

## **Turtle Beach Q3 FY14 Earnings Call Script**

### **Turtle Beach Corporation**

### **3Q FY2014 Prepared Comments**

**November 10, 2014**

Turtle Beach is providing a copy of these prepared remarks in combination with its press release to provide shareholders and analysts with additional time and detail for analyzing our results in connection with our quarterly conference call. As previously scheduled, the conference call was held on November 10, 2014 and included comments by Turtle Beach's management team followed by questions and answers. To access the broadcast, please visit the Investor Relations section of Turtle Beach's Website at <http://investor.turtlebeachcorp.com/events.cfm>.

### **Anne Rakunas**

Thank you. Good afternoon everyone and welcome to the Turtle Beach Corporation third quarter fiscal 2014 earnings call to discuss the financial results. Before we get started, we will be referring to the press release filed today with details of the results which can be downloaded from the investor relations page of our website at [corp.turtlebeach.com](http://corp.turtlebeach.com). In addition, we posted a supplemental slide presentation to accompany our remarks which is also available on our IR website. Shortly after we end this call, a recording of the call will be available as a replay in the Investor Relations section of the Company's website.

Please be aware that some of the comments made during our call may include forward-looking statements. They involve risks and uncertainties regarding our operations and future results that could cause Turtle Beach Corporation's results to differ materially from management's current expectations. We encourage you to review the Safe Harbor statements contained in today's press release and on our filings with the Securities and Exchange Commission, including, without limitation, our Annual Report on Form 10-K, our most recent Form 10-Q and our other periodic reports, as well as our proxy statement on Schedule 14A filed with the SEC on April 24, 2014, which identify specific risk factors that may cause actual results or events to differ materially from those described in forward-looking statements.

We also note this call contains non-GAAP financial information. Providing that information as a supplement to information prepared in accordance with accounting principles generally accepted in the United States, or GAAP. You can find a reconciliation of these metrics to our reported GAAP results in the reconciliation table provided in today's earnings release.

And now, I'll turn the call over to Juergen Stark, the Company's Chief Executive Officer.

## **Juergen Stark**

Thank you and thanks everyone for joining us on the call today. With me is John Hanson, our Chief Financial Officer. We are excited to be with you today to share the continued progress we have made in the third quarter to advance the growth of our Company. As we typically do, I will cover the business highlights, John will cover the financial performance and outlook, and then we will open up the call to take your questions.

Our main objective over the past few months was to ensure that our next generation headsets featuring several first and only innovations were ready and on retail shelves ahead of the holiday season. Our teams worked incredibly hard to achieve this difficult task which, due to the new console launches, required product development times far shorter than normal. Adding to the accomplishments was the fact that we developed more advanced headsets than ever before and more new designs in total than we did in the previous two years combined. We also developed more firmware than the previous 5 years combined to power our innovations. Indeed, going into the holidays, it looks like we are the only player to introduce some amazing new capabilities like headphones featuring DTS Headphone:X 7.1 channel surround sound and the only fully wireless headset for the Xbox One. This is what it takes to be the best in our industry and to provide gamers with the immersive experience and competitive advantages no one else can. Introducing major new features in the middle of a console transition was not easy, and we did experience a couple weeks of delays as we finalized our two high-end products which moved some revenue into Q4. But it provided us with a strong first mover advantage in the first year of the new consoles that we believe we can sustain through the coming years as the new generation consoles continue to take off. I'm extremely pleased with how we've executed and give a big Thank You to our team for these accomplishments. We know that the gamers out there also really appreciate it!

As we expressed on our earnings call back in March, the positive benefits for our business from the new consoles will take some time to develop but should provide several years of good growth. Given the fluid environment we are operating in this year, especially the uncertainty around the timing of new AAA multiplayer game launches, our focus is on successfully executing the key action items under our control to set the company up for long-term growth. Let me start by covering those key executional objectives and then discuss how the broader console headset market is developing.

- First and foremost, launching the best and broadest selection of next generation console headsets. Done.
- Second, strengthening our retail relationships and in-store experience. Done.
- Third, expanding our PC gaming business. Done.

- Fourth, growing our international market share. Done.
- And Fifth, achieving HyperSound's first large scale commercial deployment and preparing for the launch of hearing health. Done and progressing well on hearing health.

Beginning with our core gaming headset business, we have by far the deepest and most advanced line of next generation compatible headsets featuring first and only innovations that significantly enhance the user experience. This has and will continue to be the hallmark of Turtle Beach and is what sets us apart from the competition. We call them BFO's...by the way...Best First Only capabilities and you will hear me refer often to our first-and-only innovations. Gamers want the most immersive experience for their games and that's what we deliver.

Just about two weeks ago, we began shipping the Elite 800 for PlayStation®4, our new flagship wireless headset which we believe is the most technologically advanced consumer headset ever produced. The Elite 800 has several firsts for console gaming headsets, including active noise cancellation which improves the quality of outbound chat audio and blocks out external noise so the gaming experience is more immersive. The Elite 800 also uses dual invisible microphones for voice pickup, which provides a sleek, boom-free look that is not available on any competitive gaming headsets.

The Stealth 500X, the first and only truly wireless headset for the Xbox One and our highest pre-ordered wireless headset ever, arrived on shelves last week. This was a significant technological achievement as it required integration with the audio outputs from the Xbox One console, which have changed significantly from the Xbox 360. No other headset provider was able to achieve this.

The Elite 800 and Stealth 500X are also the first and only console gaming headsets to utilize DTS Headphone:X 7.1 channel surround sound which is the most accurate and realistic surround sound available on the market today. Both models reinforce Turtle Beach's leadership position in wireless headsets which are preferred by gamers because of the freedom of movement and flexibility they provide.

With these two headsets, we have also reentered the high-tier gaming headset segment above \$200, where we have been largely absent with new models since early 2013 due to the console transition. It didn't make sense to launch new high-tier products for previous generation consoles so we waited until new console specs were clear and known, and have now launched two amazing headsets with innovations and capabilities nobody else has.

Rounding out our holiday lineup we recently introduced a number of additional products such as the Stealth 500P which features DTS Headphone X at an great price of \$129, the XO One for Xbox One and the Stealth 400 for PS4 which expand our sub \$100 line-up. We also added to our growing licensed

product portfolio which began with Titanfall earlier this year and now includes Call of Duty: Advanced Warfare, Disney Infinity, Star Wars and Heroes of the Storm.

As of today, we have launched 5 PlayStation 4 compatible headsets and 8 Xbox One compatible headsets. Having a broad portfolio of leading next generation headsets on shelves ahead of the holiday season was our number one priority and I'm extremely pleased with how well our teams executed on this front. Our ability to achieve this important objective has helped further strengthen our retail relationships and provided us with even greater in-store placement for our key products. We have increased the number of interactive displays...or kiosks as we call them...in the channel by 2,000 to almost 18,000 this year and now have retail kiosks with all of our major retail partners, including Best Buy, GameStop, Walmart, and Target and the similar strong retailers in Europe. Our interactive kiosks do a great job showcasing the differentiated features of our headsets and provide a strong competitive advantage at the point of sale. Net net, we are exactly where we want and expected to be in terms of retail coverage prior to holiday.

Another major milestone was the establishment of distribution in China, where we were the first and only third party console headset brand on shelves when Microsoft launched Xbox One in late September. Game play in China has historically been dominated by mobile and online PC due to regulations that prohibited console sales until September of this year. With an estimated 500 million people playing games annually, we believe this market represents a good long-term growth opportunity for our gaming headset business. Like any market, this opportunity will take time to develop and we'll need major multiplayer games to launch in China before we can properly gauge our near-term prospects.

This year was also about growing our PC business, especially overseas where PC gaming is very popular, including China, Germany, the Nordics, Eastern Europe and Russia. I am pleased to report that our PC business is up over 75% versus last year based on our expanded portfolio and successful market efforts.

Taking a page from our console headset playbook, we introduced the Ear Force Z60, the first and only PC gaming headset to offer DTS Headphone:X 7.1 channel surround sound and with 60mm speakers that deliver an expansive soundscape and bone-rattling bass. A couple more Best, First, Only achievements. The Z60 began shipping in September and is available in more than a dozen countries in North America and Europe. We'll also be introducing a number of PC gaming headsets in China including the Heroes of the Storm licensed models soon. We believe that a full line-up of products at retail that include gaming headsets, keyboards, and mice is needed to gain share in the PC gaming market. To achieve this we signed a licensing agreement with NGS, our long-time distribution partner in Europe, for the development of Turtle Beach branded PC gaming keyboards, mice, and gaming mouse pads. These

products reflect the level of quality consumers expect from us. The first products just shipped to retailers in the Nordics and Germany and will soon be available online in the U.S. and U.K.

Turning to Hypersound, 2014 has been a year of investment, integration, and a focus on beginning the serious commercialization of this unique technology. We continue to be very excited about the prospects for HyperSound in multiple segments. Recall that we are targeting applications for retail displays and business uses of HyperSound that we call "Virtual Reality Audio" as well as a 2015 launch of a product for the hearing health segment. I stated that a key milestone for the commercial side of this business was to achieve a large-scale, brand-name showcase launch. I'm pleased to report that we've now done that.

As we announced last week, HyperSound's virtual reality audio solution has been implemented in Activision's Call of Duty: Advanced Warfare retail displays at 987 Best Buy locations in North America. This is really the first, large-scale deployment of HyperSound that is optimized for retail. For those of you who haven't had the chance to experience HyperSound in a retail installation like this, audio emitters are integrated into the base of the retail display to create a zone of audio that encompasses anyone standing in front of the display. The quality of the audio is three dimensional, creating a virtual reality effect that is similar to wearing a surround sound headset. Best, First, Only in the form of a whole new way for retail to immerse consumers in product displays. This is just the beginning for our commercial market development. We are in discussions with other high profile U.S. retailers and brands to secure meaningful installations of HyperSound, designed to raise the visibility of HyperSound as a beneficial commercial retail marketing solution.

We are also making good progress towards a 2015 launch of a living room audio product that uses the benefits of HyperSound to enable people who are hard of hearing to better understand and enjoy TV, music, and other media. We remain on target to introduce our second generation HyperSound product which benefits from several fundamental advancements, including doubling emitter efficiency as well as enabling a \$40 reduction in materials cost per emitter. Our teams have also made major advancements in the amplifier and digital signal processing technology which further improve audio quality. This work has led to a slew of new patents filed, further strengthening our robust intellectual property portfolio. This generation two system is now fully functional and will be demo'd at an investor event next week.

Within our HyperSound operations, I've stated that we would begin to build a team with expertise in the healthcare and hearing industry to put together a distribution, pricing, and marketing strategy and drive this business going forward. We've now done that. In October, we appointed Rodney Schutt as SVP and General Manager of HyperSound. Rodney brings 27 years of relevant experience in hearing health and medical devices including recently serving as President & CEO of both Unitron Hearing and Widex, two of the world's leading hearing aid companies. Rodney's addition is a major endorsement of the benefits of this technology and he's already had a big impact on our product and channel preparations for next year.

Rodney just completed a 2 week road-show with potential channel partners and the feedback has been tremendous. We continue to be very excited about this pending product launch and the positive impact it can have for the over 40 million people in the US alone who are hard of hearing.

As I look across our gaming headset and HyperSound businesses, we've executed well and are on track to meet the key objectives we set at the beginning of the year. To summarize:

- We were first to market with a broad portfolio of feature rich gaming headsets for the Xbox One and Playstation 4 which should enable us to maintain our strong market share in the U.S. and U.K. and post continued gains in each of our emerging markets.
- We've expanded our already leading floor and shelf space with our major gaming and consumer electronics retailers ahead of the holidays.
- We've introduced innovative new PC gaming headsets and accessories that have increased our penetration of the domestic and international PC gaming markets.
- And we've begun to successfully commercialize HyperSound and prepared that business for accelerated growth next year.

Let me now turn to how the surrounding console gaming market has evolved and our headset market expectations for the rest of 2014 at this point. In particular I'd like to discuss game launches and attach rates, which we also referenced last quarter.

Multiplayer game titles are a major driver of gaming headset sales. For example, when Activision launched Destiny in September, we saw average weekly sell through of some relevant headset models go up more than threefold and stay at a higher than average rate for several weeks. There is a great line-up of multiplayer games that are now launching which we expect will drive up attach rates significantly. However, the launch dates of some major titles like Evolve for example, have recently been moved to 2015. In one way, that is good for us because it spreads some traffic and potential related increases in headset sales into 2015, but it will also negatively impact traffic and sales vs. our initial expectations in 2014.

On attach rates, I went through a lot of detail during the last call and signaled 2 major trends that had started to raise our concern about overall console headset market growth this year. The first was the unexpected widespread release, availability, and purchase of the stand-alone Microsoft adapter which essentially enables consumers to utilize previous generation headsets with the Xbox One. The second was overall attach rates on new consoles running somewhat below our expectations. Both of these trends have continued and in fact resulted in an overall console gaming headset market that is slightly down year-over-year in the US, dropping 1.4 percent through the third quarter according to sales tracking data

from The NPD Group. One bright spot is that the attach rate on PS4 has now started to climb but our best estimates still put it below our initial expectations coming into the year.

It is very important to note that we expect roughly 40% of console gaming headset sales to happen in November and December and many of the multiplayer games are just launching. Plus we just launched many of our new headsets with some compelling features and given our strength in the market, the Turtle Beach headsets alone can impact these overall market trends. So while I believe we have about as sophisticated a way to model attach rates and their impact on the overall market as anybody, these estimates could change materially as we move through the holidays.

It is important to note that the impact of these market dynamics is not limited to Turtle Beach. The attach rate affects the entire gaming headset industry. However, given that we are roughly half of the market in the US, overall market trends matter more to us and impact us more than it might impact companies with very small share or a share in a small portion of the market. That is why we are providing visibility into these market trends and putting effort into projecting them. We asked IDG, one of the well-known research companies covering the gaming segment to give us their independent expectations for 2014 console gaming headsets and they have confirmed our sense that the trend is flat to down slightly. While we remain very confident about the long-term growth of the gaming headset industry and in our ability to capitalize on that growth with the great product line-up we have, we believe it is prudent to revise our sales expectations for the fourth quarter of fiscal 2014 given the lower attachment rates experienced thus far. John will go through the details but we believe that even in a flat market we'll show growth and we expect a Q4 that is up nicely over last year.

In addition to our revised sales forecast, we've also incurred additional costs to expedite some shipments of new headsets. In addition, we've been forced to pay expedited shipping costs due to the congestion at the Long Beach/Los Angeles port complex which is delaying the arrival of deliveries by up to 9 days. The West Coast port situation is very problematic for all goods coming in for the holidays and we are continuing to monitor and mitigate on a day to day basis. John will discuss how this has affected our costs and has been factored into our revised earnings estimates shortly.

Overall the gaming industry is vibrant and growing, and our revised expectations reflect a shift in timing and not a change in our overall long-term outlook. We are excited about the opportunities we see before us to grow our headset business for a number of key reasons.

First, new generation console sales continue to be very strong. Sony recently announced they've sold 13.5 million PlayStation 4's since the new console launched last November while Microsoft disclosed it has sold 7.0 million Xbox One's during the same timeframe. Based on these results, DFC Intelligence recently increased their forecasts for both PS4 and Xbox One to 18.3 million and 12.2 million units sold, respectively by the end of 2014. These figures exceed the initial projections from a year ago but represent

less than 20% of the cumulative sales expected by the time next generation consoles demand peaks in 2018. Said another way – we have more than 80% of next generation console sales still ahead of us. And as the new generation consoles sales increases begin to overtake old generation console sales reductions, accessory sales will benefit accordingly. That is why our core focus is on launching the right products and continuing to lead in innovation, at retail, and with gamers. Despite the somewhat slower start for the overall industry than we expected, we feel that that our early progress on these fronts will pay dividends over the longer-term.

Second, even with the change in some schedules, there are 9 major multiplayer releases in the fourth quarter compared to only three in the first three quarters of 2014. This includes last week's Call of Duty: Advanced Warfare and tomorrow's Halo: Master Chief Edition to name a couple, all of which we expect to drive retail traffic and gaming headset purchases. Not just in Q4 but next year as well.

Third, we believe our new next gen console headsets have differentiated features with compelling value propositions that will help drive headset sales including over the stand-alone Microsoft adapters, and increase attach rates as consumers head into the stores over the holidays. To the extent that the stand-alone adapter has provided a bridge for some consumers to use old headsets, we do believe they will ultimately buy a new headset for their new consoles. It's just a matter of time. So we continue to expect attach rates to rise over time with Xbox One reaching the mid-20s or higher and PlayStation 4 eventually reaching at least the low 20's if not ultimately catching up to Xbox One as that platform attracts more multiplayer gaming. As I mentioned, we are encouraged to see this Playstation 4 attach rate uptick begin.

We are still very early on in a multiyear console cycle with significant opportunity ahead of us to grow our gaming headset business. Given the somewhat slow start, we asked IDG to also give us an independent view for next year and they've indicated they expect year-over-year growth in console gaming headsets for 2015. I am confident that we are well positioned to take advantage of that opportunity.

I'll now turn the call over to John for a review of the financials.

**John Hanson**

Thanks Juergen.

In my presentation I will be discussing the combined results for the third quarter as well as the first nine months of 2014 which we believe is the better barometer of our overall recent performance due to the timing of the Xbox One rollout in Q1 2014. Q3 also tends to have a high velocity of shipments at the end of September which can easily move millions of dollars between Q3 and Q4 based on a few days difference in retail ordering or timing of specific product launches. So it's important to understand Q3 in the context of Q4 and for this reason I will provide guidance for Q4 later in this presentation. It is

important to note that results for the year-ago period represent Turtle Beach headset business on a standalone basis.

Net revenue totaled \$33.3 million compared to \$38.3 million in the third quarter of 2013. The decrease in revenue was driven by a decline in sales to our Canadian distributor this year that was expected as we were stocking this new distributor in Q3 2013 and realized incremental revenues in Q3 13 as a result. In addition, our two new high-end products were delayed a few weeks moving sales out of Q3 across all of our channels and into Q4. For the first nine months of 2014, revenue increased 1.7% to \$93.9 million, compared with \$92.4 million for the same period a year ago. The increase in revenue was driven by strong consumer response to the Company's Xbox One and Playstation®4 compatible headsets, partially offset by the revenue decline and delays mentioned above for the quarter.

Gross profit for the third quarter was \$7.7 million, compared to \$8.6 million in the same period in 2013. The gross margin percentage increased 70 basis points to 23.3% in the third quarter compared with the same period a year ago primarily due to sales of higher margin headsets and mix of customers compared to the prior year period. For the first nine months of 2014, the gross margin percentage improved by 100 basis points to 26.5% compared with the same period a year ago. Excluding the one-time cost of \$2.8 million earlier this year associated with packing and shipping the Microsoft adapter in time for the Xbox One headset audio and Titanfall game launches, gross margin would have been up 390 basis points to 29.4% for the nine months of 2014 over the same period last year.

Operating expenses in Q3 totaled \$15.1 million, which was a 26.1% increase year over year, due primarily to \$2.5 million of investment in HyperSound, \$1.0 million associated with higher headcount in headset R&D, non-cash expense (depreciation, amortization and stock compensation) of \$0.8 million and public company costs of \$0.7 million, partially offset by lower business transaction expenses of \$1.6 million. For the first nine months of 2014, operating expenses, excluding \$3.7 million and \$2.3 million in business transaction costs in 2014 and 2013 respectively, increased to \$42.1 million, compared to \$30.7 million in the same period a year ago. The increase was driven by \$6.7 million of investment in HyperSound, non-cash expense (depreciation, amortization and stock compensation) of \$3.0, \$1.5 million associated with the headcount increase in headset R&D, and public company expenses of \$1.5, partially offset by \$2.2 million of lower marketing expenses.

Adjusted EBITDA in Q3 2014 was a negative \$4.5 million for the combined business as compared to \$0.6 million in 2013. The Adjusted EBITDA decrease was due to lower revenue, our HyperSound investment, public company costs and higher headset operating expenses. The headset business delivered negative adjusted EBITDA of \$1.7 million for the quarter, which compares to adjusted EBITDA of \$0.6 million in 2013. Headset Adjusted EBITDA declined due to the lower revenue level, higher operating expenses partially offset by higher gross profit.

For the first nine months of 2014, adjusted EBITDA on a consolidated basis totaled a negative \$8.4 million, compared to a negative \$1.2 million in 2013. The year over year Adjusted EBITDA decline was driven by the planned \$6.7 million investment in HyperSound and lower Adjusted EBITDA in the headset business. Year to date, the headset business has delivered a negative adjusted EBITDA of \$1.5 million as compared to a negative adjusted EBITDA of \$1.2 million in 2013. The headset Adjusted EBITDA decrease for the nine months ended September 30, 2014 was driven largely by the one-time Microsoft adapter packing and shipping costs incurred in the first half of 2014.

Excluding the nonrecurring Microsoft adapter expenses of approximately \$2.8 million, the headset business substantially improved adjusted EBITDA year over year. The Company has invested approximately \$6.7 million in HyperSound on a year-to-date basis and consistent with our plan.

There were approximately 42 million total shares issued and outstanding as of September 30, 2014.

Please note that we provided a reconciliation of GAAP reported results to adjusted EBITDA in the accompanying tables at the end of the press release we issue today.

Now, turning to the balance sheet as of September 30, 2014, cash and availability under the revolving credit facility totaled \$18.1 million compared to \$6.5 million as of December 31, 2013. Outstanding debt, defined as the revolving credit facility, term loan and subordinated notes decreased 44% or \$28.4 million since December 31, 2013 and is approximately 43% below this time last year. The reduction in debt is driven by lower inventory levels consistent with our plans to improve asset utilization.

Total inventory as of September 30, 2014 was \$46.6 million, a decrease of 25.2% as compared to the same period in 2013 and approximately 6% below year-end 2013. We remain focused on our initiatives to reduce our inventory investment and have made significant progress this year. Moving on, accounts receivable decreased \$6.1 million to \$26.7 million at September 30, 2014 compared to the same period in 2013. Our customers typically pay within terms and our days sales outstanding was approximately 60 days at September 30, 2014 and consistent with our payment terms.

The company has made significant progress this year improving its capital structure and as a final step is looking to pay off the remaining subordinated debt with a long-term debt facility.

Now turning to our outlook.

For the fourth quarter of 2014, we expect net revenue for our headset business to be in the range of \$91 to \$101 million, representing an increase of approximately 12% at the mid-point of the range over the same period a year ago. Adjusted EBITDA for the headset business is expected to be in the range of \$19 to \$21 million, representing an increase of approximately 29% at the mid-point of the range over last year.

Total company fourth quarter adjusted EBITDA is expected to be in the range of \$16 to \$18 million, reflecting the impact of a roughly \$3 million anticipated HyperSound investment.

For the full year, we are revising our outlook to reflect the current view of attach rates and headset industry projections. As we have discussed, we expect the attach rate projected for the year to be lower due to higher stand-alone adapter sales and the delay in a number of multi player games to 2015. These two conditions are projected to cause the console gaming headset industry to be roughly flat to possibly down slightly for the year. We expect our strong portfolio of products and positioning with retailers to deliver growth ahead of the industry but below our initial full year guidance. Again, with roughly 40% of annual sales happening in November and December, these attach and market projections could change significantly. As a result of the lower revenue outlook, we now expect full year adjusted EBITDA to be lower and as Juergen mentioned earlier we have incurred some incremental costs in Q3 and will incur further incremental costs in Q4 to expedite shipments to customers for our two high-tier products that required airfreight to arrive on time and other products that require expedited shipping due to the port congestion on the west coast. In total, we expect to incur approximately \$2.4 million of incremental logistics costs in Q4.

Based on these factors, we now expect full year net revenues for the Turtle Beach headset business to be in the range of \$185 to \$195 million, representing an increase of approximately 7% at the mid-point of the range over 2013. For the full year, adjusted EBITDA for the headset business is now expected to be in the range of \$18 to \$20 million, representing an increase of approximately 32% at the mid-point of the range over 2013. This translates into an approximately 10% EBITDA margin for our headset business in 2014. Total company 2014 adjusted EBITDA is expected to be in the range of \$8 to \$10 million, reflecting the impact of a \$10 million anticipated HyperSound investment.

I'll now turn it back to Juergen for closing comments.

**Juergen Stark**

Thanks John.

I am really pleased with how our team continues to execute the operational and strategic initiatives that form the foundation for sustained, long-term growth. Our leadership in the gaming headset industry is illustrated by the largest assortment of next-generation compatible headsets available for the holiday season, providing our retail partners with a wide variety of first-to-market products at compelling price points, and consumers with innovation and advanced technology that allows for a richer and more engaging gaming experience. We've also executed on the key objectives for commercializing HyperSound and, as I've stated, continue to see that as a very promising opportunity. Both HyperSound and our Gaming Headset business highlight our focus on Best, First, Only innovations in audio. This goal

of differentiating products with innovation and quality will continue to be the hallmark of how we think about and run our business. And of course we will protect our innovations as reflected with a patent portfolio of now well over a 100 issued and pending US and international patents.

Given the importance of the next two months on our industry, industry growth forecasts for 2015 could certainly change. That said, I do want to share some insight into how we are thinking about our headset business next year. Particularly in light of the somewhat lower start industrywide on console headsets than expected. Based on where we sit today, we expect to grow headset revenue at least 10% in 2015 driven by an uptick in attach rates from the growing installed base of next generation consoles, more multiplayer game launches and demand for our broad portfolio of leading headsets. With respect to gross margin, we expect to be in the low 30% range consistent with our past communications. Finally, we expect adjusted EBITDA margins for the headset business to improve from this year's projected level of approximately 10% including some investments we will make in 2015 to reconfigure our supply chain. We expect those investments to reduce our long term product costs and help us track towards our goal of 15% Adjusted EBITDA margin over time.

Turning to HyperSound, momentum continues to build in our commercial business and we are on schedule and very excited for the launch of our healthcare product line in 2015. We will provide specific targets for HyperSound on our next call once we have completed our Healthcare launch plan.

To close, I want to say thanks again to our great team of dedicated colleagues around the world delivered these multiple Best, First, and Only capabilities and are helping make our vision become a reality every day.

With that, we will now take your questions.

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### *Forward-Looking Statements*

These remarks include forward-looking information and statements within the meaning of the federal securities laws. Except for historical information contained in this release, statements in this release may constitute forward-looking statements regarding assumptions, projections, expectations, targets, intentions or beliefs about future events. Forward looking statements are based on management's statements containing the words "may", "could", "would", "should", "believe", "expect", "anticipate", "plan", "estimate", "target", "project", "intend" and similar expressions constitute forward-looking statements. Forward-looking statements involve known and unknown risks and uncertainties, which could cause actual results to differ materially from those contained in any forward-looking statement. Forward-looking statements are based on management's current belief, as well as assumptions made by, and information currently available to, management.

While the Company believes that its expectations are based upon reasonable assumptions, there can be no assurances that its goals and strategy will be realized. Numerous factors, including risks and uncertainties, may affect actual results and may cause results to differ materially from those expressed in forward-looking statements made by the Company or on its behalf. Some of these factors include, but are not limited to, the substantial uncertainties inherent in acceptance of existing and future products, the difficulty of commercializing and protecting new technology, the impact of competitive products and

pricing, general business and economic conditions, risks associated with the expansion of our business including the implementation of any businesses we acquire, our indebtedness, and other factors discussed in our public filings, including the risk factors included in the Company's Prospectus Supplement filed with the SEC on April 24, 2014, the Company's Proxy Statement on Schedule 14A filed in connection with our recent merger and the Company's most recent Annual Report on Form 10-K and Quarterly Report on Form 10-Q. 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, the Company any is under no obligation to publicly update or revise any forward-looking statement after the date of this release whether as a result of new information, future developments or otherwise.

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

#### *Adjusted EBITDA*

"Adjusted EBITDA" is defined as net income (loss) before interest, taxes, depreciation and amortization, stock-based compensation (non-cash), non-cash amortization of payments to founders and certain business transaction expenses. Management adjusts net income (loss) for business transaction costs because it believes that such items are not representative of core operations. We believe Adjusted EBITDA provides useful information to investors about us and our financial condition and results of operations for the following reasons: (i) it is one of the measures used by our board of directors and management team to evaluate our operating performance; (ii) it is one of the measures used by our management team to make day-to-day operating decisions; (iii) the adjustments made in our calculation of Adjusted EBITDA (business transaction costs, payments to our founders, and stock-based compensation) 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 expense).

Adjusted EBITDA has limitations as an analytical tool, and when assessing our operating performance, it should not consider Adjusted EBITDA in isolation or as a substitute for net income (loss) or other consolidated income statement data. Some of these limitations include, but are not limited to:

- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted EBITDA does not reflect interest expense, or the cash requirements necessary to service interest or principal payments, on our debt;
- Adjusted EBITDA does not reflect income taxes or the cash requirements for any tax payments; and
- Other companies may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure.

