

Turtle Beach Corp
Form 10-Q/A
March 29, 2019

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

FORM 10-Q/A
(Amendment No. 1)

(Mark one)

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

For the quarterly period ended June 30, 2018
or

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

For the transition period from _____ to _____

Commission File Number: 001-35465

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

Nevada 27-2767540
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification Number)

11011 Via Frontera, Suite A/B 92127
San Diego, California
(Address of principal executive offices) (Zip Code)

(888) 496-8001
(Registrant's telephone number, including area code)

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

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

Indicate by check mark 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 Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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Emerging growth company "

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

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

The number of shares of the registrant's Common Stock, par value \$0.001 per share, outstanding on July 31, 2018 was 13,796,031.

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EXPLANATORY NOTE

On March 13, 2019, the Audit Committee of the Board of Directors (the “Audit Committee”) of Turtle Beach Corporation (the “Company”), after considering the recommendations of management and consulting with BDO USA, LLP, the Company’s independent registered public accounting firm, concluded that our unaudited condensed consolidated financial statements included in the quarterly reports on Form 10-Q for the interim periods ended June 30, 2018, and September 30, 2018 (the “Initial Filings”) should not be relied upon because the Company had improperly accounted for the fully-funded warrants issued in connection with the Company’s exchange of Series B Preferred Stock on April 23, 2018. The warrants are exercisable for a fixed number of shares of the Company’s common stock, except that the warrant holders have the right to receive cash in connection with the completion of a transaction defined as a Fundamental Transaction under the warrant agreement. Upon subsequent review, the Company determined that the proper accounting treatment for the warrants due to this possible future cash conversion option was as a financial instrument obligation rather than as an equity instrument, as originally reported. Accounting for the warrants as a financial instrument obligation results in the Company reporting a liability equal to the fair value of the warrants at the time of the transaction, with subsequent changes in fair value reported quarterly in earnings based on a Black-Scholes mark-to-market valuation.

We are filing this Amendment No. 1 to the Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2018 (“Form 10-Q/A”), which was filed with the United States Securities and Exchange Commission (“SEC”) on August 6, 2018 (the “Original Filing”), to reflect restatements of the Condensed Consolidated Balance Sheet at June 30, 2018, the Condensed Consolidated Statements of Income (Loss) for the three and six months ended June 30, 2018, and Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2018, and the related notes thereto.

The following sections in the Original Filing are revised in this Form 10-Q/A, solely as a result of, and to reflect, the restatement:

Part I - Item 1 - Financial Statements

Part I - Item 2 - Management’s Discussion and Analysis of Financial Condition and Results of Operations

Part I - Item 4 - Controls and Procedures

Part II - Item 1A - Risk Factors

Part II - Item 6 - Exhibits

Pursuant to the rules of the SEC, Part II, Item 6 of the Original Filing has been amended to include the currently-dated certifications from our principal executive officer and principal financial officer, as required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002. The certifications of the principal executive officer and principal financial officer are included in this Form 10-Q/A as Exhibits 31.1, 31.2 and 32.1.

For the convenience of the reader, this Form 10-Q/A sets forth the information in the Original Filing in its entirety, as such information is modified and superseded where necessary to reflect the restatement. This Form 10-Q/A should be read in conjunction with our filings with the SEC subsequent to the date of the Original Filing, in each case as those filings may have been, or with respect to the Initial Filings will be, superseded or amended.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Turtle Beach Corporation

Condensed Consolidated Balance Sheets

	June 30, 2018	December 31, 2017
	(unaudited, restated)	
	(in thousands, except par value and share amounts)	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$9,108	\$ 5,247
Accounts receivable, net	34,582	50,534
Inventories	28,043	27,518
Prepaid expenses and other current assets	5,190	3,467
Total Current Assets	76,923	86,766
Property and equipment, net	2,839	4,677
Intangible assets, net	1,196	1,404
Deferred income taxes	127	362
Other assets	1,095	1,042
Total Assets	\$82,180	\$ 94,251
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current Liabilities:		
Revolving credit facility	\$—	\$ 38,467
Term loans	375	4,173
Accounts payable	29,976	13,459
Other current liabilities	14,061	11,451
Total Current Liabilities	44,412	67,550
Term loans, long-term portion, net of unamortized debt issuance costs of \$734 and \$759	11,391	6,789
Series B redeemable preferred stock	—	18,921
Subordinated notes - related party, net of unamortized discount of \$811 and \$1,075	19,092	20,836
Financial instrument obligation	11,176	—
Other liabilities	2,311	2,312
Total Liabilities	88,382	116,408
Commitments and Contingencies		
Stockholders' Equity (Deficit)		
Common stock, \$0.001 par value - 25,000,000 shares authorized; 13,794,251 and 12,349,449 shares issued and outstanding as of June 30, 2018 and December 31, 2017, respectively	14	12
Additional paid-in capital	165,111	148,082
Accumulated deficit	(171,009)	(170,048)
Accumulated other comprehensive loss	(318)	(203)
Total Stockholders' Equity (Deficit)	(6,202)	(22,157)
Total Liabilities and Stockholders' Equity (Deficit)	\$82,180	\$ 94,251

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

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Turtle Beach Corporation
Condensed Consolidated Statements of Operations
(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2018 (restated)	June 30, 2017	June 30, 2018 (restated)	June 30, 2017
	(in thousands, except per-share data)			
Net revenue	\$60,805	\$19,112	\$101,691	\$33,464
Cost of revenue	40,528	12,811	66,385	24,947
Gross profit	20,277	6,301	35,306	8,517
Operating expenses:				
Selling and marketing	6,818	5,529	12,747	9,978
Research and development	1,327	1,697	2,656	3,087
General and administrative	3,863	4,070	7,848	8,241
Restructuring charges	—	(30)	—	268
Total operating expenses	12,008	11,266	23,251	21,574
Operating income (loss)	8,269	(4,965)	12,055	(13,057)
Interest expense	1,258	1,835	3,263	3,675
Other non-operating expense (income), net	9,029	(214)	8,784	(265)
Income (loss) before income tax	(2,018)	(6,586)	8	(16,467)
Income tax expense	300	475	364	520
Net income (loss)	\$(2,318)	\$(7,061)	\$(356)	\$(16,987)
Net income (loss) per share:				
Basic	\$(0.17)	\$(0.57)	\$(0.03)	\$(1.38)
Diluted	\$(0.17)	\$(0.57)	\$(0.03)	\$(1.38)
Weighted average number of shares:				
Basic	13,401	12,337	12,877	12,325
Diluted	13,401	12,337	12,877	12,325

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

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

	Three Months Ended		Six Months Ended	
	June 30, 2018 (restated) (in thousands)	June 30, 2017	June 30, 2018 (restated)	June 30, 2017
Net income (loss)	\$ (2,318)	\$ (7,061)	\$ (356)	\$ (16,987)
Other comprehensive income (loss):				
Foreign currency translation adjustment	(270)	118	(115)	158
Other comprehensive income (loss)	(270)	118	(115)	158
Comprehensive income (loss)	\$ (2,588)	\$ (6,943)	\$ (471)	\$ (16,829)

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

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

	Six Months Ended	
	June 30, 2018	June 30, 2017
	(restated)	
	(in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$(356)	\$(16,987)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	2,204	2,213
Amortization of intangible assets	156	170
Amortization of debt financing costs	642	781
Stock-based compensation	822	817
Accrued interest on Series B redeemable preferred stock	501	702
Paid-in-kind interest	1,256	1,196
Deferred income taxes	235	(43)
Reversal of sales returns reserve	(489)	(2,438)
Provision for doubtful accounts	144	3
Provision for obsolete inventory	1,766	1,689
Loss on disposal of property and equipment	93	—
Unrealized loss on financial instrument obligation	8,619	—
Changes in operating assets and liabilities:		
Accounts receivable	15,692	47,073
Inventories	(2,291)	(907)
Accounts payable	16,461	(601)
Prepaid expenses and other assets	(1,723)	(505)
Income taxes payable	293	329
Other liabilities	2,316	(6,845)
Net cash provided by operating activities	46,341	26,647
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(402)	(506)
Net cash used for investing activities	(402)	(506)
CASH FLOWS FROM FINANCING ACTIVITIES		
Borrowings on revolving credit facilities	81,991	51,909
Repayment of revolving credit facilities	(120,458)	(82,638)
Repayment of capital leases	—	(4)
Proceeds from term loan	3,265	—
Repayment of term loan	(2,485)	(427)
Repayment of subordinated notes - related party	(3,265)	—
Settlement of Series B Preferred Stock	(1,390)	—
Proceeds from exercise of stock options	734	—
Debt financing costs	(405)	—
Net cash used for financing activities	(42,013)	(31,160)
Effect of exchange rate changes on cash and cash equivalents	(65)	74
Net decrease in cash and cash equivalents	3,861	(4,945)
Cash and cash equivalents - beginning of period	5,247	6,183

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Cash and cash equivalents - end of period	\$9,108	\$1,238
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SUPPLEMENTAL DISCLOSURE OF INFORMATION

Cash paid for interest	\$763	\$918
Cash paid for income taxes	\$—	\$—
Exchange of Series B Preferred Stock	\$18,032	\$—

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

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

	Common Stock Shares	Amount	Additional Paid-In Capital (restated)	Accumulated Deficit (restated)	Accumulated Other Comprehensive Income (Loss)	Total Income (restated)
	(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)
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	—	—			—
Net loss	—	—	—	(356)	—	(356)
Other comprehensive income	—	—	—	—	(115)	(115)
Stock options exercised	110	1	733	—	—	734
Stock-based compensation		—	822	—	—	822
Balance at June 30, 2018	13,794	\$ 14	\$ 165,111	\$(171,009)	\$ (318)	\$(6,202)

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

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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, is the global leader in gaming headsets and has been an innovator in premier audio technology for over 40 years. The Turtle Beach® brand is highly regarded among the over 700 million gamers in North America and Europe where the Company has a leading market share in gaming headsets for Xbox and PlayStation® consoles. In addition to its gaming headset business, the Company acquired and developed an innovative and patent-protected sound technology that delivers immersive, directional audio called HyperSound®.

Turtle Beach was incorporated in the state of Nevada in 2010 and the Company’s stock is traded on the Nasdaq Global Market under the symbol HEAR.

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

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, 2017 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 6, 2018 (“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.

Reverse Split

On April 6, 2018, the Company effected a one-for-four reverse stock split of its common stock pursuant to which every four shares of common stock outstanding immediately prior to the reverse split were combined into one share of common stock. As a result of the reverse split, all outstanding share amounts and computations using such amounts in the Company’s financial statements and notes thereto have been retroactively adjusted to reflect the reverse stock split.

Restatement

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On March 13, 2019, the Audit Committee of the Board of Directors (the “Audit Committee”) of Turtle Beach Corporation (the “Company”), after considering the recommendations of management and consulting with BDO USA, LLP, the Company’s independent registered public accounting firm, concluded that its unaudited condensed consolidated financial statements included in the quarterly reports on Form 10-Q for the interim periods ended June 30, 2018, and September 30, 2018 (the “Initial Filings”) should not be relied upon because the Company had improperly accounted for the fully-funded warrants issued in connection with the Company’s exchange of Series B Preferred Stock on April 23, 2018.

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

The warrants are exercisable for a fixed number of shares of the Company's common stock, except that the warrant holders have the right to receive cash in connection with the completion of a transaction defined as a Fundamental Transaction under the warrant agreement. Upon subsequent review, the Company determined that the proper accounting treatment for the warrants due to this possible future cash conversion option was as a financial instrument obligation rather than as an equity instrument, as originally reported. Accounting for the warrants as a financial instrument obligation results in the Company reporting a liability equal to the fair value of the warrants at the time of the transaction, with subsequent changes in fair value reported quarterly in earnings based on a Black-Scholes mark-to-market valuation.

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. The fair value of the warrants upon issuance and at June 30, 2018, was \$2.6 million and \$11.2 million, respectively. This Form 10-Q/A for the period ended June 30, 2018 reflects a \$8.6 million reduction of net income from the reported amounts for the quarter resulting in a net loss of \$2.3 million, or a diluted loss per share of \$(0.17), compared to net income originally reported of \$6.3 million, or diluted earnings per share of \$0.40.

Impact of the Restatement

The following table presents the Company's condensed consolidated statements of income (loss) as previously reported, restatement adjustments and the condensed consolidated statements of income (loss) as restated for the three and six months ended June 30, 2018:

Condensed Consolidated Statements of Operations (unaudited)

	Three Months Ended			Six Months Ended		
	As Reported	Adjustment	As Restated	As Reported	Adjustment	As Restated
	(in thousands, except per-share data)					
Operating income (loss)	\$8,269	\$ —	\$8,269	\$12,055	\$ —	\$12,055
Interest expense	1,258	—	1,258	3,263	—	3,263
Other non-operating expense (income), net	410	8,619	9,029	165	8,619	8,784
Income (loss) before income tax	6,601	(8,619)	(2,018)	8,627	(8,619)	8
Income tax expense	300	—	300	364	—	364
Net income (loss)	\$6,301	\$ (8,619)	\$ (2,318)	\$8,263	\$ (8,619)	\$ (356)
Net income (loss) per share:						
Basic	\$0.47	\$ (0.64)	\$ (0.17)	\$0.64	\$ (0.67)	\$ (0.03)
Diluted	\$0.40	\$ (0.57)	\$ (0.17)	\$0.56	\$ (0.59)	\$ (0.03)
Weighted average number of shares:						
Basic	13,401	—	13,401	12,877	—	12,877
Diluted	15,644	(2,243)	13,401	14,816	(1,939)	12,877

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

The following table presents the condensed consolidated balance sheet as previously reported, restatement adjustments and the condensed consolidated balance sheet as restated at June 30, 2018:

Condensed Consolidated Balance Sheet (unaudited)

	June 30, 2018		
	As Reported	Adjustment	As Restated
	(in thousands)		
Total Current Liabilities	\$44,412	\$ —	\$44,412
Term loans, long-term portion	11,391	—	11,391
Series B redeemable preferred stock	—	—	—
Deferred income taxes	—	—	—
Subordinated notes - related party	19,092	—	19,092
Financial instrument obligation	—	11,176	11,176
Other liabilities	2,311	—	2,311
Total Liabilities	77,206	11,176	88,382
Stockholders' Equity (Deficit)			
Common stock	14	—	14
Additional paid-in capital	167,668	(2,557)	165,111
Accumulated deficit	(162,390)	(8,619)	(171,009)
Accumulated other comprehensive loss	(318)	—	(318)
Total Stockholders' Equity (Deficit)	4,974	(11,176)	(6,202)
Total Liabilities and Stockholders' Equity (Deficit)	\$82,180	\$ —	\$82,180

The following table presents the Company's condensed consolidated statement of cash flows as previously reported, restatement adjustments and the condensed consolidated statement of cash flows as restated for the six months ended June 30, 2018:

Condensed Consolidated Statements of Cash Flows (unaudited)

	Six Months Ended		
	As Reported	Adjustment	As Restated
	(in thousands)		
Net income (loss)	\$8,263	\$ (8,619)	\$(356)
Unrealized loss on financial instrument obligation	\$—	\$ 8,619	\$8,619
Net cash provided by operating activities	\$46,341	\$ —	\$46,341

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 our 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.

The Company's significant accounting policies are included in Note 1 of the Annual Report on Form 10-K for the year ended December 31, 2017. As described further in "Recent Accounting Pronouncements" below, on January 1, 2018, the Company adopted Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers. Turtle Beach's transition to the new revenue standard did not result in a material adjustment to opening retained earnings and the Company expects the adoption of the new standard to have an immaterial impact to its results of operations on an ongoing basis.

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

Revenue Recognition and Sales Return Reserve

Net revenue consists primarily of revenue from the sale of gaming headsets and accessories to wholesalers, retailers and to a lesser extent, on-line customers. These headsets function on a standalone basis (in connection with a readily available gaming console, personal computer or stereo) and are not sold with additional services or rights to future goods or services. Revenue is recorded for a contract through the following steps: (i) identifying the contract with the customer; (ii) identifying the performance obligations in the contract; (iii) determining the transaction price; (iv) allocating the transaction price to the performance obligations; and (v) recognizing revenue when or as each performance obligation is satisfied.

Each contract at inception is evaluated to determine whether the contract should be accounted for as having one or more performance obligations. Revenue is recognized when obligations under the terms of a contract with our customer are satisfied; generally this occurs at a point in time when the transfer of risk and title to the product transfers to the customer. Our standard terms of delivery are included in our contracts of sale, order confirmation documents, and invoices. The Company excludes sales taxes collected from customers from "Net Revenue" in its Consolidated Statements of Operations.

Certain customers may receive cash-based incentives (including: cash discounts, quantity rebates, price concessions), which are accounted for as variable consideration. Provisions for sales returns are recognized in the period the sale is recorded, based upon our prior experience and current trends. These revenue reductions are established by the Company based upon management's best estimates at the time of sale following the historical trend, adjusted to reflect known changes in the factors that impact such reserves and allowances, and the terms of agreements with customers. We do not expect to have significant changes in our estimates for variable considerations.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for such goods or services. The new guidance also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In 2018, the Company adopted ASU 2014-09 using the modified retrospective approach, and recorded a net decrease to beginning retained earnings of \$0.6 million reflecting the cumulative impact of adoption. The impact to beginning retained earnings was due to certain price concessions and right of return arrangements recorded as part of the transaction price determination. Results for reporting periods beginning January 1, 2018 are presented under Topic 606, Revenue from Contracts with Customers while prior period amounts were not adjusted and continue to be reported in accordance with the Company's historic accounting under Topic 605, Revenue Recognition.

In February 2016, the FASB issued ASU No. 2016-02, Leases, that introduces 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 guidance will be effective for public companies for annual reporting periods beginning after December 15, 2018, and interim periods within those fiscal years with early adoption permitted. The Company has not yet selected a transition method or determined the effect on its consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting, to provide clarity and reduce diversity in practice and cost and complexity when applying the guidance to a change to the terms or conditions of a share-based payment award. This update provides that an entity will not have to account for the effects of a modification if: (i) the fair value of the modified award is the same immediately before and after the modification; (ii) the vesting conditions of the modified award are the same immediately before and after the modification; and (iii) the classification of the modified award as either an equity instrument or liability instrument is the same immediately before and after the modification. The Company adopted these amendments in the first quarter of 2018, which did not have a material impact upon our financial condition or results of operations.

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

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

after December 15, 2020. Early adoption is permitted. The Company is evaluating the effect that this guidance will have on the financial statements and related disclosures.

Note 3. 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, and debt instruments. As of June 30, 2018 and December 31, 2017, there were no outstanding financial assets and liabilities recorded at fair value on a recurring basis and the Company had not elected the fair value option for any financial assets and liabilities for which such an election would have been permitted.

The following is a summary of the carrying amounts and estimated fair values of our financial instruments at June 30, 2018 and December 31, 2017:

	June 30, 2018		December 31, 2017	
	Reported	Fair Value	Reported	Fair Value
	(in thousands)			
Financial Assets and Liabilities:				
Cash and cash equivalents	\$9,108	\$9,108	\$5,247	\$5,247
Revolving credit facility	—	—	38,467	38,467
Term loans	12,500	13,020	11,721	11,329
Subordinated notes	19,903	22,394	21,911	22,442
Financial instrument obligation	11,176	11,176	—	—

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 fair values of our term loans and subordinated notes are based upon an estimated market value calculation that factors principal, time to maturity, interest rate and current cost of debt, which is considered a Level 3 input. The liability-classified warrants reported as a financial instrument obligation are 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.

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Note 4. 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 June 30, 2018		Six Months Ended June 30, 2017	
	2018	2017	2018	2017
	(in thousands)			
Balance, beginning of period	\$4,260	\$3,033	\$5,533	\$4,591
Reserve accrual	5,184	951	8,441	2,082
Recoveries and deductions, net	(4,400)	(1,831)	(8,930)	(4,520)
Balance, end of period	\$5,044	\$2,153	\$5,044	\$2,153

Note 5. Composition of Certain Financial Statement Items

Inventories

Inventories consist of the following:

	June 30, December 31, 2018		2017	
	(in thousands)			
Raw materials	\$1,581	\$	837	
Finished goods	26,462	26,681		
Total inventories	\$28,043	\$	27,518	

Property and Equipment, net

Property and equipment, net, consists of the following:

	June 30, December 2018		31, 2017	
	(in thousands)			
Machinery and equipment	\$1,506	\$	1,396	
Software and software development	300	383		
Furniture and fixtures	530	525		
Tooling	1,997	1,968		
Leasehold improvements	1,327	1,318		
Demonstration units and convention booths	9,308	11,719		
Total property and equipment, gross	14,968	17,309		
Less: accumulated depreciation and amortization	(12,129)	(12,632)		
Total property and equipment, net	\$2,839	\$	4,677	

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Other Current Liabilities

Other current liabilities consist of the following:

	June 30, December 31,	
	2018	2017
	(in thousands)	
Accrued vendor expenses	\$242	\$ 652
Accrued royalties	4,361	2,848
Accrued employee expenses	2,302	2,510
Accrued freight	2,242	130
Accrued expenses	4,914	5,311
Total other current liabilities	\$14,061	\$ 11,451

Note 6. Goodwill and Other Intangible Assets

Acquired Intangible Assets

Acquired identifiable intangible assets, and related accumulated amortization, as of June 30, 2018 and December 31, 2017 consist of:

	June 30, 2018		
	Gross	Accumulated	Net
	Carrying	Amortization	Book
	Value		Value
	(in thousands)		
Customer relationships	\$5,796	\$ 4,356	\$ 1,440
Foreign currency	(997)	(753)	(244)
Total Intangible Assets	\$4,799	\$ 3,603	\$ 1,196

	December 31, 2017		
	Gross	Accumulated	Net
	Carrying	Amortization	Book
	Value		Value
	(in thousands)		
Customer relationships	\$5,796	\$ 4,173	\$ 1,623
Foreign currency	(899)	(680)	(219)
Total Intangible Assets	\$4,897	\$ 3,493	\$ 1,404

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.

Amortization expense related to definite lived intangible assets of \$0.1 million and \$0.2 million was recognized for the three and six months ended June 30, 2018, respectively, and \$0.1 million and \$0.2 million for the three and six months ended June 30, 2017, respectively.

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As of June 30, 2018, estimated annual amortization expense related to definite lived intangible assets in future periods is as follows:

	(in thousands)
2018	\$ 183
2019	307
2020	258
2021	217
2022	182
Thereafter	293
Total	\$ 1,440

Note 7. Revolving Credit Facility and Long-Term Debt

	June 30, 2018	December 31, 2017
	(in thousands)	
Revolving credit facility, maturing March 2023	\$—	\$ 38,467
Term Loan Due 2018	—	1,923
Term Loan Due 2019	—	9,798
Term Loan Due 2023	12,500	—
Less: unamortized deferred financing fees	734	759
Total Term Loans	11,766	10,962
Subordinated notes - related party	19,903	21,911
Less: unamortized debt discount	811	1,075
Total Subordinated notes	19,092	20,836
Total outstanding debt	30,858	70,265
Less: current portion of revolving credit facility	—	(38,467)
Less: current portion of term loans	(375)	(4,173)
Total noncurrent portion of long-term debt	\$30,483	\$27,625

Total interest expense, inclusive of amortization of deferred financing costs, on long-term debt obligations was \$1.0 million and \$2.5 million for the three and six months ended June 30, 2018, respectively, and \$1.3 million and \$2.7 million for three and six months ended June 30, 2017, respectively. This includes related party interest of \$0.7 million and \$1.3 million for the three and six months ended June 30, 2018, respectively, and \$0.6 million and \$1.2 million for the three and six months ended June 30, 2017, respectively, incurred in connection with the subordinated notes. Amortization of deferred financing costs was \$0.2 million and \$0.6 million for the three and six months ended June 30, 2018, respectively, and \$0.4 million and \$0.8 million for the three and six months ended June 30, 2017, respectively. In connection with the Company's amendment and restatement of its Credit Facility (as noted below), the Company incurred \$0.4 million of financing costs that have been deferred and will be recognized over the term of the respective agreements.

Revolving Credit Facility

On March 5, 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, 2023, provides for a line of credit of up to \$60 million inclusive of a sub-facility limit of \$12 million for TB Europe, a wholly-owned subsidiary of Turtle Beach. The Credit Facility may be used for working capital, the issuance of bank guarantees, letters of credit and other corporate purposes.

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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.

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 U.S. base rate loans and between 1.50% to 2.25% for U.S. LIBOR loans and U.K. loans. As of June 30, 2018, interest rates for outstanding borrowings were 5.50% for base rate loans and 3.74% for LIBOR rate loans. 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.

The Company is subject to monthly financial covenant testing for so long as revolving commitments or obligations are outstanding. The Credit Facility requires the Company and its restricted subsidiaries to maintain a fixed charge coverage ratio of at least 1.10 to 1.00 on the last day of each month, a consolidated leverage ratio of greater than 3.00 to 1.00, as well as a limit to Capital Expenditures and HyperSound Division Net Operating Disbursement (as defined in the Credit Facility).

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 June 30, 2018, the Company was in compliance with all financial covenants, as amended, and excess borrowing availability was approximately \$30.5 million.

Term Loans

Term Loan Due 2018

On December 29, 2014, the Company amended the Credit Facility with Bank of America to enter in to an additional loan (the "Term Loan Due 2018") for the repayment of \$7.7 million of then existing subordinated debt and accrued interest. The Term Loan Due 2018 resulted in modified financial covenants while it was outstanding, had an interest rate of LIBOR plus 5% and was subject to equal monthly installments beginning on April 1, 2015 and ending on October 1, 2018, reflecting a six month waiver. On March 5, 2018, the Company repaid the remaining \$1.3 million principal balance.

Term Loan Due 2019

On July 22, 2015, the Company and its subsidiaries, entered into a term loan, guaranty and security agreement (the "Term Loan Due 2019") with Crystal Financial LLC, as agent, sole lead arranger and sole bookrunner, Crystal Financial SPV LLC and the other persons party thereto ("Crystal"), which provided for an aggregate term loan commitment of \$15 million with an interest rate per annum equal to the 90-day LIBOR rate plus 10.25%. Under the terms of the Term Loan Due 2019, the Company was required to make payments of interest in arrears on the first day of each month beginning August 1, 2015 and repay the principal in monthly payments that began January 1, 2016, inclusive of a nine month waiver, with a final payment on June 28, 2019, the maturity date.

Term Loan Due 2023

On March 5, 2018, the Company and its subsidiaries, entered into an amended, extended and restated term loan, guaranty and security agreement (the “Term Loan Due 2023”) with Crystal, as agent, sole lead arranger and sole bookrunner and the Lenders from time to time party thereto, which replaced the then existing Term Loan Due 2019 and provides for a maximum aggregate term loan of \$12.5 million, at an interest rate per annum equal to the 90-day LIBOR rate plus 6.75%. As of June 30, 2018, \$12.5 million was outstanding with the additional \$3.3 million borrowed on May 2, 2018. Under the terms of the Term Loan Due 2023, the Company is required to make payments of interest in arrears on the first day of each month and will repay the principal in monthly payments beginning April 1, 2019, with a final payment on March 5, 2023, the maturity date.

The Term Loan Due 2023 is secured by a security interest in substantially all of the Company and each of its subsidiaries' working capital assets and is subject to the first-priority lien of Bank of America, as agent, under the Credit Facility, other than

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with respect to equipment, fixtures, real property interests, intellectual property, intercompany property, intercompany indebtedness, equity interest in their subsidiaries, and certain other assets specified in an inter-creditor agreement between Bank of America and Crystal.

The Company and its subsidiaries are required to comply with various customary covenants including, (i) maintaining a fixed charge coverage ratio of at least 1.10 to 1.00, (ii) maintaining a Consolidated Leverage Ratio (as defined in the Term Loan Due 2023) to be measured on the last day of each month while the term loans are outstanding of no more than 3.00:1, (iii) not making capital expenditures in excess of the amount stated therein in any year until December 31, 2023, (iv) restrictions on the Company's and its subsidiaries ability to prepay its subordinated notes, pay dividends, incur debt, create or suffer liens and engage in certain fundamental transactions and (v) an obligation to provide certain financial and other information.

The Term Loan Due 2023 contains customary representations, mandatory prepayment events and events of default, including defaults triggered by the failure to make payments when due, breaches of covenants and representations, material impairment in the perfection of Crystal's security interest in the collateral and events related to bankruptcy and insolvency of the Company and its subsidiaries. Upon an event of default, Crystal may declare all outstanding obligations immediately due and payable (along with a prepayment fee), impose a default rate of an additional 2.0% to amounts outstanding and may take other actions including collecting or taking such other action with respect to the collateral pledged in connection with the term loan.

As of June 30, 2018, the Company was in compliance with all the financial covenants.

Subordination Agreement

On November 16, 2015, as a condition precedent to the Company's lenders permitting the Company to enter into certain subordinated notes, the Company entered into a subordination agreement with and between Bank of America and Crystal, pursuant to which the parties agreed that the Company's obligations under any such notes would be subordinate in right of payment to the payment in full of all the Company's obligations under the Credit Facility, the then existing Term Loan Due 2019 and the current Term Loan Due 2023.

Subordinated Notes - Related Party

During 2015, the Company issued a \$5.0 million subordinated note (the "April Note"), subordinated notes (the "May Notes") with an aggregate principal amount of \$3.8 million and a subordinated note (the "June Note") with an aggregate principal amount of \$9.0 million to SG VTB Holdings, LLC, the Company's largest stockholder ("SG VTB"), and a trust affiliated with Ronald Doornink, the Chairman of the Company's board of directors (the "Board"). The subordinated notes were issued with an interest rate of (i) 10% per annum for the first year and (ii) 20% per annum for all periods thereafter, with interest accruing and being added to the principal amount of the note quarterly.

On July 22, 2015, the Company amended and restated each of its outstanding subordinated notes (the "Amended Notes"). The obligations of the Company under the Amended Notes are subordinate and junior to the prior payment of amounts due under the then existing credit facility and term loans. In addition, the stated maturity date of the Amended Notes was extended to September 29, 2019, subject to acceleration in certain circumstances, such as a change of control in the Company. The Amended Notes were issued with an interest rate per annum equal to LIBOR plus 10.5% and were paid-in-kind by adding the amount to the principal amount due. Further, as consideration for the concessions in the Amended Notes, the Company issued warrants to purchase 0.4 million of the Company's common stock at an exercise price of \$10.16 per share.

On November 16, 2015, the Company issued a \$2.5 million subordinated note (the "November Note") to SG VTB, the proceeds of which, as set forth in the amendment to the Term Loan Due 2019, were applied against the outstanding balance of the Term Loan Due 2019. The November Note was issued with an interest rate of 15% per annum until its

maturity date, which was September 29, 2019, and was subordinated to all senior debt of the Company.

In consideration of the credit extended under the November Note, VTB and VTBH entered into a Third Lien Continuing Guaranty, (as amended, the "Third Lien Guaranty"), under which they guarantee and promise to pay to SG VTB, any and all obligations of the Company under the November Note. To secure the Company's obligations under the November Note and the Third Lien Guaranty, the Company entered into a Third Lien Security Agreement, dated as of November 16, 2015, pursuant to which Stripes was granted a security interest upon all property of the VTB and VTBH until the payment in full of the Amended Notes and November Note or the release of the guarantee or collateral, as applicable. Concurrent with entering into the

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November Note and Third Lien Guaranty, the Company also issued a warrant to purchase 0.3 million shares of the Company's common stock at an exercise price of \$8.00 per share.

On March 5, 2018, the Company amended and restated the Amended Notes with an aggregate principal amount of \$18.9 million and the November Note with an aggregate principal amount of \$3.5 million. The amended subordinated notes bear in-kind interest at a rate of (i) LIBOR plus 9.1% per annum until March 5, 2020 (or, solely with respect to the November Note, until September 5, 2018) or until its maturity date, which is June 5, 2023, provided that its principal amount is reduced by a specified amount by the six month anniversary of the restatement effective date and (ii) LIBOR plus 10.5% per annum (or, solely with respect to the November Note, 15.0% if the prepayment described above does not occur) until its maturity date.

On May 4, 2018, the Company satisfied the repayment provision with a \$3.3 million repayment of the November Note with funds from the Term Loan Due 2023. Further, on August 3, 2018, the Company paid down an additional \$5.0 million with funds from operations.

SG VTB is an affiliate of Stripes Group LLC ("Stripes"), a private equity firm focused on internet, software, healthcare IT and branded consumer products businesses. Kenneth A. Fox, one of our directors, is the managing general partner of Stripes and the sole manager of SG VTB, and Ronald Doornink, our Chairman of the Board, is an operating partner of Stripes.

Note 8. Income Taxes

In order to determine the quarterly provision for income taxes, we use 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, we determine the quarterly 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 quarter during which they occur and can be a source of variability in the effective tax rates from quarter to quarter.

The following table presents our income tax expense (benefit) and effective income tax rate:

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	2018	2017	2018	2017
	(in thousands)			
Income tax expense	\$300	\$475	\$364	\$520
Effective income tax rate	(14.9)%	(7.2)%	4,550%	(3.2)%

Income tax expense for the three and six months ended June 30, 2018 was \$0.3 million at an effective tax rate of (14.9)% and, \$0.4 million at an effective tax rate of 4,550.0%, respectively. Income tax expense for the three and six months ended June 30, 2017 was \$0.5 million at an effective tax rate of (7.2)% and \$0.5 million at an effective tax rate of (3.2)%, respectively. The effective tax rate was primarily impacted by the full valuation allowance on domestic earnings, foreign entity tax benefits and certain state tax expense.

The Company is subject to income taxes domestically and in various foreign jurisdictions. Significant judgment is required in evaluating uncertain tax positions and determining its 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 statement of operations. As of June 30, 2018, the Company had uncertain tax positions of \$2.3 million, inclusive of \$0.8 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 2013 through 2016, and the state tax years open under the statute of limitations are 2012 through 2016. The Company's federal income tax return for year ended December 31, 2015 is currently under IRS examination.

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Note 9. 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 comprised as follows:

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	2018	2017	2018	2017
	(in thousands)			
Cost of revenue	\$313	\$(1)	\$331	\$(86)
Selling and marketing	30	20	55	56
Research and development	33	63	63	120
General and administrative	223	349	373	727
Total stock-based compensation	\$599	\$431	\$822	\$817

The following table presents the stock activity and the total number of shares available for grant as of June 30, 2018:

	(in thousands)				
Balance at December 31, 2017	387				
Plan Amendment	1,500				
Options granted	(445)				
Restricted Stock granted	(198)				
Forfeited/Expired shares added back	142				
Balance at June 30, 2018	1,386				
Stock Option Activity					
	Options Outstanding Number of Shares Underlying Outstanding Options	Weighted-Average Exercise Price	Weighted-Average Contractual Term	Remaining	Aggregate Intrinsic Value
			(In years)		
Outstanding at December 31, 2017	1,740,103	\$ 6.20	6.64		\$6
Granted	445,195	3.55			
Exercised	(109,681)	6.69			
Forfeited	(142,297)	7.83			
Outstanding at June 30, 2018	1,933,320	\$ 5.44	7.40		\$28,762,929
Vested and expected to vest at June 30, 2018	1,875,294	\$ 5.56	7.34		\$27,788,808
Exercisable at June 30, 2018	949,598	\$ 7.42	5.69		\$12,348,636

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 2013 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

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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 \$1.1 million for the six months ended June 30, 2018.

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 six months ended June 30, 2018.

Expected term (in years)	6.1
Risk-free interest rate	2.3% - 3.0%
Expected volatility	38.2% - 39.5%
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 six months ended June 30, 2018 was \$1.49.

The total estimated fair value of employee options vested during the six months ended June 30, 2018 was \$0.4 million. As of June 30, 2018, total unrecognized compensation cost related to non-vested stock options granted to employees was \$1.4 million, which is expected to be recognized over a remaining weighted average vesting period of 3.0 years.

Restricted Stock Activity

	Shares	Weighted Average Grant Date Fair Value Per Share
Nonvested restricted stock at December 31, 2017	41,867	3.84
Granted	198,247	17.60
Vested	(27,978)	4.02
Nonvested restricted stock at June 30, 2018	212,136	16.68

As of June 30, 2018, total unrecognized compensation cost related to the nonvested restricted stock awards, which will be recognized over a remaining weighted average vesting period of 3.0 years was minimal.

Stock Warrants

In connection with and as consideration for the concessions in the Amended Notes, the Company issued to SG VTB and a trust affiliated with Ronald Doornink, the Chairman of the Board, warrants to purchase an aggregate 0.4 million shares of the Company's common stock at an exercise price of \$10.16 per share. The warrants are exercisable for a period of five years beginning on the date of issuance, July 22, 2015. The exercise price and the number of purchasable shares of common stock are subject to adjustment and do not carry any voting rights or other rights as a stockholder of the Company prior to exercise.

In connection with the November Note, the Company issued warrants to purchase 0.3 million shares of the Company's common stock at an exercise price of \$8.00 per share to SG VTB. The exercise price and the number of purchasable shares of common stock are subject to standard anti-dilution adjustments and do not carry any voting rights as a stockholder of the Company prior to exercise. The warrants are exercisable for a period of ten years beginning on the date of issuance and do not entitle the holder to any voting rights or other rights as a stockholder of the Company prior to exercise.

The warrants entitle the holder to purchase a stated amount of shares of common stock at a fixed exercise price that are not puttable (either the warrant or the shares) to the Company or redeemable for cash, and as such are classified within equity. The shares issuable upon exercise of the warrants are also subject to the “demand” and “piggyback” registration rights set forth in the in the Company’s Stockholder Agreement, dated August 5, 2013, as amended July 10, 2014.

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Note 10. 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		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
	(in thousands, except per-share data)			
Net income (loss)	\$(2,318)	\$(7,061)	\$(356)	\$(16,987)
Weighted average common shares outstanding — Basic	13,401	12,337	12,877	12,325
Plus incremental shares from assumed conversions:				
Dilutive effect of restricted stock	—	—	—	—
Dilutive effect of stock options	—	—	—	—
Dilutive effect of warrants	—	—	—	—
Weighted average common shares outstanding — Diluted	13,401	12,337	12,877	12,325
Net income (loss) per share:				
Basic	\$(0.17)	\$(0.57)	\$(0.03)	\$(1.38)
Diluted	\$(0.17)	\$(0.57)	\$(0.03)	\$(1.38)

Incremental shares from stock options and restricted stock awards are computed by 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, unrecognized compensation expense for outstanding awards and the estimated tax benefit of the assumed exercises.

	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
	(in thousands)			
Stock options	1,945	1,602	1,833	1,591
Warrants	1,314	765	965	766
Unvested restricted stock awards	62	34	52	30
Total	3,321	2,401	2,850	2,387

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Note 11. Segment and Geographic Information

The following tables show our net revenues, operating income and total assets by our reporting segments:

	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
Net Revenues	(in thousands)			
Headset	\$60,805	\$19,084	\$101,673	\$33,344
HyperSound	—	28	18	120
Total	\$60,805	\$19,112	\$101,691	\$33,464
Operating Income (Loss)				
Headset	\$8,369	\$(4,542)	\$12,166	\$(11,598)
HyperSound	(100)	(423)	(111)	(1,459)
Total	8,269	(4,965)	12,055	(13,057)
Interest Expense	1,258	1,835	3,263	3,675
Other non-operating expense (income), net	9,029	(214)	8,784	(265)
Income (loss) before income tax	\$(2,018)	\$(6,586)	\$8	\$(16,467)

	June 30, 2018	December 31, 2017
Total Assets	(in thousands)	
Headset	\$82,194	\$94,114
HyperSound ⁽¹⁾	36,402	26,787
Eliminations	(36,416)	(26,650)
Total	\$82,180	\$94,251

(1) At June 30, 2018, HyperSound assets excluding eliminations, totaled less than \$0.1 million.

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

	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
	(in thousands)			
North America	\$45,967	\$12,996	\$78,951	\$24,051
United Kingdom	7,628	2,124	11,657	3,978
Europe	5,858	2,769	9,105	3,937
Other	1,352	1,223	1,978	1,498
Total net revenues	\$60,805	\$19,112	\$101,691	\$33,464

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Note 12. 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) 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 cases 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.

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 interests 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. VTB maintains that its termination of the agreement was valid and that BigBen's claims against it are without merit. VTB's statement of defense was submitted to the plaintiff. BigBen submitted additional written pleadings on January 4, 2018 and on April 19, 2018. VTB submitted further written pleadings on March 20, 2018 and March 29, 2018. VTB argues inter alia that the courts of Berlin do not have jurisdiction. On April 23, 2018, an oral hearing was held at the Regional Court of Berlin that focused exclusively on the question of jurisdiction. Following such oral hearing, the court rendered an interim judgment by which it accepted jurisdiction. The parties are currently awaiting the court's decision on the further process in the litigation.

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 June 30, 2018 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.

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

Warranties

We warrant our 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 warranties, which are included in accrued liabilities:

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	2018	2017	2018	2017
	(in thousands)			
Warranty, beginning of period	\$534	\$589	\$472	\$639
Warranty costs accrued	210	54	444	114
Settlements of warranty claims	(162)	(113)	(334)	(223)
Warranty, end of period	\$582	\$530	\$582	\$530

Note 13. Series B Preferred Stock Exchange Transactions and Settlement

In September 2010, VTBH issued 1,000,000 shares of its Series B Redeemable Preferred Stock with a fair value of \$12.4 million. The Series B Redeemable Preferred Stock was required to be redeemed on the earlier of September 28, 2030, or the occurrence of a liquidation event at its original issue price of \$12.425371 per share plus any accrued but unpaid dividends.

On February 18, 2015, Dr. John Bonanno (“Dr. Bonanno”), the original holder of the Series B Redeemable Preferred Stock of VTB Holdings, Inc. (the “Series B Preferred Stock”) filed a complaint in Delaware Chancery Court alleging breach of contract. According to the complaint, the Merger purportedly triggered a contractual obligation for VTBH to redeem Dr. Bonanno's stock. Dr. Bonanno requested a declaratory judgment stating that he was entitled to damages, including a redemption of his stock valued at \$15.1 million (equal to the original issue price of his stock plus accrued dividends) as well as other costs and expenses.

On April 23, 2018, the Company facilitated and entered into a series of transactions pursuant to which the Series B Preferred Stock was acquired from Dr. Bonanno by non-affiliate investors and subsequently retired. As part of the transactions, the Company entered into (i) an Exchange Agreement (the “Exchange Agreement”) with such non-affiliate investors pursuant to which the Company agreed to exchange the Series B Preferred Stock for an aggregate of 1,307,143 newly issued shares of the Company’s common stock and pre-funded warrants exercisable for an aggregate of 550,000 shares of the Company's common stock and (ii) a Settlement Agreement (the “Settlement Agreement”) with Dr. Bonanno

Pursuant to the Settlement Agreement, Dr. Bonanno agreed to discontinue certain previously disclosed claims and actions against the Company related to the Series B Preferred Stock, as well as to provide a release of the Company with respect to all such claims and any other claims related to Dr. Bonanno’s ownership or disposition of the Series B Preferred Stock. In connection with and as consideration thereof, the Company agreed to pay Dr. Bonanno a cash sum of \$1.0 million to settle non-redemption claims in connection with the matter, and to pay an additional \$1.25 million if a change of control transaction meeting certain specified requirements is consummated within three years of the date of the Settlement Agreement.

Accordingly, on April 26, 2018, all exchanged shares of Series B Preferred Stock were retired, and no shares of Series B Preferred stock remain outstanding. The redemption value of the Series B Preferred Stock was \$19.4 million as of the transaction date, and \$18.9 million as of December 31, 2017.

The Company assessed the relative fair values of the Series B Preferred Stock retired pursuant to the Exchange Agreement and the litigation settlement in the Settlement Agreement to determine the amount of the total transaction consideration transferred that was allocable to each component. The Company determined the fair value of the Series B Preferred Stock to be greater than the total consideration transferred. In addition, the Company was not able to reliably estimate the fair value of the litigation settlement. Based on these fair value assessments, the Company utilized the residual approach and first allocated proceeds to the Series B Preferred Stock, which resulted in no amount of the consideration being allocated to the litigation settlement. Accordingly, the entire transaction was accounted for as an equity transaction with the difference between the carrying value of the Series B Preferred Stock and the fair value of the consideration transferred included in stockholders' equity. The warrants issued in connection with the retirement of the Series B Preferred Stock are accounted for as a financial instrument obligation. See Note 1, "Background and Basis of Presentation," for further details.

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/A and with our audited consolidated financial statements and the related notes included in our Annual Report on Form 10-K filed with the Securities Exchange Commission on March 7, 2018 (the "Annual Report.")

This Report on Form 10-Q/A 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. C 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/A, 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 audio technology company with expertise and experience in developing, commercializing and marketing innovative products across a range of large addressable markets operating under two reportable segments, Turtle Beach® ("Headset") and HyperSound®.

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. HyperSound technology is an innovative patent-protected sound technology that delivers immersive, directional audio with applications in digital signage and kiosks, consumer electronics and hearing healthcare.

Business Trends

Gaming Headset Market

Gaming headsets are part of a global, growing gaming market sized at over \$100 billion. Global gaming now exceeds both global cinema and global music market sizes with over 2.1 billion active gamers worldwide. Gaming peripherals are a \$2 billion business globally with over 75%, over \$800 million, of that market in the Americas and Europe where the company's business is focused. Gaming headsets are nearly half of that, at over \$1 billion in global market size.

eSports is a global phenomenon where professional gamers train, compete, win prize money and attract fans similar to other professional sports. There are over 140 million eSports enthusiasts globally and growing quickly. Gaming headsets are a must-have piece of equipment for competitive gaming.

Xbox and PlayStation® consoles are the dominant gaming platforms in North America and Europe. Many gamers play online where gaming headsets - which include a microphone and allow players to communicate with one another in real time - provide the ability to jump in and engage in the industry's most popular games and franchises. Gaming headsets also create a more immersive and rich gaming experience. In addition to consoles, personal computers are a key platform for gaming and utilize similar style headsets with the requisite benefits. Gaming on mobile/tablet devices represents about a third of the global gaming market and headsets can be used for mobile gaming, but Xbox, PlayStation®, and PC gaming are by far the largest drivers of gaming headset use. Nintendo Switch™ has emerged as a popular gaming platform, although much less of a driver of gaming headset sales.

Historically, Microsoft and Sony go through cycles where their respective console platform is changed and/or updated to a significant new version. In holiday 2013, Microsoft launched Xbox One to replace Xbox 360, while Sony launched Playstation®4 to replace Playstation®3. Those console transitions created a major disruption for gaming headsets and other

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accessories because the fundamental connectivity to the new platforms changed. From 2013 to 2015, that disruption negatively impacted the gaming accessory market as the old generation headset business rapidly declined and new headsets had to be developed for the new consoles. In 2016 and 2017, respectively, both Microsoft and Sony launched “Pro” versions of their latest console platforms which didn’t create any disruption for the gaming headset business and the Company believes this is a positive indication that any potential future console changes will not be as disruptive.

In addition to console sales, the Xbox, PlayStation®, and PC gaming markets are driven by major games that encourage players to buy equipment and accessories. On Xbox and PlayStation®, tentpole games like Call of Duty®, Destiny, Battlefield, Grand Theft Auto and more recently Fortnite and PlayerUnknown’s Battlegrounds are examples of major franchises that feature online multiplayer modes, which drive gaming headset sales. Many of these established franchises launch new titles annually leading into the holidays, which furthers the popularity of gaming headsets as gift items. As a result, the gaming headset business is highly seasonal, often with 45%-55% of the business occurring in the fourth quarter. The gaming headset business can also expand or contract based on the success of these major game launches.

During 2017, PlayerUnknown’s Battlegrounds introduced a new style of multiplayer game known as “battle royale,” where players compete in a large, but shrinking map until a single winner remains. Players can play on teams, and audio cues are very helpful to surviving, making headsets a key accessory for this type of game. Epic Games introduced Fortnite which includes a similar format in late 2017, but with a more kid-friendly feel. Both games have soared in popularity over the past several months with large and growing audiences of both players and spectators via content sharing platforms like Twitch, YouTube, Xbox’s Mixer, and PlayStation® Now.

Gaming headsets are sold through major retailers such as Argos, Best Buy, GameStop, Target and Walmart as well as online retailers such as Amazon and NewEgg. Brick and mortar retailers often have “kiosks” which enable shoppers to “try before they buy,” offering consumers the opportunity to 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 (loss), the nearest GAAP financial measure) for the three and six months ended June 30, 2018 and 2017, are as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
	(in thousands)			
Net income (loss)	\$(2,318)	\$(7,061)	\$(356)	\$(16,987)
Interest expense	1,258	1,835	3,263	3,675
Depreciation and amortization	1,333	1,530	2,360	2,383
Stock-based compensation	599	431	822	817
Income tax expense	300	475	364	520
Unrealized loss on financial instrument obligation	8,619	—	8,619	—
Restructuring charges	—	(30)	—	268
Business model transition charge	—	—	—	353
Adjusted EBITDA	\$9,791	\$(2,820)	\$15,072	\$(8,971)

Comparison of the Three Months Ended June 30, 2018 to the Three Months Ended June 30, 2017

Net loss for the three months ended June 30, 2018 was \$2.3 million, including a \$8.6 million unrealized loss on a financial instrument obligation, compared to a net loss of \$7.1 million in the prior year period, including \$6.4 million of net income and \$6.6 million of net loss attributable to the Headset business, respectively.

For the three months ended June 30, 2018, Adjusted EBITDA on a consolidated basis was \$9.8 million compared to \$(2.8) million, including investments of \$0.2 million in the HyperSound business during the three months ended June 30, 2017. Net loss decreased and Adjusted EBITDA increased on higher revenues and fixed cost leveraging margin improvement as a result of strong consumer demand driven by the continued popularity of the “battle royale” style games Fortnite and PlayerUnknown’s Battlegrounds.

Comparison of the Six Months Ended June 30, 2018 to the Six Months Ended June 30, 2017

Net loss for the six months ended June 30, 2018 was \$(0.4) million, including a \$8.6 million unrealized loss on a financial instrument obligation, compared to a net loss of \$17.0 million in the prior year period, including \$8.4 million of net income and \$15.5 million of net loss attributable to the Headset business, respectively.

For the six months ended June 30, 2018, Adjusted EBITDA on a consolidated basis was \$15.1 million compared to \$(9.0) million, including investments of \$0.8 million in the HyperSound business, during the six months ended June 30, 2017. Net loss decreased and Adjusted EBITDA increased on higher revenues and fixed cost leveraging margin improvement as a result of strong consumer demand related to new “battle royale” style game launches Fortnite and PlayerUnknown’s Battlegrounds.

Results of Operations

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
	(in thousands)			
Net revenue	\$60,805	\$19,112	\$101,691	\$33,464
Cost of revenue	40,528	12,811	66,385	24,947
Gross profit	20,277	6,301	35,306	8,517
Operating expenses	12,008	11,266	23,251	21,574
Operating income (loss)	8,269	(4,965)	12,055	(13,057)
Interest expense	1,258	1,835	3,263	3,675
Other non-operating expense (income), net	9,029	(214)	8,784	(265)
Income (loss) before income tax	(2,018)	(6,586)	8	(16,467)
Income tax expense	300	475	364	520
Net income (loss)	\$(2,318)	\$(7,061)	\$(356)	\$(16,987)

Net Revenue and Gross Profit

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
	(in thousands)			
Net Revenue	\$60,805	\$19,112	\$101,691	\$33,464
Gross Profit	\$20,277	\$6,301	\$35,306	\$8,517
Gross Margin	33.3 %	33.0 %	34.7 %	25.5 %
Cash Margin (1)	34.0 %	34.0 %	35.3 %	26.1 %

(1) Excludes non-cash charges

Comparison of the Three Months Ended June 30, 2018 to the Three Months Ended June 30, 2017

Net revenues for the three months ended June 30, 2018 were \$60.8 million, a \$41.7 million increase and more than triple the net revenues of \$19.1 million in the comparable prior year period as blockbuster "battle royale" style games continued to drive significant gains in sales of gaming headsets from new gamers and upgrade purchases from existing players. Higher volumes across all channels were driven by demand for the Ear Force Recon 50 Series, Stealth 600 Series and Recon Chat headsets.

For the three months ended June 30, 2018, gross profit as a percentage of net revenue increased to 33.3% from 33.0% in the comparable prior year period. Headset margins were positively impacted by higher volume driving fixed-cost leveraging, and lower obsolescence reserves resulting from higher than normal first half sales volumes. These improvements were partially offset by incremental air freight (\$2.8 million) as consumer demand depleted inventory levels.

Comparison of the Six Months Ended June 30, 2018 to the Six Months Ended June 30, 2017

Net revenues for the six months ended June 30, 2018 were \$101.7 million, a \$68.2 million increase and more than triple the net revenues of \$33.5 million in the comparable prior year period. This increase was driven by higher volumes across all channels as the blockbuster releases of Fortnite and PlayerUnknown's Battlegrounds helped fuel

strong consumer demand and introduced new gamers into the gaming headset market where the Company was well-positioned to grow market share in our core markets.

For the six months ended June 30, 2018, gross profit as a percentage of net revenue increased to 34.7% from 25.5% in the comparable prior year period. Headset margins were positively impacted by higher volume driving fixed-cost leveraging and a less promotional environment as compared to the prior year period in which channel inventories were much higher than normal following weaker than expected 2016 performance of the major holiday game releases.

Operating Expenses

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	2018	2017	2018	2017
	(in thousands)			
Selling and marketing	\$6,818	\$5,529	\$12,747	\$9,978
Research and development	1,327	1,697	2,656	3,087
General and administrative	3,863	4,070	7,848	8,241
Restructuring charges	—	(30)	—	268
Total operating expenses	\$12,008	\$11,266	\$23,251	\$21,574

By Segment:

Headset	\$12,008	\$10,901	\$23,251	\$20,735
HyperSound	\$—	\$365	\$—	\$839

Selling and Marketing

Selling and marketing expenses for the three months ended June 30, 2018 totaled \$6.8 million, or 11.2% as a percentage of net revenues, compared to \$5.5 million, or 28.9% as a percentage of net revenues, for the three months ended June 30, 2017. This increase was primarily due to variable sales-based commissions and compensation, expansion of our eSports presence and certain website related costs.

Selling and marketing expenses for the six months ended June 30, 2018 totaled \$12.7 million, or 12.5% as a percentage of net revenues, compared to \$10.0 million, or 29.8% as a percentage of net revenues, for the six months ended June 30, 2017. This increase was primarily due to variable sales-based commissions and compensation, higher volume-based web costs and increased marketing spend related to our website, eSports presence, in-store promotional material and direct media buys.

Research and Development

Research and development decreased slightly year-over-year on lower non-cash expenses as we continue to invest in the resources that we believe are necessary to maintain and expand our technical capability to manufacture multiple product lines that incorporate the latest technologies.

General and Administrative

General and administrative expenses for the three months ended June 30, 2018 totaled \$3.9 million compared to \$4.1 million for the three months ended June 30, 2017 as lower non-cash stock compensation charges and a reduction in professional service charges were partially offset by higher variable compensation costs.

General and administrative expenses for the six months ended June 30, 2018 totaled \$7.8 million compared to \$8.2 million for the six months ended June 30, 2017. In addition to certain royalty settlements in the comparable prior-year period, the reduction was attributable to lower non-cash stock compensation charges and a reduction in professional service charges, partially offset by certain other fees related to debt refinance activities and higher legal costs.

Interest Expense

For the three and six months ended June 30, 2018, interest expense decreased as compared to June 30, 2017 due to lower borrowing costs on our Term Loan Due 2023 and exchange of the Series B Preferred Stock.

Other Non-Operating Expense (Income)

Other non-operating expense totaled \$9.0 million and \$8.8 million for the three and six months ended June 30, 2018, respectively, including a \$8.6 million loss from the change in fair value of a financial instrument and the negative exchange impact of the stronger U.S. dollar on our foreign operations. Other non-operating income totaled \$0.2 million and \$0.3 million for the three and six months ended June 30, 2017, respectively, as a result of the U.S. dollar weakening.

Income Taxes

Income tax expense for the three and six months ended June 30, 2018 was \$0.3 million at an effective tax rate of (14.9)% and, \$0.4 million at an effective tax rate of 4,550.0%, respectively. Income tax expense for the three and six months ended June 30, 2017 was \$0.5 million at an effective tax rate of (7.2)% and \$0.5 million at an effective tax rate of (3.2)%, respectively. The effective tax rate was primarily impacted by the full valuation allowance on domestic earnings, foreign entity tax benefits and certain state tax expense.

Liquidity and Capital Resources

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

The following table summarizes our sources and uses of cash:

	Six Months Ended June 30, 2018 2017 (in thousands)	
Cash and cash equivalents at beginning of period	\$5,247	\$6,183
Net cash provided by operating activities	46,341	26,647
Net cash used for investing activities	(402)	(506)
Net cash used for financing activities	(42,013)	(31,160)
Effect of foreign exchange on cash	(65)	74
Cash and cash equivalents at end of period	\$9,108	\$1,238

Operating activities

Cash provided by operating activities for the six months ended June 30, 2018 was \$46.3 million, an increase of \$19.7 million as compared to \$26.6 million for the six months ended June 30, 2017. The increase is primarily the result of higher gross receipts from the significant increase in revenue and improved days sales outstanding partially offset by higher inventory levels and freight costs.

Investing activities

Cash used for investing activities was \$0.4 million for the six months ended June 30, 2018 compared to \$0.5 million in the prior period primarily due to certain advertising display and manufacturing investments.

Financing activities

Net cash used for financing activities was \$42.0 million during the six months ended June 30, 2018 compared to \$31.2 million during the six months ended June 30, 2017. Financing activities during the six months ended June 30, 2018 included net

repayments on our revolving credit facility of \$38.5 million and term loan repayments of \$2.5 million. Financing activities during the six months ended June 30, 2017 included net repayments on our revolving credit facility of \$30.7 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 June 30, 2018 and December 31, 2017 were \$2.9 million and \$0.1 million, respectively.

Revolving Credit Facility

On March 5, 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, 2023, provides for a line of credit of up to \$60 million inclusive of a sub-facility limit of \$12 million for TB Europe, a wholly-owned subsidiary of Turtle Beach. The Credit Facility may be used for working capital, the issuance of bank guarantees, letters of credit and other corporate purposes.

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.

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 U.S. base rate loans and between 1.50% to 2.25% for U.S. LIBOR loans and U.K. loans. As of June 30, 2018, interest rates for outstanding borrowings were 5.50% for base rate loans and 3.74% for LIBOR rate loans. 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.

The Company is subject to monthly financial covenant testing for so long as revolving commitments or obligations are outstanding. The Credit Facility requires the Company and its restricted subsidiaries to maintain a fixed charge coverage ratio of at least 1.10 to 1.00 on the last day of each month, a consolidated leverage ratio of greater than 3.00 to 1.00, as well as a limit to Capital Expenditures and HyperSound Division Net Operating Disbursement (as defined in the Credit Facility).

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 June 30, 2018, the Company was in compliance with all financial covenants, as amended, and excess borrowing availability was approximately \$30.5 million.

Term Loan Due 2018

On December 29, 2014, the Company amended the Credit Facility with Bank of America to enter in to an additional loan (the “Term Loan Due 2018”) for the repayment of \$7.7 million of then existing subordinated debt and accrued interest. The Term Loan Due 2018 resulted in modified financial covenants while it was outstanding, had an interest rate of LIBOR plus 5% and was subject to equal monthly installments beginning on April 1, 2015 and ending on October 1, 2018, reflecting a six month waiver. On March 5, 2018, the Company repaid the remaining \$1.3 million

principal balance.

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Term Loan Due 2019

On July 22, 2015, the Company and its subsidiaries, entered into a term loan, guaranty and security agreement (the “Term Loan Due 2019”) with Crystal Financial LLC, as agent, sole lead arranger and sole bookrunner, Crystal Financial SPV LLC and the other persons party thereto (“Crystal”), which provided for an aggregate term loan commitment of \$15 million with an interest rate per annum equal to the 90-day LIBOR rate plus 10.25%. Under the terms of the Term Loan Due 2019, the Company was required to make payments of interest in arrears on the first day of each month beginning August 1, 2015 and repay the principal in monthly payments that began January 1, 2016, inclusive of a nine month waiver, with a final payment on June 28, 2019, the maturity date.

Term Loan Due 2023

On March 5, 2018, the Company and its subsidiaries, entered into an amended, extended and restated term loan, guaranty and security agreement (the “Term Loan Due 2023”) with Crystal, as agent, sole lead arranger and sole bookrunner and the Lenders from time to time party thereto, which replaced the then existing Term Loan Due 2019 and provides for a maximum aggregate term loan of \$12.5 million, at an interest rate per annum equal to the 90-day LIBOR rate plus 6.75%. As of June 30, 2018, \$12.5 million was outstanding with the additional \$3.3 million borrowed on May 2, 2018. Under the terms of the Term Loan Due 2023, the Company is required to make payments of interest in arrears on the first day of each month and will repay the principal in monthly payments beginning April 1, 2019, with a final payment on March 5, 2023, the maturity date.

The Term Loan Due 2023 is secured by a security interest in substantially all of the Company and each of its subsidiaries' working capital assets and is subject to the first-priority lien of Bank of America, as agent, under the Credit Facility, other than with respect to equipment, fixtures, real property interests, intellectual property, intercompany property, intercompany indebtedness, equity interest in their subsidiaries, and certain other assets specified in an inter-creditor agreement between Bank of America and Crystal.

The Company and its subsidiaries are required to comply with various customary covenants including, (i) maintaining a fixed charge coverage ratio of at least 1.10 to 1.00, (ii) maintaining a Consolidated Leverage Ratio (as defined in the Term Loan Due 2023) to be measured on the last day of each month while the term loans are outstanding of no more than 3.00:1, (iii) not making capital expenditures in excess of the amount stated therein in any year until December 31, 2023, (iv) restrictions on the Company's and its subsidiaries ability to prepay its subordinated notes, pay dividends, incur debt, create or suffer liens and engage in certain fundamental transactions and (v) an obligation to provide certain financial and other information.

The Term Loan Due 2023 contains customary representations, mandatory prepayment events and events of default, including defaults triggered by the failure to make payments when due, breaches of covenants and representations, material impairment in the perfection of Crystal's security interest in the collateral and events related to bankruptcy and insolvency of the Company and its subsidiaries. Upon an event of default, Crystal may declare all outstanding obligations immediately due and payable (along with a prepayment fee), impose a default rate of an additional 2.0% to amounts outstanding and may take other actions including collecting or taking such other action with respect to the collateral pledged in connection with the term loan.

As of June 30, 2018, the Company was in compliance with all the financial covenants.

Subordinated Notes - Related Party

During 2015, the Company issued a \$5.0 million subordinated note (the “April Note”), subordinated notes (the “May Notes”) with an aggregate principal amount of \$3.8 million and a subordinated note (the “June Note”) with an aggregate principal amount of \$9.0 million to SG VTB Holdings, LLC, the Company's largest stockholder (“SG VTB”), and a trust

affiliated with Ronald Doornink, the Chairman of the Company's board of directors (the "Board"). The subordinated notes were issued with an interest rate of (i) 10% per annum for the first year and (ii) 20% per annum for all periods thereafter, with interest accruing and being added to the principal amount of the note quarterly.

On July 22, 2015, the Company amended and restated each of its outstanding subordinated notes (the "Amended Notes"). The obligations of the Company under the Amended Notes are subordinate and junior to the prior payment of amounts due under the then existing credit facility and term loans. In addition, the stated maturity date of the Amended Notes was extended to September 29, 2019, subject to acceleration in certain circumstances, such as a change of control in the Company. The Amended Notes were issued with an interest rate per annum equal to LIBOR plus 10.5% and were paid-in-kind by adding the

amount to the principal amount due. Further, as consideration for the concessions in the Amended Notes, the Company issued warrants to purchase 0.4 million of the Company's common stock at an exercise price of \$10.16 per share.

On November 16, 2015, the Company issued a \$2.5 million subordinated note (the "November Note") to SG VTB, the proceeds of which, as set forth in the amendment to the Term Loan Due 2019, were applied against the outstanding balance of the Term Loan Due 2019. The November Note was issued with an interest rate of 15% per annum until its maturity date, which was September 29, 2019, and was subordinated to all senior debt of the Company.

In consideration of the credit extended under the November Note, VTB and VTBH entered into a Third Lien Continuing Guaranty, (as amended, the "Third Lien Guaranty"), under which they guarantee and promise to pay to SG VTB, any and all obligations of the Company under the November Note. To secure the Company's obligations under the November Note and the Third Lien Guaranty, the Company entered into a Third Lien Security Agreement, dated as of November 16, 2015, pursuant to which Stripes was granted a security interest upon all property of the VTB and VTBH until the payment in full of the Amended Notes and November Note or the release of the guarantee or collateral, as applicable. Concurrent with entering into the November Note and Third Lien Guaranty, the Company also issued a warrant to purchase 0.3 million shares of the Company's common stock at an exercise price of \$8.00 per share.

On March 5, 2018, the Company amended and restated the Amended Notes with an aggregate principal amount of \$18.9 million and the November Note with an aggregate principal amount of \$3.5 million. The amended subordinated notes bear in-kind interest at a rate of (i) LIBOR plus 9.1% per annum until March 5, 2020 (or, solely with respect to the November Note, until September 5, 2018) or until its maturity date, which is June 5, 2023, provided that its principal amount is reduced by a specified amount by the six month anniversary of the restatement effective date and (ii) LIBOR plus 10.5% per annum (or, solely with respect to the November Note, 15.0% if the prepayment described above does not occur) until its maturity date.

On May 4, 2018, the Company satisfied the repayment provision with a \$3.3 million repayment of the November Note with funds from the Term Loan Due 2023. Further, on August 3, 2018, the Company paid down an additional \$5.0 million with funds from operations.

Series B Redeemable Preferred Stock

In September 2010, VTBH issued 1,000,000 shares of its Series B Redeemable Preferred Stock with a fair value of \$12.4 million. The Series B Redeemable Preferred Stock was required to be redeemed on the earlier of September 28, 2030, or the occurrence of a liquidation event at its original issue price of \$12.425371 per share plus any accrued but unpaid dividends. On April 23, 2018, the Company entered into a series of transactions pursuant to which the Series B Preferred Stock was retired in exchange for a combination of 1,307,143 shares of common stock and wholly-funded warrants exercisable for 550,000 shares of the Company's common stock. The redemption value of the Series B Preferred Stock was \$19.4 million as of the transaction date, and \$18.9 million as of December 31, 2017. Refer to Note 13. "Series B Preferred Stock Exchange Transactions and Settlement" for further details.

Stock Warrants

In connection with and as consideration for the concessions in the Amended Notes, the Company issued to SG VTB and a trust affiliated with Ronald Doornink, the Chairman of the Board, warrants to purchase 0.4 million shares of the Company's common stock at an exercise price of \$10.16 per share. The warrants are exercisable for a period of five years beginning on the date of issuance, July 22, 2015. The exercise price and the number of shares of Common Stock purchasable are subject to adjustment and do not carry any voting rights or other rights as a stockholder of the Company prior to exercise.

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In connection with the November Note, the Company issued warrants to purchase 0.3 million shares of the Company's common stock at an exercise price of \$8.00 per share to SG VTB. The exercise price and the number of shares are subject to standard anti-dilution adjustments and do not carry any voting rights as a stockholder of the Company prior to exercise. The warrants are exercisable for a period of ten years beginning on the date of issuance and does not entitle the holder to any voting rights or other rights as a stockholder of the Company prior to exercise.

The shares issuable upon exercise of the warrants are also subject to the "demand" and "piggyback" registration rights set forth in the in the Company's Stockholder Agreement, dated August 5, 2013, as amended July 10, 2014.

Critical Accounting Estimates

Our discussion and analysis of our results of operations and capital resources are based on our condensed consolidated financial statements, which have been prepared in conformity with GAAP. The preparation of these condensed 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.

Except for the adoption of Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers, as described herein, there have been no material changes to the critical accounting policies and estimates from the information provided in Note 1 to our consolidated financial statements in our Annual Report.

See Note 2, “Summary of Significant Accounting Policies,” to the 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 a company's 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 and foreign currency exchange rates and inflation.

In the past, 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. 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 June 30, 2018 and December 31, 2017, we did not have any derivative financial instruments.

Interest Rate Risk

The Company's total variable rate debt was consisted of a \$12.5 million Term Loan and \$19.9 million of Subordinated Notes. A hypothetical 10% increase in borrowing rates would not result in a material increase in interest expense on the existing principal balances.

Foreign Currency Exchange Risk

The Company has exchange rate exposure primarily with respect to the British Pound and Euro. As of June 30, 2018 and December 31, 2017, 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 proportionately 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.

In connection with our restatement for the period covered by this Quarterly Report on Form 10-Q/A, 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 not effective as of June 30, 2018. In making this assessment, we used the framework and criteria established in Internal Control-Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company did not maintain effective internal controls over the review of certain material non-routine transactions or events, which resulted in a material adjustment to the accounting for warrants issued in connection with the retirement of the Company’s Series B Preferred Stock in April 2018.

Notwithstanding the material weakness discussed above, our management, including our Chief Executive Officer and our Chief Financial Officer, concluded that the condensed consolidated financial statements in this Quarterly Report on Form 10-Q/A fairly present, in all material respects, the Company's financial condition, results of operations and cash flows for the periods presented, in conformity with accounting principles generally accepted in the United States of America.

Changes in Internal Control over Financial Reporting

Except for the material weakness described above, there were no changes in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1 - Legal Proceedings

Please refer to Note 12, “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/A, 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 to understanding any statement in this Form 10-Q/A 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/A.

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 Liquidity

We depend upon the availability of capital under our revolving credit facility and term loan 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 revolving credit facility (the "Credit Facility") provided by Bank of America, as Agent, Sole Lead Arranger and Sole Bookrunner and our term loan (the "Term Loan") provided by Crystal Financial LLC ("Crystal"), 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 or the Term Loan (collectively, the "Loan

Documents”) and are unable to obtain a waiver under the applicable Loan Documents, Bank of America or Crystal, as applicable, may declare the outstanding borrowings under the applicable Loan Documents 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 Loan Documents 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 Loan Documents contain financial and other covenants that we are obligated to maintain. If we violate any of these covenants, we will be in default under the applicable Loan Documents. These covenants include restrictions that prohibit or otherwise limit our ability to pay dividends, incur additional indebtedness, acquire assets or engage in certain other types of transactions. If a default occurs and is not timely cured or waived, Bank of America or Crystal, as applicable, 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 Loan Documents. 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. As of the date of this Report, we were in compliance with our covenants under the Loan Documents. The Credit Facility and Term Loans provide our lenders with a first-priority lien against substantially all of our working capital assets, including trade accounts receivable, inventories, and intellectual property and contains certain restrictions on our ability to take certain actions.

The Credit Facility and Term Loan 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.

In addition, we have granted the lenders a first-priority lien against substantially all of our assets, including trade accounts receivable, inventories and our intellectual property. Failure to comply with the operating restrictions or financial covenants could result in a default which could cause the lenders 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 result in further loss of confidence, which, in turn, 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 Our Operations

We depend upon the success and availability of third-party gaming platforms and software 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.

In order for certain of our headsets to connect to the Xbox One 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.

In addition, 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 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 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 2017, our three largest individual customers accounted for approximately 43% 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 or support of 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.

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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.

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 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 headset growth strategy.

We believe that our ability to extend the recognition and favorable perception of our Turtle Beach brand is critical to implement our headset 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.

Future 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 such as those sold by us, 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 headset connect with or work

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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 more 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. For example, Sony and Microsoft have announced hardware upgrades to the current console generations with the PS®4 Pro and Xbox One X, respectively. In addition, competing technologies such as tablet-based gaming and virtual reality may result in further disruption to the overall console gaming market.

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 Item 3, "Legal Proceedings," and Note 12, "Commitments and Contingencies," we are involved in legal proceedings related to the merger of VTBH and Paris Acquisition Corp. involving certain of our stockholders.

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 from time-to-time 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, 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, 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, changes in current 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. If we are not able to 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 ("NASDAQ"), the SEC or other regulatory authorities, or shareholder litigation.

In 2019, our management identified control deficiencies in our internal control over financial reporting that constituted a material weakness in our internal control over financial reporting. As such, our controls over financial reporting were not designed or operating effectively, and as a result there were adjustments required in connection with preparing our condensed consolidated financial statements for the quarterly periods ended June 30, 2018, and September 30, 2018, resulting in the Company having to restate its filings on Forms 10-Q for such periods.

While we took steps to remediate the material weakness by implementing additional reviews and processes, the revised controls need to be operating effectively for a reasonable period of time in order for the material weakness to be considered fully remediated. There can be no assurance that these measures will significantly improve or remediate

the material weakness even with the passage of time. There is also no assurance that we have identified all of our material weaknesses or that we will not in the future have additional material weaknesses. There is no assurance that this material weakness will be fully remediated or, that in the future, additional material weaknesses will not exist or otherwise be discovered. If our efforts to remediate the material weakness are not successful, or if other material weaknesses or other deficiencies occur, our ability to

accurately and timely report our financial position could be impaired, which could result in late filings of our annual and quarterly reports under the Securities Exchange Act of 1934, as amended (“Exchange Act”), restatements of our condensed consolidated financial statements, a decline in our stock price or suspension or delisting of our common stock from the Nasdaq Global Market.

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

Our competitive position will be seriously 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 infringed 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 and 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; and as a consequence, 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.

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. As of December 31, 2017 and the date of this Report, the Company has not received notice of any lawsuits against the Company in connection with any recall actions.

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”). For example, under Section 1502 of the Dodd-Frank Act, the SEC has adopted additional disclosure requirements related to the source of certain “conflict minerals” for issuers for which such “conflict minerals” are necessary to the functionality or production of a product manufactured, or contracted to be manufactured, by that issuer. The metals covered by the rules include tin, tantalum, tungsten and gold. Our suppliers may use some or all of these materials in their production processes. The rules require us to conduct a reasonable country of origin inquiry to determine if we know or have reason to believe any of the minerals used in the production process may have originated from the Democratic Republic of the Congo or an adjoining country. If we are not able to determine the minerals did not originate from a covered country or conclude that there is no reason to believe that the minerals used in the production process may have originated in a covered country, we would be required to perform supply chain due diligence on members of our supply chain. Global supply chains can have multiple layers, thus the costs of complying with these new requirements could be substantial. These new requirements may also reduce the number of suppliers who provide conflict free

metals, and may affect our ability to obtain products in sufficient quantities or at competitive prices. Compliance costs such as these could have a material adverse effect on our results of operations.

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.

The current administration has called for substantial change to fiscal and tax policies, which include comprehensive tax reform and may include changes to the implementation of the Dodd-Frank Act and related or similar regulations. The “Tax Cuts and Jobs Act,” enacted in December 2017, reduces the U.S. federal corporate tax rate from 35% to 21% effective January 1, 2018. We cannot predict whether in total we benefit from, or are negatively affected by, the changes.

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, but it has not done so to date. We also are required to notify the FDA in writing 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, it is possible that we, or one of our customers, could be required to modify the technology, or a product incorporating the technology, to comply with requirements that may be imposed by the FDA. 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. In connection with the recent restructuring of the HyperSound business, we terminated sales of HyperSound Clear 500P products, and in March 2017 we deactivated our FDA listing of these devices. We also did not renew our 2017 European Union certifications for HyperSound Clear 500P devices. Any future sales of regulated products would require new registrations and certifications.

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 or 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. The environmental laws and regulations applying to our business include those governing the discharge of pollutants into the air and water, the management, disposal and

labeling of, and exposure to, hazardous substances and wastes and the cleanup of contaminated sites. 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.

We operate in 44 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.

Risks Related to Ownership of our Common Stock

Our principal stockholders and management exert significant control over matters subject to stockholder approval.

As of June 30, 2018, our executive officers, directors, holders of 5% or more of our capital stock and their respective affiliates beneficially owned approximately 33.0% of our outstanding voting stock. As a result, these stockholders will be able to exert significant control over the outcome of matters requiring stockholder approval, including the elections of directors, amendments of our organizational documents, or the approval of any merger, sale of assets or other major corporate transaction. The interests of this group of stockholders may not always coincide with your interests or the interests of other stockholders and they may act in a manner that advances their best interests and not necessarily those of other stockholders, including seeking a premium value for their common stock, and might affect the prevailing market price for our common stock.

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 the Company's Current Report on Form 10-Q filed with the Securities and Exchange Commission on August 6, 2018).
- 4.1 Form of Warrant (Incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 27, 2018).
- 4.2 Registration Rights Agreement, dated April 23, 2018, by and among Turtle Beach Corporation and the investors named therein (Incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 27, 2018).
- 10.1 Exchange Agreement, dated April 23, 2018, by and among Turtle Beach Corporation and the investors named therein (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 27, 2018).
- 10.2 Turtle Beach Corporation 2013 Stock-Based Incentive Plan, as amended. (Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 10-Q filed with the Securities and Exchange Commission on August 6, 2018).
- 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.SCHXBRL Taxonomy Extension Schema Document
101.CALXBRL Taxonomy Extension Calculation Linkbase Document
101.DEF XBRL Taxonomy Extension Definition Linkbase Document
101.LABXBRL Taxonomy Extension Labels Linkbase Document
101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

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

TURTLE BEACH CORPORATION

Date: March 29, 2019 By: /S/ JOHN T. HANSON

John T. Hanson

Chief Financial Officer, Treasurer and Secretary

(Principal Financial and Accounting Officer)