

Turtle Beach Corp  
Form 10-Q  
November 09, 2015

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

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2015  
or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-35465

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

Nevada  
(State or other jurisdiction of  
incorporation or organization)

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

100 Summit Lake Drive, Suite 100  
Valhalla, New York  
(Address of principal executive offices)

10595  
(Zip Code)

(914) 345-2255  
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

Edgar Filing: Turtle Beach Corp - Form 10-Q

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

The number of shares of the registrant's Common Stock, par value \$0.001 per share, outstanding on October 31, 2015 was 42,518,116.

---

INDEX

|   | Page      |
|---|-----------|
| PART I. FINANCIAL INFORMATION   |           |
| Item 1. Financial Statements (unaudited)  |           |
| <u>Condensed Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014</u>   | <u>2</u>  |
| <u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2015 and 2014</u>                  | <u>3</u>  |
| <u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the Three and Nine Months Ended September 30, 2015 and 2014</u> | <u>4</u>  |
| <u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2015 and 2014</u>                            | <u>5</u>  |
| <u>Condensed Consolidated Statement of Stockholders' Equity for the Nine Months Ended September 30, 2015</u>                            | <u>6</u>  |
| <u>Notes to Condensed Consolidated Financial Statements</u>   | <u>7</u>  |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                                    | <u>24</u> |
| Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>   | <u>36</u> |
| Item 4. <u>Controls and Procedures</u>  | <u>36</u> |
| PART II. OTHER INFORMATION  |           |
| Item 1. <u>Legal Proceedings</u>  | <u>37</u> |
| Item 1A. <u>Risk Factors</u>  | <u>37</u> |
| Item 6. <u>Exhibits</u>   | <u>49</u> |
| SIGNATURES  | <u>50</u> |

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements.

Turtle Beach Corporation  
Condensed Consolidated Balance Sheets  
(unaudited)

|  | September 30,<br>2015                                 | December 31,<br>2014 |
|--|---|----------------------|
|  | (in thousands, except par value and<br>share amounts) |                      |
| <b>ASSETS</b>  |   |                      |
| Current Assets:  |   |                      |
| Cash and cash equivalents  | \$3,074   | \$7,908              |
| Accounts receivable, net   | 30,254  | 61,059               |
| Inventories  | 49,736  | 38,400               |
| Deferred income taxes  | 5,053   | 4,930                |
| Prepaid income taxes   | 1,210   | 1,482                |
| Prepaid expenses and other current assets  | 4,466   | 3,818                |
| Total Current Assets   | 93,793  | 117,597              |
| Property and equipment, net  | 5,366   | 6,722                |
| Goodwill   | 80,974  | 80,974               |
| Intangible assets, net   | 39,297  | 39,726               |
| Deferred income taxes  | —   | 1,128                |
| Other assets   | 2,141   | 821                  |
| Total Assets   | \$221,571   | \$246,968            |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |   |                      |
| Current Liabilities:   |   |                      |
| Revolving credit facilities  | \$20,617  | \$36,863             |
| Term loan  | 21,410  | 1,923                |
| Accounts payable   | 32,884  | 35,546               |
| Other current liabilities  | 9,313   | 14,525               |
| Total Current Liabilities  | 84,224  | 88,857               |
| Term loan, long-term portion   | —   | 5,769                |
| Series B redeemable preferred stock  | 15,826  | 14,916               |
| Deferred income taxes  | 5,053   | 648                  |
| Subordinated notes - related party   | 13,323  | —                    |
| Other liabilities  | 2,165   | 5,592                |
| Total Liabilities  | 120,591   | 115,782              |
| Commitments and Contingencies  |   |                      |
| Stockholders' Equity   |   |                      |
| Common stock, \$0.001 par value - 100,000,000 and 50,000,000 shares<br>authorized; 42,437,116 and 42,027,991 shares issued and outstanding as of<br>September 30, 2015 and December 31, 2014, respectively | 42  | 42                   |
| Additional paid-in capital   | 134,350   | 128,084              |
| Retained earnings (accumulated deficit)  | (33,082   | ) 3,289              |
| Accumulated other comprehensive loss   | (330  | ) (229               |
| Total Stockholders' Equity   | 100,980   | 131,186              |
| Total Liabilities and Stockholders' Equity   | \$221,571   | \$246,968            |

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

2

---

Edgar Filing: Turtle Beach Corp - Form 10-Q

Turtle Beach Corporation  
Condensed Consolidated Statements of Operations  
(unaudited)

|  | Three Months Ended                    |                       | Nine Months Ended     |                       |
|--|---------------------------------------|-----------------------|-----------------------|-----------------------|
|  | September 30,<br>2015                 | September 30,<br>2014 | September 30,<br>2015 | September 30,<br>2014 |
|  | (in thousands, except per-share data) |                       |                       |                       |
| Net Revenue                              | \$35,887                              | \$33,325              | \$78,188              | \$93,909              |
| Cost of Revenue                          | 26,323                                | 25,576                | 62,106                | 69,053                |
| Gross Profit                             | 9,564                                 | 7,749                 | 16,082                | 24,856                |
| Operating expenses:                      |                                       |                       |                       |                       |
| Selling and marketing                    | 7,142                                 | 7,962                 | 21,849                | 22,660                |
| Research and development                 | 2,963                                 | 2,797                 | 8,641                 | 6,866                 |
| General and administrative               | 5,393                                 | 4,311                 | 16,124                | 12,582                |
| Business transaction costs               | —                                     | —                     | —                     | 3,744                 |
| Restructuring charges                    | (173                                  | ) —                   | 336                   | —                     |
| Total operating expenses                 | 15,325                                | 15,070                | 46,950                | 45,852                |
| Operating loss                           | (5,761                                | ) (7,321              | ) (30,868             | ) (20,996             |
| Interest expense                         | 1,540                                 | 866                   | 3,158                 | 6,161                 |
| Other non-operating expense, net         | 347                                   | 334                   | 629                   | 239                   |
| Loss before income tax expense (benefit) | (7,648                                | ) (8,521              | ) (34,655             | ) (27,396             |
| Income tax expense (benefit)             | 8,232                                 | (2,883                | ) 1,716               | (9,550                |
| Net loss                                 | \$(15,880                             | ) \$(5,638            | ) \$(36,371           | ) \$(17,846           |
| Net loss per share:                      |                                       |                       |                       |                       |
| Basic                                    | \$(0.38                               | ) \$(0.13             | ) \$(0.86             | ) \$(0.46             |
| Diluted                                  | \$(0.38                               | ) \$(0.13             | ) \$(0.86             | ) \$(0.46             |
| Weighted average number of shares:       |                                       |                       |                       |                       |
| Basic                                    | 42,325                                | 41,962                | 42,185                | 38,869                |
| Diluted                                  | 42,325                                | 41,962                | 42,185                | 38,869                |

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

3

---

Edgar Filing: Turtle Beach Corp - Form 10-Q

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

|   | Three Months Ended |               | Nine Months Ended |               |
|---|--------------------|---------------|-------------------|---------------|
|   | September 30,      | September 30, | September 30,     | September 30, |
|   | 2015               | 2014          | 2015              | 2014          |
|   | (in thousands)     |               |                   |               |
| Net loss                                | \$(15,880          | ) \$(5,638    | ) \$(36,371       | ) \$(17,846   |
| Other comprehensive income:             |                    |               |                   |               |
| Foreign currency translation adjustment | (131               | ) (574        | ) (101            | ) 62          |
| Other comprehensive income              | (131               | ) (574        | ) (101            | ) 62          |
| Comprehensive loss                      | \$(16,011          | ) \$(6,212    | ) \$(36,472       | ) \$(17,784   |



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

4

---

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

|   | Nine Months Ended  |                    |
|---|--------------------|--------------------|
|   | September 30, 2015 | September 30, 2014 |
|   | (in thousands)     |                    |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                     |                    |                    |
| Net loss  | \$(36,371          | ) \$(17,846        |
| Adjustments to reconcile net loss to net cash provided by operating activities: |                    |                    |
| Depreciation and amortization   | 4,544              | 4,339              |
| Amortization of intangible assets   | 685                | 808                |
| Amortization of debt financing costs  | 195                | 2,587              |
| Stock-based compensation  | 4,648              | 3,916              |
| Accrued interest on Series B redeemable preferred stock                         | 910                | 908                |
| Paid in kind interest   | 509                | 953                |
| Deferred income taxes   | 5,410              | (10,282            |
| Reversal of sales returns reserve   | (1,652             | ) (3,534           |
| Provision of (Reversal of) doubtful accounts                                    | 1                  | (8                 |
| Provision for obsolete inventory  | 683                | 179                |
| Loss on disposal of property and equipment                                      | 43                 | 9                  |
| Changes in operating assets and liabilities:                                    |                    |                    |
| Accounts receivable   | 32,456             | 25,419             |
| Inventories   | (12,019            | ) 3,559            |
| Accounts payable  | (1,661             | ) (16,027          |
| Due to shareholders   | —                  | (3,125             |
| Prepaid expenses and other assets   | (710               | ) (2,418           |
| Income taxes payable  | (3,067             | ) 1,784            |
| Other liabilities   | (5,550             | ) (3,318           |
| Net cash used for operating activities  | (10,946            | ) (12,097          |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                     |                    |                    |
| Purchase of property and equipment  | (4,232             | ) (1,947           |
| Cash acquired in business combination   | —                  | 4,093              |
| Net cash provided by (used for) investing activities                            | (4,232             | ) 2,146            |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                     |                    |                    |
| Borrowings on revolving credit facilities                                       | 139,509            | 93,057             |
| Repayment of revolving credit facilities  | (155,755           | ) (104,130         |
| Repayment of capital leases   | (30                | ) (25              |
| Proceeds from term loan   | 15,000             | —                  |
| Repayment of term loan  | (1,282             | ) (14,500          |
| Repayment of subordinated notes - related party                                 | —                  | (10,789            |
| Proceeds from sale of common stock, net of issuance costs                       | —                  | 37,230             |
| Proceeds from exercise of stock options   | 582                | 1,552              |
| Debt financing costs  | (1,455             | ) (1,509           |
| Proceeds from issuance of subordinated notes - related party                    | 13,800             | 7,000              |
| Net cash provided by financing activities                                       | 10,369             | 7,886              |
| Effect of exchange rate changes on cash and cash equivalents                    | (25                | ) (28              |
| Net decrease in cash and cash equivalents                                       | (4,834             | ) (2,093           |

Edgar Filing: Turtle Beach Corp - Form 10-Q

|   |         |         |
|---|---------|---------|
| Cash and cash equivalents - beginning of period | 7,908   | 6,509   |
| Cash and cash equivalents - end of period       | \$3,074 | \$4,416 |

SUPPLEMENTAL DISCLOSURE OF INFORMATION

|   |       |           |
|---|-------|-----------|
| Cash paid for interest  | \$980 | \$1,782   |
| Cash paid for income taxes  | \$—   | \$190     |
| Value of shares issued to acquire HyperSound business                                 | \$—   | \$113,782 |
| See accompanying Notes to the Condensed Consolidated Financial Statements (unaudited) |       |           |

5

---

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

|                                  | Common Stock   |        | Additional<br>Paid-In<br>Capital | Retained<br>Earnings<br>(Accumulated<br>Deficit) | Accumulated Other<br>Comprehensive Income<br>(Loss) | Total       |
|----------------------------------|----------------|--------|----------------------------------|--|---|-------------|
|                                  | Shares         | Amount |                                  |  |   |             |
|                                  | (in thousands) |        |                                  |  |   |             |
| Balance at December 31,<br>2014  | 42,028         | \$42   | \$128,084                        | \$3,289  | \$ (229)  | ) \$131,186 |
| Net loss                         | —              | —      | —                                | (36,371)   | ) —   | (36,371 )   |
| Other comprehensive<br>income    | —              | —      | —                                | —  | (101)   | ) (101 )    |
| Issuance of warrants             | —              | —      | 1,016                            | —  | —   | 1,016       |
| Stock options exercised          | 409            | —      | 602                              | —  | —   | 602         |
| Stock-based compensation         | —              | —      | 4,648                            | —  | —   | 4,648       |
| Balance at September 30,<br>2015 | 42,437         | \$42   | \$134,350                        | \$(33,082)                                       | ) \$ (330)  | ) \$100,980 |

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

6

---

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

Note 1. Background and Basis of Presentation

Organization

Turtle Beach Corporation (“Turtle Beach” or the “Company”), incorporated in the state of Nevada in 2010, merged with VTB Holdings, Inc. (“VTBH”) and its subsidiary, Voyetra Turtle Beach, Inc. (“VTB”), which is headquartered in Valhalla, New York and was incorporated in the state of Delaware in 1975, to form a premier audio innovation company with expertise and experience in developing, commercializing and marketing audio technologies across a range of large addressable markets under the Turtle Beach® and HyperSound® brands. Turtle Beach is a worldwide leading provider of feature-rich headset solutions for use across multiple platforms, including video game and entertainment consoles, handheld consoles, personal computers, Macintosh computers, tablets and mobile devices. HyperSound is a novel patent-protected sound delivery technology that delivers immersive, directional audio offering unique benefits in a variety of commercial and consumer audio devices.

On June 18, 2015, the Company amended the Company’s Articles of Incorporation to effect an increase in the Company’s authorized capital stock shares to 100 million shares of common stock and 1 million shares of preferred stock.

Basis of Presentation

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

On January 15, 2014, VTBH, which operated the Turtle Beach business, completed the merger (the “Merger”) with and into a wholly-owned subsidiary of the Company (f/k/a Parametric Sound Corporation (“Parametric”) which operated the HyperSound business. For accounting purposes, the Merger was treated as a “reverse acquisition” and VTBH was considered the accounting acquirer. Accordingly, VTBH’s historical results of operations replace Parametric’s historical results for all periods prior to the Merger, and from the acquisition date forward the results of operations of both companies are included. The results of operations for the interim periods are not necessarily indicative of the results of operations for the entire fiscal year.

The December 31, 2014 Condensed Consolidated Balance Sheet has been derived from the Company’s most recent audited financial statements included in its Annual Report on Form 10-K.

These financial statements should be read in conjunction with the annual financial statements and the notes thereto included in our Annual Report on Form 10-K filed with the SEC on March 30, 2015 (“Annual Report”) that contains information useful to understanding the Company’s businesses and financial statement presentations.

The financial statements included in this quarterly report have been prepared assuming that we will continue as a going concern, which contemplates the recoverability of assets and the satisfaction of liabilities in the normal course of business. The Company is subject to minimum EBITDA covenants under the Term Loan Due 2019 and in an event of default, the lenders could declare all outstanding obligations immediately due and payable. The Company determined that it would not meet the existing minimum EBITDA covenants under the Term Loan Due 2019 for September 30, 2015. Based on this determination, the Company began discussions in September 2015 with its lenders

and secured an amendment dated November 2, 2015 to the Term Loan Due 2019 and the Credit Facility to suspend testing of the existing EBITDA covenants and to add certain amended covenants for the period from September 2015 through November 2015. As future compliance with the minimum EBITDA covenants subsequent to November 30, 2015 is not expected, the Company is currently in discussions with its lenders to further amend the existing agreements to reset covenant measures to correspond to current forecasts. Until such time that we are able to revise our covenants to a level that we believe is achievable, all outstanding term debt will be reclassified as a current liability. There can be no assurance that we will be able to secure a resolution and, accordingly, our liquidity and ability to operate could be adversely affected.

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

Management's plans include an amendment to our existing debt agreements to revise covenants, obtain additional funds from capital markets and incremental revenue through the HyperSound business. These financial statements do not include any adjustments that might result from the adverse outcome relating to these uncertainties.

Note 2. Summary of Significant Accounting Policies

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

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

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers, which requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. The new guidance also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. On July 9, 2015, the FASB agreed to a one-year deferral of the effective date to annual reporting periods beginning after December 15, 2017 and interim periods within those annual periods, but will permit public business entities to adopt the standard as of the original effective date (annual reporting periods beginning after December 15, 2016). The Company is currently evaluating the impact, if any, this new standard will have on its consolidated financial statements and has not yet determined the method of adoption.

In April 2015, the FASB issued ASU No. 2015-03, Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. ASU 2015-15 further clarified that debt issuance costs related to line-of-credit arrangements may continue to be presented as an asset and amortized ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The amendment is effective for annual reporting periods beginning after December 15, 2015 and interim periods within those annual periods with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the Company's financial condition or results of operations.

In July 2015, the FASB issued ASU 2015-11, Simplifying the Measurement of Inventory, which states that inventory should be measured at the lower of cost and "net realizable value." Net realizable value is defined as the "estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation." ASU 2015-11 eliminates the guidance that entities consider replacement cost or net realizable value less an approximately normal profit margin in the subsequent measurement of inventory when cost is determined on a first-in, first-out or average cost basis.

The amendment is effective for interim and annual periods beginning after December 15, 2016. Early application is permitted and should be applied prospectively. Management is evaluating the provisions of this statement, including which period to adopt, and has not determined what impact the adoption will have on the Company's financial position



or results of operations.

In September 2015, the FASB issued ASU 2015-16, Simplifying the Accounting for Measurement-Period Adjustments, which eliminates the requirement to restate prior period financial statements for measurement period adjustments related to business acquisitions. The new guidance requires that the cumulative impact of a measurement period adjustment (including the impact on prior periods) be recognized in the reporting period in which the adjustment is identified. In addition, ASU 2015-16 requires that companies present separately on the face of the income statement, or disclose in the notes, the portion of the adjustment recorded in current period earnings by line item that would have been recorded in previous reporting periods if the adjustment had been recognized as of the acquisition date. The new standard is effective for periods beginning after December 15, 2015 and should be applied prospectively to measurement period adjustments that occur after the effective date. Early adoption is permitted. Upon adoption, we will apply the new standard to measurement period adjustments related to business acquisitions.

8

---

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

9

---

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

Note 3. Business Combination

On January 15, 2014, VTBH completed the Merger with and into a wholly-owned subsidiary of Turtle Beach (f/k/a Parametric) in an all-stock, tax-free reorganization. VTBH entered into the Merger to acquire and commercialize Parametric's technology and gain access to capital market opportunities as a public company.

Business Transaction Costs

Business transaction costs as a result of the Merger of \$3.7 million were recognized for the nine months ended September 30, 2014. The components of business transaction costs are presented below.

|                           | Nine Months Ended<br>September 30,<br>2014<br>(in thousands) |
|---------------------------|--|
| Legal fees                | \$ 786   |
| Accounting fees           | 84   |
| Advisory fees             | 2,219  |
| Termination and severance | 450  |
| Other                     | 205  |
| Total Transaction Costs   | \$ 3,744   |

Advisory fees include success based fees payable to investment bankers for both merger parties.

Note 4. Fair Value Measurement

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

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

Financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, and debt instruments. Cash equivalents are stated at amortized cost, which approximates fair value as of the consolidated balance sheet dates, due to the short period of time to maturity; and accounts receivable and accounts payable are stated at their carrying value, which approximates fair value due to the short time to the expected receipt or payment. The credit facility, term loans and subordinated notes are stated at the carrying value as the stated interest rate approximates market rates currently available to the Company, which are considered Level 2 inputs. As of September 30, 2015 and December 31, 2014, there were no outstanding financial assets and liabilities recorded at fair value on a recurring basis and the Company had not elected the fair value option for any financial assets and liabilities for which such an election would have been permitted.



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

Note 5. Allowance for Sales Returns

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

|                                | Three Months Ended |          | Nine Months Ended |           |
|--------------------------------|--------------------|----------|-------------------|-----------|
|                                | September 30,      |          | September 30,     |           |
|                                | 2015               | 2014     | 2015              | 2014      |
|                                | (in thousands)     |          |                   |           |
| Balance, beginning of period   | \$1,975            | \$2,429  | \$4,155           | \$6,266   |
| Reserve accrual                | 2,951              | 2,686    | 9,373             | 7,526     |
| Recoveries and deductions, net | (2,423             | ) (2,383 | ) (11,025         | ) (11,060 |
| Balance, end of period         | \$2,503            | \$2,732  | \$2,503           | \$2,732   |

Note 6. Composition of Certain Financial Statement Items

Inventories

Inventories consist of the following:

|                   | September 30, 2015 | December 31, 2014 |
|-------------------|--------------------|-------------------|
|                   | (in thousands)     |                   |
| Raw materials     | \$2,849            | \$2,065           |
| Finished goods    | 46,887             | 36,335            |
| Total inventories | \$49,736           | \$38,400          |

Property and Equipment, net

Property and equipment, net, consists of the following:

|   | September 30, 2015 | December 31, 2014 |
|---|--------------------|-------------------|
|   | (in thousands)     |                   |
| Machinery and equipment                         | \$1,067            | \$599             |
| Software and software development               | 912                | 847               |
| Furniture and fixtures                          | 268                | 226               |
| Tooling   | 3,210              | 2,417             |
| Leasehold improvements                          | 295                | 104               |
| Demonstration units and convention booths       | 15,222             | 13,702            |
| Total property and equipment, gross             | 20,974             | 17,895            |
| Less: accumulated depreciation and amortization | (15,608            | ) (11,173         |
| Total property and equipment, net               | \$5,366            | \$6,722           |

Note 7. Goodwill and Other Intangible Assets

At acquisition, the Company estimates and records the fair value of purchased intangible assets. The fair values of these intangible assets are estimated based on our assessment. Goodwill is the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations. Goodwill and certain other intangible assets having indefinite lives are not amortized to earnings, but instead are subject to periodic testing for impairment. Intangible assets determined to have definite lives are amortized over their remaining useful lives.

We assess the impairment of long lived assets, intangibles assets and goodwill whenever events or changes in circumstances indicate that full recoverability of net asset balances through future cash flows is in question. Goodwill and indefinite-lived intangible assets are assessed at least annually, but also whenever events or changes in circumstances indicate the carrying



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

values may not be recoverable. Factors that could trigger an impairment review include: (a) significant underperformance relative to historical or projected future operating results; (b) significant changes in the manner of use of the acquired assets or the strategy for our overall business; (c) significant negative industry or economic trends; (d) significant decline in our stock price for a sustained period; and (e) a decline in our market capitalization below net book value. No impairment indicators were noted in the third quarter of 2015 which would trigger the need for testing for both definite and indefinite lived assets.

Management's forecasts of planned revenue are largely dependent on the final development and launch of the HyperSound hearing healthcare product to generate the projected revenue in subsequent years. If the performance of our HyperSound products in the hearing healthcare market does not meet expectations based on recent market data, a future impairment charge could result for a portion or all of the goodwill noted previously as the change in fair value would occur outside the purchase price allocation period. The amount of any impairment is dependent on the performance of the business which is dependent upon a number of variables which cannot be predicted with certainty.

#### Acquired Intangible Assets

Acquired identifiable intangible assets, and related accumulated amortization, as of September 30, 2015 and December 31, 2014 consist of:

|                                     | September 30, 2015   |                          |                |
|-------------------------------------|----------------------|--------------------------|----------------|
|                                     | Gross Carrying Value | Accumulated Amortization | Net Book Value |
|                                     | (in thousands)       |                          |                |
| Customer relationships              | \$5,796              | \$3,025                  | \$2,771        |
| Non-compete agreements              | 177                  | 177                      | —              |
| In-process Research and Development | 27,100               | —                        | 27,100         |
| Developed technology                | 8,880                | 159                      | 8,721          |
| Trade names                         | 170                  | 58                       | 112            |
| Patent and trademarks               | 703                  | —                        | 703            |
| Foreign Currency                    | \$(335)              | ) \$(225)                | ) \$(110)      |
| Total Intangible Assets             | \$42,491             | \$3,194                  | \$39,297       |

|                                     | December 31, 2014    |                          |                |
|-------------------------------------|----------------------|--------------------------|----------------|
|                                     | Gross Carrying Value | Accumulated Amortization | Net Book Value |
|                                     | (in thousands)       |                          |                |
| Customer relationships              | \$5,796              | \$2,458                  | \$3,338        |
| Non-compete agreements              | 177                  | 177                      | —              |
| In-process Research and Development | 27,100               | —                        | 27,100         |
| Developed technology                | 8,880                | 104                      | 8,776          |
| Trade names                         | 170                  | 33                       | 137            |
| Patent and trademarks               | 439                  | —                        | 439            |
| Foreign Currency                    | \$(205)              | ) \$(141)                | ) \$(64)       |
| Total Intangible Assets             | \$42,357             | \$2,631                  | \$39,726       |

In October 2012, VTB acquired Lygo International Limited, subsequently renamed TB Europe Ltd. The acquired intangible assets relating to customer relationships and non-compete agreements are being amortized over an estimated useful life of thirteen years and two years, respectively, with the amortization being included within sales and marketing expense.

In January 2014, the Merger between VTBH and Turtle Beach (f/k/a Parametric) was completed. The acquired intangible assets relating to developed technology, customer relationships and trade name are subject to amortization. Developed technology is being amortized over an estimated economic useful life of approximately seven years with the amortization being included within cost of revenue. Customer relationships and trade name are being amortized over an estimated useful life of two years and five years, respectively, with the amortization being included within sales and marketing expense. In-process Research and Development (“IPR&D”) is considered an indefinite-lived intangible asset until the completion or abandonment of the



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

associated research and development efforts. Accordingly, during the development period, the IPR&D is not amortized but rather subject to impairment review. As of September 30, 2015, no impairment indicators were noted.

Amortization expense related to definite lived intangible assets of \$0.2 million and \$0.7 million was recognized in the three and nine months ended September 30, 2015, respectively, and \$0.2 million and \$0.8 million for the three and nine months ended September 30, 2014, respectively.

As of September 30, 2015, estimated annual amortization expense related to definite lived intangible assets in future periods is as follows:

|            | (in thousands) |
|------------|----------------|
| 2015       | \$1,980        |
| 2016       | 2,048          |
| 2017       | 1,882          |
| 2018       | 1,802          |
| 2019       | 1,709          |
| Thereafter | 2,183          |
| Total      | \$11,604       |

Goodwill

Changes in the carrying values of goodwill for the nine months ended September 30, 2015 are as follows:

|                                  | (in thousands) |
|----------------------------------|----------------|
| Balance as of January 1, 2015    | \$ 80,974      |
|                                  | —              |
| Balance as of September 30, 2015 | \$ 80,974      |

Note 8. Credit Facilities and Long-Term Debt

|   | September 30, 2015<br>(in thousands) | December 31, 2014 |
|---|--------------------------------------|-------------------|
| Revolving credit facility, maturing March 2019    | \$20,617                             | \$36,863          |
| Term Loan Due 2018                                | 6,410                                | 7,692             |
| Term Loan Due 2019                                | 15,000                               | —                 |
| Subordinated notes                                | 13,323                               | —                 |
| Total outstanding debt                            | 55,350                               | 44,555            |
| Less: current portion of revolving line of credit | (20,617                              | ) (36,863         |
| Less: current portion of term loans               | (21,410                              | ) (1,923          |
| Total noncurrent portion of long-term debt        | \$13,323                             | \$5,769           |

Total interest expense, inclusive of amortization of deferred financing costs, on long-term debt obligations was \$1.1 million and \$2.0 million for the three and nine months ended September 30, 2015, respectively, and \$0.9 million and \$5.3 million for the three and nine months ended September 30, 2014, respectively.

Amortization of deferred financing costs was \$0.1 million and \$0.2 million for the three and nine months ended September 30, 2015, respectively, and \$0.1 million and \$2.6 million for the three and nine months ended September 30, 2014, respectively. The amount for the nine months ended September 30, 2014 includes the write-off of \$2.2 million in deferred financing costs associated with the repayment of the Company's former loan and security agreement. In connection with the Term Loan Due 2019 and Amended Notes, the Company incurred \$2.4 million of financing costs, including \$1.0 million related to the fair value of the warrants issued recorded as debt discount, which has been deferred and will be recognized over the term of the respective agreements.

### Revolving Credit Facility

On March 31, 2014, Turtle Beach and certain of its subsidiaries entered into a new asset-based revolving credit agreement (“Credit Facility”) with Bank of America, N.A., as Agent, Sole Lead Arranger and Sole Bookrunner, which replaced the then existing loan and security agreement. The Credit Facility, which expires on March 31, 2019, provides for a line of credit of up to \$60 million inclusive of a sub-facility limit of \$10 million for TB Europe, a wholly owned subsidiary of Turtle Beach. The Credit Facility may be used for working capital, the issuance of bank guarantees, letters of credit and other corporate purposes.

The maximum credit availability for loans and letters of credit under the Credit Facility is governed by a borrowing base determined by the application of specified percentages to certain eligible assets, primarily eligible trade accounts receivable and inventories, and is subject to discretionary reserves and revaluation adjustments.

Amounts outstanding under the Credit Facility bear interest at a rate equal to either a rate published by Bank of America or the LIBOR rate, plus in each case, an applicable margin, which is between 1.00% to 1.50% for U.S. base rate loans and between 2.00% to 2.50% for U.S. LIBOR loans and U.K. loans. As of September 30, 2015, interest rates for outstanding borrowings were 4.75% for base rate loans and approximately 2.71% for LIBOR rate loans. In addition, Turtle Beach is required to pay a commitment fee on the unused revolving loan commitment at a rate ranging from 0.25% to 0.50%, and letter of credit fees and agent fees.

If certain availability thresholds are not met, meaning that the Company does not have receivables and inventory which are eligible to borrow on under the Credit Facility in excess of amounts borrowed, the Credit Facility requires the Company and its restricted subsidiaries to maintain a fixed charge coverage ratio. The fixed charge ratio is defined as the ratio, determined on a consolidated basis for the most recent four fiscal quarters, of (a) EBITDA minus capital expenditures, excluding those financed through other instruments, and cash taxes paid, and (b) Fixed Charges defined as the sum of cash interest expense plus scheduled principal payments.

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

In March 2015, Bank of America notified the Company that certain events of default had occurred and were continuing under the Credit Facility, including (i) the Company's failure to deliver in a timely matter certain monthly financial statements in accordance with the Credit Facility, (ii) the Company's failure to deliver in a timely matter certain financial projections in accordance with the Credit Facility, (iii) the Company's failure to repay an over-advance of approximately \$100,000 that existed between March 6, 2015 and March 9, 2015, and (iv) the Company's failure to satisfy the fixed charge coverage ratio under the Credit Facility for certain measurement dates during the fourth quarter of 2014 (in part as a result of certain retroactive changes to the calculation of such ratio pursuant to the December Amendment, as defined below) (the “Existing Events of Default”).

On March 16, 2015, the Company entered into a third amendment (the “Third Amendment”) to the Credit Facility pursuant to which Bank of America and the lenders under the Credit Facility agreed to waive the Existing Events of Default. In addition, the Third Amendment amends certain other provisions of the agreement and requires that we maintain a certain EBITDA ratio (as defined under the Credit Facility) at the end of each month beginning April 30, 2015 on a cumulative basis through the remainder of 2015 and thereafter on a trailing twelve-month basis, and that our EBITDA must be in an amount equal to at least 75% of our monthly projected EBITDA as set forth in projections delivered pursuant to the Credit Facility. The current fixed charge coverage ratio of at least 1.15 to 1.00 on the last day of each month while a Covenant Trigger Period (as defined in the Credit Facility) is in effect will become effective again after the Company has complied with such ratio for six consecutive months.

On July 22, 2015, in connection with the Term Loan Due 2019 (as defined below), the Company and its subsidiaries entered into a fifth amendment (the “Fifth Amendment”) to the Credit Facility that modified the borrowing base pursuant to which availability of loans under the Credit Facility is determined, provided for additional mandatory

prepayment events and modified

13

---

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

certain covenants, including to permit the Company to enter into the term loan. In addition, the Fifth Amendment permits certain equity holders of the Company to contribute funds to the Company to cure financial covenant defaults.

On November 2, 2015, the Company entered into a sixth amendment to the Credit Facility that modified certain provisions to provide (i) that the the Company will make certain periodic reports with respect to certain financial metrics, (ii) that the existing financial covenants are suspended and replaced by amended EBITDA levels during the months ended September 30, 2015 through the month ending November 30, 2015, and (iii) that the loan availability is decreased by an additional block.

As of September 30, 2015, the Company was in compliance with all the amended financial covenants, and excess borrowing availability was approximately \$13.3 million, net of the outstanding Term Loan Due 2018 (as defined below) that is considered to be an additional outstanding amount under the Credit Facility.

Term Loans

Term Loan Due 2018

On December 29, 2014, the Company amended the Credit Facility (the “December Amendment”) to permit the repayment of \$7.7 million of then existing subordinated debt and accrued interest with the proceeds of an additional loan (the “Term Loan Due 2018”). The Term Loan Due 2018 resulted in modified financial covenants while it is outstanding, will bear interest at a rate of LIBOR for the applicable interest period plus 5% and will be repaid in equal monthly installments beginning on April 1, 2015 and ending on April 1, 2018. Amounts so repaid are recognized by lowering the balance of the term loan tranche and increasing the lower interest rate base revolver amount, with no net impact on borrowing availability.

Term Loan Due 2019

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

The Term Loan Due 2019 is secured by a security interest in substantially all of the Company and each of its subsidiaries' working capital assets and is subject to the first-priority lien of Bank of America , N.A., as agent, under the Credit Facility, other than with respect to equipment, fixtures, real property interests, intellectual property, intercompany property, intercompany indebtedness, equity interest in their subsidiaries, and certain other assets specified in an inter-creditor agreement between Bank of America and Crystal.

The Company and its subsidiaries are required to comply with various customary covenants including, (i) maintaining minimum EBITDA and Headset EBITDA (each as defined in the Term Loan Due 2019) in each trailing twelve month period beginning August 31, 2015, (ii) maintaining a Consolidated Leverage Ratio (as defined in the Term Loan Due 2019) to be measured on the last day of each month while the term loans are outstanding of no more than 5.75:1 beginning December 31, 2015 with periodic step-downs to 3.00:1 on January 31, 2017, (iii) not making capital expenditures in excess of \$11 million in the year ending December 31, 2015 and in excess of \$7 million in each of the years ending December 31, 2016, 2017, 2018 and 2019, (iv) restrictions on the Company's and its subsidiaries ability to prepay its subordinated notes, pay dividends, incur debt, create or suffer liens and engage in certain fundamental

transactions and (v) an obligation to provide certain financial and other information. The agreement permits certain equity holders of the Company to contribute funds to the Company to cure certain financial covenant defaults.

The Term Loan Due 2019 contains customary representations, mandatory prepayment events and events of default, including defaults triggered by the failure to make payments when due, breaches of covenants and representations, material impairment in the perfection of Crystal's security interest in the collateral and events related to bankruptcy and insolvency of the Company and its subsidiaries. Upon an event of default, Crystal may declare all outstanding obligations immediately due and payable (along with a prepayment fee), a default rate of an additional 2.0% may be applied to amounts outstanding and may take other actions including collecting or taking such other action with respect to the collateral pledged in connection with the term loan.

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

The net proceeds received from the Term Loan Due 2019 were used to repay a portion of the outstanding subordinated notes and for general corporate purposes.

On November 2, 2015, the Company entered into an amendment (the "Term Loan Amendment") to the Term Loan Due 2019 to, among other things, provide (i) that upon receipt all the proceeds from the future issuance of subordinated notes will immediately be used to prepay outstanding principal in an amount equal to \$2.5 million, (ii) that the the Company will make certain periodic reports with respect to certain financial metrics, (iii) that the existing financial covenants are suspended and replaced by amended EBITDA levels during the months ended September 30, 2015 through the month ending November 30, 2015.

Subordinated Notes - Related Party

On April 23, 2015, the Company issued a \$5.0 million subordinated note (the "April Note") to SG VTB Holdings, LLC, the Company's largest stockholder ("SG VTB"). The April Note was issued with an interest rate of (i) 10% per annum for the first year and (ii) 20% per annum for all periods thereafter, with interest accruing and being added to the principal amount of the note quarterly.

On May 13, 2015, the Company issued subordinated notes (the "May Notes") with an aggregate principal amount of \$3.8 million to SG VTB, and a trust affiliated with Ronald Doornink, the Chairman of the Company's board of directors (the "Board"). The May Notes were issued with an interest rate of 10% per annum until the maturity date of the May Notes (which was August 13, 2015 but could be extended up to two additional 90 day periods upon the written agreement of the Company and the noteholder), with interest accruing and being added to the principal amount of the May Notes quarterly. Following the maturity date, the interest rate would have increased to 20% per annum.

On June 17, 2015, the Company issued a subordinated note (the "June Note") with an aggregate principal amount of \$3.0 million to SG VTB. The June Note was issued at an interest rate of 10% per annum until the maturity date of the June Note (which was September 17, 2015 but could be extended up to two additional 90 day periods upon the written agreement of the Company and the noteholder), with interest accruing and being added to the principal amount of the June Note quarterly. Following the maturity date, the interest rate would have increased to 20% per annum. In addition, the Company had the option to request that SG VTB make, in SG VTB's sole discretion, additional advances from time to time up to an aggregate principal amount of \$15.0 million. Prior to the amendment (see below), following an additional advance of \$6.0 million on July 8, 2015, \$9.0 million was outstanding under the June Note.

Concurrently with the completion of the Term Loan Due 2019, the Company amended and restated each of its outstanding subordinated notes (the "Amended Notes"). The obligations of the Company under the Amended Notes are subordinate and junior to the prior payment of amounts due under the Credit Facility and Term Loan Due 2019. In addition, the stated maturity date of the Amended Notes was extended to September 29, 2019, subject to acceleration in certain circumstances, such as a change of control of the Company. The Amended Notes bear interest at a rate per annum equal to LIBOR plus 10.5% and shall be paid-in-kind by adding the amount to the principal amount due. Further, as consideration for the concessions in the Amended Notes, the Company issued warrants to purchase 1.7 million of the Company's common stock at an exercise price of \$2.54 per share.

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

Note 9. Income Taxes

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

## Edgar Filing: Turtle Beach Corp - Form 10-Q

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

At September 30, 2015, as a majority of our annual headset business revenues are generated during the holiday season of September to December, the Company reassessed its valuation allowance requirements taking into consideration the latest forecasted net taxable loss for the current year. As a result of cumulative losses in recent years primarily due to incremental costs associated with the console transition, acquisition costs and initial investments in the HyperSound business, the Company concluded that a full valuation allowance is required on its net deferred tax assets.

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

|                              | Three Months Ended |           | Nine Months Ended |           |
|------------------------------|--------------------|-----------|-------------------|-----------|
|                              | September 30,      |           | September 30,     |           |
|                              | 2015               | 2014      | 2015              | 2014      |
|                              | (in thousands)     |           |                   |           |
| Income tax expense (benefit) | \$ 8,232           | \$(2,883) | \$ 1,716          | \$(9,550) |
| Effective income tax rate    | (107.6             | )% 33.8   | (5.0              | )% 34.9   |

Income tax expense for the three and nine months ended September 30, 2015 was \$8.2 million at an effective tax rate of (107.6)% and \$1.7 million at an effective tax rate of (5.0)%, respectively. The effective tax rate was primarily impacted by two discrete items, the release of certain reserves related to uncertain tax positions due to the closure of an IRS examination, a \$0.9 million benefit, that occurred during the three months ended September 30, 2015 and the establishment of a valuation allowance of \$10.5 million on all of its deferred tax assets in the United States and the United Kingdom, a \$2.4 million expense.

Absent the discrete items, the effective tax rate for the nine months ended September 30, 2015 was (0.3)%, which is less than the statutory rate primarily due to the Company's full valuation allowance against its deferred tax assets.

Income tax benefit for the three and nine months ended September 30, 2014 was \$2.9 million at an effective tax rate of 33.8% and \$9.6 million at an effective tax rate of 34.9%, respectively. The effective tax rate for the three and nine months was impacted by differences in book and tax treatment of transaction costs, interest on the Series B Redeemable Preferred Stock and other non-deductible expenses.

At December 31, 2014, the Company had \$29.4 million of net operating loss carryforwards and \$12.8 million of state net operating loss carryforwards, which will begin to expire in 2029. An ownership change occurred on January 15, 2014 as a result of the Merger, and \$12.7 million of federal net operating losses included in the above are pre-change losses subject to Section 382 of the Internal Revenue Code of 1986, as amended.

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

The Company recognizes only those tax positions that meet the more-likely-than-not recognition threshold, and establishes tax reserves for uncertain tax positions that do not meet this threshold. Interest and penalties associated with income tax matters are included in the provision for income taxes in the condensed consolidated statement of operations. As of September 30, 2015, the Company had uncertain tax positions of \$2.2 million, inclusive of \$0.7 million of interest compared to \$5.6 million as of December 31, 2014, a decrease of \$3.4 million as the reduced its uncertain tax positions as a result of the close of the IRS audit.

The Company files U.S., state and foreign income tax returns in jurisdictions with various statutes of limitations. The federal tax years open under the statute of limitations are 2012 through 2014, and the state tax years open under the



statute of limitations are 2011 through 2014.

Note 10. Stock-Based Compensation

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

16

---

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

|                                | Three Months Ended |          | Nine Months Ended |          |
|--------------------------------|--------------------|----------|-------------------|----------|
|                                | September 30,      |          | September 30,     |          |
|                                | 2015               | 2014     | 2015              | 2014     |
|                                | (in thousands)     |          |                   |          |
| Cost of revenue                | \$ 185             | \$ 151   | \$ 727            | \$ 219   |
| Selling and marketing          | 46                 | 279      | 265               | 607      |
| Research and development       | 155                | 241      | 625               | 656      |
| General and administrative     | 867                | 848      | 3,031             | 2,434    |
| Total stock-based compensation | \$ 1,253           | \$ 1,519 | \$ 4,648          | \$ 3,916 |

In April 2015, the Company commenced an exchange offer (the “Exchange Offer”) to allow employees, executive officers and certain consultants the opportunity to voluntarily exchange their eligible stock options having an exercise price per share equal to or greater than \$5.00 for replacement options having a market value exercise price and covering a smaller number of shares. Each Replacement Option has a term equal to the remaining contractual term of the corresponding eligible stock option it replaced, and (i) with respect to the portion of the eligible stock option that had vested, a proportionate amount of the replacement option vested upon the issuance thereof and (ii) with respect to the portion of the eligible stock option that had not vested, the period over which such portion was scheduled to vest in equal installments was extended by six months.

Pursuant to the Exchange Offer, eligible option holders tendered, and the Company accepted for cancellation, eligible stock options to purchase an aggregate of 4,382,918 shares of common stock and in exchange granted new options to purchase 2,624,657 shares of common stock (the “Replacement Options”). The exercise price per share of the new options granted in the exchange offer was \$1.93, the last reported sale price per share of the Company’s common stock on the new stock option grant date, which was May 20, 2015 .

The exchange was treated as a modification of the terms or conditions of the existing option awards. Accordingly, the Company will recognize incremental compensation costs of \$0.8 million ratably over the vesting period of the Replacement Options, of which \$0.5 million was recognized for the nine months ended September 30, 2015 and, the remainder is expected to be recognized over a remaining weighted average vesting period of 2.0 years.

In addition to reducing our equity award overhang by 1.8 million options, the exchange returned approximately 1.1 million shares to the 2013 Plan reserve related to the 2012 Plan or the 2013 Plan shares terminated in connection with the exchange. The following table presents the stock activity and the total number of shares available for grant as of September 30, 2015:

|                                     | (in thousands) |   |
|-------------------------------------|----------------|---|
| Balance at December 31, 2014        | 443            |   |
| Plan Amendment                      | 3,200          |   |
| Option Exchange shares returned     | 1,111          |   |
| Options granted                     | (2,157         | ) |
| Restricted Stock granted            | (66            | ) |
| Forfeited/Expired shares added back | 539            |   |
| Balance at September 30, 2015       | 3,070          |   |

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

## Stock Option Activity

|   | Options Outstanding<br>Number of<br>Shares<br>Underlying<br>Outstanding<br>Options | Weighted-Average<br>Exercise Price | Weighted-Average<br>Remaining<br>Contractual Term<br><br>(In years) | Aggregate<br>Intrinsic<br>Value |
|---|--|------------------------------------|---|---------------------------------|
| Outstanding at December 31, 2014                  | 6,588,097  | 5.08                               | 6.96  | 1,327,366                       |
| Option Exchange                                   | (1,758,261 )   | 10.31                              |   |                                 |
| Granted   | 2,156,552  | 2.01                               |   |                                 |
| Exercised   | (409,125 )   | 1.47                               |   |                                 |
| Forfeited   | (683,302 )   | 8.07                               |   |                                 |
| Outstanding at September 30, 2015                 | 5,893,961  | 2.30                               | 7.38  | 2,592,519                       |
| Vested and expected to vest at September 30, 2015 | 5,662,721  | 2.29                               | 7.31  | 2,503,011                       |
| Exercisable at September 30, 2015                 | 2,540,005  | 2.35                               | 5.37  | 1,187,336                       |

Stock options are time-based and the majority are exercisable within 10 years of the date of grant, but only to the extent they have vested. The options generally vest as specified in the option agreements subject, in some instances, to acceleration in certain circumstances. In the event participants in the 2013 Plan cease to be employed or engaged by the Company, then all of the options would be forfeited if they are not exercised within 90 days. Forfeitures on option grants are estimated at 10% for non-executives and 0% for executives based on evaluation of historical and expected future turnover. Stock-based compensation expense was recorded net of estimated forfeitures, such that expense was recorded only for those stock-based awards expected to vest. The Company reviews this assumption periodically and will adjust it if it is not representative of future forfeiture data and trends within employee types (executive vs. non-executive).

Aggregate intrinsic value represents the difference between the estimated fair value of the underlying common stock and the exercise price of outstanding, in-the-money options. The aggregate intrinsic value of options exercised was \$0.3 million for the nine months ended September 30, 2015.

The Company uses the Black-Scholes option-pricing model to estimate the fair value of options granted as of the grant date. The following are assumptions for the nine months ended September 30, 2015.

|                          |               |
|--------------------------|---------------|
| Expected term (in years) | 6.1           |
| Risk-free interest rate  | 1.5% - 1.9%   |
| Expected volatility      | 40.9% - 47.1% |
| Dividend rate            | 0%            |

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

The weighted average grant date fair value of options granted during the nine months ended September 30, 2015 was \$0.88. The total estimated fair value of employee options vested during the nine months ended September 30, 2015 was \$2.4 million. As of September 30, 2015, total unrecognized compensation cost related to non-vested stock options granted to employees was \$8.7 million, which is expected to be recognized over a remaining weighted average vesting period of 3.2 years.

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

Restricted Stock Activity

|  | Shares | Weighted Average<br>Grant Date Fair Value<br>Per Share |
|--|--------|--|
| Nonvested restricted stock at December 31, 2014  | 6,396  | \$ 15.63   |
| Granted  | 65,502 | 2.29   |
| Nonvested restricted stock at September 30, 2015 | 71,898 | 3.48   |

As of September 30, 2015, total unrecognized compensation cost related to the nonvested restricted stock awards granted was \$0.1 million, which is expected to be recognized over a remaining weighted average vesting period of 0.7 years.

Stock Warrants

In connection with and as consideration for the concessions in the Amended Notes, the Company issued to SG VTB and a trust affiliated with Ronald Doornink warrants to purchase 1.7 million shares of the Company's common stock at an exercise price of \$2.54 per share. The warrants are exercisable for a period of five years beginning on the date of issuance, July 22, 2015. The exercise price and the number of shares of Common Stock purchasable are subject to adjustment and do not carry any voting rights or other rights as a stockholder of the Company prior to exercise. The shares issuable upon exercise are also subject to the "demand" and "piggyback" registration rights set forth in the in the Company's Stockholder Agreement, dated August 5, 2013, as amended July 10, 2014. The warrants meet the requirements for classification within equity as warrants entitle the holder to purchase a stated amount of shares of common stock at a fixed exercise price that are not puttable (either the warrant or the shares) to the Company or redeemable for cash.

Series B Redeemable Preferred Stock

In September 2010, VTBH issued 1,000,000 shares of its Series B Redeemable Preferred Stock with a fair value of \$12.4 million. The Series B Redeemable Preferred Stock is required to be redeemed on the earlier of September 28, 2030, or the occurrence of a liquidation event at its original issue price of \$12.425371 per share plus any accrued but unpaid dividends. The redemption value was \$15.8 million and \$14.9 million as of September 30, 2015 and December 31, 2014, respectively.

On February 18, 2015, the holder of the Series B Redeemable Preferred Stock, filed a complaint in Delaware Chancery Court alleging breach of contract against VTBH. According to the complaint, the Merger purportedly triggered a contractual obligation for VTBH to redeem the stock. Refer to Note 13, "Commitments and Contingencies" for further information.

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

## Phantom Equity Activity

In November 2011, VTBH adopted a 2011 Phantom Equity Appreciation Plan (the “Appreciation Plan”) that covers certain employees, consultants, and directors of VTBH (“Participants”) who are entitled to phantom units, as applicable, pursuant to the provisions of their respective award agreements. The Appreciation Plan is shareholder-approved, which permits the granting of phantom units to VTBH’s Participants of up to 1,500,000 units. These units are not exercisable or convertible into shares of common stock but give the holder a right to receive a cash bonus equal to the appreciation in value between the exercise price and value of common stock at the time of a change in control event as defined in the plan.

As of September 30, 2015 and December 31, 2014, 714,347 and 807,578 phantom units at a weighted-average exercise price of \$0.93 and \$0.88, respectively, have been granted and are outstanding. Because these phantom units are not exercisable or convertible into common shares, said amounts and exercise prices were not subject to the exchange ratio provided by the Merger agreement. As of September 30, 2015, compensation expense related to the Appreciation Plan units remained unrecognized because as of those dates a change in control, as defined in the plan, had not occurred and is not probable to occur. In July 2015, the Appreciation Plan was terminated as to new grants, but vested and unvested phantom units will continue.

## Note 11. Net Loss Per Share

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

|   | Three Months Ended<br>September 30,   |            | Nine Months Ended<br>September 30, |             |
|---|---------------------------------------|------------|------------------------------------|-------------|
|   | 2015                                  | 2014       | 2015                               | 2014        |
|   | (in thousands, except per-share data) |            |                                    |             |
| Net Loss  | \$(15,880 )                           | \$(5,638 ) | \$(36,371 )                        | \$(17,846 ) |
| Weighted average common shares outstanding —<br>Basic   | 42,325                                | 41,962     | 42,185                             | 38,869      |
| Plus incremental shares from assumed conversions:       |                                       |            |                                    |             |
| Dilutive effect of stock options                        | —                                     | —          | —                                  | —           |
| Weighted average common shares outstanding —<br>Diluted | 42,325                                | 41,962     | 42,185                             | 38,869      |
| Net loss per share:                                     |                                       |            |                                    |             |
| Basic   | \$(0.38 )                             | \$(0.13 )  | \$(0.86 )                          | \$(0.46 )   |
| Diluted   | \$(0.38 )                             | \$(0.13 )  | \$(0.86 )                          | \$(0.46 )   |

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



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

|                                  | Three Months Ended |       | Nine Months Ended |       |
|----------------------------------|--------------------|-------|-------------------|-------|
|                                  | September 30,      |       | September 30,     |       |
|                                  | 2015               | 2014  | 2015              | 2014  |
|                                  | (in thousands)     |       |                   |       |
| Stock options                    | 6,091              | 6,118 | 6,383             | 6,066 |
| Warrants                         | 1,318              | 31    | 465               | 38    |
| Unvested restricted stock awards | 72                 | 6     | 48                | 6     |
| Total                            | 7,481              | 6,155 | 6,896             | 6,110 |

Note 12. Segment and Geographic Information

The Company has historically aggregated its two operating segments - Voyetra Turtle Beach (“Headset”) and HyperSound. In light of the subsequent development and anticipated launch of the HyperSound Clear™ product, the Company evaluated whether its operating segments should continue to be aggregated for reporting purposes and determined that as a result of the new hearing healthcare product, the HyperSound operating segment will no longer have similar economic characteristics, production processes, clients or methods of distribution. As such, the Company has disclosed the Headset and HyperSound operating segments separately. The entire business is managed by a single management team whose Chief Operating Decision Maker is the Chief Executive Officer.

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

|  | Three Months Ended |           | Nine Months Ended |              |
|--|--------------------|-----------|-------------------|--------------|
|  | September 30,      |           | September 30,     |              |
|  | 2015               | 2014      | 2015              | 2014         |
|  | (in thousands)     |           |                   |              |
| Net Revenues                             |                    |           |                   |              |
| Headset                                  | \$35,700           | \$33,198  | \$77,823          | \$93,677     |
| HyperSound                               | 187                | 127       | 365               | 232          |
| Total                                    | \$35,887           | \$33,325  | \$78,188          | \$93,909     |
| Operating Income (Loss)                  |                    |           |                   |              |
| Headset                                  | \$(1,943)          | \$(4,441) | \$(20,431)        | \$(11,193)   |
| HyperSound                               | (3,818)            | (2,880)   | (10,437)          | (9,803)      |
| Total                                    | \$(5,761)          | \$(7,321) | \$(30,868)        | \$(20,996)   |
| Interest Expense                         | \$1,540            | \$866     | \$3,158           | \$6,161      |
| Other non-operating expense, net         | \$347              | \$334     | \$629             | \$239        |
| Loss before income tax expense (benefit) | \$(7,648)          | \$(8,521) | \$(34,655)        | \$(27,396)   |
|  |                    |           | September 30,     | December 31, |
|  |                    |           | 2015              | 2014         |
|  | (in thousands)     |           |                   |              |
| Total Assets                             |                    |           |                   |              |
| Headset                                  |                    | \$58,035  |                   | \$82,798     |
| HyperSound                               |                    | 163,536   |                   | 164,170      |
| Total                                    |                    | \$221,571 |                   | \$246,968    |

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

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

|                    | Three Months Ended |          | Nine Months Ended |          |
|--------------------|--------------------|----------|-------------------|----------|
|                    | September 30,      |          | September 30,     |          |
|                    | 2015               | 2014     | 2015              | 2014     |
|                    | (in thousands)     |          |                   |          |
| United States      | \$23,136           | \$19,377 | \$52,940          | \$59,258 |
| United Kingdom     | 3,322              | 4,867    | 7,855             | 14,788   |
| Europe             | 2,756              | 5,656    | 6,026             | 12,341   |
| International      | 6,673              | 3,425    | 11,367            | 7,522    |
| Total net revenues | \$35,887           | \$33,325 | \$78,188          | \$93,909 |

### Note 13. Commitments and Contingencies

#### Litigation

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

**Shareholders Class Action:** On August 5, 2013, VTBH and the Company (f/k/a Parametric) announced that they had entered into the Merger Agreement pursuant to which VTBH would acquire an approximately 80% ownership interest and existing shareholders would maintain an approximately 20% ownership interest in the combined company. Following the announcement, several shareholders filed class action lawsuits in California and Nevada seeking to enjoin the Merger. The plaintiffs in each case alleged that members of the Company's Board of Directors breached their fiduciary duties to the shareholders by agreeing to a Merger that allegedly undervalued the Company. VTBH and the Company were named as defendants in these lawsuits under the theory that they had aided and abetted the Company's Board of Directors in allegedly violating their fiduciary duties. The plaintiffs in both cases sought a preliminary injunction seeking to enjoin closing of the Merger, which, by agreement, was heard by the Nevada court with the California plaintiffs invited to participate. On December 26, 2013, the court in the Nevada cases denied the plaintiffs' motion for a preliminary injunction. Following the closing of the Merger, the Nevada plaintiffs filed a second amended complaint, which made essentially the same allegations and sought monetary damages as well as an order rescinding the Merger. The California plaintiffs dismissed their action without prejudice, and sought to intervene in the Nevada action, which was granted. Subsequent to the intervention, the plaintiffs filed a third amended complaint, which made essentially the same allegations as prior complaints and sought monetary damages. On June 20, 2014, VTBH and the Company moved to dismiss the action, but that motion was denied on August 28, 2014. That denial is currently under review by the Nevada Supreme Court, which held a hearing on the Company's petition for review on September 1, 2015. After the hearing, the Nevada Supreme Court requested supplemental briefing, which the parties completed on October 13, 2015. The Nevada Supreme Court also invited the Business Law Section of the Nevada State Bar to submit an amicus brief by December 3, 2015. The Company believes that the plaintiffs' claims against it are without merit and intends to vigorously defend itself in the litigation.

**Dr. John Bonanno Complaint:** On February 18, 2015, Dr. John Bonanno, a minority shareholder of VTBH, filed a complaint in Delaware Chancery Court alleging breach of contract against VTBH. According to the complaint, the Merger purportedly triggered a contractual obligation for VTBH to redeem Dr. Bonanno's stock. Dr. Bonanno requests a declaratory judgment stating that he is entitled to damages including a redemption of his stock for the redemption value of \$15.1 million (equal to the original issue price of his stock plus accrued dividends) as well as other costs and expenses. VTBH maintains that the Merger did not trigger any obligation to redeem Mr. Bonanno's stock and VTBH intends to vigorously defend itself in the litigation.



The Company will continue to vigorously defend itself in the foregoing matters. However, litigation and investigations are inherently uncertain. Accordingly, the Company cannot predict the outcome of these matters. The Company has not recorded any accrual at September 30, 2015 for contingent losses associated with these matters based on its belief that losses, while possible, are not probable. Further, any possible range of loss cannot be reasonably estimated at this time. The unfavorable resolution of these matters could have a material adverse effect on the Company's business, results of operations, financial

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

condition or cash flows. The Company is engaged in other legal actions not described above arising in the ordinary course of its business and, while there can be no assurance, believes that the ultimate outcome of these other legal actions will not have a material adverse effect on its business, results of operations, financial condition or cash flows.

#### Warranties

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

|                                | Three Months Ended |        | Nine Months Ended |        |
|--------------------------------|--------------------|--------|-------------------|--------|
|                                | September 30,      |        | September 30,     |        |
|                                | 2015               | 2014   | 2015              | 2014   |
|                                | (in thousands)     |        |                   |        |
| Warranty, beginning of period  | \$443              | \$260  | \$493             | \$139  |
| Warranty costs accrued         | 125                | —      | 338               | 354    |
| Settlements of warranty claims | (112               | ) (192 | ) (375            | ) (425 |
| Warranty, end of period        | \$456              | \$68   | \$456             | \$68   |

XO4 Stealth Product Recall: In August 2015, the Company received a limited number of reports from consumers and retailers that certain EAR FORCE® XO FOUR Stealth headsets appeared to have a white substance or spots on the ear pads. Upon receiving the reports, the Company promptly stopped shipping any units of the XO FOUR Stealth headsets and notified our retail customers to stop sales pending the results of the Company's investigation. An outside laboratory engaged by the Company identified the substance as mold. In cooperation with the U.S. Consumer Product Safety Commission, the Company is voluntarily recalling certain units of the headsets. As of September 30, 2015 and the date of this report, the Company has not received notice of any law suits against the Company in connection with the recall and is in the process of working with the contract manufacturer to provide replacement units and collect reimbursement for certain related costs.

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

The following discussion and analysis of our operations should be read together with our unaudited condensed consolidated financial statements and the related notes included in Part I of this Quarterly Report on Form 10-Q and with our audited consolidated financial statements and the related notes included in our Annual Report on Form 10-K filed with the Securities Exchange Commission on March 30, 2015 (the "Annual Report.")

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

On January 15, 2014, VTB Holdings, Inc. ("VTBH"), which operated the Turtle Beach business, completed the merger (the "Merger") with the Company (f/k/a Parametric Sound Corporation "Parametric"), which operated the HyperSound business. For accounting purposes, the Merger was treated as a "reverse acquisition" and VTBH was considered the accounting acquirer. Accordingly, VTBH's historical results of operations replace Parametric's historical results for all periods prior to the Merger, and from the acquisition date forward the results of operations of both companies are included.

### Business Overview

Turtle Beach Corporation (herein referred to as the "Company," "we," "us," or "our"), incorporated in the state of Nevada in 2010, merged with VTB Holdings, Inc. ("VTBH") and its subsidiary, Voyetra Turtle Beach, Inc. ("VTB"), which is headquartered in Valhalla, New York and was incorporated in the state of Delaware in 1975, to form a premier audio innovation company with expertise and experience in developing, commercializing and marketing audio technologies across a range of large addressable markets under two reportable segments, Turtle Beach® ("Headset") and HyperSound®.

Turtle Beach is a worldwide leading provider of feature-rich headset solutions for use across multiple platforms, including video game and entertainment consoles, handheld consoles, personal computers, tablets and mobile devices. HyperSound technology is an innovative patent-protected sound technology that delivers immersive, directional audio offering unique potential benefits in a variety of commercial settings and consumer devices. The upcoming launch of HyperSound Clear™ will transition the business to the hearing healthcare market, where we believe a large percentage of people with hearing loss will be able to use the product to improve their listening experiences from sources such as TV, CD/DVD players and stereo systems.

The Company's stock is traded on NASDAQ under the symbol HEAR.

### Business Trends

The video game industry is a global and growing market. Sales in the console accessories market, which includes gaming headsets and other peripherals such as gamepads and specialty controllers, adapters, batteries, memory and interactive gaming toys are significantly influenced by the launch and sales of new game consoles. In 2013, the gaming industry experienced a cyclical event as Microsoft and Sony each announced new consoles for the first time in eight years, and the strong consumer response to the Xbox One and PlayStation®4 (the "next generation consoles") has created a growing installed base of gamers and a market for next generation headsets.

With the introduction of the next generation consoles, the gaming industry is now entering its seventh console cycle. As with past console transitions, total industry revenue declined in 2013 as software developers launched fewer new

games and shifted development efforts to the new console platforms, and consumers slowed spending in anticipation of the introduction of new hardware and software.

The following chart shows the projected global console hardware and software sales and current stage of the console transition based on estimates from the April 2015 Intelligence: Worldwide Console Forecast report by DFC Intelligence Forecasts, or “DFC.”

(1) Graph as of June 30, 2015

Based on the above, total industry revenue is expected to reach new highs within three years of the launch of new consoles. DFC has forecasted that unit sales of the next generation consoles will be 67% higher in the first three years than in the same period in the previous cycle. At the end of 2014, only 20% of the anticipated five-year cumulative sales are projected to have been made. As such, the console transition is at the front end what we believe will be a strong growth period for the industry, and in 2014, Turtle Beach was the number one console gaming headset manufacturer in the U.S. with a 46% dollar share of the market according to market research company NPD Group's Retail Tracking Service.

#### Products

##### Xbox One

In 2014, we expanded our Xbox One compatible headset portfolio with the launch of the XO FOUR, XO SEVEN, XO ONE and Stealth 500X and developed headsets that included many new and unique features including DTS Headphone:X, full wireless integration with Xbox One, and Superhuman Hearing™. In 2015, continuing with our strategy to deliver innovative, high quality console gaming headsets that incorporate advanced audio and wireless technology, we launched two upgraded versions of market-leading Xbox One headsets – the XO SEVEN Pro and the XO FOUR Stealth, and introduced the Elite 800X and Stealth 420X, which bring several more firsts to Xbox One gaming, including active noise cancellation and invisible, boom-free microphones.

##### PlayStation®4

In January 2014, we announced an agreement with Sony Computer Entertainment Inc. to make officially licensed headsets for the PlayStation®4. During 2014, we added three wireless headsets -- the ELITE 800, Stealth 500P and Stealth 400 -- and the P12 and Recon 60P, new entry-level headsets for the PlayStation®4 which expanded our core portfolio of headsets for the PlayStation®4.

Additionally, in October 2015, we launched the Ear Force PX24, a true multiplatform headset that works with PlayStation®4, Xbox One, PC, Mac and mobile/tablet devices.

#### PC Gaming Accessories

Our new line of PC gaming accessories, being produced by Nordic Game Supply pursuant to an exclusive licensing agreement, offers six models, including the Impact 700 and Impact 500 mechanical keyboards, the Grip 500 programmable laser mouse, the Grip 300 optical mouse, and the Drift and Traction gaming mousepads. In September 2015, we launched the Stealth 450 wireless and Ear Force Recon 50 PC gaming headsets.

#### Seasonality

Our gaming headset business is seasonal with a significant portion of sales and profits typically occurring around the holiday period. Historically, more than 50% of headset business revenues are generated during the period from September through December as new headsets are introduced and consumers engage in holiday shopping.

#### Geographic Expansion

In addition to the traditional markets of the United States and United Kingdom, we have pursued growth in countries such as Germany and France, and have begun to support long-term growth efforts in Asia Pacific and Latin America. In September 2014, sales of our XO Four and XO Seven officially-licensed Xbox One gaming headsets began in China. The launch of the gaming headsets coincided with the launch of the Xbox One console, which debuted in China on September 29, 2014. We believe China offers a growth opportunity over the next several years and therefore, in concert with the introduction of our officially-licensed Xbox One headsets, we created a Chinese language version of the Turtle Beach brand and logo; phonetically pronounced “Huan Jing,” the Chinese language version of the brand name translates as “Fantasy Space.”

#### Key Performance Indicators and Non-GAAP Measures

Management routinely reviews key performance indicators including revenue, operating income and margins, and earnings per share, among others. In addition, we consider other certain measures to be useful to management and investors evaluating our operating performance for the periods presented, and believe these additional measures provide a tool for evaluating our ongoing operations, liquidity and management of assets. These metrics, however, are not measures of financial performance under accounting principles generally accepted in the United States of America (“GAAP”) and should not be considered a substitute for net income (loss) or other consolidated income statement data as determined in accordance with GAAP. These other measures may not be comparable to similarly titled measures employed by other companies. We consider the following non-GAAP measure, which may not be comparable to similarly titled measures reported by other companies, to be key performance indicators:

Adjusted EBITDA is defined as net income (loss) before interest, taxes, depreciation and amortization, stock-based compensation (non-cash) and, certain special items that we believe are not representative of core operations. We believe this measure provides useful information to investors about us and our financial condition and results of operations for the following reasons: (i) it is one of the measures used by our board of directors and management team to evaluate our operating performance; (ii) it is one of the measures used by our management team to make day-to-day operating decisions; (iii) the adjustments made in our calculation of Adjusted EBITDA are often viewed as either non-recurring or not reflective of ongoing financial performance or have no cash impact on operations; and (iv) it is used by securities analysts, investors and other interested parties as a common operating performance measure to compare results across companies in our industry by backing out potential differences caused by variations in capital structures (affecting relative interest expense), and the age and book value of facilities and equipment (affecting relative depreciation and amortization expense).

Adjusted EBITDA has limitations as an analytical tool, and when assessing our operating performance, it should not be considered in isolation or as a substitute for net income (loss) or other consolidated income statement data. Some of these limitations include, but are not limited to (i) it does not reflect changes in, or cash requirements for, our working capital needs; (ii) it does not reflect interest expense, or the cash requirements necessary to service interest or principal payments, on our debt; and (iii) it does not reflect income taxes or the cash requirements for any tax payments; and Adjusted EBITDA (and a reconciliation to Net loss, the nearest GAAP financial measure) for the three and nine months ended September 30, 2015 and 2014 are as follows:

|                               | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |             |
|-------------------------------|-------------------------------------|------------|------------------------------------|-------------|
|                               | 2015                                | 2014       | 2015                               | 2014        |
|                               | (in thousands)                      |            |                                    |             |
| Net loss                      | \$(15,880                           | ) \$(5,638 | ) \$(36,371                        | ) \$(17,846 |
| Interest expense              | 1,540                               | 866        | 3,158                              | 6,161       |
| Depreciation and amortization | 1,700                               | 1,602      | 5,229                              | 5,147       |
| Stock-based compensation      | 1,253                               | 1,519      | 4,648                              | 3,916       |
| Income tax expense (benefit)  | 8,232                               | (2,883     | ) 1,716                            | (9,550      |
| Restructuring charges         | (173                                | ) —        | 336                                | —           |
| Business transaction costs    | —                                   | —          | —                                  | 3,744       |
| Adjusted EBITDA               | \$(3,328                            | ) \$(4,534 | ) \$(21,284                        | ) \$(8,428  |

Comparison of the Three Months Ended September 30, 2015 to the Three Months Ended September 30, 2014

For the three months ended September 30, 2015, Adjusted EBITDA on a consolidated basis was \$(3.3) million, including investments of \$3.6 million in the HyperSound business compared to \$(4.5) million, including investments of \$2.5 million in the HyperSound business during the three months ended September 30, 2014. Headset adjusted EBITDA totaled approximately \$0.3 million in the three months ended September 30, 2015 compared to \$(2.0) million in the prior year period.

Adjusted EBITDA increased for the three months ended September 30, 2015 as compared to the prior year period on product mix driven margin improvement and higher domestic retail and distributor revenues as our expanded next generation headset portfolio outpaced an overall decline in sales of previous generation headsets. These costs were partially offset by an increase in the HyperSound investment primarily related to additional sales force and higher research and development expense to support the anticipated launch of the HyperSound Clear™ product. Comparison of the Nine Months Ended September 30, 2015 to the Nine Months Ended September 30, 2014

For the nine months ended September 30, 2015, Adjusted EBITDA on a consolidated basis was \$(21.3) million, including investments of \$9.7 million in the HyperSound business compared to \$(8.4) million, including investments of \$6.7 million in the HyperSound business during the nine months ended September 30, 2014. Headset adjusted EBITDA totaled approximately \$(11.6) million in the nine months ended September 30, 2015 compared to \$(1.7) million in the prior year period.

Adjusted EBITDA decreased for the nine months ended September 30, 2015 as compared to the prior year period which included the initial sell-in of the Company's and the industry's first ever Xbox One compatible headsets resulting from a delay in gaming headset audio for the Xbox One console. In addition to the lower sales volume, the current period was negatively impacted by promotion credits to continue to clear channel inventory and higher third party licensing and royalty costs which included \$1.3 million of reserves for products associated with certain discontinued legacy license agreements as well as an incremental \$3.0 million investment in the HyperSound investment primarily related to additional sales force and higher research and development expense to support the anticipated launch of the HyperSound Clear™ product.





## Results of Operations

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

|  | Three Months Ended |           | Nine Months Ended |            |
|--|--------------------|-----------|-------------------|------------|
|  | September 30,      |           | September 30,     |            |
|  | 2015               | 2014      | 2015              | 2014       |
|  | (in thousands)     |           |                   |            |
| Net Revenue                              | \$ 35,887          | \$ 33,325 | \$ 78,188         | \$ 93,909  |
| Cost of Revenue                          | 26,323             | 25,576    | 62,106            | 69,053     |
| Gross Profit                             | 9,564              | 7,749     | 16,082            | 24,856     |
| Operating expenses                       | 15,325             | 15,070    | 46,950            | 45,852     |
| Operating loss                           | (5,761)            | (7,321)   | (30,868)          | (20,996)   |
| Interest expense                         | 1,540              | 866       | 3,158             | 6,161      |
| Other non-operating expense, net         | 347                | 334       | 629               | 239        |
| Loss before income tax expense (benefit) | (7,648)            | (8,521)   | (34,655)          | (27,396)   |
| Income tax expense (benefit)             | 8,232              | (2,883)   | 1,716             | (9,550)    |
| Net loss                                 | \$(15,880)         | \$(5,638) | \$(36,371)        | \$(17,846) |

The following table summarizes net revenue by segment for the three and nine months ended September 30, 2015 and 2014, respectively:

|                   | Three Months Ended |          | Nine Months Ended |          |
|-------------------|--------------------|----------|-------------------|----------|
|                   | September 30,      |          | September 30,     |          |
|                   | 2015               | 2014     | 2015              | 2014     |
|                   | (in thousands)     |          |                   |          |
| Headset           | \$35,700           | \$33,198 | \$77,823          | \$93,677 |
| HyperSound        | 187                | 127      | 365               | 232      |
| Total Net Revenue | 35,887             | 33,325   | 78,188            | 93,909   |

## Net Revenue

## Headset

Net revenues for the three months ended September 30, 2015 increased \$2.5 million, or 7.5%, as compared to three months ended September 30, 2014, on higher domestic retail and distributor revenues as our expanded next generation headset portfolio, lead by a 15.3% increase in Xbox One compatible headset revenues, outpaced an overall decline in sales of previous generation headsets. This was partially offset by lower international distributor sales and the negative impact of foreign currency.

Despite strong consumer response to our next generation Xbox One and PlayStation®4 compatible headsets, expansion into Asia and the initial sales of a new line of PC accessories, net revenues for the nine months ended September 30, 2015 decreased 16.9% over the comparable 2014 period to \$77.8 million. The decrease reflects the continued decline in demand for previous generation products and the benefit of the initial sell-in for the new Xbox One compatible headsets, which launched during the first quarter of 2014 as a result of a delay in gaming headset audio, in the comparable prior year period.

## HyperSound

Net revenues for the three and nine months ended September 30, 2015 were \$0.2 million and \$0.4 million, respectively, from sales of the previous generation commercial product as we continue to focus on larger volume applications for the digital signage, kiosk and related applications. Additionally, with strong initial pre-orders, the product will begin initial order



fulfillments to our multiple distribution partners that are among the leading hearing healthcare groups and collectively represent the vast majority of all audiologist offices in the United States.

#### Cost of Revenue and Gross Profit

Gross profit as a percentage of net revenues for the three months ended September 30, 2015 was 26.7% versus 23.3% in the comparable 2014 period primarily due to a product mix shift to higher margin next generation headsets with the release of certain new models for the holiday season sell-in and continued channel mix shift to higher margin domestic revenues. These benefits were partially offset by higher royalty costs and the negative impact of promotional credits in order to continue clearing previous generation inventory.

Gross profit as a percentage of net revenues for the nine months ended September 30, 2015 was 20.6% versus 26.5% in the comparable 2014 period. We experienced a year-over-year decrease in gross margin rate performance primarily due to higher promotion credits to clear previous generation and licensed headsets, incremental costs associated with our refurbishment model and contract manufacture transitions and, higher third party licensing and royalty costs which included \$1.3 million of reserves for products associated with certain discontinued legacy license agreements.

#### Operating Expenses

|                            | Three Months Ended    |          | Nine Months Ended     |          |
|----------------------------|-----------------------|----------|-----------------------|----------|
|                            | September 30,<br>2015 | 2014     | September 30,<br>2015 | 2014     |
|                            | (in thousands)        |          |                       |          |
| Selling and marketing      | \$7,142               | \$7,962  | \$21,849              | \$22,660 |
| Research and development   | 2,963                 | 2,797    | 8,641                 | 6,866    |
| General and administrative | 5,393                 | 4,311    | 16,124                | 12,582   |
| Business transaction costs | —                     | —        | —                     | 3,744    |
| Restructuring charges      | (173                  | ) —      | 336                   | —        |
| Total operating expenses   | \$15,325              | \$15,070 | \$46,950              | \$45,852 |

#### Selling and Marketing

Selling and marketing expenses for the three months ended September 30, 2015 totaled \$7.1 million, or 19.9% as a percentage of net revenues, compared to \$8.0 million, or 23.9% as a percentage of net revenues, for the three months ended September 30, 2014. The 10.3% decrease was primarily due to lower direct media spend and licensing costs, partially offset by additional sales force related to the HyperSound Clear™ product launch.

Selling and marketing expenses for the nine months ended September 30, 2015 of \$21.8 million, or 27.9% as a percentage of net revenues, and as a result of lower trade show and direct media activity in connection with a strategic shift to an increased social media presence and more targeted promotional activity at retail with refreshed interactive displays, remained consistent versus the comparable prior-year period, despite the impact of \$0.6 million of leadership team severance and related costs, and additional sales force and incremental marketing activity related to the HyperSound Clear™ product launch.

#### Research and Development

The increase in research and development expenses for the three and nine months ended September 30, 2015 versus the respective comparable prior year periods was primarily due to increased staffing levels to support the development of the HyperSound Clear™ product as well as new advanced audio and wireless development initiatives to expand our Xbox One compatible headset portfolio and launch of our true multiplatform headset - the EarForce PX24.

#### General and Administrative

The increase in general and administrative expenses for the three and nine months ended September 30, 2015 versus the respective comparable prior year periods was primarily due to additional headcount, incremental stock compensation expense,



legal fees associated with recent public filings in connection with our stock option exchange and financing activity, and initial clinical costs related to the HyperSound Clear™ product.

#### Business Transaction

Business transaction expenses for the nine months ended September 30, 2014 related to investment banker success fees of \$2.2 million as well as associated legal and accounting fees in connection with the acquisition of the HyperSound business.

#### Restructuring Charges

During 2014, we began to focus on company-wide overhead and operating expense cost reduction activities, such as closing excess facilities and reducing redundancies. In connection with our efforts to improve our operating efficiency and reduce costs, we completed the closure of certain production operations at one of our contract manufacturing operations in China in June 2015.

#### Interest Expense

Interest expense decreased by \$3.0 million for the nine months ended September 30, 2015 as compared to September 30, 2014, primarily due to the prior year impact of a \$2.2 million write-off of unamortized debt issuance costs related to the refinancing of our then existing credit facility on March 31, 2014 and a \$0.4 million benefit from lower average overall borrowings on our credit facility.

For the three months ended September 30, 2015, interest expense increased by \$0.7 million as compared to September 30, 2014 due to additional expense related to the Term Loan Due 2019 and the Subordinated Notes.

#### Income Taxes

At September 30, 2015, as a majority of our annual headset business revenues are generated during the holiday season of September to December, the Company reassessed its valuation allowance requirements taking into consideration the latest forecasted net taxable loss for the current year. As a result of cumulative losses in recent years primarily due to incremental costs associated with the console transition, acquisition costs and initial investments in the HyperSound business, the Company concluded that a full valuation allowance is required.

Income tax expense for the three and nine months ended September 30, 2015 was \$8.2 million at an effective tax rate of (107.6)% and \$1.7 million at an effective tax rate of (5.0)%, respectively. The effective tax rate was primarily impacted by two discrete items, the release of certain reserves related to uncertain tax positions due to the closure of an IRS examination, a \$0.9 million benefit, that occurred during the three months ended September 30, 2015 and the establishment of a valuation allowance of \$10.5 million on all of its deferred tax assets in the United States and the United Kingdom, a \$2.4 million expense.

Absent the discrete items, the effective tax rate for the nine months ended September 30, 2015 was (0.3)%, which is less than the statutory rate primarily due to the Company's full valuation allowance against its deferred tax assets.

Income tax benefit for the three and nine months ended September 30, 2014 was \$2.9 million at an effective tax rate of 33.8% and \$9.6 million at an effective tax rate of 34.9%, respectively. The effective tax rate for the three and nine months was impacted by differences in book and tax treatment of transaction costs, interest on the Series B Redeemable Preferred Stock and other non-deductible expenses.

### Liquidity and Capital Resources

Our primary source of working capital is cash flow from operations. We have funded operations and acquisitions in recent periods with operating cash flows, and proceeds from debt and equity financings.

The following table summarizes our sources and uses of cash:

|  | Nine Months Ended |           |
|--|-------------------|-----------|
|  | September 30,     |           |
|  | 2015              | 2014      |
|  | (in thousands)    |           |
| Cash and cash equivalents at beginning of period     | \$7,908           | \$6,509   |
| Net cash used for operating activities               | (10,946           | ) (12,097 |
| Net cash provided by (used for) investing activities | (4,232            | ) 2,146   |
| Net cash provided by financing activities            | 10,369            | 7,886     |
| Effect of foreign exchange on cash                   | (25               | ) (28     |
| Cash and cash equivalents at end of period           | \$3,074           | \$4,416   |

#### Operating activities

Cash used for operating activities for the nine months ended September 30, 2015 was \$10.9 million, a decrease of \$1.2 million as compared to \$12.1 million for the nine months ended September 30, 2014. The decrease is primarily the result of efforts to improve collections of receivables and lower year-over-year payments of accounts payable compared to the prior year that included the impact of a debt refinancing process that started in late 2013 and was completed in March 2014, offset by a decrease in net income adjusted for non-cash expenses primarily due to the valuation allowance recorded.

#### Investing activities

Cash used for investing activities was \$4.2 million during the nine months ended September 30, 2015 compared to cash provided by investing activities of \$2.1 million during the nine months ended September 30, 2014, as a result of \$4.1 million of cash acquired in the merger. Capital expenditures increased \$2.3 million compared to the prior year period to \$4.2 million for the nine months ended September 30, 2015 primarily due to tooling and interactive display purchases related to the expansion of our headset portfolio.

#### Financing activities

Net cash provided by financing activities was \$10.4 million during the nine months ended September 30, 2015 compared to \$7.9 million during the nine months ended September 30, 2014. Financing activities during the nine months ended included net payments on our revolving credit facilities of \$16.2 million with cash from operations and the issuance of a \$15 million term loan and \$13.8 million principal amount of subordinated notes. Financing activities in the nine months ended September 30, 2014 included \$37.2 million of proceeds from the sale of common stock and the issuance of \$7.0 million principal amount of subordinated notes partially offset by (i) net payments on our revolving credit facilities of \$11.1 million with cash from operations and funds from our equity offering, (ii) repayment of our \$14.5 million legacy term loan and (iii) repayment of \$10.8 million of outstanding subordinated notes.

#### Management assessment of liquidity

Management believes that the Company's current cash and cash equivalents and the amounts available under its asset-based credit facility including the impact of the proceeds from our recent term loans, and its cash flows derived from operations will be sufficient to meet anticipated cash needs for working capital and capital expenditures for at least the next 12 months. Significant assumptions underlie this belief, including, among other things, that there will be no material adverse developments in our business, liquidity or capital requirements.

The financial statements included in this quarterly report have been prepared assuming that we will continue as a going concern, which contemplates the recoverability of assets and the satisfaction of liabilities in the normal course of business. The



Company is subject to minimum EBITDA covenants under the Term Loan Due 2019 and in an event of default, the lenders could declare all outstanding obligations immediately due and payable. The Company determined that it would not meet the existing minimum EBITDA covenants under the Term Loan Due 2019 for September 30, 2015. Based on this determination, the Company began discussions in September 2015 with its lenders and secured an amendment dated November 2, 2015 to the Term Loan Due 2019 and the Credit Facility to suspend testing of the existing EBITDA covenants and to add certain amended covenants for the period from September 2015 through November 2015. As future compliance with the minimum EBITDA covenants subsequent to November 30, 2015 is not expected, the Company is currently in discussions with its lenders to further amend the existing agreements to reset covenant measures to correspond to current forecasts. Until such time that we are able to revise our covenants to a level that we believe is achievable, all outstanding term debt will be reclassified as a current liability. There can be no assurance that we will be able to secure a resolution and, accordingly, our liquidity and ability to operate could be adversely affected.

Management's plans include an amendment to our existing debt agreements to revise covenants, obtain additional funds from capital markets and incremental revenue through the HyperSound business. These financial statements do not include any adjustments that might result from the adverse outcome relating to these uncertainties.

We may explore additional financing sources to fund expansion, to respond to competitive pressures, to acquire or to invest in complementary products, businesses or technologies, or to lower our cost of capital, which could include equity and debt financings. There can be no guarantee that any additional financing will be available on acceptable terms, if at all. If additional funds are raised through the issuance of equity or convertible debt, existing stockholders could suffer significant dilution, and if we raise additional funds through the issuance of debt securities or other borrowings, these securities or borrowings could have rights senior to common stock and could contain covenants that could restrict operations.

Foreign cash balances at September 30, 2015 and December 31, 2014 were \$0.3 million and \$2.5 million, respectively.

#### Revolving Credit Facility

On March 31, 2014, Turtle Beach and certain of its subsidiaries entered into a new asset-based revolving credit agreement ("Credit Facility") with Bank of America, N.A., as Agent, Sole Lead Arranger and Sole Bookrunner, which replaced the then existing loan and security agreement. The Credit Facility, which expires on March 31, 2019, provides for a line of credit of up to \$60 million inclusive of a sub-facility limit of \$10 million for TB Europe, a wholly owned subsidiary of Turtle Beach. The Credit Facility may be used for working capital, the issuance of bank guarantees, letters of credit and other corporate purposes.

The maximum credit availability for loans and letters of credit under the Credit Facility is governed by a borrowing base determined by the application of specified percentages to certain eligible assets, primarily eligible trade accounts receivable and inventories, and is subject to discretionary reserves and revaluation adjustments.

Amounts outstanding under the Credit Facility bear interest at a rate equal to either a rate published by Bank of America or the LIBOR rate, plus in each case, an applicable margin, which is between 1.00% to 1.50% for U.S. base rate loans and between 2.00% to 2.50% for U.S. LIBOR loans and U.K. loans. As of September 30, 2015, interest rates for outstanding borrowings were 4.75% for base rate loans and 2.71% for LIBOR rate loans. In addition, Turtle Beach is required to pay a commitment fee on the unused revolving loan commitment at a rate ranging from 0.25% to 0.50%, and letter of credit fees and agent fees.

If certain availability thresholds are not met, meaning that the Company does not have receivables and inventory which are eligible to borrow on under the Credit Facility in excess of amounts borrowed, the Credit Facility requires the Company and its restricted subsidiaries to maintain a fixed charge coverage ratio. The fixed charge ratio is defined as the ratio, determined on a consolidated basis for the most recent four fiscal quarters, of (a) EBITDA minus capital



expenditures, excluding those financed through other instruments, and cash taxes paid, and (b) Fixed Charges defined as the sum of cash interest expense plus scheduled principal payments.

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

In March 2015, Bank of America notified the Company that certain events of default had occurred and were continuing under the Credit Facility, including (i) the Company's failure to deliver in a timely manner certain monthly financial statements in accordance with the Credit Facility, (ii) the Company's failure to deliver in a timely manner certain financial projections in accordance with the Credit Facility, (iii) the Company's failure to repay an over-advance of approximately \$100,000 that existed between March 6, 2015 and March 9, 2015, and (iv) the Company's failure to satisfy the fixed charge coverage ratio under the Credit Facility for certain measurement dates during the fourth quarter of 2014 (in part as a result of certain retroactive changes to the calculation of such ratio pursuant to the December Amendment, as defined below) (the "Existing Events of Default").

On March 16, 2015, the Company entered into a third amendment (the "Third Amendment") to the Credit Facility pursuant to which Bank of America and the lenders under the Credit Facility agreed to waive the Existing Events of Default. In addition, the Third Amendment amends certain other provisions of the Credit Facility and requires that we maintain a certain EBITDA ratio (as defined under the Credit Facility) at the end of each month beginning April 30, 2015 on a cumulative basis through the remainder of 2015 and thereafter on a trailing twelve-month basis, and that our EBITDA must be in an amount equal to at least 75% of our monthly projected EBITDA as set forth in projections delivered pursuant to the Credit Facility. The current fixed charge coverage ratio of at least 1.15 to 1.00 on the last day of each month while a Covenant Trigger Period (as defined in the Credit Facility) is in effect will become effective again after the Company has complied with such ratio for six consecutive months.

On July 22, 2015, in connection with the term loan (see below), the Company and its subsidiaries entered into a fifth amendment (the "Fifth Amendment") to the Credit Facility that modified the borrowing base pursuant to which availability of loans under the Credit Facility is determined, provided for additional mandatory prepayment events and modified certain covenants, including to permit the Company to enter into the term loan. In addition, the Fifth Amendment permits certain equity holders of the Company to contribute funds to the Company to cure financial covenant defaults.

On November 2, 2015, the Company entered into a sixth amendment to the Credit Facility that modified certain provisions to provide (i) that the the Company will make certain periodic reports with respect to certain financial metrics, (ii) that the existing financial covenants are suspended and replaced by amended EBITDA levels during the months ended September 30, 2015 through the month ending November 30, 2015, and (iii) that the loan availability is decreased by an additional block.

As of September 30, 2015, the Company was in compliance with all the amended financial covenants, and excess borrowing availability was approximately \$13.3 million, net of the outstanding Term Loan Due 2018 (as defined below) that is considered to be an additional outstanding amount under the Credit Facility.

Term Loan Due 2018

On December 29, 2014, the Company amended the Credit Facility (the "December Amendment") to permit the repayment of \$7.7 million of then existing subordinated debt and accrued interest with the proceeds of an additional loan (the "Term Loan Due 2018"). The Term Loan Due 2018 resulted in modified financial covenants while it is outstanding, will bear interest at a rate of LIBOR for the applicable interest period plus 5% and will be repaid in equal monthly installments beginning on April 1, 2015 and ending on April 1, 2018. Amounts so repaid are recognized by lowering the balance of the term loan tranche and increasing the lower interest rate base revolver amount, with no net impact on borrowing availability.

Term Loan Due 2019

On July 22, 2015, the Company and its subsidiaries, entered into a term loan, guaranty and security agreement (the "Term Loan Due 2019") with Crystal Financial LLC, as agent, sole lead arranger and sole bookrunner, Crystal Financial

SPV LLC and the other persons party thereto (“Crystal”), which provides for an aggregate term loan commitment of \$15 million that bears interest at a rate per annum equal to the 90-day LIBOR rate plus 10.25%. Under the terms of the Term Loan Due 2019, the Company is required to make payments of interest in arrears on the first day of each month beginning August 1, 2015 and will repay the principal in monthly payments beginning January 1, 2016, with a final payment on June 28, 2019, the maturity date.

The Term Loan Due 2019 is secured by a security interest in substantially all of the Company and each of its subsidiaries working capital assets and is subject to the first-priority lien of Bank of America , N.A., as agent, under the Credit Facility, other than with respect to equipment, fixtures, real property interests, intellectual property, intercompany property,

intercompany indebtedness, equity interest in their subsidiaries, and certain other assets specified in an inter-creditor agreement between Bank of America and Crystal.

The Company and its subsidiaries are required to comply with various customary covenants including, (i) maintaining minimum EBITDA and Headset EBITDA (each as defined in the Term Loan Due 2019) in each trailing twelve month period beginning August 31, 2015, (ii) maintaining a Consolidated Leverage Ratio (as defined in the Term Loan Due 2019) to be measured on the last day of each month while the term loans are outstanding of no more than 5.75:1 beginning December 31, 2015 with periodic step-downs to 3.00:1 on January 31, 2017, (iii) not making capital expenditures in excess of \$11 million in the year ending December 31, 2015 and in excess of \$7 million in each of the years ending December 31, 2016, 2017, 2018 and 2019, (iv) restrictions on the Company's and its subsidiaries ability to prepay its subordinated notes, pay dividends, incur debt, create or suffer liens and engage in certain fundamental transactions and (v) an obligation to provide certain financial and other information. The agreement permits certain equity holders of the Company to contribute funds to the Company to cure financial covenant defaults.

The Term Loan Due 2019 contains customary representations, mandatory prepayment events and events of default, including defaults triggered by the failure to make payments when due, breaches of covenants and representations, material impairment in the perfection of Crystal's security interest in the collateral and events related to bankruptcy and insolvency of the Company and its subsidiaries. Upon an event of default, Crystal may declare all outstanding obligations immediately due and payable (along with a prepayment fee), a default rate of an additional 2.0% may be applied to amounts outstanding and may take other actions including collecting or taking such other action with respect to the collateral pledged in connection with the term loan.

The net proceeds received from the Term Loan Due 2019 were used to repay a portion of the outstanding subordinated notes and for general corporate purposes.

On November 2, 2015, the Company entered into an amendment (the "Term Loan Amendment") to the Term Loan Due 2019 to, among other things, provide (i) that upon receipt all the proceeds from the future issuance of subordinated notes will immediately be used to prepay outstanding principal in an amount equal to \$(2.5) million, (ii) that the the Company will make certain periodic reports with respect to certain financial metrics, (iii) that the existing financial covenants are suspended and replaced by amended EBITDA levels during the months ended September 30, 2015 through the month ending November 30, 2015.

#### Subordinated Notes - Related Party

On April 23, 2015, the Company issued a \$5.0 million subordinated note (the "April Note") to SG VTB Holdings, LLC, the Company's largest stockholder ("SG VTB"). The April Note was issued with an interest rate of (i) 10% per annum for the first year and (ii) 20% per annum for all periods thereafter, with interest accruing and being added to the principal amount of the note quarterly.

On May 13, 2015, the Company issued subordinated notes (the "May Notes") with an aggregate principal amount of \$3.8 million to SG VTB, and a trust affiliated with Ronald Doornink, the Chairman of the Company's board of directors (the "Board"). The May Notes were issued with an interest rate of 10% per annum until the maturity date of the May Notes (which was August 13, 2015 but could be extended up to two additional 90 day periods upon the written agreement of the Company and the noteholder), with interest accruing and being added to the principal amount of the May Notes quarterly. Following the maturity date, the interest rate would have increased to 20% per annum.

On June 17, 2015, the Company issued a subordinated note (the "June Note") with an aggregate principal amount of \$3.0 million to SG VTB. The June Note was issued at an interest rate of 10% per annum until the maturity date of the June Note (which was September 17, 2015 but could be extended up to two additional 90 day periods upon the written agreement of the Company and the noteholder), with interest accruing and being added to the principal amount of the

Edgar Filing: Turtle Beach Corp - Form 10-Q

June Note quarterly. Following the maturity date, the interest rate would have increased to 20% per annum. In addition, the Company had the option to request that SG VTB make, in SG VTB's sole discretion, additional advances from time to time up to an aggregate principal amount of \$15.0 million. Prior to the amendment (see below), following an additional advance of \$6.0 million on July 8, 2015, \$9.0 million was outstanding under the June Note.

Concurrently with the completion of the Term Loan Due 2019, the Company amended and restated each of its outstanding subordinated notes (the "Amended Notes"). The obligations of the Company under the Amended Notes are subordinate and

junior to the prior payment of amounts due under the Credit Facility and Term Loan Due 2019. In addition, the stated maturity date of the Amended Notes was extended to September 29, 2019, subject to acceleration in certain circumstances, such as a change of control of the Company. The Amended Notes bear interest at a rate per annum equal to LIBOR plus 10.5% and shall be paid-in-kind by adding the amount to the principal amount due. As noted above, the Company also repaid \$4.0 million under the subordinated notes payable to SG VTB with a portion of the proceeds received under the Term Loan Due 2019.

Further, as consideration for the concessions in the Amended Notes, the Company issued warrants to purchase 1.7 million of the Company's common stock at an exercise price of \$2.54 per share.

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

#### Series B redeemable preferred stock

In September 2010, VTBH issued 1,000,000 shares of its Series B Redeemable Preferred Stock with a fair value of \$12.4 million. We are required to redeem the Series B Redeemable Preferred Stock on the earlier to occur of September 28, 2030 or the occurrence of a liquidation event at its original issue price of \$12.425371 per share plus any accrued but unpaid dividends. The redemption value was \$15.8 million and \$14.9 million as of September 30, 2015 and December 31, 2014, respectively.

#### Stock Warrants

In connection with and as consideration for the concessions in the Amended Notes, the Company issued to SG VTB and a trust affiliated with Ronald Doornink warrants to purchase 1,384,884 and 306,391 shares, respectively, of the Company's common stock at an exercise price of \$2.54 per share. The warrants are exercisable for a period of five years beginning on the date of issuance, July 22, 2015. The exercise price and the number of shares of Common Stock purchasable are subject to adjustment and do not carry any voting rights or other rights as a stockholder of the Company prior to exercise. The share issuable upon exercise are also subject to the "demand" and "piggyback" registration rights set forth in the in the Company's Stockholder Agreement, dated August 5, 2013, as amended July 10, 2014.

#### Critical Accounting Estimates

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

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

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

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



### Contractual Obligations

Our principal commitments primarily consist of obligations for minimum payment commitments to leases for office space, redeemable preferred stock, the revolving credit facility, certain term loans and subordinated notes. As of September 30, 2015, the future non-cancelable minimum payments under these commitments were as follows (debt includes scheduled principal payments only.):

|   | Payments Due by Period<br>(in thousands) |                       |             |             |                         |
|---|--|-----------------------|-------------|-------------|-------------------------|
|   | Total                                    | Less Than<br>One Year | 1 - 3 Years | 3 - 5 Years | More Than<br>Five Years |
| Contractual Obligations: (1)            |  |                       |             |             |                         |
| Operating lease obligations (2)         | \$8,390                                  | \$1,559               | \$3,318     | \$2,709     | 804                     |
| Series B Redeemable Preferred Stock (3) | 51,928                                   | —                     | —           | —           | 51,928                  |
| Long term debt (4)                      | 20,617                                   | 20,617                | —           | —           | —                       |
| Term loans (5)                          | 21,410                                   | \$21,410              | —           | —           | —                       |
| Subordinated notes                      | 14,309                                   | —                     | —           | \$14,309    | —                       |
| Total                                   | \$116,654                                | \$43,586              | \$3,318     | \$17,018    | \$52,732                |

(1) Contractual obligations exclude tax liabilities of \$4.0 million related to uncertain tax positions because we are unable to make a reasonably reliable estimate of the timing of settlement, if any, of these future payments.

(2) Operating lease agreements represent obligations to make payments under non-cancelable lease agreements for certain facilities. In January 2015, we entered into a 5 year lease for an aggregate of approximately 35,000 square feet of office space in San Diego, California, that will consolidate our San Diego and Poway, California locations. The initial base rent of \$1.0 million per year is subject to a 3% annual increase (not included in chart).

(3) In September 2010, VTBH issued shares of its Series B Redeemable Preferred Stock. If the Series B Redeemable Preferred Stock is still outstanding as of October 2030 or if the Company experiences a liquidation event as defined in VTBH's Certification of Incorporation, the Company will be required to redeem the shares for an aggregate of \$51.9 million, which is comprised of the aggregate purchase price of \$12.4 million plus cumulative preferred dividends of 8.0% per annum, or \$39.5 million in the aggregate. See Note 13, "Commitments and Contingencies" for further information.

(4) On March 31, 2014, the Company entered into the Credit Facility that expires March 31, 2019. However, due to certain terms of the facility, the indebtedness is required to be classified as a current liability. See Note 8, "Credit Facilities and Long-Term Debt" for further information.

### Item 3 - Qualitative and Quantitative Disclosures about Market Risk

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

To date, the Company has used derivative financial instruments, specifically foreign currency forward and option contracts, to manage exposure to foreign currency risks, by hedging a portion of its forecasted expenses denominated in British Pounds expected to occur within a year. The effect of exchange rate changes on foreign currency forward and option contracts is expected to offset the effect of exchange rate changes on the underlying hedged item. The Company does not use derivative financial instruments for speculative or trading purposes. As of September 30, 2015, we do not have any derivative financial instruments.

#### Interest Rate Risk

The Company's total variable rate debt is comprised of \$20.6 million outstanding under the Credit Facility, \$21.4 million presented as a Term Loan and \$13.3 million of Subordinated Notes. A hypothetical 10% increase in borrowing rates at September 30, 2015 would not result in a material increase in interest expense on the existing principal balances.

#### Foreign Currency Exchange Risk



The Company has exchange rate exposure primarily with respect to the British Pound and Euro. As of September 30, 2015 and December 31, 2014, our monetary assets and liabilities which are subject to this exposure are immaterial, therefore the potential immediate loss to us that would result from a hypothetical 10% change in foreign currency exchange rates would not be expected to have a material impact on our earnings or cash flows. This sensitivity analysis assumes an unfavorable 10% fluctuation in the exchange rates affecting the foreign currencies in which monetary assets and liabilities are denominated and does not take into account the offsetting effect of such a change on our foreign currency denominated revenues.

#### Inflation Risk

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

#### Item 4 - Controls and Procedures

##### Disclosure Controls and Procedures

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

At the conclusion of the period covered by this Quarterly Report on Form 10-Q, we carried out an evaluation, under the supervision of our Chief Executive Officer (our principal executive officer, or PEO) and our Chief Financial Officer (our principal financial officer, or PFO), of the effectiveness of the design and operation of our disclosure controls and procedures.

Based upon that evaluation, our PEO and PFO concluded that our disclosure controls and procedures, as defined in Rule 13a-15(e) of the Exchange Act, were effective at a reasonable assurance level as of the end of the period.

#### Changes in Internal Control over Financial Reporting

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

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

## PART II. OTHER INFORMATION

### Item 1 - Legal Proceedings

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

### Item 1A - Risk Factors

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

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

#### Risks Related to Liquidity

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

In addition to cash flow generated from sales, we finance our operations with a revolving credit facility, which we refer to as the "Credit Facility," provided by Bank of America, N.A. ("BofA"), as Agent, Sole Lead Arranger and Sole Bookrunner and our term loan, which we refer to as the "Term Loan Due 2019," provided by Crystal Financial LLC ("Crystal"), as Agent, Sole Lead Arranger and Sole Bookrunner. If we are unable to comply with the restrictive and financial covenants contained in the Credit Facility or the Term Loan Due 2019, which we refer to collectively as the "Loan Documents", and are unable to obtain a waiver under the applicable Loan Documents, BofA or Crystal, as applicable, may declare the outstanding borrowings under the Credit Facility or Term Loan Due 2019, as applicable,

immediately due and payable. Such an event would have an immediate and material adverse impact on our business, results of operations and financial condition. We would be required to obtain additional financing from other sources, and we cannot predict whether or on what terms, if any, additional financing might be available. If we are required to seek additional financing and are unable to obtain it, we may have to change our business and capital expenditure plans, which may have a materially adverse effect on our business, financial condition and results of operations. In addition, the debt under the Loan Documents could make it more difficult to obtain other debt financing in the future, which could put us at a competitive disadvantage to competitors with less debt.

The Loan Documents contain financial and other covenants that we are obligated to maintain. If we violate any of these covenants, we will be in default under the applicable Loan Documents. These covenants include restrictions that prohibit or otherwise limit our ability to pay dividends, incur additional indebtedness, acquire assets or engage in certain other types of transactions, and also require that we maintain certain financial ratios and EBITDA levels during specified periods. If a default occurs and is not timely cured or waived, BofA or Crystal, as applicable, could seek remedies against us, including termination

or suspension of obligations to make loans and issue letters of credit and acceleration of amounts due under the applicable Loan Documents. No assurance can be given that we will be able to maintain compliance with these covenants in the future. The Credit Facility is asset based and can only be drawn down in an amount to which eligible collateral exists and can be negatively impacted by extended collection of accounts receivable, unexpectedly high product returns and slow moving inventory, among other factors. As of the date of this Report, we were in compliance with our covenants under the Loan Documents.

The Credit Facility provides our lenders with a first-priority lien against substantially all of our working capital assets, including trade accounts receivable, inventories, and intellectual property and contains certain restrictions on our ability to take certain actions.

The Credit Facility contains certain financial covenants and other restrictions that limit our ability, among other things, to incur certain additional indebtedness; pay dividends and repurchase stock; make certain investments and other payments; enter into certain mergers or consolidations; engage in sale and leaseback transactions and transactions with affiliates; and encumber and dispose of assets.

In addition, we have granted the lenders a first-priority lien against substantially all of our working capital assets, including trade accounts receivable, inventories and our intellectual property. Failure to comply with the operating restrictions or financial covenants in the Credit Facility could result in a default which could cause the lenders to accelerate the timing of payments and exercise their lien on substantially all of our working capital assets.

If suppliers, customers, landlords, employees or other stakeholders lose confidence in our business, it may be more difficult for us to operate and materially adversely affect our business, results of operations and financial condition. Doubts regarding our ability to continue as a going concern could result in further loss of confidence by our customers, suppliers, landlords, employees and other stakeholders, which, in turn, could materially adversely affect our ability to operate. Concerns about our financial condition may cause our suppliers and other counterparties to tighten credit terms or cease doing business with us altogether, which would have a material adverse effect on our business and results of operations.

#### Risks Related to Our Operations

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

The performance of our headset business is affected by the continued success of third-party gaming platforms, such as Microsoft Xbox and Sony PlayStation®, as well as video games developed by such manufacturers and other third-party publishers. Our business could suffer if any of these parties fail to continue to drive the success of these platforms, develop new or enhanced videogame platforms, develop popular game and entertainment titles for current or future generation platforms or produce and timely release sufficient quantities of such consoles. If a platform is withdrawn from the market or fails to sell, we may be forced to liquidate inventories relating to that platform or accept returns resulting in significant losses.

Further, in order for headsets to receive integrated voice and chat audio from the Xbox One, a Microsoft proprietary hardware adapter is currently required, and in the future a Microsoft proprietary computer chip will be required. As a result, with respect to our products designed for the Xbox One, we are currently reliant on Microsoft to provide us with sufficient quantities of the headset adapters, and in the future will rely on Microsoft or their designated supplier to provide us with sufficient quantities of the chips. If we are unable to obtain sufficient quantities of these headset adapters or chips, sales of our Xbox One headsets and consequently our revenues would be adversely affected.

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

Accordingly, Microsoft, Sony and other third-party gaming platform manufacturers may control our ability to manufacture headsets compatible with their platforms, and could cause unanticipated delays in the release of our

products as well as increases to projected development, manufacturing, licensing, marketing or distribution costs, any of which could negatively impact our business.

We face significant competition from other consumer electronics companies and this competition could have a material adverse effect on our financial condition and results of operations.

We compete with other producers of personal computers and video game console headsets, including the video game

console manufacturers. Our competitors may spend more money and time on developing and testing products, undertake more extensive marketing campaigns, adopt more aggressive pricing policies, pay higher fees to licensors for motion picture, television, sports, music and character properties, or develop more commercially successful products for the personal computer or video game platforms than we do. In addition, competitors with large product lines and popular products, in particular the video game console manufacturers, typically have greater leverage with retailers, distributors and other customers, who may be willing to promote products with less consumer appeal in return for access to those competitors' more popular products. For example, during 2014 first party gaming headsets realized significant gains in market share in part due to price discounts and bundling.

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

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

Our industry is subject to competition in an environment of rapid technological change, and if we do not adapt to, and appropriately allocate our resources among, emerging technologies, our revenues could be negatively affected.

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

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

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

The on-going console platform transition has adversely affected, and future transitions in console platforms may adversely affect, our headset business.

In 2005, Microsoft released the Xbox 360; in 2006, Sony introduced the PlayStation®3; and in 2012, Nintendo introduced the Wii U. Sony launched its next generation console, PlayStation®4, on November 15, 2013, and Microsoft launched its next generation console, Xbox One, on November 22, 2013. When new console platforms are announced or introduced into the market, consumers have historically reduced their purchases of game console peripherals and accessories, including headsets, for previous generation console platforms in anticipation of new platforms becoming available. During these console transition periods, sales of game console headsets such as those sold by us, related to previous generation consoles slow or decline until new platforms are introduced and achieve wide consumer acceptance, which we cannot

guarantee. This decrease or decline may not be offset by increased sales of products for the new console platforms. Over time as the old generation platform user base declines, products for the old platforms are typically discontinued which can result in lower margins, excess inventory, excess parts, or similar costs related to end of life of a product model. In addition, as a third party gaming headset company, we are reliant on working with the console manufacturers for our headsets compatible with any new console platforms, which if not done on a timely basis may adversely affect sales. For example, the headset adapter that was provided to us by Microsoft for inclusion with new gaming headsets for the Xbox One was not available until March 2014, even though the console platform was available starting in November 2013. Sony and Microsoft may make changes to their platforms that impact how headset connect with or work with the new consoles which could create a disruption to consumer buying behavior and/or product life-cycles.

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

Our HyperSound business has not generated significant revenues, has a history of operating losses, expects additional losses and may not achieve or sustain profitability.

Our HyperSound business has incurred operating losses since Parametric's spin-off from LRAD Corporation in 2010, and we expect additional losses in the near-term as we continue to expend significant resources on personnel, consultants, intellectual property protection, research and development, marketing, production and administration. Our ability to achieve future profitability is dependent on a variety of factors, many of which are outside our control. Failure to achieve profitability or sustain profitability, if achieved, may require us to continue to make additional capital investments in our HyperSound business which could materially impact our results of operations.

Substantially all our HyperSound revenues to date have been derived from sales of a limited number of products to a limited number of customers, and we cannot guarantee that we will be able to develop a larger customer base, introduce new products to generate additional revenues or obtain and fulfill increased orders from both existing and new customers. Further, even if we continue to retain existing customers and obtain new customers, we cannot guarantee that those customers will purchase sufficient quantities of our HyperSound products at prices that will enable us to recover our costs in acquiring those customers and fulfilling orders. We also cannot guarantee that we will be able to generate any future license revenues. Our ability to increase sales of our HyperSound products or generate license revenues depends on a number of factors, including:

- our ability to timely demonstrate or manufacture reliable products that have the features required by our HyperSound customers;
- our ability to develop relationships with new customers that will lead to sales of our HyperSound products or licensing opportunities for our HyperSound technology;
- our ability to develop and expand into new markets for our HyperSound audio products and technology; and
- our ability to develop international product distribution or licensing directly or through partners.

A deterioration in future expected profitability or cash flows could result in an impairment of our recorded goodwill and other intangibles.

At December 31, 2014, recorded goodwill of \$81.0 million and indefinite lived intangible assets of \$27.1 million associated with our HyperSound reporting unit. Under US GAAP, the Company reviews its goodwill and intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Additionally, goodwill and indefinite lived intangible assets are required to be tested for impairment at least annually. The valuations used to determine the fair values used to test goodwill or intangible assets are dependent upon various assumptions and reflect management's best estimates. Net sales growth, discount rates, earnings multiples and future cash flows are critical assumptions used to determine these fair values. Slower net sales growth rates in the dental or medical device industries, an increase in discount rates, unfavorable changes in earnings multiples or a decline in future cash flows, among other factors, may cause a change in circumstances indicating that the carrying value of the



Company's goodwill or intangible assets may not be recoverable. The Company may be required to record a significant charge to earnings in the financial statements during the period in which any impairment of the Company's goodwill or intangible assets is determined.

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

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

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

During 2014, our three largest individual customers accounted for approximately 45% of our gross sales in the aggregate. The loss of, or financial difficulties experienced by, any of these or any of our other significant customers, including as a result of the bankruptcy of a customer, could have a material adverse effect on our business, results of operations, financial condition and liquidity. We do not have long-term agreements with these or other significant customers and our agreements with these customers do not require them to purchase any specific amount of products. All of our customers generally purchase from us on a purchase order basis. As a result, agreements with respect to pricing, returns, cooperative advertising or special promotions, among other things, are subject to periodic negotiation with each customer. No assurance can be given that these or other customers will continue to do business with us or that they will maintain their historical levels of business. In addition, the uncertainty of product orders can make it difficult to forecast our sales and allocate our resources in a manner consistent with actual sales, and our expense levels are based in part on our expectations of future sales. If our expectations regarding future sales are inaccurate, we may be unable to reduce costs in a timely manner to adjust for sales shortfalls. In addition, financial difficulties experienced by a significant customer could increase our exposure to uncollectible receivables and the risk that losses from uncollected receivables exceed the reserves we have set aside in anticipation of this risk.

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

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

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

During 2015, we began to wind down our activities with one of our contract manufacturing partners in China and expand activities with our global manufacturing partner. Delays or issues with this decision could result in incremental costs and/or disrupt product flows.

In particular, certain of our products have a number of components and subassemblies produced by outside suppliers. In addition, for certain of these items, we qualify only a single source of supply with long lead times, which can magnify the risk of shortages or result in excess supply and also decreases our ability to negotiate price with our suppliers. For example, in our HyperSound commercial product we depend on one piezo-film supplier to provide

expertise and materials used in our proprietary emitters and one supplier for a majority of our plastic and metal parts. If shortages occur we could lose sales or if we purchase excess inventory, we could be subject to loss from lack of sales or if models change. The manufacturing of our new HyperSound emitter is complex and involves several new processes, and any unexpected issues or delays in setting up those processes could delay the launch of our HyperSound Clear™ product. Also if we experience quality problems with suppliers, then our production schedules could be significantly delayed or costs significantly increased, which could have an adverse effect on our business, liquidity, results of operation and financial position.

In addition, the ongoing effectiveness of our supply chain is dependent on the timely performance of services by third parties shipping products and materials to and from our warehouse facilities and other locations. If we encounter problems with

these shipments, our ability to meet retailer expectations, manage inventory, complete sales and achieve objectives for operating efficiencies could be materially adversely affected. We have experienced some of these problems in the past and we cannot assure you that we will not experience similar problems in the future.

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

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

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

If our forecasts of demand for products are too high, we may accumulate excess inventories of products, which could lead to markdown allowances or write-offs affecting some or all of such excess inventories. We may also have to adjust the prices of our existing products to reduce such excess inventories.

If demand for specific products increases beyond what we forecast, our suppliers and third-party manufacturers may not be able to increase production rapidly enough to meet the demand. Our failure to meet market demand may lead to missed opportunities to increase our base of gamers, damage our relationships with retailers or harm our business.

The on-going console transition increases the likelihood that we could fail to accurately forecast demand for our next generation console headsets and our existing headsets.

Rapid increases in production levels to meet unanticipated demand could result in increased manufacturing errors, as well as higher component, manufacturing and shipping costs, all of which could reduce our profit margins and harm our relationships with retailers and consumers.

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

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

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

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

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

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

to improve existing operations and support future growth, and ultimately have a material adverse effect on our business.

The reliability and capacity of our information systems are critical. Despite preventative efforts, our systems are vulnerable from time-to-time to damage or interruption from, among other things, natural disasters, technical malfunctions, inadequate systems

capacity, human error, power outages, computer viruses and security breaches. Any disruptions affecting our information systems could have a material adverse impact on our business. In addition, any failure to maintain adequate system security controls to protect our computer assets and sensitive data, including associate and client data, from unauthorized access, disclosure or use could damage our reputation with our associates and our clients. While we have implemented measures to prevent security breaches and cyber incidents, our preventative measures and incident response efforts may not be entirely effective. Finally, our ability to continue to operate our business without significant interruption in the event of a disaster or other disruption depends, in part, on the ability of our information systems to operate in accordance with our disaster recovery and business continuity plans. Our reliance on information systems and other technology also gives rise to cybersecurity risks, including security breach, espionage, system disruption, theft and inadvertent release of information.

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

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

trade restrictions, higher tariffs, currency fluctuations or the imposition of additional regulations relating to import or export of our products, especially in China, where all of our Turtle Beach products are manufactured, which could force us to seek alternate manufacturing sources or increase our expenses;

difficulties obtaining domestic and foreign export, import and other governmental approvals, permits and licenses, and compliance with foreign laws, which could halt, interrupt or delay our operations if we cannot obtain such approvals, permits and licenses;

difficulties encountered by our international distributors or us in staffing and managing foreign operations or international sales, including higher labor costs;

transportation delays and difficulties of managing international distribution channels;

longer payment cycles for, and greater difficulty collecting, accounts receivable,;

political and economic instability, including wars, terrorism, political unrest, boycotts, curtailment of trade and other business restrictions, any of which could materially and adversely affect our net sales and results of operations; and natural disasters.

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

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

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

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

Effective internal controls are necessary to provide reliable financial reports and to assist in the effective prevention of fraud. Any inability to provide reliable financial reports or prevent fraud could harm our business. The Sarbanes-Oxley Act requires, among other things, that we perform system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting. If we are not able to comply with the requirements of Section 404 of the Sarbanes-Oxley Act, or if we or our independent registered public accounting firm identifies deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, investors could lose confidence in the accuracy and completeness of our financial reports, the market price of our common stock could decline and we could be subject to sanctions, investigations by NASDAQ, the SEC or other regulatory authorities, or shareholder litigation.

In addition, failure to maintain effective internal controls could result in financial statements that do not accurately reflect our financial condition or results of operations. There can be no assurance that we will be able to maintain a

system of internal controls that fully complies with the requirements of the Sarbanes-Oxley Act of 2002 or that our management and independent registered public accounting firm will continue to conclude that our internal controls are effective.



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

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

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

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

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

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

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

We are susceptible to counterfeiting of our products, which may harm our reputation for producing high-quality products and force us to incur expenses in enforcing our intellectual property rights. Such claims and lawsuits can be expensive to resolve, require substantial management time and resources, and may not provide a satisfactory or timely result, any of which may harm our results of operations. As some of our products are sold internationally, we are also dependent on the laws of a range of countries to protect and enforce our intellectual property rights. These laws may not protect intellectual property rights to the same extent or in the same manner as the laws of the United States. Further, we are party to licenses that grant us rights to intellectual property, including trademarks, which are necessary or useful to our Turtle Beach business. For example, we license the right to market certain products with the trade names and imagery of brands such as Activision, Marvel and Major League Gaming. One or more of our licensors may allege that we have breached our license agreement with them, and seek to terminate our license. If successful, this could result in our loss of the right to use the licensed intellectual property, which could adversely affect our

ability to commercialize our technologies or products, as well as harm our competitive business position and our business prospects.

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

45

---

technologies. Further, any patent that we may obtain will expire, and it is possible that it may be challenged, invalidated or circumvented. If we do not secure and maintain patent protection for our HyperSound technology and products, our competitive position could be significantly harmed. A competitor may independently develop or patent technologies that are substantially similar or superior to our HyperSound technology.

As we expand our HyperSound product line or develop new uses for our HyperSound technology, these products or uses may be outside the protection provided by our current patent applications and other intellectual property rights. In addition, if we develop new HyperSound products or enhancements to existing products we cannot assure you that we will be able to obtain patents to protect them. Even if we do receive patents for our existing or new HyperSound products, these patents may not provide meaningful protection, or may be too costly to enforce protection. In some countries outside of the United States where our HyperSound products may be sold or our HyperSound technology may be licensed, patent protection is not available. Moreover, some countries that do allow for the registration of patents do not provide meaningful redress for violations of patents. As a result, protecting intellectual property in these countries is difficult and our competitors may successfully sell products in these countries that have functions and features that infringe on our intellectual property.

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

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

As a third-party gaming headset company, the technology used in next generation consoles, such as integrated voice and chat audio from the Xbox One, require that we obtain a license to ensure that our products are compatible with the consoles.

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

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

Under the Radiation Control for Health and Safety Act of 1968, and the associated regulations promulgated by the Food and Drug Administration (“FDA”), HyperSound products are regulated as electrical emitters of ultrasonic vibrations. Under the terms of such regulations, in August 2012 we provided an abbreviated report to the FDA describing the HyperSound commercial product and in September 2015 we provided an initial product report describing the HyperSound Clear™ product. The FDA may respond to these reports and request changes or safeguards to our HyperSound products, but it has not done so to date. We also are required to notify the FDA in writing should a product be found to have a defect relating to safety of use due to the emission of electronic product radiation. We do not believe our technology poses any human health risks. However, it is possible that we, or one of our customers, could be required to modify the technology, or a product incorporating the technology, to comply with requirements that may be imposed by the FDA. Our HyperSound product advertising is regulated by the Federal Trade Commission (the “FTC”).

HyperSound Clear™, which is intended specifically for group hearing aid use, is also regulated by the FDA as a medical device pursuant to the Federal Food, Drug, and Cosmetic Act, or FDCA, and implementing regulations. HyperSound Clear™ has received 510(k) clearance permitting over the counter (“OTC”) commercial distribution for this use. The 510(k) provision of the FDCA allows medical devices to obtain permission for commercial distribution based upon “substantial equivalence” to one or more devices already legally on the market with such clearance or certain grandfather status. Recently, FDA exempted this type of device from the 510(k) requirement. Therefore, we may modify it in the future without seeking additional 510(k) clearance, provided that we do not alter the medical purpose for which it is sold or incorporate a fundamentally different scientific technology, either of which would require a new 510(k) clearance.

We continue to be subject to FDA's requirements for marketed medical devices, such as the Quality System Regulation, or QSR (which imposes procedural, documentation and record keeping requirements); the Medical Device Reporting regulation (which requires that manufacturers report to the FDA if their device may have caused or contributed to a death or serious injury or malfunctioned in a way that would likely cause or contribute to a death or serious injury if it were to recur); and the Reports of Corrections and Removals regulation (which requires manufacturers to report recalls and field actions to the FDA if initiated to reduce a risk to health posed by the device or to remedy a violation of the FDCA that may pose a risk to health). FDA enforces these requirements by inspection and market surveillance. If the FDA finds a violation, it can institute a wide range of enforcement actions, ranging from a public warning letter to more severe sanctions such as fines, penalties, suspension or

withdrawal of regulatory approvals, product recalls, seizure of products, operating restrictions or total shutdown of production, and criminal prosecution.

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

To market HyperSound products internationally, we must establish and comply with numerous and varying governmental requirements of other countries regarding safety and effectiveness. The time and expense required to obtain approval in other countries might differ from that required to obtain FDA clearance. It may be costly for us to comply with applicable postmarket regulation in each country where we do business. If we fail to do so, we may be subject to fines, suspension or withdrawal of regulatory approvals, product recalls, seizure of products, operating restrictions or total shutdown of production, and criminal prosecution.

Even if our products do not become subject to enforcement sanctions, we could incur unanticipated expenses in order to comply with any applicable governmental regulations, in connection with warranty or product liability claims relating to a recall of one or more of our products which could require significant expenditures to defend. For example, in the event of unanticipated defects in our HyperSound products, we may be required to comply with governmental requirements to remedy the defect and/or notify consumers of the problem. This eventuality could lead to unanticipated expense, and possible product liability litigation against a customer or us.

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

New laws or regulations, or changes in existing laws or regulations or the manner of their interpretation or enforcement, may create uncertainty for public companies, increase our cost of doing business and restrict our ability to operate our business or execute our strategies. This could include, among other things, compliance costs and enforcement under the Dodd-Frank Wall Street Reform and Consumer Protection Act. For example, under Section 1502 of the Dodd-Frank Act, the SEC has adopted additional disclosure requirements related to the source of certain “conflict minerals” for issuers for which such “conflict minerals” are necessary to the functionality or production of a product manufactured, or contracted to be manufactured, by that issuer. The metals covered by the rules include tin, tantalum, tungsten and gold. Our suppliers may use some or all of these materials in their production processes. The rules require us to conduct a reasonable country of origin inquiry to determine if we know or have reason to believe any of the minerals used in the production process may have originated from the Democratic Republic of the Congo or an adjoining country. If we are not able to determine the minerals did not originate from a covered country or conclude that there is no reason to believe that the minerals used in the production process may have originated in a covered country, we would be required to perform supply chain due diligence on members of our supply chain. Global supply chains can have multiple layers, thus the costs of complying with these new requirements could be substantial. These new requirements may also reduce the number of suppliers who provide conflict free metals, and may affect our ability to obtain products in sufficient quantities or at competitive prices. Compliance costs such as these could have a material adverse effect on our results of operations.

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

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

Our operations and some of our products are regulated under various federal, state, local and international environmental laws. In addition, regulatory bodies in many of the jurisdictions in which we operate propose, enact and amend environmental laws and regulations on a regular basis. The environmental laws and regulations applying to our business include those governing the discharge of pollutants into the air and water, the management, disposal and

labeling of, and exposure to, hazardous substances and wastes and the cleanup of contaminated sites. If we were to violate or become liable under these environmental laws, we could be required to incur additional costs to comply with such regulations and may incur fines and civil or criminal sanctions, third-party property damage or personal injury claims, or could be required to incur substantial investigation or remediation costs. Liability under environmental laws may be joint and several and without regard to comparative fault. The ultimate costs under environmental laws and the timing of these costs are difficult to predict. Although

we cannot predict the ultimate impact of any new environmental laws and regulations, such laws may result in additional costs or decreased revenue, and could require that we redesign or change how we manufacture our products, any of which could have a material adverse effect on our business. Additionally, to the extent that our competitors choose not to abide by these environmental laws and regulations, we may be at a cost disadvantage, thereby hindering our ability to effectively compete in the marketplace.

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

We operate in 44 countries, including countries known to have a reputation for corruption. We are committed to doing business in accordance with applicable anti-corruption laws. We are subject, however, to the risk that our officers, directors, employees, agents and collaborators may take action determined to be in violation of such anti-corruption laws, including the U.S. Foreign Corrupt Practices Act of 1977, the U.K. Bribery Act 2010 and the European Union Anti-Corruption Act, or that subjects us to trade sanctions administered by the Office of Foreign Assets Control and the U.S. Department of Commerce. Any such violation could result in substantial fines, sanctions, civil and/or criminal penalties or curtailment of operations in certain jurisdictions, and might adversely affect our results of operations. In addition, actual or alleged violations could damage our reputation and ability to do business.

#### Risks Related to the Merger

We are subject to, and could become subject to in the future, stockholder litigation associated with the Merger, which could harm our business, financial condition and operating results.

Stockholders of companies involved in mergers may at times initiate litigation alleging, among other things, improprieties in the manner in which mergers or dispositions of business units were approved or executed. We have had, and may continue to have, actions brought against us by stockholders in connection with the merger, past transactions, changes in our stock price or other matters. Any such claims, whether or not resolved in our favor, could divert our management and other resources from the operation of our business and otherwise result in unexpected and substantial expenses that would adversely and materially impact our business, financial condition and operating results. For example, and as further described in Item 3, “Legal Proceedings” and Note 13, “Commitments and Contingencies,” we are involved in legal proceedings related to the merger involving certain of our stockholders, including the holder of VTBH’s Series B Redeemable Preferred Stock, or the Series B Holder, filing a complaint in Delaware Chancery Court alleging breach of contract against VTBH and requesting a declaratory judgment that he is entitled to damages, including the redemption of his stock. The redemption value of VTBH’s Series B Redeemable Preferred Stock was \$14.9 million as of December 31, 2014.

#### Risks Related to Ownership of our Common Stock

Ownership of our common stock is highly concentrated, and we are a “controlled company” within the meaning of the corporate governance standards of NASDAQ and, as a result, qualify for, and rely on, exemptions from certain corporate governance requirements.

Certain Turtle Beach stockholders acting as a group beneficially own or control approximately 72.6% of our common stock. Accordingly, these stockholders, acting as a group pursuant to a stockholder agreement, have substantial influence over the outcome of our corporate actions requiring stockholder approval, including the election of directors, any merger, consolidation or sale of all or substantially all of our assets or any other significant corporate transaction. These stockholders also may exert influence in delaying or preventing a change in control of the Company, even if such change in control would benefit our other stockholders. In addition, the significant concentration of stock ownership may affect adversely the market value of our common stock due to investors’ perception that such conflicts of interest may exist or arise.

Additionally, we have elected to be treated as a “controlled company” under NASDAQ rules. A “controlled company” under NASDAQ rules is a listed company more than 50% of the voting power of which is held by an individual, a group or another company (and which elects to be treated as a “controlled company”). Certain stockholders of Turtle Beach constitute a group controlling more than 50% of the voting power of our voting stock. As a “controlled company,” we are permitted to, and have, opted out of certain NASDAQ rules that would otherwise require (i) a majority of the members of our board to be independent, (ii) that our compensation committee be comprised entirely of independent directors and (iii) that we establish a nominating and governance committee comprised entirely of

independent directors, or otherwise ensure that director nominees are determined or recommended to our board by the independent members of our board. Accordingly, our stockholders may not have the same protections afforded to stockholders of companies that are subject to all of the corporate governance requirements of NASDAQ.



Item 6. Exhibits

- 4.1 Warrant, issued to SG VTB Holdings, LLC, dated July 22, 2015 (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed with the SEC on July 23, 2015).
- 4.2 Warrant, issued to the Doornink Revocable Living Trust, originally executed December 17, 1996, as amended and restated August 6, 2013, dated July 22, 2015 (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed with the SEC on July 23, 2015).
- 10.1 Term Loan, Guaranty and Security Agreement, dated July 22, 2015, by and among Turtle Beach Corporation, Voyetra Turtle Beach, Inc. Turtle Beach Europe Limited, VTB Holdings, Inc., Crystal Financial LLC, as agent sole lead arranger and sole bookrunner and the other parties thereto (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on July 23, 2015).
- 10.2 Fifth Amendment to Loan, Guaranty and Security Agreement, dated July 22, 2015, originally dated March 31, 2014, by and among Turtle Beach Corporation, Voyetra Turtle Beach Inc., Turtle Beach Europe Limited, PSC Licensing Corp., VTB Holdings, Inc. and Bank of America, N.A., as collateral agent and security trustee (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the SEC on July 23, 2015).
- 10.3 Amended and Restated Subordinated Promissory Note, dated July 22, 2015, originally dated April 23, 2015, by and between Turtle Beach Corporation and SG VTB Holdings, LLC (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed with the SEC on July 23, 2015).
- 10.4 Amended and Restated Subordinated Promissory Note, dated July 22, 2015, originally dated May 13, 2015, by and between Turtle Beach Corporation and SG VTB Holdings, LLC (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed with the SEC on July 23, 2015).
- 10.5 Amended and Restated Subordinated Promissory Note, dated July 22, 2015, originally dated June 17, 2015, by and between Turtle Beach Corporation and SG VTB Holdings, LLC (incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed with the SEC on July 23, 2015).
- 10.6 Amended and Restated Subordinated Promissory Note, dated July 22, 2015, originally dated May 13, 2015, by and between Turtle Beach Corporation and the Doornink Revocable Living Trust, originally executed December 17, 1996, as amended and restated August 6, 2013 (incorporated by reference to Exhibit 10.6 to the Company's Current Report on Form 8-K filed with the SEC on July 23, 2015).
- 31.1 Certification of Juergen Stark, Principal Executive Officer, pursuant to Rule 13a-14(a) or 15d-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 31.2 Certification of John T. Hanson, Principal Financial Officer, pursuant to Rule 13a-14(a) or 15d-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by Juergen Stark, Principal Executive Officer and John Hanson,

Edgar Filing: Turtle Beach Corp - Form 10-Q

Principal Financial Officer (filed herewith).

Extensible Business Reporting Language (XBRL) Exhibits

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

SIGNATURES

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

TURTLE BEACH CORPORATION

Date: November 9, 2015

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