

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2019

or

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

For the transition period from _____ to _____

Commission File Number: 001-35465



TURTLE BEACH CORPORATION
(Exact name of registrant as specified in its charter)

Nevada
(State or other jurisdiction of
incorporation or organization)

11011 Via Frontera, Suite A/B
San Diego, California
(Address of principal executive offices)

27-2767540
(I.R.S. Employer
Identification Number)

92127
(Zip Code)

(888) 496-8001

(Registrant's telephone number, including area code)

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

Title of each class
Common Stock, par value \$0.001

Trading Symbols
HEAR

Name of each exchange on which registered
Nasdaq

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See 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
Non-accelerated filer
Emerging growth company

Accelerated filer
Smaller reporting 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

The number of shares of the registrant's Common Stock, par value \$0.001 per share, outstanding on October 31, 2019 was 14,517,229.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

**Turtle Beach Corporation
Condensed Consolidated Balance Sheets**

	September 30, 2019	December 31, 2018
	(unaudited)	
	<small>(in thousands, except par value and share amounts)</small>	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 7,037	\$ 7,078
Accounts receivable, net	28,468	52,797
Inventories	67,032	49,472
Prepaid expenses and other current assets	5,500	4,469
Total Current Assets	108,037	113,816
Property and equipment, net	4,909	5,856
Goodwill	9,096	—
Intangible assets, net	4,836	1,036
Other assets	3,719	1,212
Total Assets	<u>\$ 130,597</u>	<u>\$ 121,920</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Revolving credit facility	\$ 26,561	\$ 37,385
Accounts payable	37,490	17,724
Other current liabilities	20,489	18,488
Total Current Liabilities	84,540	73,597
Deferred income taxes	187	187
Financial instrument obligation	—	7,848
Other liabilities	4,264	2,792
Total Liabilities	88,991	84,424
Commitments and Contingencies		
Stockholders' Equity		
Common stock, \$0.001 par value - 100,000,000 shares authorized; 14,512,599 and 14,268,184 shares issued and outstanding as of September 30, 2019 and December 31, 2018, respectively	15	14
Additional paid-in capital	176,295	169,421
Accumulated deficit	(133,905)	(131,463)
Accumulated other comprehensive loss	(799)	(476)
Total Stockholders' Equity	41,606	37,496
Total Liabilities and Stockholders' Equity	<u>\$ 130,597</u>	<u>\$ 121,920</u>

See accompanying Notes to the Condensed Consolidated Financial Statements (unaudited)

Turtle Beach Corporation
Condensed Consolidated Statements of Operations
(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2019	September 30, 2018	September 30, 2019	September 30, 2018
	(in thousands, except per-share data)			
Net revenue	\$ 46,723	\$ 74,427	\$ 132,899	\$ 176,118
Cost of revenue	31,680	43,925	89,898	110,310
Gross profit	15,043	30,502	43,001	65,808
Operating expenses:				
Selling and marketing	10,150	8,517	24,581	21,264
Research and development	2,198	1,400	5,388	4,056
General and administrative	5,214	4,063	16,057	11,911
Total operating expenses	17,562	13,980	46,026	37,231
Operating income (loss)	(2,519)	16,522	(3,025)	28,577
Interest expense	240	1,093	595	4,356
Other non-operating expense (income), net	302	99	(1,430)	8,883
Income (loss) before income tax	(3,061)	15,330	(2,190)	15,338
Income tax expense	63	398	252	762
Net income (loss)	\$ (3,124)	\$ 14,932	\$ (2,442)	\$ 14,576
Net income (loss) per share				
Basic	\$ (0.22)	\$ 1.07	\$ (0.17)	\$ 1.10
Diluted	\$ (0.22)	\$ 0.91	\$ (0.17)	\$ 1.05
Weighted average number of shares:				
Basic	14,506	14,019	14,477	13,263
Diluted	14,506	16,229	14,477	13,828

See accompanying Notes to the Condensed Consolidated Financial Statements (unaudited)

Turtle Beach Corporation
Condensed Consolidated Statements of Comprehensive Income (Loss)
(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2019	September 30, 2018	September 30, 2019	September 30, 2018
	(in thousands)			
Net income (loss)	\$ (3,124)	\$ 14,932	\$ (2,442)	\$ 14,576
Other comprehensive income (loss):				
Foreign currency translation adjustment	(330)	(81)	(323)	(196)
Other comprehensive income (loss)	(330)	(81)	(323)	(196)
Comprehensive income (loss)	<u>\$ (3,454)</u>	<u>\$ 14,851</u>	<u>\$ (2,765)</u>	<u>\$ 14,380</u>

See accompanying Notes to the Condensed Consolidated Financial Statements (unaudited)

Turtle Beach Corporation
Condensed Consolidated Statements of Cash Flows
(unaudited)

	Nine Months Ended	
	September 30, 2019	September 30, 2018
(in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ (2,442)	\$ 14,576
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	3,477	2,944
Amortization of intangible assets	413	230
Amortization of debt financing costs	142	956
Stock-based compensation	2,555	1,409
Accrued interest on Series B redeemable preferred stock	—	501
Paid-in-kind interest	—	1,747
Deferred income taxes	—	714
Provision for (reversal of) sales returns reserve	(4,262)	1,097
Provision for doubtful accounts	(8)	373
Provision for obsolete inventory	2,081	2,273
Loss on disposal of property and equipment	—	93
Unrealized loss (gain) on financial instrument obligation	(1,601)	8,410
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	30,017	19,463
Inventories	(12,622)	(48,103)
Accounts payable	14,426	35,223
Prepaid expenses and other assets	(1,005)	(1,727)
Income taxes payable	(1,569)	431
Other liabilities	(2,298)	2,748
Net cash provided by operating activities	<u>27,304</u>	<u>43,358</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(1,628)	(2,046)
Acquisition of a business, net of cash acquired	(12,667)	—
Net cash used for investing activities	<u>(14,295)</u>	<u>(2,046)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Borrowings on revolving credit facilities	148,087	205,810
Repayment of revolving credit facilities	(158,911)	(240,753)
Proceeds of term loan	—	3,265
Repayment of term loan	—	(2,485)
Repayment of subordinated notes - related party	—	(8,265)
Settlement of Series B Preferred Stock	—	(1,390)
Proceeds from exercise of stock options and warrants	214	4,097
Repurchase of common stock	(1,941)	—
Repurchase of common stock to satisfy employee tax withholding obligations	(201)	(141)
Debt financing costs	—	(405)
Net cash used for financing activities	<u>(12,752)</u>	<u>(40,267)</u>
Effect of exchange rate changes on cash and cash equivalents	(298)	(114)
Net increase (decrease) in cash and cash equivalents	(41)	931
Cash and cash equivalents - beginning of period	7,078	5,247
Cash and cash equivalents - end of period	<u>\$ 7,037</u>	<u>\$ 6,178</u>
SUPPLEMENTAL DISCLOSURE OF INFORMATION		
Cash paid for interest	<u>\$ 488</u>	<u>\$ 1,062</u>
Cash paid for income taxes	<u>\$ 447</u>	<u>\$ —</u>
Reclassification of financial instrument obligation	<u>\$ 6,248</u>	<u>\$ —</u>
Exchange of Series B Preferred Stock	<u>\$ —</u>	<u>\$ 18,032</u>

See accompanying Notes to the Condensed Consolidated Financial Statements (unaudited)

Turtle Beach Corporation
Condensed Consolidated Statement of Stockholders' Equity (Deficit)
(unaudited)

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount				
	(in thousands)					
Balance at December 31, 2018	14,268	\$ 14	\$ 169,421	\$ (131,463)	\$ (476)	\$ 37,496
Net income	—	—	—	3,055	—	3,055
Other comprehensive income, net of tax	—	—	—	—	165	165
Reclassification of financial instrument obligation	—	—	6,248	—	—	6,248
Issuance of restricted stock	12	—	—	—	—	—
Repurchase of common stock and retirement of related treasury shares	(6)	—	(101)	—	—	(101)
Issuance of common stock upon exercise of warrants	295	—	—	—	—	—
Stock options exercised	6	—	23	—	—	23
Stock-based compensation	—	—	522	—	—	522
Balance at March 31, 2019	<u>14,575</u>	<u>14</u>	<u>176,113</u>	<u>(128,408)</u>	<u>(311)</u>	<u>47,408</u>
Net loss	—	—	—	(2,373)	—	(2,373)
Other comprehensive income, net of tax	—	—	—	—	(158)	(158)
Issuance of restricted stock	56	—	—	—	—	—
Repurchase of common stock and retirement of related treasury shares	(4)	—	(44)	—	—	(44)
Common stock buyback	(156)	—	(1,499)	—	—	(1,499)
Stock options exercised	22	—	71	—	—	71
Stock-based compensation	—	—	1,003	—	—	1,003
Balance at June 30, 2019	<u>14,493</u>	<u>14</u>	<u>175,644</u>	<u>(130,781)</u>	<u>(469)</u>	<u>44,408</u>
Net loss	—	—	—	(3,124)	—	(3,124)
Other comprehensive income, net of tax	—	—	—	—	(330)	(330)
Issuance of restricted stock	43	1	(1)	—	—	—
Repurchase of common stock and retirement of related treasury shares	(6)	—	(56)	—	—	(56)
Common stock buyback	(50)	—	(442)	—	—	(442)
Stock options exercised	33	—	120	—	—	120
Stock-based compensation	—	—	1,030	—	—	1,030
Balance at September 30, 2019	<u>14,513</u>	<u>\$ 15</u>	<u>\$ 176,295</u>	<u>\$ (133,905)</u>	<u>\$ (799)</u>	<u>\$ 41,606</u>

See accompanying Notes to the Condensed Consolidated Financial Statements (unaudited)

Turtle Beach Corporation
Condensed Consolidated Statement of Stockholders' Equity (Deficit)
(unaudited) (continued)

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount				
	(in thousands)					
Balance at December 31, 2017	12,349	\$ 12	\$ 148,082	\$ (170,048)	\$ (203)	\$ (22,157)
Cumulative effect of the adoption of ASC 606	—	—	—	(605)	—	(605)
Net income	—	—	—	1,962	—	1,962
Other comprehensive income, net of tax	—	—	—	—	155	155
Stock-based compensation	—	—	223	—	—	223
Balance at March 31, 2018	12,349	12	148,305	(168,691)	(48)	(20,422)
Net loss	—	—	—	(2,318)	—	(2,318)
Other comprehensive income, net of tax	—	—	—	—	(270)	(270)
Issuance of common stock in exchange for Series B preferred stock, net of issuance costs	1,307	1	15,474	—	—	15,475
Issuance of restricted stock	28	—	—	—	—	—
Stock options exercised	110	1	733	—	—	734
Stock-based compensation	—	—	599	—	—	599
Balance at June 30, 2018	13,794	14	165,111	(171,009)	(318)	(6,202)
Net income	—	—	—	14,932	—	14,932
Other comprehensive income, net of tax	—	—	—	—	(81)	(81)
Issuance of restricted stock	16	—	—	—	—	—
Repurchase of common stock and retirement of related treasury shares	(6)	—	(141)	—	—	(141)
Issuance of common stock upon exercise of warrant	77	—	778	—	—	778
Stock options exercised	349	—	2,585	—	—	2,585
Stock-based compensation	—	—	587	—	—	587
Balance at September 30, 2018	14,230	\$ 14	\$ 168,920	\$ (156,077)	\$ (399)	\$ 12,458

See accompanying Notes to the Condensed Consolidated Financial Statements (unaudited)

Turtle Beach Corporation
Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 1. Background and Basis of Presentation

Organization

Turtle Beach Corporation (“Turtle Beach” or the “Company”), headquartered in San Diego, California and incorporated in the state of Nevada in 2010, is a premier gaming accessory company with expertise and experience in developing, commercializing and marketing innovative products across a range of large addressable markets under the Turtle Beach® and ROCCAT® brands. Turtle Beach is a worldwide leading provider of feature-rich headset solutions for use across multiple platforms, including video game and entertainment consoles, handheld consoles, personal computers, tablets and mobile devices. ROCCAT is a leading provider of gaming keyboards, mice and other accessories focused in the personal computer peripherals market.

VTB Holdings, Inc. (“VTBH”), a wholly-owned subsidiary of Turtle Beach and the owner of Voyetra Turtle Beach, Inc. (“VTB”) and Turtle Beach Europe Limited (“TB Europe”), was incorporated in the state of Delaware in 2010. VTB was incorporated in the state of Delaware in 1975 with operations principally located in Valhalla, New York.

Basis of Presentation

The accompanying interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and, in the opinion of management, reflect all adjustments (which include normal recurring adjustments) considered necessary for a fair presentation of the financial position, results of operations, and cash flows for the periods presented. All intercompany accounts and transactions have been eliminated in consolidation. Certain information and footnote disclosures, normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”), have been condensed or omitted pursuant to those rules and regulations. The Company believes that the disclosures made are adequate to make the information presented not misleading. The results of operations for the interim periods are not necessarily indicative of the results of operations for the entire fiscal year.

The December 31, 2018 Condensed Consolidated Balance Sheet has been derived from the Company’s audited financial statements included in its Annual Report on Form 10-K filed with the SEC on March 18, 2019 (“Annual Report”).

These financial statements should be read in conjunction with the annual financial statements and the notes thereto included in the Annual Report that contains information useful to understanding the Company’s businesses and financial statement presentations.

Note 2. Summary of Significant Accounting Policies

The preparation of consolidated annual and quarterly financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the Company’s consolidated financial statements, and the reported amounts of revenue and expenses during the reporting periods. The Company can give no assurance that actual results will not differ from those estimates.

There have been no material changes to the critical accounting policies and estimates from the information provided in Note 1 of the notes to our consolidated financial statements in our Annual Report.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, that introduced the recognition of a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term and, a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis for all leases (with the exception of short-term leases). The Company adopted this standard on its effective date of January 1, 2019, using the optional alternative approach, which applies the provisions of the new guidance at the effective date without adjusting the comparative periods. As part of the adoption of the new standard, the Company elected the package of practical expedients that permits entities to not reassess prior conclusions regarding lease identification, lease classification, and initial direct costs under the new standard. Upon adoption of the new standard as it relates to the Company’s accounting for real estate operating leases, assets and liabilities increased by approximately \$3.3 million. Refer to Note 13, “Commitments and Contingencies” for further details.

In June 2018, the FASB issued ASU 2018-07, *Improvements to Non-employee Share-Based Payment Accounting*, that expands the scope of *Topic 718, Compensation—Stock Compensation*, to include share-based payments issued to non-employees for goods or services and substantially aligned the accounting for share-based payments to non-employees and employees. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. The Company is evaluating the effect that this guidance will have on its financial statements and related disclosures.

In August 2018, the FASB issued ASU No. 2018-13, *Changes to the Disclosure Requirements for Fair Value Measurement* that removes certain disclosure requirements related to the fair value hierarchy, modifies existing disclosure requirements related to measurement uncertainty and adds new disclosure requirements. The new disclosure requirements include disclosing the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. The provisions of this ASU are effective for years beginning after December 15, 2019, with early adoption permitted. Certain disclosures in the new guidance will need to be applied on a retrospective basis and others on a prospective basis.

Note 3. Acquisitions

ROCCAT

On May 31, 2019, the Company completed its acquisition of the business and assets of ROCCAT, a provider of gaming keyboards, mice and other accessories for a purchase price of approximately \$12.7 million and up to \$3.4 million in potential earn-outs based on revenues for the years ending December 31, 2019 and 2020, as provided in the asset purchase agreement. The purchase price was paid in cash at closing and was funded by the Company's cash reserves and additional borrowings under its credit facility. In addition, business transaction costs incurred in connection with the acquisition of \$0.6 million and \$3.0 million for the three and nine months ended September 30, 2019, respectively, were recorded as a component of "General and administrative" expenses in the Condensed Consolidated Statements of Operations.

The preliminary ROCCAT purchase price allocation as of May 31, 2019, is shown in the following table:

(In thousands)	Amount
Receivables	\$ 1,418
Inventories	7,018
Property and equipment	1,110
Intangible assets	4,243
Other long-term assets	461
Accounts payable	(5,548)
Accrued and other current liabilities	(3,211)
Contingent consideration	(1,592)
Other non-current liabilities	(328)
Total identifiable net assets	3,571
Goodwill	9,096
Total consideration	\$ 12,667

The fair values of ROCCAT's assets and liabilities are provisional and were determined based on preliminary estimates and assumptions that management believes are reasonable. The preliminary purchase price allocation is subject to further refinement and may require significant adjustments to arrive at the final purchase price allocation. These adjustments will primarily relate to certain short-term assets, intangible assets, and certain liabilities including contingent consideration. The final determination of the fair value of certain assets and liabilities will be completed as soon as the necessary information is available, including the completion of a valuation of the tangible and intangible assets and the contingent consideration, but no later than one year from the acquisition date.

The goodwill from the acquisition of ROCCAT, which is fully deductible for tax purposes, consists largely of synergies and economies of scale expected from combining the operations of ROCCAT and the Company's existing business.

The estimate of fair value of ROCCAT’s identifiable intangible assets was determined primarily using the “income approach,” which requires a forecast of all of the expected future cash flows either through the use of the multi-period excess earnings method or the relief-from-royalty method. Some of the more significant assumptions inherent in the development of intangible asset values include: the amount and timing of projected future cash flows, the discount rate selected to measure the risks inherent in the future cash flows, the assessment of the intangible asset’s life cycle, as well as other factors. The following table summarizes key information underlying intangible assets related to the ROCCAT acquisition:

(In thousands)	Life	Amount
Customer relationships	7 Years	\$ 1,930
Tradenames	5 Years	1,529
Developed technology	7 Years	784
Total		\$ 4,243

For the three and nine months ended September 30, 2019, ROCCAT had revenue of \$3.8 million and \$5.1 million, respectively, and an operating loss of \$2.1 million and \$2.5 million, respectively.

The Company has not presented combined pro forma financial information of the Company and the pre-acquisition ROCCAT business because the results of operations of the acquired business are considered immaterial.

Note 4. Fair Value Measurement

The Company follows a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1 — Quoted prices in active markets for identical assets or liabilities.
- Level 2 — Observable inputs other than quoted prices included in Level 1, such as quoted prices for markets that are not active, or other inputs that are observable or can be corroborated by observable market data.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

Financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, debt instruments and certain warrants. As of September 30, 2019 and December 31, 2018, the Company had not elected the fair value option for any financial assets and liabilities for which such an election would have been permitted, and the only outstanding financial assets and liabilities recorded at fair value on a recurring basis were the wholly-funded warrants reported as a financial instrument obligation as of December 31, 2018. The following is a summary of the carrying amounts and estimated fair values of our financial instruments at September 30, 2019 and December 31, 2018

	September 30, 2019		December 31, 2018	
	Reported	Fair Value	Reported	Fair Value
	(in thousands)			
Financial Assets and Liabilities:				
Cash and cash equivalents	\$ 7,037	\$ 7,037	\$ 7,078	\$ 7,078
Revolving credit facility	\$ 26,561	\$ 26,561	\$ 37,385	\$ 37,385
Financial instrument obligation	\$ —	\$ —	\$ 7,848	\$ 7,848
Contingent consideration liabilities	\$ 1,529	\$ 1,529	\$ —	\$ —

Cash equivalents are stated at amortized cost, which approximates fair value as of the consolidated balance sheet dates, due to the short period of time to maturity; and accounts receivable and accounts payable are stated at their carrying value, which approximates fair value due to the short time to the expected receipt or payment. The carrying value of the revolving credit facility equals fair value as the stated interest rate approximates market rates currently available to the Company, which are considered Level 2 inputs. The liability-classified warrants reported as a financial instrument obligation were classified within Level 3 because the Company uses a Black-Scholes pricing model to estimate the fair value based on inputs that are not observable in any market.

Contingent consideration liabilities are measured at their estimated fair value as of the date of acquisition, with subsequent changes in fair value recorded in the consolidated statements of operations. The Company estimated the contingent consideration liability using a Monte Carlo simulation which required the Company to make estimates and assumptions regarding expected volatilities, discount rates, and future revenues of the acquired business, which are considered Level 3 inputs.

Note 5. Allowance for Sales Returns

The following table provides the changes in our sales return reserve, which is classified as a reduction of accounts receivable:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(in thousands)			
Balance, beginning of period	\$ 4,046	\$ 5,044	\$ 9,212	\$ 5,533
Reserve accrual	4,477	5,607	9,757	14,048
Recoveries and deductions, net	(3,573)	(4,021)	(14,019)	(12,951)
Balance, end of period	<u>\$ 4,950</u>	<u>\$ 6,630</u>	<u>\$ 4,950</u>	<u>\$ 6,630</u>

Note 6. Composition of Certain Financial Statement Items

Inventories

Inventories consist of the following:

	September 30, 2019	December 31, 2018
	(in thousands)	
Raw materials	\$ 2,582	\$ 1,410
Finished goods	64,450	48,062
Total inventories	<u>\$ 67,032</u>	<u>\$ 49,472</u>

Inventories increased primarily due to the seasonality of the headset business as inventory is purchased during the third quarter in order to have stock on hand to fulfill the holiday season orders from our large retail customers.

Property and Equipment, net

Property and equipment, net, consists of the following:

	September 30, 2019	December 31, 2018
	(in thousands)	
Machinery and equipment	\$ 1,735	\$ 1,616
Software and software development	439	306
Furniture and fixtures	595	535
Tooling	5,809	3,925
Leasehold improvements	1,323	1,325
Demonstration units and convention booths	11,994	11,659
Total property and equipment, gross	21,895	19,366
Less: accumulated depreciation and amortization	(16,986)	(13,510)
Total property and equipment, net	<u>\$ 4,909</u>	<u>\$ 5,856</u>

Other Current Liabilities

Other current liabilities consist of the following:

	September 30, 2019	December 31, 2018
	(in thousands)	
Accrued customer fees	\$ 3,533	\$ 570
Accrued royalty	2,060	4,069
Accrued employee expenses	3,024	4,570
Contingent consideration	1,592	—
Accrued marketing	2,003	1,692
Accrued freight	1,967	1,044
Accrued expenses	6,310	6,543
Total other current liabilities	<u>\$ 20,489</u>	<u>\$ 18,488</u>

Other non-operating expense (income), net

Other non-operating expense (income), net consists of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(in thousands)			
Unrealized loss (gain) on financial instrument obligation	\$ —	\$ (209)	\$ (1,601)	\$ 8,410
Other non-operating expense (income)	302	308	171	473
Total other non-operating expense (income),net	<u>\$ 302</u>	<u>\$ 99</u>	<u>\$ (1,430)</u>	<u>\$ 8,883</u>

Note 7. Goodwill and Other Intangible Assets

Acquired Intangible Assets

Acquired identifiable intangible assets, and related accumulated amortization, as of September 30, 2019 and December 31, 2018 consist of:

	September 30, 2019		
	Gross Carrying Value	Accumulated Amortization	Net Book Value
	(in thousands)		
Customer relationships	\$ 7,726	\$ 4,862	\$ 2,864
Tradenames	1,529	102	1,427
Developed technology	784	37	747
Foreign currency	(1,308)	(1,106)	(202)
Total Intangible Assets	<u>\$ 8,731</u>	<u>\$ 3,895</u>	<u>\$ 4,836</u>

	December 31, 2018		
	Gross Carrying Value	Accumulated Amortization	Net Book Value
	(in thousands)		
Customer relationships	\$ 5,796	\$ 4,539	\$ 1,257
Foreign currency	(1,158)	(937)	(221)
Total Intangible Assets	<u>\$ 4,638</u>	<u>\$ 3,602</u>	<u>\$ 1,036</u>

In connection with the October 2012 acquisition of TB Europe, the acquired intangible asset related to customer relationships is being amortized over an estimated useful life of thirteen years with the amortization being included within sales and marketing expense.

In May 2019, the Company completed its acquisition of ROCCAT. The acquired intangible assets relating to developed technology, customer relationships and trade name are subject to amortization. Refer to Note 3, "Acquisitions" for additional information related to ROCCAT's identifiable intangible assets.

Amortization expense related to definite lived intangible assets of \$0.2 million and \$0.4 million was recognized for the three and nine months ended September 30, 2019, respectively, and \$0.1 million and \$0.2 million for the three and nine months ended September 30, 2018, respectively.

As of September 30, 2019, estimated annual amortization expense related to definite lived intangible assets in future periods is as follows:

	(in thousands)
2019	\$ 249
2020	952
2021	911
2022	876
2023	847
Thereafter	1,203
Total	\$ 5,038

Changes in the carrying values of goodwill for nine months ended September 30, 2019 are as follows:

	(in thousands)
Balance as of January 1, 2019	\$ —
ROCCAT Acquisition	9,096
Balance as of September 30, 2019	\$ 9,096

Note 8. Revolving Credit Facility and Long-Term Debt

	September 30, 2019	December 31, 2018
	(in thousands)	
Revolving credit facility, maturing March 2024	\$ 26,561	\$ 37,385

Total interest expense, inclusive of amortization of deferred financing costs, on long-term debt obligations was \$0.2 million and \$0.6 million for the three and nine months ended September 30, 2019, respectively, and \$1.0 million and \$3.4 million for the three and nine months ended September 30, 2018, respectively. This includes no related party interest for the three and nine months ended September 30, 2019, and \$0.5 million and \$1.7 million of related party interest for the three and nine months ended September 30, 2018, respectively, in connection with the subordinated notes.

Amortization of deferred financing costs was \$47,000 and \$0.1 million for the three and nine months ended September 30, 2019, respectively, and \$0.3 million and \$1.0 million for the three and nine months ended September 30, 2018, respectively.

Revolving Credit Facility

On December 17, 2018, Turtle Beach and certain of its subsidiaries entered into an amended and restated loan, guaranty and security agreement ("Credit Facility") with Bank of America, N.A. ("Bank of America"), as Agent, Sole Lead Arranger and Sole Bookrunner, which replaced the then existing asset-based revolving loan agreement. The Credit Facility, which expires on March 5, 2024, provides for a line of credit of up to \$80 million inclusive of a sub-facility limit of \$12 million for TB Europe, a wholly-owned subsidiary of Turtle Beach. In addition, the Credit Facility provides for a \$40 million accordion feature and the ability to increase the borrowing base with a FILO Loan of up to \$6.8 million.

On May 31, 2019, the Company amended the Credit Facility to provide for, amongst other items, (i) the addition of TBC Holding Company LLC, a wholly-owned subsidiary of VTB, as an obligor and (ii) the ability to make investments in TB Germany GmbH, a wholly-owned subsidiary of TB Europe, of up to \$4 million in connection with the acquisition of ROCCAT and up to an additional \$4 million annually.

The maximum credit availability for loans and letters of credit under the Credit Facility is governed by a borrowing base determined by the application of specified percentages to certain eligible assets, primarily eligible trade accounts receivable and inventories, and is subject to discretionary reserves and revaluation adjustments. The Credit Facility may be used for working capital, the issuance of bank guarantees, letters of credit and other corporate purposes.

Amounts outstanding under the Credit Facility bear interest at a rate equal to either a rate published by Bank of America or the LIBOR rate, plus in each case, an applicable margin, which is between 0.50% to 1.25% for base rate loans and between 1.25% to 2.00% for U.S. LIBOR loans and U.K. loans, and between 2.00% to 2.75% for the FILO loan. In addition, Turtle Beach is required to pay a commitment fee on the unused revolving loan commitment at a rate ranging from 0.25% to 0.50% and letter of credit fees and agent fees. As of September 30, 2019, interest rates for outstanding borrowings were 5.50% for base rate loans and 3.38% for LIBOR rate loans.

The Company is subject to quarterly financial covenant testing if certain availability thresholds are not met or certain other events occur (as defined in the Credit Facility). The Credit Facility requires the Company and its restricted subsidiaries to maintain a fixed charge coverage ratio of at least 1.00 to 1.00 as of the last day of each fiscal quarter.

The Credit Facility also contains affirmative and negative covenants that, subject to certain exceptions, limit our ability to take certain actions, including the Company's ability to incur debt, pay dividends and repurchase stock, make certain investments and other payments, enter into certain mergers and consolidations, engage in sale leaseback transactions and transactions with affiliates, and encumber and dispose of assets. Obligations under the Credit Facility are secured by a security interest and lien upon substantially all of the Company's assets.

As of September 30, 2019, the Company was in compliance with all financial covenants under the Credit Facility, as amended, and excess borrowing availability was approximately \$31.0 million.

Note 9. Income Taxes

In order to determine the quarterly provision for income taxes, the Company uses an estimated annual effective tax rate ("ETR"), which is based on expected annual income and statutory tax rates in the various jurisdictions. However, to the extent that application of the estimated annual effective tax rate is not representative of the quarterly portion of actual tax expense expected to be recorded for the year, the Company determines the provision for income taxes based on actual year-to-date income (loss). Certain significant or unusual items are separately recognized as discrete items in the period during which they occur and can be a source of variability in the effective tax rates from quarter to quarter.

The following table presents the Company's income tax expense and effective income tax rate:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
	(in thousands)			
Income tax expense	\$ 63	\$ 398	\$ 252	\$ 762
Effective income tax rate	(2.1%)	2.6%	(11.5%)	5.0%

Income tax expense for the three and nine months ended September 30, 2019 was \$0.1 million at an effective tax rate of (2.1%) and \$0.3 million at an effective tax rate of (11.5%), respectively. Income tax expense for the three and nine months ended September 30, 2018 was \$0.4 million at an effective tax rate of 2.6% and \$0.8 million at an effective tax rate of 5.0%. The effective tax rate was primarily impacted by the full valuation allowance on domestic earnings, foreign entity tax benefits, certain state tax expense, and the unrealized loss (gain) on a financial instrument obligation.

The Company is subject to income taxes domestically and in various foreign jurisdictions. Significant judgment is required in evaluating uncertain tax positions and determining the provision for income taxes.

The Company recognizes only those tax positions that meet the more-likely-than-not recognition threshold and establishes tax reserves for uncertain tax positions that do not meet this threshold. Interest and penalties associated with income tax matters are included in the provision for income taxes in the condensed consolidated statements of operations. As of September 30, 2019, the Company had uncertain tax positions of \$3.5 million, inclusive of \$1.2 million of interest and penalties.

The Company files U.S., state and foreign income tax returns in jurisdictions with various statutes of limitations. The federal tax years open under the statute of limitations are 2016 through 2017, and the state tax years open under the statute of limitations are 2014 through 2017.

Note 10. Stock-Based Compensation

Total estimated stock-based compensation expense for employees and non-employees, related to all of the Company's stock-based awards, was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(in thousands)			
Cost of revenue	\$ 108	\$ 69	\$ 76	\$ 400
Selling and marketing	200	47	490	102
Research and development	123	26	311	89
General and administrative	599	445	1,678	818
Total stock-based compensation	<u>\$ 1,030</u>	<u>\$ 587</u>	<u>\$ 2,555</u>	<u>\$ 1,409</u>

The following table presents the stock activity and the total number of shares available for grant as of September 30, 2019:

	(in thousands)
Balance at December 31, 2018	1,202
Plan amendment	1,440
Options granted	(602)
Restricted stock granted	(287)
Forfeited/Expired shares added back	38
Balance at September 30, 2019	<u>1,791</u>

Stock Option Activity

	Options Outstanding			
	Number of Shares Underlying Outstanding Options	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2018	1,654,729	\$ 6.41	7.36	\$ 14,374,572
Granted	601,892	11.47		
Exercised	(60,645)	3.54		
Forfeited	(37,246)	15.01		
Outstanding at September 30, 2019	<u>2,158,730</u>	<u>\$ 7.76</u>	<u>7.36</u>	<u>\$ 10,197,014</u>
Vested and expected to vest at September 30, 2019	<u>2,098,818</u>	<u>\$ 7.73</u>	<u>7.31</u>	<u>\$ 9,996,009</u>
Exercisable at September 30, 2019	<u>1,020,950</u>	<u>\$ 6.54</u>	<u>5.63</u>	<u>\$ 5,855,145</u>

Stock options are time-based and the majority are exercisable within 10 years of the date of grant, but only to the extent they have vested. The options generally vest as specified in the option agreements subject to acceleration in certain circumstances. In the event participants in the plan cease to be employed or engaged by the Company, then all of the options would be forfeited if they are not exercised within 90 days. Forfeitures on option grants are estimated at 10% for non-executives and 0% for executives based on evaluation of historical and expected future turnover. Stock-based compensation expense was recorded net of estimated forfeitures, such that expense was recorded only for those stock-based awards expected to vest. The Company reviews this assumption periodically and will adjust it if it is not representative of future forfeiture data and trends within employee types (executive vs. non-executive).

Aggregate intrinsic value represents the difference between the estimated fair value of the underlying common stock and the exercise price of outstanding, in-the-money options. The aggregate intrinsic value of options exercised was \$0.4 million for the nine months ended September 30, 2019.

The Company uses the Black-Scholes option-pricing model to estimate the fair value of options granted as of the grant date. The following are the assumptions for options granted during the nine months ended September 30, 2019.

Expected term (in years)	6.1
Risk-free interest rate	1.5% - 2.8%
Expected volatility	38.0% - 38.8%
Dividend rate	0%

Each of these inputs is subjective and generally requires significant judgment to determine.

The weighted average grant date fair value of options granted during the nine months ended September 30, 2019 was \$4.70. The total estimated fair value of employee options vested during the nine months ended September 30, 2019 was \$0.8 million. As of September 30, 2019, total unrecognized compensation cost related to non-vested stock options granted to employees was \$3.8 million, which is expected to be recognized over a remaining weighted average vesting period of 2.9 years.

Restricted Stock Activity

	Shares	Weighted Average Grant Date Fair Value Per Share
Nonvested restricted stock at December 31, 2018	265,636	\$ 19.29
Granted	286,654	11.52
Vested	(112,250)	14.45
Shares forfeited	(825)	12.10
Nonvested restricted stock at September 30, 2019	<u>439,215</u>	<u>\$ 15.47</u>

As of September 30, 2019, total unrecognized compensation cost related to the nonvested restricted stock awards was \$6.2 million, which will be recognized over a remaining weighted average vesting period of 2.8 years.

Stock Warrants

In connection with certain subordinated notes, the Company issued warrants to purchase an aggregate 0.4 million shares and 0.3 million shares of the Company's common stock at an exercise price of \$10.16 and \$8.00 per share, respectively, to SG VTB Holdings, LLC, all of which were settled through cashless exercises during the nine months ended September 30, 2019.

In connection with the retirement of the Series B Preferred Stock in April 2018, the Company issued fully-funded warrants exercisable for an aggregate of 0.5 million shares of its common stock. Under the terms of the warrants, the holders had the right to receive, at their option, a cash payment for the remaining unexercised portion of the warrants upon the Company consummating a Fundamental Transaction (as defined in the warrant agreement, and including any merger, consolidation, sale or other reorganization event in which its common stock is converted into or exchanged for securities, cash or other property). If so elected by the warrant holders, the cash payment will be based on a Black-Scholes pricing model and will be made upon the consummation of a Fundamental Transaction or during the ensuing 30-day period thereafter. As a result of these terms regarding the possible future cash payment, the Company has accounted for the warrants issued in connection with the retirement of the Series B Preferred Stock as a financial instrument obligation that is marked to market each period, with subsequent changes in fair value reported in earnings.

On March 30, 2019, the Company and the warrant holders entered into an amendment to the warrant agreement that revises the terms under which warrant holders may exercise their rights under a Fundamental Transaction. As a result of this amendment, the warrants are no longer accounted for as a financial instrument obligation and reported as a liability that is marked to market each period with changes in fair value reported in earnings. The warrants were marked to market through March 30, 2019, the execution date of the amendment, at which time the warrants are accounted for as an equity instrument. The fair value on that date of \$6.2 million was reclassified to additional paid-in-capital. For the nine months ended September 30, 2019, the Company recognized an unrealized gain on the warrants of \$1.6 million that is included in "Other non-operating expense (income), net" in the Condensed Consolidated Statement of Operations.

Note 11. Net Income (Loss) Per Share

The following table sets forth the computation of basic and diluted net income (loss) per share of common stock attributable to common stockholders:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(in thousands, except per-share data)			
Net income (loss)	\$ (3,124)	\$ 14,932	\$ (2,442)	\$ 14,576
Unrealized gain on financial instrument obligation	—	(209)	—	—
Net income (loss) - diluted	<u>\$ (3,124)</u>	<u>\$ 14,723</u>	<u>\$ (2,442)</u>	<u>\$ 14,576</u>
Weighted average common shares outstanding — Basic	14,506	14,019	14,477	13,263
Plus incremental shares from assumed conversions:				
Dilutive effect of restricted stock	—	52	—	24
Dilutive effect of stock options	—	1,209	—	408
Dilutive effect of warrants	—	949	—	133
Weighted average common shares outstanding — Diluted	<u>14,506</u>	<u>16,229</u>	<u>14,477</u>	<u>13,828</u>
Net income (loss) per share:				
Basic	\$ (0.22)	\$ 1.07	\$ (0.17)	\$ 1.10
Diluted	\$ (0.22)	\$ 0.91	\$ (0.17)	\$ 1.05

Incremental shares from stock options and restricted stock awards are computed using the treasury stock method. The weighted average shares listed below were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for the periods presented or were otherwise excluded under the treasury stock method. The treasury stock method calculates dilution assuming the exercise of all in-the-money options and vesting of restricted stock, reduced by the repurchase of shares with the proceeds from the assumed exercises and unrecognized compensation expense for outstanding awards.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(in thousands)			
Stock options	2,135	69	1,961	35
Warrants	550	—	729	319
Unvested restricted stock awards	404	185	330	71
Total	<u>3,089</u>	<u>254</u>	<u>3,020</u>	<u>425</u>

Note 12. Geographic Information

The following table represents total net revenues based on where customers are physically located:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
	(in thousands)			
North America	\$ 33,295	\$ 52,702	\$ 97,019	\$ 131,653
United Kingdom	4,965	9,462	13,111	21,119
Europe	6,489	8,916	18,065	18,021
Other	1,974	3,347	4,704	5,325
Total net revenues	<u>\$ 46,723</u>	<u>\$ 74,427</u>	<u>\$ 132,899</u>	<u>\$ 176,118</u>

Note 13. Commitments and Contingencies

Litigation

The Company is subject to various legal proceedings and claims that arise in the ordinary course of its business. Although the amount of any liability that could arise with respect to these actions cannot be determined with certainty, in the Company's opinion, any such liability will not have a material adverse effect on its consolidated financial position, consolidated results of operations or liquidity.

Shareholders Class Action: On August 5, 2013, VTBH and the Company (f/k/a Parametric Sound Corporation) announced that they had entered into the Merger Agreement pursuant to which VTBH would acquire an approximately 80% ownership interest and existing shareholders would maintain an approximately 20% ownership interest in the combined company. Following the announcement, several shareholders filed class action lawsuits in California and Nevada seeking to enjoin the Merger. The plaintiffs in each case alleged that members of the Company's Board of Directors breached their fiduciary duties to the shareholders by agreeing to a merger that allegedly undervalued the Company. VTBH and the Company were named as defendants in these lawsuits under the theory that they had aided and abetted the Company's Board of Directors in allegedly violating their fiduciary duties. The plaintiffs in both cases sought a preliminary injunction seeking to enjoin closing of the Merger, which, by agreement, was heard by the Nevada court with the California plaintiffs invited to participate. On December 26, 2013, the court in the Nevada case denied the plaintiffs' motion for a preliminary injunction. Following the closing of the Merger, the Nevada plaintiffs filed a second amended complaint, which made essentially the same allegations and sought monetary damages as well as an order rescinding the Merger. The California plaintiffs dismissed their action without prejudice, and sought to intervene in the Nevada action, which was granted. Subsequent to the intervention, the plaintiffs filed a third amended complaint, which made essentially the same allegations as prior complaints and sought monetary damages. On June 20, 2014, VTBH and the Company moved to dismiss the action, but that motion was denied on August 28, 2014. On September 14, 2017, a unanimous en banc panel of the Nevada Supreme Court granted defendants' petition for writ of mandamus and ordered the trial court to dismiss the complaint but provided a limited basis upon which plaintiffs could seek to amend their complaint. Plaintiffs amended their complaint on December 1, 2017 to assert the same claims in a derivative capacity on behalf of the Company, as a well as in a direct capacity, against VTBH, Stripes Group, LLC, SG VTB Holdings, LLC, and the former members of the Company's Board of Directors. All defendants moved to dismiss this amended complaint on January 2, 2018, and those motions were denied on March 13, 2018. Defendants petitioned the Nevada Supreme Court to reverse this ruling on April 18, 2018. On June 15, 2018, the Nevada Supreme Court denied defendants' writ petition without prejudice. The district court subsequently entered a pretrial schedule and set trial for November 2019. On January 18, 2019, the district court certified a class of shareholders of the Company as of January 15, 2014. On October 11, 2019, the parties notified the District Court that they had reached a settlement that would resolve the pending action if ultimately approved by the Court. All pending court dates and deadlines, including the trial date, have been stayed while the parties proceed with the settlement process.

Commercial Dispute: On July 20, 2016, Bigben Interactive S.A. ("BigBen") filed a statement of claim before the Regional Court of Berlin, Germany against VTB, which statement of claim was formally serviced upon VTB on June 28, 2017. The statement of claim alleges that VTB's termination of a distribution agreement by and between BigBen and VTB breached the terms thereof and was invalid, and that BigBen is entitled to damages amounting to €5.0 million plus accrued interest thereon plus certain additional damages as a result of such invalid termination. VTB filed its statement of defense with the court on September 21, 2017. On January 7, 2019, the Regional Court of Berlin issued its judgment on this dispute, dismissing BigBen's claim in its entirety. On February 7, 2019, BigBen Interactive S.A. has filed an appeal against the judgment of the Regional Court of Berlin on January 7, 2019 (the "Judgment"). On April 15, 2019, Big Ben provided the reasoning for its appeal against the Judgment. On June 21, VTB replied to the reasoning for the appeal. Upon Big Ben's application, the Higher Regional Court of Berlin has reviewed the provisions of the Judgment specifically relating to preliminary enforceability of the Judgment in separate proceedings and before the appellate proceedings regarding the main part of the Judgment. On July 9, 2019, the Higher Regional Court of Berlin completely rejected Big Ben's applications with regard to the suspension of the preliminary enforceability of the Judgment. The Higher Regional Court of Berlin has scheduled an oral hearing on the main part of Big Ben's appeal of the Judgment for November 19, 2019.

The Company will continue to vigorously defend itself in the foregoing matters. However, litigation and investigations are inherently uncertain. Accordingly, the Company cannot predict the outcome of these matters. The Company has not recorded any accrual at September 30, 2019 for contingent losses associated with these matters based on its belief that losses, while possible, are not probable. Further, any possible range of loss cannot be reasonably estimated at this time. The unfavorable resolution of these matters could have a material adverse effect on the Company's business, results of operations, financial condition, or cash flows. The Company is engaged in other legal actions, not described above, arising in the ordinary course of its business and, while there can be no assurance, believes that the ultimate outcome of these other legal actions will not have a material adverse effect on its business, results of operations, financial condition, or cash flows.

Warranties

The Company warrants its products against certain manufacturing and other defects. These product warranties are provided for specific periods of time depending on the nature of the product. Warranties are generally fulfilled by replacing defective products with new products. The following table provides the changes in our product warranty reserve, which are included in accrued liabilities:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
	(in thousands)			
Warranty, beginning of period	\$ 752	\$ 582	\$ 668	\$ 472
Warranty costs accrued	162	242	663	686
Settlements of warranty claims	(169)	(175)	(586)	(509)
Warranty, end of period	<u>\$ 745</u>	<u>\$ 649</u>	<u>\$ 745</u>	<u>\$ 649</u>

Operating Leases - Right of Use Assets

The Company adopted ASU 2016-02, *Leases*, on January 1, 2019. The Company determines whether an arrangement is a lease at inception. The Company leases office spaces that provide for future minimum rental lease payments under non-cancelable operating leases that have remaining lease terms of one year to nine years, and do not contain any material residual value guarantees or material restrictive covenants.

The components of the right-of-use assets and lease liabilities were as follows:

	Balance Sheet Classification	September 30,
		2019
		(in thousands)
Right-of-use assets	Other assets	<u>\$ 2,621</u>
Lease liability obligations, current	Other current liabilities	\$ 1,568
Lease liability obligations, noncurrent	Other liabilities	1,472
Total lease liability obligations		<u>\$ 3,040</u>
Weighted-average remaining lease term (in years)		2.2
Weighted-average discount rate		3.75%

During the nine months ended September 30, 2019, the Company recognized approximately \$0.7 million of lease costs in operating expenses and approximately \$1.3 million of operating cash flows from operating leases.

Approximate future minimum lease payments for the Company's right of use assets over the remaining lease periods as of September 30, 2019, are:

	(in thousands)
2019	\$ 457
2020	1,482
2021	566
2022	216
2023	103
Thereafter	397
Total minimum payments	<u>3,221</u>
Less: Imputed interest	(181)
Total	<u>\$ 3,040</u>

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

The following discussion and analysis of our operations should be read together with our unaudited condensed consolidated financial statements and the related notes included in Part I of this Quarterly Report on Form 10-Q and with our audited consolidated financial statements and the related notes included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 18, 2019 (the "Annual Report.")

This Report on Form 10-Q contains forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements in this Report are indicated by words such as "anticipates," "expects," "believes," "intends," "plans," "estimates," "projects," "strategies" and similar expressions. Caution should be taken not to place undue reliance on any such forward-looking statements because they involve risks, uncertainties and other factors that could cause actual results to differ materially from those expressed or implied in, or reasonably inferred from, such statements. Forward-looking statements are based on the beliefs, as well as assumptions made by, and information currently available to, the Company's management and are made only as of the date hereof. The Company undertakes no obligation to update or revise the forward-looking statements, whether as a result of new information, future events or otherwise. In addition, forward-looking statements are subject to certain risks and uncertainties, including those described elsewhere in this Quarterly Report on Form 10-Q that could cause actual results to differ materially from the Company's historical experience and its present expectations or projections.

Business Overview

Turtle Beach Corporation (herein referred to as the "Company," "we," "us," or "our"), headquartered in San Diego, California, and incorporated in the state of Nevada in 2010, is a premier gaming accessory company with expertise and experience in developing, commercializing and marketing innovative products across a range of large addressable markets under the Turtle Beach® and ROCCAT® brands. Turtle Beach is a worldwide leading provider of feature-rich headset solutions for use across multiple platforms, including video game and entertainment consoles, handheld consoles, personal computers, tablets and mobile devices. The recently acquired ROCCAT is a leading provider of gaming keyboards, mice and other accessories focused in the personal computer peripherals market.

Business Trends

Gaming Headset Market

Gaming headsets are part of a growing global gaming market sized at approximately \$150 billion. The global gaming audience now exceeds global cinema and music markets with over 2.4 billion active gamers worldwide. Gaming peripherals, such as headsets, are a \$4.7 billion business globally with over 75% of that market in the Americas and Europe where the Company's business is focused. Gaming headsets represent more than a \$3.4 billion global market, or more than 70% of the total peripherals market.

Competitive esports is a global phenomenon where professional gamers train, compete, win prize money, partner with major brands, and attract/gain fans - similar to traditional professional sports. There are over 195 million esports enthusiasts globally and the market is growing quickly. We believe a quality gaming headset is a must-have piece of equipment for any competitive esports gamer.

Many gamers play online where a gaming headset (which typically includes a microphone and allows players to communicate in real-time) provides a more immersive experience in the industry's most popular games and franchises.

Xbox and PlayStation® consoles are still the dominant gaming platforms in North America and Europe, however, Nintendo's Switch console continues to perform well two years into its lifecycle. In addition to consoles, personal computers are a popular gaming platform where players utilize a similar style headset. Gaming on mobile/tablet devices represents about a third of the global gaming market, and while headsets can be used for mobile gaming, console and PC gaming are by far the largest drivers of gaming headset use.

Historically, Microsoft and Sony have gone through cycles where their respective console platform is changed significantly or updated to a new version. Microsoft and Sony launched Pro versions of their existing console platforms in 2016 and 2017, respectively, that did not result in the same levels of disruption as previous cycles in the gaming headset business. Turtle Beach believes this is a good indication that any potential future console changes will not be as disruptive. In 2019, Microsoft announced that "Project Scarlett," the next generation of Xbox, will be released in late 2020, and Sony confirmed that the PlayStation®5 will arrive for holiday 2020. The Nintendo Switch™ is completing its second year in the market with more than 25 million units sold through the end of December 2018, during which there has been an expanding library of games and an increased number of multiplayer chat-enabled games.

In addition to console sales, we believe Xbox, PlayStation®, Nintendo, and PC gaming markets are driven by major game launches and franchises that encourage players to buy equipment and accessories. On Xbox and PlayStation®, flagship games like *Call of Duty*®, *Destiny*, *Star Wars: Battlefront*, *Battlefield*, *Grand Theft Auto*, and the recently popular battle royale games like *Fortnite*, *Apex Legends* and *PlayerUnknown's Battlegrounds*, are examples of major franchises that prominently feature online multiplayer modes that encourage communication, which tend to drive increased gaming headset sales. Many of these established franchises launch new titles annually leading into the holidays, and as a result, the gaming headset business tends to be highly seasonal, often with 45%-55% of sales occurring in the fourth quarter.

In 2017, *PlayerUnknown's Battlegrounds* popularized a style of multiplayer game known as battle royale, in which players compete on large but shrinking maps until there is a single winner left. Players are able to play in teams and audio cues and communication can be very helpful, making headsets a key accessory for this type of game.

Toward the end of 2017, Epic Games introduced *Fortnite*, which includes a similar battle royale format and soared in popularity resulting in large and growing audiences of both players and spectators through content sharing platforms like Twitch, YouTube, Xbox's Mixer and PlayStation® Now.

Gaming headsets are sold at major retailers such as Amazon, Best Buy, GameStop, Target and Walmart. Brick and mortar retailers often have kiosks that allow shoppers to try the headsets and experience each headset's specific fit, feel, and overall audio quality.

Key Performance Indicators and Non-GAAP Measures

Management routinely reviews key performance indicators including revenue, operating income and margins, and earnings per share, among others. In addition, we believe certain other measures provide useful information to management and investors about us and our financial condition and results of operations for the following reasons: (i) they are measures used by our board of directors and management team to evaluate our operating performance; (ii) they are measures used by our management team to make day-to-day operating decisions; (iii) the adjustments made are often viewed as either non-recurring or not reflective of ongoing financial performance or have no cash impact on operations; and (iv) they are used by securities analysts, investors and other interested parties as a common operating performance measure to compare results across companies in our industry by adjusting for potential differences caused by variations in capital structures (affecting relative interest expense), and the age and book value of facilities and equipment (affecting relative depreciation and amortization expense). These metrics, however, are not measures of financial performance under accounting principles generally accepted in the United States of America ("GAAP") and, given the limitations of these metrics as analytical tools, should not be considered a substitute for gross profit, gross margins, net income (loss) or other consolidated income statement data as determined in accordance with GAAP. We consider the following non-GAAP measures, which may not be comparable to similarly titled measures reported by other companies, to be key performance indicators:

- *Adjusted EBITDA* is defined as net income (loss) before interest, taxes, depreciation and amortization, stock-based compensation (non-cash) and certain special items that we believe are not representative of core operations.
- *Cash Margin* is defined as gross margin excluding depreciation and amortization, and stock-based compensation.

Adjusted EBITDA (and a reconciliation to Net income, the nearest GAAP financial measure) for the three and nine months ended September 30, 2019 and 2018, are as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
	(in thousands)			
Net income (loss)	\$ (3,124)	\$ 14,932	\$ (2,442)	\$ 14,576
Interest expense	240	1,093	595	4,356
Depreciation and amortization	1,489	814	3,890	3,174
Stock-based compensation	1,030	587	2,555	1,409
Income tax expense	63	398	252	762
Unrealized loss (gain) on financial instrument obligation	—	(209)	(1,601)	8,410
Business transaction expense	618	—	2,961	—
Adjusted EBITDA	\$ 316	\$ 17,615	\$ 6,210	\$ 32,687

Comparison of the Three Months Ended September 30, 2019 to the Three Months Ended September 30, 2018

Net loss for the three months ended September 30, 2019 was \$3.1 million compared to net income of \$14.9 million, including a \$0.2 million gain related to the change in fair value of a financial instrument, in the comparable prior year period.

For the three months ended September 30, 2019, Adjusted EBITDA was \$0.3 million compared to \$17.6 million for the three months ended September 30, 2018, primarily due to a decline in the gaming accessory market from the battle royale driven record levels in the prior year period.

Comparison of the Nine Months Ended September 30, 2019 to the Nine Months Ended September 30, 2018

Net loss for the nine months ended September 30, 2019 was \$2.4 million, inclusive of a \$1.6 million unrealized financial instrument obligation gain, compared to net income of \$14.6 million in the prior period, inclusive of an \$8.4 million unrealized financial instrument obligation loss.

For the nine months ended September 30, 2019, Adjusted EBITDA was \$6.2 million compared to \$32.7 million for the nine months ended September 30, 2018, primarily due to lower sales as compared to the record volumes in the comparable prior year period, as well as increased promotional activity and marketing spend in conjunction with the Recon 70 Series release and incremental acquisition costs and sales support headcount in 2019.

Results of Operations

The following table sets forth the Company's statements of operations for the periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(in thousands)			
Net revenue	\$ 46,723	\$ 74,427	\$ 132,899	\$ 176,118
Cost of revenue	31,680	43,925	89,898	110,310
Gross profit	15,043	30,502	43,001	65,808
Operating expenses	17,562	13,980	46,026	37,231
Operating income (loss)	(2,519)	16,522	(3,025)	28,577
Interest expense	240	1,093	595	4,356
Other non-operating expense (income), net	302	99	(1,430)	8,883
Income (loss) before income tax	(3,061)	15,330	(2,190)	15,338
Income tax expense	63	398	252	762
Net income (loss)	\$ (3,124)	\$ 14,932	\$ (2,442)	\$ 14,576

Net Revenue and Gross Profit

The following table summarizes net revenue and gross profit for the periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(in thousands)			
Net Revenue	\$ 46,723	\$ 74,427	\$ 132,899	\$ 176,118
Gross Profit	\$ 15,043	\$ 30,502	\$ 43,001	\$ 65,808
Gross Margin	32.2%	41.0%	32.4%	37.4%
Cash Margin (1)	33.6%	41.3%	33.4%	37.8%

(1) Excludes non-cash charges

Comparison of the Three Months Ended September 30, 2019 to the Three Months Ended September 30, 2018

Net revenues for the three months ended September 30, 2019 were \$46.7 million, compared to net revenues of \$74.4 million in the prior year period when consumer demand driven by the continued popularity of the battle royale style games supported record revenue. As anticipated, the battle royale driven increase in revenue has moderated back and stabilized; however, the current base of gamers has grown significantly compared to pre-battle royale levels.

For the three months ended September 30, 2019, gross profit as a percentage of net revenue decreased to 32.2% from 41.0% in the comparable prior year period. Margins were negatively impacted by promotional activity, product mix, a decline in volume-based fixed cost leverage as a result of the decrease in revenue, acquisition-related transition costs, and refurbishment channel investments.

Comparison of the Nine Months Ended September 30, 2019 to the Nine Months Ended September 30, 2018

Net revenues for nine months ended September 30, 2019 were \$132.9 million, a \$43.2 million decrease from \$176.1 million in the prior year period when battle royale driven consumer demand reached record levels. While the overall gaming accessory market declined across all channels, the Company held 42.2% of the North American console market revenue share on the strong performance of the Stealth 600 Series, which continued to be the top selling console model, and the recently released Recon 70 Series.

For the nine months ended September 30, 2019, gross profit as a percentage of net revenue decreased to 32.4% from 37.4% in the comparable prior year period. Margins were impacted by product mix, a more promotional environment, increased refurbishment and warehouse costs, and volume-based fixed cost leveraging, which was partially offset by reduced revenue-driven royalties and lower freight costs.

Operating Expenses

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(in thousands)			
Selling and marketing	\$ 10,150	\$ 8,517	\$ 24,581	\$ 21,264
Research and development	2,198	1,400	5,388	4,056
General and administrative	5,214	4,063	16,057	11,911
Total operating expenses	<u>\$ 17,562</u>	<u>\$ 13,980</u>	<u>\$ 46,026</u>	<u>\$ 37,231</u>

Selling and Marketing

Selling and marketing expenses for the three months ended September 30, 2019 totaled \$10.2 million compared to \$8.5 million for the three months ended September 30, 2018. This increase was primarily due to incremental costs associated with the ROCCAT acquisition and certain digital and sponsorship initiatives, partially offset by decreases in revenue-based commissions.

Selling and marketing expenses for the nine months ended September 30, 2019 totaled \$24.6 million compared to \$21.3 million for the nine months ended September 30, 2018. This increase was primarily due to incremental costs associated with the ROCCAT acquisition and marketing spend in conjunction with the Recon 70 Series launch, additional sponsorships and certain digital and social media initiatives, partially offset by decreases in revenue-based commissions and advertising display depreciation.

Research and Development

Research and development costs for the three and nine months ended September 30, 2019 were \$2.2 million and \$5.4 million, respectively, compared to \$1.4 million and \$4.1 million for the three and nine months ended September 30, 2018. Such increases were primarily due to incremental ROCCAT-related headcount and consultant costs, and increased costs for legal research and patent-related expenses associated with the development of new products.

General and Administrative

General and administrative expenses for the three months ended September 30, 2019 totaled \$5.2 million, inclusive of \$0.6 million of acquisition integration costs, compared to \$4.1 million for the three months ended September 30, 2018. Excluding the acquisition integration costs, the year-over-year increase was primarily due to certain professional service and information technology costs, higher non-cash stock compensation expense and incremental ROCCAT-related headcount.

General and administrative expenses for the nine months ended September 30, 2019 totaled \$16.1 million, inclusive of \$3.0 million of acquisition integration costs, compared to \$11.9 million for the nine months ended September 30, 2018. Excluding the acquisition integration costs, the year-over-year increase was primarily due to higher non-cash stock compensation expense, incremental ROCCAT-related headcount, certain warehouse transition costs and informational technology investments, partially offset by lower variable compensation costs, legal expenses and allowances for doubtful accounts.

Interest Expense

For the three and nine months ended September 30, 2019, interest expense decreased to \$0.2 million and \$0.6 million, respectively, as compared to the comparable prior periods, due to the full repayment of the subordinated notes and term loans, and the exchange of the Series B redeemable preferred stock.

Other Non-Operating Expense (Income)

Other non-operating income totaled \$0.3 million for three months ended September 30, 2019 related to currency fluctuations on our foreign operations compared to other non-operating loss of \$0.1 for the three months ended September 30, 2018, which included a \$0.2 million unrealized gain related to the change in fair value of a financial instrument obligation.

Other non-operating income totaled \$1.4 million for the nine months ended September 30, 2019 primarily due to a \$1.6 million unrealized gain related to the change in fair value of a financial instrument obligation compared to other non-operating loss of \$8.9 million for the nine months ended September 30, 2018, which included a \$8.5 million unrealized loss related to the change in fair value of a financial instrument obligation.

Income Taxes

Income tax benefit for the three and nine months ended September 30, 2019 was \$0.1 million at an effective tax rate of (2.1%) and \$0.3 million at an effective tax rate of (11.5%), respectively. Income tax expense for the three and nine months ended September 30, 2018 was \$0.4 million at an effective tax rate of 2.6% and \$0.8 million at an effective tax rate of 5.0%, respectively. The effective tax rate was primarily impacted by the full valuation allowance on domestic earnings, foreign entity tax benefits, certain state tax expense and the unrealized loss (gain) on a financial instrument obligation.

Liquidity and Capital Resources

Our primary sources of working capital are cash flows from operations and availability under our revolving credit facility. We have funded operations and acquisitions in recent periods with operating cash flows.

The following table summarizes our sources and uses of cash:

	Nine Months Ended	
	September 30,	
	2019	2018
	(in thousands)	
Cash and cash equivalents at beginning of period	\$ 7,078	\$ 5,247
Net cash provided by operating activities	27,304	43,358
Net cash used for investing activities	(14,295)	(2,046)
Net cash used for financing activities	(12,752)	(40,267)
Effect of foreign exchange on cash	(298)	(114)
Cash and cash equivalents at end of period	<u>\$ 7,037</u>	<u>\$ 6,178</u>

Operating activities

Cash provided by operating activities for the nine months ended September 30, 2019 was \$27.3 million, a decrease of \$16.1 million as compared to \$43.4 million for the nine months ended September 30, 2018. The decrease is primarily the result of lower gross receipts, incremental ROCCAT costs and, increased sales and marketing-related expenditures, partially offset by a reduction in inventory purchases.

Investing activities

Cash used for investing activities was \$14.3 million for the nine months ended September 30, 2019, as a result of \$12.7 million related to the ROCCAT acquisition and \$1.6 million of capital expenditures compared to \$2.0 million of capital expenditures in the prior year period.

Financing activities

Net cash used for financing activities was \$12.8 million during the nine months ended September 30, 2019 compared to \$40.3 million during the nine months ended September 30, 2018. Financing activities during the nine months ended September 30, 2019 included net repayments on our revolving credit facility of \$10.8 million and \$1.9 million of common stock repurchases. Financing activities during the nine months ended September 30, 2018 included net repayments on our revolving credit facility of \$34.9 million, repayment of certain subordinated notes of \$8.3 million, and exchange of Series B redeemable preferred stock of \$1.4 million.

Management assessment of liquidity

Management believes that our current cash and cash equivalents, the amounts available under our revolving credit facility and cash flows derived from operations will be sufficient to meet anticipated cash needs for working capital and capital expenditures for at least the next twelve months. Significant assumptions underlie this belief, including, among other things, that there will be no material adverse developments in our business, liquidity or capital requirements.

Foreign cash balances at September 30, 2019 and December 31, 2018 were \$1.5 million and \$5.2 million, respectively.

Revolving Credit Facility

On December 17, 2018, Turtle Beach and certain of its subsidiaries entered into an amended and restated loan, guaranty and security agreement (“Credit Facility”) with Bank of America, N.A. (“Bank of America”), as Agent, Sole Lead Arranger and Sole Bookrunner, which replaced the then existing asset-based revolving loan agreement. The Credit Facility, which expires on March 5, 2024, provides for a line of credit of up to \$80 million inclusive of a sub-facility limit of \$12 million for TB Europe, a wholly-owned subsidiary of Turtle Beach. In addition, the Credit Facility provides for a \$40 million accordion feature and the ability to increase the borrowing base with a FILO Loan of up to \$6.8 million.

On May 31, 2019, the Company amended the Credit Facility to provide for, amongst other items, (i) the addition of TBC Holding Company LLC, a wholly-owned subsidiary of VTB, as an obligor and (ii) the ability to make investments in TB Germany GmbH, a wholly-owned subsidiary of TB Europe, of up to \$4 million in connection with the acquisition of ROCCAT and up to an additional \$4 million annually.

The maximum credit availability for loans and letters of credit under the Credit Facility is governed by a borrowing base determined by the application of specified percentages to certain eligible assets, primarily eligible trade accounts receivable and inventories, and is subject to discretionary reserves and revaluation adjustments. The Credit Facility may be used for working capital, the issuance of bank guarantees, letters of credit and other corporate purposes.

Amounts outstanding under the Credit Facility bear interest at a rate equal to either a rate published by Bank of America or the LIBOR rate, plus in each case, an applicable margin, which is between 0.50% to 1.25% for base rate loans and between 1.25% to 2.00% for U.S. LIBOR loans and U.K. loans, and between 2.00% to 2.75% for the FILO loan. In addition, Turtle Beach is required to pay a commitment fee on the unused revolving loan commitment at a rate ranging from 0.25% to 0.50% and letter of credit fees and agent fees. As of September 30, 2019, interest rates for outstanding borrowings were 5.50% for base rate loans and 3.38% for LIBOR rate loans.

The Company is subject to quarterly financial covenant testing if certain availability thresholds are not met or certain other events occur (as defined in the Credit Facility). The Credit Facility requires the Company and its restricted subsidiaries to maintain a fixed charge coverage ratio of at least 1.00 to 1.00 as of the last day of each fiscal quarter.

The Credit Facility also contains affirmative and negative covenants that, subject to certain exceptions, limit our ability to take certain actions, including the Company’s ability to incur debt, pay dividends and repurchase stock, make certain investments and other payments, enter into certain mergers and consolidations, engage in sale leaseback transactions and transactions with affiliates, and encumber and dispose of assets. Obligations under the Credit Facility are secured by a security interest and lien upon substantially all of the Company’s assets.

As of September 30, 2019, the Company was in compliance with all financial covenants under the Credit Facility, as amended, and excess borrowing availability was approximately \$31.0 million.

Stock Warrants

In connection with certain subordinated notes, the Company issued warrants to purchase an aggregate 0.4 million shares and 0.3 million shares of the Company’s common stock at an exercise price of \$10.16 and \$8.00 per share, respectively, to SG VTB Holdings, LLC, all of which were settled through cashless exercises in March 2019.

Critical Accounting Estimates

Our discussion and analysis of our results of operations and capital resources are based on our consolidated financial statements, which have been prepared in conformity with GAAP. The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses and the disclosure of contingent assets and liabilities. Management bases its estimates, assumptions and judgments on historical experience and on various other factors that it believes to be reasonable under the circumstances.

Different assumptions and judgments would change the estimates used in the preparation of the condensed consolidated financial statements, which, in turn, could change the results from those reported. Management evaluates its estimates, assumptions and judgments on an ongoing basis.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, that introduced the recognition of a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term, and a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis for all leases (with the exception of short-term leases). The Company adopted this standard on its effective date of January 1, 2019, using the optional alternative approach, which applies the provisions of the new guidance at the effective date without adjusting the comparative periods. Upon adoption of the new standard as it relates to the Company's accounting for real estate operating leases, assets and liabilities increased by approximately \$3.3 million.

See Note 2, "Summary of Significant Accounting Policies," to the unaudited condensed consolidated financial statements contained herein for a complete discussion of recent accounting pronouncements. We are currently evaluating the impact of certain recently issued guidance on our financial condition and results of operations in future periods.

Item 3 - Qualitative and Quantitative Disclosures about Market Risk

Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. The Company's market risk exposure is primarily a result of fluctuations in interest rates, foreign currency exchange rates and inflation.

The Company has used derivative financial instruments, specifically foreign currency forward and option contracts, to manage exposure to foreign currency risks, by hedging a portion of its forecasted expenses denominated in British Pounds expected to occur within a year. When such derivative financial instruments are used, the effect of exchange rate changes on foreign currency forward and option contracts is expected to offset the effect of exchange rate changes on the underlying hedged item. The Company does not use derivative financial instruments for speculative or trading purposes. As of September 30, 2019 and December 31, 2018, we did not have any derivative financial instruments.

Foreign Currency Exchange Risk

The Company has exchange rate exposure primarily with respect to the British Pound. As of September 30, 2019 and December 31, 2018, our monetary assets and liabilities that are subject to this exposure are immaterial, therefore the potential immediate loss to us that would result from a hypothetical 10% change in foreign currency exchange rates would not be expected to have a material impact on our earnings or cash flows. This sensitivity analysis assumes an unfavorable 10% fluctuation in the exchange rates affecting the foreign currencies in which monetary assets and liabilities are denominated and does not take into account the offsetting effect of such a change on our foreign currency denominated revenues.

Inflation Risk

The Company is exposed to market risk due to the possibility of inflation, such as increases in the cost of its products. Although the Company does not believe that inflation has had a material impact on its financial position or results of operations to date, a high rate of inflation in the future may have an adverse effect on the Company's ability to maintain current levels of gross margin and selling, general and administrative expenses as a percentage of net revenue if the selling prices of products do not increase with these increased costs.

Item 4 - Controls and Procedures

Disclosure Controls and Procedures

Disclosure controls and procedures (as defined in Rules 13(a)-15(e) and 15(d)-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")), are designed to ensure that (1) information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms; and (2) that such information is accumulated and communicated to management, including the principal executive officer and principal financial officer, to allow timely decisions regarding required disclosures.

At the conclusion of the period covered by this Quarterly Report on Form 10-Q, we carried out an evaluation, under the supervision of our Chief Executive Officer (our principal executive officer, or PEO) and our Chief Financial Officer (our principal financial officer, or PFO), of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, our PEO and PFO concluded that our disclosure controls and procedures, as defined in Rule 13a-15(e) of the Exchange Act, were effective as of September 30, 2019.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting during the period covered that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Our process for evaluating controls and procedures is continuous and encompasses constant improvement of the design and effectiveness of established controls and procedures and the remediation of any deficiencies, which may be identified during this process.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PART II. OTHER INFORMATION

Item 1 - Legal Proceedings

Please refer to Note 13, "Commitments and Contingencies" in the notes to the unaudited condensed consolidated financial statements included in Part I, Item 1 of this Report on Form 10-Q, which is incorporated into this item by reference.

Item 1A - Risk Factors

The following discussion of risk factors contains forward-looking statements. These risk factors may be important in understanding any statement in this Form 10-Q or elsewhere. The following information should be read in conjunction with our financial statements and related notes in Part I, Item 1, "Financial Statements" and Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Form 10-Q.

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

Risks Related to Our Operations

We depend upon the success and availability of third-party gaming platforms and release of certain game titles to drive sales of our headset products.

The performance of our headset business is affected by the continued success of third-party gaming platforms, such as Microsoft's Xbox consoles and Sony's PlayStation® consoles, as well as video games developed by such manufacturers and other third-party publishers. Our business could suffer if any of these parties fail to continue to drive the success of these platforms, develop new or enhanced videogame platforms, develop popular game and entertainment titles for current or future generation platforms or produce and timely release sufficient quantities of such consoles. For example, DFC Intelligence forecasts' estimates of future cumulative new generation console has declined since the debut of the new-gen consoles in 2013, which, if such estimates are accurate, may negatively impact our future headset sales or otherwise negatively impact our business. Further, if a platform is withdrawn from the market or fails to sell, we may be forced to liquidate inventories relating to that platform or accept returns resulting in significant losses.

The battle royale genre, such as *Fortnite*, *Apex Legends* and *PlayerUnknown's Battlegrounds*, has increased demand for our headset products and driven significant revenue growth over prior year results. If console and personal computer game titles that are enhanced by the use of gaming headsets decline in number, popularity, or are delayed, our revenue and profits may decrease substantially and our business may be adversely affected.

Our Turtle Beach brand faces significant competition from other consumer electronics companies and this competition could have a material adverse effect on our financial condition and results of operations.

We compete with other producers of personal computers and video game console headsets, including the video game console manufacturers. Our competitors may spend more money and time on developing and testing products, undertake more extensive marketing campaigns, adopt more aggressive pricing policies, pay higher fees to licensors for motion picture, television, sports, music and character properties, or develop more commercially successful products for the personal computer or video game platforms than we do. In addition, competitors with large product lines and popular products, in particular the video game console manufacturers, typically have greater leverage with retailers, distributors and other customers, who may be willing to promote products with less consumer appeal in return for access to those competitors' more popular products.

In the event that a competitor reduces prices, we could be forced to respond by lowering our prices to remain competitive. If we are forced to lower prices, we may be required to "price protect" products that remain unsold in our customers' inventories at the time of the price reduction. Price protection results in our issuing a credit to our customers in the amount of the price reduction for each unsold unit in that customer's inventory. Our price protection policies, which are customary in the industry, can have a major impact on our sales and profitability.

In addition, if console manufacturers implement new technologies, through hardware or software, which would cause our headsets to become incompatible with that hardware manufacturer's console, there could be unanticipated delays in the release of our products as well as increases to projected development, manufacturing, marketing or distribution costs, any of which could harm our business and financial results.

Further, new and emerging technologies and alternate platforms for gaming, such as mobile devices and virtual reality devices, could make the consoles for which our headsets are designed less attractive or, in time, obsolete, which could require us to transition our business model such as develop products for other gaming platforms.

The industries in which we operate are subject to competition in an environment of rapid technological change, and if we do not adapt to, and appropriately allocate our resources among, emerging technologies, our revenues could be negatively affected.

We must make substantial product development and other investments to align our product portfolio and development efforts in response to market changes in the gaming industry. We must anticipate and adapt our products to emerging technologies in order to keep those products competitive. When we choose to incorporate a new technology into our products or to develop a product for a new platform or operating system, we are often required to make a substantial investment prior to the introduction of the product. If we invest in the development of a new technology or for a new platform that does not achieve significant commercial success, our revenues from those products likely will be lower than anticipated and may not cover our costs.

Further, our competitors may adapt to an emerging technology more quickly or effectively than we do, creating products that are technologically superior to ours, more appealing to consumers, or both. If, on the other hand, we elect not to pursue the development of products incorporating a new technology or for new platforms that achieve significant commercial success, our revenues could also be adversely affected. It may take significant time and resources to shift product development resources to that technology or platform and it may be more difficult to compete against existing products incorporating that technology or for that platform. Any failure to successfully adapt to, and appropriately allocate resources among, emerging technologies could harm our competitive position, reduce our share and significantly increase the time it takes us to bring popular products to market.

There are numerous steps required to develop a product from conception to commercial introduction and to ensure timely shipment to retail customers, including designing, sourcing and testing the electronic components, receiving approval of hardware and other third-party licensors, factory availability and manufacturing and designing the graphics and packaging. Any difficulties or delays in the product development process will likely result in delays in the contemplated product introduction schedule. It is common in new product introductions or product updates to encounter technical and other difficulties affecting manufacturing efficiency and, at times, the ability to manufacture the product at all. Although these difficulties can be corrected or improved over time with continued manufacturing experience and engineering efforts, if one or more aspects necessary for the introduction of products are not completed as scheduled, or if technical difficulties take longer than anticipated to overcome, the product introductions will be delayed, or in some cases may be terminated. No assurances can be given that our products will be introduced in a timely fashion, and if new products are delayed, our sales and revenue growth may be limited or impaired.

Our business could be adversely affected by actions on trade by domestic and foreign governments.

The U.S. government has altered its approach to international trade policy and in some cases renegotiated, or terminated, certain existing bilateral or multi-lateral trade agreements and treaties with foreign countries, including the North American Free Trade Agreement (“NAFTA”). In addition, the U.S. government has initiated or is considering imposing tariffs on certain foreign goods, including consumer goods. Related to this action, certain foreign governments, including China, have instituted or are considering imposing tariffs on certain U.S. goods. It remains unclear what the U.S. Administration or foreign governments will or will not do with respect to tariffs, NAFTA or other international trade agreements and policies. A trade war or other governmental action related to tariffs or international trade agreements or policies has the potential to adversely impact demand for our products, our costs, customers, suppliers and/or the U.S. economy or certain sectors thereof and, thus, to adversely impact our businesses. The majority of our production occurs in foreign jurisdictions, including China, and while the majority of our products are currently not subject to tariffs, the U.S. government announced a plan for new tariffs which will cover our products and may have an adverse effect on our results.

The decision by British voters to exit the European Union may negatively impact our operations.

In 2017, the U.K. submitted the formal notification of its intention to withdraw from the European Union pursuant to Article 50 of the Treaty on the European Union, as amended (“Brexit”). If no formal withdrawal agreement is reached between the U.K. and the European Union, then it is currently expected the U.K.’s membership of the European Union will automatically terminate on January 31, 2020 unless a further extension is agreed between the U.K. and European Union. The U.K.’s decision to leave the European Union will have political, legal and economic ramifications for both the U.K. and the European Union, although these are expected to be more pronounced for the U.K. The outcome of the negotiations on the U.K.’s withdrawal and any subsequent negotiations on trade and access to the country’s major trading markets, including the single European Union market, is currently unknown. As a result, there is ongoing uncertainty over the terms under which the U.K. will leave the European Union, in particular after any agreed transitional period, and the potential for an exit by the U.K. without a negotiated agreement (“hard Brexit”).

If there is a hard Brexit, it will likely have an adverse impact on labor and trade in addition to creating further short-term uncertainty and currency volatility. In the absence of a future trade deal, the U.K.’s trade with the European Union and the rest of the world would be subject to tariffs and duties set by the World Trade Organization. Additionally, the movement of goods between the U.K. and the remaining member states of the European Union will be subject to additional inspections and documentation checks, leading to possible delays at ports of entry and departure.

These changes to the trading relationship between the U.K and European Union would likely result in increased cost of goods imported into and exported from the U.K. and may decrease the profitability of our U.K. and other European operations. Additional currency volatility could drive a weaker British pound, which increases the cost of goods imported into our U.K. operations and may decrease the profitability of our U.K. operations. A weaker British pound versus the Euro and U.S. dollar also causes local currency results of our U.K. operations to be translated into fewer U.S. dollars during a reporting period. With a range of outcomes still possible, the impact from Brexit remains uncertain and will depend, in part, on the final outcome of tariff, trade, regulatory and other negotiations.

Our business could be adversely affected by significant movements in foreign currency exchange rates.

We are exposed to fluctuations in foreign currency transaction exchange rates, particularly with respect to the Euro and British Pound. Any significant change in the value of currencies of the countries in which we do business relative to the value of the U.S. dollar could affect our ability to sell products competitively and control our cost structure. Additionally, we are subject to foreign exchange translation risk due to changes in the value of foreign currencies in relation to our reporting currency, the U.S. dollar. The translation risk is primarily concentrated in the exchange rate between the U.S. dollar and the British Pound. As the U.S. dollar fluctuates against other currencies in which we transact business, revenue and income can be impacted.

A significant portion of our revenue is derived from a few large customers, and the loss of any such customer, or a significant reduction in purchases by such customer, could have a material adverse effect on our business, financial condition and results of operations.

During 2018, our three largest individual customers accounted for approximately 44% of our gross sales in the aggregate. The loss of, or financial difficulties experienced by, any of these or any of our other significant customers, including as a result of the bankruptcy of a customer, could have a material adverse effect on our business, results of operations, financial condition and liquidity. We do not have long-term agreements with these or other significant customers and our agreements with these customers do not require them to purchase any specific amount of products. All of our customers generally purchase from us on a purchase order basis. As a result, agreements with respect to pricing, returns, cooperative advertising or special promotions, among other things, are subject to periodic negotiation with each customer. No assurance can be given that these or other customers will continue to do business with us or that they will maintain their historical levels of business. In addition, the uncertainty of product orders can make it difficult to forecast our sales and allocate our resources in a manner consistent with actual sales, and our expense levels are based in part on our expectations of future sales. If our expectations regarding future sales are inaccurate, we may be unable to reduce costs in a timely manner to adjust for sales shortfalls. In addition, financial difficulties experienced by a significant customer could increase our exposure to uncollectible receivables and the risk that losses from uncollected receivables exceed the reserves we have set aside in anticipation of this risk.

The manufacture, supply and shipment of our products are dependent upon a limited number of third parties, and our success is dependent upon the ability of these parties to manufacture, supply and ship sufficient quantities of their product components to us in a timely fashion, as well as the continued viability and financial stability of these third-parties.

Because we rely on a limited number of manufacturers and suppliers for our products, we may be materially and adversely affected by the failure of any of those manufacturers and suppliers to perform as expected or supply us with sufficient quantities of their product components to ensure consumer availability of our own products. Our suppliers' ability to supply products to us is also subject to a number of risks, including the availability of raw materials, their financial instability, the destruction of their facilities, or work stoppages. Any shortage of raw materials or components or an inability to control costs associated with manufacturing could increase our costs or impair our ability to ship orders in a timely and cost-efficient manner. As a result, we could experience cancellations of orders, refusal to accept deliveries or a reduction in our prices and margins, any of which could harm our financial performance and results of operations.

Moreover, there can be no assurance that such manufacturers and suppliers will not refuse to supply us at prices we deem acceptable, independently market their own competing products in the future, or otherwise discontinue their relationships with us. Our failure to maintain these existing manufacturing and supplier relationships, or to establish new relationships on similar terms in the future, could have a material adverse effect on our business, results of operations, financial condition and liquidity.

In particular, certain of our products have a number of components and subassemblies produced by outside suppliers. In addition, for certain of these items, we qualify only a single source of supply with long lead times, which can magnify the risk of shortages or result in excess supply and also decreases our ability to negotiate price with our suppliers. Also, if we experience quality problems with suppliers, then our production schedules could be significantly delayed or costs significantly increased, which could have an adverse effect on our business, liquidity, results of operation and financial position.

In addition, the ongoing effectiveness of our supply chain is dependent on the timely performance of services by third parties shipping products and materials to and from our warehouse facilities and other locations. If we encounter problems with these shipments, our ability to meet retailer expectations, manage inventory, complete sales and achieve objectives for operating efficiencies could be materially adversely affected. We have experienced some of these problems in the past and we cannot assure you that we will not experience similar problems in the future.

Our net sales and operating income fluctuate on a seasonal basis and decreases in sales or margins during peak seasons could have a disproportionate effect on our overall financial condition and results of operations.

Historically, a majority of our annual revenues have been generated during the holiday season of September to December. If we do not accurately forecast demand for particular products, we could incur additional costs or experience manufacturing delays. Any shortfall in net sales during this period would cause our annual results of operations to suffer significantly.

Demand for our products depends on many factors such as consumer preferences and the introduction or adoption of game platforms and related content, and can be difficult to forecast. If we misjudge the demand for our products, we could face the following problems in our operations, each of which could harm our operating results:

- If our forecasts of demand for products are too high, we may accumulate excess inventories of products, which could lead to markdown allowances or write-offs affecting some or all of such excess inventories. We may also have to adjust the prices of our existing products to reduce such excess inventories;
- If demand for specific products increases beyond what we forecast, our suppliers and third-party manufacturers may not be able to increase production quickly enough to meet the demand. Our failure to meet market demand may lead to missed opportunities to increase our base of gamers, damage our relationships with retailers or harm our business;
- The on-going console transition increases the likelihood that we could fail to accurately forecast demand for our new generation console headsets and our existing headsets; and
- Rapid increases in production levels to meet unanticipated demand could result in increased manufacturing errors, as well as higher component, manufacturing and shipping costs, all of which could reduce our profit margins and harm our relationships with retailers and consumers.

If we are unable to continue to develop innovative and popular headset products, or if our design and marketing efforts do not effectively raise the recognition and reputation of our Turtle Beach brand, we may not be able to successfully implement our gaming accessory growth strategy.

We believe that our ability to extend the recognition and favorable perception of our Turtle Beach brand, and the recently acquired ROCCAT brand, is critical to implement our gaming accessory growth strategy, which includes further establishing our position in existing gaming headsets, developing a strong position in new console headsets, expanding beyond existing console, PC and mobile applications to new technology applications, accelerating our international growth and expanding complementary product categories. To extend the reach of our Turtle Beach brand, we believe we must devote significant time and resources to headset product design, marketing and promotions. These expenditures, however, may not result in a sufficient increase in net sales to cover such costs.

Transitions in console platforms may adversely affect our headset business.

When new console platforms are announced or introduced into the market, consumers have historically reduced their purchases of game console peripherals and accessories, including headsets, for old generation console platforms in anticipation of new platforms becoming available. During these console transition periods, sales of gaming console headsets related to old generation consoles slow or decline until new platforms are introduced and achieve wide consumer acceptance, which we cannot guarantee. This decrease or decline may not be offset by increased sales of products for the new console platforms. Over time as the old generation platform user base declines, products for the old platforms are typically discontinued which can result in lower margins, excess inventory, excess parts, or similar costs related to end of life of a product model. In addition, as a third party gaming headset company, we are reliant on working with the console manufacturers for our headsets to be compatible with any new console platforms, which if not done on a timely basis may adversely affect sales. Sony and Microsoft may make changes to their platforms that impact how headsets connect with or work with the new consoles which could create a disruption to consumer buying behavior and/or product life-cycles.

As console hardware moves through its life cycle, hardware manufacturers typically enact price reductions, and decreasing prices may put downward pressure on prices for products for such platforms. During platform transitions, we may simultaneously incur costs both in continuing to develop and market new products for prior-generation video game platforms, which may not sell at premium prices, and also in developing products for current-generation platforms, which will not generate immediate or near-term revenue. As a result, our operating results during platform transitions are more volatile and difficult to predict than during other times.

Further, technological and other developments may in the future accelerate the frequency of such console transitions resulting in such disruption occurring more frequently. In addition, competing technologies such as tablet-based gaming and virtual reality may result in further disruption to the overall console gaming market.

Any acquisitions we pursue could disrupt our business and harm our financial condition and results of operations.

As part of our business strategy, we review and intend to continue to review acquisition opportunities that we believe would be advantageous or complementary to the development of our business. During the second quarter of 2019, we acquired certain assets of ROCCAT GmbH and its subsidiaries, and we may acquire additional businesses, assets, or technologies in the future. If we make any acquisitions, we could take any or all of the following actions, any one of which could adversely affect our business, financial condition, results of operations or share price:

- use a significant portion of our available cash;
- require a significant devotion of management’s time and resources in the pursuit or consummation of any acquisition;
- incur debt, which may not be available to us on favorable terms and may adversely affect our liquidity;
- issue equity or equity-based securities that would dilute existing stockholders’ ownership percentage;
- assume contingent and other liabilities; and
- take charges in connection with such acquisitions.

Acquisitions also entail numerous other risks, including, without limitation: difficulties in assimilating acquired operations, products, technologies and personnel; unanticipated costs; diversion of management’s attention from existing operations; risks of entering markets in which we have limited or no prior experience; regulatory approvals; unanticipated costs or liabilities; and potential loss of key employees from either our existing business or the acquired organization. Acquisitions may result in accounting charges for restructuring and other expenses, amortization of purchased technology and intangible assets and stock-based compensation expense, any of which could materially and adversely affect our operating results. We may not be able to realize the anticipated synergies, innovation, operational efficiencies, benefits of or successfully integrate with our existing business the businesses, products, technologies or personnel that we acquire, and our failure to do so could harm our business and operating results.

Loss of our key management and other personnel could impact our business.

Our future success depends largely upon the continued service of our executive officers and other key management and technical personnel and on our ability to continue to attract, retain and motivate qualified personnel. In addition, competition for skilled and non-skilled employees among companies like ours is intense, and the loss of skilled or non-skilled employees or an inability to attract, retain and motivate additional skilled and non-skilled employees required for the operation and expansion of our business could hinder our ability to conduct research activities successfully, develop new products, attract customers and meet customer shipments.

If we are unable to protect our information systems against service interruption, misappropriation of data or breaches of security, our operations could be disrupted, our reputation may be damaged, and we may be financially liable for damages.

We rely heavily on information systems to manage our operations, including a full range of retail, financial, sourcing and merchandising systems. We regularly make investments to upgrade, enhance or replace these systems, as well as leverage new technologies to support our growth strategies. In addition, we have implemented enterprise-wide initiatives that are intended to standardize business processes and optimize performance. Any delays or difficulties in transitioning to new systems or integrating them with current systems or the failure to implement our initiatives in an orderly and timely fashion could result in additional investment of time and resources, which could impair our ability to improve existing operations and support future growth, and ultimately have a material adverse effect on our business.

The reliability and capacity of our information systems are critical. Despite preventative efforts, our systems are vulnerable to damage or interruption from, among other things, natural disasters, technical malfunctions, inadequate systems capacity, human error, power outages, computer viruses and security breaches. Any disruptions affecting our information systems could have a material adverse impact on our business. In addition, any failure to maintain adequate system security controls to protect our computer assets and sensitive data, including associate and client data, from unauthorized access, disclosure or use could damage our reputation with our associates and our clients, exposing us to financial liability, legal proceedings (such as class action lawsuits), and regulatory action. While we have implemented measures to prevent security breaches and cyber incidents, our preventative measures and incident response efforts may not be entirely effective. As a result, we may not be able to immediately detect any security breaches, which may increase the losses that we would suffer. Finally, our ability to continue to operate our business without significant interruption in the event of a disaster or other disruption depends, in part, on the ability of our information systems to operate in accordance with our disaster recovery and business continuity plans.

Our reliance on information systems and other technology also gives rise to cybersecurity risks, including security breach, espionage, system disruption, theft and inadvertent release of information. The occurrence of any of these events could compromise our networks, and the information stored there could be accessed, publicly disclosed, lost or stolen. Any such access, disclosure or other loss of information could result in legal claims or proceedings, liability or regulatory penalties under laws protecting the privacy of personal information, disrupt operations, and damage our reputation, which could adversely affect our business. In addition, as security threats continue to evolve we may need to invest additional resources to protect the security of our systems.

Our results of operations and financial condition may be adversely affected by global business, political, operational, financial and economic conditions.

We face business, political, operational, financial and economic risks inherent in international business, many of which are beyond our control, including:

- trade restrictions, higher tariffs, currency fluctuations or the imposition of additional regulations relating to import or export of our products, especially in China, where all of our Turtle Beach products are manufactured, which could force us to seek alternate manufacturing sources or increase our costs;
- difficulties obtaining domestic and foreign export, import and other governmental approvals, permits and licenses, and compliance with foreign laws, which could halt, interrupt or delay our operations if we cannot obtain such approvals, permits and licenses;
- difficulties encountered by our international distributors or us in staffing and managing foreign operations or international sales, including higher labor costs;
- transportation delays and difficulties of managing international distribution channels;
- longer payment cycles for, and greater difficulty collecting, accounts receivable;
- political and economic instability, including wars, terrorism, political unrest, boycotts, curtailment of trade and other business restrictions, any of which could materially and adversely affect our net sales and results of operations; and
- natural disasters.

Any of these factors could reduce our net sales, decrease our gross margins, increase our expenses or reduce our profitability. Should we establish our own operations in international territories where we currently utilize a distributor, we will become subject to greater risks associated with operating outside of the United States.

The electronics industry in general has historically been characterized by a high degree of volatility and is subject to substantial and unpredictable variations resulting from changing business cycles. Our operating results will be subject to fluctuations based on general economic conditions, and in particular conditions that impact discretionary consumer spending. The audio products sector of the electronics industry has and may continue to experience a slowdown in sales, which adversely impacts our ability to generate revenues and impacts the results of our future operations. A lack of available credit in financial markets may adversely affect the ability of our commercial customers to finance purchases and operations and could result in an absence of orders or spending for our products as well as create supplier disruptions. We are unable to predict the likely duration and severity of any adverse economic conditions and disruptions in financial markets and the effects they will have on our business and its financial condition.

Further, certain Turtle Beach products are manufactured in China for export to the United States and worldwide. As a result of opposition to policies of the Chinese government and China's growing trade surpluses with the United States, there has been, and in the future may be, opposition to the extension of normal trade relations ("NTR") status for China. The loss of NTR status for China, further changes in tariff structures or adoption in the United States of other trade policies adverse to China could increase our manufacturing expenses and make it more difficult for us to manufacture our products in China.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report financial results or prevent fraud, which could have an adverse effect on our business and financial condition.

Effective internal controls are necessary to provide reliable financial reports and to assist in the effective prevention of fraud. Any inability to provide reliable financial reports or prevent fraud could harm our business. The Sarbanes-Oxley Act requires, among other things, that we evaluate our systems and processes and test our internal controls over financial reporting to allow management and our independent registered public accounting firm, as applicable, to report on the effectiveness of our internal control over financial reporting. We have reported the remediation of a material weakness related to the review of material non-routine transactions or events disclosed in our 2018 Annual Report on Form 10-K. In the future, if we are not able to remediate any identified material weakness or otherwise comply with the requirements of Section 404 of the Sarbanes-Oxley Act, or if we or our independent registered public accounting firm identifies deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, investors could lose confidence in the accuracy and completeness of our financial reports, the market price of our common stock could decline and we could be subject to sanctions, investigations by the Nasdaq Stock Market, LLC, the SEC or other regulatory authorities, or shareholder litigation.

In addition, failure to maintain effective internal controls could result in financial statements that do not accurately reflect our financial condition or results of operations. There can be no assurance that we will be able to maintain a system of internal controls that fully complies with the requirements of the Sarbanes-Oxley Act of 2002 or that our management and independent registered public accounting firm will continue to conclude that our internal controls are effective.

Risks Related to our Intellectual Property and other Legal and Regulatory Matters

Our competitive position will be adversely damaged if our products are found to infringe on the intellectual property rights of others.

Other companies and our competitors may currently own or obtain patents or other proprietary rights that might prevent, limit or interfere with our ability to make, use or sell our products. Although we do not believe that our products infringe the proprietary rights of any third parties, there can be no assurance that infringement or other legal claims will not be asserted against us or that we will not be found to infringe the intellectual property rights of others. The electronics industry is characterized by vigorous protection and pursuit of intellectual property rights or positions, resulting in significant and often protracted and expensive litigation. In the event of a successful claim of infringement against us and our failure or inability to license the infringing technology, our business and operating results could be adversely affected. Any litigation or claims, whether or not valid, could result in substantial costs or a diversion of our resources. An adverse result from intellectual property litigation could force us to do one or more of the following:

- cease selling, incorporating or using products or services that incorporate the challenged intellectual property;
- obtain a license from the holder of the infringed intellectual property right, which license may not be available on reasonable terms, if at all; and/or
- redesign products or services that incorporate the disputed technology.

If we are forced to take any of the foregoing actions, we could face substantial costs and shipment delays and our business could be seriously harmed. Although we carry general liability insurance, our insurance may not cover potential claims of this type or may be inadequate to insure us for all liability that may be imposed.

In addition, it is possible that our customers or end users may seek indemnity from us in the event that our products are found or alleged to infringe the intellectual property rights of others. Any such claim for indemnity could result in substantial expenses to us that could harm our operating results.

If we are unable to obtain and maintain intellectual property rights and/or enforce those rights against third parties who are violating those rights, our business could suffer.

We rely on various intellectual property rights, including patents, trademarks, trade secrets and trade dress to protect our Turtle Beach brand name, reputation, product appearance, technology and our proprietary rights in our HyperSound technology. Although we have entered into confidentiality and invention assignment agreements with our employees and contractors, and nondisclosure agreements with selected parties with whom we conduct business to limit access to and disclosure of our proprietary information, these contractual arrangements and the other steps we have taken to protect our intellectual property may not prevent misappropriation of that intellectual property or deter independent third-party development of similar technologies. Monitoring the unauthorized use of proprietary technology and trademarks is costly, and any dispute or other litigation, regardless of outcome, may be costly and time consuming and may divert the attention of management and key personnel from our business operations. The steps taken by us may not prevent unauthorized use of proprietary technology or trademarks. Many features of our products are not protected by patents; we may not have the legal right to prevent others from reverse engineering or otherwise copying and using these features in competitive products. If we fail to protect or to enforce our intellectual property rights successfully, our competitive position could suffer, which could adversely affect our financial results.

We are susceptible to counterfeiting of our products, which may harm our reputation for producing high-quality products and force us to incur expenses in enforcing our intellectual property rights. Such claims and lawsuits can be expensive to resolve, require substantial management time and resources, and may not provide a satisfactory or timely result, any of which may harm our results of operations. As some of our products are sold internationally, we are also dependent on the laws of a range of countries to protect and enforce our intellectual property rights. These laws may not protect intellectual property rights to the same extent or in the same manner as the laws of the United States.

Further, we are party to licenses that grant us rights to intellectual property, including trademarks, which are necessary or useful to our Turtle Beach business. One or more of our licensors may allege that we have breached our license agreement with them, and seek to terminate our license. If successful, this could result in our loss of the right to use the licensed intellectual property, which could adversely affect our ability to commercialize our technologies or products, as well as harm our competitive business position and our business prospects.

Our success also depends in part on our ability to obtain and enforce intellectual property protection of our technology, particularly our patents. There is no guarantee any patent be granted on any patent application that we have filed or may file. Claims allowed from existing or pending patents may not be of sufficient scope or strength to protect the economic value of our technologies. Further, any patent that we may obtain will expire, and it is possible that it may be challenged, invalidated or circumvented.

We may initiate claims or litigation against third parties in the future for infringement of our proprietary rights or to determine the scope and validity of our proprietary rights or the proprietary rights of our competitors. These claims could result in costly litigation and divert the efforts of our technical and management personnel. As a result, our operating results could suffer and our financial condition could be harmed.

We are dependent upon third-party intellectual property to manufacture some of our products.

The performance of certain technology used in new generation consoles, such as integrated voice and chat audio from the Xbox One, is improved by a licensed component to ensure compatibility with our products.

While we currently believe that we have the necessary licenses, or can obtain the necessary licenses, in order to produce compatible products, there is no guarantee that our licenses will be renewed or granted in the first instance. Moreover, if these first parties enter into license agreements with companies other than us for their “closed systems” or if we are unable to obtain sufficient quantities of these headset adapters or chips, we would be placed at a competitive disadvantage.

In order for certain of our headsets to connect to the Xbox One's advanced features and controls, a proprietary computer chip or wireless module is required. As a result, with respect to our products designed for the Xbox One, we are currently reliant on Microsoft or their designated supplier to provide us with sufficient quantities. If we are unable to obtain sufficient quantities of these headset adapters or chips, sales of such Xbox One headsets and consequently our revenues would be adversely affected.

We are licensed and approved by Microsoft to develop and sell Xbox One compatible audio products pursuant to a license agreement under which we have the right to manufacture (including through third party manufacturers), market and sell audio products for the Xbox One video game console (the “Xbox One Agreement”). Our Xbox One headsets are dependent on this license. Microsoft has the right to terminate the Xbox One Agreement under certain circumstances set forth in the agreement. Should the Xbox One Agreement be terminated, our headset offerings may be limited, thereby significantly reducing our revenues.

Accordingly, Microsoft, Sony and other third-party gaming platform manufacturers may control our ability to manufacture headsets compatible with their platforms, and could cause unanticipated delays in the release of our products as well as increases to projected development, manufacturing, licensing, marketing or distribution costs, any of which could negatively impact our business.

Our products may be subject to warranty claims, product liability and product recalls.

We may be subject to product liability or warranty claims that could result in significant direct or indirect costs, or we could experience greater returns from retailers than expected, which could harm our net sales. The occurrence of any quality problems due to defects in our products could make us liable for damages and warranty claims in excess of any existing reserves. In addition to the risk of direct costs to correct any defects, warranty claims, product recalls or other problems, any negative publicity related to the perceived quality of our products could also affect our brand image, decrease retailer and distributor demand and our operating results and financial condition could be adversely affected.

We could incur unanticipated expenses in connection with warranty or product liability claims relating to a recall of one or more of our products, which could require significant expenditures to defend. Additionally, we may be required to comply with governmental requirements to remedy the defect and/or notify consumers of the problem that could lead to unanticipated expense, and possible product liability litigation against a customer or us.

Changes in laws or regulations or the manner of their interpretation or enforcement could adversely impact our financial performance and restrict our ability to operate our business or execute our strategies.

New laws or regulations, or changes in existing laws or regulations or the manner of their interpretation or enforcement, may create uncertainty for public companies, increase our cost of doing business and restrict our ability to operate our business or execute our strategies. This could include, among other things, compliance costs and enforcement under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).

We continually evaluate and monitor developments with respect to new and proposed laws, regulations, standards and rules and cannot predict or estimate the amount of the additional costs we may incur or the timing of such costs. Any such new or changed laws, regulations, standards and rules may be subject to varying interpretations and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, regulatory authorities may initiate legal proceedings against us and we may be harmed.

Our HyperSound technology is subject to government regulation, which could lead to unanticipated expenses and/or enforcement action against us.

Under the Radiation Control for Health and Safety Act of 1968, and the associated regulations promulgated by the Food and Drug Administration (“FDA”), HyperSound products are regulated as electrical emitters of ultrasonic vibrations. Under the terms of such regulations, in August 2012 we provided, and in January 2016 further supplemented, an abbreviated report to the FDA describing the HyperSound commercial product. In September 2015 we provided an initial product report describing the HyperSound Clear® 500P product. The FDA may respond to these reports and request changes or safeguards to our HyperSound products. We also are required to notify the FDA should a product be found to have a defect relating to safety of use due to the emission of electronic product radiation. We do not believe our technology poses any human health risks. However, modifications to the technology may be required. Our HyperSound product advertising is regulated by the Federal Trade Commission (the “FTC”), which requires all advertising be truthful, not deceptive or unfair, and evidence based.

The HyperSound Clear 500P and the HyperSound Tinnitus Module were regulated by the FDA as medical devices pursuant to the Federal Food, Drug, and Cosmetic Act, or FDCA, and implementing regulations. HyperSound Clear 500P received 510(k) clearance permitting over-the-counter (“OTC”) commercial distribution for use as a group auditory trainer or group hearing aid and the HyperSound Tinnitus Module feature received 510(k) clearance for prescription use in the temporary relief of tinnitus symptoms.

Although we have discontinued sales of our HyperSound Clear 500P and the HyperSound Tinnitus Module, we continue to be subject to FDA’s requirements for marketed medical devices with respect to those HyperSound Clear 500P products that have already been sold, such as the Quality System Regulation, or QSR (which imposes procedural, documentation and record keeping requirements regarding the manufacture of medical devices); the Medical Device Reporting regulation (which requires that manufacturers report to the FDA if their device may have caused or contributed to a death or serious injury or malfunctioned in a way that would likely cause or contribute to a death or serious injury if it were to recur); and the Reports of Corrections and Removals regulation (which requires manufacturers to report recalls and field actions to the FDA if initiated to reduce a risk to health posed by the device or to remedy a violation of the FDCA that may pose a risk to health). FDA enforces these requirements by inspection and market surveillance. If the FDA finds a violation, it can institute a wide range of enforcement actions, ranging from a public warning letter to more severe sanctions such as fines, penalties, suspension or withdrawal of regulatory approvals, product recalls, seizure of products, operating restrictions, total shutdown of production, and criminal prosecution.

We are subject to various environmental laws and regulations that could impose substantial costs on us and may adversely affect our business, operating results and financial condition.

Our operations and some of our products are regulated under various federal, state, local and international environmental laws. In addition, regulatory bodies in many of the jurisdictions in which we operate propose, enact and amend environmental laws and regulations on a regular basis. If we were to violate or become liable under these environmental laws, we could be required to incur additional costs to comply with such regulations and may incur fines and civil or criminal sanctions, third-party property damage or personal injury claims, or could be required to incur substantial investigation or remediation costs. Liability under environmental laws may be joint and several and without regard to comparative fault. The ultimate costs under environmental laws and the timing of these costs are difficult to predict. Although we cannot predict the ultimate impact of any new environmental laws and regulations, such laws may result in additional costs or decreased revenue, and could require that we redesign or change how we manufacture our products, any of which could have a material adverse effect on our business. Additionally, to the extent that our competitors choose not to abide by these environmental laws and regulations, we may be at a cost disadvantage, thereby hindering our ability to effectively compete in the marketplace.

Failure to comply with the U.S. Foreign Corrupt Practices Act or other applicable anti-corruption legislation could result in fines, criminal penalties and an adverse effect on our business.

Our products are sold in over 40 countries, including countries known to have a reputation for corruption. We are committed to doing business in accordance with applicable anti-corruption laws. We are subject, however, to the risk that our officers, directors, employees, agents and collaborators may take action determined to be in violation of such anti-corruption laws, including the U.S. Foreign Corrupt Practices Act of 1977, the U.K. Bribery Act 2010, the European Union Anti-Corruption Act and other similar laws, or that subjects us to trade sanctions administered by the Office of Foreign Assets Control and the U.S. Department of Commerce. Any such violation could result in substantial fines, sanctions, civil and/or criminal penalties or curtailment of operations in certain jurisdictions, and might adversely affect our results of operations. In addition, actual or alleged violations could damage our reputation and ability to do business.

We are party to ongoing stockholder litigation, and in the future could be party to additional stockholder litigation, any of which could harm our business, financial condition and operating results.

We have had, and may continue to have, actions brought against us by stockholders in connection with the merger, past transactions, changes in our stock price or other matters. Any such claims, whether or not resolved in our favor, could divert our management and other resources from the operation of our business and otherwise result in unexpected and substantial expenses that would adversely and materially impact our business, financial condition and operating results. For example, and as further described in Note 13, “Commitments and Contingencies,” we are involved in legal proceedings related to the merger of VTBH and Paris Acquisition Corp. involving certain of our stockholders.

Risks Related to Liquidity

We depend upon the availability of capital under our revolving credit facility to finance our operations. Any additional financing that we may need may not be available on favorable terms, or at all.

In addition to cash flow generated from operations, we finance our operations with a credit facility (the “Credit Facility”) provided by Bank of America, as Agent, Sole Lead Arranger and Sole Bookrunner. If we are unable to comply with the financial and other covenants contained in the Credit Facility, and are unable to obtain a waiver under the Credit Facility, Bank of America may declare the outstanding borrowings under the Credit Facility immediately due and payable. Such an event would have an immediate and material adverse impact on our business, results of operations, and financial condition. We would be required to obtain additional financing from other sources, and we cannot predict whether or on what terms, if any, additional financing might be available. If we are required to seek additional financing and are unable to obtain it, we may have to change our business and capital expenditure plans, which may have a materially adverse effect on our business, financial condition and results of operations. In addition, the debt under the Credit Facility could make it more difficult to obtain other debt financing in the future, which could put us at a competitive disadvantage to competitors with less debt. The Credit Facility contains financial and other covenants that we are obligated to maintain. The Credit Facility contain certain financial covenants and other restrictions that limit our ability, among other things, to incur certain additional indebtedness; pay dividends and repurchase stock; make certain investments and other payments; enter into certain mergers or consolidations; engage in sale and leaseback transactions and transactions with affiliates; and encumber and dispose of assets.

If we violate any of these covenants, we will be in default under the Credit Facility. If a default occurs and is not timely cured or waived, Bank of America could seek remedies against us, including termination or suspension of obligations to make loans and issue letters of credit, and acceleration of amounts due under the applicable Credit Facility. No assurance can be given that we will be able to maintain compliance with these covenants in the future. The Credit Facility is asset based and can only be drawn down in an amount to which eligible collateral exists, and can be negatively impacted by extended collection of accounts receivable, unexpectedly high product returns and slow moving inventory, among other factors. In addition, we have granted the lender a first-priority lien against substantially all of our assets, including trade accounts receivable and inventories. Failure to comply with the operating restrictions or financial covenants could result in a default which could cause the lender to accelerate the timing of payments and exercise their lien on substantially all of our assets.

If suppliers, customers, landlords, employees or other stakeholders lose confidence in our business, it may be more difficult for us to operate and may materially adversely affect our business, results of operations and financial condition.

If suppliers, customers, landlords, employees or other stakeholders have doubts regarding our ability to continue as a going concern, this could materially adversely affect our ability to operate. Concerns about our financial condition may cause our suppliers and other counterparties to tighten credit terms or cease doing business with us altogether, which would have a material adverse effect on our business and results of operations.

Risks Related to Ownership of our Common Stock

The market price of our common stock may fluctuate significantly.

We cannot predict the prices at which our common stock may trade. The market price of our common stock may fluctuate widely, depending on many factors, some of which may be beyond our control, including but not limited to:

- actual or anticipated fluctuations in our operating results due to factors related to our business;
- success or failure of our business strategy;
- the success of third-party gaming platforms and certain game titles to drive sales;
- our quarterly or annual earnings, or those of other companies in our industry;
- changes in earnings estimates by securities analysts or our ability to meet those estimates;
- our ability to execute transformation, restructuring and realignment actions;
- the operating and stock price performance of other comparable companies;
- overall market fluctuations and,
- general economic conditions and other external factors.

Stock markets in general have experienced volatility that has often been unrelated to the operating performance of a particular company. These broad market fluctuations could adversely affect the trading price of our common stock.

Item 2- Unregistered Sale of Equity Securities and Use of Proceeds

On April 9, 2019, the Company's board of directors authorized a stock repurchase program to acquire up to \$15.0 million of its common stock. Any repurchases under the program will be made from time to time on the open market at prevailing market prices. The following table summarizes, by month, the repurchases made during the three months ended September 30, 2019, under the repurchase program and in connection with shares repurchased from employees to satisfy tax withholding obligations in connection with the vesting of restricted stock awards.

Period	Issuer Purchases of Equity Securities			
	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
July 1- 31, 2019	—	\$ —	—	—
August 1- 31, 2019	56,204	\$ 8.88	50,000	\$ 13,059,370
September 1- 30, 2019	—	\$ —	—	—
Total	56,204	\$ 8.88	50,000	

For the second quarter of 2019, we repurchased approximately \$0.1 million of common shares related to employee transactions. These amounts represent common shares repurchased from employees in an amount equal to the statutory tax liability associated with the vesting of their equity awards, which is then remitted on behalf of the employee.

Item 5 - Other Information

None.

Item 6. Exhibits

- 3.1 [Articles of Incorporation of Turtle Beach Corporation, as amended \(Incorporated by reference to Exhibit 3.1 to Company's 10-Q filed August 6, 2018\).](#)
- 3.2 [Bylaw, as amended, of Turtle Beach Corporation \(Incorporated by reference to Exhibit 3.1 to Company's 8-K filed June 20, 2019\).](#)
- 31.1 ** [Certification of Juergen Stark, Principal Executive Officer, pursuant to Rule 13a-14\(a\) or 15d-14\(a\) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 \(filed herewith\).](#)
- 31.2 ** [Certification of John T. Hanson, Principal Financial Officer, pursuant to Rule 13a-14\(a\) or 15d-14\(a\) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 \(filed herewith\).](#)
- 32.1 ** [Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by Juergen Stark, Principal Executive Officer and John Hanson, Principal Financial Officer \(filed herewith\).](#)

Extensible Business Reporting Language (XBRL) Exhibits

- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Labels Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

** Filed herewith.

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Each of the undersigned hereby certifies, in accordance with 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, in his or her capacity as an officer of Turtle Beach Corporation (the "Company"), that, to his or her knowledge, the Quarterly Report of the Company on Form 10-Q for the period ended September 30, 2019, fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 and that the information contained in such report fairly presents, in all material respects, the financial condition and results of operation of the Company.

Date: November 7, 2019

By: _____ /s/ JUERGEN STARK
Juergen Stark
Chief Executive Officer and President
(Principal Executive Officer)

Date: November 7, 2019

By: _____ /s/ JOHN T. HANSON
John T. Hanson
Chief Financial Officer, Treasurer and Secretary
(Principal Financial Officer)