government, enterprise, consumer, education, healthcare and transportation. Sales to our ten largest customers accounted for 33% of total net revenue in 2017 and 34% of total net revenue in 2016. A significant amount of revenue is sourced from sales of products and systems to our OEM partners and an indirect sales network who sell to various entities within the U.S. federal government sector. U.S. federal government sales are primarily delivered through our OEM partners and an indirect sales network or are priced using published General Service Administration schedules.

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Sales and Marketing

We primarily conduct our own sales and marketing activities in each of the markets in which we compete, utilizing our own sales and marketing organization to solicit prospective channel partners and customers, provide technical advice and support with respect to products, systems and services, and manage relationships with customers, distributors and/or OEMs. We sell our smart card readers and RFID/NFC products directly to end users and utilize indirect sales channels that may include OEMs, dealers, systems integrators, value added resellers, resellers or Internet sales. We sell our physical access control solutions and access card services primarily through systems integrators, dealers and value added partners, although we also sell directly to end users. In support of our sales efforts, we participate in trade shows and conduct sales training courses, targeted marketing programs, and ongoing customer, channel partner and third-party communications programs.

Competition

The market for security solutions is competitive and characterized by rapidly changing technology and evolving standards in the industry as a whole and within specific markets. We believe that competition for security solutions is likely to intensify as a result of an ongoing increase in demand for our solutions that help converge physical and logical access control systems and RFID and NFC products to enable expansion of the connected world. The increase in competition will come from two additional factors. First, the vast growth of data being generated by high bandwidth security devices, especially video, as well as the increasing number of electronic-access doors. As data volumes become increasingly unmanageable with classic systems relying on monitoring by guards, real-time analytics and purpose built forensic platforms will deliver these critical security results. Second, technically advanced hardware is moving into commercial markets, driven by volume cost curves as disruptive consumer and small and medium business focused startups launch commercial-scale capabilities into these high volume markets.

As these longer-term competitive dynamics emerge, we currently face a range of competition for our products, systems and solutions. Competition for our smart card readers and related products primarily comes from several well-established companies, including Gemalto NV and OMNIKEY/HID Global (a division of ASSA ABLOY AB), as well as from a number of smaller suppliers in Asia. Competition for our RFID inlays and inlay-based products comes from a small number of organizations that understand the specialized processes and have the capital equipment required to serve the RFID/NFC technology market. Competitors in this market include SMARTRAC NV, as well as a number of inlay conversion companies in Asia. In the market for NFC tags, readers and other solutions, we face competition from traditional smart card reader and RFID technology providers, including Gemalto and ASSA ABLOY for NFC readers, and SMARTRAC and other inlay converters for NFC tags.

Enterprise-class physical access control solutions are available from multiple suppliers. In this market we primarily compete with Lenel Systems International (a division of United Technologies Corp.), Software House (a division of Tyco International Ltd.), Gallagher Group Ltd., Honeywell International Inc., and AMAG Technology (a division of G4S plc). Competition for our video management and analytics solutions, which mainly consist of the solutions added through the acquisition of 3VR, is expected from several other companies either offering video management systems (“VMS”) or analytics solutions, including Exacq, Genetec, Inc., Milestone Systems, and RetailNext, Inc.

We may in the future face competition from other parties that develop physical security and RFID solutions based upon approaches similar to or different from those employed by us. In addition, these markets for security solutions may ultimately be dominated by approaches other than the approach marketed by us. We believe that the principal competitive factors affecting the market for our products, systems and solutions include:

- technical features;
- the ability of channel partners to effectively integrate multiple products and systems in order to address customer requirements including full system capabilities, cost of ownership and ease of use;
- quality and reliability;

• the ability of suppliers to quickly develop new products and integrated solutions to satisfy new customer requirements;

• ease of use;

• strength of sales and distribution channels; and

• price and total cost of system ownership.

While we believe that we compete favorably within our market environment, our ability to continue to successfully compete is subject to a variety of factors, as further discussed below in “Item 1A. Risk Factors” in this Annual Report on Form 10-K.

Seasonality and Other Factors

In our business overall, we may experience significant variations in demand for our offerings from quarter to quarter, and typically experience a stronger demand cycle in the second half of our fiscal year. Sales of our premises solutions to U.S. Government agencies are subject to annual government budget cycles and generally are highest in the third quarter of each year. However, the usual seasonal trend can be negatively impacted by actions such as government shutdowns and the passing of continuing resolutions which can act to delay the completion of certain projects. Sales of our identity reader chips, many of which are sold to government agencies worldwide, are impacted by testing and compliance schedules of government bodies as well as roll-out schedules for application deployments, both of which contribute to variability in demand from quarter to quarter. Further, this business is typically subject to seasonality based on differing commercial and global government budget cycles. Lower sales are expected in the U.S. in the first half, and in particular the first quarter of the year, with higher sales typically in the second half of each year. In Asia and Australia, with fiscal year-ends in March and June, order demand can be high in the first half as customers attempt to complete projects before the end of the fiscal year. Accordingly, our net revenue levels in the first quarter and first half each year often depends on the relative strength of project completions and sales mix between our U.S. customer base and our International customer base.

In addition to the general seasonality of demand, overall U.S. Government expenditure patterns have a significant impact on demand for our products due to the significant portion of revenues that are typically sourced from U.S. Government agencies. Therefore, any significant reduction in U.S. Government spending could adversely impact our financial results and could cause our operating results to fall below any guidance we provide to the market or below the expectations of investors or security analysts.

Backlog

We typically do not maintain a significant level of backlog and revenue in any quarter significantly depends on contracts entered into or orders received and shipped in that quarter. The majority of our sales are made primarily pursuant to purchase orders for current delivery or agreements covering purchases over a period of time. While our customer contracts generally do not require fixed long-term purchase commitments, from time to time we do enter into customer contracts where delivery of products, systems or services is ongoing or is scheduled over multiple quarters or years. In view of our order and shipment patterns, and because of the possibility of customer changes in delivery schedules or cancellation of orders, we do not believe that the ongoing arrangements we enter into provide meaningful backlog figures or are necessarily indicative of actual sales for any succeeding period.

Research and Development

We have made and continue to make significant investments in research and the development of solutions for customers in the government, enterprise, consumer and commercial markets. We focus the bulk of our research and development activities on the development of products and solutions for new and emerging market opportunities. In addition to developing core technology that can be leveraged across a number of products, our engineering team works with product managers, applications engineers, distribution partners, third party consultants and customers to develop new products, product enhancements, software and systems to meet customer and market requirements. We also strive to develop and maintain close relationships with key suppliers of components and technologies in order to be able to quickly introduce new offerings that incorporate the latest technological advances. New offerings introduced across our businesses resulting in new inventions provide opportunities for new patent applications.

Our recent research and development activities have included enhancements for our physical access controller platforms, which address new market trends such as secure mobile access and extends our available customer base to include smaller enterprises. On an ongoing basis, we invest in the development of new contactless readers, tokens and modules, new physical access readers to enable converged physical and logical access, and in the extension of our contactless platforms. In addition, we continue to enhance and broaden our RFID and NFC inlay designs and

technologies in the areas of security, enablement for NFC applications, card manufacturing and other applications.

We attempt to balance our investment in new technologies, products and services with careful management of our development resources so that our increased development activities do not result in unexpected or significant changes in our overall spending on research and development. Research and development expenses were \$6.1 million in 2017 and \$6.5 million in 2016. We capitalized payroll related expenses related to development of our card issuance services of \$0.2 million and \$0.2 million in 2017 and 2016, respectively. In addition, we capitalized \$0.4 million of software development costs in 2017 for costs incurred subsequent to a product achieving technological feasibility and prior to the product's general release to customers. No software development costs were capitalized in 2016.

We conduct our research and development activities from several locations around the world. Development of our smart card reader products and technologies primarily takes places in India. Development of our physical access control solutions primarily takes place in California. Development of our RFID and NFC products and technology primarily takes place in Singapore.

Proprietary Technology and Intellectual Property

Our success depends partly upon our proprietary technology. We currently rely on a combination of patent, copyright and trademark laws, trade secrets, confidentiality agreements and contractual provisions to protect our proprietary rights, which afford only limited protection. Although we often seek to protect our proprietary technology through patents, it is possible that no new patents will be issued, that our proprietary products or technologies are not patentable, and that any issued patent will fail to provide us with any competitive advantages. The core of our proprietary technology advantage is the combination of our advanced technical expertise combined with our intimate customer knowledge, enabling us to develop and bring to market products uniquely positioned to deliver benefits to customers. This is an intellectual property advantage more characterized by trade secrets and unique relationships than formal patents.

There has been a great deal of litigation in the technology industry regarding intellectual property rights and from time to time we may be required to use litigation to protect our proprietary technology. This may result in our incurring substantial costs and there is no assurance that we would be successful in any such litigation. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to use our proprietary information and software without authorization. In addition, the laws of some foreign countries do not protect proprietary and intellectual property rights to the same extent as do the laws in the U.S. Because many of our products are sold and a substantial portion of our business is conducted outside the U.S., our exposure to intellectual property risks may be higher. Our means of protecting our proprietary and intellectual property rights may not be adequate. There is a risk that our competitors will independently develop similar technology, duplicate our products or design around our patents or other intellectual property rights. If we are unsuccessful in protecting our intellectual property or our products or technologies are duplicated by others, our business could be harmed.

In addition, we have from time to time received claims that we are infringing upon third parties' intellectual property rights. Future disputes with third parties may arise and these disputes may not be resolved on terms acceptable to us. As the number of products and competitors in our target markets grow, the likelihood of infringement claims also increases. Any claims or litigation may be time-consuming and costly, divert management resources, cause product shipment delays, or require us to redesign our products, accept product returns or to write-off inventory. Any of these events could have a material adverse impact on our business and operating results.

We have a portfolio of approximately 30 patent families (designs, patents, utility models, patents pending and exclusive licenses) in individual or regional filings, covering products, electrical and mechanical designs, software systems and methods and manufacturing process ideas for our various businesses. We also submitted and have pending U.S. and foreign patent filings in RFID tags, converged access readers and systems, smart card manufacturing methods, authentication and NFC offerings. Additionally, we leverage our own ASIC designs for smart card interface in some of our reader devices. However, none of our patents are currently material to our business.

Manufacturing and Sources of Supply

We utilize a combination of our own manufacturing facilities and the services of contract manufacturers in various countries around the world to manufacture our products and components. Our physical access keypads, controllers and software are manufactured primarily in California, using locally sourced components. The majority of our smart card reader products and components are manufactured in Singapore and China. Our RFID and NFC inlays and inlay-based products such as labels and tags are manufactured and assembled by our own internal manufacturing teams in Singapore primarily using locally sourced components and are certified to the ISO 9001:2000 quality manufacturing standard.

We have implemented formal quality control programs to satisfy customer requirements for high quality and reliable products. To ensure that products manufactured by third parties are consistent with internal standards, our quality control programs include management of all key aspects of the production process, including establishing product

specifications, selecting the components to be used to produce products, selecting the suppliers of these components and negotiating the prices for certain of these components. In addition, we may work with suppliers to improve process control and product design.

We believe that our success will depend in large part on our ability to provide quality products and services while ensuring the highest level of security for our products during the manufacturing process. In the event any of our contract manufacturers are unable or unwilling to continue to manufacture our products, we may have to rely on other current manufacturing sources or identify and qualify new contract manufacturers. Any significant delay in our ability to obtain adequate supplies of our products from current or alternative sources would harm our business and operating results.

For the majority of our product manufacturing, we utilize a global sourcing strategy that serves all business solution areas within the company, which allows us to achieve economies of scale and uniform quality standards for our products and support higher gross margins.

On an ongoing basis, we analyze the need to add alternative sources for both our products and components. For example, we currently utilize the foundry services of external suppliers to produce our ASICs for smart cards readers and inlays, and we use chips and antenna components from third-party suppliers in our RFID and NFC inlays and contactless smart card readers. Wherever possible, we have qualified additional sources of supply for components. However, a risk remains that we may be adversely impacted by an inadequate supply of components, price increases, late deliveries or poor component quality. In addition, some of the basic components used in our reader products, such as semiconductors, may at any time be in great demand. This could result in components not being available to us in a timely manner or at all, particularly if larger companies have ordered significant volumes of these components, or higher prices being charged for components we require.

Employees

As of December 31, 2017, we had 223 employees, of which 56 were in research and development, 63 were in sales and marketing, 28 were in general and administrative and 76 were in manufacturing and related functions. We are not subject to any collective bargaining agreements and, to our knowledge, none of our employees are currently represented by a labor union. To date, we have experienced no work stoppages and believe that our employee relations are generally good.

Corporate Information

Our corporate headquarters are located in Fremont, California. We maintain research and development facilities in California; Chennai, India; Munich, Germany; and local operations and sales facilities in Germany, the United Kingdom, Hong Kong, Singapore, India and the United States. We were founded in 1990 in Munich, Germany and incorporated in 1996 under the laws of the State of Delaware.

Legal Proceedings

On December 16, 2015, we and certain of our present and former officers and directors were named as defendants in a putative class action lawsuit filed in the United States District Court for the Northern District of California, entitled *Rok v. Identiv, Inc., et al.*, Case No. 15-cv-05775, alleging violations of Section 10(b) of the Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and Section 20(a) of the Exchange Act of 1934. On May 3, 2016, the court-appointed lead plaintiff Thomas Cunningham in the Rok lawsuit filed an amended complaint and a notice of dismissal without prejudice of all current or former officers and directors other than Jason Hart and Brian Nelson. On June 6, 2016, each of us, Jason Hart, and Brian Nelson filed a motion to dismiss for failure to state a claim upon which relief can be granted in the Rok lawsuit; on August 5, 2016, the court granted those motions with leave for the lead plaintiff to file a second amended complaint. On September 12, 2016, the lead plaintiff in the Rok lawsuit filed a second amended complaint. On October 10, 2016, each of us, Jason Hart, and Brian Nelson filed a motion to dismiss that second amended complaint for failure to state a claim upon which relief can be granted in the Rok lawsuit; on January 4, 2017, the court granted those motions with prejudice and entered judgment for us and the other defendants and against the lead plaintiff. On February 6, 2017, the lead plaintiff initiated an appeal of the court's decision in the Ninth Circuit Court of Appeals. Following the lead plaintiff's routine request to extend filing deadlines, which the Court of Appeals approved, the lead plaintiff's opening appellate brief was filed on June 14, 2017. Following Jason Hart's routine request to extend filing deadlines, which the Court of Appeals approved, the answering briefs of the Company and the other defendants were filed on August 14, 2017. Following the lead plaintiff's routine request to extend filing deadlines, which the Court of Appeals approved, the lead plaintiff's optional reply brief was filed on October 5, 2017. The Ninth Circuit Court of Appeals held oral argument on March 13, 2018. On March 23, 2018, the Ninth Circuit issued an order affirming the dismissal with prejudice. In the interim, on January 3, 2018, lead plaintiffs filed a motion under Federal Rules of Civil Procedure Rule 60(b) in the trial court to vacate the January 4, 2017 judgment of dismissal. On February 9, 2018, following additional briefing, the trial court denied the motion.

In addition, three shareholder derivative actions were filed between January and February 2016. On January 1, 2016, certain of our present and former officers and directors were named as defendants, and we were named as nominal defendant, in a shareholder derivative lawsuit filed in the United States District Court for the Northern District of California, entitled *Oswald v. Humphreys, et al.*, Case No. 16-cv-00241-CRB, alleging breach of fiduciary duty and waste claims. On January 25, 2016, certain of our present and former officers and directors were named as defendants, and we were named as nominal defendant, in a shareholder derivative lawsuit filed in the Superior Court of the State of California, County of Alameda, entitled *Chopra v. Hart, et al.*, Case No. RG16801379, alleging breach of fiduciary duty claims. On February 9, 2016, certain of our present and former officers and directors were named as defendants, and we were named as nominal defendant, in a shareholder derivative lawsuit filed in the Superior Court of the State of California, County of Alameda, entitled *Wollnik v. Wenzel, et al.*, Case No. HG16803342, alleging breach of fiduciary duty, corporate waste, gross mismanagement, and unjust enrichment claims. These lawsuits generally allege that we made false and/or misleading statements and/or failed to disclose information in certain public filings and disclosures between 2013 and 2015. Each of the lawsuits seeks one or more of the following remedies: unspecified compensatory damages, unspecified exemplary or punitive damages, restitution, declaratory relief, equitable and injunctive relief, and reasonable costs and attorneys' fees. On May 2, 2016, the court in the Chopra lawsuit entered an order staying proceedings in the Chopra lawsuit in favor of the Oswald lawsuit, based on a stipulation to

that effect filed by the parties in the Chopra lawsuit on April 28, 2016. Similarly, on June 28, 2016, the court in the Wollnik lawsuit entered a stipulated order staying proceedings in the Wollnik lawsuit in favor of the Oswald lawsuit. On June 17, 2016, the plaintiff in the Oswald lawsuit filed an amended complaint. On August 1, 2016, we filed a motion to dismiss for failure by plaintiff to make a pre-lawsuit demand on our board of directors, which motion was heard on October 14, 2016. The judge in the Oswald lawsuit issued an order on November 7, 2016 granting our motion to dismiss, without prejudice. In addition, the court stayed the case so that plaintiff could exercise whatever rights he had under Section 220 of the Delaware General Corporation Law. On or around November 30, 2016, the plaintiff purported to serve a books and records demand under Section 220 of the Delaware General Corporation Law. We have responded to that demand. On March 21, 2017, we and the plaintiff in the Oswald lawsuit filed a stipulation and proposed order lifting the stay of the case, granting the plaintiff leave to amend, and setting a briefing schedule. That stipulation proposed that the judge's stay of the case entered November 7, 2016 be lifted, that a stay of proceedings as to the individual defendants that the judge previously entered remain in place, that the plaintiff may file a second amended complaint on or before April 10, 2017, that we may file a motion to dismiss that second amended complaint on or before May 12, 2017, that the plaintiff's opposition to such a motion to dismiss shall be filed on or before June 12, 2017, that our reply in support of such a motion shall be filed on or before June 30, 2017, and that the hearing on such a motion to dismiss shall be held on August 11, 2017 or such other date as the court may order. On March 22, 2017, the court entered an order approving that stipulation. The plaintiff in the Oswald lawsuit filed his second amended complaint on April 10, 2017. We then filed a motion to dismiss that second amended complaint on May 12, 2017, the plaintiff filed an opposition to that motion to dismiss on June 12, 2017, and we filed a reply in support of the motion on June 30, 2017. The hearing on that motion to dismiss was rescheduled by stipulation of the parties to September 22, 2017 and then further rescheduled by the court to October 6, 2017. The hearing on that motion to dismiss was held on October 6, 2017, and that day the court entered a minute entry indicating the motion would be denied. On October 22, 2017, the court issued its written order denying the motion to dismiss on the basis of demand futility. On December 15, 2017, the court held a status conference. On January 3, 2018, the court entered a stipulated order setting a response and briefing schedule for defendants to the second amended complaint. Pursuant to the schedule, defendants filed motions to dismiss under Rule 12(b)(6) on January 16, 2018. Plaintiff filed his opposition brief on February 14, 2018. Defendants' reply briefs are due on March 2, 2018. The court heard argument on the motions to dismiss on March 23, 2018 and took the matters under submission. On October 18, 2017, the court in the Wollnik lawsuit conducted a case management conference, at the conclusion of which the court scheduled a complex determination hearing for November 28, 2017. We filed a notice of non-opposition to complex case designation and request for coordination with the Chopra lawsuit on October 24, 2017. The plaintiff in the Wollnik lawsuit filed a statement of non-opposition to complex case designation on or about November 27, 2017. The court continued the complex determination hearing to April 3, 2018. We intend to vigorously defend against these lawsuits. We cannot currently predict the impact or resolution of each of these lawsuits or reasonably estimate a range of possible loss, if any, which could be material, and the resolution of these lawsuits may harm our business and have a material adverse impact on our financial condition.

From time to time, we could become subject to claims arising in the ordinary course of business or could be named a defendant in additional lawsuits. The outcome of such claims or other proceedings cannot be predicted with certainty and may have a material effect on our financial condition, results of operations or cash flows.

Availability of SEC Filings

We make available through our website our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K and amendments to those reports free of charge as soon as reasonably practicable after we electronically file such reports with the Securities and Exchange Commission ("SEC"). Our Internet address is www.identiv.com. The content on our website is not, nor should it be deemed to be, incorporated by reference into this Annual Report. Additionally, documents filed by us with the SEC may be read and copied at the Public Reference Section of the SEC, 100 F Street, N.E., Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. Our filings with the SEC are also available to the public through the SEC's website at www.sec.gov.

Item 1A. Risk Factors

The following discussion of risk factors contains forward-looking statements. These risk factors may be important to understanding any statement in this Form 10-K or elsewhere. The following information should be read in conjunction with Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the consolidated financial statements and related notes in Part II, Item 8, “Financial Statements and Supplementary Data” of this Form 10-K.

Because of the following factors, as well as other factors affecting our financial condition and operating results, past financial performance should not be considered to be an indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

Our revenues and operating results are subject to significant fluctuations and such fluctuations may lead to a reduced market price for our stock.

Our revenues and operating results have varied in the past and will likely continue to fluctuate in the future. We believe that period-to-period comparisons of our operating results are not necessarily meaningful, but securities analysts and investors often rely upon these comparisons as indicators of future performance. If our operating results in any future period fall below the expectations of securities analysts and investors, or the guidance that we provide, the market price of our stock would likely decline.

Factors that have caused our results to fluctuate in the past and which are likely to affect us in the future include the following:

- business and economic conditions overall and in our markets;
- the timing and size of customer orders that may be tied to annual or other budgetary cycles, seasonal demand, product plans or program roll-out schedules;
- the effects of the U.S. Government shut downs, spending cuts and other changes in budget allocation or availability that create uncertainty for customers in certain parts of our business;
- the absence of significant backlog in our business;
- cancellations or delays of customer orders or the loss of a significant customer;
- the length of sales cycles associated with our product or service offerings;
- variations in the mix of products and services we sell;
- reductions in the average selling prices that we are able to charge due to competition or other factors;
- our ability to obtain an adequate supply of quality components and to deliver our products on a timely basis;
- our inventory levels and the inventory levels of our customers and indirect sales channels;
- the extent to which we invest in development, sales and marketing, and other expense categories;
- acquisitions, dispositions or organizational restructuring;
 - fluctuations in the value of foreign currencies against the U.S. dollar;
- the cost or impact of litigation; and
- the write-off of investments.

Estimating the amount and mix of future revenues is difficult, and our failure to do so accurately could affect our ability to be profitable or reduce the market price for our stock.

Accurately estimating future revenues is difficult because the purchasing patterns of our customers can vary depending upon a number of factors. We sell our smart card readers primarily through a channel of distributors who place orders on an ongoing basis depending on their customers' requirements. As a result, the size and timing of these orders can vary from quarter to quarter. The increasing market demand for RFID and NFC technology is resulting in larger program deployments of these products and components, as well as increasing competition for these solutions. Across our business, the timing of closing larger orders increases the risk of quarter-to-quarter fluctuation in revenues. If orders forecasted for a specific group of customers for a particular quarter are not realized or revenues are not otherwise recognized in that quarter, our operating results for that quarter could be materially adversely affected. For example, in the quarter ended September 30, 2017, we experienced lower sales in our Premises segment as a result of the timing of orders received from federal government customers late or after the quarter ended. In addition, from time to time, we may experience an unexpected increase or decrease in demand for our products resulting from fluctuations in our customers' budgets, purchasing patterns or deployment schedules. These occurrences are not always predictable and can have a significant impact on our results in the period in which they occur.

Failure to accurately forecast customer demand may result in excess or obsolete inventory, which if written down might adversely impact our cost of revenues and financial condition. For example, in the quarter ended December 31, 2017, in the Credentials segment, we recorded a transponder related inventory reserve adjustment associated with a customer relationship which ended at the end of 2015 and our decision to discontinue plans for alternate use of the

product.

In addition, our expense levels are based, in significant part, upon our expectations as to future revenues and are largely fixed in the short term. We may be unable to adjust spending in a timely manner to compensate for any unexpected shortfall in revenues. Any significant shortfall in revenues in relation to our expectations could have an immediate and significant effect on our operating results for that quarter and may lead to a reduced market price for our stock.

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Our loan covenants may affect our liquidity or limit our ability to incur debt, make investments, sell assets, merge or complete other significant transactions.

On February 8, 2017, we entered into Loan and Security Agreements with East West Bank ("EWB") and Venture Lending & Leasing VII, Inc. and Venture Lending & Leasing VIII, Inc. (collectively referred to as "VLL7 and VLL8"). The Loan and Security Agreement with EWB provides for a \$10.0 million revolving loan facility (the "Revolving Loan Facility"), and the Loan Security Agreement with VLL7 and VLL8 provides for a term loan in an aggregate principal amount of \$10.0 million (the "Term Loan Facility"). Our obligations under these agreements are secured by substantially all of our assets. Each of the Revolving Loan Facility and the Term Loan Facility contain customary representations and warranties and customary affirmative and negative covenants, including, limits or restrictions on our ability to incur liens, incur indebtedness, make certain restricted payments, merge or consolidate and dispose of assets. The Revolving Loan Facility also contains various financial covenants. In addition, each of the Revolving Loan Facility and the Term Loan Facility contains customary events of default that entitle EWB or VLL7 and VLL8, as appropriate, to cause any or all of our indebtedness under the Revolving Loan Facility or the Term Loan Facility, respectively, to become immediately due and payable. The events of default (some of which are subject to applicable grace or cure periods), include, among other things, non-payment defaults, covenant defaults, cross-defaults to other material indebtedness, bankruptcy and insolvency defaults and material judgment defaults. Upon the occurrence and during the continuance of an event of default, EWB and VLL7 and VLL8 may terminate their lending commitments and/or declare all or any part of the unpaid principal of all loans, all interest accrued and unpaid thereon and all other amounts payable under the Loan and Security Agreements to be immediately due and payable. If repayment of the indebtedness is accelerated, we could face a substantial liquidity problem and may be forced to dispose of material assets or operations, seek to obtain equity capital, or restructure or refinance our indebtedness. Such alternative measures may not be available or successful. Also, our loan covenants may limit our ability to dispose of material assets or operations or to restructure or refinance our indebtedness. Even if we are able to restructure or refinance our indebtedness, the economic terms may not be favorable to us. Any of the foregoing could have a material adverse effect on our financial condition and results of operations. Our ability to make periodic interest payments and to repay our debt when due depends on our financial and operating performance, which in turn, is subject to prevailing economic and competitive conditions and other factors. If our cash flow and capital resources are insufficient to fund our debt service obligations, we could face substantial liquidity problems and may be forced to dispose of material assets or operations, seek to obtain equity capital, or restructure or refinance our indebtedness. Such alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations.

If we are not able to secure additional financing when needed, our business could be adversely affected.

We may seek or need to raise additional funds for general corporate and commercial purposes or for acquisitions. Our ability to obtain financing depends on our historical and expected future operating and financial performance, and is also subject to prevailing economic conditions and to financial, business and other factors beyond our control. If we are unable to secure additional financing when desired, our ability to fund our business operations, make capital expenditures, pursue additional expansion or acquisition opportunities, or have resources available to capitalize on other opportunities could be limited, and this could adversely impact our financial results. There can be no assurance that additional capital will be available to us on favorable terms or at all. The sale of additional debt or equity securities may cause dilution to existing stockholders. Any debt or equity securities issued may also provide for rights, preferences or privileges senior to those of our common stock and could impose significant restrictions on our operations. In addition, any capital we raise may be restricted with respect to use. For example, we raised approximately \$12.0 million in December 2017 through the sale of convertible preferred stock, which proceeds may only be used to pay down debt, or for acquisitions.

Acquisitions and strategic investments require substantial resources, expose us to significant risks and may adversely impact our business.

As part of our growth strategy, we may seek to acquire or make investments in companies, products or technologies that we believe complement or augment our existing business, product offerings or technology portfolio. For example, on February 14, 2018, we acquired 3VR Security, Inc., a video technology and analytics company for approximately \$6.9 million, consisting of (i) approximately \$1.6 million in cash, (ii) the issuance of subordinated unsecured promissory notes in an aggregate principal amount of \$2.0 million, and (iii) the issuance of shares of our common stock with a value of approximately \$3.3 million. In addition, in the event that 3VR Security, Inc. achieves \$24.1 million in product shipments in 2018, we will be obligated to issue further earn-out consideration of \$3.5 million payable in shares of our common stock (subject to certain conditions) with a potential maximum earn-out value of \$7.0 million in the event that such shipments exceed \$48.2 million. Further, in calendar year 2019, we may also be obligated to pay, in cash, and subject to certain conditions, contingent consideration equal to the lesser of (A) 35% of the gross margin of certain products sold and services rendered by 3VR Security, Inc. in 2018 pursuant to a supply arrangement and (B) \$25.0 million, each subject to adjustments. Acquiring and integrating acquired assets into our business exposes us to certain risks.

Executing acquisition or investment transactions and assimilating personnel and operations from an acquired business may require significant attention and resources, which may divert the attention of our management and employees from day-to-day operations and disrupt our business. This may adversely impact our results of operations. In addition, there can be no assurances that the expected benefits of any acquisitions will be achieved.

The costs associated with an acquisition may be significant, whether or not the acquisition transaction is successfully concluded. As a result, acquisition activities may reduce the amount of capital available to fund our business. To purchase another company, we may be required to issue additional equity securities, which would result in dilution to our stockholders. Acquisitions may result in the assumption of additional liabilities or debt, including unanticipated liabilities, or charges to earnings for such items as amortization of purchased intangibles or in-process research and development expenses. Such liabilities, indebtedness or charges could have a material and adverse impact on our financial condition and results of operations. Acquisitions and strategic investments may also lead to substantial increases in non-current assets, including goodwill. Write-downs of these assets due to unforeseen business developments may materially and adversely impact our financial condition and results of operations.

Additionally, we have in the past acquired companies that we have subsequently divested, in some cases for less than we paid to acquire the companies. Such divestitures involve risks, such as difficulty separating out portions of or entire businesses, distracting our management team and employees, potential loss of revenue and potentially disrupting customer relationships. We have and may again in the future incur significant costs associated with exit or disposal activities, related impairment charges, or both, if we exit or divest a business or product line. If we are not able to successfully integrate or divest products, technologies, or personnel from businesses that we acquire or divest, or if we are not able to realize the expected benefits of our acquisitions, divestitures, or strategic investments, our business and financial results could be adversely affected.

Our business and reputation may adversely affected by information technology system failures or network disruptions.

We may be subject to information technology system failures and network disruptions. These may be caused by natural disasters, accidents, power disruptions, telecommunications failures, acts of terrorism or war, computer viruses, physical or electronic break-ins, or other events or disruptions. System redundancy may be ineffective or inadequate, and our disaster recovery planning may not be sufficient for all eventualities. Such failures or disruptions could compromise company or customer data and result in delayed or cancelled orders. System failures and disruptions could also impede the manufacturing and shipping of products, delivery of online services, processing of transactions and reporting of financial results. In addition, any such failures or disruptions could harm our reputation.

Our success depends largely on the continued service and availability of key personnel.

Our future success depends on our ability to continue to attract, retain, and motivate our senior management team as well as qualified technical personnel, particularly software engineers. Competition for these employees is intense and many of our competitors may have greater name recognition and significantly greater financial resources to better compete for these employees. If we are unable to retain our existing personnel, or attract and train additional qualified personnel, our growth may be limited. All of our key employees are employed on an “at will” basis, meaning either we or the employee may terminate their employment with us at any time. The loss of key employees could slow our product development processes and sales efforts or harm our reputation. Also, our low common stock price may result in difficulty attracting and retaining personnel as stock options and other forms of equity incentives generally comprise a significant portion of our employee compensation. Further, restructurings and reductions in force that we have recently experienced may have a negative effect on employee morale and the ability to attract and retain qualified personnel.

Our business could be adversely affected by reductions or delays in the purchase of our products or services for government security programs in the United States and globally.

We derive a substantial portion of our revenues from indirect sales to U.S. federal, state and local governments and government agencies, as well as from subcontracts under federal government prime contracts. Large government programs are an important market for our business, as high-security systems employing physical access, smart card, RFID or other access control technologies are increasingly used to enable applications ranging from authorizing building and network access for federal employees to paying taxes online, to citizen identification, to receiving health care. We believe that the success and growth of our business will continue to be influenced by our successful procurement of government business either directly or through our indirect sales channels. Accordingly, changes in government purchasing policies or government budgetary constraints, including government shutdowns, could directly affect our financial performance. Sales to government agencies and customers primarily serving the U.S. Government, including further sales pursuant to existing contracts, may be adversely affected by factors outside our control, such as the sequester, federal government shutdowns or other Congressional actions to reduce federal spending, and by adverse economic, political or market conditions. A reduction in current or future anticipated sales to the U.S. Government sector could harm our results of operations.

Additionally, we anticipate that an increasingly significant portion of our future revenues will come from government programs outside the U.S., such as electronic national identity, eGovernment and eHealth programs. We currently supply smart card readers, RFID products and credential provisioning and management solutions for various government programs in Europe, Asia and Australia and are actively targeting additional programs in these and other geographic areas. However, the allocation and availability of funding for such programs are often impacted by economic or political factors over which we have no control, and which may cause delays in program implementation, which could negatively impact our sales and results of operations.

Our revenues may decline if we cannot compete successfully in an intensely competitive market.

We target our products at the rapidly evolving market for security technologies. Many of our current and potential competitors have significantly greater financial, technical, marketing, purchasing and other resources than we do. As a result, our competitors may be able to respond more quickly to new or emerging technologies or standards and to changes in customer requirements. Our competitors may also be able to devote greater resources to the development, promotion and sale of products or solutions and may be able to deliver competitive products or solutions at a lower end user price.

We also experience indirect competition from certain of our customers who currently offer alternative products or solutions or are expected to introduce competitive offerings in the future. For example, in our Premises business, many of our dealer channel partners act as system integrators, providing installation and service, and therefore carry competitive lines of products and systems. This is a common practice within the industry as the integrators need access to multiple lines in order to support all potential service and user requirements. Depending on the technical competence of their sales forces, the comfort level of their technical staff with our systems and price pressures from customers, these integrators may choose to offer a competitor's product. There is also business pressure to provide some level of sales to all vendors to maintain access to a range of products and systems.

We believe that the principal competitive factors affecting the markets for our products and solutions include:

- the extent to which products and systems must support evolving industry standards and provide interoperability;
- the extent to which products are differentiated based on technical features, quality and reliability, ease of use, strength of distribution channels and price;
- the ability to quickly develop new products and solutions to satisfy new market and customer requirements; and
- the total cost of ownership including installation, maintenance and expansion capability of systems.

Increased competition and increased market volatility in our industry could result in lower prices, reduced margins or the failure of our product and service offerings to achieve or maintain market acceptance, any of which could have a serious adverse impact on our business, financial condition and results of operations.

Our percentage of revenue and customer concentration is significant in certain of our businesses.

Sales to our ten largest customers accounted for 33% of total net revenue in 2017 and 34% of total net revenue in 2016. No customer accounted for more than 10% of our total net revenue in 2017 or 2016. A significant amount of revenue is sourced from sales of products and systems to our OEM partners and an indirect sales network who sell to various entities within the U.S. federal government sector. We cannot guarantee that future reductions in U.S. Government budgets will not impact our sales to these government entities or that the terms of existing contracts will not be subject to renegotiation. Our loss of one or more significant customers could have a significant adverse impact on our business, financial condition and results of operations.

Our business will not be successful if we do not keep up with the rapid changes in our industry.

The market for security products and related services is characterized by rapid technological developments, frequent new product introductions and evolving industry standards. To be competitive, we have to continually improve the

performance, features and reliability of our products and services, particularly in response to competitive offerings, and quickly demonstrate the value of new products and services or enhancements to existing products and services. Our failure to develop and introduce new products and services successfully on a timely basis and to achieve market acceptance for such products and services could have a significant adverse impact on our business, financial condition and results of operations.

Security breaches, whether or not related to our products, could result in the disclosure of sensitive government information or private personal information that could result in the loss of clients and negative publicity.

Many of the systems we sell manage private personal information or protect sensitive information related to our customers in the government or commercial markets. A well-publicized actual or perceived breach of network or computer security in one of these systems, regardless of whether such a breach is attributable to our products, could adversely affect the market's perception of us and our products, and could result in the loss of customers, have an adverse effect on our reputation and reduce demand for our products.

As part of our technical support services, we agree, from time to time, to possess all or a portion of the security system database of our customers. This service is subject to a number of risks. For example, despite our security measures our systems may be vulnerable to cyber-attacks by hackers, physical break-ins and service disruptions that could lead to interruptions, delays or loss of data. If any such compromise of our security were to occur, it could be very expensive to correct, could damage our reputation and result in the loss of customers, and could discourage potential customers from using our services. We could also be liable for damages and penalties. Although we have not experienced attempted cyber or physical attacks, we may experience such attempts in the future. Our systems also may be affected by outages, delays and other difficulties. Our insurance coverage may be insufficient to cover losses and liabilities that may result from such events.

Sales of our products could decline and we could be subject to legal claims for damages if our products are found to have defects.

Despite our testing efforts, our products may contain defects that are not detected until after the products have been shipped. The discovery of defects or potential defects may result in damage to our reputation, delays in market acceptance of our products and additional expenditures to resolve issues related to the products' implementation. If we are unable to provide a solution to actual or potential product defects that is acceptable to our customers, we may be required to incur substantial costs for product recall, repair and replacement, or costs related to legal or warranty claims made against us.

The global nature of our business exposes us to operational and financial risks and our results of operations could be adversely affected if we are unable to manage them effectively.

We market and sell our products and solutions to customers in many countries around the world. To support our global sales, customer base and product development activities, we maintain company offices and/or business operations in several locations around the world, including Germany, Hong Kong, India, Japan, Singapore and the U.S. We also maintain manufacturing facilities in Singapore and California and engage contract manufacturers in multiple countries outside the U.S. Managing our global development, sales, administrative and manufacturing operations places a significant burden on our management resources and our financial processes and exposes us to various risks, including:

- longer accounts receivable collection cycles;
- changes in foreign currency exchange rates;
- changes in foreign laws and regulatory requirements;
- changes in political or economic conditions and stability, particularly in emerging markets;
- difficulties managing widespread sales and manufacturing operations;
- export controls;
- less effective protection of our intellectual property; and
- potentially adverse tax consequences.

Any failure to effectively mitigate these risks and effectively manage our global operations could have a material adverse effect on our business, financial condition or operating results.

A significant portion of our revenue is through an indirect sales channel, and the loss of dealers, systems integrators, resellers, or other channel partners could result in decreased revenue.

We currently use an indirect sales channel that includes dealers, systems integrators, value added resellers and resellers to sell a significant portion of our products and solutions, primarily into markets or to customers where the channel partner may have closer relationships or greater access than we do. Some of these channel partners also sell our competitors' products, and if they favor our competitors' products for any reason, they may fail to market our products as effectively or to devote necessary resources that result in effective sales, which would cause our sales to suffer. Indirect selling arrangements are intended to benefit both us and the channel partner, and may be long- or

short-term relationships, depending on market conditions, competition in the marketplace and other factors. If we are unable to maintain effective indirect sales channels, there could be a reduction in the amount of product we are able to sell, and our revenues could decrease.

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We depend upon third-party manufacturers and a limited number of suppliers, and if we experience disruptions in our supply chain or manufacturing, our business may suffer.

We rely upon a limited number of suppliers for some key components of our products which exposes us to various risks, including whether or not our suppliers will provide adequate quantities with sufficient quality on a timely basis and the risk that supplier pricing may be higher than anticipated. In addition, some of the basic components used in some of our products, such as semiconductors, may at any time be in great demand. This could result in components not being available to us in a timely manner or at all, particularly if larger companies have ordered significant volumes of those components, or in higher prices being charged for components we require. Disruption or termination of the supply of components or software used in our products could delay shipments of our products, which could have a material adverse effect on our business and operating results and could also damage relationships with current and prospective customers.

Many of our products are manufactured outside the U.S. by contract manufacturers. Our reliance on these manufactures poses a number of risks, including lack of control over the manufacturing process and ultimately over the quality and timing of delivery of our products. If any of our contract manufacturers cannot meet our production requirements, we may be required to rely on other contract manufacturing sources or identify and qualify new contract manufacturers, and we may not be able to do this in a timely manner or on reasonable terms. Additionally, we may be subject to currency fluctuations, potentially adverse tax consequences, unexpected changes in regulatory requirements, tariffs and other trade barriers, export controls, or political and economic instability. Any significant delay in our ability to obtain adequate supplies of our products from our current or alternative manufacturers could materially and adversely affect our business and operating results. In addition, if we are not successful at managing the contract manufacturing process, the quality of our products could be jeopardized or inventory levels could be inadequate or excessive, which could result in damage to our reputation with our customers and in the marketplace, as well as possible shortages of products or write-offs of excess inventory.

Our U.S. Government business depends upon the continuance of regulations that require federal agencies to implement security systems such as ours, and upon our ability to receive certain government approvals or certifications and demonstrate compliance in government audits or investigations. A failure to receive these government approvals or certifications or a negative audit result could result in a material adverse impact on our business, financial condition and results of operations.

While we are not able to quantify the amount of sales made to end customers in the U.S. Government market due to the indirect nature of our selling process, we believe that orders from U.S. Government agencies represent a significant portion of our revenues. The U.S. Government, suppliers to the U.S. Government and certain industries in the public sector currently fall, or may in the future fall, under particular regulations that require federal agencies to implement security systems that utilize physical and logical access control products and solutions such as ours. These regulations include, but are not limited to HSPD 12 and FIPS 201 produced by the National Institute of Standards and Technology (“NIST”). Discontinuance of, changes in, or lack of adoption of laws or regulations pertaining to security related to sales to end customers in the U.S. Government market could adversely affect our sales.

Our U.S. Government business is also dependent upon the receipt of certain governmental approvals or certifications and failure to receive such approvals or certifications could have a material adverse effect on our sales in those market segments for which such approvals or certifications are customary or required. Government agencies in the U.S. and other countries may audit our business as part of their routine audits and investigations of government procurement programs. Based on the outcome of any such audit, if any of our costs are found to be improperly allocated to a specific order, those costs may not be reimbursed and any costs already reimbursed for such order may have to be refunded. If a government agency audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions. A negative audit could materially affect our competitive position and result in a material adverse impact on our business, financial condition and results of operations.

Fluctuations in foreign exchange rates between the U.S. dollar and other major currencies in which we do business may adversely affect our business, financial condition and results of operations.

A significant portion of our business is conducted in foreign currencies, principally the euro. Fluctuations in the value of foreign currencies relative to the U.S. dollar will result in currency exchange gains and losses in our reported results. If a significant portion of operating expenses are incurred in a foreign currency such as the euro, and revenues are generated in U.S. dollars, exchange rate fluctuations might have a positive or negative net financial impact on these transactions, depending on whether the value of the U.S. dollar decreases or increases compared to the euro. In addition, the valuation of current assets and liabilities that are denominated in a currency other than the functional currency can result in currency exchange gains and losses. For example, when one of our subsidiaries uses the euro as the functional currency, and this subsidiary has a receivable in U.S. dollars, a devaluation of the U.S. dollar against the euro of 10% would result in a foreign exchange loss to the reporting entity of 10% of the value of the underlying U.S. dollar receivable. We cannot predict the effect of exchange rate fluctuations upon future operating results. The effect of currency exchange rate changes may increase or decrease our costs and/or revenues in any given period, and we may experience currency losses in the future. To date, we have not adopted a hedging program to protect against the risks associated with foreign currency fluctuations.

We may not be able to protect our intellectual property rights, which could make us less competitive and cause us to lose market share.

Our future success will depend, in part, upon our intellectual property rights and our ability to protect these rights. We rely on a combination of patent, copyright, trademark and trade secret laws, nondisclosure agreements and other contractual provisions to establish, maintain and protect our proprietary rights. From time to time we may be required to use litigation to protect our proprietary technology. This may result in our incurring substantial costs and we may not be successful in any such litigation. Despite our efforts to protect our proprietary rights, unauthorized third parties may copy aspects of our products, obtain and use information that we regard as proprietary, or infringe upon our patents. In addition, the laws of some foreign countries do not protect proprietary and intellectual property rights to the same extent as do the laws in the U.S. Because many of our products are sold and a significant portion of our business is conducted outside the U.S., our exposure to intellectual property risks may be higher. Our efforts to protect our proprietary and intellectual property rights may not be adequate. Additionally, there is a risk that our competitors will independently develop similar technology or duplicate our products or design around patents or other intellectual property rights. If we are unsuccessful in protecting our intellectual property or our products or technologies are duplicated by others, our competitive position could be harmed and we could lose market share.

We face risks from future claims of third parties and litigation, which could have an adverse effect on our results of operations.

From time to time, we may be subject to claims of third parties, possibly resulting in litigation, which could include, among other things, claims regarding infringement of the intellectual property rights of third parties, product defects, employment-related claims, and claims related to acquisitions, dispositions or restructurings. Addressing any such claims or litigation may be time-consuming and costly, divert management resources, cause product shipment delays, require us to redesign our products, require us to accept returns of products and to write-off inventory, or result in other adverse effects to our business. Any of the foregoing could have a material adverse effect on our results of operations and could require us to pay significant monetary damages.

We expect the likelihood of intellectual property infringement and misappropriation claims may increase as the number of products and competitors in the security market grows and as we increasingly incorporate third-party technology into our products. As a result of infringement claims, we could be required to license intellectual property from a third party or redesign our products. Licenses may not be offered when required or on acceptable terms. If we do obtain licenses from third parties, we may be required to pay license fees or royalties or we may be required to license some of our intellectual property to others in return for such licenses. If we are unable to obtain a license necessary for us or our third-party manufacturers to manufacture our allegedly infringing products, we could be required to suspend the manufacture of products or stop our suppliers from using processes that may infringe the rights of third parties. We may also be unsuccessful in redesigning our products. Our suppliers and customers may be subject to infringement claims based on intellectual property included in our products. We have historically agreed to indemnify our suppliers and customers for patent infringement claims relating to our products. The scope of this indemnity varies, but may, in some instances, include indemnification for damages and expenses, including attorney's fees. We may periodically engage in litigation as a result of these indemnification obligations. Our insurance policies exclude coverage for third-party claims for patent infringement.

Our stock price has been and is likely to remain volatile.

Over the past few years, The Nasdaq Capital Market has experienced significant price and volume fluctuations that have particularly affected the market prices of the stocks of technology companies. Volatility in our stock price may result from a number of factors, including, among others:

- low volumes of trading activity in our stock;
- technical trading patterns of our stock;

- variations in our or our competitors' financial and/or operational results;
- the fluctuation in market value of comparable companies in any of our markets;
- expected or announced news about partner relationships, customer wins or losses, product announcements or organizational changes;
- comments and forecasts by securities analysts;
- the inclusion or removal of our stock from market indices, such as groups of technology stocks or other indices;
- litigation developments; and
- general market downturns.

In the past, companies that have experienced volatility in the market price of their stock have been the object of securities class action litigation.

We have been named as a defendant in putative securities class action and derivative lawsuits. These lawsuits and other litigation could cause us to incur substantial expenses and divert our attention and resources.

Securities class action lawsuits have often been brought against a company following periods of volatility in the market price of its securities. Companies such as ours in the technology industry are particularly vulnerable to this kind of litigation due to the volatility of their stock prices. We and a number of our current and former officers and directors are defendants in putative class lawsuits and derivative litigation, which is discussed in the Section entitled “Legal Proceedings.” Any litigation to which we are a party may result in the diversion of management attention and resources from our business and business strategy. In addition, any litigation to which we are a party may result in onerous or unfavorable judgments that may not be reversed upon appeal and that may require us to pay substantial monetary damages or fines, or we may decide to settle lawsuits on similarly unfavorable terms, which could have a material adverse effect on our business, financial condition or results of operations.

You may experience dilution of your ownership interests due to the future issuance of additional shares of our stock, and future sales of shares of our common stock could adversely affect our stock price.

We have issued a significant number of shares of our common stock, together with warrants to purchase shares of our common stock and convertible preferred stock, in connection with a number of financing transactions and acquisitions in recent years. In the future, from time to time we may issue additional previously authorized and unissued securities, resulting in the dilution of the ownership interests of our current stockholders.

In addition, we have reserved shares of common stock for potential future issuance including stock issuable pursuant to various equity incentive plans, as contingent consideration related to previous acquisitions, the conversion of our preferred stock and various warrants issued in connection with previous capital raises and other transactions. As of March 15, 2018, 2,132,485 shares of common stock are reserved for future grants and outstanding equity awards under our various equity incentive plans and an additional 6,855,089 shares of common stock are reserved for future issuance in connection with other commitments, including the potential issuance of shares pursuant to warrant exercises and conversion of convertible preferred stock. We may issue additional shares of common stock or other securities that are convertible into or exercisable for shares of common stock in connection with the hiring of personnel, future acquisitions, future financings or for other business purposes. If we issue additional securities, the aggregate percentage ownership of our existing stockholders will be reduced. In addition, any new securities that we issue may have rights senior to those of our common stock.

The issuance of additional shares of common stock or preferred stock or other securities, or the perception that such issuances could occur, may create downward pressure on the trading price of our common stock.

If current or future export laws limit or otherwise restrict our business, we could be prohibited from shipping our products to certain countries, which could cause our business, financial condition and results of operations to suffer.

Some of our products are subject to export controls or other laws restricting the sale of our products under the laws of the U.S., the European Union (“EU”) and other governments. The export regimes and the governing policies applicable to our business are subject to change. We cannot be certain that such export authorizations will be available to us or for our products in the future. In some cases, we rely upon the compliance activities of our prime contractors, and we cannot be certain they have taken or will take all measures necessary to comply with applicable export laws. If we or our prime contractor partners cannot obtain required government approvals under applicable regulations, we may not be able to sell our products in certain international jurisdictions.

Changes in tax laws or the interpretation thereof, adverse tax audits and other tax matters may adversely affect our future results.

On December 22, 2017, the President of the United States signed into law the Tax Cuts and Jobs Act (the “Tax Act”), which significantly changed prior U.S. tax law and includes numerous provisions that affect our business in the current year and future years. Accounting for these provisions in fiscal 2017 requires the use of provisional estimates in our financial statements, and the exercise of significant judgment in accounting for the Tax Act's provisions. As regulations and guidance evolve with respect to the Tax Act, and as we gather more information and perform more analysis, our results may materially differ from previous estimates, and those differences may materially affect our financial position. The net impact of such changes are uncertain, and could adversely affect our tax rate and cash flow in future years.

A number of other factors may impact our tax position as well, including:

- the jurisdictions in which profits are determined to be earned and taxed;
- the resolution of issues arising from tax audits with various tax authorities;
- changes in the valuation of our deferred tax assets and liabilities;
- adjustments to estimated taxes upon finalization of various tax returns;
- increases in expenses not deductible for tax purposes; and
- the repatriation of non-U.S. earnings for which we have not previously provided for U.S. taxes.

Any of these factors could make it more difficult for us to project or achieve expected tax results. An increase or decrease in our tax liabilities due to these or other factors could adversely affect our financial results in future periods.

We had a material weakness in our internal con