ENPHASE ENERGY, INC.

NASDAQ: ENPH

TARGET PRICE: $1.01

Prescience Point Reiterates Strong Sell Recommendation On Additional Red Flags Of Accounting Impropriety

On July 25, 2018, Prescience Point published a research paper (the "Initiation Report") on Enphase Energy ("ENPH" or "the company"). In our Initiation Report, we concluded that ENPH's financial results since Q3 2017 have been materially inflated by manipulative, and potentially improper, accounting practices that have become increasingly severe with each passing quarter.

ENPH continues to hold our interest for the following reasons, each of which we thoroughly discuss in our Follow-Up Report:

- Our analysis of ENPH's Q2'18 results shows a continued increase in the severity of manipulative accounting practices to inflate financial performance
- Management tried to explain away some of the anomalies and discrepancies in ENPH's financial results we had pointed out in our Initiation Report. As we show, management's explanations in some cases conflict with statements previously made on the record and in other cases lack in credibility
- Despite the use of aggressive and potentially improper accounting practices to inflate financial performance, ENPH still missed Q2 consensus estimates and whiffed on guidance. The 12.9% and 8.9% YoY decline in ENPH's Q2'18 inverter volume and adjusted revenue, respectively, indicate that its business is deteriorating at a faster pace than we initially thought
- According to sources, disgraced former SunEdison CEO Ahmad Chatila is currently working for ENPH. ENPH appears to have adopted many of the same questionable practices which ultimately led to SUNE's downfall

We hope that current and future investors and creditors familiarize themselves with the risks we have addressed and take immediate action to preserve the value of their holdings.

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Prescience Point Reiterates Strong Sell On ENPH, Recent Developments Further Indicate That Its Reported Financials Cannot Be Relied Upon

In this report, we present seven additional red flags which have emerged since the release of our Initiation Report on July 25th

1) Q2 Results Appear To Have Been Significantly Inflated Yet Again By Improper Deferred Revenue Accounting Practices
2) ENPH Reported Another Anomalous YoY Increase In Revenue Per Inverter In Q2 2018, In Our View, Confirming That Revenue Was Significantly Inflated
3) Management Has Provided Three Different Explanations For ENPH's Anomalous Revenue Per Inverter Increase, None Of Which We Find Credible
4) Q2 Revenue Was Further Inflated By A Questionable Milestone Payment, Which Was Suspiciously Booked At A 100% Gross Margin
5) Management Could Not Credibly Explain The $6.3M Shortfall In Its Beginning Q1 2018 Deferred Revenue Balance; A Forensic Accounting Firm Agreed With Our Assessment
6) According To Sources, Disgraced Former SunEdison CEO Ahmad Chatila Is Currently Working For ENPH
7) Q2 Results Indicate That ENPH's Business Is Deteriorating At A Faster Rate Than We Initially Thought

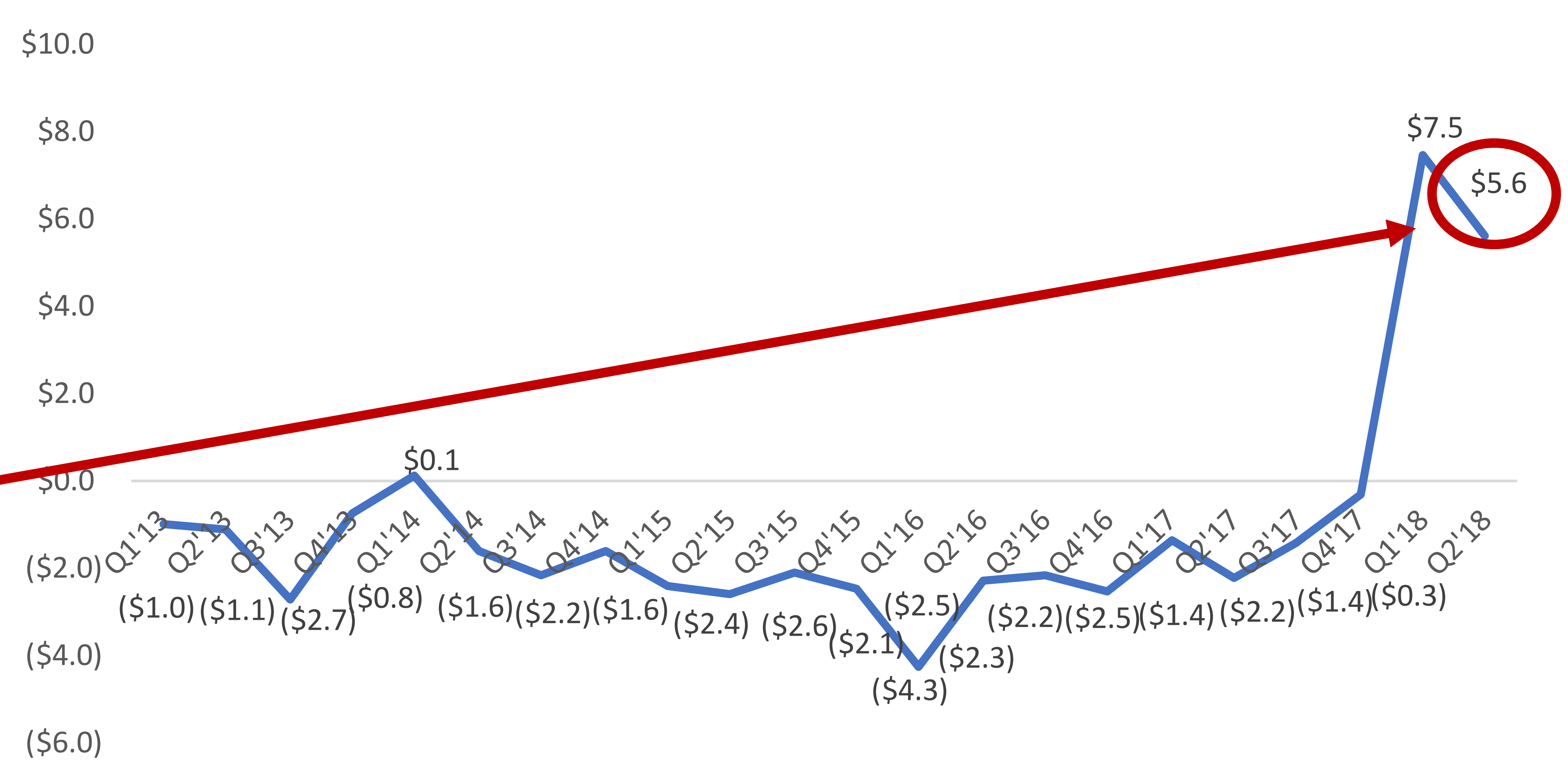
Red Flag #1: Q2 Results Appear To Have Been Significantly Inflated Yet Again By Improper Deferred Revenue Accounting Practices

- Our research indicates that ENPH's Q2 2018 results, just as in Q1 2018, were significantly inflated by deferred revenue accounting shenanigans
- Clear evidence of this can be seen in the large decline in its deferred revenue balance – In Q2 2018, the company's deferred revenue balance declined by $5.6m, meaning that ENPH recognized $5.6m more deferred Envoy revenue than what it actually billed in the quarter
- As shown in the graph below, Q1 2018 and Q2 2018 are the only quarters over the past 5 ½ years in which recognized deferred revenue has significantly exceeded billings. We do not believe this is a coincidence. Instead, we believe that the company's seemingly improper deferred revenue accounting practices initiated in Q1 2018 continued in Q2 2018

Q2 2018 Recognized Deferred Revenue vs. Billings

	Q2'18
Beginning Deferred Revenue Balance	$115.7
Ending Deferred Revenue Balance	$110.1
Change In Deferred Revenue Balance	**($5.6)**
Recognized Deferred Revenue, Amount In Excess Of Billings	***$5.6***

Recognized Deferred Revenue: Amount In Excess Of / (Lower Than) Billings



Source: ENPH filings with the SEC. Prescience Point estimates.

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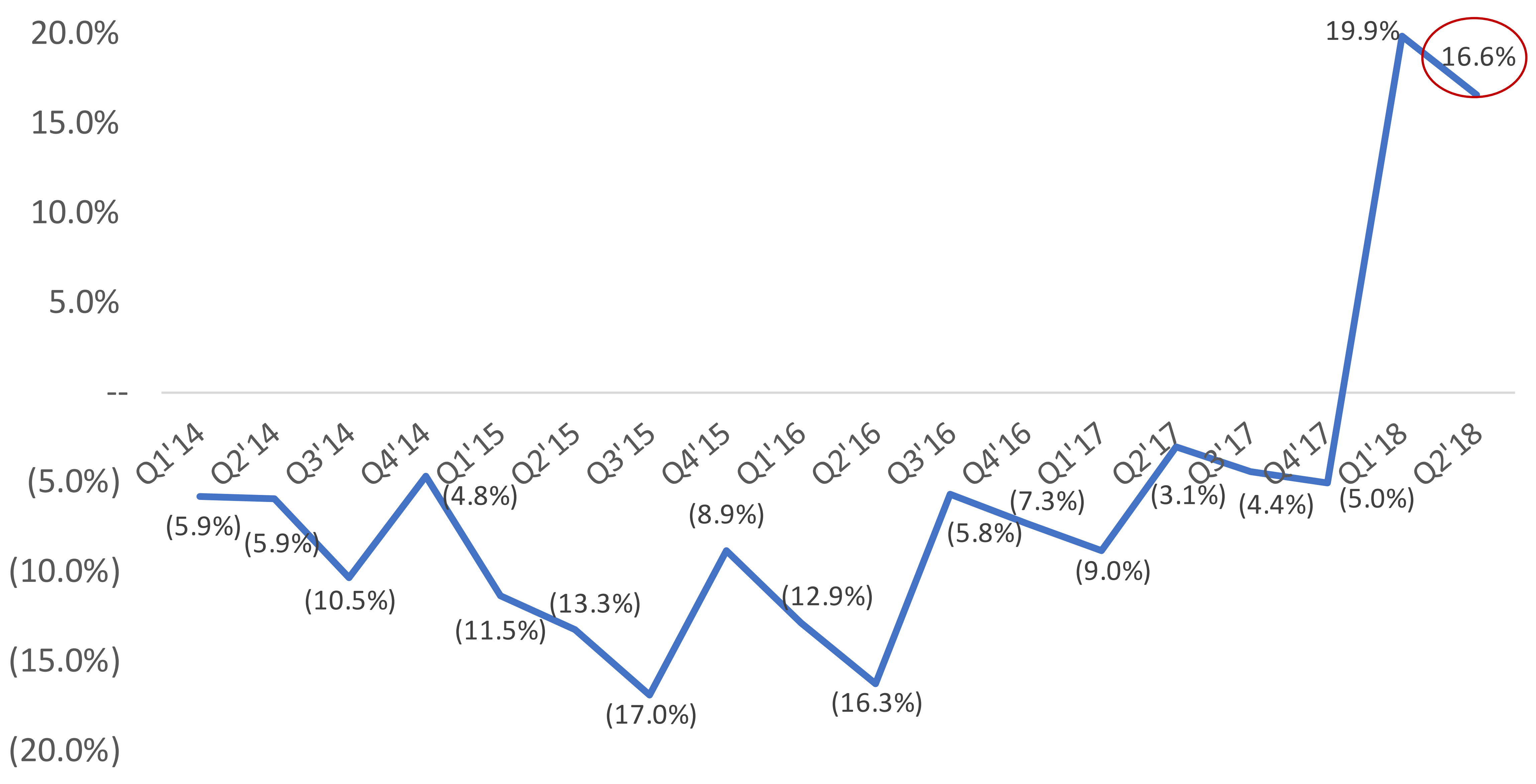
Red Flag #2: ENPH Reported Another Anomalous YoY Increase In Revenue Per Inverter In Q2 2018, In Our View, Confirming That Revenue Was Significantly Inflated

- In Q2 2018, ENPH's revenue per inverter once again increased an unusually large amount, this time by 16.6% YoY. We believe this large increase in revenue per inverter amounts to further proof that the company's results in Q2 2018, just as in Q1 2018, were significantly inflated
- As detailed in our Initiation Report, given that pricing for MLPE components typically decline around 5% - 10% per year, such large increases in revenue per inverter should not occur absent accounting shenanigans. This is clearly illustrated by the fact that, prior to Q1 2018, ENPH's revenue per inverter had declined in every single quarter dating back to Q1 2014

Revenue Per Inverter - YoY Growth



Source: ENPH earnings reports.

Red Flag #3: Management Has Provided Three Different Explanations For ENPH's Anomalous Revenue Per Inverter Increase, None Of Which We Find Credible

Management has puzzlingly provided three different explanations for why ENPH's revenue per inverter / revenue per watt has increased by such an unusually large amount over the past two quarters. We believe that management's inability to coherently answer such a simple and important question about its business supports our assertion that ENPH's financial results are fabricated

Explanation #1

ENPH Management, Q1 2018 Earnings Call:

Total net revenue per DC watt increased by 8% in the fourth quarter of 2017, ***largely as a result of changes in product mix…for Q1 '18, for example, our pricing was flat****. There has been not much change.*

Explanation #2

ENPH Management, Q2 2018 Earnings Call:

Basically in the last four to five quarters what has happened is, because of our excellent pricing management ***we have gradually have transitioned from to few big accounts and more of a long tail accounts. Because of that our average price per microinverter has gone up nearly by 10% to 15%***

Explanation #3

ENPH Q2 2018 10-Q:

We sold 675,000 microinverter units in the three months ended June 30, 2018, as compared to 775,000 units in the same period in 2017. The impact of the lower sales volume was more than ***offset by an increase in average selling price per microinverter due to the transition to our IQ series of microinverters****.*

<u>Red Flag #3:</u> Management Has Provided Three Different Explanations For ENPH's Anomalous Revenue Per Inverter Increase, None Of Which We Find Credible (Cont'd)

The explanations that management has provided for ENPH's revenue per inverter increase are both conflicting and not credible

Source	Explanation For Increase In Revenue Per Inverter	Our Comments	Our Verdict
ENPH Management, Q1 2018 Earnings Call	During ENPH's Q1 2018 earnings call, former CFO Bert Garcia attributed the revenue per inverter increase to an increase in % of non-inverter product sales. During a subsequent call in May, he clarified that the increase was specifically due to a sharp uptick in cables & accessories sales	As detailed in our Initiation Report, sales of cables & accessories would have had to increase by an estimated 303% to cause the 20% YoY increase in rev per inverter reported in Q1'18. Given that distributors purchase the components of a microinverter system together rather than separately, such a large uptick does not appear possible	NOT CREDIBLE
ENPH Management, Q2 2018 Earnings Call	During ENPH's Q2 2018 earnings call, Mr. Kothandaraman attributed the revenue per inverter increase to a greater % of long-tail customers over the past "four to five" quarters. He claimed that, because long-tail installers purchase microinverters at a premium to larger installers, this has resulted in a 10% - 15% increase in ENPH's price per microinverter	Mr. Kothandaraman's explanation does not hold weight because it 1) **directly contradicts management's statement during its prior earnings call that pricing was flat YoY in Q1'18**, 2) implies an unrealistically high turnover in ENPH's customer base, and 3) implies that long-tail installers are purchasing microinverters at an unrealistically high premium which is far in excess of the 10% - 15% overall increase in pricing cited	NOT CREDIBLE
Q2 2018 10-Q	On pg. 25 of its Q2 2018 10-Q, ENPH attributed the revenue per inverter increase to an increase in price per microinverter, driven by an increasing % of sales from its newer generation IQ series	According to several solar distributors, ENPH's IQ series microinverters are sold at a lower price than its prior generation microinverters. Thus, ENPH's claim that an increase in sales of IQ series caused an increase in price per microinverter makes zero sense. If anything, this should have caused its price per microinverter to decline meaningfully	NOT CREDIBLE

<u>Red Flag #4:</u> Q2 Revenue Was Further Inflated By A Questionable Milestone Payment, Which Was Suspiciously Booked At A 100% Gross Margin

- In Q2 2018, ENPH reported that it received a $2.0m milestone payment for customization work that it performed for a IQ8 customer / partner
- Based on the evidence, we suspect that this milestone payment may be another lever that ENPH is using to inflate its financial results
  - Consider that, as disclosed during ENPH's Q2 2018 earnings call, this payment was recognized at a 100% gross margin. This, at the very least, seems highly aggressive from an accounting perspective as ENPH certainly will not be selling the microinverters it is customizing for its partner at a 100% margin
  - Management's evasiveness when pressed by analysts for more detail on the milestone payment and partnership is also concerning:

<u>Analyst #1:</u> *Great, shifting gears back to the milestone payments, I know it's a 100% margin now $2 million in the guide for Q3, suggesting $2 million for Q4 as well. But can you give us a little more color on the business arrangement there?*

<u>ENPH Management:</u> *Right. Yes, this - well we can't say too many things about the specific partner...*

<u>Analyst #1:</u> *Can you give us a little bit of color of what kind of partner this might be, is it a utility, is it a government or is it - what's the category of partner that this might represent?*

<u>ENPH Management:</u> *...the answer is no. I cannot give you*

<u>Analyst #2:</u> *Well, let me just follow up on Phil may be ask a little differently. This relationship would not necessarily entail some type of limited preferred supplier agreement because of their early investment would it?*

<u>ENPH Management:</u> *We're not prepared to talk about the arrangement with our suppliers, I mean with our consumers right now*

Red Flag #5: Management Could Not Credibly Explain The $6.3M Shortfall In Its Beginning Q1 2018 Deferred Revenue Balance; A Forensic Accounting Firm Agreed With Our Assessment

- ENPH reported that its beginning Q1 2018 deferred revenue balance, pro forma for ASC 606 changes, was $116.8m. However, as detailed in our Initiation Report, our analysis indicated that it should have been $6.3m higher at $123.1m
- Based on this and other discrepancies in its financial statements and disclosures, we concluded that ENPH had improperly and prematurely recognized $6.3m of deferred revenue in Q1 2018
- During its Q2 2018 earnings call, ENPH tried to explain away the $6.3m shortfall in its beginning Q1 2018 deferred revenue balance by claiming that it was due to a $6.4m invoice receivables adjustment *(Note: ENPH quantified the discrepancy as being $6.4m rather than $6.3m)*
- However, the ASC 606 adjustments disclosed in ENPH's Q1 2018 10Q do not include an adjustment to its receivables balance. Thus, we believe that management's explanation is clearly bogus

What ENPH Tells Investors…

*So these transactions that we booked basically the $6.4 million that you referred to did not impact the P&L nor cash…**we took the, what we call it an invoice receivable balance** which is an asset seen on the books **and against that, we offset it against the deferred revenue account** on the books*

(Source: CFO Eric Branderiz, ENPH Q2'18 Earnings Call)

???

…Is Not Reflected In The ASC 606 Adjustments Disclosed In Its Q1'18 10Q:

	March 31, 2018		
	As Reported	Adjustments	Without Adoption of Topic 606
Prepaid expenses and other	20,435	(10,761)	9,674
Other assets	35,236	(27,330)	7,906
Accrued liabilities	30,223	(5,736)	$ 24,487
Deferred revenues	37,408	(21,350)	$ 16,058
Deferred revenues, noncurrent	78,265	(49,714)	28,551
Accumulated deficit	(339,803)	38,709	(301,094)

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Red Flag #5: Management Could Not Credibly Explain The $6.3M Shortfall In Its Beginning Q1 2018 Deferred Revenue Balance; A Forensic Accounting Firm Agreed With Our Assessment (Cont'd)

- We asked a forensic accounting firm to assess the validity of management's explanation for the $6.3m shortfall in its deferred revenue balance
- The firm agreed with our assessment that ENPH's explanation did not add up as it was not supported by the actual adjustments made to the company's financial statements

On its Q2'2018 Conference Call on 07/31/18, Enphase indicated the $6.4 million "gap" in the Q4'2017 pro forma adjusted deferred revenue balance and the beginning deferred revenue balance (as of 01/01/18) in the Q1'2018 deferred revenue rollforward was "purely a balance sheet transaction" and related to an "invoice receivable" asset that offset the deferred revenue balance. From an accounting perspective, it's possible to book deferred revenue (i.e. credit) with a corresponding receivable (i.e. debit), but in our experience this doesn't happen very often. Generally, deferred revenue is booked when a Company actually receives cash. Moreover, <u>the ASC 606 adjustments provided in the Company's Q1'2018 10Q do not show that any adjustments were made to accounts receivable</u>; the only asset adjusted was deferred costs. As a result, <u>we are skeptical about the Company's explanation as the commentary on the Conference Call is not supported by the adjustments provided in the Company's financial statements</u>.

(Source: Forensic Accountant Report, 8/2/2018)

Red Flag #6: According To Sources, Disgraced Former SunEdison CEO Ahmad Chatila Is Currently Working For ENPH

- We recently received word from an individual in the solar space that Ahmad Chatila – disgraced former SunEdison CEO and architect of the largest US bankruptcy of 2016 – is currently an executive or consultant at ENPH:

From: [redacted]
Date: July 25, 2018 at 2:52:40 PM CDT
To: [redacted]@presciencepoint.com'[redacted]presciencepoint.com>
Subject: ENPH Items

- SUNE – one of largest bankruptcies since recession (2016) – attended InterSolar last week – Ahmad Chatilla working for ENPH – what is he up to? ENPH following similar path (buying growth at any price possible)

- Another individual appeared to confirm this in a comment on Seeking Alpha from August 2017:

I have been very vocal on SA that Nahi should go. I got my wish. As a customer and shareholder, this was a painful but necessary move. I applaud the board. Troubled to hear today from one of my few remaining contacts at the company that Ahmad Chatila, former SunEdison CEO, has quietly joined the company in some executive management capacity. Chatila is ex-Cypress so is tight with Rodgers and the COO. I was told Chatila might be inline to be the new CEO. If this happens, I will stop all business with Enphase. The SunEdison debacle disqualifies him from running another solar company and I'm shocked Enphase would be considering him.

Aug 10, 2017, 11:11 PM Link

Red Flag #6: According To Sources, Disgraced Former SunEdison CEO Ahmad Chatila Is Currently Working For ENPH (Cont'd)

The involvement of Mr. Chatila, who is purportedly close to Mr. Kothandaraman as the two previously worked together at Cypress Semiconductor, may explain why ENPH appears to have adopted the same questionable and ultimately destructive path as SUNE

The Enphase Story Is Following The Same Destructive Path As SunEdison **

	Enphase	SunEdison	Comments
Use of highly questionable accounting practices	✓	✓	• ENPH appears to have used manipulative and seemingly improper accounting practices which have materially inflated its financial results • SUNE was investigated by the SEC for potentially exaggerating its liquidity, and its former CEO Ahmad Chatila was sued for providing potentially misleading information to shareholders
Value destructive deals	✓	✓	• ENPH's recently announced deal with SPWR is an incredibly value destructive transaction, in our view, as it paid ~34.4x EBIT for a limited, five-year supply agreement. ENPH has seemingly misrepresented the true economics of this agreement by providing overly rosy and misleading Non-GAAP projections • SUNE was known for its growth at any cost acquisition strategy which ultimately sunk the company. SUNE was also criticized for allegedly misleading shareholders regarding the true economics of its deals
Overly promotional management	✓	✓	• ENPH frequently issues fluff press releases and makes questionable comments seemingly for purpose of pumping up its share price. For example, in a recent GTM article, ENPH's VP of Marketing stated that ENPH's share price was *"going to go up — higher. Quote me on that. To the moon!"* • Ahmad Chatila was known for constantly pumping SUNE, and at one point made the brash prediction that SUNE would someday be worth more than $350 Billion
Overly bullish / clueless Wall Street analysts	✓	✓	• The majority of SUNE analysts had a Buy rating on its stock just prior to its eventual collapse • The majority of ENPH analysts currently have a Buy rating on its stock. These analysts have completely whiffed on identifying the issues outlined in our reports

** Reflects Prescience Point Research Opinions

Red Flag #7: Q2 Results Indicate That ENPH's Business Is Deteriorating At A Faster Rate Than We Initially Thought

- From FY 2014 to FY 2017, ENPH's reported revenue declined by 17.5% from $343.9m to $283.6m as the company has ceded a significant amount of market share to SEDG's more cost effective solution over the past few years
- In our Initiation Report, we concluded that ENPH's business was likely to continue to deteriorate due to the recent entrance of Huawei and other well-capitalized competitors into the space, as well as what looks to be a much less favorable industry environment for MLPE providers going forward
- Based on ENPH's recent Q2 results and weak Q3 guidance, it appears that its business is deteriorating at a faster rate than even we initially thought
  - After excluding the impact of its deferred revenue accounting shenanigans and recent milestone payment, ENPH's adjusted revenue declined by 8.6% YoY from $74.7m in Q2 2017 to $68.3m in Q2 2018. During that same timeframe, its inverter volume declined by 12.9% from 775K in 675K
  - ENPH's Q3 2018 revenue guidance of $76m - $82m was meaningfully lower than consensus of $84.2m, and includes an additional $2m milestone payment. Pro forma for the exclusion of this milestone payment, ENPH's adjusted Q3 2018 revenue guidance was $74m - $80m which, at the midpoint, is 8.5% or $7.2m lower than consensus

Inverter Volume and Revenue: Q2 2018 vs Q2 2017

($ in millions)	Q2'17	Q2'18
Reported Inverter Volume	775,000	675,000
YoY Decrease In Reported Inverter Volume		***(12.9%)***
Reported Revenue	$74.7	$75.9
(-) Inflation From Deferred Revenue	$0.0	($5.6)
(-) Milestone Payment	$0.0	($2.0)
PP-Adjusted Revenue	**$74.7**	**$68.3**
YoY Decrease In PP-Adjusted Revenue		***(8.6%)***

Source: ENPH filings with the SEC. Prescience Point estimates.

Consensus vs. Management Guidance

($ in millions)	Q3'18
Consensus Revenue Estimate	$84.2
Revenue Guidance (Midpoint)	$79.0
(-) Milestone Payment	($2.0)
PP-Adjusted Revenue Guidance	**$77.0**
PP-Adjusted Revenue Guidance, Discount To Consensus Estimate	***(8.5%)***

Source: ENPH earnings reports and filings with the SEC. Prescience Point estimates.