

Turtle Beach Corp
Form 10-K
March 08, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

(Mark one)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016

or

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

For the transition period from _____ to _____

Commission File Number: 001-35465

TURTLE BEACH CORPORATION

(Exact name of registrant as specified in its charter)

Nevada 27-2767540

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

12220 Scripps Summit Drive, Suite 100

San Diego, California 92131

(Address of principal executive offices) (Zip Code)

(888) 496-8001

(Registrant's telephone number, including area code)

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

Common Stock, par value \$0.001

(Title of Class)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

The aggregate market value of the registrant’s voting stock held by non-affiliates of the registrant as of June 30, 2016 was \$9,802,194.

The number of shares of Common Stock, \$0.001 par value, outstanding on February 28, 2017 was 49,251,336.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this Report is incorporated herein by reference from the registrant’s definitive proxy statement relating to its 2015 annual meeting of stockholders or annual report on Form 10-K/A, to be filed with the Securities and Exchange Commission within 120 days after the close of the registrant’s fiscal year.

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PART I

Statement Regarding Forward-Looking Disclosures

This Annual Report on Form 10-K (this “Report”) includes, and incorporates by reference, certain forward-looking statements within the meaning of the federal securities laws. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements include statements preceded by, followed by or that include the words “may,” “could,” “will,” “would,” “should,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “intend,” “predict,” “seek,” “contemplate,” “potential” or “continue” and similar expressions. Forward-looking statements reflect the current expectations of Turtle Beach Corporation concerning future events and actual results may differ materially from current expectations or historical results. Any such forward-looking statements are subject to various risks and uncertainties, including without limitation those discussed in the sections of this Report entitled “Business Overview,” “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Forward-looking statements are only predictions and are not guarantees of performance. These statements are based on our management’s beliefs and assumptions, which in turn are based on currently available information. Important assumptions relating to the forward-looking statements include, among others, assumptions regarding demand for our products, the expansion of product offerings geographically or through new marketing applications, the timing and cost of planned capital expenditures, competitive conditions and general economic conditions. These assumptions could prove inaccurate. Forward-looking statements also involve known and unknown risks and uncertainties, which could cause actual results to differ materially from those contained in any forward-looking statement. In addition, even if our actual results are consistent with the forward-looking statements contained in this Annual Report on Form 10-K, those results may not be indicative of results or developments in subsequent periods. Many of these factors are beyond our ability to control or predict. Such factors include, but are not limited to, the following:

- The availability of capital under our revolving credit facility and term loan;
- Our dependence on the success and availability of third-party platforms and software to drive sales of our headset products;
- Continued relationships with our largest customers;
- Our ability to adapt to new technologies and introduce new products on a timely basis;
- The impact of competitive products, technologies and pricing;
- The impact of seasonality on our business;
- Manufacturing capacity constraints and difficulties;
- Current and future transitions in video gaming console platforms and the potential impact on our business;
- The scope of protection we are able to establish and maintain for intellectual property rights covering our technology;
- Our ability to forecast demand for our products;
- Estimates of our future revenues, expenses, capital requirements and our needs for additional financing;
- Cybersecurity and other information technology risks;
- Our success at managing the risks involved in the foregoing items;
- Our financial performance; and
- Other factors discussed under Item 1A - Risk Factors or elsewhere in this Report.

Except as required by applicable law, including the securities laws of the United States and the rules and regulations of the Securities and Exchange Commission (“SEC”), we undertake no obligation to publicly update or revise any forward-looking statements after we file this Annual Report on Form 10-K, whether as a result of any new information, future events or otherwise. Investors, potential investors and other readers are urged to consider the above mentioned factors carefully in evaluating the forward looking statements and are cautioned not to place undue reliance on such forward looking statements. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results or performance.

Unless the context indicates otherwise, all references in this Report to “we,” “our,” “us,” “the Company,” and “Turtle Beach” refer to Turtle Beach Corporation and its wholly-owned subsidiaries.

Item 1 - Business Overview

Turtle Beach Corporation, headquartered in San Diego, California and incorporated in the state of Nevada in 2010, is a premier audio technology company with expertise and experience in developing, commercializing and marketing innovative products across a range of large addressable markets 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, 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, including improved clarity and comprehension for listeners with hearing loss.

VTB Holdings, Inc. (“VTBH”), the parent holding company of the historical headset business, was incorporated in the state of Delaware in 2010 with operations principally located in Valhalla, New York. Voyetra Turtle Beach, Inc. (“VTB”) was incorporated in the state of Delaware in 1975.

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

Headset Business

Turtle Beach launched its first gaming headset in 2005 and has grown to be the leading brand in gaming audio, and designs and markets premium audio peripherals for video game consoles, personal computers and mobile devices, including headsets for PlayStation®4 consoles and officially-licensed headsets for the Xbox One consoles. Turtle Beach branded headsets are distributed internationally across North America, South America, Europe, the Middle East, Africa, Australia, and Asia, and sold at thousands of storefronts, including major retailers such as Amazon, Argos, Best Buy, Game, GameStop, EB Games, Target, and Walmart.

We offer a variety of headsets, spanning multiple wired and wireless retail price points ranging from \$20 to \$300 and have offerings across all major gaming platforms. Our price tiers correspond to customer profiles, beginning with “Entry-Level” gamers and progressing through “Casual,” “Enthusiast” and “Core.” Each successive price tier incorporates a higher level of finishing, features and technology, progressing from passive mono to amplified stereo, surround sound, and programmable surround sound. Premium headsets have padded leather headbands, accent stitching, and noise-isolating memory foam ear cups. Other features in certain of our premium headsets include removable microphones, breakaway cables and “charge-and-play” batteries that allow gamers to continue playing even as they recharge their batteries. As gaming consoles have evolved from dedicated video game platforms to home entertainment hubs, and as mobile devices have become platforms for entertainment, we have continued to evolve our headsets to reflect how content is consumed.

Each headset model is designed for a “primary” platform, such as a specific console or for the PC platform, though many can be used with multiple platforms, and most are compatible with mobile devices. A primary platform and unique packaging often results in the products being represented in the applicable platform area by retailers, increasing the prominence of Turtle Beach products in physical retail locations and online catalogs.

Turtle Beach was the leading console gaming headset manufacturer in the U.S. with a 42% dollar share of the market, as noted by the December 2016 sales tracking data from The NPD Group, Inc, with four of the Top 5 third-party headsets for both the Xbox One and PlayStation®4.

Our 2016 was highlighted by:

- Entered competitive gaming audio gear market with the Elite Pro Headset, which includes the groundbreaking ComforTec™ Fit System, and partnered with top professional eSports organizations, OpTic Gaming and FaZe Clan;
- Launched Stealth 350VR headset, the first and only headset created specifically for use with the new virtual reality devices like PlayStation®VR, HTC Vive™; and
- Launched Stream Mic, a professional-quality desktop microphone created for gamers livestreaming from their consoles.

HyperSound Business

HyperSound technology is a pioneering audio solution that provides an effective means of projecting sound in a highly directional manner, without use of large speaker arrays, to a specific location creating a precise audio zone. HyperSound directs a beam of audio to targeted listeners in a specific spot, delivering an immersive, 3D-like audio

experience. The Company sells HyperSound Professional Audio Solutions, which is being purchased for commercial retail environments where a targeted zone of sound is desired.

We believe our technology offers a number of advantages over regular audio speakers, including:

- the ability to create a beam of sound and place it where it is intended;
- the ability to deliver a beam of sound over longer distances; and
- the ability to penetrate other competing ambient sounds to more effectively communicate.

HyperSound Glass, unveiled in June 2016, is similar in design to touchscreen glass, where there are multiple layers of transparent materials and electronics working in conjunction with the glass. For HyperSound Glass, the glass pane is layered with a set of transparent films allowing it to generate a beam of ultrasound that delivers crisp, clear audio to the targeted listener.

In September 2016, we started the process of restructuring the HyperSound business and winding down direct sales of the HyperSound Clear™ 500P product, in an effort to reduce costs and align spending with revenues, while continuing to pursue certain additional opportunities, including licensing the technology for HyperSound Glass and other applications.

Industry Overview

Gaming Headset Market

Sales in the gaming accessories market, which includes headsets and other peripherals such as gamepads, specialty controllers, adapters, batteries, memory and interactive gaming toys are heavily dependent on the global video game industry. 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 consumer response to the Xbox One and PlayStation®4 (the “new generation” or “new-gen” consoles) has been overwhelmingly positive, creating a new installed base of gamers and a market for new-gen headsets.

When new console platforms are introduced into the market, changes to their platforms impact how headset connect with or work with the new consoles and, such as with the most recent consoles, required a transition of console gaming headsets and consumers reduced their purchases of game console peripherals and accessories, including headsets, for old generation console platforms in anticipation of the new platforms becoming available.

The October 2016 Intelligence: Worldwide Console Forecast report by DFC Intelligence Forecasts, or “DFC,” estimates that cumulative new generation consoles are expected to exceed \$65 billion by 2020. While sales of the new-gen consoles have outperformed previous platforms, the overall console gaming market uncharacteristically slowed in the recent holiday season. Sales tracking data from The NPD Group, Inc. indicated that console gaming headset sales in the U.S. were nearly \$400 million, up slightly from prior year, as consumer deferred purchases ahead of mid-cycle console refreshes and a limited line up of multi-player games.

We believe next year will be a key point in the evolution of the console landscape. Following the recent PlayStation®4 Slim and Pro releases, Microsoft's Xbox One Scorpio, with a focus on high-end 4K and VR gaming, potentially provides the opportunity to combine the console and the rapidly growing PC gaming market through cross-platform initiatives.

HyperSound Markets

Hearing Health Care. Gradual hearing loss can affect individuals of all ages, varying from mild to profound and is a growing, widespread issue. In the United States, there are nearly 50 million people with some degree of hearing loss significant enough to require a hearing aid. HyperSound technology offers a fundamentally new way to deliver sound, and research indicates that it improves sound clarity and speech intelligibility, particularly for those with hearing loss.

Commercial. We are currently marketing our HyperSound technology to retailers and audio-visual integrators for use in settings where directed audio and sound zones are beneficial, such as digital signage and interactive retail displays. Convenience retailers and fast moving consumer good brands face ever-greater challenges as competition for customers intensifies, and as shoppers increasingly rely on in-store cues. As a result, digital signage is a growing form of direct advertising, capturing an increasing share of advertising spending as restaurants, banks, retail outlets, museums and other outlets and organizations employ commercial displays to communicate with patrons.

Consumer Applications. Our HyperSound technology has the potential to be developed into consumer products for various applications, including computers, video game consoles, televisions, home theater and home audio. With the

advent of flat panel displays for use in televisions and mobile devices, manufacturers have been focused on creating thinner products often at the expense of sound quality. We believe that our ability to create a 3D sound image from two thin emitters, compared to a five- or seven-speaker surround sound set-up using conventional speakers can deliver a compelling and enhanced audio experience.

Business Strategy

We intend to build upon the Turtle Beach brand awareness, sophisticated audio technology and high quality products to grow the core console and casual gaming business to increase sales and profitability.

Console Headset Market Share Growth. We believe that our brand's image among consumers is a competitive advantage and that our success is attributable to our emphasis on delivering the highest quality, most innovative headsets.

To maintain our competitive position in our markets, we are focused on the following:

- continuing to deliver innovative, high quality console gaming headsets that incorporate advanced audio and wireless technology;

- growing our gaming headset business in all areas including personal computer headsets;

- maintaining our strategic relationships that provide our brand a larger presence with consumers and create opportunities for retailers to carry our products;

- continuing to improve our cost position through increased global sourcing and expanded points of distribution.

Expand Our Product Lines. We intend to increase our sales by continuing to develop internally, or through potential acquisitions, products that we offer to our customers. In 2016, we launched new products in two small markets in virtual reality and live streaming that we believe have rapid growth potential. We continue to invest in the resources necessary to maintain and expand our technical capability to manufacture multiple product lines that incorporate the latest technologies.

Accelerate International Expansion. We have a strong gaming headset market position in North America, the United Kingdom, Germany, France and Australia, and, as part of our long-term strategy, believe there are additional growth opportunities in Latin America and Asia. In particular in China, under a Chinese language version of the Turtle Beach brand and logo, phonetically pronounced “Huan Jing” (translates as “Fantasy Space”), where we believe there is a potential growth opportunity in the personal computer market as well as the console market following the Chinese government lifting its ban on video game consoles in September 2013.

Develop HyperSound License Model. This is expected to require less capital compared to internal development efforts in recent years while still allowing for revenue generating opportunities, including (i) the technology for HyperSound Glass, (ii) commercial retail display sales and (iii) hearing related and other applications.

Product Development

We continue to innovate, make improvements to our technology and develop new products, and anticipate that we will continue to devote substantial resources to research and development in the near future. Our product management team takes a disciplined approach to product design that balances iteration, incremental improvement and innovation to achieve a blend of differentiated technology designed to attract customers, maintain product design continuity and exceed expectations as to quality, reliability and profitability. For the year ended December 31, 2016, we invested \$8.3 million in the continued expansion of our new generation headset portfolio including the launch of the Stealth 350VR, Elite Pro headsets and Stream Mic, professional-quality live streaming microphone as well as product development efforts around HyperSound Glass. For the years ended December 31, 2015 and 2014, we expended \$11.6 million and \$9.4 million, respectively.

Intellectual Property

We operate in industries where innovations, investment in new ideas and protection of resulting intellectual property rights are critical to success. We have a substantial base of intellectual property assets to protect our current and future product development, such as key innovations in gaming headsets as well as all of the core technology areas behind HyperSound, and intend to vigorously enforce such rights.

As a third-party gaming headset company certain technology used in the new generation of consoles, such as integrated voice and chat audio from the Xbox One, requires a license to enable products to connect to that platform.

While Playstation®4 does not require any license to produce headsets that can connect, certain connections on the Xbox One require the purchase of proprietary chips to integrate into the locked chat audio.

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

Supply Chain and Operations

We have a global network of suppliers that manufacture products to meet our cost objectives and quality standards sought by our customers. We have worked closely with component, manufacturing and global logistic partners to build a supply chain that we consider predictable, scalable and consistent to provide high-quality, reliable products and leading cost management practices. The use of outsourced manufacturing facilities is designed to take advantage of specific expertise and allow for flexibility and scalability to respond to seasonality and changing demands for our products.

In anticipation of new product development and incremental growth, we made additional investments with a focus on making advancements to our planning systems. In connection with our initiative to improve our operating efficiency and reduce costs, we have continued efforts to focus on company-wide overhead reduction activities including right-sizing our supply chain, consolidation of warehouses with our global logistics partnership with Keuhne & Nagel as well as the planned transition of our European warehouse to a third-party logistics provider in 2017.

We believe we have solid relationships with our suppliers and that, subject to the discussion in “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources,” we will continue to have a sufficient supply of quality products on satisfactory terms.

Retail Distribution

Our headsets are sold in over 40 countries, by retailers such as Amazon, Argos, Best Buy, Game, GameStop, EB Games, Target, and Walmart. We often have a broader assortment and more shelf space than competitors at video game and electronics retailers such as GameStop and Best Buy which we believe reinforces the brand’s authenticity with gaming enthusiasts, and our presence in mass channel retailers such as Walmart and Target enables the brand to reach a wider audience of casual gamers. Our established presence on Amazon.com and other online retail sites, and positive consumer product ratings on those sites, increases the search visibility of our products and helps to influence both online and in-store sales.

Turtle Beach UK serves as a primary sales office for the European market, and has strengthened Turtle Beach’s European operations with support for sales, marketing, customer service and distribution.

TurtleBeach.com is an important focal point for our marketing efforts serving as a destination for paid and earned media. Earned media is favorable publicity gained through promotional efforts other than advertising, as compared with paid media, which refers to publicity gained through advertising. The website acts as a hub for both online and offline activity, and provides a direct sales channel for new and refurbished products.

Customers

The following tables show net revenues by product type:

	December 31,		
	2016	2015	2014
Net Revenues	(in thousands)		
Headset	\$173,323	\$161,835	\$185,469
HyperSound (1)	655	912	707
Total	\$173,978	\$162,747	\$186,176

(1) Business acquired in January 2014.

The Headset business customer base is comprised primarily of large retailers and distributors, both domestic and international. In 2016, net sales to our major market channels consisted of \$114.3 million to domestic retail customers, \$37.5 million to international customers, \$12.6 million to domestic distributors and \$8.9 million to other customers. Our three largest individual customers accounted for approximately 49% of our gross sales in 2016, 47% of our gross sales in 2015 and 45% of our gross sales in 2014. During 2016, our three largest customers, Best Buy, Walmart and Game Stop each accounted for between 14% to 17% of our consolidated net sales.

Geographic Information

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 believe that additional long-term growth opportunities exist in Asia Pacific and Latin America.

During 2016, we began to improve our international structure by taking retailers across Europe direct, leveraging off our new warehousing facility and simplifying our distribution model to provide less risk and lower infrastructure costs. In 2017, the Company believes this new model will provide significant growth in the European markets. The following table presents total net revenues, and percentage of total, based on where customers are physically located for each of the three years ended December 31, 2016:

	2016		2015		2014	
	(in thousands)					
North America	\$ 130,371	74.9 %	\$ 117,526	72.2 %	\$ 123,908	66.6 %
United Kingdom	21,778	12.5 %	20,881	12.8 %	29,425	15.8 %
Europe	15,729	9.0 %	17,329	10.6 %	24,082	12.9 %
Other	6,100	3.6 %	7,011	4.4 %	8,761	4.7 %
Total revenues	\$ 173,978		\$ 162,747		\$ 186,176	

Long-lived assets are largely held in the United States, refer to Note 12, “Geographic Information” in the Notes to the Consolidated Financial Statements.

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. In addition, launches of major new online multiplayer games and specific retailer purchasing behavior can drive significant revenue shifts between months and quarters in a given year.

Employees

As of December 31, 2016, Turtle Beach had 172 employees, of which 150 were full-time salaried employees. None of our employees are represented by a labor union. We believe that our relationship with our employees is good.

Available Information

We make available free of charge on or through our website, <http://corp.turtlebeach.com>, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission. Information contained on our website is not incorporated by reference unless specifically stated therein. In addition, the public may read or copy any materials filed with the SEC at the SEC’s Public Reference Room located at 100 F Street NE, Washington, D.C. 20549. The public may also obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. These reports and other information are also available, free of charge, at www.sec.gov.

Item 1A - Risk Factors

Set forth below is a summary of certain material risks related to an investment in our securities, which should be considered carefully in evaluating such an investment. Our business, financial condition, operating results and cash flows can be affected by a number of factors, whether currently known or unknown, including but not limited to those described below, any one or more of which could, directly or indirectly, cause the Company's actual results of operations and financial condition to vary materially from past, or from anticipated future, results of operations and financial condition. Any of these factors, in whole or in part, could materially and adversely affect the Company's business, financial condition, results of operations, cash flows and common stock price. Additional risks and uncertainties not presently known to us or that we currently consider immaterial may also impair our business operations.

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. Please also see "Statement Regarding Forward-Looking Disclosures" in the section immediately preceding Item 1 of this Report.

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 (the "Credit Facility") provided by Bank of America, as Agent, Sole Lead Arranger and Sole Bookrunner and our term loan (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 financial and other covenants contained in the Credit Facility or the Term Loan Due 2019 (collectively, the "Loan Documents") and are unable to obtain a waiver under the applicable Loan Documents, Bank of America or Crystal, as applicable, may declare the outstanding borrowings under the applicable Loan Documents immediately due and payable. Such an event would have an immediate and material adverse impact on our business, results of operations and financial condition. We would be required to obtain additional financing from other sources, and we cannot predict whether or on what terms, if any, additional financing might be available. If we are required to seek additional financing and are unable to obtain it, we may have to change our business and capital expenditure plans, which may have a materially adverse effect on our business, financial condition and results of operations. In addition, the debt under the Loan Documents could make it more difficult to obtain other debt financing in the future, which could put us at a competitive disadvantage to competitors with less debt.

The Loan Documents contain financial and other covenants that we are obligated to maintain. If we violate any of these covenants, we will be in default under the applicable Loan Documents. These covenants include restrictions that prohibit or otherwise limit our ability to pay dividends, incur additional indebtedness, acquire assets or engage in certain other types of transactions, 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, Bank of America or Crystal, as applicable, could seek remedies against us, including termination or suspension of obligations to make loans and issue letters of credit and acceleration of amounts due under the applicable Loan Documents. No assurance can be given that we will be able to maintain compliance with these covenants in the future. The Credit Facility is asset based and can only be drawn down in an amount to which eligible collateral exists and can be negatively impacted by extended collection of accounts receivable, unexpectedly high product returns and slow moving inventory, among other factors. As of the date of this Report, we were in compliance with our covenants under the Loan Documents.

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

The Credit Facility and Term Loan Due 2019 contain certain financial covenants and other restrictions that limit our ability, among other things, to incur certain additional indebtedness; pay dividends and repurchase stock; make certain investments and other payments; enter into certain mergers or consolidations; engage in sale and leaseback transactions and transactions with affiliates; and encumber and dispose of assets.

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

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

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

Risks Related to Our Operations

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

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

In order for our headsets to connect to the Xbox One advanced features and controls, a proprietary computer chip is required. As a result, with respect to our products designed for the Xbox One, we are currently reliant on Microsoft or their designated supplier to provide us with sufficient quantities 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 (including through third party manufacturers), market and sell audio products for the Xbox One video game console (the "Xbox One Agreement"). Our Xbox One headsets are dependent on this license. Microsoft has the right to terminate the Xbox One Agreement under certain circumstances set forth in the agreement. Should the Xbox One Agreement be terminated, our headset offerings may be limited, thereby significantly reducing our revenues.

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

Our HyperSound business has not generated significant revenues and we may not be successful in implementing our strategic priorities for our HyperSound business, which may have a material adverse impact on our business and financial results.

Our HyperSound business has incurred operating losses since the spin-off of Parametric Sound Corporation from LRAD Corporation in 2010, and could incur additional losses in the near-term if we are unable to successfully complete our previously announced strategic alternative process to continue the development and commercialization of the HyperSound technology.

Substantially all our HyperSound revenues to date have been derived from sales of a limited number of products to a limited number of customers. We cannot guarantee that we will have sufficient capital to continue development of our HyperSound products and technology, or that we will be able to develop a larger customer base and introduce new products to generate additional revenues. Further, we cannot guarantee that we will be able to generate any future license revenues.

Our ability to achieve future profitability is dependent on a variety of factors, many of which are outside our control, including, but not limited to, the outcome of our strategic review. Failure to achieve profitability or sustain profitability, if achieved, may require us to continue to make additional capital investments in, or to dispose of, our HyperSound business, either of which could materially impact our results of operations.

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

We compete with other producers of personal computers and video game console headsets, including the video game console manufacturers. Our competitors may spend more money and time on developing and testing products, undertake more

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

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

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

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

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

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

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

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

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

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

British Pound. As the U.S. dollar fluctuates against other currencies in which we transact business, revenue and income can be impacted.

The affirmative vote in the United Kingdom to withdraw from the European Union may adversely affect our business. On June 23, 2016, the United Kingdom ("UK") held a referendum in which voters approved a potential exit from the European Union ("EU"), commonly referred to as "Brexit." As a result of the referendum, it is expected that the British government will begin negotiating the terms of the UK's future relationship with the EU. The Brexit vote may result in regulatory uncertainty throughout the region and could adversely affect business activity, political stability and economic conditions in the UK, the Eurozone, the EU and elsewhere. Any of these developments could have a material adverse effect on business activity in the UK, the Eurozone, or the EU.

The uncertainty concerning the timing and terms of the exit could also have a negative impact on the growth of the UK and/or EU economies and cause greater volatility in the pound sterling, euro and/or other currencies.

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 2016, our three largest individual customers accounted for approximately 49% of our gross sales in the aggregate. The loss of, or financial difficulties experienced by, any of these or any of our other significant customers, including as a result of the bankruptcy of a customer, could have a material adverse effect on our business, results of operations, financial condition and liquidity. We do not have long-term agreements with these or other significant customers and our agreements with these customers do not require them to purchase any specific amount of products. All of our customers generally purchase from us on a purchase order basis. As a result, agreements with respect to pricing, returns, cooperative advertising or special promotions, among other things, are subject to periodic negotiation with each customer. No assurance can be given that these or other customers will continue to do business with us or that they will maintain their historical levels of business. In addition, the uncertainty of product orders can make it difficult to forecast our sales and allocate our resources in a manner consistent with actual sales, and our expense levels are based in part on our expectations of future sales. If our expectations regarding future sales are inaccurate, we may be unable to reduce costs in a timely manner to adjust for sales shortfalls. In addition, financial difficulties experienced by a significant customer could increase our exposure to uncollectible receivables and the risk that losses from uncollected receivables exceed the reserves we have set aside in anticipation of this risk.

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

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

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

In particular, certain of our products have a number of components and subassemblies produced by outside suppliers. In addition, for certain of these items, we qualify only a single source of supply with long lead times, which can magnify the risk of shortages or result in excess supply and also decreases our ability to negotiate price with our

suppliers. 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. Also, if we experience quality problems with suppliers, then our production schedules could be significantly delayed or costs significantly increased, which could have an adverse effect on our business, liquidity, results of operation and financial position.

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

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

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

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

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

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

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

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

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

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.

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 new generation console, PlayStation®4, on November 15, 2013, and Microsoft launched its new 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 old generation console platforms in anticipation of new platforms becoming available. During these console transition periods, sales of gaming console headsets such as those sold by us, related to old generation consoles slow or decline until new platforms are introduced and achieve wide consumer

acceptance, which we cannot guarantee. This decrease or decline may not be offset by increased sales of products for the new console platforms. Over time as the old generation platform user base declines, products for the old platforms are typically discontinued which can result in lower margins, excess inventory, excess parts, or similar costs related to end of life of a product model. In addition, as a third party gaming headset

company, we are reliant on working with the console manufacturers for our headsets to be compatible with any new console platforms, which if not done on a timely basis may adversely affect sales. Sony and Microsoft may make changes to their platforms that impact how headset connect with or work with the new consoles which could create a disruption to consumer buying behavior and/or product life-cycles.

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

Further, technological and other developments may in the future accelerate the frequency of such console transitions resulting in such disruption occurring more frequently. For example, journalists have begun to report rumors of new consoles on the horizon from each of Sony and Microsoft, Neo and Project Scorpio respectively. In addition, competing technologies such as tablet-based gaming and virtual reality may result in further disruption to the overall console gaming market.

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

We have had, and may continue to have, actions brought against us by stockholders in connection with the merger, past transactions, changes in our stock price or other matters. Any such claims, whether or not resolved in our favor, could divert our management and other resources from the operation of our business and otherwise result in unexpected and substantial expenses that would adversely and materially impact our business, financial condition and operating results. For example, and as further described in Item 3, "Legal Proceedings," and Note 13, "Commitments and Contingencies," we are involved in legal proceedings related to the merger of VTBH and Paris Acquisition Corp. involving certain of our stockholders, including the holder of VTBH's Series B Redeemable Preferred Stock, (the "Series B Holder"), filing a complaint in New York state court alleging breach of contract against VTBH and seeking a declaratory judgment that he is entitled to damages and specific performance, including the redemption of his stock. The redemption value of VTBH's Series B Redeemable Preferred Stock was \$17.5 million as of December 31, 2016. If we are unable to protect our information systems against service interruption, misappropriation of data or breaches of security, our operations could be disrupted, our reputation may be damaged, and we may be financially liable for damages.

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

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

the ability of our information systems to operate in accordance with our disaster recovery and business continuity plans.

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

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

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

trade restrictions, higher tariffs, currency fluctuations or the imposition of additional regulations relating to import or export of our products, especially in China, where all of our Turtle Beach products are manufactured, which could force us to seek alternate manufacturing sources or increase our 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 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, as applicable, to report on the effectiveness of our internal control over financial reporting. If we are not able to comply with the requirements of Section 404 of the Sarbanes-Oxley Act, or if we or our independent registered public accounting firm identifies deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, investors could lose confidence in the accuracy and completeness of our financial reports, the market price of our common stock could decline and we could be subject to sanctions, investigations by NASDAQ, the SEC or other regulatory authorities, or shareholder litigation.

In connection with the audit of our consolidated financial statements for the year ended December 31, 2015, our management identified control deficiencies in our internal control over financial reporting that constituted a material

weakness in our internal control over financial reporting. As such, our controls over financial reporting were not designed or operating effectively, and as a result there were adjustments required in connection with preparing our consolidated financial statements for the year ended December 31, 2016. The control deficiency resulted in more than a remote likelihood that a material misstatement of our annual and interim financial statements would not be prevented or detected.

We are currently taking steps in an effort to remediate our material weakness, but there can be no assurance that we will be successful in pursuing these measures or that these measures will significantly improve or remediate the material weakness described above. There is also no assurance that we have identified all of our material weaknesses or that we will not in the future have additional material weaknesses. There is no assurance that we will be able to remediate the material weakness in a timely manner, or at all, or that in the future, additional material weaknesses will not exist or otherwise be discovered. If our efforts to remediate the material weakness described above are not successful, or if other material weaknesses or other deficiencies occur, our ability to accurately and timely report our financial position could be impaired, which could result in late filings of our annual and quarterly reports under the Securities Exchange Act of 1934, as amended ("Exchange Act"), restatements of our consolidated financial statements, a decline in our stock price or suspension or delisting of our common stock from the NASDAQ Global Market.

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

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

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

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

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

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

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

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

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

to the same extent or in the same manner as the laws of the United States.

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

Our success also depends in part on our ability to obtain and enforce intellectual property protection of our technology, particularly our patents. There is no guarantee any patent 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 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.

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

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

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

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

In addition, HyperSound Clear 500P and the HyperSound Tinnitus Module feature available in the HyperSound Clear 500P are regulated by the FDA as medical devices pursuant to the Federal Food, Drug, and Cosmetic Act, or FDCA, and implementing regulations. HyperSound Clear 500P has received 510(k) clearance permitting over - the - counter (“OTC”) commercial distribution for use as a group auditory trainer or group hearing aid and in August 2016, the HyperSound Tinnitus Module feature available in the HyperSound Clear 500P received 510(k) clearance for prescription use in the temporary relief of tinnitus symptoms. Recently, FDA exempted group hearing aids from the 510(k) requirement. Therefore, we may modify HyperSound Clear 500P in the future without seeking additional 510(k) clearance, provided that we do not alter its intended use

or incorporate a fundamentally different scientific technology, either of which would require a new 510(k) clearance or premarket approval. The Tinnitus Module remains subject to 510(k) clearance requirements.

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 regarding the manufacture of medical devices); the Medical Device Reporting regulation (which requires that manufacturers report to the FDA if their device may have caused or contributed to a death or serious injury or malfunctioned in a way that would likely cause or contribute to a death or serious injury if it were to recur); and the Reports of Corrections and Removals regulation (which requires manufacturers to report recalls and field actions to the FDA if initiated to reduce a risk to health posed by the device or to remedy a violation of the FDCA that may pose a risk to health). FDA enforces these requirements by inspection and market surveillance. If the FDA finds a violation, it can institute a wide range of enforcement actions, ranging from a public warning letter to more severe sanctions such as fines, penalties, suspension or withdrawal of regulatory approvals, product recalls, seizure of products, operating restrictions or total shutdown of production, and criminal prosecution.

In the European Union we are subject to similar government regulation regarding medical device safety and effectiveness and ongoing certification and related costs. In the European Union and in other markets we may enter we will be subject to numerous and varying governmental requirements. The timing and expense to obtain or maintain any required clearances or approvals in foreign markets are difficult to estimate and may be significant. It may also be costly for us to comply with any applicable regulations and postmarket requirements 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.

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

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

We could incur unanticipated expenses in connection with warranty or product liability claims relating to a recall of one or more of our products, including the XO FOUR Stealth headset recall in 2015, which could require significant expenditures to defend. Additionally, we may be required to comply with governmental requirements to remedy the defect and/or notify consumers of the problem that could lead to unanticipated expense, and possible product liability litigation against a customer or us. As of December 31, 2016 and the date of this report, the Company has not received notice of any lawsuits against the Company in connection with any recall actions.

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

New laws or regulations, or changes in existing laws or regulations or the manner of their interpretation or enforcement, may create uncertainty for public companies, increase our cost of doing business and restrict our ability to operate our business or execute our strategies. This could include, among other things, compliance costs and enforcement under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). For example, under Section 1502 of the Dodd-Frank Act, the SEC has adopted additional disclosure requirements related to the source of certain "conflict minerals" for issuers for which such "conflict minerals" are necessary to the functionality or production of a product manufactured, or contracted to be manufactured, by that issuer. The metals covered by the rules include tin, tantalum, tungsten and gold. Our suppliers may use some or all of these materials in their production processes. The rules require us to conduct a reasonable country of origin inquiry to determine if we know or have reason to believe any of the minerals used in the production process may have originated from the Democratic Republic of the Congo or an adjoining country. If we are not able to determine the minerals did not originate from a covered country or conclude that there is no reason to believe that the minerals used in the production process may have originated in a covered country, we would be required to perform supply chain due diligence on members of our

supply chain. Global supply chains can have multiple layers, thus the costs of complying with these new requirements could be substantial. These new requirements may also reduce the number of suppliers who provide conflict free metals, and may affect our ability to obtain products in sufficient quantities or at competitive prices. Compliance costs such as these could have a material adverse effect on our results of operations.

We continually evaluate and monitor developments with respect to new and proposed laws, regulations, standards and rules and cannot predict or estimate the amount of the additional costs we may incur or the timing of such costs. Any such new or changed laws, regulations, standards and rules may be subject to varying interpretations and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing

uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, regulatory authorities may initiate legal proceedings against us and we may be harmed.

The current administration has called for substantial change to fiscal and tax policies, which may include comprehensive tax reform and changes to the implementation of the Dodd-Frank Act and related or similar regulations. We cannot predict the impact, if any, of these changes to our business. However, it is possible that these changes could adversely affect our business. Until we know what changes are enacted, we will not know whether in total we benefit from, or are negatively affected by, the changes.

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 Ownership of our Common Stock

If we cannot meet Nasdaq's continuing listing requirements and Nasdaq rules, Nasdaq may delist our securities, which could negatively affect us, the price of our securities and your ability to sell our securities.

Although our shares are currently in compliance with requirements and currently listed on Nasdaq, we may not be able to meet the continued listing requirements of Nasdaq in the future, which require, among other things, a minimum bid price of \$1.00 per share for common shares listed on the exchange. While we would consider implementation of customary options, including a reverse stock split, if our common stock does not trade at the required level that regains compliance, if our efforts are unsuccessful or we are otherwise unable to satisfy the Nasdaq criteria for maintaining our listing, our securities could be subject to delisting. As a consequence of any such delisting, our shareholders would likely find it more difficult to dispose of, or to obtain accurate quotations as to the prices of our securities. In the event of a delisting, we could face significant material adverse consequences including a limited availability of market quotations for our securities; a limited amount of news and analyst coverage for our company;

and a decreased ability to issue additional securities or obtain additional financing in the future.

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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 54% 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 1B - Unresolved Staff Comments

None.

Item 2 - Properties

The table below describes our principal facilities as of December 31, 2016.

Location	State or Country	Principal Business Activity	Approx. Square Feet	Owned or Expiration Date of Lease
San Diego	CA	Corporate Headquarters	30,000	2020
Valhalla	NY	Administration	21,000	2019
Basingstoke	U.K.	Administration	6,850	2021
Poway	CA	Administration	2,830	2017
San Jose	CA	Research & Development	3,500	2018
Darlington	U.K.	Warehouse	120,000	2017

Item 3 - Legal Proceedings

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.

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 and briefing was completed on that date. The Company believes that the plaintiffs' claims against it are without merit.

On February 18, 2015, On February 18, 2015, Dr. John Bonanno, a minority shareholder of Series B Preferred Stock 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 preferred 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. On February 8, 2016, the Delaware Chancery Court granted VTBH's motion to dismiss for improper venue, and Dr. Bonanno's complaint was dismissed without prejudice. In January of 2017, Dr. Bonanno filed a complaint in New York state court alleging breach of contract against VTBH and seeking a declaratory judgment that he is entitled to damages and specific performance, including redemption of his stock. The Company answered the complaint on March 7, 2017. At the order of the Court, the parties will be filing cross-motions for summary judgment on March 31, 2017, on the sole question of whether the Merger was a defined event in the purported contract entitling Dr. Bonanno to redemption of his shares. VTBH maintains that the Merger did not trigger any obligation to redeem Mr. Bonanno's preferred stock.

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 December 31, 2016 for contingent losses associated with these matters based on its belief that losses, while possible, are not probable. Further, any possible range of loss cannot be reasonably estimated at this time. The unfavorable resolution of these matters could have a material adverse effect on the Company's business, results of operations, financial condition or cash flows. The Company is engaged in other legal actions not described above arising in the ordinary course of its business and, while there can be no assurance, believes that the ultimate outcome of these other legal actions will not have a material adverse effect on its business, results of operations, financial condition or cash flows.

Item 4 - Mine Safety Disclosures

Not applicable.

PART II

Item 5 - Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's stock is traded on NASDAQ under the symbol "HEAR." The following table sets forth the high and low sale prices per share of our common stock on the NASDAQ for the period indicated:

	High	Low
Fiscal Year 2016		
First Quarter	\$2.07	\$0.91
Second Quarter	1.42	0.83
Third Quarter	1.55	0.91
Fourth Quarter	2.00	1.21
	Market Price	
	High	Low
Fiscal Year 2015		
First Quarter	\$3.27	\$1.85
Second Quarter	3.29	1.75
Third Quarter	3.19	1.91
Fourth Quarter	3.72	1.86

The closing price of our common stock on February 28, 2017 was \$1.06 per share. The number of holders of record of common stock at February 28, 2017 was 952.

Stock Performance Graph

Notwithstanding any statement to the contrary in any of our previous or future filings with the SEC, the following information relating to the price performance of our common stock shall not be deemed to be "filed" with the SEC for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), to be "soliciting material" or subject to Rule 14A of the Exchange Act, or to be incorporated by reference into any of our filings under the Securities Act of 1933, as amended (the "Securities Act") or the Exchange Act whether made before or after the date of this Report, except to the extent we specifically incorporate it by reference into such filing.

The following graph shows a comparison from January 15, 2014 (the date following the reverse acquisition) through December 31, 2016 of the cumulative total return assuming a \$100 investment in our common stock, the S&P 500 Index and the S&P 500 Consumer Durables Index. In accordance with the rules of the Securities and Exchange Commission, the returns are indexed to a value of \$100 at December 31, 2013 and assume that all dividends, if any, were reinvested. The comparisons in this graph below are based on historical data and are not intended to forecast or be indicative of future performance of our common stock.

Dividend Policy

We have not paid regular cash dividends on our common stock and do not anticipate paying cash dividends in the foreseeable future. Any future determination to pay cash dividends will be at the discretion of our board of directors and will depend on our financial condition, operating results, capital requirements and such other factors as our board of directors deems relevant.

Unregistered Sale of Equity Securities and Issuer Purchases of Equity Securities

In February 2016, concurrent with the completion of the Offering, SG VTB Holdings, LLC, the Company's largest shareholder, purchased 1,700,000 shares of our common stock for \$1.00 per shares in a private placement, resulting in total gross proceeds of approximately \$1.7 million. The sale of these shares was not registered under the Securities Act of 1933, as amended, in reliance on the exemptions set forth under Section 4(2) thereof and Rule 506 of Regulation D thereunder.

Securities Authorized for Issuance under Equity Compensation Plans

See Part III, Item 12 of this annual report for disclosure relating to our equity compensation plans. Such information will be included in our Proxy Statement or an amendment to this Form 10-K, which is incorporated herein by reference.

Item 6 - Selected Financial Data

The merger (the “Merger”) between VTB Holdings, Inc. and Parametric Sound Corporation (“Parametric”) was treated as a “reverse acquisition” with VTBH considered the accounting acquirer. Accordingly, VTBH's historical results of operations on a stand-alone basis replace Parametric’s historical results of operations for all periods on or prior to January 15, 2014, and for all periods following the Merger, the results of operations of both companies have been included.

The following table sets forth selected consolidated financial data for each of the five years ended December 31, 2016. This selected financial data should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the consolidated financial statements and the notes thereto included in this Report.

	Year Ended December 31,				
	2016 (3)	2015 (2)	2014 (1)	2013	2012
	(in thousands, except per share data)				
Net Revenue	\$173,978	\$162,747	\$186,176	\$178,470	\$207,136
Cost of Revenue	131,368	122,056	135,509	128,141	132,795
Gross Profit	42,610	40,691	50,667	50,329	74,341
Gross Margin	24.5 %	25.0 %	27.2 %	28.2 %	35.9 %
Operating loss	(77,701)	(74,399)	(13,825)	1,589	42,910
Operating Margin	(44.7)%	(45.7)%	(7.4)%	0.9 %	20.7 %
Net income (loss)	\$(87,182)	\$(82,907)	\$(15,486)	\$(6,163)	\$26,460
Net earnings (loss) per share:					
Basic	\$(1.79)	\$(1.96)	\$(0.39)	\$(0.49)	\$0.13
Diluted	\$(1.79)	\$(1.96)	\$(0.39)	\$(0.49)	\$0.13
Weighted average number of shares:					
Basic	48,592	42,269	39,665	12,700	12,700
Diluted	48,592	42,269	39,665	12,700	12,700
Balance Sheet Data					
Cash and cash equivalents	6,183	7,114	7,908	6,509	5,219
Total Assets	94,800	172,460	249,968	127,307	134,195
Total Debt	66,875	64,806	44,555	64,578	74,250
Series B Redeemable Preferred Stock	17,480	16,145	14,916	13,713	12,703
Series A Convertible Preferred Stock	—	—	—	24,345	24,345

(1) In 2014, we completed the merger with Parametric, which contributed revenue of \$0.7 million in the year and \$129.1 million of total assets on date of the merger.

(2) Includes goodwill impairment charge of \$49.8 million.

(3) Includes a \$7.1 million charge for inventory reserves associated with the HyperSound restructuring and goodwill and other intangibles impairment charges of \$63.2 million.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our consolidated financial statements and the notes thereto. This discussion summarizes the significant factors affecting our results of operations and the financial condition of our business during each of the fiscal years in the three-year period ended December 31, 2016.

On January 15, 2014 the Company completed the merger (the “Merger”) with VTB Holdings, Inc. which was treated as a “reverse acquisition” with VTBH considered the accounting acquirer and surviving entity, as a wholly-owned subsidiary of the Company (f/k/a Parametric Sound Corporation), a publicly-traded company. Accordingly, VTBH's historical results of operations on a stand-alone basis replace Parametric’s historical results of operations for all periods on or prior to January 15, 2014, and for all periods following the Merger, the results of operations of both companies have been included.

Turtle Beach Corporation (herein referred to as the “Company,” “we,” “us,” or “our”), headquartered in San Diego, California and incorporated in the state of Nevada in 2010, is a premier audio technology company with expertise and experience in developing, commercializing and marketing innovative products across a range of large addressable markets operating under two reportable segments, Turtle Beach® (“Headset”) and HyperSound®.

Turtle Beach is a worldwide leading provider of feature-rich headset solutions for use across multiple platforms, including video game and entertainment consoles, handheld consoles, personal computers, tablets and mobile devices. HyperSound technology is a pioneering audio solution that provides an effective means of projecting sound in a highly directional manner, without use of large speaker arrays, to a specific location creating a precise audio zone. HyperSound directs a beam of audio to targeted listeners in a specific spot, delivering an immersive, 3D-like audio experience.

Business Trends

Headset

Sales in the gaming accessories market, which includes headsets and other peripherals such as gamepads, specialty controllers, adapters, batteries, memory and interactive gaming toys are heavily dependent on the global video game console industry. 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 consumer response to the Xbox One and PlayStation®4 (the “new generation” or “new-gen” consoles) has been overwhelmingly positive, creating a growing installed base of gamers and a market for new-gen headsets.

Cumulative New Generation Console Sales (in millions)

Source: DFC Intelligence Forecasts: Worldwide Console Forecast, October 2016.

In September 2016, Sony discontinued the original PlayStation®4 console and released a new, slimmer, and lower-priced PlayStation®4 Slim, which no longer includes an optical audio connector. Despite dropping the optical connector, we were

largely able to accommodate this audio connectivity change via software updates to a small selection of our products affected by Sony's hardware change.

We believe this is a good indication that any potential future console changes are not expected to be nearly as disruptive as this past change as the new generation of platform uses fairly standard audio connectivity, which we believe is unlikely to change and many headsets now have the capability to be updated via software upgrades. Over the long term, we expect to benefit from the extension of the new-gen cycle, driven by the introductions of Xbox One S, PlayStation®VR, PlayStation®4 Pro, and Microsoft's upcoming Project Scorpio, expected to be available in holiday of next year, which should result in stronger gaming engagement for the next several years.

HyperSound

HyperSound technology is a pioneering audio solution that provides an effective means of projecting sound in a highly directional manner, without use of large speaker arrays, to a specific location creating a precise audio zone.

HyperSound directs a beam of audio to targeted listeners in a specific spot, delivering an immersive, 3D-like audio experience. The Company sells HyperSound Professional Audio Solutions, which is being purchased for commercial retail environments where a targeted zone of sound is desired.

Hearing Health Care. HyperSound technology offers a fundamentally new way to deliver sound, and our research indicates that it improves the home listening experience.

Commercial. We are currently marketing our HyperSound technology to retailers and audio-visual integrators for use in settings where directed audio and sound zones are beneficial, such as digital signage and interactive retail displays. Convenience retailers and fast moving consumer good brands face ever-greater challenges as competition for customers intensifies, and as shoppers increasingly rely on in-store cues. As a result, digital signage is a growing form of direct advertising, capturing an increasing share of advertising spending as restaurants, banks, retail outlets, museums and other outlets and organizations employ commercial displays to communicate with patrons.

Consumer Applications. Our HyperSound technology has the potential to be developed into consumer products for various applications, including computers, video game consoles, televisions, home theater and home audio. With the advent of flat panel displays for use in televisions and mobile devices, manufacturers have been focused on creating thinner products often at the expense of sound quality. We believe that our ability to create a 3D sound image from two thin emitters, compared to a five- or seven-speaker surround sound set-up using conventional speakers can deliver a compelling and enhanced audio experience.

Results of Operations

Management Overview

In 2016, our next-gen headsets continued to gain market share led by stronger-than-expected demand for our entry-level Recon series headsets, the introduction and sales of our Stealth 520 and 420X+ wireless headsets and solid overall performance across the rest of our line. As a result, our net revenues increased \$11.2 million, or 6.9%, to \$174.0 million and headset margins improved 540 basis points to 31.9%.

In addition, we completed a ground-up redesign of the competitive gaming headset that brings to market multiple first-and-only innovations in the core mechanics of headset design, weight and fit with the launch of our Elite Pro headset and tournament audio controller, which delivered a whole new level of gaming audio. Further, the year marked our entrance into two small but burgeoning new markets in virtual reality and live streaming with our just-launched Stealth 350VR headset, the first and only headset created specifically for use with the new virtual reality devices like PlayStation®VR and HTC Vive™; and our Stream Mic, the first professional-quality live streaming microphone that works with Xbox One as well as with PlayStation 4, PC and Mac.

In September 2016, we started the process of restructuring the HyperSound business in an effort to reduce costs and align spending with revenues, while continuing to pursue certain additional opportunities, including licensing the technology for HyperSound Glass and other applications. By tightly managing the costs in our headset business our operating expenses, excluding non-cash asset impairments, decreased roughly 20% in the fourth quarter compared to 2015 and we expect to maintain that level with operating expenses approximately 20% lower for the full year in 2017. For 2016, our reported net loss increased to \$87.2 million, or diluted net loss per share of \$1.79, driven largely by the negative non-cash impacts of the goodwill and other intangible impairment charges and inventory reserves associated

with the HyperSound restructuring. Our Headset Segment, reported net loss of \$0.7 million, with operating income, compared to a prior year net loss of \$17.2 and negative operating income, on the strength of our new-gen portfolio, product cost improvements and certain operating expense cost reduction efforts.

Finally, as noted with the release of Sony's new, slimmer PlayStation®4 console, we believe future console changes will not be nearly as disruptive as this past change was on our business as this new generation of platform uses fairly standard audio connectivity, which we believe is unlikely to change and the majority of our headsets now have the capability to be updated with simple software upgrades. As such, in 2017, we expect to benefit from the extension of the new-gen cycle, driven by the introductions of Xbox One S, PlayStation®VR, PlayStation®4 Pro, and Microsoft's upcoming Project Scorpio, expected to be available in holiday of next year, which should result in stronger gaming engagement for the next several years.

Key Performance Indicators and Non-GAAP Measures

Management routinely reviews key performance indicators including revenue, operating income and margins, earnings per share, among others. In addition, we believe certain other measures provide useful information to management and investors about us and our financial condition and results of operations for the following reasons: (i) 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 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). These metrics, however, are not measures of financial performance under accounting principles generally accepted in the United States of America ("GAAP") and, given the limitations of these metrics as analytical tools, should not be considered a substitute for gross profit, gross margins, net income (loss) or other consolidated income statement data as determined in accordance with GAAP. We consider the following non-GAAP 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.

Cash Margins is defined as gross margin excluding depreciation and amortization, and stock-based compensation.

Adjusted EBITDA

Adjusted EBITDA (and a reconciliation to Net loss, the nearest GAAP financial measure) for the years ended December 31, 2016, 2015 and 2014 are as follows:

	Year Ended		
	December 31,		
	2016	2015	2014
	(in thousands)		
Net loss	\$(87,182)	\$(82,907)	\$(15,486)
Interest expense	7,447	5,099	7,209
Depreciation and amortization	9,194	7,916	6,866
Stock-based compensation	3,960	5,897	5,194
Income tax expense (benefit)	(387)	2,393	(6,272)
Impairment charge	63,236	49,822	—
Business transaction costs	—	—	3,744
Restructuring charges	664	399	747
HyperSound business transition charge	7,079	—	—
Adjusted EBITDA	\$4,011	\$(11,381)	\$2,002

Comparison of the Year Ended December 31, 2016 to the Year Ended December 31, 2015

Net loss for the year ended December 31, 2016 was \$87.2 million compared to a net loss of \$82.9 million in the prior year period, including \$0.2 million and \$17.2 million of net loss attributable to the Headset segment, for the year

ended December 31, 2016 and the prior year, respectively.

For the year ended December 31, 2016, Adjusted EBITDA on a consolidated basis was \$4.0 million, including investments of \$10.4 million in the HyperSound business, compared to Adjusted EBITDA on a consolidated basis of \$(11.4) million, including investments of \$13.8 million in the HyperSound business from the year ended December 31, 2015.

Headset Adjusted EBITDA totaled approximately \$14.4 million in the year ended December 31, 2016 compared to \$2.4 million in the prior year, despite the negative impacts of \$2.4 million related to foreign currency, as new-gen headset consumer demand on both platforms continued to drive higher North American and United Kingdom retailer sales volumes and product mix driven margin improvement.

Comparison of the Year Ended December 31, 2015 to the Year Ended December 31, 2014

Net loss for the year ended December 31, 2015 was \$82.9 million compared to a net loss of \$15.5 million in the prior year period, including \$17.2 million and \$2.0 million of net loss attributable to the Headset segment, for the year ended December 31, 2015 and the prior year, respectively.

For the year ended December 31, 2015, Adjusted EBITDA on a consolidated basis was \$(11.4) million, including investments of \$13.8 million in the HyperSound business, compared to Adjusted EBITDA on a consolidated basis of \$2.0 million, including investments of \$10.0 million in the HyperSound business from the year ended December 31, 2014.

Headset Adjusted EBITDA totaled approximately \$2.4 million in the year ended December 31, 2015 compared to \$12.0 million in the prior year, which included the initial sell-in of the Company's and the industry's first ever Xbox One compatible headsets. In addition to the lower sales volume driven primarily by the strong dollar on our international business, the current period was negatively impacted by promotional credits to continue to clear channel inventory and higher third party licensing and royalty

Financial Results

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

	Year Ended		
	December 31,		
	2016	2015	2014
	(in thousands)		
Net Revenue	\$173,978	\$162,747	\$186,176
Cost of Revenue	131,368	122,056	135,509
Gross Profit	42,610	40,691	50,667
Gross Margin	24.5	% 25.0	% 27.2
Operating expenses	120,311	115,090	64,492
Operating loss	(77,701)	(74,399)	(13,825)
Interest expense	7,447	5,099	7,209
Other non-operating expense, net	2,421	1,016	724
Loss before income tax expense (benefit)	(87,569)	(80,514)	(21,758)
Income tax expense (benefit)	(387)	2,393	(6,272)
Net loss	\$(87,182)	\$(82,907)	\$(15,486)

Net Revenue and Gross Profit
Headset Segment

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

	December 31,		
	2016	2015	2014
	(in thousands)		
Net Revenue	\$173,323	\$161,835	\$185,469
Gross Profit	55,221	42,832	50,550
Gross Margin	31.9	% 26.5	% 27.3
Cash Margin (1)	32.5	% 27.5	% 27.5

(1) Excludes non-cash charges of \$1.1 million, \$1.7 million and \$0.5 million, respectively.

Comparison of Fiscal Years 2016 and 2015

Net revenues for year ended December 31, 2016 increased \$11.2 million, or 6.9%, with 28.8% increase in new-gen headset sales on robust North American retailer sales (up 10.9%) and less promotional activity as a result of continued stronger-than-expected demand for our entry-level Recon series headsets, positive consumer response to the introduction and sales of the Stealth 420X+ and Playstation compatible headset market gains across all price points lead by the Ear Force PX24 and the introduction of the Stealth 520.

For the year ended December 31, 2016, gross profit as a percentage of net revenue increased to 31.9% from 26.5% in the prior year. The year-over-year improved margin was primarily due to product mix, as heavily discounted old-gen products are no longer a significant portion of revenues with new-gen headsets up to 92.3% of net revenues, a channel mix shift to higher margin North America retailers as well as an operational move away from branded headsets that reduced third party licensing and royalty costs.

Comparison of Fiscal Years 2015 and 2014

Net revenues for year ended December 31, 2015, which decreased \$23.4 million, or 12.6%, were negatively impacted by a more rapid than expected decline in old-gen revenues, which were down over \$40 million compared to 2014 and, the strong dollar on our international business that declined 29.0% in the United Kingdom and 28.0% in Europe.

These declines were

offset, in part, by a 27.0% increase in new-gen revenues reflecting the continued positive consumer reaction to the XO ONE, XO FOUR Stealth and Stealth 500P headsets and the strong performance of our new products as we completed our headset portfolio transition with the launch of five new headsets for the holiday season.

Despite the benefit of the product mix shift to higher margin new-gen headsets during the second half of the year, for the year ended December 31, 2015, gross profit as a percentage of net revenue decreased to 26.5% from 27.3% in the prior year. The year-over-year decrease in gross margin performance was primarily due to higher promotion credits to clear, and subsequent excess reserves of, old-gen and licensed headsets, incremental costs associated with our refurbishment model and contract manufacture transitions and, higher third party licensing and royalty costs.

Excluding the impact of \$1.8 million previous generation and licensed headset charges, gross profit as a percentage of net sales would have been 27.6% driven largely by sales of higher margin headsets.

HyperSound Segment

	December 31,		
	2016	2015	2014

HyperSound655	912	707
Gross Profit (12,611)	(2,141)	117

Comparison of Fiscal Years 2016 and 2015

Net revenues for the years ended December 31, 2016 and 2015 reflect the initial sales of the HyperSound Clear 500P product that launched in November 2015. The slower than anticipated ramp in sales volumes resulted from the extensive training and resources necessary to build market awareness in the hearing healthcare channel and we reduced resources as part of our transition away from Clear 500P direct sales in order to pursue a licensing model.

As a result of certain costs related to the HyperSound Clear 500P product, including the incremental amortization expense related to technological feasibility of the purchased in-process research and development intangible asset and \$7.1 million inventory reserve in connection with the Company's HyperSound strategic alternative plans, gross profit as a percentage of net revenue was negative for the year. Refer to Note 1, "Summary of Significant Accounting Policy" for additional information.

Comparison of Fiscal Years 2015 and 2014

Net revenues for the year ended December 31, 2015 were \$0.9 million and reflect the initial sales of the HyperSound Clear 500P product that launched in November 2015, compared to \$0.7 million in the prior year primarily from the first wide-scale deployment of the commercial product in Activision Call of Duty® retail displays.

As a result of certain start-up costs related to the HyperSound Clear 500P product, including the incremental amortization expense related to technological feasibility of the purchased in-process research and development intangible asset, gross profit as a percentage of net revenue was negative for the year ended December 31, 2015. Excluding these costs, the cash margin was 39.8% reflecting the initial shipments of the higher margin HyperSound Clear 500P product.

Operating Expenses

	Year Ended		
	December 31,		
	2016	2015	2014
	(in thousands)		
Selling and marketing	\$28,572	\$31,829	\$33,442
Research and development	8,259	11,556	9,400
General and administrative	19,580	21,484	17,159
Business transaction costs	—	—	3,744
Goodwill and other intangible asset impairment	63,236	49,822	—
Restructuring charges	664	399	747
Total operating expenses	\$120,311	\$115,090	\$64,492

By Segment:

Headset	\$46,588	\$51,530	\$51,640
HyperSound	\$73,723	\$63,560	\$13,167

Selling and Marketing

Selling and marketing expense for the year ended December 31, 2016 totaled \$28.6 million, or 16.4% as a percentage of net revenues, compared to \$31.8 million, or 19.6% as a percentage of net revenues, for the prior year. This decrease was attributable to headcount reductions in connection with our marketing department realignment (\$0.7 million), lower retail marketing and depreciation, as certain of our major retail customers have shifted away from independent in-store displays.

Selling and marketing expense for the year ended December 31, 2015 totaled \$31.8 million, or 19.6% as a percentage of net revenues, compared to \$33.4 million, or 18.0% as a percentage of net revenues, for the prior year. The 4.8%

decrease was primarily due to lower direct media spend and licensing costs (\$1.5 million) and a reduction in trade show spend (\$0.9 million) in connection with a strategic shift to more targeted promotional activity, partially offset by incremental marketing costs and additional sales force related to the HyperSound Clear 500P product launch.

Research and Development

Despite the continued development initiatives such as the Stealth 350VR headset, Stream Mic and HyperSound Glass, research and development expenses for the year ended December 31, 2016 decreased versus the prior year on cost reductions following the launch of the HyperSound Clear 500P product (\$3.0 million).

The increase in research and development expenses for the year ended December 31, 2015 versus the prior year was primarily due to increased staffing levels to support the development of the HyperSound Clear 500P product (\$1.9 million) 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 (\$0.3 million).

General and Administrative

General and administrative expenses for the year ended December 31, 2016 decreased \$1.9 million to \$19.6 million compared to \$21.5 million for the year ended December 31, 2015. The year over year decrease was primarily due to a lower non-cash stock compensation charges as compared to incremental expense in connection with our stock option exchange in the prior year (\$1.1 million), a reduction in HyperSound related expenses (\$0.4 million) and lower legal expenses (\$0.3 million).

General and administrative expenses for the year ended December 31, 2015 increased \$4.3 million to \$21.5 million compared to \$17.2 million for the year ended December 31, 2014. The year over year increase was primarily driven by higher employee costs as a result of the full year impact of additional headcount required of a public company (\$1.5 million), legal fees associated with recent public filings in connection with our stock option exchange and financing activities (\$0.7 million) and higher stock compensation expense (\$0.7 million).

Goodwill and Other Intangibles Impairment

As a result of interim and annual impairment tests, for the years ended December 31, 2016 and 2015, respectively, we recorded a \$63.2 million and \$49.8 million goodwill impairment charge, respectively, in connection with the decline in implied fair value of the HyperSound reporting unit. There were no such charges in 2014.

Business Transaction

Business transaction expenses for the year ended December 31, 2014 incurred in connection with the Merger included investment banker success fees of \$2.2 million payable upon the close of the merger and legal and accounting fees required to complete the transaction. There were no such charges in 2016 or 2015.

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 in our Headset business and reduce costs, we consolidated certain operational functions in 2016 and completed the closure of certain production operations at one of our contract manufacturing operations in China in 2015.

In September 2016, we announced actions intended to significantly reduce HyperSound business operating expenses while pursuing strategic alternatives and evolving the business to a licensing model.

Interest Expense

Interest expense increased \$2.3 million for the year ended December 31, 2016 primarily due to \$1.6 million of additional interest related to the Term Loan Due 2019 and the Subordinated Notes, and non-cash amortization of related debt issuance costs.

Interest expense decreased \$2.1 million for the year ended December 31, 2015 primarily due to the write-off of \$2.2 million of unamortized debt issuance costs related to the refinancing of our credit facility in the comparable period. Excluding this item, interest expense increased \$0.1 million as additional interest related to the issuance of the Term Loan Due 2019 and subordinated notes offset by savings associated with rate reductions and lower average

borrowings on our revolving line of credit.

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Income Taxes

Income tax benefit for the year ended December 31, 2016 was \$0.4 million at an effective tax rate of 0.4% compared to income tax expense of \$2.4 million for the year ended December 31, 2015 at an effective tax rate of (3.0)%. The effective tax rate was primarily impacted by the full valuation allowance on domestic earnings, foreign entity tax benefits and certain state tax expense.

Income tax expense for the year ended December 31, 2015 was \$2.4 million at an effective tax rate of (3.0)% compared to income tax benefit \$6.3 million for the year ended December 31, 2014 at an effective tax rate of 28.8%. 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 and the establishment of a valuation allowance on all of our deferred tax assets in the United States and the United Kingdom.

Other Non-Operating Expenses

Other non-operating expenses increased for the year ended December 31, 2016 to \$2.4 million due to negative effect if the Brexit vote on exchange rates as it relates to our United Kingdom operations.

Liquidity and Capital Resources

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

The following table summarizes our sources and uses of cash:

	2016	2015	2014
	(in thousands)		
Cash and cash equivalents at beginning of period	\$7,114	\$7,908	\$6,509
Net cash used for operating activities	(1,830)	(15,133)	(14,834)
Net cash provided by (used for) investing activities	(3,229)	(6,693)	557
Net cash provided by financing activities	4,213	21,134	15,969
Effect of foreign exchange on cash	(85)	(102)	(293)
Cash and cash equivalents at end of period	\$6,183	\$7,114	\$7,908

Operating activities

Cash used for operating activities for the year ended December 31, 2016 was \$1.8 million, a decline of \$13.3 million as compared to \$15.1 million for the year ended December 31, 2015. The year-over-year decrease is primarily the result of certain operational actions to lower net cash burn in the HyperSound business and better align costs with our revenue, and increased Headset cash flows on the strength of our new-gen portfolio, product cost improvements and certain operating expense cost reduction efforts.

Cash used for operating activities for the year ended December 31, 2015 was \$15.1 million compared to \$14.8 million for the year ended December 31, 2014. The year-over-year increase is primarily the result of lower net income adjusted for non-cash expenses and higher year-over-year payments of accounts payable due to incremental expenses incurred in connection with the launch of the HyperSound Clear 500P product. These impacts were offset, in part, by the valuation allowance recorded on the Company's deferred tax assets.

Investing activities

Cash used for investing activities was \$3.2 million during the year ended December 31, 2016 compared to \$6.7 million in 2015, primarily due to lower capital expenditures compared to certain tooling purchases in connection with the expansion of our headset portfolio and the initial production line for HyperSound Clear 500P in the prior year. In 2016, capital expenditures primarily related to interactive display purchases and certain website costs.

Cash used for investing activities was \$6.7 million during the year ended December 31, 2015 compared to cash provided by

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investing activities of \$0.6 million in 2014, which included \$4.1 million of cash acquired in the Merger. Capital expenditures increased \$3.2 million compared to the prior year to \$6.7 million primarily due to expenditures on tooling related to the expansion of our headset portfolio and the initial production line for HyperSound Clear 500P as well as interactive display purchases in connection with our initial international headset display units.

Financing activities

Net cash provided by financing activities was \$4.2 million during the year ended December 31, 2016 compared to \$21.1 million and \$16.0 million during the years ended December 31, 2015 and 2014, respectively. Financing activities in 2016 included \$6.0 million of proceeds from the sale of common stock and net borrowings on our revolving credit facilities of \$3.4 million, partially offset by \$4.0 million of term loan repayments and \$1.2 million in debt issuance costs related to recent debt amendments.

Financing activities in 2015 included the issuance of a \$15 million term loan and \$16.3 million principal amount of subordinated notes, partially offset by repayments of term loans and net payments on our revolving credit facilities of \$8.8 million.

Financing activities in 2014 included \$37.2 million of proceeds from the sale of common stock, the issuance of \$7.0 million principal amount of subordinated notes and a \$7.7 million term loan borrowing partially offset by (i) net payments on our revolving credit facilities of \$2.9 million, (ii) repayment of our \$14.5 million legacy term loan and (iii) repayment of \$18.5 million of outstanding subordinated notes.

Management assessment of liquidity

Management believes that our current cash and cash equivalents, the amounts available under our revolving credit facility, the impact of the proceeds from our recent financings and cash flows derived from operations will be sufficient to meet anticipated cash needs for working capital and capital expenditures for at least the next 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.

We believe the combination of our revolving credit facility, long-term debt and cash flow generated by our gaming headset business and reduced costs related to the HyperSound business will provide the necessary liquidity to fund our annual working capital needs.

Foreign cash balances at December 31, 2016 and December 31, 2015 were \$0.2 million and \$0.2 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 December 31, 2016, interest rates

for outstanding borrowings were 5.25% for base rate loans and 3.21% 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 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.

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.

On November 2, 2015, the Company entered into a sixth amendment (the "Sixth Amendment") to the Credit Facility pursuant to which Bank of America and the lenders amended certain provisions of the Credit Facility to, among other things, modify certain provisions to provide (i) that the Company will make certain periodic reports with respect to certain financial metrics and (ii) that the loan availability is decreased by an additional block.

On December 1, 2015, in connection with the sixth amendment, the Company amended the definition of EBITDA to exclude certain non-recurring expenses and replaced certain financial covenants by amended EBITDA levels each month beginning with the month ended December 31, 2015 through (and including) the month ending March 31, 2017 (with revised financial covenants to be agreed upon based on new financial projections after such date) on both an overall and segment-by-segment basis.

On February 1, 2016, the Company further amended certain provisions of the Credit Facility to, among other things, provide that, on or prior to February 5, 2016, the Company receive net proceeds of not less than \$6.0 million of additional equity capital or additional third lien debt financing and apply such proceeds against the outstanding principal balance of the working capital line of credit, amend the definition of EBITDA to exclude certain non-recurring expenses and replace certain financial covenants by amended EBITDA levels. The Company satisfied its paydown obligation with the proceeds from the Offering and private placement. Refer to Note 2, "Equity Offering and Private Placement" for further details.

On June 17, 2016, the Company amended certain provisions of the Credit Facility to, among other things, temporarily reduce the existing loan availability blocks, maintain certain cash flow levels with respect to its HyperSound division during each rolling four week period through the period ending October 28, 2016 and make certain periodic reports with respect to certain financial metrics.

On October 31, 2016, in connection with the recently announced HyperSound business restructuring, the Company amended certain provisions to provide, among other things, that (i) the existing loan availability blocks be permanently reduced during certain specified periods, (ii) replaced certain financial covenants determined on a segment-by-segment basis by amended EBITDA levels for the Headset business beginning with the month ended October 31, 2016, (iii) the Company maintain revised cash flow levels, in the aggregate and with respect to its HyperSound segment, during each rolling four week period beginning with the period ended October 31, 2016 through December 31, 2018 and September 30, 2017, respectively, and (iv) in the event the Company's availability is less than certain specified amounts, obtain additional funding from the issuance of a subordinated promissory note provided by SG VTB (the "Promissory Note").

As of December 31, 2016, the Company was in compliance with all the amended financial covenants, and excess borrowing availability was approximately \$11.0 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 to permit the repayment of \$7.7 million of then existing subordinated debt and accrued interest with the proceeds thereof with Bank of America to enter into an

additional loan (the “Term Loan”). The Term Loan 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, including a six month waiver and ending on October 1, 2018. As of December 31, 2016, the outstanding principal balance was \$3.6 million.

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, we are 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, inclusive of a nine month waiver, 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 (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, 2018, (iii) not making capital expenditures in excess of \$11 million in the year ending December 31, 2015 and in excess of \$5 million in each of the years ending December 31, 2016, 2018 and 2019 and in excess of \$5.5 million in the year ending December 31, 2017, (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.

On February 1, 2016, the Company entered into a third amendment (the “Term Loan Amendment”) to the Term Loan Due 2019 to, among other things, amend the definition of EBITDA to exclude certain non-recurring expenses and replace certain financial covenants by amended EBITDA levels each month beginning with the month ended December 31, 2015 and on a trailing twelve-month period basis beginning with the period ending October 31, 2016, through the termination date on both an overall and segment-by-segment basis.

On June 17, 2016, the Company entered into a fourth amendment to the Term Loan Due 2019 to, among other things, temporarily reduce the existing loan availability blocks, maintain certain cash flow levels with respect to its HyperSound division during each rolling four week period through the period ending October 28, 2016 and make certain periodic reports with respect to certain financial metrics.

On October 31, 2016, in connection with the recently announced HyperSound business restructuring, the Company amended certain provisions to provide, among other things, that (i) the existing loan availability blocks be permanently reduced during certain specified periods, (ii) replaced certain financial covenants determined on a segment-by-segment basis by amended EBITDA levels for the Headset business beginning with the month ended October 31, 2016, (iii) the Company maintain revised cash flow levels, in the aggregate and with respect to its HyperSound segment, during each rolling four week period beginning with the period ended October 31, 2016 through December 31, 2018 and September 30, 2017, respectively, and (iv) in the event the Company's availability is less than certain specified amounts, obtain additional funding from the issuance of a subordinated promissory note provided by SG VTB (the “Promissory Note”).

As of December 31, 2016, the Company was in compliance with the amended financial covenants, and outstanding principal balance was \$10.7 million.

Subordination Agreement

On November 16, 2015, as a condition precedent to our lenders permitting certain subordinated notes, we entered into a subordinated agreement with and between certain parties that our obligations under any such notes would be subordinated in right of payment in full of all the Company's obligations under the Credit Facility and Term Loan Due 2019.

Subordinated Notes - Related Party

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 \$13.8 million obligation of the Company under the Amended Notes is 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 in 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.

On November 16, 2015, the Company issued a \$2.5 million subordinated note (the "November Note") to SG VTB, the proceeds of which, as set forth in the amendment to the Term Loan Due 2019, were applied against the outstanding balance of the Term Loan Due 2019. The November Note will bear interest at a rate of 15% per annum until its maturity date, which is September 29, 2019, and is subordinated to all senior debt of the Company. In connection with the November Note, the Company issued a warrant to purchase 1.4 million shares of the Company's common stock at an exercise price of \$2.00 per share.

On October 31, 2016, in connection with certain amendments to the Credit Facility and Term Loan Due 2019, the Company and SG VTB entered into the Promissory Note, which states that in the event the Company's availability under the Credit Facility is less than certain specified amounts, the Company may, upon request, at any time until September 29, 2019 require that SG VTB provide a \$2 million subordinated loan. Upon issuance, the loan would bear interest at a rate of either (i) LIBOR plus 10.5% per annum or (ii) 12.0%, dependent upon the Company's compliance with certain financial covenants and would be subordinated to all senior debt of the Company. Concurrent with entering into the November Note and Third Lien Guaranty, the Company also issued to SG VTB a warrant to purchase 1.4 million shares of the Company's common stock at an exercise price of \$2.00 per share.

In addition, under the terms of the Promissory Note, if and when the funding occurs, as additional consideration the Company would issue to SG VTB a warrant, exercisable for a period of ten years beginning on the date of issuance, to purchase an amount of shares of the Company's common stock equal to 2.4% of the Company's then fully diluted shares outstanding at an exercise price equal to the closing price on that date. The warrant would not entitle the holder to any voting rights or other rights as a stockholder of the Company prior to exercise.

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 (as defined in VTBH's Certificate of Incorporation) at its original issue price of \$12.425371 per share plus any accrued but unpaid dividends. The redemption value was \$17.5 million and \$16.1 million as of December 31, 2016 and December 31, 2015, respectively.

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.

Based on the above, we have determined that our most critical accounting policies are those related to revenue recognition and sales return reserve, inventory valuation, asset impairment, and income taxes.

Revenue Recognition and Sales Return Reserve

Revenue is recognized when products are shipped and title has been transferred to a customer, the sales price is fixed and determinable, and collection is reasonably assured. Product is considered delivered to the customer once it has been shipped and title and risk of loss have been transferred. Net revenue for on-line purchases is recognized when products are shipped from our distribution facilities.

Provisions for cash discounts, quantity rebates, and sales returns in the period the sale is recorded, based upon our prior experience and current trends, as a reduction of revenue. These revenue reductions are established based upon management's best estimates at the time of sale following the historical trend, adjusted to reflect known changes in the factors that impact such reserves and allowances, and the terms of agreements with customers.

Inventory Valuation

Inventories are valued at the lower of weighted average cost or market, at the individual item level. Market is determined based on the estimated net realizable value, which is generally the selling price. Inventory levels are monitored to identify slow-moving items and markdowns are used to clear such product. Physical inventory counts are performed annually in January and estimates are made for any shortage between the date of the physical inventory count and the balance sheet date.

Asset Impairment

We have significant long-lived tangible and intangible assets, including goodwill with indefinite lives, which are susceptible to valuation adjustments as a result of changes in various factors or conditions. We assess the potential impairment of intangible and fixed assets 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 values may not be recoverable. Factors we consider important, which could trigger an impairment of such assets include significant underperformance relative to historical or projected future operating results; significant changes in the manner of or use of the acquired assets or the strategy for our overall business; significant negative industry or economic trends; significant decline in our stock price for a sustained period; and a decline in our market capitalization below net book value.

Management estimates future pre-tax cash flows based on historical experience, knowledge and market data.

Estimates of future cash flows require that we make assumptions and apply judgment, including forecasting future sales and expenses and estimating useful lives of the assets. These estimates can be affected by factors such as future product development and economic conditions that can be difficult to predict, as well as other factors such as those outlined in "Risk Factors." If the expected future cash flows related to the long-lived assets are less than the assets' carrying value, an impairment loss would be recognized for the difference between estimated fair value and carrying value.

There are inherent assumptions and estimates used in developing future cash flows requiring management judgment including projecting revenues, interest rates and the cost of capital. Many of the factors used in assessing fair value are outside our control and it is reasonably likely that assumptions and estimates will change in future periods. These changes can result in future impairments.

In connection with the Merger, the Company performed a valuation of the acquired goodwill and intangible assets and recorded \$81.0 million of goodwill based on the fair values of the assets acquired and liabilities assumed. As a result of the annual impairment assessment as of November 1, 2015, the Company recorded a \$49.8 million goodwill impairment charge, which resulted in a \$31.2 million remaining carrying value as of December 31, 2015. The goodwill impairment was attributed to planned revenues reflective of certain operational decisions, including a slower roll-out to ensure customer satisfaction, an increase to the risk factor that is included in the discount rate used to calculate the discounted cash flows and continued deterioration of the stock price.

During 2016, as a result of the shortfall versus plan and capital intensive nature of the rollout, we concluded that indicators of potential goodwill impairment were present and based on the two-step impairment test, recorded goodwill and other intangibles charges of \$63.2 million, which resulted in no remaining carrying value as of December 31, 2016. Refer to Note 1, "Summary of Significant Accounting Policy" for further details.

Income Taxes

We account for income taxes using the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized based on the differences between the financial statement carrying value of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates and laws expected to be in effect when the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date. Inherent in the measurement of these deferred balances are certain judgments and interpretations of existing tax law and other published guidance as applied to our operations. Our effective tax rate considers our judgment of expected tax liabilities in the various jurisdictions within which we are subject to tax.

The determination of the need for a valuation allowance on deferred tax assets requires Management to make assumptions and to apply judgment, including forecasting future earnings, taxable income, and the mix of earnings in the jurisdictions in which we operate. During 2015, 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 tax effects of uncertain tax positions taken or expected to be taken in income tax returns are recognized only if they are “more likely-than-not” to be sustained on examination by the taxing authorities, based on the technical merits as of the reporting date. The tax benefits recognized in the financial statements from such positions are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. We recognize estimated accrued interest and penalties related to uncertain tax positions in income tax expense.

We are currently under examination by certain state and local taxing jurisdictions. Further, at any given time, multiple tax years may be subject to examination by various taxing authorities. The recorded amounts of income tax are subject to adjustment upon examination, changes in interpretation and changes in judgment utilized in determining estimates. See Note 1, “Summary of Significant Accounting Policy,” in the notes to the 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.

Off-Balance Sheet Arrangements

Off balance sheet arrangements are transactions, agreements, or other contractual arrangements with an unconsolidated entity for which we have an obligation to the entity that is not recorded in the consolidated financial statements. As of December 31, 2016, there are no significant off-balance sheet arrangements.

Contractual Obligations

Our principal commitments primarily consist of obligations for minimum payment commitments to leases for office space, redeemable preferred stock and the revolving credit facility. As of December 31, 2016, the future non-cancelable minimum payments under these commitments were as follows:

	Payments Due by Period				
	Total	Less Than One Year	1 - 3 Years	3 - 5 Years	More Than Five Years
Contractual Obligations: (1)					
Operating lease obligations (2)	\$5,135	\$1,663	\$2,824	\$648	—
Series B Redeemable Preferred Stock (3)	51,928	—	—	—	51,928
Long term debt (4)	69,676	38,552	11,720	19,404	—
Interest payments on long-term debt (5)	12,181	1,340	579	10,262	—
Total	\$138,920	\$41,555	\$15,123	\$30,314	\$51,928

(1) Contractual obligations exclude tax liabilities of \$1.5 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 its facilities.

(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. Long term debt includes scheduled principal payments only. See Note 7, “Credit Facilities and Long-Term Debt” for further information.

(5) These amounts reflect estimated interest payments under our outstanding long-term debt agreements based on the applicable rates in effect as of December 31, 2016, except for interest payments under our Credit Facility because the amount that will be borrowed in future years is uncertain.

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Item 7A - Qualitative and Quantitative Disclosures about Market Risk

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

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 December 31, 2016, we do not have any derivative financial instruments.

Interest Rate Risk

The Company's total variable rate debt is comprised of \$35.9 million outstanding under the Credit Facility, \$14.4 million presented as term loans and \$16.5 million of Subordinated Notes. A hypothetical 10% increase in borrowing rates at December 31, 2016 would have resulted in a \$0.3 million annual increase in interest expense on the existing principal balance.

Foreign Currency Exchange Risk

The Company has exchange rate exposure, primarily, with respect to the British Pound. As of December 31, 2016, 2015 and 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 8. Financial Statements and Supplementary Data

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Turtle Beach Corporation
San Diego, California

We have audited the accompanying consolidated balance sheets of Turtle Beach Corporation as of December 31, 2016 and 2015 and the related consolidated statements of operations, comprehensive loss, convertible preferred stock and stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2016. In connection with our audits of the financial statements, we have also audited the financial statement schedule listed in the accompanying index. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedules. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Turtle Beach Corporation at December 31, 2016 and 2015, and the results of its operations and its cash flows for the years in the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ BDO USA, LLP
Stamford, Connecticut
March 8, 2017

Turtle Beach Corporation
Consolidated Balance Sheets

	December 31, 2016	December 31, 2015
	(in thousands, except par value and share amounts)	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$6,183	\$ 7,114
Accounts receivable, less allowances for \$12,783 and \$13,829 in 2016 and 2015, respectively	54,633	57,192
Inventories	21,698	26,146
Prepaid income taxes	—	260
Prepaid expenses and other current assets	4,121	4,191
Total Current Assets	86,635	94,903
Property and equipment, net	4,311	6,859
Goodwill	—	31,152
Intangible assets, net	1,618	37,956
Deferred income taxes	543	—
Other assets	1,693	1,590
Total Assets	\$94,800	\$ 172,460
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current Liabilities:		
Revolving credit facilities	\$35,905	\$ 32,453
Term loans	2,647	4,814
Accounts payable	11,927	17,680
Other current liabilities	16,414	14,236
Total Current Liabilities	66,893	69,183
Term loans, long-term portion	10,442	12,174
Series B redeemable preferred stock	17,480	16,145
Deferred income taxes	—	4
Subordinated notes - related party	17,881	15,365
Other liabilities	2,800	2,937
Total Liabilities	115,496	115,808
Commitments and Contingencies		
Stockholders' Equity		
Common stock, \$0.001 par value - 100,000,000 shares authorized; 49,251,336 and 42,529,502 shares issued and outstanding as of December 31, 2016 and 2015, respectively	49	43
Additional paid-in capital	146,615	136,693
Accumulated deficit	(166,800)	(79,618)
Accumulated other comprehensive loss	(560)	(466)
Total Stockholders' Equity (Deficit)	(20,696)	56,652
Total Liabilities and Stockholders' Equity (Deficit)	\$94,800	\$ 172,460

See accompanying Notes to the Consolidated Financial Statements

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Turtle Beach Corporation
Consolidated Statements of Operations

	Year Ended		
	December 31, 2016	December 31, 2015	December 31, 2014
	(in thousands, except share and per share data)		
Net Revenue	\$ 173,978	\$ 162,747	\$ 186,176
Cost of Revenue	131,368	122,056	135,509
Gross Profit	42,610	40,691	50,667
Operating expenses:			
Selling and marketing	28,572	31,829	33,442
Research and development	8,259	11,556	9,400
General and administrative	19,580	21,484	17,159
Goodwill and other intangible asset impairment	63,236	49,822	—
Restructuring charges	664	399	747
Business transaction costs	—	—	3,744
Total operating expenses	120,311	115,090	64,492
Operating loss	(77,701)	(74,399)	(13,825)
Interest expense	7,447	5,099	7,209
Other non-operating expense, net	2,421	1,016	724
Loss before income tax expense (benefit)	(87,569)	(80,514)	(21,758)
Income tax expense (benefit)	(387)	2,393	(6,272)
Net loss	\$(87,182)	\$(82,907)	\$(15,486)
Net loss per share :			
Basic	\$(1.79)	\$(1.96)	\$(0.39)
Diluted	\$(1.79)	\$(1.96)	\$(0.39)
Weighted average number of shares:			
Basic	48,592	42,269	39,665
Diluted	48,592	42,269	39,665

See accompanying Notes to the Consolidated Financial Statements

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Turtle Beach Corporation
 Consolidated Statements of Comprehensive Income (Loss)

	Year Ended		
	December 31, 2016	December 31, 2015	December 31, 2014
	(in thousands)		
Net loss	\$ (87,182)	\$ (82,907)	\$ (15,486)
Other comprehensive income (loss):			
Foreign currency translation adjustment	(94)	(237)	(334)
Other comprehensive income (loss)	(94)	(237)	(334)
Comprehensive loss	\$ (87,276)	\$ (83,144)	\$ (15,820)

See accompanying Notes to the Consolidated Financial Statements

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Turtle Beach Corporation
Consolidated Statements of Cash Flows

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	\$(87,182)	\$(82,907)	\$(15,486)
Adjustments to reconcile net loss to net cash used for operating activities:			
Depreciation and amortization	5,066	5,901	5,800
Amortization of intangible assets	4,128	2,015	1,066
Amortization of deferred financing costs	1,342	360	2,621
Stock-based compensation	3,960	5,897	5,194
Accrued interest on Series B redeemable preferred stock	1,335	1,230	1,203
Paid in kind interest	2,156	947	1,138
Deferred income taxes	(547)	5,414	(9,998)
Provision for (Reversal of) sales returns reserve	(1,677)	2,113	(2,111)
Provision for doubtful accounts	144	2	37
Provision for obsolete inventory	11,414	1,107	532
Loss on disposal of property and equipment	15	76	9
Loss on impairment of HyperSound assets	63,236	49,822	—
Changes in operating assets and liabilities:			
Accounts receivable	4,092	1,752	(10,396)
Inventories	(6,966)	11,147	11,363
Accounts payable	(5,057)	(17,287)	(10,552)
Due to shareholders	—	—	(3,125)
Prepaid expenses and other assets	245	(712)	(212)
Income taxes payable	395	(1,700)	4,704
Other liabilities	2,071	(310)	3,379
Net cash used for operating activities	(1,830)	(15,133)	(14,834)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property and equipment	(3,229)	(6,693)	(3,536)
Cash acquired in business combinations	—	—	4,093
Net cash provided by (used for) investing activities	(3,229)	(6,693)	557
CASH FLOWS FROM FINANCING ACTIVITIES			
Borrowings on revolving credit facilities	208,920	217,644	157,982
Repayment of revolving credit facilities	(205,468)	(222,054)	(160,855)
Repayment of capital leases	(41)	(40)	(34)
Borrowings on term loan	—	15,110	7,692
Repayment of term loan	(4,011)	(4,423)	(14,500)
Repayment of subordinated notes	—	—	(18,481)
Proceeds from sale of common stock, net of issuance costs	5,968	—	37,230
Proceeds from exercise of stock options	—	731	1,618
Debt financing costs	(1,155)	(2,134)	(1,683)
Proceeds from issuance of subordinated notes	—	16,300	7,000
Net cash provided by financing activities	4,213	21,134	15,969
Effect of exchange rate changes on cash and cash equivalents	(85)	(102)	(293)
Net increase (decrease) in cash and cash equivalents	(931)	(794)	1,399
Cash and cash equivalents - beginning of period	7,114	7,908	6,509
Cash and cash equivalents - end of period	\$6,183	\$7,114	\$7,908

SUPPLEMENTAL DISCLOSURE OF INFORMATION

Cash paid for interest	\$2,053	\$1,731	\$3,209
Cash paid for income taxes	\$—	\$16	\$554
Accrual for purchases of property and equipment	\$145	\$841	\$1,420
Value of shares issued to acquire HyperSound business	\$—	\$—	\$113,782
Conversion of Series A Preferred Stock	\$—	\$—	\$24,345
Issuance of warrants	\$—	\$1,983	\$—

See accompanying Notes to the Consolidated Financial Statements

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Turtle Beach Corporation

Consolidated Statement of Convertible Preferred Stock and Stockholders' Equity (Deficit)

	Series A Convertible Preferred Stock Shares Amount (in thousands)		Common Stock Shares Amount		Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Income
Balance at December 31, 2013	48,690	\$24,345	12,700	\$ 13	\$(54,031)	\$ 18,775	\$ 105	\$(35,138)
Net loss	—	—	—	—	—	(15,486)	—	(15,486)
Other comprehensive loss	—	—	—	—	—	—	(334)	(334)
Adjustment for reverse merger			7,275	7	113,775		—	113,782
Conversion of Series A Preferred	(48,690)	(24,345)	17,527	18	24,327		—	24,345
Cashless exercise of warrants	—	—						