

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

**FORM 10-Q**

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended June 29, 2019  
or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from      to  
  
Commission File Number: 001-38603

**SONOS, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction  
of incorporation or organization)

**03-0479476**  
(I.R.S. Employer Identification No.)

614 Chapala Street  
Santa Barbara, CA 93101  
(805) 965-3001

(Address, including zip code, and telephone number, including area code, of registrant’s principal executive offices)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, \$0.0001 par value	SONO	The Nasdaq Stock Market LLC

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 ☒ Smaller reporting company ☐  
Emerging growth company ☐

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

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

As of July 27, 2019 the registrant had 106,324,760 shares of common stock outstanding.

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# PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

### SONOS, INC. CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited, in thousands, except par values)

	As of	
	June 29, 2019	September 29, 2018
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 338,292	\$ 220,930
Restricted cash	186	190
Accounts receivable, net of allowances	91,333	73,214
Inventories	121,225	193,193
Prepays and other current assets	15,363	10,073
Total current assets	566,399	497,600
Property and equipment, net	72,856	85,371
Deferred tax assets	1,056	941
Other noncurrent assets	3,607	3,586
Total assets	<u>\$ 643,918</u>	<u>\$ 587,498</u>
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Accounts payable	\$ 153,478	\$ 195,159
Accrued expenses	46,562	38,687
Accrued compensation	34,300	33,371
Short-term debt	11,667	6,667
Deferred revenue	13,349	11,615
Other current liabilities	16,146	10,858
Total current liabilities	275,502	296,357
Long-term debt	28,154	33,097
Deferred revenue	42,757	39,352
Other noncurrent liabilities	9,080	10,334
Total liabilities	355,493	379,140
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Common stock, \$0.001 par value	107	101
Treasury stock	(11,904)	(11,072)
Additional paid-in capital	480,170	424,617
Accumulated deficit	(178,777)	(203,611)
Accumulated other comprehensive loss	(1,171)	(1,677)
Total stockholders' equity	288,425	208,358
Total liabilities and stockholders' equity	<u>\$ 643,918</u>	<u>\$ 587,498</u>

The accompanying notes are an integral part of these condensed consolidated financial statements.

**SONOS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)**  
*(unaudited, in thousands, except share and per share amounts)*

	Three Months Ended		Nine Months Ended	
	June 29, 2019	June 30, 2018	June 29, 2019	June 30, 2018
Revenue	\$ 260,119	\$ 208,398	\$ 966,663	\$ 864,069
Cost of revenue	142,749	112,909	563,591	491,037
Gross profit	117,370	95,489	403,072	373,032
Operating expenses				
Research and development	44,355	35,444	121,530	104,209
Sales and marketing	61,482	60,819	176,705	214,077
General and administrative	26,583	20,860	74,308	63,822
Total operating expenses	132,420	117,123	372,543	382,108
Operating income (loss)	(15,050)	(21,634)	30,529	(9,076)
Other income (expense), net				
Interest income (expense), net	806	(1,116)	1,019	(3,367)
Other income (expense), net	1,068	(3,744)	(3,640)	(315)
Total other income (expense), net	1,874	(4,860)	(2,621)	(3,682)
Income (loss) before provision for income taxes	(13,176)	(26,494)	27,908	(12,758)
Provision for income taxes	833	494	3,074	1,126
Net income (loss)	\$ (14,009)	\$ (26,988)	\$ 24,834	\$ (13,884)
Net income (loss) attributable to common stockholders:				
Basic	\$ (14,009)	\$ (26,988)	\$ 24,834	\$ (13,884)
Diluted	\$ (14,009)	\$ (26,988)	\$ 24,834	\$ (13,884)
Net income (loss) per share attributable to common stockholders:				
Basic	\$ (0.13)	\$ (0.45)	\$ 0.24	\$ (0.23)
Diluted	\$ (0.13)	\$ (0.45)	\$ 0.22	\$ (0.23)
Weighted-average shares used in computing net income (loss) per share attributable to common stockholders:				
Basic	105,522,313	60,074,763	102,667,316	59,484,761
Diluted	105,522,313	60,074,763	112,542,998	59,484,761
Total comprehensive income (loss)				
Net income (loss)	\$ (14,009)	\$ (26,988)	\$ 24,834	\$ (13,884)
Change in foreign currency translation adjustment	(663)	162	506	523
Comprehensive income (loss)	\$ (14,672)	\$ (26,826)	\$ 25,340	\$ (13,361)

The accompanying notes are an integral part of these condensed consolidated financial statements.

SONOS, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY  
(unaudited, in thousands, except share amounts)

Three Months Ended June 29, 2019										
	Common Stock		Additional Paid-In Capital	Treasury Stock		Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity		
	Shares	Amount		Shares	Amount					
Balance at March 30, 2019	105,692,632	\$ 106	\$ 463,677	(861,354)	\$ (11,638)	\$ (164,768)	\$ (508)	\$ 286,869		
Issuance of common stock pursuant to equity incentive plans	1,481,047	1	3,085	—	—	—	—	3,086		
Purchase of treasury stock	—	—	—	(25,565)	(266)	—	—	(266)		
Stock-based compensation expense	—	—	13,408	—	—	—	—	13,408		
Net loss	—	—	—	—	—	(14,009)	—	(14,009)		
Change in foreign currency translation adjustment	—	—	—	—	—	—	(663)	(663)		
Balance at June 29, 2019	107,173,679	\$ 107	\$ 480,170	(886,919)	\$ (11,904)	\$ (178,777)	\$ (1,171)	\$ 288,425		

  

Three Months Ended June 30, 2018										
	Redeemable Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Treasury Stock		Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Shares	Amount	Shares	Amount		Shares	Amount			
Balance at March 31, 2018	32,482,590	\$ 90,341	60,707,232	\$ 61	\$ 223,720	(799,174)	\$ (10,953)	\$ (174,903)	\$ (1,804)	\$ 36,121
Issuance of common stock pursuant to equity incentive plans	—	—	367,854	—	1,391	—	—	—	—	1,391
Purchase of treasury stock	—	—	—	—	—	(7,866)	(119)	—	—	(119)
Stock-based compensation expense	—	—	—	—	10,333	—	—	—	—	10,333
Net loss	—	—	—	—	—	—	—	(26,988)	—	(26,988)
Change in foreign currency translation adjustment	—	—	—	—	—	—	—	—	162	162
Balance at June 30, 2018	32,482,590	\$ 90,341	61,075,086	\$ 61	\$ 235,444	(807,040)	\$ (11,072)	\$ (201,891)	\$ (1,642)	\$ 20,900

## SONOS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY

(unaudited, in thousands, except share amounts)

Nine Months Ended June 29, 2019										
	Common Stock		Additional Paid-In Capital	Treasury Stock		Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity		
	Shares	Amount		Shares	Amount					
Balance at September 29, 2018	100,868,250	\$ 101	\$ 424,617	(807,040)	\$ (11,072)	\$ (203,611)	\$ (1,677)	\$ 208,358		
Issuance of common stock pursuant to equity incentive plans	6,305,429	6	22,028	—	—	—	—	22,034		
Purchase of treasury stock	—	—	—	(79,879)	(832)	—	—	(832)		
Stock-based compensation expense	—	—	33,525	—	—	—	—	33,525		
Net income	—	—	—	—	—	24,834	—	24,834		
Change in foreign currency translation adjustment	—	—	—	—	—	—	506	506		
Balance at June 29, 2019	107,173,679	\$ 107	\$ 480,170	(886,919)	\$ (11,904)	\$ (178,777)	\$ (1,171)	\$ 288,425		

  

Nine Months Ended June 30, 2018										
	Redeemable Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Treasury Stock		Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Shares	Amount	Shares	Amount		Shares	Amount			
Balance at September 30, 2017	32,482,590	\$ 90,341	59,339,336	\$ 59	\$ 200,301	(746,462)	\$ (10,161)	\$ (188,007)	\$ (2,165)	\$ 27
Issuance of common stock pursuant to equity incentive plans	—	—	1,735,750	2	5,746	—	—	—	—	5,748
Purchase of treasury stock	—	—	—	—	—	(60,578)	(911)	—	—	(911)
Stock-based compensation expense	—	—	—	—	29,397	—	—	—	—	29,397
Net loss	—	—	—	—	—	—	—	(13,884)	—	(13,884)
Change in foreign currency translation adjustment	—	—	—	—	—	—	—	—	523	523
Balance at June 30, 2018	32,482,590	\$ 90,341	61,075,086	\$ 61	\$ 235,444	(807,040)	\$ (11,072)	\$ (201,891)	\$ (1,642)	\$ 20,900

The accompanying notes are an integral part of these condensed consolidated financial statements.

**SONOS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(unaudited, in thousands)

	Nine Months Ended	
	June 29, 2019	June 30, 2018
<b>Cash flows from operating activities</b>		
Net income (loss)	\$ 24,834	\$ (13,884)
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation	27,403	28,647
Stock-based compensation expense	33,525	29,397
Other	1,962	639
Deferred income taxes	(129)	117
Foreign currency transaction loss	1,430	301
Changes in operating assets and liabilities:		
Accounts receivable, net	(19,114)	(5,659)
Inventories, net	69,683	(79)
Other assets	(5,434)	(4,901)
Accounts payable and accrued expenses	(33,680)	(24,357)
Accrued compensation	1,091	(4,237)
Deferred revenue	5,279	10,342
Other liabilities	4,086	(534)
Net cash provided by operating activities	110,936	15,792
<b>Cash flows from investing activities</b>		
Purchases of property and equipment	(14,092)	(25,927)
Net cash used in investing activities	(14,092)	(25,927)
<b>Cash flows from financing activities</b>		
Proceeds from borrowings, net of borrowing costs	—	30,000
Repayments of borrowings	—	(30,000)
Payments for purchase of treasury stock	(832)	(911)
Proceeds from exercise of common stock options	22,034	5,748
Payments of offering costs	(585)	(2,154)
Net cash provided by financing activities	20,617	2,683
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(103)	1,289
Net increase (decrease) in cash, cash equivalents and restricted cash	117,358	(6,163)
<b>Cash, cash equivalents and restricted cash</b>		
Beginning of period	221,120	130,788
End of period	\$ 338,478	\$ 124,625
<b>Supplemental disclosure</b>		
Cash paid for interest	\$ 1,334	\$ 3,596
Cash paid for taxes, net of refunds	\$ 2,534	\$ 1,251
<b>Supplemental disclosure of non-cash investing and financing activities</b>		
Purchases of property and equipment in accounts payable and accrued expenses	\$ 6,053	\$ 7,187
Deferred offering costs in accounts payable and accrued expenses	\$ —	\$ 972

The accompanying notes are an integral part of these condensed consolidated financial statements.

**SONOS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
*(unaudited)*

## **1. Business overview and basis of presentation**

### ***Description of business***

Sonos, Inc. and its wholly owned subsidiaries (collectively, “Sonos,” the “Company,” “we,” “us” or “our”) designs, develops, manufactures and sells multi-room audio products. The Sonos sound system provides customers with an immersive listening experience created by the design of its speakers and components, a proprietary software platform and the ability to stream content from a variety of sources throughout the home over the customer’s wireless network.

The Company’s products are sold through third-party physical retailers, including custom installers of home audio systems. The Company also sells through select e-commerce retailers and its website sonos.com. The Company’s products are distributed in over 50 countries through its wholly owned subsidiaries: Sonos Europe B.V., Beijing Sonos Technology Co., Ltd., Sonos Japan GK and Sonos Australia Pty Ltd., located in the Netherlands, China, Japan and Australia, respectively.

### ***Basis of presentation and preparation***

The accompanying condensed consolidated financial statements are unaudited. The condensed consolidated balance sheet as of June 29, 2019 has been derived from the audited financial statements of the Company. The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) for interim financial information, and in management’s opinion, includes all adjustments, consisting of only normal recurring adjustments, necessary for the fair statement of the Company’s financial position, its results of operations and cash flows for the interim periods presented. The results of operations for the nine months ended June 29, 2019 are not necessarily indicative of the results to be expected for the full fiscal year or any other period.

The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company’s Annual Report on Form 10-K for the fiscal year ended September 29, 2018 (the “Annual Report”), filed with the Securities and Exchange Commission (“SEC”) on November 28, 2018. Certain prior period amounts have been reclassified to conform to the current period presentation.

The Company has a 4-4-5 fiscal year ending on the Saturday nearest September 30 each year. The Company’s fiscal year is divided into four quarters of 13 weeks, each beginning on a Sunday and containing two 4-week periods followed by a 5-week period. An additional week is included in the fourth fiscal quarter approximately every five years to realign fiscal quarters with calendar quarters. This last occurred in the fourth quarter of the Company’s fiscal year ended October 3, 2015. The nine months ended June 29, 2019 and June 30, 2018 spanned 39 weeks each. As used in this Quarterly Report on Form 10-Q, “fiscal 2019” refers to the fiscal year ending September 28, 2019 and “fiscal 2018” refers to the fiscal year ended September 29, 2018.

### ***Initial public offering***

On August 6, 2018, the Company completed its initial public offering (the “IPO”) of its common stock, in which it sold 6,388,888 shares of its common stock, including 833,333 shares of its common stock pursuant to the underwriters’ over-allotment option, and selling stockholders sold 9,583,333 shares of the Company’s common stock, including 1,250,000 shares pursuant to the underwriters’ over-allotment option. The shares were sold at the IPO price of \$15.00 per share for net proceeds of \$90.6 million, after deducting underwriting discounts and commissions of \$5.3 million. Additionally, offering costs incurred by the Company totaled approximately \$4.6 million. Upon the closing of the IPO, all outstanding shares of the Company’s redeemable convertible preferred stock automatically converted into 32,482,590 shares of common stock on a one -for-one basis.

SONOS, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)

#### ***Stock split***

On July 19, 2018, the Company effected a two -for-one stock split of all outstanding shares of the Company's capital stock, including its common stock and its redeemable convertible preferred stock. All share and per share information presented in the condensed consolidated financial statements has been retroactively adjusted for all periods presented for the effects of the stock split.

#### ***Use of estimates and judgments***

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and judgments that affect the amounts reported and disclosed in the condensed consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. On an ongoing basis, the Company evaluates its estimates and judgments compared to historical experience and expected trends.

## **2. Summary of significant accounting policies**

There have been no changes in the Company's significant accounting policies, recently adopted accounting pronouncements, or recent accounting pronouncements pending adoption from those disclosed in the Annual Report, except as noted below.

#### ***Recently adopted accounting pronouncements***

In June 2018, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2018-07, *Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*, which aligns the accounting for share-based payment awards issued to nonemployees with the guidance applicable to grants to employees. Under this new standard, equity-classified share-based payment awards issued to nonemployees will be measured on the grant date, instead of the current requirement to remeasure the awards through the performance completion date. Further, compensation cost for awards with performance conditions will be recognized when it is probable the conditions will be achieved, rather than upon actual achievement of the conditions. In the second quarter of fiscal 2019, the Company early adopted the standard using the prospective approach. There was no cumulative effect entry needed to adjust the opening retained earnings balance upon adoption. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, which reduces diversity in practice in how certain transactions are classified in the statement of cash flows. In the first quarter of fiscal 2019, the Company retrospectively adopted this standard to all periods presented in this Quarterly Report on Form 10-Q. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*. ASU 2016-16 removes the prohibition in Accounting Standards Codification ("ASC") Topic 740, *Income Taxes*, against the immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. ASU 2016-16 is intended to reduce the complexity of U.S. GAAP and diversity in practice related to the tax consequences of certain types of intra-entity asset transfers, particularly those involving intellectual property. In the first quarter of fiscal 2019, the Company adopted this standard on a modified retrospective basis. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In November 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which enhances and clarifies the classification and presentation of restricted cash in the statement of cash flows. In the first quarter of fiscal 2019, the Company adopted this standard retrospectively to all periods presented in this Quarterly Report on Form 10-Q. The Company now includes restricted cash and restricted cash equivalents with cash and cash equivalents when reconciling beginning and ending amounts shown on the statement of cash flows. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

SONOS, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
(unaudited)

In August 2018, the SEC adopted the final rule under SEC Release No. 33-10532, *Disclosure Update and Simplification*, amending certain disclosure requirements that were redundant, duplicative, overlapping, outdated or superseded. In addition, the amendments expanded the disclosure requirements on the analysis of stockholders' equity for interim financial statements. Under the amendments, an analysis of changes in each caption of stockholders' equity presented in the balance sheet must be provided in a note or separate statement. The analysis should present a reconciliation of the beginning balance to the ending balance of each period for which a statement of comprehensive income is required to be filed. This final rule became effective November 5, 2018. In the first quarter of fiscal 2019, the Company adopted this standard for all periods presented in this Quarterly Report on Form 10-Q, presenting the activity of the stockholders' equity accounts in the accompanying consolidated statements of redeemable convertible preferred stock and stockholders' equity for the periods presented.

***Recent accounting pronouncements pending adoption***

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, and other subsequent amendments to amend historical lease accounting in order to increase transparency and comparability among entities. The standard requires lessees to recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements. This standard is effective for public entities for fiscal years beginning after December 15, 2018, and interim periods within those years, with early adoption permitted. The Company expects to adopt the new lease standard in the first quarter of fiscal 2020. In July 2018, the FASB issued ASU No. 2018-11, "Leases (Topic 842): Targeted improvements," which provides an alternative transition method that entities can elect when adopting this standard. Under this alternative transition method, a company is permitted to use its effective date as the date of initial application without restating comparative period financial statements. The Company currently anticipates to adopt Topic 842 utilizing this alternative transition method. In adopting the new guidance, the Company expects to elect the package of practical expedients which allows the Company not to reassess (1) whether any expired or existing contracts contain leases under the new definition of a lease; (2) the lease classification for any expired or existing leases; and (3) whether previously capitalized initial direct costs would qualify for capitalization under Topic 842. Upon adoption, the Company will recognize any qualifying right-of-use assets and lease liabilities on its condensed consolidated balance sheets, which will increase the Company's total assets and total liabilities. The Company is currently evaluating the impact of adoption on its consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-15, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350- 40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. The new guidance aligns the requirements for capitalizing implementation costs incurred in a cloud computing arrangement that is a service contract, with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The standard will be effective for the Company in the first quarter of fiscal 2021, with early adoption permitted. The Company is currently evaluating the timing of adoption and impact on the Company's consolidated financial statements.

In November 2018, the FASB issued ASU No. 2018-18, *Collaborative Arrangements (Topic 808): Clarifying the Interaction between Topic 808 and Topic 606*. This standard resolves the diversity in practice concerning whether certain transactions between collaborative arrangement participants should be accounted for as revenue under Accounting Standards Codification 606, *Revenue from Contracts with Customers* ("Topic 606"). This standard specifies when a participant is a customer in a collaboration, adds unit of account guidance to align with Topic 606 and provides presentation guidance for collaborative arrangements. This guidance is effective for public entities for fiscal years beginning after December 15, 2019, and for interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the timing of the adoption and its impact on the Company's consolidated financial statements.

**3. Fair value measurements**

The carrying values of the Company's financial instruments, including accounts receivable and accounts payable, approximate their fair values due to the short period of time to maturity or repayment. The carrying values of the Company's long-term debt approximate their fair values as of June 29, 2019 and September 29, 2018 as the debt carries a variable rate or market rates that approximate those currently available to the Company.

**SONOS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
*(unaudited)*

The following table summarizes fair value measurements by level for the assets measured at fair value on a recurring basis as of June 29, 2019 and September 29, 2018 :

<b>June 29, 2019</b>				
<b>(In thousands)</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets:</b>				
Money market funds (cash equivalents)	\$ 266,326	\$ —	\$ —	\$ 266,326

  

<b>September 29, 2018</b>				
<b>(In thousands)</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets:</b>				
Money market funds (cash equivalents)	\$ 140,588	\$ —	\$ —	\$ 140,588

#### 4. Revenue and geographic information

##### *Disaggregation of revenue*

Revenue by geographical region includes the applicable service revenue attributable to each region and is based on ship-to address, as follows:

<b>(In thousands)</b>	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>June 29, 2019</b>	<b>June 30, 2018</b>	<b>June 29, 2019</b>	<b>June 30, 2018</b>
Americas	\$ 145,612	\$ 122,982	\$ 520,684	\$ 447,705
Europe, Middle East and Africa (“EMEA”)	88,151	75,585	383,537	374,790
Asia Pacific (“APAC”)	26,356	9,831	62,442	41,574
Total revenue	<u>\$ 260,119</u>	<u>\$ 208,398</u>	<u>\$ 966,663</u>	<u>\$ 864,069</u>

Revenue is attributed to individual countries based on ship-to address and includes the applicable service revenue attributable to each country. Revenue by significant countries is as follows:

<b>(In thousands)</b>	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>June 29, 2019</b>	<b>June 30, 2018</b>	<b>June 29, 2019</b>	<b>June 30, 2018</b>
United States	\$ 134,924	\$ 113,558	\$ 481,888	\$ 409,701
Germany	20,636	18,512	96,775	95,720
United Kingdom	19,810	17,930	90,036	88,421
Other countries	84,749	58,398	297,964	270,227
Total revenue	<u>\$ 260,119</u>	<u>\$ 208,398</u>	<u>\$ 966,663</u>	<u>\$ 864,069</u>

**SONOS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
*(unaudited)*

Revenue by product categories includes the applicable service revenue attributable to each product category. Revenue by major product category is as follows:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>June 29, 2019</b>	<b>June 30, 2018</b>	<b>June 29, 2019</b>	<b>June 30, 2018</b>
<b>(In thousands)</b>				
Wireless speakers	\$ 104,626	\$ 93,867	\$ 401,994	\$ 453,185
Home theater speakers	89,660	66,732	388,902	283,952
Components	48,135	42,283	137,539	113,530
Other	17,698	5,516	38,228	13,402
Total revenue	<u>\$ 260,119</u>	<u>\$ 208,398</u>	<u>\$ 966,663</u>	<u>\$ 864,069</u>

SONOS, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
(unaudited)

## 5. Balance sheet components

### *Accounts receivable, net of allowances*

Accounts receivable, net of allowances, consist of the following:

	June 29, 2019	September 29, 2018
<b>(In thousands)</b>		
Accounts receivable	\$ 110,507	\$ 85,840
Allowance for doubtful accounts	(1,069)	(872)
Allowance for sales incentives	(18,105)	(11,754)
Accounts receivable, net of allowances	<u>\$ 91,333</u>	<u>\$ 73,214</u>

### *Inventories*

Inventories, net, consist of the following:

	June 29, 2019	September 29, 2018
<b>(In thousands)</b>		
Finished goods	\$ 104,078	\$ 176,181
Component parts	17,147	17,012
Inventories	<u>\$ 121,225</u>	<u>\$ 193,193</u>

The Company writes down inventory as a result of excess and obsolete inventories, or when it believes that the net realizable value of inventories is less than the carrying value.

### *Accrued expenses*

Accrued expenses consisted of the following:

	June 29, 2019	September 29, 2018
<b>(In thousands)</b>		
Accrued advertising and marketing	\$ 17,707	\$ 11,613
Accrued taxes	4,999	4,175
Accrued inventory	1,723	4,179
Accrued manufacturing, logistics and product development	9,348	8,290
Accrued general and administrative expenses	7,413	3,322
Other accrued payables	5,372	7,108
Total accrued expenses	<u>\$ 46,562</u>	<u>\$ 38,687</u>

**SONOS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
*(unaudited)*

**Deferred revenue**

Amounts invoiced in advance of revenue recognition are recorded as deferred revenue on the condensed consolidated balance sheets. Deferred revenue primarily relates to revenue allocated to unspecified software upgrades and platform services. The following table presents the changes in the Company's deferred revenue for the nine months ended June 29, 2019 and June 30, 2018 :

	<b>June 29, 2019</b>	<b>June 30, 2018</b>
<b>(In thousands)</b>		
Deferred revenue, beginning of period	\$ 50,967	\$ 45,567
Recognition of revenue included in beginning of period deferred revenue	(8,827)	(8,367)
Revenue deferred, net of revenue recognized on contracts in the respective period	13,966	18,594
Deferred revenue, end of period	<u>\$ 56,106</u>	<u>\$ 55,794</u>

The Company expects the following recognition of deferred revenue as of June 29, 2019 :

	<b>For the fiscal years ending</b>					
	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023 and Beyond</b>	<b>Total</b>
<b>(In thousands)</b>						
Deferred revenue expected to be recognized	\$ 3,561	\$ 12,934	\$ 11,631	\$ 9,785	\$ 18,195	\$ 56,106

**Other current liabilities**

Other current liabilities consist of the following:

	<b>June 29, 2019</b>	<b>September 29, 2018</b>
<b>(In thousands)</b>		
Reserve for returns	\$ 10,390	\$ 5,005
Product warranty liability	3,096	2,450
Other	2,660	3,403
Total other current liabilities	<u>\$ 16,146</u>	<u>\$ 10,858</u>

The following table presents the changes in the Company's warranty liability for the nine months ended June 29, 2019 and June 30, 2018 :

	<b>June 29, 2019</b>	<b>June 30, 2018</b>
<b>(In thousands)</b>		
Warranty liability, beginning of period	\$ 2,450	\$ 2,437
Provision for warranties issued during the period	9,474	6,865
Settlements of warranty claims during the period	(8,828)	(6,785)
Warranty liability, end of period	<u>\$ 3,096</u>	<u>\$ 2,517</u>

**SONOS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
*(unaudited)*

## 6. Debt

The Company's debt obligations consist of the Secured Credit Facility with J.P. Morgan Chase Bank, N.A. (the "Credit Facility") and the J.P. Morgan Chase Bank, N.A. Secured Term Loan (the "Term Loan"). The Company's short- and long-term debt obligations as of June 29, 2019 and September 29, 2018 was as follows:

	June 29, 2019		September 29, 2018	
	Rate	Balance	Rate	Balance
<b>(dollars in thousands)</b>				
J.P. Morgan Chase Bank, N.A Secured Term Loan <sup>(1)</sup>	5.1%	\$ 40,000	4.8%	\$ 40,000
Unamortized debt issuance costs <sup>(2)</sup>		(179)		(236)
Total indebtedness		39,821		39,764
Less short-term portion		(11,667)		(6,667)
Long-term debt		\$ 28,154		\$ 33,097

(1) Bears interest at a variable rate equal to an adjusted LIBOR plus 2.25% and is payable quarterly. Due in October 2021, with quarterly principal payments beginning in July 2019.

(2) Debt issuance costs are recorded as a debt discount and recorded as interest expense over the term of the agreement.

The Credit Facility allows the Company to borrow up to \$80.0 million restricted to the value of the borrowing base which is based on the value of inventory and accounts receivable and is subject to monthly redetermination. The Credit Facility matures in October 2021 and may be drawn as Commercial Bank Floating Rate Loans (at the higher of prime rate or adjusted LIBOR plus 2.50% ) or Eurocurrency Loans (at LIBOR plus an applicable margin). As of both June 29, 2019 and September 29, 2018 , the Company did not have any outstanding borrowings and had \$ 4.5 million in undrawn letters of credit that reduce the availability under the Credit Facility.

Debt obligations under the Credit Facility and the Term Loan require the Company to maintain a consolidated fixed charge ratio of at least 1.0 , restrict distribution of dividends unless certain conditions are met, such as having a fixed charge ratio of at least 1.15 , and require financial statement reporting and delivery of borrowing base certificates. As of June 29, 2019 and September 29, 2018 , the Company was in compliance with all financial covenants. The Credit Facility and the Term Loan are collateralized by eligible inventory and accounts receivable of the Company, as well as the Company's intellectual property including patents and trademarks.

## 7. Commitments and contingencies

### *Legal proceedings*

From time to time, the Company is involved in legal proceedings in the ordinary course of business, including claims relating to employee relations, business practices and patent infringement. Litigation can be expensive and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict and the Company's view of these matters may change in the future as the litigation and events related thereto unfold. The Company expenses legal fees as incurred. The Company records a provision for contingent losses when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. An unfavorable outcome to any legal matter, if material, could have an adverse effect on the Company's operations or its financial position, liquidity or results of operations.

On March 10, 2017, Implicit, LLC ("Implicit") filed a patent infringement action in the United States District Court, District of Delaware against the Company. Implicit is asserting that the Company infringed on two patents in

**SONOS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
*(unaudited)*

this case. The Company denies the allegations. There is no assurance of a favorable outcome and the Company's business could be adversely affected as a result of a finding that the Company patents-in-suit are invalid and/or unenforceable. A range of loss, if any, associated with this matter is not probable or reasonably estimable as of June 29, 2019 and September 29, 2018 .

The Company is involved in certain other litigation matters not listed above but does not consider the matters to be material either individually or in the aggregate at this time. The Company's view of the matters not listed may change in the future as the litigation and events related thereto unfold.

**SONOS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
*(unaudited)*

## 8. Stock-based compensation

In 2003, the Company's board of directors (the "Board") established the 2003 Stock Plan (as amended, the "2003 Plan"). In July 2018, the Board adopted the 2018 Equity Incentive Plan (the "2018 Plan") and ceased granting awards under the 2003 Plan. The 2018 Plan became effective in connection with the IPO. Any remaining shares of common stock available for issuance under the 2003 Plan on the effective date of the 2018 Plan were added to the shares of common stock reserved for issuance under the 2018 Plan as of such date, and additional shares of common stock that would become available for issuance under the 2003 Plan in the future will instead become available for issuance under the 2018 Plan, as further discussed in the Annual Report.

### *Stock options*

Pursuant to the 2018 Plan, the Company issues stock options to employees. The fair value of the stock options is based on the Company's closing stock price on the trading day immediately prior to the date of grant. The option price, number of shares and grant date are determined at the discretion of the Board. For so long as the optionholder performs services for the Company, the options generally vest over 48 months, with cliff vesting after one year and generally vest on a monthly or quarterly basis thereafter, and are exercisable for a period not to exceed ten years from the date of grant.

The summary of the Company's stock option activity is as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
<b>Outstanding at September 29, 2018</b>	48,504,182	\$ 10.33	6.6	\$ 276,959
Granted	1,714,328			
Exercised	(5,869,451)			
Forfeited	(4,247,115)			
<b>Outstanding at June 29, 2019</b>	<u>40,101,944</u>	\$ 11.10	6.4	\$ 82,902
At June 29, 2019				
Options exercisable	27,343,825	\$ 9.62	5.4	\$ 82,475
Options vested and expected to vest	38,174,480	\$ 10.93	6.3	\$ 82,792

As of June 29, 2019 and September 29, 2018, the Company had \$51.4 million and \$71.5 million, respectively, of unrecognized stock-based compensation expense, which is expected to be recognized over a weighted-average period of 2.2 and 2.6 years, respectively.

**SONOS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
*(unaudited)*

***Restricted stock units***

Pursuant to the 2018 Plan, the Company issues restricted stock units (“RSUs”) to employees. The fair value of RSUs is based on the Company’s closing stock price on the trading day immediately preceding the date of grant. RSUs typically have an initial annual cliff vest and then vest quarterly over the service period, which is generally four years. The summary of the Company’s unvested RSU activity is as follows:

	Number of Units	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value (in thousands)
<b>Unvested at September 29, 2018</b>	—	\$ —	\$ —
Granted	7,369,802		
Vested	(435,978)		
Forfeited	(225,899)		
<b>Unvested at June 29, 2019</b>	<b>6,707,925</b>	<b>\$ 11.31</b>	<b>\$ 76,068</b>
At June 29, 2019			
Units expected to vest	5,118,685	\$ 11.32	\$ 58,046

As of June 29, 2019, the Company had \$ 55.1 million of unrecognized stock-based compensation expense related to their RSUs, which is expected to be recognized over a weighted-average period of 3.6 years.

***Stock-based compensation***

Total stock-based compensation expense by function category was as follows:

	Three Months Ended		Nine Months Ended	
	June 29, 2019	June 30, 2018	June 29, 2019	June 30, 2018
<b>(In thousands)</b>				
Cost of revenue	\$ 298	\$ 49	\$ 701	\$ 156
Research and development	4,904	3,651	12,792	10,417
Sales and marketing	3,608	4,391	9,416	12,414
General and administrative	4,598	2,242	10,616	6,410
Total stock-based compensation expense	<b>\$ 13,408</b>	<b>\$ 10,333</b>	<b>\$ 33,525</b>	<b>\$ 29,397</b>

**9. Income taxes**

The Company’s tax provision and the resulting effective tax rate for interim periods is determined based upon its estimated annual effective tax rate, adjusted for the effect of discrete items arising in that quarter. The impact of such inclusions could result in a higher or lower effective tax rate during a particular quarter, based upon the mix and timing of actual earnings or losses versus annual projections. In each quarter, the Company updates its estimate of the annual effective tax rate, and if the estimated annual tax rate changes, a cumulative adjustment is made in that quarter.

The Company had an income tax expense of \$0.8 million and income tax expense of \$0.5 million for the three months ended June 29, 2019 and June 30, 2018, respectively. The Company had income tax expense of \$ 3.1 million and income tax expense of \$ 1.1 million for the nine months ended June 29, 2019 and June 30, 2018, respectively.

**SONOS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
*(unaudited)*

For the three and nine months ended June 29, 2019, we calculated our U.S. income tax provision using the discrete method as though the interim year to date period was an annual period. The Company believes that the application of the estimated annual effective tax rate (“AETR”) method generally required by ASC 740 is impractical for the U.S. tax provision given that normal deviations in the projected pre-tax net income (loss) in the U.S. could result in a disproportionate and unreliable effective tax rate under the AETR method.

For the quarter-ended June 29, 2019, the Company has maintained a full valuation allowance on its U.S. deferred tax assets due to its history of U.S. operating losses. It is possible that within the next 12 months there may be sufficient positive evidence to release a significant portion of the valuation allowance. Release of the U.S. valuation allowance would result in the establishment of certain deferred tax assets and a benefit to income tax expense for the period the release is recorded which could have a material impact on net earnings. The exact timing and amount of the valuation allowance release are subject to change based on the level of profitability achieved.

***Tax Cuts and Jobs Act***

On December 22, 2017, President Trump signed the Tax Cuts and Jobs Act (the “Tax Act”) into law, introducing significant changes to U.S. income tax law. Changes include, but are not limited to, a corporate tax rate decrease from 35% to 21% effective for tax years beginning after December 31, 2017 and the transition of U.S. international taxation from a worldwide tax system to a territorial system.

The Company is subject to certain of the provisions of the Tax Act during the year ending September 28, 2019. These provisions include a new tax on global intangible low-taxed income (“GILTI”), a deduction for foreign derived intangible income (“FDII”) and a minimum tax on certain transactions deemed to erode the U.S. tax base (“BEAT”). The Company has elected to account for GILTI as a period cost. In fiscal 2019, the Company does not believe that its effective tax rate will be materially impacted by GILTI or FDII, but the Company may be subject to BEAT. The total BEAT provision for the year is subject to change based on the Company’s results of operations and new Internal Revenue Service guidance issued during the year.

On December 22, 2017, the SEC issued Staff Accounting Bulletin No. 118, which allows the Company to record provisional amounts during a measurement period not to extend beyond one year of the enactment date. During the three months ended December 29, 2018, the Company completed the accounting for the elements of the Tax Act. The Company had previously not recorded a provision related to the Tax Act and has determined further adjustment was not required.

**SONOS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
*(unaudited)*

**10. Net income (loss) per share attributable to common stockholders**

Basic and diluted net income (loss) per share attributable to common stockholders is presented in conformity with the two-class method required for participating securities. The Company considers its redeemable convertible preferred stock to be participating securities as the holders of redeemable convertible preferred stock were entitled to receive noncumulative dividends in the event that a dividend was paid on common stock. Upon the closing of the IPO, all outstanding shares of the Company's redeemable convertible preferred stock automatically converted into 32,482,590 shares of common stock on a one -for-one basis.

Basic net income (loss) attributable to common stockholders per share is calculated by dividing net income (loss) attributable to common stockholders by the weighted-average number of shares of common stock outstanding less shares subject to repurchase. Diluted net income (loss) per share attributable to common stockholders adjusts the basic net income (loss) per share attributable to common stockholders and the weighted-average number of shares of common stock outstanding for the potentially dilutive impact of stock options and RSUs, using the treasury stock method, and convertible preferred stock using the as-if-converted method.

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

	Three Months Ended		Nine Months Ended	
	June 29, 2019	June 30, 2018	June 29, 2019	June 30, 2018
<b>(In thousands, except share and per share data)</b>				
Numerator:				
Net income (loss) attributable to common stockholders - basic and diluted	\$ (14,009)	\$ (26,988)	\$ 24,834	\$ (13,884)
Denominator:				
Weighted-average shares of common stock—basic	105,522,313	60,074,763	102,667,316	59,484,761
Effect of potentially dilutive stock options	—	—	9,115,070	—
Effect of RSUs	—	—	760,612	—
Weighted-average shares of common stock—diluted	105,522,313	60,074,763	112,542,998	59,484,761
Net income (loss) per share attributable to common stockholders:				
Net income (loss) per share attributable to common stockholders - basic	\$ (0.13)	\$ (0.45)	\$ 0.24	\$ (0.23)
Net income (loss) per share attributable to common stockholders - diluted	\$ (0.13)	\$ (0.45)	\$ 0.22	\$ (0.23)

**SONOS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**  
*(unaudited)*

The following potentially dilutive shares were excluded from the computation of diluted net income (loss) per share attributable to common stockholders because including them would have been antidilutive:

	Three Months Ended		Nine Months Ended	
	June 29, 2019	June 30, 2018	June 29, 2019	June 30, 2018
Convertible preferred stock	—	32,482,590	—	32,482,590
Stock options to purchase common stock	40,916,245	48,370,248	34,408,923	48,370,248
Restricted stock units	6,394,726	—	2,532,886	—
Shares subject to repurchase	—	53,892	—	53,892
Total	47,310,971	80,906,730	36,941,809	80,906,730

**11. Defined contribution plans**

The Company has a defined contribution 401(k) plan (the "401(k) Plan") for the Company's U.S.-based employees, as well as defined contribution plans for employees in Germany, France and Netherlands. In the second quarter of fiscal 2019, the Company began making contributions towards the 401(k) Plan, as well as towards the defined contribution plans in Germany, France and Netherlands.

## Item 2. Management's discussion and analysis of financial condition and results of operations

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes included in Part I, Item 1 of this Quarterly Report on Form 10-Q and with our audited consolidated financial statements included in our Annual Report.*

*We have a 4-4-5 fiscal year ending on the Saturday nearest September 30 each year. Our fiscal year is divided into four quarters of 13 weeks, each beginning on a Sunday and containing two 4-week periods followed by a 5-week period.*

### Forward-looking statements

*This Quarterly Report on Form 10-Q contains forward-looking statements. All statements other than statements of historical facts contained in this Quarterly Report on Form 10-Q, including statements regarding future operations are forward-looking statements. In some cases, forward-looking statements may be identified by words such as “believe,” “may,” “will,” “estimate,” “continue,” “anticipate,” “intend,” “could,” “would,” “expect,” “objective,” “plan,” “potential,” “seek,” “grow,” “target,” “if,” and similar expressions intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and trends that we believe may affect our financial condition, results of operations, business strategy, short-term and long-term business operations and objectives and financial needs. These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including those described in the section titled “Risk Factors” set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q and in our other SEC filings, including our Annual Report. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties and assumptions, the future events and trends discussed in this Quarterly Report on Form 10-Q may not occur and actual results may differ materially and adversely from those anticipated or implied in the forward-looking statements. You should read this Quarterly Report on Form 10-Q with the understanding that our actual future results, levels of activity, performance and events and circumstances may be materially different from what we expect.*

### Overview

Sonos was founded with a clear mission—to fill every home with music. This mission led us to invent wireless multi-room home audio. Sonos transforms the way people live and interact by restoring the shared experience of music throughout the home. Our home sound system provides an immersive listening experience created by our thoughtfully designed speakers and components, our proprietary software platform and the ability to wirelessly stream the content our customers love from the services they prefer.

We generate substantially all revenue from the sale of our wireless speakers, home theater speakers and component products, as new customers buy our products and existing customers continue to add products to their Sonos home sound systems. Our wireless speakers include Play:1, Play:5 and Sonos One, which includes native voice control. Our home theater products include Playbar, Playbase and Sub, as well as Sonos Beam, which includes native voice control. Our component products include Connect, Connect:Amp and Sonos Amp, as well as our architectural speakers recently released in connection with our Sonance partnership. We also generate revenue from other sources, such as module revenue, the sale of Sonos and third-party accessories like speaker stands and wall mounts, as well as licensing revenue. Module revenue is comprised of sales of hardware and embedded software that is integrated into final products that are manufactured and sold by our partners. We sell our products primarily through over 10,000 third-party physical retailers, including custom installers of home audio systems. We also sell through select e-commerce retailers and our website sonos.com. Our products are distributed in over 50 countries. We operate offices and development labs worldwide, with a significant presence in the United States, the Netherlands and China.

## Key metrics

In addition to the measures presented in our condensed consolidated financial statements, we use the following additional key metrics to evaluate our business, measure our performance, identify trends affecting our business and assist us in making strategic decisions. Our key metrics are products sold, adjusted EBITDA and adjusted EBITDA margin.

Net income (loss) is the most directly comparable financial measure calculated under U.S. GAAP for adjusted EBITDA. In the three months ended June 29, 2019 and June 30, 2018, we had net losses of \$14.0 million and \$27.0 million, respectively. In the nine months ended June 29, 2019 and June 30, 2018, we had net income of \$24.8 million and a net loss of \$13.9 million, respectively.

	Three Months Ended		Nine Months Ended	
	June 29, 2019	June 30, 2018	June 29, 2019	June 30, 2018
<b>(in thousands, except percentages)</b>				
Products sold	1,083	887	4,253	3,957
Adjusted EBITDA	\$ 6,797	\$ (1,541)	\$ 91,457	\$ 48,968
Adjusted EBITDA margin	2.6%	(0.7)%	9.5%	5.7%

### *Products sold*

Products sold represents the number of products that are sold during a period, net of returns. Products sold includes the sale of wireless speakers, home theater speakers and component products. Products sold excludes the sale of other products, such as module units from our IKEA partnership and Sonos and third-party accessories. Historically, the sale of other items has not materially contributed to our revenue. Growth rates between products sold and revenue are not perfectly correlated because our revenue is affected by other variables, such as the mix of products sold during the period, promotional discount activity and the introduction of new products that may have higher or lower than average selling prices.

### *Adjusted EBITDA and adjusted EBITDA margin*

We define adjusted EBITDA as net income (loss) adjusted to exclude the impact of stock-based compensation expense, depreciation, interest, other income (expense), taxes and items considered to be non-recurring. We define adjusted EBITDA margin as adjusted EBITDA divided by revenue. See “Non-GAAP financial measures” below for information regarding our use of adjusted EBITDA and adjusted EBITDA margin and a reconciliation of net income (loss) to adjusted EBITDA.

### *Non-GAAP financial measures*

To supplement our condensed consolidated financial statements presented in accordance with U.S. GAAP, we monitor and consider adjusted EBITDA and adjusted EBITDA margin, which are non-GAAP financial measures. These non-GAAP financial measures are not based on any standardized methodology prescribed by U.S. GAAP and are not necessarily comparable to similarly titled measures presented by other companies.

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We use these non-GAAP financial measures to evaluate our operating performance and trends and make planning decisions. We believe that these non-GAAP financial measures help identify underlying trends in our business that could otherwise be masked by the effect of the expenses and other items that we exclude in these non-GAAP financial measures. Accordingly, we believe that these non-GAAP financial measures provide useful information to investors and others in understanding and evaluating our operating results, enhance the overall understanding of our past performance and future prospects and allow for greater transparency with respect to key financial metrics used by our management in its financial and operational decision-making. Adjusted EBITDA and adjusted EBITDA margin are non-GAAP financial measures, and should not be considered in isolation of, or as an alternative to, measures prepared in accordance with U.S. GAAP. There are a number of limitations related to the use of adjusted EBITDA rather than net income (loss), which is the nearest U.S. GAAP equivalent of adjusted EBITDA, and the use of adjusted EBITDA margin rather than operating margin, which is the nearest U.S. GAAP equivalent of adjusted EBITDA margin. Some of these limitations are:

- these non-GAAP financial measures exclude depreciation and, although these are non-cash expenses, the assets being depreciated may be replaced in the future;
- these non-GAAP financial measures exclude stock-based compensation expense, which has been, and will continue to be, a significant recurring expense for our business and an important part of our compensation strategy;
- these non-GAAP financial measures do not reflect interest expense, or the cash requirements necessary to service interest or principal payments on our debt, which reduces cash available to us;
- these non-GAAP financial measures do not reflect the effect of foreign currency exchange gains or losses, which is included in other income (expense), net;
- these non-GAAP financial measures do not reflect income tax payments that reduce cash available to us; and
- the expenses and other items that we exclude in our calculation of these non-GAAP financial measures may differ from the expenses and other items, if any, that other companies may exclude from these non-GAAP financial measures when they report their operating results.

Because of these limitations, these non-GAAP financial measures should be considered along with other operating and financial performance measures presented in accordance with U.S. GAAP.

The following table presents a reconciliation of net income (loss) to adjusted EBITDA:

	Three Months Ended		Nine Months Ended	
	June 29, 2019	June 30, 2018	June 29, 2019	June 30, 2018
<b>(in thousands, except percentages)</b>				
Net income (loss)	\$ (14,009)	\$ (26,988)	\$ 24,834	\$ (13,884)
Depreciation	8,439	9,760	27,403	28,647
Stock-based compensation expense	13,408	10,333	33,525	29,397
Interest (income) expense, net	(806)	1,116	(1,019)	3,367
Other (income) expense, net	(1,068)	3,744	3,640	315
Provision for income taxes	833	494	3,074	1,126
Adjusted EBITDA	\$ 6,797	\$ (1,541)	\$ 91,457	\$ 48,968
Revenue	\$ 260,119	\$ 208,398	\$ 966,663	\$ 864,069
Adjusted EBITDA margin	2.6%	(0.7)%	9.5%	5.7%

## Factors affecting performance

**New product introductions.** To date, new product introductions have had a positive impact on our revenue. New product launches and changes in our product mix can contribute to significant year-over-year revenue variability. When new products are introduced, initial sales of the product to our retail channel partners can lead to revenue that is higher than normal for the period. Additionally, although channels are typically filled before general availability, revenue recognition related to new product introductions is delayed until the date of general availability, which can sometimes magnify the impact of a new product launch in quarters where there is a general availability launch.

**Seasonality** . Historically, we have experienced the highest levels of revenue in the first fiscal quarter of the year, coinciding with the holiday shopping season. Our promotional discounting activity is higher in the first fiscal quarter as well, which negatively impacts gross margin during this period. However, our higher sales volume in the holiday shopping season has historically resulted in a higher operating margin in the first fiscal quarter due to positive operating leverage.

## Components of results of operations

### **Revenue**

We generate substantially all of our revenue from the sale of wireless speakers, home theater speakers and component products. We also generate a small portion of our revenue from other revenue sources, such as module revenue from our IKEA partnership, the sale of Sonos and third-party accessories like speaker stands and wall mounts, as well as professional services and licensing revenue. Our revenue is recognized net of allowances for returns, discounts, sales incentives and any taxes collected from customers. We also defer a portion of our revenue that is allocated to unspecified software upgrades and cloud-based services. Our revenue is subject to fluctuation based on the foreign currency in which our products are sold, principally for sales denominated in the euro and the British pound. The introduction of new products may result in an increase in revenue but may also impact revenue generated from existing products as volume mix shifts to the new products.

### **Cost of revenue**

Cost of revenue consists of product costs, including costs of our contract manufacturers for production, component product costs, shipping and handling costs, warranty replacement costs, packaging, fulfillment costs, manufacturing and tooling equipment depreciation, warehousing costs, hosting costs and excess and obsolete inventory write-downs. In addition, we allocate certain costs related to management and facilities, personnel-related expenses and other expenses associated with supply chain logistics. Personnel-related expenses consist of salaries, bonuses, benefits and stock-based compensation expenses.

### **Gross profit and gross margin**

Our gross margin may, in the future, fluctuate from period to period based on a number of factors, including the mix of products we sell, the channel mix through which we sell our products and the foreign currency in which our products are sold. As we increase the pace of our product introductions, we expect our gross margin to decline in the near to intermediate term as new products gain a larger share of our overall product mix. We have historically seen that the gross margin for our newly released products are lowest at launch and have tended to increase over time as we realize cost efficiencies. As such, our ability to reduce the cost of our products is critical to increasing our gross margin over the long term.

### **Operating expenses**

Operating expenses consist of research and development, sales and marketing and general and administrative expenses.

**Research and development** . Research and development expenses consist primarily of personnel-related expenses, consulting and contractor expenses, tooling, test equipment, prototype materials and related overhead costs. To date, software development costs have been expensed as incurred, because the period between achieving technological feasibility and the release of the software has been short and development costs qualifying for capitalization have been insignificant. We expect to continue to invest in research and development as we develop new products.

**Sales and marketing** . Sales and marketing expenses consist primarily of advertising and marketing promotions of our products and personnel-related expenses, as well as trade show and event costs, sponsorship costs, consulting and contractor expenses, travel, product display expenses and related depreciation, customer care costs and overhead costs.

**General and administrative** . General and administrative expenses consist of personnel-related expenses for our finance, legal, human resources and administrative personnel, as well as the costs of professional services, information

technology, litigation expenses, patent costs, related overhead and other administrative expenses. We expect our general and administrative expenses to increase in absolute dollars due to the growth of our business and related infrastructure as well as legal, accounting, insurance, investor relations and other costs associated with operating as a public company.

***Other income (expense), net***

*Interest income (expense), net.* Interest income consists primarily of interest income earned on our cash and cash equivalents balances. Interest expense consists primarily of interest expense associated with our debt financing arrangements and amortization of debt issuance costs.

*Other income (expense), net.* Other income (expense), net consists primarily of our foreign currency exchange gains and losses relating to transactions and remeasurement of asset and liability balances denominated in currencies other than the U.S. dollar. We expect our foreign currency gains and losses to continue to fluctuate in the future due to changes in foreign currency exchange rates.

***Provision for income taxes***

We are subject to income taxes in the United States and foreign jurisdictions in which we operate. Foreign jurisdictions have statutory tax rates different from those in the United States. Accordingly, our effective tax rate will vary depending on the relative proportion of foreign to U.S. income, the utilization of foreign tax credits and changes in tax laws.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. A valuation allowance is provided when it is more likely than not that the deferred tax assets will not be realized. We have established a full valuation allowance to offset our U.S. and certain foreign net deferred tax assets due to the uncertainty of realizing future tax benefits from our net operating loss carryforwards and other deferred tax assets. It is possible that within the next 12 months there may be sufficient evidence to release a significant portion of the U.S. valuation allowance. Release of the U.S. valuation allowance would result in the establishment of certain deferred tax assets and a benefit to income tax expense for the period the release is recorded which could have a material impact on net earnings. The exact timing and amount of the valuation allowance release are subject to change based on the level of profitability achieved.

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**Results of operations**

The following table sets forth our condensed consolidated results of operations for the periods indicated. The period-to-period comparison of financial results is not necessarily indicative of financial results to be achieved in future periods.

	Three Months Ended		Nine Months Ended	
	June 29, 2019	June 30, 2018	June 29, 2019	June 30, 2018
<b>(in thousands)</b>				
Revenue	\$ 260,119	\$ 208,398	\$ 966,663	\$ 864,069
Cost of revenue <sup>(1)</sup>	142,749	112,909	563,591	491,037
Gross profit	117,370	95,489	403,072	373,032
Operating expenses				
Research and development <sup>(1)</sup>	44,355	35,444	121,530	104,209
Sales and marketing <sup>(1)</sup>	61,482	60,819	176,705	214,077
General and administrative <sup>(1)</sup>	26,583	20,860	74,308	63,822
Total operating expenses	132,420	117,123	372,543	382,108
Operating income (loss)	(15,050)	(21,634)	30,529	(9,076)
Other income (expense), net				
Interest income (expense), net	806	(1,116)	1,019	(3,367)
Other income (expense), net	1,068	(3,744)	(3,640)	(315)
Total other income (expense), net	1,874	(4,860)	(2,621)	(3,682)
Income (loss) before provision for income taxes	(13,176)	(26,494)	27,908	(12,758)
Provision for income taxes	833	494	3,074	1,126
Net income (loss)	\$ (14,009)	\$ (26,988)	\$ 24,834	\$ (13,884)
Adjusted EBITDA <sup>(2)</sup>	\$ 6,797	\$ (1,541)	\$ 91,457	\$ 48,968

(1) Amounts include stock-based compensation expense as follows:

	Three Months Ended		Nine Months Ended	
	June 29, 2019	June 30, 2018	June 29, 2019	June 30, 2018
Cost of revenue	\$ 298	\$ 49	\$ 701	\$ 156
Research and development	4,904	3,651	12,792	10,417
Sales and marketing	3,608	4,391	9,416	12,414
General and administrative	4,598	2,242	10,616	6,410
Total stock-based compensation expense	\$ 13,408	\$ 10,333	\$ 33,525	\$ 29,397

(2) Adjusted EBITDA is a financial measure that is not calculated in accordance with U.S. GAAP. See the section titled “Non-GAAP financial measures” above.

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The following table sets forth selected condensed consolidated financial data for the periods indicated, expressed as a percentage of revenue (the table may not foot due to rounding):

	Three Months Ended		Nine Months Ended	
	June 29, 2019	June 30, 2018	June 29, 2019	June 30, 2018
Revenue	100.0%	100.0 %	100.0%	100.0%
Cost of revenue <sup>(1)</sup>	54.9	54.2	58.3	56.8
Gross profit	45.1	45.8	41.7	43.2
Operating expenses				
Research and development <sup>(1)</sup>	17.1	17.0	12.6	12.1
Sales and marketing <sup>(1)</sup>	23.6	29.2	18.3	24.8
General and administrative <sup>(1)</sup>	10.2	10.0	7.7	7.4
Total operating expenses	50.9	56.2	38.5	44.2
Operating income (loss)	(5.8)	(10.4)	3.2	(1.1)
Other income (expense), net				
Interest income (expense), net	0.3	(0.5)	0.1	(0.4)
Other income (expense), net	0.4	(1.8)	(0.4)	—
Total other income (expense), net	0.7	(2.3)	(0.3)	(0.4)
Income (loss) before provision for income taxes	(5.1)	(12.7)	2.9	(1.5)
Provision for income taxes	0.3	0.2	0.3	0.1
Net income (loss)	(5.4)	(13.0)	2.6	(1.6)
Adjusted EBITDA margin <sup>(2)</sup>	2.6%	(0.7)%	9.5%	5.7%

(1) Amounts include stock-based compensation expense as follows:

	Three Months Ended		Nine Months Ended	
	June 29, 2019	June 30, 2018	June 29, 2019	June 30, 2018
Cost of revenue	0.1%	—%	0.1%	—%
Research and development	1.9	1.8	1.3	1.2
Sales and marketing	1.4	2.1	1.0	1.4
General and administrative	1.8	1.1	1.1	0.7
Total stock-based compensation expense	5.2%	5.0%	3.5%	3.4%

(2) Adjusted EBITDA is a financial measure that is not calculated in accordance with U.S. GAAP. See the section titled “Non-GAAP financial measures” above.

**Comparison of the three and nine months ended June 29, 2019 and June 30, 2018**
**Revenue**

*Comparison of the three months ended June 29, 2019 and June 30, 2018*

	Three Months Ended		Change	
	June 29, 2019	June 30, 2018	\$	%
<b>(dollars and products sold in thousands)</b>				
Americas	\$ 145,612	\$ 122,982	\$ 22,630	18.4%
EMEA	88,151	75,585	12,566	16.6%
APAC	26,356	9,831	16,525	168.1%
Total revenue	<u>\$ 260,119</u>	<u>\$ 208,398</u>	<u>\$ 51,721</u>	<u>24.8%</u>
Total products sold	1,083	887	196	22.1%

Total revenue increased by \$51.7 million, or 24.8% , from \$208.4 million for the three months ended June 30, 2018 to \$260.1 million for the three months ended June 29, 2019 , due to growth in all our product categories. Growth in home theater products was primarily related to the launch of our newest home theater product, Sonos Beam, which launched in July 2018 and an increase in sales of our Sub product. The growth in our home theater category was partially offset by decreases in Playbar and Playbase speakers. The growth in our other category was driven primarily by revenue from module units. Revenue growth in our wireless speaker category was driven primarily by increases in sales of our Sonos One speakers. Revenue growth in our component category was attributed to the launch of Sonos Amp in November 2018, which was partially offset by a decrease in sales of Connect:Amp.

Products sold increased by 22.1% for the three months ended June 29, 2019 compared to the three months ended June 30, 2018 . The volume growth was primarily driven by sales of Sonos One, Sonos Beam and Sonos Amp products. Volume growth was partially offset by a decrease in sales of our Connect:Amp products, due to volume mix shifting from Connect:Amp to Sonos Amp, and a decrease in Play:3 speakers due to discontinuing Play:3 speakers in fiscal 2018.

Revenue from the Americas increased \$ 22.6 million, or 18.4% , from \$ 123.0 million for the three months ended June 30, 2018 to \$ 145.6 million for the three months ended June 29, 2019 . The increase in Americas revenue was driven by strong growth in home theater products related to the launch of Sonos Beam, the addition of retailers, and growth in sales of our wireless speakers and component products.

Revenue from EMEA increased \$ 12.6 million, or 16.6% , from \$ 75.6 million for the three months ended June 30, 2018 to \$ 88.2 million for the three months ended June 29, 2019 . The increase in EMEA revenue was driven by increases in sales of wireless speaker products, home theater products and component products.

Revenue from APAC increased \$ 16.5 million, or 168.1% , from \$ 9.8 million for the three months ended June 30, 2018 to \$ 26.4 million for the three months ended June 29, 2019 . The increase in APAC revenue was primarily driven by revenue from module units and an increase in sales of our home theater products.

In constant U.S. dollars, total revenue increased by 27.9% for the three months ended June 29, 2019 compared to the three months ended June 30, 2018 , which excludes the impact of foreign currencies fluctuating against the U.S. dollar. We calculate constant currency growth percentages by translating our prior-period financial results using the current period average currency exchange rates and comparing these amounts to our current period reported results.

Comparison of the nine months ended June 29, 2019 and June 30, 2018

	Nine Months Ended		Change	
	June 29, 2019	June 30, 2018	\$	%
<b>(dollars and products sold in thousands)</b>				
Americas	\$ 520,684	\$ 447,705	\$ 72,979	16.3%
EMEA	383,537	374,790	8,747	2.3%
APAC	62,442	41,574	20,868	50.2%
Total revenue	\$ 966,663	\$ 864,069	\$ 102,594	11.9%
Total products sold	4,253	3,957	296	7.5%

Total revenue increased by \$ 102.6 million, or 11.9% , from \$ 864.1 million for the nine months ended June 30, 2018 to \$ 966.7 million for the nine months ended June 29, 2019 , due to growth in each of our home theater, components and other categories. Growth in home theater products was primarily related to the launch of our newest home theater product, Sonos Beam, and an increase in sales of our Sub product. The growth in our home theater category was partially offset by decreases in Playbar and Playbase speakers. Growth in our components products was driven by the launch of Sonos Amp in November 2018, which was partially offset by a decrease in sales of Connect:Amp. The growth in our other category was driven by revenue from module units. Total revenue growth was partially offset by a decrease in revenue from our wireless speaker category, primarily driven by decreases in sales of earlier generations of our wireless speakers products. The decrease in our wireless speakers category was partially offset by an increase in sales of Sonos One speakers related to the volume mix shifting from Play:1 to Sonos One speakers.

Products sold increased by 7.5% , from 4.0 million for the nine months ended June 30, 2018 to 4.3 million for the nine months ended June 29, 2019 . Volume growth was driven by the launch of Sonos Beam, sales of Sonos One and the launch of Sonos Amp. Volume growth was partially offset by a decrease in sales of earlier generations of our wireless speaker products.

Revenue from the Americas increased \$ 73.0 million, or 16.3% , from \$ 447.7 million for the nine months ended June 30, 2018 to \$ 520.7 million for the nine months ended June 29, 2019 . The increase in Americas revenue was driven by strong growth in home theater products related to the launch of Sonos Beam, sales growth in component products related to the launch of Sonos Amp and the addition of retailers, and was partially offset by decreases in wireless speaker products.

Revenue from EMEA increased \$ 8.7 million, or 2.3% , from \$ 374.8 million for the nine months ended June 30, 2018 to \$ 383.5 million for the nine months ended June 29, 2019 . The increase in EMEA revenue was driven by increased sales of home theater products related to the launch of Sonos Beam and increased sales of our components category, and was partially offset by decreases in wireless speaker products.

Revenue from APAC increased \$ 20.9 million, or 50.2% , from \$ 41.6 million for the nine months ended June 30, 2018 to \$ 62.4 million for the nine months ended June 29, 2019 . The increase in APAC revenue was primarily driven by sales revenue from module units.

In constant U.S. dollars, total revenue increased by 14.5% for the nine months ended June 29, 2019 compared to the nine months ended June 30, 2018 , which excludes the impact of foreign currencies fluctuating against the U.S. dollar. We calculate constant currency growth percentages by translating our prior-period financial results using the current period average currency exchange rates and comparing these amounts to our current period reported results.

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### Cost of revenue and gross profit

Comparison of the three months ended June 29, 2019 and June 30, 2018

	Three Months Ended		Change	
	June 29, 2019	June 30, 2018	\$	%
<b>(dollars in thousands)</b>				
Cost of revenue	\$ 142,749	\$ 112,909	\$ 29,840	26.4%
Gross profit	\$ 117,370	\$ 95,489	\$ 21,881	22.9%
Gross margin	45.1%	45.8%		

Cost of revenue increased \$29.8 million, or 26.4% , from \$112.9 million for the three months ended June 30, 2018 to \$142.7 million for the three months ended June 29, 2019 , primarily due to the 24.8% increase in revenue and higher costs related to a shift in product mix driven by the launch of Sonos Beam in July 2018.

Gross margin decreased to 45.1% for the three months ended June 29, 2019 compared to 45.8% for the three months ended June 30, 2018 , primarily due to a reduction in licensing revenue and unfavorable foreign currency exchange impacts.

Comparison of the nine months ended June 29, 2019 and June 30, 2018

	Nine Months Ended		Change	
	June 29, 2019	June 30, 2018	\$	%
<b>(dollars in thousands)</b>				
Cost of revenue	\$ 563,591	\$ 491,037	\$ 72,554	14.8%
Gross profit	\$ 403,072	\$ 373,032	\$ 30,040	8.1%
Gross margin	41.7%	43.2%		

Cost of revenue increased \$ 72.6 million, or 14.8% , from \$ 491.0 million for the nine months ended June 30, 2018 to \$ 563.6 million for the nine months ended June 29, 2019 , primarily due to the 11.9% increase in revenue and higher costs related to a shift in product mix driven by the launch of Sonos Beam in July 2018.

Gross margin decreased to 41.7% for the nine months ended June 29, 2019 compared to 43.2% for the nine months ended June 30, 2018 , primarily due to the shift in product mix and unfavorable foreign currency exchange impacts.

### Research and development

Comparison of the three months ended June 29, 2019 and June 30, 2018

	Three Months Ended		Change	
	June 29, 2019	June 30, 2018	\$	%
<b>(dollars in thousands)</b>				
Research and development	\$ 44,355	\$ 35,444	\$ 8,911	25.1%
Percentage of revenue	17.1%	17.0%		

Research and development expenses increased \$8.9 million, or 25.1% , from \$35.4 million for the three months ended June 30, 2018 to \$44.4 million for the three months ended June 29, 2019 . The increase was primarily due to higher personnel-related expenses of \$7.2 million as we increased our headcount, particularly in software personnel as we continue to invest in new products and features.

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Comparison of the nine months ended June 29, 2019 and June 30, 2018

	Nine Months Ended		Change	
	June 29, 2019	June 30, 2018	\$	%
<b>(dollars in thousands)</b>				
Research and development	\$ 121,530	\$ 104,209	\$ 17,321	16.6%
Percentage of revenue	12.6%	12.1%		

Research and development expenses increased \$ 17.3 million, or 16.6% , from \$ 104.2 million for the nine months ended June 30, 2018 to \$ 121.5 million for the nine months ended June 29, 2019 . The increase was primarily due to higher personnel-related expenses of \$14.4 million as we increased our headcount, particularly in software personnel as we continue to invest in new products and features.

#### Sales and marketing

Comparison of the three months ended June 29, 2019 and June 30, 2018

	Three Months Ended		Change	
	June 29, 2019	June 30, 2018	\$	%
<b>(dollars in thousands)</b>				
Sales and marketing	\$ 61,482	\$ 60,819	\$ 663	1.1%
Percentage of revenue	23.6%	29.2%		

Sales and marketing expenses increased \$ 0.7 million, or 1.1% , from \$ 60.8 million for the three months ended June 30, 2018 to \$ 61.5 million for the three months ended June 29, 2019 . The increase was due to an increase of \$5.2 million in marketing and advertising costs and \$1.8 million in professional fees primarily related to new advertising campaigns, offset by a decrease of \$6.2 million in personnel-related costs driven by a decrease in headcount.

Comparison of the nine months ended June 29, 2019 and June 30, 2018

	Nine Months Ended		Change	
	June 29, 2019	June 30, 2018	\$	%
<b>(dollars in thousands)</b>				
Sales and marketing	\$ 176,705	\$ 214,077	\$ (37,372)	(17.5)%
Percentage of revenue	18.3%	24.8%		

Sales and marketing expenses decreased \$ 37.4 million, or 17.5% , from \$ 214.1 million for the nine months ended June 30, 2018 to \$ 176.7 million for the nine months ended June 29, 2019 . The decrease was primarily due to a decline of \$19.5 million in marketing and advertising costs primarily related to reduced marketing expenses as we continue to transition away from traditional paid media and we adopt more efficient direct-to-consumer and digital marketing tools. The decrease was also due to \$17.5 million in reductions from personnel-related costs driven by a decrease in headcount.

### General and administrative

Comparison of the three months ended June 29, 2019 and June 30, 2018

	Three Months Ended		Change	
	June 29, 2019	June 30, 2018	\$	%
<b>(dollars in thousands)</b>				
General and administrative	\$ 26,583	\$ 20,860	\$ 5,723	27.4%
Percentage of revenue	10.2%	10.0%		

General and administrative expenses increased \$5.7 million, or 27.4% , from \$20.9 million for the three months ended June 30, 2018 to \$26.6 million for the three months ended June 29, 2019 . The increase was primarily due to an increase in personnel-related costs of \$4.1 million, predominantly driven by higher wages and incentive compensation, and an increase of \$1.4 million in professional fees as we invest in the programs necessary to support our public company infrastructure.

Comparison of the nine months ended June 29, 2019 and June 30, 2018

	Nine Months Ended		Change	
	June 29, 2019	June 30, 2018	\$	%
<b>(dollars in thousands)</b>				
General and administrative	\$ 74,308	\$ 63,822	\$ 10,486	16.4%
Percentage of revenue	7.7%	7.4%		

General and administrative expenses increased \$ 10.5 million, or 16.4% , from \$ 63.8 million for the nine months ended June 30, 2018 to \$ 74.3 million for the nine months ended June 29, 2019 . The increase was primarily due to an increase in personnel-related costs of \$8.0 million and \$1.7 million of increased overhead expenses, predominantly driven by higher wages and incentive compensation as we invest in the programs necessary to support our public company infrastructure.

### Interest income (expense), net and other income (expense), net

Comparison of the three months ended June 29, 2019 and June 30, 2018

	Three Months Ended		Change	
	June 29, 2019	June 30, 2018	\$	%
<b>(dollars in thousands)</b>				
Interest income (expense), net	\$ 806	\$ (1,116)	\$ 1,922	*
Other income (expense), net	\$ 1,068	\$ (3,744)	\$ 4,812	*

\* not meaningful

The change in interest income (expense), net was primarily due to higher investment yields on our cash balances and a lower effective interest rate as a result of refinancing our Term Loan. The change in other income (expense), net was primarily due to foreign currency exchange gains and losses.

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Comparison of the nine months ended June 29, 2019 and June 30, 2018

	Nine Months Ended		Change	
	June 29, 2019	June 30, 2018	\$	%
<b>(dollars in thousands)</b>				
Interest income (expense), net	\$ 1,019	\$ (3,367)	\$ 4,386	*
Other expense, net	\$ (3,640)	\$ (315)	\$ (3,325)	*

\* not meaningful

The change in interest income (expense), net was due to higher investment yields on our cash balances and a lower effective interest rate as a result of refinancing our Term Loan. The change in other income (expense), net was primarily due to foreign currency exchange gains and losses.

**Provision for income taxes**

Comparison of the three months ended June 29, 2019 and June 30, 2018

	Three Months Ended		Change	
	June 29, 2019	June 30, 2018	\$	%
<b>(dollars in thousands)</b>				
Provision for income taxes	\$ 833	\$ 494	\$ 339	*

\* not meaningful

Provision for income taxes changed from a provision of \$0.5 million for the three months ended June 30, 2018 to a provision of \$ 0.8 million for the three months ended June 29, 2019 .

For the three-months ended June 29, 2019 , we recorded a provision for income taxes of \$0.6 million for certain profitable foreign entities and \$0.2 million for U.S. federal and state income tax for a total provision of \$0.8 million. For the three months ended June 29, 2019 , we calculated our U.S. income tax provision using the discrete method as though the interim year to date period was an annual period. We believe that the application of the estimated annual effective tax rate ("AETR") method generally required by ASC 740 is impractical for the U.S. tax provision given that normal deviations in the projected pre-tax net income (loss) in the U.S. could result in a disproportionate and unreliable effective tax rate under the AETR method. We recorded a provision for income taxes of \$0.5 million for certain profitable foreign entities for the three months ended June 30, 2018 .

Comparison of the nine months ended June 29, 2019 and June 30, 2018

	Nine Months Ended		Change	
	June 29, 2019	June 30, 2018	\$	%
<b>(dollars in thousands)</b>				
Provision for income taxes	\$ 3,074	\$ 1,126	\$ 1,948	*

\* not meaningful

Provision for income taxes increased from \$1.1 million for the nine months ended June 30, 2018 to \$ 3.1 million for the nine months ended June 29, 2019 .

For the nine -months ended June 29, 2019 , we recorded a provision for income taxes of \$1.2 million for certain profitable foreign entities and a provision of \$1.9 million for U.S. federal and state income tax for a total provision of \$3.1 million. For the nine months ended June 29, 2019 , we calculated our U.S. income tax provision using the discrete method as though the interim year to date period was an annual period for the reasons described above.

For the nine months ended June 30, 2018 , we recorded a provision for income taxes of \$1.3 million for certain profitable foreign entities and a benefit of \$0.2 million as a result of U.S. tax reform for a total provision of \$1.1 million.

## Liquidity and capital resources

Our operations are financed primarily through cash flow from operating activities, net proceeds from the sale of our equity securities, including net proceeds of \$90.6 million from the closing of our IPO on August 6, 2018, and borrowings under our Term Loan and Credit Facility. As of June 29, 2019, our principal sources of liquidity consisted of cash flow from operating activities, cash and cash equivalents of \$338.3 million, including \$ 43.6 million held by our foreign subsidiaries, proceeds from exercise of stock options and borrowing capacity under the Credit Facility. In accordance with our policy, the undistributed earnings of our non-U.S. subsidiaries remain indefinitely reinvested outside of the United States as of June 29, 2019, as they are required to fund needs outside the United States. In the event funds from foreign operations are needed to fund operations in the United States and if U.S. tax has not already been previously provided, we may be required to accrue and pay additional U.S. taxes to repatriate these funds.

We believe our existing cash and cash equivalent balances, cash flow from operations and committed credit lines will be sufficient to meet our working capital and capital expenditure needs for the next 12 months. Our future capital requirements may vary materially from those currently planned and will depend on many factors, including our rate of revenue growth, the timing and extent of spending on research and development efforts and other business initiatives, our planned sales and marketing activities, the timing of new product introductions, market acceptance of our products and overall economic conditions. To the extent that current and anticipated future sources of liquidity are insufficient to fund our future business activities and requirements, we may be required to seek additional equity or debt financing. The sale of additional equity would result in additional dilution to our stockholders. The incurrence of additional debt financing would result in increased debt service obligations and the instruments governing such debt could provide for operating and financing covenants that would restrict our operations.

### Debt obligations

Our debt obligations consist of the Credit Facility and the Term Loan. Our short- and long-term debt obligations as of June 29, 2019 and September 29, 2018 was as follows:

(dollars in thousands)	As of			
	June 29, 2019		September 29, 2018	
	Rate	Balance	Rate	Balance
Term Loan <sup>(1)</sup>	5.1%	\$ 40,000	4.8%	\$ 40,000
Unamortized debt issuance costs <sup>(2)</sup>		(179)		(236)
Total indebtedness		39,821		39,764
Less short-term portion		(11,667)		(6,667)
Long-term debt		\$ 28,154		\$ 33,097

(1) Bears interest at a variable rate equal to an adjusted LIBOR plus 2.25% and is payable quarterly. Due in October 2021, with quarterly principal payments beginning in July 2019.

(2) Debt issuance costs are recorded as a debt discount and recorded as interest expense over the term of the agreement.

The Credit Facility allows us to borrow up to \$80.0 million restricted to the value of the borrowing base which is based on the value of our inventory and accounts receivable and is subject to monthly redetermination. The Credit Facility matures in October 2021 and may be drawn as Commercial Bank Floating Rate Loans (at the higher of prime rate or adjusted LIBOR plus 2.50%) or Eurocurrency Loans (at LIBOR plus an applicable margin). As of both June 29, 2019 and September 29, 2018, we did not have any outstanding borrowings and had \$ 4.5 million in undrawn letters of credit that reduce the availability under the Credit Facility.

Debt obligations under the Credit Facility and the Term Loan require that we maintain a consolidated fixed charge ratio of at least 1.0, restrict distribution of dividends unless certain conditions are met, such as having a fixed charge ratio of at least 1.15, and require financial statement reporting and delivery of borrowing base certificates. As of June 29, 2019 and September 29, 2018, we were in compliance with all financial covenants. The Credit Facility

and the Term Loan are collateralized by eligible inventory and accounts receivable, as well as our intellectual property including patents and trademarks.

### Cash flows

The following table summarizes our cash flows for the periods indicated:

	Nine Months Ended	
	June 29, 2019	June 30, 2018
<b>(In thousands)</b>		
Net cash provided by (used in):		
Operating activities	\$ 110,936	\$ 15,792
Investing activities	(14,092)	(25,927)
Financing activities	20,617	2,683
Effect of exchange rate changes	(103)	1,289
Net change in cash, cash equivalents and restricted cash	\$ 117,358	\$ (6,163)

#### Cash flows from operating activities

Net cash provided by operating activities of \$110.9 million for the nine months ended June 29, 2019 consisted of net income of \$24.8 million, non-cash adjustments of \$64.2 million and a net increase in cash related to changes in operating assets and liabilities of \$21.9 million. Non-cash adjustments primarily consisted of stock-based compensation expense of \$33.5 million and depreciation of \$27.4 million. The change in operating assets and liabilities was primarily due to a decrease in inventory of \$69.7 million due to the seasonality of our business, an increase in deferred revenue of \$5.3 million, an increase in other liabilities of \$4.1 million and an increase in accrued compensation of \$1.1 million. The increase in net change in operating assets and liabilities was offset by a decrease in accounts payable and accrued expenses of \$33.7 million related to the decrease in inventory, an increase in accounts receivable of \$19.1 million due to the seasonality of our business and an increase in other assets of \$5.4 million.

Net cash provided by operating activities of \$15.8 million for the nine months ended June 30, 2018 consisted of a net loss of \$13.9 million, non-cash adjustments of \$59.1 million and a net decrease in cash related to changes in operating assets and liabilities of \$29.4 million. Non-cash adjustments primarily consisted of stock-based compensation expense of \$29.4 million and depreciation of \$28.6 million. The change in operating assets and liabilities was primarily due to a \$24.4 million net decrease in accounts payable and accrued expenses due to seasonality, an increase in accounts receivable of \$5.7 million primarily due to seasonality, and a decrease in accrued compensation of \$4.2 million, offset by an increase in deferred revenue of \$10.3 million primarily related to shipments of Sonos Beam as the product was not yet available for sale to the general public.

#### Cash flows from investing activities

Cash used in investing activities for the nine months ended June 29, 2019 of \$14.1 million was due to payments for property and equipment, which were primarily comprised of manufacturing-related tooling and test equipment to support the launch of new products, leasehold improvements and marketing-related product displays.

Cash used in investing activities for the nine months ended June 30, 2018 of \$25.9 million was due to payments for property and equipment, which was primarily comprised of marketing-related product displays and manufacturing-related tooling and test equipment used at our contract manufacturers to support the launch of new products.

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### *Cash flows from financing activities*

Cash provided by financing activities for the nine months ended June 29, 2019 of \$20.6 million primarily consisted of proceeds from exercise of stock options of \$22.0 million , partially offset by payments for purchases of treasury stock of \$0.8 million and final payments of offering costs of \$0.6 million .

Cash provided by financing activities for the nine months ended June 30, 2018 of \$2.7 million primarily consisted of net proceeds of \$30.0 million from the issuance of debt and proceeds from the exercise of common stock options of \$5.7 million. These increases were offset by a net paydown of our revolving credit facilities of \$30.0 million, payment of offering costs of \$2.2 million, and \$0.9 million related to the repurchase of common stock to provide liquidity for existing equity holders.

### *Commitments and contingencies*

At June 29, 2019 , we had \$56.3 million in non-cancelable purchase commitments for inventory we expect to purchase in the remainder of fiscal 2019 .

### *Off-balance sheet arrangements*

We have not entered into any off-balance sheet arrangements, except as described above, and do not have any holdings in variable interest entities.

### **Critical accounting policies and estimates**

Our unaudited condensed consolidated financial statements are prepared in accordance with U.S. GAAP. The preparation of these unaudited condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses and related disclosures. We evaluate our estimates and assumptions on an ongoing basis. Our estimates are based on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ materially from those estimates.

Other than items discussed in Note 2 of our condensed consolidated financial statements, there have been no material changes to our critical accounting policies as compared to the critical accounting policies and significant judgments and estimates disclosed in our Annual Report.

### **Item 3. Quantitative and qualitative disclosures about market risk**

We are exposed to financial market risks, including changes in currency exchange rates and interest rates. For quantitative and qualitative disclosures about market risk, refer to Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in our Annual Report. Our exposure to market risk has not changed materially, except as follows:

#### *Foreign currency risk*

Our inventory purchases are primarily denominated in U.S. dollars. Our international sales are primarily denominated in foreign currencies and any movement in the exchange rate between the U.S. dollar and the currencies in which we conduct sales in foreign countries could have an impact on our revenue, principally for sales denominated in the euro and the British pound. A portion of our operating expenses are incurred outside the United States and are denominated in foreign currencies, which are also subject to foreign currency exchange rate fluctuations. In certain countries where we may invoice customers in the local currency our revenues benefit from a weaker dollar and are adversely affected by a stronger dollar. The opposite impact occurs in countries where we record expenses in local currencies. In those cases, our costs and expenses benefit from a stronger dollar and are adversely affected by a weaker dollar. The fluctuations in our operating expenses outside the United States resulting from volatility in foreign exchange rates are not generally moderated by corresponding fluctuations in revenues from existing contracts.

We do not currently use foreign exchange contracts or derivatives to hedge any foreign currency exposures. The volatility of exchange rates depends on many factors that we cannot forecast with reliable accuracy. Our continued

international expansion increases our exposure to exchange rate fluctuations and, as a result, such fluctuations could have a significant impact on our future results of operations.

We recognized a gain of \$ 1.1 million and a loss of \$3.8 million from foreign currency gains and losses for the three months ended June 29, 2019 and June 30, 2018 , respectively. We recognized a loss of \$ 3.6 million and a loss of \$ 0.4 million from foreign currency gains for the nine months ended June 29, 2019 and June 30, 2018 , respectively. Based on transactions denominated in currencies other than respective functional currencies as of June 29, 2019 , a hypothetical adverse change of 10% would have resulted in an adverse impact on income (loss) before provision for income taxes of approximately \$ 1.5 million for the three months ended June 29, 2019 and \$ 8.8 million for the nine months ended June 29, 2019 .

#### **Item 4. Controls and procedures**

##### **Evaluation of disclosure controls and procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended), as of the end of the period covered by this Quarterly Report on Form 10-Q.

Based on the evaluation of our disclosure controls and procedures as of June 29, 2019 , our Chief Executive Officer and Chief Financial Officer concluded that as a result of the material weaknesses in our internal control over financial reporting that were disclosed in our Annual Report, our disclosure controls and procedures were not effective as of June 29, 2019 .

Notwithstanding the material weaknesses, our management has concluded that the condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q present fairly, in all material respects, our financial position, results of operations and cash flows in conformity with GAAP.

##### **Management's plan to remediate the material weaknesses**

As previously described in Part II, Item 9A of our Annual Report, we began implementing a remediation plan to address the material weaknesses mentioned above. The initiatives we are implementing to remediate the material weaknesses are subject to continued management review supported by confirmation and testing, as well as audit committee oversight. We will continue to implement measures to remedy our internal control deficiencies through the end of fiscal 2019, which coincides with the first year in which we will be required to provide the management's report on internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act").

##### **Changes in internal control**

Other than the changes intended to remediate the material weaknesses noted above, there were no changes in our internal control over financial reporting during the three months ended June 29, 2019 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

From time to time, we may become involved in legal proceedings or be subject to claims arising in the ordinary course of our business. Other than the matters described in Note 7 of the notes to our condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q, we are not presently a party to any legal proceedings that in the opinion of our management, if determined adversely to us, would individually or taken together have a material adverse effect on our business, operating results, financial condition or cash flows. Regardless of the outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources, and other factors.

### Item 1A. Risk factors

*Investing in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below, as well as the other information in this Quarterly Report on Form 10-Q, including our condensed consolidated financial statements and the related notes, and the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations," before making an investment decision. The occurrence of any of the events or developments described below could materially and adversely affect our business, financial condition, results of operations and growth prospects. In such an event, the market price of our common stock could decline, and you may lose all or part of your investment. Additional risks and uncertainties not currently known to us or that we currently believe are not material may also impair our business, financial condition, results of operations and growth prospects.*

#### Risks related to our business

***We have a recent history of losses and expect to incur increased operating costs in the future, and we may not achieve or sustain profitability.***

We have experienced net losses in our recent annual periods. In the fiscal years ended September 29, 2018, September 30, 2017 and October 1, 2016, we had net losses of \$15.6 million, \$14.2 million and \$38.2 million, respectively. We had an accumulated deficit of \$178.8 million as of June 29, 2019. We expect our operating expenses to increase in the future as we expand our operations and execute on our product roadmap. We plan to make significant future expenditures related to the expansion of our business and our product offerings, including investments in:

- research and development to continue to introduce innovative new products, enhance existing products and improve our customers' listening experience;
- sales and marketing to expand our global brand awareness, promote new products, increase our customer base and expand sales within our existing customer base; and
- legal, accounting, information technology and other administrative expenses to sustain our operations as a public company.

We need to increase our revenue to achieve and maintain profitability in the future. We cannot assure you that our revenue will continue to grow or that it will not decline. In addition, we anticipate that new product introductions will adversely impact our gross margin in the near to intermediate term due to the increasing frequency of these product introductions and their anticipated increased share of our overall product volume. In the past, we have taken cost savings initiatives, including our reorganization effort in the third quarter of fiscal 2018. However, our cost savings initiatives do not assure our profitability. Additional reorganizations may be implemented in the future and cost savings may be offset by future hiring or other costs to pursue strategic objectives. Our revenue may decline, or we may incur significant losses for a number of reasons, including the other risks and uncertainties described in these Risk Factors.

***The pace of our revenue growth has been volatile, and we cannot assure you that we will continue to achieve consistent revenue growth.***

We have experienced volatile revenue growth and demand for our products since launching our first product in 2005. Our revenue grew 14.6% in fiscal 2018 over fiscal 2017, 10.1% in fiscal 2017 over fiscal 2016 and 6.8% in fiscal 2016 over fiscal 2015. Our historical revenue growth rates therefore should not be considered indicative of our future

performance. Additionally, because our ability to achieve continued growth will depend on our ability to execute on our product roadmap, we cannot guarantee that our revenue will continue to grow. In order for our revenue growth to continue, and for the volatility of our growth to stabilize, we will need to be successful in determining the market opportunity for new products and developing and delivering products that appeal to consumers and stimulate demand. If we are unable to do so, our revenue may not grow as anticipated or at all, and the trading price of our common stock may decline.

The volatility of our revenue growth could cause our operating expenses to exceed our revenue in some periods. The unpredictable nature of the growth and expansion of our business and product offerings also places a continuous and significant strain on our management, operational and financial resources. In future periods, we could experience a decline in revenue, or revenue could grow more slowly than we expect, which could have a material negative effect on our operating results and our stock price could be harmed.

***Our operating results depend on a number of factors and are likely to fluctuate from quarter to quarter, which makes them difficult to predict and which could cause the trading price of our common stock to decline.***

Our operating results and other key metrics have fluctuated in the past and may continue to fluctuate from quarter to quarter. We expect that this trend will continue as a result of a number of factors, many of which are outside of our control and may be difficult to predict, including:

- fluctuations in demand for our products, including seasonal variations;
- the timing and success of new product introductions, which products initially tend to have a lower gross margin;
- the timing and success of new product introductions by our competitors;
- pricing pressure as a result of competition or otherwise;
- shifts in product, geographic or channel mix;
- the imposition of tariffs and other trade barriers, and the effects of retaliatory trade measures;
- delays or disruptions in our supply, manufacturing or distribution chain;
- fluctuations in costs and availability of raw materials and components, and in other manufacturing costs;
- fluctuations in levels of channel inventory;
- amount and timing of sales and marketing and other operating expenses related to maintenance and expansion of our business;
- negative publicity about our products;
- adverse litigation judgments, settlements or other litigation-related costs, especially from litigation involving alleged patent infringement or defense of our patents;
- fluctuations in foreign exchange rates;
- changes in tax rates or adverse changes in tax laws that expose us to additional income tax liabilities;
- natural disasters, geopolitical unrest, war, terrorism and other catastrophes outside of our control; and
- general economic conditions in domestic or international markets.

Any one of the factors above or the cumulative effect of some of the factors above may result in significant fluctuations in our operating results. As a result, period-to-period comparisons of our operating results may not be meaningful, and you should not rely on them as an indication of our future performance. The variability and unpredictability of our quarterly operating results or other operating metrics could result in our failure to meet our expectations or those of investors or any

analysts that cover us with respect to revenue or other operating results for a particular period. If we fail to meet or exceed such expectations for these or any other reasons, the market price of our common stock could fall substantially.

***The success of our business depends on the continued growth of the voice-enabled speaker market, and our ability to establish and maintain market share.***

We have increasingly focused our product roadmap on voice-enabled speakers, and we introduced our first voice-enabled speaker, Sonos One, in October 2017, and our first voice-enabled home theater speaker, Sonos Beam, in July 2018. The voice-enabled speaker market and the voice-enabled smart home systems market are still in the early stages of development. If these markets do not continue to grow, or grow in unpredictable ways, our revenue may fall short of expectations and our operating results may be harmed, particularly since we incur substantial costs to introduce new products in advance of anticipated sales. Additionally, even if the market for voice-enabled speakers does expand, we may not be successful in developing and selling speakers that appeal to consumers or gain sufficient market acceptance. To succeed in this market, we will need to design, produce and sell innovative and compelling products and partner with other businesses that enable us to capitalize on new technologies. We also face intense competition in our markets, and we are dependent on a number of technology partners for the development of our products, some of which have developed or may develop and sell voice-enabled speaker products of their own. For example, Sonos One and Sonos Beam both feature voice-control enablement powered by Amazon's Alexa or Google's Google Assistant technology, and Amazon and Google currently compete with us by offering speaker products of their own. As we continue to execute on our product roadmap, our success in introducing voice-enabled speakers that utilize third-party technology, especially voice control, will increasingly depend on the willingness of our technology partners, many of which sell or may develop products that compete with ours, to continue to promote and enhance our products. These technology partners may cease doing business with us or disable the technology they provide our products for a variety of reasons, including to promote their products over our own. If these partners disable the integration of their technology into our products, demand for our products may decrease and our sales may be harmed. We cannot assure you that the resources we invest in research and development, existing or alternative technology partnerships, marketing and sales will be adequate for us to successfully establish and maintain a large share of the voice-enabled speaker market. If we are not able to capture and sustain market share, our future revenue growth will be negatively impacted.

***To remain competitive and stimulate consumer demand, we must successfully manage frequent new product introductions and transitions.***

Due to the highly volatile and competitive nature of the home audio and broader consumer electronics industry, we must frequently introduce new products, enhance existing products and effectively stimulate customer demand for new and upgraded products in both mature and developing markets. The successful introduction of our new products depends on a number of factors, such as the timely completion of development efforts to correspond with limited windows for market introduction. In recent years, we have experienced delays in bringing new products to market, along with higher-than-expected costs in doing so. We face significant challenges in managing the risks associated with new product introductions and production ramp-up issues, including accurately forecasting initial consumer demand, as well as the risk that new products may have quality or other defects in the early stages of introduction. New and upgraded products can also affect the sales and profitability of existing products. In addition, from time to time, we enter into strategic alliances or collaborative partnerships with third parties to develop, commercialize and market new products, which may not be successful or result in significant revenues. Accordingly, if we cannot properly manage the introduction of our new products, our operating results and financial condition may be adversely impacted, particularly if the cadence of new product introductions increases as we expect.

***We are highly dependent on a key contract manufacturer to manufacture our products, and while we recently began using additional manufacturers, we may be unable to operate our business if our key contract manufacturer is unable to manufacture our products or ends its relationship with us.***

We have historically depended on a single manufacturer, Inventec Appliances Corporation ("Inventec"), to manufacture our products. Recently, we began using additional manufacturers to manufacture certain of our products, though Inventec remains our key manufacturer for the vast majority of our production. Our reliance on Inventec increases the risk that, in the event of an interruption in Inventec's operations, whether due to a natural catastrophe, labor dispute or otherwise, we would not be able to maintain our production capacity without incurring material additional costs and substantial delays. Additionally, Inventec can terminate its agreement with us for any reason with 180 days' advance notice. If Inventec breaches or terminates its agreement with us or otherwise fails to perform its obligations in a timely manner, we may be severely delayed or fully prevented from selling our products. If Inventec were unable to perform its obligations or were to end its relationship with us, it would take a significant amount of time to increase our production with other manufacturers.

or to identify and onboard a new manufacturer that has the capability and resources to build our products to our specifications in sufficient volume. Moreover, a violation of labor, environmental, intellectual property or other laws by our manufacturers, or a failure of our manufacturers to follow generally accepted ethical business practices, could create negative publicity, harm our reputation and require us to contract with new manufacturers. Identifying additional manufacturers would require us to evaluate and approve their quality control systems, technical capabilities, responsiveness, service, financial stability, regulatory compliance and labor and other ethical practices. Any material disruption in our relationship with our manufacturers would harm our ability to compete effectively and satisfy demand for our products, and could adversely impact our revenue, gross margin and operating results.

***We depend on a limited number of third-party components suppliers and logistics providers. Our business may be harmed if these parties do not perform their obligations or if they suffer interruptions to their own operations, or if alternative component sources are unavailable or if there is an increase in the costs of these components.***

We are dependent on a limited number of suppliers for various key components used in our products, and the cost, quality and availability of these components are essential to the successful production and sale of our products. We have sole-source suppliers, particularly for product-specific mechanical enclosures, and single-source suppliers, particularly for processor components. We are subject to the risk of shortages and long lead times in the supply of these components and other materials, and the risk that our suppliers discontinue or modify, or increase the price of, the components used in our products. If the supply of these components were to be delayed or constrained, or if one or more of our main suppliers were to go out of business, alternative sources or suppliers may not be available on acceptable terms or at all. Further, if there were a shortage of supply, the cost of these components may increase and harm our ability to sell our products on a cost-effective basis. For example, similar to other companies in the electronics industries, we have from time to time experienced shortages of random-access memory that is integral to manufacturing our products. More recently, the global supply of multilayer ceramic capacitors, which are components used across the consumer electronics industry as well as in all of our products, is experiencing shortages due to an imbalance of global demand and supply capacity, resulting in related price increases that we expect will negatively impact our gross margin through calendar year 2019. In connection with any supply shortages in the future, reliable and cost-effective replacement sources may not be available on short notice or at all, and this may result in decreased sales or force us to increase prices and face a corresponding decrease in demand for our products. In the event that any of our suppliers were to discontinue production of our key product components, developing alternate sources of supply for these components would be time consuming, difficult and costly. This would harm our ability to sell our products in order to meet market demand and could materially and adversely affect our brand, image, business prospects and operating results.

We use a small number of logistics providers for substantially all of our product delivery to both distributors and retailers. If one of these providers were to experience financial difficulties or disruptions in its business, our own operations could be adversely affected. Because substantially all of our products are distributed from a small number of locations and by a small number of companies, we are susceptible to both isolated and system-wide interruptions caused by events out of our control. Our distribution facilities employ computer-controlled and automated equipment, and thus may be vulnerable to computer viruses or other security risks, as well as to electronic or power interruptions or other system failures. Any disruption to the operations of our distribution facilities could delay product delivery, harm our reputation among our customers and adversely affect our operating results and financial condition.

We have limited control over these parties on which our business depends. If any of these parties fails to perform its obligations on schedule, or breaches or ends its relationship with us, we may be unable to satisfy demand for our products. Delays, product shortages and other problems could impair our retail distribution and brand image and make it difficult for us to attract new customers. If we experience significantly increased demand, or if we need to replace an existing supplier or logistics provider, we may be unable to supplement or replace such supply or logistics capacity on terms that are acceptable to us, which may undermine our ability to deliver our products to customers in a timely manner. Further, we do not have long-term contracts with all of these parties, and there can be no assurance that we will be able to renew our contracts with them on favorable terms or at all. Accordingly, a loss or interruption in the service of any key party could adversely impact our revenue, gross margin and operating results.

***Our investments in marketing may not yield the results we expect.***

We have made significant investments in marketing our products. Such efforts include direct marketing to consumers to promote awareness of our products, and of our brand in general. These efforts may not yield the results we anticipate and may prove more expensive than we currently anticipate, and revenue may not increase sufficiently to offset these higher expenses. Failures in our marketing efforts could adversely impact our business, financial condition and results of operations.

***The home audio and consumer electronics industries are highly competitive. Competition presents an ongoing threat to the success of our business.***

The markets in which we operate are extremely competitive and rapidly evolving, and we expect that competition will intensify in the future. Our competition includes established, well-known sellers of speakers and sound systems such as Bang & Olufsen, Bose, Samsung (and its subsidiaries Harman International and JBL), Sony and Sound United (and its subsidiaries Denon and Polk), and developers of voice-enabled speakers and systems such as Amazon, Apple and Google. We could also face competition from new market entrants, some of whom might be current partners of ours. In order to deliver products that appeal to changing and increasingly diverse consumer preferences, and to overcome the fact that a relatively high percentage of consumers may already own or use products that they perceive to be similar to those that we offer, we must develop superior technology, anticipate increasingly diverse consumer tastes and rapidly develop attractive products with competitive selling prices. Even if we are able to efficiently develop and offer innovative products at competitive selling prices, our operating results and financial condition may be adversely impacted if we are unable to effectively anticipate and counter the ongoing price erosion that frequently affects consumer products or if the average selling prices of our products decrease faster than we are able to reduce our manufacturing costs.

Most of our competitors have greater financial, technical and marketing resources available to them than those available to us, and, as a result, they may develop competing products that cause the demand for our products to decline. Our current and potential competitors have established, or may establish, cooperative relationships among themselves or with third parties in order to increase the abilities of their products to address the needs of our prospective customers, and other companies may enter our markets by acquiring or entering into strategic relationships with our competitors. To remain competitive, we may also need to increase our selling and marketing expenses. We may not have the financial resources, technical expertise or marketing and sales capabilities to continue to compete successfully. A failure to efficiently anticipate and respond to these established and new competitors may adversely impact our business and operating results.

Further, our current and prospective competitors may consolidate with each other or acquire companies that will allow them to develop products that better compete with our products. Such consolidation would intensify the competition that we face and may also disrupt or lead to termination of our distribution, technology and content partnerships. For example, if one of our content partners were to acquire a home audio hardware company, that partner may decide to disable the streaming functionality of its service with our products. If we are unable to compete with these consolidated companies or if consolidation in the market disrupts our partnerships or reduces the number of companies we partner with, our business would be adversely affected.

***Conflicts with our distribution and technology partners could harm our business and operating results.***

Several of our existing products compete, and products that we may offer in the future could compete, with the product offerings of some of our significant channel and distribution partners, which partners have greater financial resources than we do. Amazon and Apple, for example, already offer products that compete with ours. To the extent products offered by our partners compete with our products, they may choose to promote their own products over ours or could end our partnerships and cease selling or promoting our products entirely. If our distribution partners, such as Amazon and Apple, continue to compete with us more directly in the future, they would be able to market and promote their products more prominently than they market and promote our products, and could refuse to promote or offer our products for sale alongside their own, or at all, in distribution channels. Any reduction in our ability to place and promote our products, or increased competition for available shelf or website placement, especially during peak retail periods, such as the holiday shopping season, would require us to increase our marketing expenditures and to seek other distribution channels in order to promote our products. If we are unable to effectively sell our products due to conflicts with our distribution partners, our business would be harmed.

We are currently developing, manufacturing and selling voice-enabled speaker systems that are enhanced with the technology of our partners, including those who sell competing products. We introduced Sonos One in October 2017 and Sonos Beam in July 2018, which both feature built in voice-control enablement powered by Amazon's Alexa or Google's Google Assistant technology. One or more of our partners could disable their integration or begin charging us for their

integration with our Sonos One or Sonos Beam products. For example, our current agreement with Amazon allows Amazon to disable the Alexa integration in our Sonos One or Sonos Beam products with limited notice. We cannot assure you that we will be successful in establishing partnerships with other companies that have developed voice-control enablement technology or in developing such technology on our own. If one or more of such partners do not maintain their integration with our products or seek to charge us for this integration, or if we have not developed alternative partnerships for similar voice-enabled products or such technology on our own, our sales may decline, our reputation may be harmed and our business and operating results may suffer.

***Competition from our partners who are able to sell speaker products at lower prices could force us to lower our prices, which would harm our operating results.***

Many of our current and potential partners have business objectives that may drive them to sell their speaker products at a significant discount to ours. Amazon and Google, for example, both currently offer their speaker products at significantly lower prices than Sonos One and Sonos Beam. Many of these partners may subsidize these prices and seek to monetize their customers through the sale of additional services rather than the speakers themselves. Our business model, by contrast, is dependent on the sale of our speakers. Should we be forced to lower the price of our products in order to compete on a price basis, our operating results could be harmed.

***Competition with our content partners could cause these partners to cease to allow their content to be streamed on our products, which could lower product demand.***

Demand for our products depends in large part on the availability of streaming third-party content that appeals to our existing and prospective customers. Compatibility with streaming music services, podcast platforms and other content provided by our content partners is a key feature of our products. To date, all of our arrangements have been entered into on a royalty-free basis. Some of these content partners compete with us already, and others may in the future produce and sell speakers along with their streaming services. Additionally, other content partners may form stronger alliances with our competitors in the home audio market. Any of our content partners may cease to allow their content to be streamed on our products for a variety of reasons, including to promote other partnerships or their products over our products, or seek to charge us for this streaming. If this were to happen, demand for our products could decrease and our operating results could be harmed.

***If we are unable to accurately anticipate market demand for our products, we may have difficulty managing our production and inventory and our operating results could be harmed.***

We must forecast production and inventory needs in advance with our suppliers and manufacturer, and our ability to do so accurately could be affected by many factors, including an increase or decrease in customer demand for our products or those of our competitors, the success of new products in the market, sales promotions by us or our competitors, channel inventory levels and unanticipated shifts in general economic conditions or consumer confidence levels. Such a rapid increase in production could also cause a decline in manufacturing quality and customer satisfaction. If demand does not meet our forecast, excess product inventory could force us to write-down or write-off inventory, or to sell the excess inventory at discounted prices, which could cause our gross margin to suffer and could impair the strength of our brand. In addition, if we were to have excess inventory, we may have reduced working capital, which could adversely affect our ability to invest in other important areas of our business such as marketing and product development. If our channel partners have excess inventory of our products, they may decrease purchase of our products in subsequent periods. If demand exceeds our forecast and we do not have sufficient inventory to meet this demand, we would have to rapidly increase production and suffer higher supply and manufacturing costs that would lower our gross margin. Any of these scenarios could adversely impact our operating results and financial condition.

***We experience seasonal demand for our products, and if our sales in high-demand periods are below our forecasts, our overall financial condition and operating results could be adversely affected.***

Given the seasonal nature of our sales, accurate forecasting is critical to our business. Our fiscal year ends on the Saturday closest to September 30, the holiday shopping season occurs in the first quarter of our fiscal year and the typically slower summer months occur in the fourth quarter of our fiscal year. Historically, our revenue has been significantly higher in our first fiscal quarter due to increased consumer spending patterns during the holiday season. We attempt to time our new product releases to coincide with relatively higher consumer spending in the first fiscal quarter, which contributes to this seasonal variation. Any shortfalls in expected first fiscal quarter revenue, due to macroeconomic conditions, product release patterns, a decline in the effectiveness of our promotional activities, supply chain disruptions or for any other reason, could cause our annual operating results to suffer significantly. In addition, if we fail to accurately forecast customer

demand for the holiday season, we may experience excess inventory levels or a shortage of products available for sale, which could further harm our financial condition and operating results.

***If market demand for streaming music does not grow as anticipated or the availability and quality of streaming services does not continue to increase, our business could be adversely affected.***

A large proportion of our customer base uses our products to listen to content via subscription-based streaming music services. Accordingly, we believe our future revenue growth will depend in significant part on the continued expansion of the market for streaming music. We cannot assure you that this market will continue to grow. The success of the streaming music market depends on the quality, reliability and adoption of streaming technology, and on the continued success of streaming music services such as Apple Music, Pandora, Spotify and TuneIn. In order to attract and retain customers, these services must continue to attract record labels, artists, other content providers and advertisers and all parties must be able to successfully monetize their streaming-based businesses over the long term. If the development of the streaming music market fails to keep pace with consumer demand expectations, the market for streaming music could decline and our business may be harmed. Additionally, we cannot assure you that the streaming music business model or the streaming music services we partner with will be successful over the long term. If the streaming music market in general declines or if the streaming services we partner with are not successful, demand for our products may suffer and our operating results may be adversely affected.

***If we are not successful in expanding our direct-to-consumer sales channel by driving consumer traffic and consumer purchases through our website, our business and results of operations could be harmed.***

We are currently investing in our direct-to-consumer sales channel, primarily through our website, and our future growth relies in part on our ability to attract consumers to this channel. We plan to invest in driving sales through this channel. The level of consumer traffic and volume of consumer purchases through our website depends in large part on our ability to provide a user-friendly and visually appealing interface, a seamless consumer experience, sufficient inventory and reliable, timely delivery of our products. Building this channel and improving our website and product delivery services will continue to require significant expenditures in marketing, software development and infrastructure. If we are unable to drive traffic to, and increase sales through, our website, our business and results of operations could be harmed. The success of direct-to-consumer sales through our website is subject to risks associated with e-commerce, including implementing and maintaining appropriate technology and systems, reliance on third-party service providers, data breaches and disruption of internet service. Our inability to adequately respond to these risks and uncertainties or to successfully maintain and expand our direct-to-consumer business via our website may have an adverse impact on our results of operations.

Additionally, the expansion of our direct-to-consumer channel may alienate some of our channel partners and could cause a reduction in product sales from these partners. Channel partners may perceive themselves to be at a disadvantage based on the direct-to-consumer sales offered through our website. Due to these and other factors, conflicts in our sales channels could arise and cause channel partners to divert resources away from the promotion and sale of our products or to offer competitive products. Further, to the extent we use our mobile app to increase traffic to our website and increase direct-to-consumer sales, we will rely on application marketplaces such as the Apple App Store and Google Play to drive downloads of our mobile app. Apple and Google, both of which sell products that compete with ours, may choose to use their marketplaces to promote their competing products over our products or may make access to our mobile app more difficult. Any of these situations could adversely impact our business and results of operations.

***We sell our products through a limited number of key channel partners, and the loss of any such channel partner would adversely impact our business.***

We are dependent on our channel partners for a vast majority of our product sales. Some of our key channel partners include Best Buy, which accounted for 16% of our revenue in fiscal 2019, and the ALSO Group, our distributor in Germany, Sweden, Denmark and Norway, which accounted for 10% of our revenue in fiscal 2019. We do not enter into long-term volume commitments with our major channel partners. If one or several of our channel partners were to discontinue selling our products, increase their promotion of competing products or choose to promote competing products over ours, the volume of our products sold to customers could decrease, which could in turn harm our business. In addition, the loss of a key channel partner for distribution would require us to identify and contract with alternative channel partners, or to rely more heavily on direct-to-consumer sales, which we may be unable to do successfully, or which could prove time-consuming and expensive. In addition, revenue from our channel partners depends on a number of factors outside our control and may vary from period to period. If one or more of our channel partners were to experience serious financial difficulty as a result of weak economic conditions or otherwise, and were to reduce its inventory of our products or limit or cease

operations, our business and results of operations would be significantly harmed. Consolidation of our channel partners in the future or additional concentration of market share among our channel partners may also exacerbate this risk.

Because we compete with many other providers of consumer products for placement and promotion of products in the stores of our channel partners, our success depends on our channel partners and their willingness to promote our products successfully. In general, our contracts with these third parties allow them to exercise significant discretion over the placement and promotion of our products in their stores, and they could give higher priority to other products. Our channel partners may also give their own products or those of our competitors better placement over our products in stores or online. If our channel partners do not effectively market and sell our products, or if they choose to use greater efforts to market and sell their own or our competitors' products, our business, operating results and prospects may be adversely affected.

***A significant disruption in our websites, servers or information technology systems, or those of our third-party partners, or flaws or other vulnerabilities in our products, could impair our customers' listening experience or otherwise adversely affect our customers, damage our reputation or harm our business.***

As a consumer electronics company, our website and mobile app are important presentations of our business, identity and brand, and an important means of interacting with, and providing information to, consumers of our products. We depend on our servers and centralized information technology systems, and those of third parties, for product functionality and to store intellectual property, forecast our business, maintain financial records, manage operations and inventory and operate other critical functions. Accordingly, we rely heavily on the accuracy, capacity and security of both our information technology systems and those of third parties. We allocate significant resources to maintaining our information technology systems and deploying network security, data encryption, training and other measures to protect against unauthorized access or misuse. Nevertheless, our website and information technology systems, and those of the third parties we rely on, are susceptible to damage, disruptions or shutdowns due to power outages, hardware failures, structural or operational failures, computer viruses, hacking attacks, telecommunication failures, user error, malfeasance, system upgrades, integration or migration, and other foreseeable and unforeseeable events. All of our products are connected to the internet and receive periodic software updates from our servers and it is possible that such servers could be compromised, resulting in the delivery of malicious code, severely hampering product functionality. System failures and disruptions could impede the manufacturing and shipping of products, delivery of online services, functionality of our products, transactions processing and financial reporting, and could result in the loss of intellectual property or data, require substantial repair costs and damage our reputation and business relationships. Such failures and disruptions could therefore adversely affect our reputation, competitive position, financial condition and results of operations.

For example, we use Amazon Web Services ("AWS") to maintain the interconnectivity of our mobile app to our servers and those of the streaming services that our customers access to enjoy our products. Our brand, reputation and ability to retain and attract new customers depend on the reliable performance of our technology and cloud-based content delivery. Because AWS runs its own platform that we access, we are vulnerable to both system-wide and Sonos-specific service outages at AWS. Our access to AWS' infrastructure could be limited by a number of potential causes, including technical failures, natural disasters, fraud or security attacks that we cannot predict or prevent. If we were to experience an AWS service interruption, or if the security of the AWS infrastructure were compromised or believed to have been compromised, our ability to serve our customers and our reputation with current and potential customers would be negatively impacted.

Additionally, our products may contain flaws that make them susceptible to unauthorized access or use. For example, we previously discovered a vulnerability in our products that could be exploited when a customer visited a website with malicious content, allowing the customer's local network to be accessed by third parties who could then gain unauthorized access to the customer's playlists and other data and limited control of the customer's devices. While we devote significant resources to address and eliminate flaws and other vulnerabilities in our products, there can be no assurance that our products will not be compromised in the future. Any such flaws or vulnerabilities, whether actual or merely potential, could harm our reputation, competitive position, financial condition and results of operations.

***Changes in how network operators manage data that travel across their networks or in net neutrality rules could harm our business.***

Our business relies in part upon the ability of consumers to access high-quality streaming content through the internet. As a result, the growth of our business depends partially on our customers' ability to obtain low-cost, high-speed internet access, which relies in part on network operators' continued willingness to upgrade and maintain their equipment as needed to sustain a robust internet infrastructure, as well as their continued willingness to preserve the open and interconnected nature of the internet. We exercise no control over network operators, which makes us vulnerable to any errors, interruptions or delays in their operations. Any material disruption in internet services could harm our business.

To the extent that the number of internet users continues to increase, network congestion could adversely affect the reliability of our platform. We may also face increased costs of doing business if network operators engage in discriminatory practices with respect to streamed audio content in an effort to monetize access to their networks by content providers. In the past, internet service providers ("ISPs") have attempted to implement usage-based pricing, bandwidth caps and traffic shaping or throttling. To the extent network operators create tiers of internet access service and charge our customers in direct relation to their consumption of audio content, our ability to attract and retain customers could be impaired, which would harm our business. Net neutrality rules, which were designed to ensure that all online content is treated the same by ISPs and other companies that provide broadband services, were repealed by the Federal Communications Commission effective June 2018. The repeal of the net neutrality rules could force us to incur greater operating expenses, cause our streaming partners to seek to shift costs to us or result in a decrease in the streaming-based usage of our platform by our customers, any of which would harm our results of operations.

***Our investments in research and development may not yield the results expected.***

Our business operates in intensely competitive markets characterized by changing consumer preferences and rapid technological innovation. Due to advanced technological innovation and the relative ease of technology imitation, new products tend to become standardized more rapidly, leading to more intense competition and ongoing price erosion. In order to strengthen the competitiveness of our products in this environment, we continue to invest heavily in research and development. However, these investments may not yield the innovation or the results expected on a timely basis, or our competitors may surpass us in technological innovation, hindering our ability to timely commercialize new and competitive products that meet the needs and demands of the market, which consequently may adversely impact our operating results as well as our reputation.

***If we are not able to maintain and enhance the value and reputation of our brand, or if our reputation is otherwise harmed, our business and operating results could be adversely affected.***

Our continued success depends on our reputation for providing high-quality products and consumer experiences, and the "Sonos" name is critical to preserving and expanding our business. Maintaining, promoting and positioning our brand depends largely on the success of our marketing efforts, the consistency of the quality of our products and our ability to successfully secure, maintain and defend the trademarks that are key to our brand. Each of these objectives requires significant expenditures, and there is no guarantee that we will be able to achieve these objectives successfully. If we fail to successfully maintain, promote and position our brand and protect our reputation, or if we incur significant expenses in this effort, our business, financial condition and operating results may be adversely affected. The value of our brand could also be severely damaged by isolated incidents, particularly if these incidents receive considerable negative publicity or result in litigation, and by events outside of our control. Additionally, in the United States, we rely on custom installers of home audio systems for a significant portion of our sales but maintain no control over the quality of their work and thus could suffer damage to our brand or business to the extent such installations are unsatisfactory or defective. The market demand for our products, the value of our brand and our reputation generally could be harmed if any such incidents or other matters erode consumer confidence in us or our products. Any negative effect on our brand, regardless of whether it is within our control, could adversely affect our reputation, business and results of operations.

***Our efforts to expand beyond our core product offerings and offer products with applications outside the home may not succeed and could adversely impact our business.***

We may seek to expand beyond our core sound systems and develop products that have wider applications outside the home, such as commercial or office. Developing these products would require us to devote substantial additional resources, and our ability to succeed in developing such products to address such markets is unproven. It is likely that we would need to hire additional personnel, partner with new third parties and incur considerable research and development expenses in order to pursue such an expansion successfully. We have less familiarity with consumer preferences for these products and less product or category knowledge, and we could encounter difficulties in attracting new customers due to

lower levels of consumer familiarity with our brand. As a result, we may not be successful in future efforts to achieve profitability from new markets or new types of products, and our ability to generate revenue from our existing products may suffer. If any such expansion does not enhance our ability to maintain or grow our revenue or recover any associated development costs, our operating results could be adversely affected.

***We may choose to discontinue support for older versions of our products, resulting in customer dissatisfaction that could negatively affect our business and operating results.***

We have historically maintained, and we believe our customers have grown to expect, extensive backward compatibility for our older products and the software that supports them, allowing older products to continue to benefit from new software updates. We expect that in the near to intermediate term, this backward compatibility will no longer be practical or cost-effective, and we may decrease or discontinue service for our older products. If we no longer provide extensive backward capability for our products, we may damage our relationship with our customers, and the value proposition of our products with existing and prospective customers may decline. We may lose existing customers if their older products cannot integrate with newer versions of our software, and this may also result in negative publicity that could adversely affect our reputation and brand loyalty and impact our ability to attract new customers or sell new products to existing customers. For these reasons, any decision to decrease or discontinue backward capability may decrease sales and adversely affect our business, operating results and financial condition.

***Product quality issues and a higher-than-expected number of warranty claims or returns could harm our business and operating results.***

The products that we sell could contain defects in design or manufacture. Defects could also occur in the products or components that are supplied to us. There can be no assurance we will be able to detect and remedy all defects in the hardware and software we sell, which could result in product recalls, product redesign efforts, loss of revenue, reputational damage and significant warranty and other remediation expenses. Similar to other consumer electronics, our products have a risk of overheating and fire in the course of usage or upon malfunction. Any such defect could result in harm to property or in personal injury. If we determine that a product does not meet product quality standards or may contain a defect, the launch of such product could be delayed until we remedy the quality issue or defect. The costs associated with any protracted delay necessary to remedy a quality issue or defect in a new product could be substantial.

We generally provide a one-year warranty on all of our products, except in the European Union (the “EU”) and select other countries where we provide a two-year warranty on all of our products. The occurrence of any material defects in our products could expose us to liability for damages and warranty claims in excess of our current reserves, and we could incur significant costs to correct any defects, warranty claims or other problems. In addition, if any of our product designs are defective or are alleged to be defective, we may be required to participate in a recall campaign. In part due to the terms of our warranty policy, any failure rate of our products that exceeds our expectations may result in unanticipated losses. Any negative publicity related to the perceived quality of our products could affect our brand image and decrease retailer, distributor and consumer confidence and demand, which could adversely affect our operating results and financial condition. Further, accidental damage coverage and extended warranties are regulated in the United States at the state level and are treated differently within each state. Additionally, outside the United States, regulations for extended warranties and accidental damage vary from country to country. Changes in interpretation of the regulations concerning extended warranties and accidental damage coverage on a federal, state, local or international level may cause us to incur costs or have additional regulatory requirements to meet in the future in order to continue to offer our support services. Our failure to comply with past, present and future laws regulating extended warranties and accidental damage coverage could result in reduced sales of our products, reputational damage, penalties and other sanctions, which could harm our business and financial condition.

***The loss of one or more of our key personnel, or our failure to attract, assimilate and retain other highly qualified personnel in the future, could harm our business.***

We depend on the continued services and performance of our key personnel. The loss of key personnel, including key members of management as well as our product development, marketing, sales and technology personnel, could disrupt our operations and have an adverse effect on our ability to grow our business. In addition, the loss of key personnel in our finance and accounting departments could harm our internal controls, financial reporting capability and capacity to forecast and plan for future growth.

As we become a more mature company, we may find our recruiting efforts more challenging. In particular, we have experienced difficulties in recruiting qualified software engineers. The equity incentives we currently use to attract, retain and motivate employees may not be as effective as in the past. We rely heavily on equity incentives to attract and retain

employees, and if the value of the underlying common stock does not grow commensurate with expectations, we may not be able to effectively recruit new employees and we may risk losing existing employees. If we do not succeed in attracting, hiring and integrating high-quality personnel, or in retaining and motivating existing personnel, we may be unable to grow effectively, and our financial condition may be harmed.

***We may be subject to intellectual property rights claims and other litigation which are expensive to support, and if resolved adversely, could have a significant impact on us and our stockholders.***

Companies in the consumer electronics industries own large numbers of patents, copyrights, trademarks, domain names and trade secrets, and frequently enter into litigation based on allegations of infringement, misappropriation or other violations of intellectual property or other rights. As we gain an increasingly high profile and face more intense competition in our markets, the possibility of intellectual property rights claims against us grows, including the threat of lawsuits from non-practicing entities. For example, on March 10, 2017, Implicit, LLC filed a patent infringement action in the United States District Court, District of Delaware against us and is asserting we infringed on two patents. Our technologies may not be able to withstand any third-party claims or rights against their use, and we may be subject to litigation and disputes. The costs of supporting such litigation and disputes is considerable, and there can be no assurance that a favorable outcome would be obtained. We may be required to settle such litigations and disputes on terms that are unfavorable to us. Similarly, if any litigation to which we may be party fails to settle and we go to trial, we may be subject to an unfavorable judgment that may not be reversible upon appeal. The terms of such a settlement or judgment may require us to cease some or all of our operations, limit our ability to use certain technologies, pay substantial amounts to the other party or issue additional shares of our capital stock to the other party, which would dilute our existing stockholders.

With respect to intellectual property rights claims, we may have to negotiate a license in order to continue practices found to be in violation of a third party's rights. Any such license may not be available on reasonable terms and may significantly increase our operating expenses, or may not be available to us at all. As a result, we may also be required to develop alternative, non-infringing technology or practices or to discontinue the practices altogether. The development of alternative non-infringing technology or practices could require significant effort and expense and ultimately may not be successful, and our business and results of operations could be materially and adversely affected.

***If we are unable to protect our intellectual property, the value of our brand and other intangible assets may be diminished, and our business may be adversely affected.***

We rely and expect to continue to rely on a combination of confidentiality and license agreements with our employees, consultants and third parties with whom we have relationships, as well as patent, trademark, copyright and trade secret protection laws, to protect our proprietary rights. In the United States and certain other countries, we have filed various applications for certain aspects of our intellectual property, most notably patents. However, third parties may knowingly or unknowingly infringe our proprietary rights, third parties may challenge our proprietary rights, pending and future patent and trademark applications may not be approved, and we may not be able to prevent infringement without incurring substantial expense. Such infringement could have a material adverse effect on our brand, business, financial condition and results of operations. We have initiated legal proceedings to protect our intellectual property rights, and we may file additional actions in the future. For example, in December 2017, a jury found that Denon had infringed and was infringing certain of our patents, and in May 2018, we settled the remaining claims in exchange for royalty payments from Denon. The cost of defending our intellectual property has been and may in the future be substantial, and there is no assurance we will be successful. Additionally, our business could be adversely affected as a result of any such actions, or a finding that any patents-in-suit are invalid or unenforceable. These actions have led and may in the future lead to additional counterclaims against us, which are expensive to defend against and for which there can be no assurance of a favorable outcome. Further, parties we bring legal action against could retaliate through non-litigious means, which could harm our ability to compete against such parties or to enter new markets.

The regulations of certain foreign countries do not protect our intellectual property rights to the same extent as the laws of the United States. As our brand grows, we will likely discover unauthorized products in the marketplace that are counterfeit reproductions of our products. Although we may expend efforts to pursue counterfeiters, it is not practical to pursue all counterfeiters. If we are unsuccessful in pursuing producers or sellers of counterfeit products, continued sales of these products could adversely impact our brand, business, financial condition and results of operations.

***Our use of open source software could negatively affect our ability to sell our products and could subject us to possible litigation.***

We incorporate open source software into our products, and we may continue to incorporate open source software into our products in the future. Open source software is generally licensed by its authors or other third parties under open

source licenses. Some of these licenses contain requirements that we make available source code for modifications or derivative works we create based upon the open source software, and that we license such modifications or derivative works under the terms of a particular open source license or other license granting third parties certain rights of further use. Additionally, if a third-party software provider has incorporated open source software into software that we license from such provider, we could be required to disclose any of our source code that incorporates or is a modification of our licensed software. If an author or other third party that distributes open source software that we use or license were to allege that we had not complied with the conditions of the applicable license, we could be required to incur significant legal expenses defending against those allegations and could be subject to significant damages, enjoined from offering or selling our products that contained the open source software and required to comply with the above conditions. Any of the foregoing could disrupt and harm our business and financial condition.

***We collect, store, process and use our customers' personally identifiable information and other data, which subjects us to governmental regulation and other legal obligations related to privacy, information security and data protection. Any cybersecurity breaches or our actual or perceived failure to comply with such legal obligations by us, or by our third-party service providers or partners, could harm our business.***

We collect, store, process and use our customers' personally identifiable information and other data, and we rely on third parties that are not directly under our control to do so as well. While we take measures intended to protect the security, integrity and confidentiality of the personal information and other sensitive information we collect, store or transmit, we cannot guarantee that inadvertent or unauthorized use or disclosure will not occur, or that third parties will not gain unauthorized access to this information. There have been a number of recent reported incidents where third parties have used software to access the personal data of their partners' customers for marketing and other purposes. While our privacy policies currently prohibit such activities, our third-party service providers or partners may engage in such activity without our knowledge or consent. If we or our third-party service providers were to experience a breach, disruption or failure of systems compromising our customers' data, or if one of our third-party service providers or partners were to access our customers' personal data without our authorization, our brand and reputation could be adversely affected, use of our products could decrease and we could be exposed to a risk of loss, litigation and regulatory proceedings. Depending on the nature of the information compromised in a data breach, disruption or other unauthorized access to our customers' data, we may also have obligations to notify customers about the incident and we may need to provide some form of remedy for the individuals affected. Such breach notification laws continue to develop and may be inconsistent across jurisdictions. Complying with these obligations could cause us to incur substantial costs and negative publicity. While we maintain insurance coverage that is designed to address certain aspects of cyber risks, such insurance coverage may be insufficient to cover all losses or all types of claims that may arise in the event we experience a security breach.

Data protection laws may be interpreted and applied inconsistently from country to country, and often impose requirements that are inconsistent with one another. In addition, because various jurisdictions have different laws and regulations concerning the use, storage and transmission of such information, we may face complex and varied compliance requirements in existing markets as well as in new international markets that we seek to enter. Such laws and regulations, and the variation between jurisdictions, could subject us to elevated costs of security measures, liabilities or negative publicity that could adversely affect our business.

Regulatory scrutiny of privacy, data collection, use of data and data protection is intensifying globally, and the personal information and other data we collect, store, process and use is increasingly subject to legislation and regulations in numerous jurisdictions around the world, especially in Europe. These laws often develop in ways we cannot predict and may materially increase our cost of doing business, particularly as we expand the nature and types of products we offer. For example, the General Data Protection Regulation (the "GDPR"), which came into effect in the EU in May 2018 and superseded prior EU data protection legislation, imposes more stringent data protection requirements and provides for greater penalties for noncompliance. Further, as discussed in more detail below, the United Kingdom has initiated the formal process to leave the EU, creating uncertainty with regard to the regulation of data protection in the United Kingdom. In particular, it is unclear whether the United Kingdom will enact data protection laws or regulations designed to be consistent with the GDPR and how data transfers to and from the United Kingdom will be regulated. Additionally, although we are making use of the EU Standard Contractual Clauses with regard to the transfer of certain personal data to countries outside the European Economic Area (the "EEA"), some regulatory uncertainty remains surrounding the future of data transfers from the EEA to the United States. Although we are closely monitoring regulatory developments in this area, any actual or perceived failure by us to comply with any regulatory requirements or orders or other domestic or international privacy or consumer protection-related laws and regulations could result in proceedings or actions against us by governmental entities or others (e.g., class action litigation), subject us to significant penalties and negative publicity, require us to change our business practices, increase our costs and adversely affect our business.

Data protection legislation is also becoming increasingly common in the United States at both the federal and state level. For example, in June 2018, the State of California enacted the California Consumer Privacy Act of 2018 (the “CCPA”), which will come into effect on January 1, 2020. The CCPA requires companies that process information on California residents to make new disclosures to consumers about their data collection, use and sharing practices, allows consumers to opt out of certain data sharing with third parties and provides a new cause of action for data breaches. However, California legislators have stated that they intend to propose amendments to the CCPA, and it remains unclear what, if any, modifications will be made to the CCPA or how it will be interpreted. Additionally, the Federal Trade Commission and many state attorneys general are interpreting federal and state consumer protection laws to impose standards for the online collection, use, dissemination and security of data. The burdens imposed by the CCPA and other similar laws that may be enacted at the federal and state level may require us to modify our data processing practices and policies and to incur substantial expenditure in order to comply.

Further, we may be or become subject to data localization laws mandating that data collected in a foreign country be processed and stored only within that country. Russia adopted such a law in 2014, and it is expected that China will do so as well. If China or another country in which we have customers were to adopt a data localization law, we could be required to expand our data storage facilities there or build new ones in order to comply. The expenditure this would require, as well as costs of compliance generally, could harm our financial condition.

***Our international operations are subject to increased business and economic risks that could impact our financial results.***

We have operations outside the United States, and we expect to continue to expand our international presence, especially in Asia. In fiscal 2019, 50.1% of our revenue was generated outside the United States. This subjects us to a variety of risks inherent in doing business internationally, including:

- fluctuations in currency exchange rates;
- political, social and/or economic instability;
- risks related to governmental regulations in foreign jurisdictions and unexpected changes in regulatory requirements and enforcement;
- higher levels of credit risk and payment fraud;
- burdens of complying with a variety of foreign laws;
- the cost of developing connected products for countries where Wi-Fi technology has been passed over in favor of more advanced cellular data networks;
- tariffs, trade barriers and duties;
- reduced protection for intellectual property rights in some countries;
- difficulties in staffing and managing global operations and the increased travel, infrastructure and legal compliance costs associated with having multiple international locations;
- compliance with statutory equity requirements;
- potential negative consequences from changes in or interpretations of U.S. and foreign tax laws;
- protectionist laws and business practices that favor local businesses in some countries;
- imposition of currency exchange controls;
- greater fluctuations in sales to customers in developing countries, including longer payment cycles and greater difficulty collecting accounts receivable; and
- delays from customs brokers or government agencies.

If we are unable to manage the complexity of our global operations successfully, or if the risks above become substantial for us, our financial performance and operating results could suffer. These factors may also harm our results of operations. Further, any measures that we may implement to reduce risks of our international operations may not be effective, may increase our expenses and may require significant management time and effort. Entry into new international markets requires considerable management time and financial resources related to market, personnel and facilities development before any significant revenue is generated. As a result, initial operations in a new market may operate at low margins or may be unprofitable.

In particular, we have significant operations in China, where many of the risks listed above are particularly acute. Our business, financial condition and results of operations may be materially adversely affected by economic, political, legal, regulatory, competitive and other factors in China. The Chinese economy differs from the economies of most developed countries in many respects, including the level of government involvement and control over economic growth. In addition, our operations in China are governed by Chinese laws, rules and regulations, some of which are relatively new. The Chinese legal system continues to rapidly evolve, which may result in uncertainties with respect to the interpretation and enforcement of Chinese laws, rules and regulations that could have a material adverse effect on our business. China also experiences high turnover of direct labor due to the intensely competitive and fluid market for labor, and the retention of adequate labor may be a challenge for our operations in China. If our labor turnover rates are higher than we expect, or we otherwise fail to adequately manage our labor needs, then our business and results of operations could be adversely affected.

***If significant tariffs or other restrictions are placed on Chinese imports or any related counter-measures are taken by China, our revenue and results of operations may be materially harmed.***

If significant tariffs or other restrictions are placed on Chinese imports or any related counter-measures are taken by China, our revenue and results of operations may be materially harmed. Between July and May 2019, the U.S. Trade Representative imposed tariffs between 10% and 25% on a variety of goods imported from China. Some of these tariffs currently affect our accessories products and we may be required to raise our prices on those products due to the tariffs, which may result in a loss of customers and harm our operating performance. If the existing tariffs are expanded or interpreted by a court or governmental agency to apply to any of our other products, we may be required to raise our prices on those products, which may further result in a loss of customers and harm our operating performance. Additionally, the Trump Administration continues to signal that it may further alter trade agreements and terms between China and the United States, including limiting trade with China, and may impose additional tariffs on imports from China. For example, on August 1, 2019, President Trump announced that he intends to impose a 10% tariff on an additional \$300 billion worth of Chinese imports on September 1, 2019, and there is a significant likelihood that our products will be included in the lists of impacted goods. In the event that these or future tariffs are imposed on imports of our products, or that China or other countries take retaliatory trade measures in response to existing or future tariffs, our business may be impacted and we may be required to raise prices or make changes to our operations, any of which could materially harm our revenue or operating results. We may seek to shift production outside of China, resulting in significant costs and disruption to our operations as we would need to pursue the time-consuming processes of recreating a new supply chain, identifying substitute components and establishing new manufacturing locations.

***We are susceptible to fluctuations in foreign currency exchange rates, which could result in declines in our reported revenue and operating results.***

Our exposure to the effects of fluctuations in foreign currency exchange rates has grown with the continued expansion of our overseas operations, and primarily relates to non-U.S. dollar denominated sales and operating expenses worldwide. Unfavorable movement in currency exchange rates will adversely affect our results of operations and financial condition. While a significant percentage of our revenue is denominated in foreign currencies, the majority of our costs are denominated in U.S. dollars. This means that a strengthening of the U.S. dollar would adversely impact our reported financial results. The strengthening of foreign currencies may also increase our cost of product components denominated in those currencies, thus adversely affecting gross margin. Fluctuations in currency exchange rates may also make it more difficult to detect underlying trends in our business and results of operations. We may in the future engage in some hedging activities, such as the use of foreign currency forward and option contracts, to limit the risk of fluctuations in currency exchange rates. However, the use of such hedging activities may not offset any, or more than a portion, of the adverse financial effects of unfavorable movements in foreign exchange rates over the limited time the hedges are in place. Moreover, the use of hedging instruments may introduce additional risks if we are unable to structure effective hedges with such instruments. In addition, a strengthening of the U.S. dollar may increase the cost of our products to our customers outside of the United States, which may also adversely affect our financial condition and results of operations.

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

In June 2016, a majority of voters in the United Kingdom elected to withdraw from the European Union (often referred to as Brexit) in a national referendum. As of the date of this Annual Report, the British Parliament has not agreed upon the terms of the withdrawal. On April 10, 2019, the leaders of the other member countries of the European Union agreed to extend the deadline for Brexit until October 31, 2019. The referendum and ongoing negotiations have created significant uncertainty about the future relationship between the United Kingdom and the European Union.

If the United Kingdom leaves the European Union with no agreement, it will likely have an adverse impact on labor and trade in addition to creating further short-term uncertainty and currency volatility. In the absence of a future trade deal, the United Kingdom's trade with the European Union and the rest of the world would be subject to tariffs and duties set by the World Trade Organization. Any adjustments we make to our business and operations as of Brexit could result in significant time and expense to complete.

Any impact from Brexit on our business and operations over the long term will depend, in part, on the outcome of tariff, tax treaties, trade, regulatory, and other negotiations the United Kingdom conducts.

***Natural disasters, geopolitical unrest, war, terrorism, public health issues or other catastrophic events could disrupt the supply, delivery or demand of products, which could negatively affect our operations and performance.***

We are subject to the risk of disruption by earthquakes, floods and other natural disasters, fire, power shortages, geopolitical unrest, war, terrorist attacks and other hostile acts, public health issues, epidemics or pandemics and other events beyond our control and the control of the third parties on which we depend. Any of these catastrophic events, whether in the United States or abroad, may have a strong negative impact on the global economy, us, our contract manufacturers or our suppliers or customers, and could decrease demand for our products, create delays and inefficiencies in our supply chain and make it difficult or impossible for us to deliver products to our customers. Further, our headquarters are located in Santa Barbara, California, in a seismically active region that is also prone to forest fires. Any catastrophic event that occurred near our headquarters, or near our manufacturing facilities in China, could impose significant damage to our ability to conduct our business and could require substantial recovery time, which could have an adverse effect on our business, operating results and financial condition.

***We must comply with extensive regulatory requirements, and the cost of such compliance, and any failure to comply, may adversely affect our business, financial condition and results of operations.***

In our current business and as we expand into new markets and product categories, we must comply with a wide variety of laws, regulations, standards and other requirements governing, among other things, electrical safety, wireless emissions, health and safety, e-commerce, consumer protection, export and import requirements, hazardous materials usage, product-related energy consumption, packaging, recycling and environmental matters. Compliance with these laws, regulations, standards and other requirements may be onerous and expensive, and they may be inconsistent from jurisdiction to jurisdiction, further increasing the cost of compliance and doing business. Our products may require regulatory approvals

or satisfaction of other regulatory concerns in the various jurisdictions in which they are manufactured, sold or both. These requirements create procurement and design challenges that require us to incur additional costs identifying suppliers and manufacturers who can obtain and produce compliant materials, parts and products. Failure to comply with such requirements can subject us to liability, additional costs and reputational harm and, in extreme cases, force us to recall products or prevent us from selling our products in certain jurisdictions. If there is a new regulation, or change to an existing regulation, that significantly increases our costs of manufacturing or causes us to significantly alter the way that we manufacture our products, this would have a material adverse effect on our business, financial condition and results of operations. Additionally, while we have implemented policies and procedures designed to ensure compliance with applicable laws and regulations, there can be no assurance that our employees, contractors and agents will not violate such laws and regulations or our policies and procedures.

***We are subject to the Foreign Corrupt Practices Act (the “FCPA”), and our failure to comply with the laws and regulations thereunder could result in penalties which could harm our reputation, business and financial condition.***

Due to our international operations, we are subject to the FCPA, which generally prohibits companies and their intermediaries from making improper payments to foreign officials for the purpose of obtaining or keeping business. The FCPA also requires companies to maintain adequate recordkeeping and internal accounting practices to accurately reflect transactions. Under the FCPA, U.S. companies may be held liable for actions taken by their strategic or local partners or representatives. The FCPA and similar laws in other countries can impose civil and criminal penalties for violations. If we do not properly implement practices and controls with respect to compliance with the FCPA and similar laws, or if we fail to enforce those practices and controls properly, we may be subject to regulatory sanctions, including administrative costs related to governmental and internal investigations, civil and criminal penalties, injunctions and restrictions on our business activities, all of which could harm our reputation, business and financial condition.

***Our corporate tax rate may increase, we may incur additional income tax liabilities and we may incur costs in complying with changing tax laws in the United States and abroad, which could adversely impact our cash flow, financial condition and results of operations.***

We are a U.S.-based company subject to taxes in multiple U.S. and foreign tax jurisdictions. Our profits, cash flow and effective tax rate could be adversely affected by changes in the tax rules and regulations in the jurisdictions in which we do business, unanticipated changes in statutory tax rates and changes to our global mix of earnings. As we expand our operations, any changes in the U.S. or foreign taxation of such operations may increase our worldwide effective tax rate.

We are also subject to examination by the IRS and other tax authorities, including state revenue agencies and foreign governments. If any tax authority disagrees with any position we have taken, our tax liabilities and operating results may be adversely affected. While we regularly assess the likelihood of favorable or unfavorable outcomes resulting from examinations by the IRS and other tax authorities to determine the adequacy of our provision for income taxes, there can be no assurance that the actual outcome resulting from these examinations will not materially adversely affect our financial condition and results of operations. In addition, the distribution of our products subjects us to numerous complex and often-changing customs regulations. Failure to comply with these systems and regulations could result in the assessment of additional taxes, duties, interest and penalties. While we believe we are in compliance with local laws, there is no assurance that tax and customs authorities agree with our reporting positions and upon audit may assess us additional taxes, duties, interest and penalties. If this occurs and we cannot successfully defend our position, our profitability will be reduced.

***Our ability to use our net operating loss carryforwards and certain other tax attributes may be limited.***

As of September 29, 2018, we had gross U.S. federal net operating loss carryforwards of \$ 74.7 million, which expire beginning in 2033, and gross state net operating loss carryforwards of \$ 45.9 million, which expire beginning in 2020, as well as \$ 21.1 million in foreign net operating loss carryforwards, of which \$ 2.1 million have an indefinite life. Also as of September 29, 2018, we had U.S. federal and state research and development tax credit carryforwards of \$ 25.4 million and \$ 19.1 million, respectively. The federal research credits will begin to expire in the year 2025, and the state research credits will begin to expire in 2024.

It is possible that we will not generate taxable income in time to use our net operating loss carryforwards before their expiration or at all. Under Sections 382 and 383 of the Internal Revenue Code of 1986, as amended (the “Code”), if a corporation undergoes an “ownership change,” the corporation’s ability to use its pre-change net operating loss carryforwards and other pre-change attributes, such as research tax credits, to offset its post-change income may be limited. In general, an “ownership change” will occur if there is a cumulative change in ownership by “5-percent shareholders” that exceeds 50 percentage points over a rolling three-year period. Similar rules may apply under state tax laws. As a result, our net operating losses generated through July 18, 2012 may be subject to limitation under Section 382 of the Code. The

amount of pre-change loss carryforward which may be subject to this limitation is \$46.8 million. Our ability to use net operating loss carryforwards and other tax attributes to reduce future taxable income and liabilities may be subject to limitations based on the ownership change of 2012. We have completed an updated Section 382 study through March 30, 2019, and the results of this study show no ownership change within the meaning of Section 382 of the Code had occurred from the previously identified ownership change on July 18, 2012 through March 30, 2019. We will continue to monitor prospective ownership changes within the meaning of Section 382.

***We may need additional capital, and we cannot be certain that additional financing will be available.***

Our operations have been financed primarily through cash flow from operating activities, borrowings under our Term Loan and Credit Facility and net proceeds from the sale of our equity securities. We may require additional equity or debt financing to fund our operations and capital expenditures. Our ability to obtain financing will depend, among other things, on our development efforts, business plans, operating performance and the condition of the capital markets at the time we seek financing. We cannot assure you that additional financing will be available to us on favorable terms if and when required, or at all.

***We may acquire other businesses or receive offers to be acquired, which could require significant management attention, disrupt our business, dilute stockholder value and adversely affect our operating results.***

As part of our business strategy, we may make investments in complementary businesses, products, services or technologies. We have not made any material acquisitions to date and, as a result, our ability as an organization to successfully acquire and integrate other companies, products, services or technologies is unproven. We may not be able to find suitable acquisition candidates and we may not be able to complete acquisitions on favorable terms, if at all. If we do complete acquisitions, we may not ultimately strengthen our competitive position or achieve our goals, and any acquisitions we complete could be viewed negatively by customers or investors. In addition, if we fail to integrate successfully such acquisitions, or the technologies associated with such acquisitions, into our company, the revenue and operating results of the combined company could be adversely affected. Any integration process will require significant time and resources, and we may not be able to manage the process successfully. We may not successfully evaluate or utilize the acquired technology and accurately forecast the financial impact of an acquisition transaction, including accounting charges. We may have to pay cash, incur debt or issue equity securities to pay for any such acquisition, any of which could affect our financial condition or the value of our capital stock. The sale of equity or issuance of debt to finance any such acquisitions could result in dilution to our stockholders. The incurrence of indebtedness would result in increased fixed obligations and could also include covenants or other restrictions that would impede our ability to manage our operations. Additionally, we may receive indications of interest from other parties interested in acquiring some or all of our business. The time required to evaluate such indications of interest could require significant attention from management, disrupt the ordinary functioning of our business and adversely affect our operating results.

***We will need to improve our financial and operational systems in order to manage our growth effectively and support our increasingly complex business arrangements, and an inability to do so could harm our business and results of operations.***

To manage our growth and our increasingly complex business operations, especially as we move into new markets internationally, we will need to upgrade our operational and financial systems and procedures, improve the coordination between our various corporate functions and expand, train and manage our workforce adequately. Our efforts to manage the expansion of our operations may place a significant strain on our management personnel, systems and resources, particularly given the limited amount of financial resources and skilled employees that may be available at the time. When implementing new or changing existing processes, we may encounter transitional issues and incur substantial additional expenses. We cannot be certain that we will institute, in a timely manner or at all, the improvements to our managerial, operational and financial systems and procedures necessary to support our anticipated increased levels of operations. Delays or problems associated with any improvement or expansion of our operational and financial systems could adversely affect our relationships with our suppliers, manufacturers, resellers and customers, cause harm to our reputation and result in errors in our financial and other reporting, any of which could harm our business and operating results. We may not be able to manage our growth effectively, and as a result may not be able to take advantage of market opportunities, execute on expansion strategies or meet the demands of our customers. In particular, we anticipate that our legacy enterprise resource management system will need to be replaced in the near to intermediate term in order to accommodate our expanding operations. Such transitions can prove difficult and time consuming and could adversely impact our business and ability to timely prepare our external financial reports.

*We have identified material weaknesses in our internal control over financial reporting and, if our remediation of these material weaknesses is not effective, or if we fail to maintain an effective system of internal control over financial reporting in the future, we may not be able to accurately or timely report our financial condition or results of operations, which may adversely affect investor confidence and the price of our common stock.*

As a public company, we will be required to maintain internal control over financial reporting and to evaluate and determine the effectiveness of our internal control over financial reporting. Beginning with our second annual report on Form 10-K following our IPO, we will be required to provide a management report on internal control over financial reporting, as well as an attestation on our internal control over financial reporting from our independent registered public accounting firm.

During 2017, we identified material weaknesses in our internal control over financial reporting. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of a company's annual or interim financial statements will not be prevented or detected on a timely basis. We identified a material weakness related to an insufficient complement of experienced personnel with the requisite technical knowledge of financial statement disclosures and accounting for non-routine, unusual or complex events and transactions. This material weakness in our control environment contributed to an additional material weakness in that we did not maintain effective internal controls to address the accounting of non-routine, unusual or complex events and transactions and the related financial statement presentation of such transactions.

We are taking steps to address these control issues, including the following:

- hiring of experienced additional accounting and financial reporting personnel; and
- creation of additional controls including those designed to strengthen our review processes around financial statement disclosures and accounting for non-routine, unusual or complex transactions.

While we believe that these efforts will improve our internal control over financial reporting, the implementation of these measures is ongoing and will require validation and testing of the design and operating effectiveness of internal controls over a sustained period of financial reporting cycles.

We cannot assure you that the measures we have taken to date, and that we are continuing to implement, will be sufficient to remediate the material weaknesses we have identified or avoid the identification of additional material weaknesses in the future. If the steps we take do not remediate the material weaknesses in a timely manner, there could continue to be a reasonable possibility that these control deficiencies or others could result in a material misstatement of our annual or interim consolidated financial statements that would not be prevented or detected on a timely basis.

The process of designing and implementing internal control over financial reporting required to comply with the disclosure and attestation requirements of Section 404 of the Sarbanes-Oxley Act ("Section 404") will be time consuming and costly. If during the evaluation and testing process, we identify additional material weaknesses in our internal control over financial reporting or determine that existing material weaknesses have not been remediated, our management will be unable to assert that our internal control over financial reporting is effective. Even if our management concludes that our internal control over financial reporting is effective, our independent registered public accounting firm may conclude that there are material weaknesses with respect to our internal control over financial reporting. If we are unable to assert that our internal control over financial reporting is effective, or when required in the future, if our independent registered public accounting firm is unable to express an unqualified opinion as to the effectiveness of our internal control over financial reporting, investors may lose confidence in the accuracy and completeness of our financial reports, the market price of our common stock could be adversely affected and we could become subject to litigation or investigations by The Nasdaq Stock Market, the SEC or other regulatory authorities, which could require additional financial and management resources.

*Our reported financial results may be adversely affected by changes in accounting principles generally accepted in the United States.*

Generally accepted accounting principles in the United States are subject to interpretation by the Financial Accounting Standards Board, the American Institute of Certified Public Accountants, the SEC and various bodies formed to promulgate and interpret appropriate accounting principles. A change in these principles or interpretations could have a significant effect on our reported financial results and could affect the reporting of transactions completed before the announcement of a change.

## **Risks related to ownership of our common stock**

### ***The stock price of our common stock has been and may continue to be volatile or may decline regardless of our operating performance.***

The market price of our common stock has been and may continue to be volatile. Since shares of our common stock were sold in our IPO in August 2018 at a price of \$15.00 per share, the closing price of our common stock has ranged from \$ 9.58 to \$ 21.69 through July 27, 2019 . The market price of our common stock may fluctuate significantly in response to numerous factors in addition to the ones described in the preceding Risk Factors, many of which are beyond our control, including:

- overall performance of the equity markets and the economy as a whole;
- changes in the financial projections we may provide to the public or our failure to meet these projections;
- actual or anticipated changes in our growth rate relative to that of our competitors;
- announcements of new products, or of acquisitions, strategic partnerships, joint ventures or capital- raising activities or commitments, by us or by our competitors;
- additions or departures of key personnel;
- failure of securities analysts to initiate or maintain coverage of us, changes in financial estimates by any securities analysts who follow our company or our failure to meet these estimates or the expectations of investors;
- rumors and market speculation involving us or other companies in our industry; and
- sales of shares of our common stock by us or our stockholders.

In addition, the stock market with respect to newly public companies, particularly companies in the technology industry, has experienced significant price and volume fluctuations that have affected and continue to affect the market prices of stock prices of these companies. In the past, stockholders have instituted securities class action litigation following periods of market volatility. If we were to become involved in securities litigation, it could subject us to substantial costs, divert resources and the attention of management from our business and adversely affect our business.

### ***Our business and financial performance may differ from any projections that we disclose or any information that may be attributed to us by third parties.***

From time to time, we may provide guidance via public disclosures regarding our projected business or financial performance. However, any such projections involve risks, assumptions and uncertainties and our actual results could differ materially from such projections. Factors that could cause or contribute to such differences include, but are not limited to, those identified in these Risk Factors, some or all of which are not predictable or within our control. Other unknown or unpredictable factors also could adversely impact our performance, and we undertake no obligation to update or revise any projections, whether as a result of new information, future events or otherwise. In addition, various news sources, bloggers and other publishers often make statements regarding our historical or projected business or financial performance, and you should not rely on any such information even if it is attributed directly or indirectly to us.

### ***Our stock price and trading volume could decline if securities or industry analysts do not publish about our business, or if they publish unfavorable research.***

Equity research analysts do not currently provide coverage of our common stock, and we cannot assure that any equity research analysts will adequately provide research coverage of our common stock. A lack of adequate research coverage may harm the liquidity and market price of our common stock. To the extent equity research analysts do provide research coverage of our common stock, we will not have any control over the content and opinions included in their reports. The price of our common stock could decline if one or more equity research analysts downgrade our

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stock or publish other unfavorable commentary or research. Moreover, if one or more equity research analysts cease coverage of our company, or fail to regularly publish reports on us, the demand for our common stock could decrease, which in turn could cause our stock price or trading volume to decline.

***Sales of a substantial amount of our common stock in the public market, particularly sales by our directors, executive officers and significant stockholders, or the perception that these sales could occur, could cause the market price of our common stock to decline.***

Sales of a substantial number of shares of our common stock in the public market, particularly sales by our directors, executive officers and principal stockholders, or the perception that these sales might occur, could cause the market price of our common stock to decline. All of the outstanding shares of our common stock are freely tradable in the public market without restrictions or further registration, except for any shares held by our affiliates, as defined in Rule 144 under the Securities Act of 1933, as amended (the “Securities Act”). Shares held by directors, executive officers, and other affiliates are also subject to volume limitations under Rule 144 under the Securities Act and various vesting agreements, as well as our insider trading policy.

In addition, we have filed a registration statement to register shares reserved for future issuance under our equity compensation plans. Subject to the satisfaction of applicable vesting requirements, the shares issued upon exercise of outstanding stock options will be available for immediate resale in the United States in the open market.

Moreover, certain holders of our common stock have rights, subject to some conditions, to require us to file registration statements for the public resale of such shares or to include such shares in registration statements that we may file for us or other stockholders.

***We do not intend to pay dividends for the foreseeable future.***

We have never declared or paid any cash dividends on our common stock, and we do not intend to pay any cash dividends in the foreseeable future. We anticipate that we will retain all of our future earnings for use in the development of our business and for general corporate purposes. Any determination to pay dividends in the future will be at the discretion of the Board. Accordingly, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investments. In addition, the terms of our credit facilities contain restrictions on our ability to declare and pay cash dividends on our capital stock.

***Additional stock issuances could result in significant dilution to our stockholders.***

We may also issue our shares of common stock or securities convertible into shares of our common stock from time to time in connection with a financing, acquisition, investments or otherwise. Additional issuances of our capital stock will result in dilution to our existing stockholders. We also grant equity awards to employees, directors and consultants under our 2018 Equity Incentive Plan. In the future, we may also grant rights to purchase our common stock under our 2018 Employee Stock Purchase Plan, which will become effective at a future date upon determination by the compensation committee of the Board. Also, to the extent outstanding options and rights to purchase our capital stock are exercised and restricted stocks units vest and are settled, there will be further dilution. The amount of dilution could be substantial depending upon the size of the issuance or exercise, which may cause the market price of our common stock to decline.

***Certain provisions in our corporate charter documents and under Delaware law may prevent or hinder attempts by our stockholders to change our management or to acquire a controlling interest in us, and the market price of our common stock may be lower as a result.***

There are provisions in our restated certificate of incorporation and restated bylaws that may make it difficult for a third party to acquire, or attempt to acquire, control of our company, even if a change in control were considered favorable by our stockholders. These anti-takeover provisions include:

- a classified Board so that not all members of the Board are elected at one time;
- the ability of the Board to determine the number of directors and to fill any vacancies and newly created directorships;
- a requirement that our directors may only be removed for cause;

- a prohibition on cumulative voting for directors;
- the requirement of a super-majority to amend some provisions in our restated certificate of incorporation and restated bylaws;
- authorization of the issuance of “blank check” preferred stock that the Board could use to implement a stockholder rights plan;
- an inability of our stockholders to call special meetings of stockholders; and
- a prohibition on stockholder actions by written consent, thereby requiring that all stockholder actions be taken at a meeting of our stockholders.

In addition, our restated certificate of incorporation provides that the Delaware Court of Chancery is the exclusive forum for any derivative action or proceeding brought on our behalf; any action asserting a breach of fiduciary duty; any action asserting a claim against us arising pursuant to the Delaware General Corporation Law (the “DGCL”), our restated certificate of incorporation or our restated bylaws; or any action asserting a claim against us that is governed by the internal affairs doctrine.

Our restated certificate of incorporation also provides that the federal district courts of the United States will be the exclusive forum for resolving any complaint asserting a cause of action arising under the Securities Act (the “Federal Forum Provision”). In December 2018, the Delaware Court of Chancery found that provisions such as the Federal Forum Provision are not valid under Delaware law. In light of this decision of the Delaware Court of Chancery, we do not intend to enforce the Federal Forum Provision in our restated certificate of incorporation unless and until such time there is a final determination by the Delaware Supreme Court regarding the validity of provisions such as the Federal Forum Provision. To the extent the Delaware Supreme Court makes a final determination that provisions such as the Federal Forum Provision are not valid as a matter of Delaware law, the Board intends to amend our restated certificate of incorporation to remove the Federal Forum Provision.

In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the DGCL, which prohibit a person who owns 15% or more of our outstanding voting stock from merging or combining with us for a three-year period beginning on the date of the transaction in which the person acquired in excess of 15% of our outstanding voting stock, unless the merger or combination is approved in a prescribed manner. Any provision in our restated certificate of incorporation, our restated bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

## Item 2. Unregistered sales of equity securities and use of proceeds

### Recent sales of unregistered securities

None.

### Use of proceeds from registered securities

On August 1, 2018, our registration statement on Form S-1 (No. 333-226076) was declared effective by the SEC for the IPO of our common stock. There has been no material change in the planned use of proceeds from our IPO from that described in the final prospectus filed pursuant to Rule 424(b) under the Securities Act and other periodic reports previously filed with the SEC.

## Item 6. Exhibit index

Exhibit number	Exhibit title	Incorporated by reference				Filed or furnished herewith
		Form	File no.	Exhibit	Filing date	
<a href="#">10.1</a>	<a href="#">Consulting agreement letter between Michael Giannetto and the Registrant, dated May 15, 2019</a>					X
<a href="#">31.1</a>	<a href="#">Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and Rule 15d-14(a) of the Exchange Act</a>					X
<a href="#">31.2</a>	<a href="#">Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and Rule 15d-14(a) of the Exchange Act</a>					X
<a href="#">32.1*</a>	<a href="#">Certification of Chief Executive Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>					X
<a href="#">32.2*</a>	<a href="#">Certification of Chief Financial Officer pursuant to Rule 13a-14(b) of the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>					X
101.INS	XBRL Instance Document					X
101.SCH	XBRL Taxonomy Extension Schema Document					X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document					X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document					X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document					X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document					X

\* The certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to accompany this Form 10-Q and are not deemed "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, nor shall they be deemed incorporated by reference into any filing under the Securities Act or the Exchange Act.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

**Sonos, Inc.**

Date: August 8, 2019

By: /s/ Patrick Spence

Patrick Spence  
Chief Executive Officer and Director  
*(Principal Executive Officer)*

Date: August 8, 2019

By: /s/ Brittany Bagley

Brittany Bagley  
Chief Financial Officer  
*(Principal Financial Officer and Principal Accounting Officer)*

# SONOS

May 15, 2019

Dear Michael,

You and Sonos, Inc. ("**Sonos**") have agreed that your employment will terminate effective as of 12:00 a.m. as of October 1, 2019 (the "**Termination Date**") and you will continue to serve as an advisor to Sonos for 18 months following your Termination Date. The purpose of this letter agreement ("**Agreement**") is to confirm the compensation you will be entitled to receive from Sonos prior to your Termination Date and as an advisor.

**1. Employment until Termination Date.** For the period commencing on the date hereof and until the Termination Date (the "**Interim Period**"), you will continue to be an employee of Sonos, subject to all the terms and conditions applicable to your employment as in effect prior to the Interim Period. During the Interim Period, you will also continue to participate in Sonos' employee benefits programs, subject to the terms and conditions applicable to each such benefit program. In addition, during the Interim Period, your stock awards covering shares of Sonos' common stock ("**Stock Awards**") will continue to vest pursuant to their normal vesting schedules.

**2. Accrued Benefits.** Notwithstanding the foregoing, you have agreed to go on leave from the period beginning on July 1, 2019 and ending on September 30, 2019, during which time you will exhaust any and all paid time off, which you have accrued.

**3. Fiscal 2019 Annual Bonus.** You acknowledge and agree that you are no longer eligible to participate in, and receive, a bonus under, Sonos's Executive Incentive Plan for fiscal 2019.

**4. Consulting Period.** Provided that you sign, date, and return this Agreement, and do not subsequently revoke it, Sonos will retain you as a consultant to Sonos from the Termination Date through the date that is 18 months after the Termination Date (the actual period of time you are retained as a consultant, the "**Consulting Period**"), unless Sonos elects to terminate this consulting period prior to the end of the 18 month period for cause<sup>1</sup> by providing written notice to you specifying the grounds for Cause in reasonable detail. During the Consulting Period, subject to your reasonable availability and in consideration to your other professional obligations, as applicable, you will make yourself available to provide consulting services (the "**Services**") within your areas of expertise as requested by Sonos including but not limited to the preparation of

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<sup>1</sup> "Cause" shall mean your (A) willful breach of your obligations under this Agreement; (B) gross negligence in the performance or intentional non-performance of your material duties to Sonos or any of its subsidiaries; (C) commission of a felony or a crime of moral turpitude; (D) commission of a material act of deceit, fraud, perjury or embezzlement that involves or directly or indirectly causes harm to Sonos or any of its subsidiaries; or (E) engaging in grossly inappropriate conduct during the Consulting Period.



Sonos's Form 10-K and other periodic reports. Subject to your reasonable availability and in consideration to your other professional obligations, as applicable, you agree to make yourself available to provide Services throughout the Consulting Period for up to, but not exceeding, ten (10) hours per month. During the Consulting Period, your Stock Awards will continue to vest pursuant to their normal vesting schedules. You acknowledge and agree that after your Termination Date and during the Consulting Period, your relationship with Sonos will be that of an independent contractor and not that of an employee. You also acknowledge and agree that any incentive stock options that you hold will cease to be incentive stock options and will become non-statutory stock options on the three-month anniversary of your Termination Date.

During the Consulting Period and thereon, Sonos will continue to provide health, dental and vision coverage for you on the Sonos US medical plan until you turn 65. You will pay the same premium that active employees on the plan pay. However, the rates and plans are subject to change every year. Benefit payments will be made to a third party administrator (currently Discovery Benefits but subject to change in the future). If, however, you obtain employment that provides medical and/or dental insurance or otherwise become covered under an alternative medical and/or dental plan before you turn 65, you must notify Sonos and Sonos' obligation to provide your Health Insurance Contributions shall cease. When you turn 65, you will come off the Sonos plan and become eligible for Medicare. Please note that Sonos reserves the right to amend and/or terminate such plan from time to time, in its sole discretion.

The benefits that you will receive as an advisor are contingent upon you executing and delivering to Sonos, a release of claims in the form attached to this Agreement as Exhibit A (the "**Release**") on the Termination Date and you not revoking the Release. You acknowledge that you have more than 21 days to consider signing the Release and that you have 7 days to revoke the Release upon signing it.

## **5. Restrictive Covenants During the Consulting Period.**

(a) *Non-solicitation of Employees.* During the Consulting Period, you will not solicit for employment or hire, in any business enterprise or activity, any employee of Sonos or any subsidiary of Sonos; provided however, that the foregoing will not be violated by any general advertising not targeted at any Company or subsidiary employees or by you serving as a reference upon request.

(b) *Non-solicitation of Clients and Vendors.* During the Consulting Period, you will not solicit, in any business enterprise or activity, any client, customer, licensee, licensor, third-party service provider or vendor (a "**Business Relation**") of Sonos or any subsidiary of Sonos to (i) cease being a Business Relation of Sonos or any subsidiary or (ii) become a Business Relation of any business that competes with any business in which Sonos or any subsidiary is engaged.

(c) *Non-Disparagement.* During the Consulting Period, neither you nor Sonos will make any statements, written or oral, to any third party which disparage, criticize, discredit or otherwise operate to the detriment of you or Sonos, its present or former officers, shareholders, directors and employees and their respective business reputation and/or goodwill; provided, however, that nothing in this Section 5 will prohibit either you or Sonos from (i) making any truthful statements or disclosures required by applicable law regulation or (ii) taking any action to enforce its rights under this Agreement or any other agreement in effect between you or Sonos.

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(d) *Sonos Confidential Information.* You agree at all times during your employment and thereafter, to hold in strictest confidence, and not to use (except for the benefit of Sonos), and not to disclose to any person, firm or corporation without written authorization of the Board of Directors of Sonos, any Confidential Information of Sonos, except under a non-disclosure agreement with a third party duly authorized and executed by Sonos. you understand that "Confidential Information" will mean any and all confidential and/or proprietary knowledge, data or information of Sonos, its affiliates, parents and subsidiaries, whether having existed, now existing, or to be developed during your employment. By way of illustration but not limitation, "Confidential Information" includes: (a) trade secrets, inventions, mask works, ideas, processes, formulas, source and object codes, data, programs, other works of authorship, know-how, improvements, discoveries, developments, designs and techniques and any other proprietary technology and all patents, copyrights and/or other proprietary rights therein; (b) information regarding research, development, new products, marketing and selling, business plans, budgets and unpublished financial statements, licenses, prices and costs, margins, discounts, credit terms, pricing and billing policies, quoting procedures, methods of obtaining business, forecasts, future plans and potential strategies, financial projections and business strategies, operational plans, financing and capital-raising plans, activities and agreements, internal services and operational manuals, methods of conducting Sonos business, suppliers and supplier information, and purchasing; (c) information regarding customers and potential customers of Sonos, including customer lists, names, representatives, their needs or desires with respect to the types of products or services offered by Sonos, proposals, bids, contracts and their contents and parties, the type and quantity of products and services provided or sought to be provided to customers and potential customers of Sonos and other non-public information relating to customers and potential customers; (d) information regarding any of Sonos' business partners and their services, including names; representatives, proposals, bids, contracts and their contents and parties, the type and quantity of products and services received by Sonos, and other non-public information relating to business partners; (e) information regarding personnel, contractors, employee lists, compensation, and employee and contractor skills; and (f) any other non-public information which a competitor of Sonos could use to the competitive disadvantage of Sonos. "Confidential Information" will not include information that: (1) is or becomes a matter of public knowledge through no fault of yours or without violation of any duty of confidentiality by you; or (2) is rightfully received by you from a third party without a duty of confidentiality. Further, nothing in this Agreement will prohibit you from discussing the terms and conditions of my employment with others to the extent expressly permitted by Section 5 of the National Labor Relations Act.

You acknowledge that the restrictions contained in this Section 5 are a reasonable and necessary protection of the immediate interests of Sonos, and any violation of these restrictions could cause substantial injury to Sonos. In the event of a breach or threatened breach by you of any of these restrictions, the procedures set forth in the At-Will Employment, Confidential Information, Invention Assignment and Arbitration Agreement will be followed.

**6. At Will Status.** Your employment remains at-will during the Interim Period, meaning that you and Sonos may terminate the employment relationship at any time, with or without cause, and with or without notice.

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**7. Prior Agreements; Amendment.** This agreement contains all of the understandings and representations between you and Sonos, and supersedes all prior and contemporaneous understandings, discussions, agreements, representations, and warranties, both written and oral; provided, however, that this Agreement will not supersede your Offer Letter dated December 27, 2011 and your At-Will Employment, Confidential Information, Invention Assignment and Arbitration Agreement dated January 4, 2012 (collectively, the "**Prior Agreements**") and you will remain subject to the terms and conditions of the Prior Agreements. This Agreement may not be amended or modified unless in writing signed by both Sonos and you.

**8. Governing Law.** This Agreement and all related documents including all exhibits attached hereto, and all matters arising out of or relating to this agreement, whether sounding in contract, tort, or statute are governed by, and construed in accordance with, the laws of the State of Massachusetts, without giving effect to the conflict of laws provisions thereof to the extent such principles or rules would require or permit the application of the laws of any jurisdiction other than those of Massachusetts.

***[Signature Page Follows]***

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We appreciate your hard work and continued efforts on behalf of Sonos. Please contact me if you have any questions about this Agreement.

**SONOS, INC.**

By:   
DocuSigned by:  
1076A64984FF4BF  
Printed Name: Patrick Spence

Title: Chief Executive Officer

Date: 2019-05-16

**MICHAEL GIANNETTO**

By:   
DocuSigned by:  
F87B51CBF4D8411...  
Printed Name: Michael Giannetto

Date: 2019-05-15

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**EXHIBIT A**

**RELEASE AGREEMENT**

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## RELEASE AGREEMENT

This Release Agreement (this "**Release**") is entered into by you and Sonos, Inc., a Delaware corporation ("**Sonos**"), effective as of September 30, 2019 (the "**Effective Date**").

In consideration of the promises set forth in the letter agreement between Sonos and you, dated May 15, 2019 (the "**Agreement**"), you and Sonos agree as follows:

1. **General Release.** In consideration of the payments and benefits provided to you under the Agreement, you, for yourself and on behalf of your representatives, agents, estate, heirs, successors and assigns ("**You**"), hereby release and waive your right to assert any form of legal claim against the Released Parties (defined in Section 6 below) whatsoever for any alleged action, inaction or circumstance, whether existing or contingent, known or unknown, suspected or unsuspected, existing or arising from the beginning of time through the date you sign this Release.

*What this general release covers:* Your waiver and release herein is intended to bar any form of legal claim, cause of action, lawsuit, charge, complaint or any other form of action against the Released Parties seeking any form of relief including, without limitation, equitable relief (whether declaratory, injunctive or otherwise), the recovery of any damages or any other form of monetary recovery whatsoever (including, without limitation, back pay, front pay, compensatory damages, emotional distress damages, punitive damages, attorneys' fees and any other costs) against the Released Parties, for any alleged action, inaction or circumstance existing or arising through the date you sign this Release (collectively referred to as "**Claims**").

Without limiting the foregoing general waiver and release, You specifically waive and release the Released Parties from any Claims arising from or related to your employment relationship with the Company or the termination thereof, including, without limitation:

- Claims under any California, Massachusetts (or any other state), federal, and/or local statute, regulation or executive order (as amended through the Effective Date) relating to employment, retaliation, discrimination (including discrimination on the basis of race, color, religion, creed, sex, sex harassment, sexual orientation, age, gender identity, marital status, familial status, pregnancy, national origin, ancestry, alienage, handicap, disability, present or past history of mental disorders or physical disability, veteran's status, candidacy for or activity in a general assembly or other public office, or constitutionally protected acts of speech), fair employment practices, or other terms and conditions of employment, including but not limited to the Age Discrimination in Employment Act and Older Workers Benefit Protection Act (29 U.S.C. § 621 *et seq.*), the Civil Rights Acts of 1866 and 1871, Title VII of the Civil Rights Act of 1964 and the Civil Rights Act of 1991 (42 U.S.C. § 2000e *et seq.*), the Equal Pay Act (29 U.S.C. § 201 *et seq.*), the Americans With Disabilities Act (42 U.S.C. § 12101 *et seq.*), the Immigration Reform and Control Act (8 U.S.C. § 1101 *et seq.*), the California Fair Employment and Housing Act (Cal. Gov. Code § 129400-951, *et seq.*), the Massachusetts Fair Employment Practices Statute (including the Pregnant Workers Fairness Act) (M.G.L. c. 151B § 1 *et seq.*), the Massachusetts Equal Rights Act (M.G.L. c. 93 §102), the Massachusetts Civil Rights Act (M.G.L. c. 12 §§ 11H & 11I), the Massachusetts Privacy

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Statute (*M.G.L. c. 214 § 1B*), the Massachusetts Sexual Harassment Statute (*M.G.L. c. 214 § 1C*), the Massachusetts law against retaliation (*M.G.L. c. 19C, §11*), and any similar California, Massachusetts or other state, federal or local statute or law.

- Claims under any California, Massachusetts (or any other state), federal and/or local statute, regulation or executive order (as amended through the Effective Date) relating to leaves of absence, layoffs or reductions-in-force, wages, hours, or other terms and conditions of employment, including but not limited to the National Labor Relations Act (29 U.S.C. § 151 *et seq.*), the Family and Medical Leave Act (29 U.S.C. § 2601 *et seq.*), the Employee Retirement Income Security Act of 1974 (29 U.S.C. § 1000 *et seq.*), COBRA (29 U.S.C. § 1161 *et seq.*), the Fair Labor Standards Act (29 U.S.C. § 201 *et seq.*), the Occupational Safety and Health Act (29 U.S.C. § 651 *et seq.*), the Worker Adjustment and Retraining Notification Act (29 U.S.C. § 2101 *et seq.*), the California Family Rights Act (*Cal. Gov. Code §§ 12945.1- 12945.2*), the California Pregnancy Disability Leave Act (*Cal. Gov. Code § 12945*), the California School Activities Act (*Cal. Labor Code § 230.8*), the Cal-WARN Act (*Cal. Labor Code §§ 1400-1408*), the California laws relating to the time, manner, and payment of wages (*Cal. Lab. §§200 et seq.*) (including the California Wage Payment Law (*Cal. Labor Code §§ 200-240*), the California Overtime Law (*Cal. Labor Code §§ 500-552*), the California Minimum Wage Law (*Cal. Labor Code § 1182.12*), the California Healthy Workplaces, Healthy Families Act of 2014 (*Cal. Labor Code § 245.5, 246, and 247.5*), the Massachusetts Small Necessities Leave Act (*M.G.L. c. 149, §52D*), the Massachusetts Parental Leave law (*M.G.L. c. 149, §105D*), the Massachusetts Sick Leave Law (*M.G.L. c. 149 § 148C*), the Massachusetts Wage Act (*M.G.L. c. 149 § 148 et. seq.*), the Massachusetts Minimum Fair Wages Act (*M.G.L. c. 151 § 1 et. seq.*), the Massachusetts Equal Pay Act (*M.G.L. c. 149 § 105A*), and any similar California, Massachusetts or other state, federal or local law. **Please note that this section specifically includes a waiver and release of Claims that you have or may have regarding payments or amounts covered by the California Wage Payment Laws, California Minimum Wage and Overtime Laws, Massachusetts Wage Act or Massachusetts Minimum Fair Wages Act (including, for instance, hourly wages, salary, overtime, minimum wages, commissions, vacation pay, holiday pay, sick leave pay, dismissal pay, bonus pay or severance pay), as well as Claims for retaliation under these Acts.**
- Claims under any California, Massachusetts (or any other state) or federal common law theory, including, without limitation, wrongful discharge, breach of express or implied contract, promissory estoppel, unjust enrichment, breach of a covenant of good faith and fair dealing, violation of public policy, defamation, interference with contractual relations, intentional or negligent infliction of emotional distress, invasion of privacy, misrepresentation, deceit, fraud, negligence, or any claim to attorneys' fees under any applicable statute or common law theory of recovery.
- Claims under any California, Massachusetts (or any other state), federal or local statute, regulation or executive order (as amended through the Effective Date) relating to whistleblower protections, violation of public policy, or any other form of retaliation or wrongful termination, including but not limited to the Sarbanes-Oxley Act of 2002 and any similar California, Massachusetts or other state or federal statute.

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- Claims under any Company compensation, benefit, stock option, incentive compensation, bonus, restricted stock, and/or equity plan, program, policy, practice or agreement.
- Any other Claim arising under other state, federal, municipal or local law.

2. **Waiver of Claims Under Section 1542.** You acknowledge that there may exist claims or facts in addition to or different from those which are now known or believed by you to exist and represent that, by means of the release in Section 1, it is nonetheless your intention to fully settle and release all such claims, whether known or unknown. You acknowledge that your intent in executing this Release is that this Release shall be effective as a bar to each and every claim covered by Section 1. In furtherance of this intention, You hereby expressly waive any and all rights and benefits conferred upon you (if any) by the provisions of Section 1542 of the California Civil Code and expressly consent that this Release shall be given full force and effect according to each and all of its express terms and provisions, including those related to unknown and/or unsuspected claims, if any, as well as those relating to any other claims described in Section 1. Section 1542 of the California Civil Code reads as follows:

"A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR OR RELEASING PARTY DOES NOT KNOW OR SUSPECT TO EXIST IN HIS OR HER FAVOR AT THE TIME OF EXECUTING THE RELEASE AND THAT, IF KNOWN BY HIM OR HER, WOULD HAVE MATERIALLY AFFECTED HIS OR HER SETTLEMENT WITH THE DEBTOR OR RELEASED PARTY."

3. **Interpretation.** The general release-of-claims shall be given the broadest interpretation permitted by law. The listing of specific claims therein shall not be interpreted to exclude any other claims not specifically listed therein.

4. **Exceptions.** The foregoing general release-of-claims will not waive or limit your right, where applicable:

- To file a complaint or to participate in, cooperate and/or communicate with, or provide information in connection with, an investigative proceeding of any federal, state or local governmental agency, including but not limited to the U.S. Equal Employment Opportunity Commission ("**EEOC**"), the California Department of Fair Employment and Housing, the Massachusetts Commission Against Discrimination, or the Securities and Exchange Commission (collectively, the "**Agencies**") without notice to Sonos. However, please understand that, because you are waiving and releasing the right to "recovery of any damages or any other form of monetary recovery whatsoever" (per Section 1), you may only seek and receive non-monetary forms of relief from the Agencies. However, nothing in this Release prohibits you from receiving monetary rewards under the whistleblower provisions of federal law or regulation;
- To pursue a claim for unemployment or workers' compensation benefits;
- To enforce this Release;

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- To pursue claims of age discrimination under the Age Discrimination in Employment Act of 1967, as amended (the "**ADEA**"), based on acts or omissions which occur after the date you sign this Release; and/or
- To challenge the validity or enforceability of any waiver of ADEA rights or claims pursuant to this Release.

**5      No Amounts Owed/Accord and Satisfaction.** You acknowledge and agree that, except for the specific consideration in the Release for consulting services, you have been paid and provided all wages, commissions, incentive pay, bonuses, vacation pay, sick pay, paid time off, holiday pay, stock and stock options, equity, severance pay, expenses, and any other form of compensation that may be due to you now or in the future in connection with your employment with or separation of employment from Sonos.

**6      Definition of Released Parties.** "Released Parties" means: (a) Sonos, Inc.; (b) all of Sonos' past, present, and future subsidiaries, parents, affiliates and divisions; (c) all of Sonos' successors and/or assigns, as well as legal representatives; (d) all of Sonos' past, present, and future officers, directors, managers, employees, shareholders, owners, attorneys, agents, insurers, employee benefit plans (including such plans' administrators, trustees, fiduciaries, record-keepers, and insurers), and legal representatives (all both individually, in their capacity acting on Sonos' behalf, and in their official capacities); and (e) all persons acting by, through, under, or in concert with any of the entities or persons listed in subsections (a)-(d).

**I UNDERSTAND AND VOLUNTARILY ACCEPT AND AGREE TO THE TERMS OF THIS RELEASE**

**MICHAEL GIANNETTO**

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**September 30, 2019**

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**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**  
**PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Patrick Spence, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Sonos, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2019

/s/ Patrick Spence

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Patrick Spence

Chief Executive Officer  
(Principal Executive Officer)

**CERTIFICATION OF CHIEF FINANCIAL OFFICER**  
**PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Brittany Bagley, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Sonos, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2019

/s/ Brittany Bagley

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Brittany Bagley

Chief Financial Officer  
(Principal Financial Officer  
and Principal Accounting Officer)

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

I, Patrick Spence, Chief Executive Officer of Sonos, Inc. (the "Company"), hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge, this Quarterly Report on Form 10-Q of the Company for the fiscal quarter ended June 29, 2019 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 8, 2019

By:

/s/ Patrick Spence

Patrick Spence

Chief Executive Officer

(Principal Executive Officer)

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

I, Brittany Bagley, Chief Financial Officer of Sonos, Inc. (the “Company”), hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge, this Quarterly Report on Form 10-Q of the Company for the fiscal quarter ended June 29, 2019 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 8, 2019

By:

/s/ Brittany Bagley

\_\_\_\_\_  
Brittany Bagley

Chief Financial Officer  
(Principal Financial Officer and  
Principal Accounting Officer)