Turtle Beach Corp
Form 10-Q
May 09, 2018

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

FORM 10-Q

(Mark one)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 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 incorporation or organization)	(I.R.S. Employer Identification Number)
11011 Via Frontera, Suite A/B San Diego, California	92127
(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. ý 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). ý 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 ý
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 ý No

The number of shares of the registrant's Common Stock, par value $0.001 per share, outstanding on April 30, 2018 was 13,683,997.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.
Turtle Beach Corporation
Condensed Consolidated Balance Sheets

	March 31, 2018 (unaudited)	December 31, 2017
	(in thousands, except par value and share amounts)	
ASSETS		
Current Assets:		
Cash and cash equivalents	$4,335	$ 5,247
Accounts receivable, net	21,751	50,534
Inventories	15,816	27,518
Prepaid expenses and other current assets	3,536	3,467
Total Current Assets	45,438	86,766
Property and equipment, net	3,979	4,677
Intangible assets, net	1,363	1,404
Deferred income taxes	382	362
Other assets	1,144	1,042
Total Assets	$52,306	$ 94,251
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current Liabilities:		
Revolving credit facility	$2,642	$ 38,467
Term loans	—	4,173
Accounts payable	9,758	13,459
Other current liabilities	8,656	11,451
Total Current Liabilities	21,056	67,550
Term loans, long-term portion, net of unamortized debt issuance costs of $801 and $759	8,434	6,789
Series B redeemable preferred stock	19,297	18,921
Subordinated notes - related party, net of unamortized discount of $946 and $1,075	21,630	20,836
Other liabilities	2,311	2,312
Total Liabilities	72,728	116,408
Commitments and Contingencies		
Stockholders' Equity (Deficit)		
Common stock, $0.001 par value - 25,000,000 shares authorized; 12,347,001 and 12,346,502 shares issued and outstanding as of March 31, 2018 and December 31, 2017, respectively	12	12
Additional paid-in capital	148,305	148,082
Accumulated deficit	(168,691)	(170,048)
Accumulated other comprehensive loss	(48)	(203)
Total Stockholders' Equity (Deficit)	(20,422)	(22,157)
Total Liabilities and Stockholders' Equity (Deficit)	$52,306	$ 94,251

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

Turtle Beach Corporation
Condensed Consolidated Statements of Operations
(unaudited)

	Three Months Ended	
	March 31, 2018	March 31, 2017
	(in thousands, except per-share data)	
Net Revenue	$40,886	$14,352
Cost of Revenue	25,857	12,136
Gross Profit	15,029	2,216
Operating expenses:		
Selling and marketing	5,929	4,449
Research and development	1,329	1,390
General and administrative	3,985	4,171
Restructuring charges	—	298
Total operating expenses	11,243	10,308
Operating income (loss)	3,786	(8,092)
Interest expense	2,005	1,840
Other non-operating expense (income), net	(245)	(51)
Income (loss) before income tax	2,026	(9,881)
Income tax expense	64	45
Net income (loss)	$1,962	$(9,926)
Net income (loss) per share:		
Basic	$0.16	$(0.81)
Diluted	$0.16	$(0.81)
Weighted average number of shares:		
Basic	12,347	12,313
Diluted	12,369	12,313

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

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

	Three Months Ended	
	March 31, 2018	March 31, 2017
	(in thousands)	
Net income (loss)	$ 1,962	$ (9,926)
Other comprehensive income (loss):		
Foreign currency translation adjustment	155	40
Other comprehensive income (loss)	155	40
Comprehensive income (loss)	$ 2,117	$ (9,886)

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

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

	Three Months Ended	
	March 31, 2018	March 31, 2017
	(in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$1,962	$(9,926)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	948	769
Amortization of intangible assets	79	84
Amortization of debt financing costs	394	388
Stock-based compensation	223	386
Accrued interest on Series B redeemable preferred stock	376	347
Paid-in-kind interest	665	582
Deferred income taxes	(21)	(145)
Reversal of sales returns reserve	(1,273)	(1,558)
Provision for doubtful accounts	131	64
Provision for obsolete inventory	582	869
Changes in operating assets and liabilities:		
Accounts receivable	29,320	51,611
Inventories	11,120	(1,456)
Accounts payable	(3,597)	(3,728)
Prepaid expenses and other assets	(68)	365
Income taxes payable	—	193
Other liabilities	(2,796)	(5,398)
Net cash provided by operating activities	38,045	33,447
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(354)	(148)
Net cash used for investing activities	(354)	(148)
CASH FLOWS FROM FINANCING ACTIVITIES		
Borrowings on revolving credit facilities	37,571	30,659
Repayment of revolving credit facilities	(73,396)	(66,564)
Repayment of capital leases	—	(4)
Repayment of term loan	(2,485)	—
Debt financing costs	(175)	—
Net cash used for financing activities	(38,485)	(35,909)
Effect of exchange rate changes on cash and cash equivalents	(118)	40
Net decrease in cash and cash equivalents	(912)	(2,570)
Cash and cash equivalents - beginning of period	5,247	6,183
Cash and cash equivalents - end of period	$4,335	$3,613
SUPPLEMENTAL DISCLOSURE OF INFORMATION		
Cash paid for interest	$482	$513
Cash paid for income taxes	$—	$—

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

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

	Common Stock Shares (in thousands)	Amount	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2017	12,347	$ 12	$ 148,082	$ (170,048)	$ (203)	$ (22,157)
Cumulative effect of the adoption of ASC 606	—	—	—	(605)	—	(605)
Net income	—	—	—	1,962	—	1,962
Other comprehensive income	—	—	—	—	155	155
Stock-based compensation	—	—	223	—	—	223
Balance at March 31, 2018	12,347	$ 12	$ 148,305	$ (168,691)	$ (48)	$ (20,422)

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

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

Note 1. Background and Basis of Presentation
Organization
Turtle Beach Corporation (“Turtle Beach” or the “Company”), headquartered in San Diego, California, 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 most recent audited financial statements included in its Annual Report on Form 10-K.

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.

These financial statements should be read in conjunction with the annual financial statements and the notes thereto included in our Annual Report on Form 10-K filed with the SEC on March 6, 2018 (“Annual Report”) that contains information useful to understanding the Company's businesses and financial statement presentations.

Note 2. Summary of Significant Accounting Policies
The preparation of consolidated annual and quarterly financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, the disclosure of contingent assets and liabilities at the date of 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.

Our significant accounting policies are included in Note 1 of our 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, we 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.

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 adopting ASC 606. 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 ASC 606, 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. The amendments in this update state 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.

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

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 March 31, 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 March 31, 2018 and December 31, 2017:

	March 31, 2018		December 31, 2017	
	Reported	Fair Value	Reported	Fair Value
	(in thousands)			
Financial Assets and Liabilities:				
Cash and cash equivalents	$4,335	$4,335	$5,247	$5,247
Revolving Credit Facility	2,642	2,642	38,467	38,467
Term Loans	9,235	9,945	11,721	11,329
Subordinated Notes	22,576	25,040	21,911	22,442

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.

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 March 31,	
	2018	2017
	(in thousands)	
Balance, beginning of period	$5,533	$4,591

Reserve accrual	3,257	1,131
Recoveries and deductions, net	(4,530)	(2,689)
Balance, end of period	$4,260	$3,033

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

Note 5. Composition of Certain Financial Statement Items
Inventories
Inventories consist of the following:

	March 31, 2018	December 31, 2017
	(in thousands)	
Raw materials	$937	$ 837
Finished goods	14,879	26,681
Total inventories	$15,816	$ 27,518

Property and Equipment, net
Property and equipment, net, consists of the following:

	March 31, 2018	December 31, 2017
	(in thousands)	
Machinery and equipment	$1,402	$ 1,396
Software and software development	383	383
Furniture and fixtures	532	525
Tooling	1,968	1,968
Leasehold improvements	1,330	1,318
Demonstration units and convention booths	11,944	11,719
Total property and equipment, gross	17,559	17,309
Less: accumulated depreciation and amortization	(13,580)	(12,632)
Total property and equipment, net	$3,979	$ 4,677

Other Current Liabilities
Other current liabilities consist of the following:

	March 31, 2018	December 31, 2017
	(in thousands)	
Accrued vendor expenses	$447	$ 652
Accrued royalties	2,080	2,848
Accrued employee expenses	1,813	2,510
Accrued expenses	4,316	5,441
Total other current liabilities	$8,656	$ 11,451

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

Note 6. Goodwill and Other Intangible Assets
Acquired Intangible Assets
Acquired identifiable intangible assets, and related accumulated amortization, as of March 31, 2018 and December 31, 2017 consist of:

	March 31, 2018		
	Gross Carrying Value	Accumulated Amortization	Net Book Value
	(in thousands)		
Customer relationships	$5,796	$ 4,265	$1,531
Foreign Currency	(721)	(553)	(168)
Total Intangible Assets	$5,075	$ 3,712	$1,363

	December 31, 2017		
	Gross Carrying Value	Accumulated Amortization	Net Book 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 $0.1 million was recognized for the three months ended March 31, 2018 and 2017, respectively.

As of March 31, 2018, estimated annual amortization expense related to definite lived intangible assets in future periods is as follows:

	(in thousands)
2018	$ 274
2019	307
2020	258
2021	217
2022	182
Thereafter	293
Total	$ 1,531

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

Note 7. Revolving Credit Facility and Long-Term Debt

	March 31, 2018	December 31, 2017
	(in thousands)	
Revolving credit facility, maturing March 2023	$2,642	$38,467
Term Loan Due 2018	—	1,923
Term Loan Due 2019	—	9,798
Term Loan Due 2023	9,235	—
Less unamortized deferred financing fees	801	759
Total Term Loans	8,434	10,962
Subordinated notes - related party	22,576	21,911
Less unamortized debt discount	946	1,075
Total Subordinated notes	21,630	20,836
Total outstanding debt	32,706	70,265
Less: current portion of revolving credit facility	(2,642)	(38,467)
Less: current portion of term loans	—	(4,173)
Total noncurrent portion of long-term debt	$30,064	$27,625

Total interest expense, inclusive of amortization of deferred financing costs, on long-term debt obligations was $1.5 million and,$1.3 million for the three months ended March 31, 2018 and 2017, respectively. This includes related party interest of $0.7 million for the three months ended March 31, 2018, and $0.6 million for the three months ended March 31, 2017, in connection with the subordinated notes.

Amortization of deferred financing costs was $0.4 million for the three months ended March 31, 2018, and $0.4 million for the three months ended March 31, 2017. In connection with the Company's debt modification, 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.

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 March 31, 2018, interest rates for outstanding borrowings were 5.75% 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

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

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 March 31, 2018, the Company was in compliance with all financial covenants, as amended, and excess borrowing availability was approximately $19.6 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, at an interest rate of LIBOR for the applicable interest period plus 5% and 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 March 31, 2018, $9.2 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.

Turtle Beach Corporation
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(unaudited)

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), a default rate of an additional 2.0% may be applied 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 March 31, 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 and 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 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 Subordinated 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 repaid $3.3 million of the November Note with funds from the Term Loan Due 2023.

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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 March 31,	
	2018	2017
	(in thousands)	
Income tax expense	$64	$45
Effective income tax rate	3.2 %	(0.5)%

Income tax expense for the three months ended March 31, 2018 was $64,000 at an effective tax rate of 3.2% and, $45,000 at an effective tax rate of (0.5)%, for the three months ended March 31, 2017. 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 March 31, 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 was notified by the IRS of an examination covering our fiscal year end 2015 federal income tax return, which is currently in the discovery phase.

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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 March 31, 2018	2017
	(in thousands)	
Cost of revenue	$18	$(85)
Selling and marketing	25	36
Research and development	30	57
General and administrative	150	378
Total stock-based compensation	$223	$386

The following table presents the stock activity and the total number of shares available for grant as of March 31, 2018:

	(in thousands)
Balance at December 31, 2017	387
Options granted	(53)
Restricted Stock granted	—
Forfeited/Expired shares added back	92
Balance at March 31, 2018	426

Stock Option Activity

	Options Outstanding Number of Shares Underlying Outstanding Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
			(In years)	
Outstanding at December 31, 2017	1,740,082	$ 6.20	6.64	$6
Granted	52,850	1.80		
Exercised	—	—		
Forfeited	(92,326)	8.20		
Outstanding at March 31, 2018	1,700,606	$ 5.95	6.85	$114,614
Vested and expected to vest at March 31, 2018	1,651,269	$ 6.12	6.78	$106,578
Exercisable at March 31, 2018	1,012,928	$ 7.56	5.50	$—

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 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).

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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. There were no option exercises during the three months ended March 31, 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 three months ended March 31, 2018.

Expected term (in years)	6.1
Risk-free interest rate	2.3% - 2.7%
Expected volatility	38.6% - 38.8%
Dividend rate	0%

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

The weighted average grant date fair value of options granted during the three months ended March 31, 2018 was \$0.76. The total estimated fair value of employee options vested during the three months ended March 31, 2018 was \$0.2 million. As of March 31, 2018, total unrecognized compensation cost related to non-vested stock options granted to employees was \$2.0 million, which is expected to be recognized over a remaining weighted average vesting period of 2.8 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	—	—
Vested	(200)	63.72
Nonvested restricted stock at March 31, 2018	41,667	3.56

As of March 31, 2018, total unrecognized compensation cost related to the nonvested restricted stock awards, which will be recognized over a remaining weighted average vesting period of 1.1 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 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.

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 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 March 31,	
	2018	2017
	(in thousands, except per-share data)	
Net income (loss)	$1,962	$(9,926)
Weighted average common shares outstanding — Basic	12,347	12,313
Plus incremental shares from assumed conversions:		
Dilutive effect of restricted stock	3	—
Dilutive effect of stock options	19	—
Weighted average common shares outstanding — Diluted	2,369	12,313
Net income (loss) per share:		
Basic	$0.16	$(0.81)
Diluted	$0.16	$(0.81)

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 March 31,	
	2018	2017
	(in thousands)	
Stock options	1,678	1,578
Warrants	765	767
Unvested restricted stock awards	14	27
Total	2,457	2,372

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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 March 31,	
	2018	2017
Net Revenues	(in thousands)	
Headset	$40,868	$14,260
HyperSound	18	92
Total	$40,886	$14,352
Operating Income (Loss)		
Headset	$3,797	$(7,056)
HyperSound	(11)	(1,036)
Total	$3,786	$(8,092)
Interest Expense	$2,005	$1,840
Other non-operating expense (income), net	(245)	(51)
Income (loss) before income tax	$2,026	$(9,881)

	March 31, 2018	December 31, 2017
Total Assets	(in thousands)	
Headset	$52,278	$ 94,114
HyperSound [1]	26,756	26,787
Eliminations	(26,728)	(26,650)
Total	$52,306	$ 94,251

(1) At March 31, 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 March 31,	
	2018	2017
	(in thousands)	
North America	$32,984	$11,055
United Kingdom	4,029	1,854
Europe	3,247	1,168
Other	626	275
Total net revenues	$40,886	$14,352

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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 Nevada Supreme 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.

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 23rd, 2018, an oral hearing was held at the Regional Court of Berlin that focused exclusively on the question of jurisdiction. VTB and BigBen are currently waiting for the court to render an interim judgment on the question whether it accepts jurisdiction or not.

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 March 31, 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.

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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 March 31,	
	2018	2017
	(in thousands)	
Warranty, beginning of period	$472	$639
Warranty costs accrued	234	60
Settlements of warranty claims	(172)	(110)
Warranty, end of period	$534	