UNIVERSAL ELECTRONICS INC
Form 10-Q
November 09, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 0-21044

UNIVERSAL ELECTRONICS INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	33-0204817
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
201 E. Sandpointe Avenue, 8th Floor Santa Ana, California	92707
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code: (714) 918-9500

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 ý No ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	ý
Non-accelerated filer	¨	Smaller reporting company	¨
		Emerging growth company	¨

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

Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No ý
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 13,805,506 shares of Common Stock, par value $0.01 per share, of the registrant were outstanding on November 6, 2018.

UNIVERSAL ELECTRONICS INC.

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PART I. FINANCIAL INFORMATION
ITEM 1. Consolidated Financial Statements (Unaudited)
UNIVERSAL ELECTRONICS INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share-related data)
(Unaudited)

	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 41,995	$ 62,438
Restricted cash	—	4,901
Accounts receivable, net	151,885	151,578
Contract assets	26,257	—
Inventories, net	135,888	162,589
Prepaid expenses and other current assets	15,429	11,687
Assets held for sale	—	12,517
Income tax receivable	2,695	1,587
Total current assets	374,149	407,297
Property, plant and equipment, net	101,025	110,962
Goodwill	48,509	48,651
Intangible assets, net	25,580	29,041
Deferred income taxes	7,371	7,913
Other assets	4,335	4,566
Total assets	$ 560,969	$ 608,430
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 108,343	$ 119,165
Line of credit	103,500	138,000
Accrued compensation	32,220	34,499
Accrued sales discounts, rebates and royalties	7,944	8,882
Accrued income taxes	1,441	3,670
Other accrued liabilities	19,899	28,719
Total current liabilities	273,347	332,935
Long-term liabilities:		
Long-term contingent consideration	10,170	13,400
Deferred income taxes	1,189	4,423
Income tax payable	2,520	2,520
Other long-term liabilities	1,534	1,603
Total liabilities	288,760	354,881
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.01 par value, 5,000,000 shares authorized; none issued or outstanding	—	—
Common stock, $0.01 par value, 50,000,000 shares authorized; 23,891,790 and 23,760,434 shares issued on September 30, 2018 and December 31, 2017, respectively	239	238
Paid-in capital	274,493	265,195
Treasury stock, at cost, 10,076,385 and 9,702,874 shares on September 30, 2018 and December 31, 2017, respectively	(274,629)	(262,065)
Accumulated other comprehensive income (loss)	(21,789)	(16,599)

Retained earnings	293,895	266,780
Total stockholders' equity	272,209	253,549
Total liabilities and stockholders' equity	$ 560,969	$ 608,430

See Note 4 for further information concerning our purchases from related party vendors.
The accompanying notes are an integral part of these consolidated financial statements.

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UNIVERSAL ELECTRONICS INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net sales	$182,717	$175,652	$509,938	$514,638
Cost of sales	142,401	132,582	405,661	386,783
Gross profit	40,316	43,070	104,277	127,855
Research and development expenses	5,593	5,415	17,703	15,859
Factory transition restructuring charges	—	446	—	6,145
Selling, general and administrative expenses	29,994	32,997	90,811	94,701
Operating income (loss)	4,729	4,212	(4,237)	11,150
Interest income (expense), net	(1,177)	(721)	(3,526)	(1,676)
Gain on sale of Guangzhou factory	—	—	36,978	—
Other income (expense), net	(2,282)	61	(3,951)	2
Income before provision for income taxes	1,270	3,552	25,264	9,476
Provision for income taxes	311	1,824	2,233	2,945
Net income	$959	$1,728	$23,031	$6,531
Earnings per share:				
Basic	$0.07	$0.12	$1.65	$0.45
Diluted	$0.07	$0.12	$1.63	$0.44
Shares used in computing earnings per share:				
Basic	13,836	14,381	13,997	14,412
Diluted	13,959	14,666	14,116	14,689

See Note 4 for further information concerning our purchases from related party vendors.
The accompanying notes are an integral part of these consolidated financial statements.

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UNIVERSAL ELECTRONICS INC.
CONSOLIDATED COMPREHENSIVE INCOME (LOSS) STATEMENTS
(In thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$959	$1,728	$23,031	$6,531
Other comprehensive income (loss):				
Change in foreign currency translation adjustment	(3,778)	2,999	(5,190)	4,990
Comprehensive income (loss)	$(2,819)	$4,727	$17,841	$11,521

See Note 4 for further information concerning our purchases from related party vendors.
The accompanying notes are an integral part of these consolidated financial statements.

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UNIVERSAL ELECTRONICS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30, 2018	2017
Cash provided by (used for) operating activities:		
Net income	$23,031	$6,531
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Depreciation and amortization	25,264	23,202
Provision for doubtful accounts	2	167
Provision for inventory write-downs	6,450	2,189
Gain on sale of Guangzhou factory	(36,978)	—
Deferred income taxes	(1,370)	(953)
Shares issued for employee benefit plan	879	591
Employee and director stock-based compensation	6,808	9,476
Performance-based common stock warrants	747	1,122
Impairment of China factory equipment	2,886	—
Changes in operating assets and liabilities:		
Accounts receivable and contract assets	(1,289)	(24,440)
Inventories	(9,535)	(21,217)
Prepaid expenses and other assets	(4,193)	(2,422)
Accounts payable and accrued liabilities	(13,142)	1,488
Accrued income taxes	(4,134)	(1,517)
Net cash provided by (used for) operating activities	(4,574)	(5,783)
Cash provided by (used for) investing activities:		
Proceeds from sale of Guangzhou factory	51,291	—
Acquisitions of property, plant and equipment	(16,838)	(29,922)
Refund of deposit received toward sale of Guangzhou factory	(5,053)	—
Acquisitions of intangible assets	(1,911)	(1,275)
Acquisition of net assets of Residential Control Systems, Inc.	—	(8,894)
Net cash provided by (used for) investing activities	27,489	(40,091)
Cash provided by (used for) financing activities:		
Borrowings under line of credit	48,000	115,000
Repayments on line of credit	(82,500)	(50,987)
Proceeds from stock options exercised	864	1,107
Treasury stock purchased	(12,564)	(20,217)
Contingent consideration payments in connection with business combinations	(3,858)	—
Net cash provided by (used for) financing activities	(50,058)	44,903
Effect of exchange rate changes on cash, cash equivalents and restricted cash	1,799	(5,504)
Net increase (decrease) in cash, cash equivalents and restricted cash	(25,344)	(6,475)
Cash, cash equivalents and restricted cash at beginning of year	67,339	59,834
Cash, cash equivalents and restricted cash at end of period	$41,995	$53,359
Supplemental cash flow information:		
Income taxes paid	$5,453	$5,770
Interest paid	$3,722	$1,697

See Note 4 for further information concerning our purchases from related party vendors.
The accompanying notes are an integral part of these consolidated financial statements.

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UNIVERSAL ELECTRONICS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018
(Unaudited)

Note 1 — Basis of Presentation and Significant Accounting Policies

In the opinion of management, the accompanying consolidated financial statements of Universal Electronics Inc. and its subsidiaries contain all the adjustments necessary for a fair presentation of financial position, results of operations and cash flows for the periods presented. All such adjustments are of a normal recurring nature and certain reclassifications have been made to prior year amounts in order to conform to the current year presentation. Information and footnote disclosures normally included in financial statements, which are prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"), have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. As used herein, the terms "Company," "we," "us," and "our" refer to Universal Electronics Inc. and its subsidiaries, unless the context indicates to the contrary.

Our results of operations for the three and nine months ended September 30, 2018 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Quantitative and Qualitative Disclosures About Market Risk," and the "Financial Statements and Supplementary Data" included in Items 1A, 7, 7A, and 8, respectively, of our Annual Report on Form 10-K for the year ended December 31, 2017.

Estimates, Judgments and Assumptions

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and assumptions, including those related to revenue recognition, allowances for sales returns and doubtful accounts, inventory valuation, our review for impairment of long-lived assets, intangible assets and goodwill, business combinations, income taxes, stock-based compensation expense and performance-based common stock warrants. Actual results may differ from these estimates and assumptions, and they may be adjusted as more information becomes available. Any adjustment may be material.

Summary of Significant Accounting Policies

We adopted Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers," and all related amendments as of January 1, 2018. The impact of this new guidance on our accounting policies and consolidated financial statements is also described below. There have been no other significant changes in our accounting policies during the three and nine months ended September 30, 2018 compared to the significant accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2017.

Revenue Recognition

Our performance obligations primarily arise from manufacturing and delivering universal control, sensing and automation products and AV accessories, which are sold through multiple channels, and intellectual property that is embedded in these products or licensed to others. These performance obligations are satisfied at a point in time or over time, as described below. Payment terms are typically on open credit terms consistent with industry practice and do not have significant financing components. Some contracts contain early payment discounts, which are recognized as a reduction to revenue if the customer typically meets the early payment conditions. Consideration may be variable based on indeterminate volumes.

Effective January 1, 2018, revenue is recognized over time when the customer simultaneously receives and consumes the benefits provided by our performance, our performance creates or enhances an asset that the customer controls, or when our performance creates an asset with no alternative use to us (custom products) and we have an enforceable right to payment for performance completed to date, such as a firm order or other contractual commitment from the customer. An asset does not have an alternative use if we are unable to redirect the asset to another customer in the foreseeable future without significant rework. The method for measuring progress towards satisfying a performance obligation for a custom product is based on the costs incurred to date (cost-to-cost method). We believe that the costs associated with production are most closely aligned with the revenue associated with those products.

We recognize revenue at a point in time if the criteria for recognizing revenue over time are not met, the title of the goods has transferred, and we have a present right to payment.

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UNIVERSAL ELECTRONICS INC.
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SEPTEMBER 30, 2018
(Unaudited)

We typically recognize revenue for the sale of tooling at a point in time, which is generally upon completion of the tooling and, if applicable, acceptance by the customer.

A provision is recorded for estimated sales returns and allowances and is deducted from gross sales to arrive at net sales in the period the related revenue is recorded. These estimates are based on historical sales returns and allowances, analysis of credit memo data and other known factors. Actual returns and claims in any future period are inherently uncertain and thus may differ from our estimates. If actual or expected future returns and claims are significantly greater or lower than the reserves that we have established, we will record a reduction or increase to net revenue in the period in which we make such a determination.

We accrue for discounts and rebates based on historical experience and our expectations regarding future sales to our customers. Accruals for discounts and rebates are recorded as a reduction to sales in the same period as the related revenue. Changes in such accruals may be required if future rebates and incentives differ from our estimates.

We license our intellectual property including our patented technologies, trademarks, and database of control codes. When license fees are paid on a per-unit basis, we record license revenue when our customers manufacture or ship a product incorporating our intellectual property and we have a present right to payment. When a fixed up-front license fee is received in exchange for the delivery of a particular database of infrared codes or the contract contains a minimum guarantee provision, we record revenue when delivery of the intellectual property has occurred. Tiered royalties are recorded on a straight-line basis according to the forecasted per-unit fees taking into account the pricing tiers.

Contract assets represent revenue which has been recognized based on our accounting policies but for which the customer has not yet been invoiced and thus an account receivable has not yet been recorded.

Under prior accounting standards, we recognized revenue on the sale of products when title of the goods had transferred, there was persuasive evidence of an arrangement (such as a purchase order from the customer), the sales price was fixed or determinable and collectability was reasonably assured. Revenue for term license fees were recognized on a straight-line basis over the effective term of the license when we could not reliably predict in which periods, within the term of the license, the licensee would benefit from the use of our patented inventions.

Recently Adopted Accounting Pronouncements

On January 1, 2018, we adopted ASU 2014-09 using the modified retrospective transition method. Under this method, we evaluated all contracts that were in effect at the beginning of 2018 as if those contracts had been accounted for under the new revenue standard based on the terms in effect as of the adoption date. Under the modified retrospective transition approach, periods prior to the adoption date were not adjusted and continue to be reported in accordance with historical U.S. GAAP. A cumulative catch-up adjustment was recorded to beginning retained earnings to reflect the impact of all existing arrangements under the new revenue standard.

The cumulative effects of the changes made to our consolidated January 1, 2018 balance sheet for the adoption of ASU 2014-09, were as follows:

Consolidated Balance Sheet (In thousands)	As reported 12/31/2017	Adjustments due to ASU 2014-09	Balance at 1/1/2018
Contract assets	$ —	$ 29,759	$ 29,759
Inventories, net	162,589	(23,830)	138,759
Prepaid expenses and other current assets	11,687	(174)	11,513

Deferred income tax assets	7,913	(102)	7,811
Accounts payable and other current liabilities	332,935	1,528	334,463
Deferred income tax liabilities	4,423	20	4,443
Retained earnings	266,780	4,084	270,864

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018
(Unaudited)

The following tables compare the reported consolidated balance sheet and statements of operations as of and for the three and nine months ended September 30, 2018, to pro forma amounts had the previous guidance been in effect. The guidance did not have a significant impact on the Company's consolidated statement of cash flows.

	As of September 30, 2018		
Consolidated Balance Sheet (In thousands)	As reported	Without Adoption of ASU 2014-09	Effect of Change
Assets			
Contract assets	$26,257	$—	$26,257
Inventories, net	135,888	156,553	(20,665)
Prepaid expenses and other current assets	15,429	15,419	10
Deferred income taxes	7,371	7,379	(8)
Liabilities and Equity			
Accounts payable and other current liabilities	$273,347	$271,734	$1,613
Retained earnings	293,895	289,914	3,981

	Three Months Ended September 30, 2018		
Consolidated Statements of Operations (In thousands)	As reported	Without Adoption of ASU 2014-09	Effect of Change
Net sales	$182,717	$184,559	$(1,842)
Cost of sales	142,401	144,426	(2,025)
Selling, general and administrative expenses	29,994	30,029	(35)
Provision for income taxes	311	355	(44)
Net income	959	697	262
Earnings per share:			
Basic	$0.07	$0.05	$0.02
Diluted	$0.07	$0.05	$0.02

	Nine months ended September 30, 2018		
Consolidated Statements of Operations (In thousands)	As reported	Without Adoption of ASU 2014-09	Effect of Change
Net sales	$509,938	$512,880	$(2,942)
Cost of sales	405,661	408,427	(2,766)
Selling, general and administrative expenses	90,811	90,866	(55)

Provision for income taxes	2,233	2,250	(17)
Net income	23,031	23,134	(103)
Earnings per share:			
Basic	$1.65	$1.66	$(0.01)
Diluted	$1.63	$1.64	$(0.01)

Other Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-15, "Classification of Certain Cash Receipts and Cash Payments," which amends Accounting Standards Codification ("ASC") 230, "Statement of Cash Flows". This new guidance addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice in how certain transactions are classified in the statement of cash flows. ASU 2016-15 is effective for fiscal periods beginning after December 15, 2017 and must be adopted retrospectively. The adoption of ASU 2016-15 did not have a material impact to the presentation of our consolidated statement of cash flows.

In October 2016, the FASB issued ASU 2016-16, "Intra-Entity Transfers of Assets Other Than Inventory," which changes the accounting for income tax consequences of intra-entity transfers of assets other than inventory. Current guidance prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party. Under this new guidance, the income tax consequences of an intra-entity transfer of an asset other than inventory will be recognized when the transfer occurs. ASU 2016-16 is effective for fiscal periods beginning after December 15, 2017. The adoption of ASU 2016-16 did not have a material impact on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18,"Restricted Cash," which amends ASC 230, "Statement of Cash Flows." This new guidance addresses the classifications and presentation of changes in restricted cash in the statement of cash flows. ASU 2016-18 is effective for fiscal periods beginning after December 15, 2017 and must be adopted retrospectively. The adoption of ASU 2016-18 modified our current disclosures by reclassifying certain amounts within the consolidated statement of cash flows, but did not have a material effect on our consolidated financial statements.

Recent Accounting Updates Not Yet Effective

In February 2016, the FASB issued ASU 2016-02, "Leases," which changes the accounting for leases and requires expanded disclosures about leasing activities. This new guidance will require lessees to recognize a right of use asset and a lease liability at the commencement date for all leases with terms greater than twelve months. Accounting by lessors is largely unchanged. ASU 2016-02 is effective for fiscal periods beginning after December 15, 2018 and must be adopted using a modified retrospective approach. Early adoption is permitted. In July 2018, the FASB issued ASU 2018-11, which provides an additional transition method when adopting ASU 2016-02. Under the original guidance, the modified retrospective approach provided that ASU 2016-02 be applied at the beginning of the earliest period presented. ASU 2018-11 allows for the application of the new guidance as of the adoption date with a cumulative-effect adjustment to the opening balance of retained earnings. We plan to adopt ASU 2016-02 effective January 1, 2019 using the new transition guidance provided in ASU 2018-11 and are currently evaluating the impact that ASU 2016-02 will have on our consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, "Simplifying the Test for Goodwill Impairment." This guidance simplifies how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Instead, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss will be recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to the reporting unit. ASU 2017-04 is effective for fiscal periods beginning after December 15, 2019. Early adoption is permitted. We do not expect the adoption of ASU 2017-04 will have a material impact on our consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07, "Improvements to Non-employee Share-Based Payment Accounting." This guidance expands the scope of Topic 718, "Compensation - Stock Compensation" to include share-based payment transactions for acquiring goods and services from non-employees, but excludes awards granted in conjunction with selling goods or services to a customer as part of a contract accounted for under ASC 606, "Revenue from Contracts with Customers." We are currently evaluating the impact that ASU 2018-07 will have on our consolidated financial statements.

In August 2018, the FASB issued ASU 2018-15, "Customer's Accounting for implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract," which amends ASC 350-40, "Intangibles - Goodwill and Other - Internal-Use Software." The ASU aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software and requires the capitalized implementation costs to be expensed over the term of the hosting arrangement. The accounting for the service element of a hosting arrangement that is a service contract is not affected. Effective for fiscal periods beginning after December 15, 2019, and interim periods within those fiscal years. We are currently evaluating the impact that ASU 2018-07 will have on our consolidated financial statements.

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UNIVERSAL ELECTRONICS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018
(Unaudited)

Note 2 — Cash and Cash Equivalents and Restricted Cash

Cash and Cash Equivalents

Cash and cash equivalents were held in the following geographic regions:

(In thousands)	September 30, 2018	December 31, 2017
United States	$ 3,694	$ 10,489
People's Republic of China ("PRC")	20,024	23,283
Asia (excluding the PRC)	1,350	1,405
Europe	7,976	18,071
South America	8,951	9,190
Total cash and cash equivalents	$ 41,995	$ 62,438

Restricted Cash

In connection with the pending sale of our Guangzhou factory in the PRC (Note 10), a prospective buyer made a cash deposit of RMB 32 million ($5.1 million based on April 2018 exchange rates) into an escrow account on September 29, 2016. Under the terms of the escrow account, these funds were not to be paid to us until the close of the sale. Accordingly, this deposit was presented as restricted cash within our consolidated balance sheet. In April 2018, the sale transaction with this buyer was terminated and this deposit was returned to the buyer.

Note 3 — Accounts Receivable, Net and Revenue Concentrations

Accounts receivable, net were as follows:

(In thousands)	September 30, 2018	December 31, 2017
Trade receivables, gross	$ 145,823	$ 142,299
Allowance for doubtful accounts	(992)	(1,064)
Allowance for sales returns	(588)	(562)
Net trade receivables	144,243	140,673
Other	7,642	10,905
Accounts receivable, net	$ 151,885	$ 151,578

Allowance for Doubtful Accounts

Changes in the allowance for doubtful accounts were as follows:

(In thousands)	Nine Months Ended September 30, 2018	2017
Balance at beginning of period	$1,064	$904
Additions to costs and expenses	2	167
(Write-offs)/Foreign exchange effects	(74)	(19)
Balance at end of period	$992	$1,052

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UNIVERSAL ELECTRONICS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2018
(Unaudited)

Significant Customers
Net sales to the following customers totaled more than 10% of our net sales:

	Three Months Ended September 30,					
	2018			2017		
	$ (thousands)	% of Net Sales		$ (thousands)	% of Net Sales	
Comcast Corporation	$32,336	17.7	%	$36,811	21.0	%
AT&T [(1)]	$—	—	%	$20,117	11.5	%

	Nine Months Ended September 30,					
	2018			2017		
	$ (thousands)	% of Net Sales		$ (thousands)	% of Net Sales	
Comcast Corporation	$99,853	19.6	%	$122,009	23.7	%
AT&T [(1)]	$—	—	%	$61,057	11.9	%

(1) Sales associated with this customer did not total more than 10% of our net sales for the indicated period.

Trade receivables associated with these significant customers that totaled more than 10% of our accounts receivable, net were as follows:

	September 30, 2018			December 31, 2017		
	$ (thousands)	% of Accounts Receivable, Net		$ (thousands)	% of Accounts Receivable, Net	
Comcast Corporation	$20,084	13.2	%	$25,142	16.6	%

Note 4 — Inventories, Net and Significant Suppliers
Inventories, net were as follows:

(In thousands)	September 30, 2018		December 31, 2017	
Raw materials	$ 62,835		$ 43,638	
Components	13,763		16,214	
Work in process	8,378		1,847	
Finished goods	58,195		105,178	
Reserve for excess and obsolete inventory	(7,283	)	(4,288	)
Inventories, net	$ 135,888		$ 162,589	

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UNIVERSAL ELECTRONICS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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(Unaudited)

Reserve for Excess and Obsolete Inventory
Changes in the reserve for excess and obsolete inventory were as follows:

(In thousands)	Nine Months Ended September 30, 2018	2017
Balance at beginning of period	$4,288	$4,205
Additions charged to costs and expenses [1]	5,353	1,960
Sell through [2]	(1,240)	(950)
(Write-offs)/Foreign exchange effects	(1,118)	(2,090)
Balance at end of period	$7,283	$3,125

(1) The additions charged to costs and expenses do not include inventory directly written-off that was scrapped during production totaling $1.1 million and $0.2 million for the nine months ended September 30, 2018 and 2017, respectively. These amounts are production waste and are not included in management's reserve for excess and obsolete inventory.
(2) These amounts represent the reduction in reserves associated with inventory items that were sold during the period.

Significant Suppliers
We purchase integrated circuits, components and finished goods from multiple sources. Purchases from the following supplier totaled more than 10% of our total inventory purchases:

	Three Months Ended September 30, 2018		2017	
	$ (thousands)	% of Total Inventory Purchases	$ (thousands)	% of Total Inventory Purchases
Texas Instruments [1]	$—	—%	$13,115	12.4 %

	Nine Months Ended September 30, 2018		2017	
	$ (thousands)	% of Total Inventory Purchases	$ (thousands)	% of Total Inventory Purchases
Texas Instruments [1]	$—	—%	$33,693	11.3 %

(1) Purchases associated with this supplier did not total more than 10% of our total inventory purchases for the indicated period.

Related Party Supplier
During the three and nine months ended September 30, 2018 and 2017, we purchased certain printed circuit board assemblies from a related party supplier. The supplier was considered a related party for financial reporting purposes because our Senior Vice President of Strategic Operations owned 40% of this supplier. In the second quarter of 2018, our Senior Vice President sold his interest in this supplier, and thus this supplier is no longer considered a related party.

Total inventory purchases made from this supplier while it was a related party were $1.1 million during the nine months ended September 30, 2018 and $1.4 million and $4.0 million during the three and nine months ended September 30, 2017, respectively.

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Note 5 — Goodwill and Intangible Assets, Net
Goodwill
Changes in the carrying amount of goodwill were as follows:

(In thousands)	
Balance at December 31, 2017	$48,651
Foreign exchange effects	(142)
Balance at September 30, 2018	$48,509

Intangible Assets, Net
The components of intangible assets, net were as follows:

	September 30, 2018			December 31, 2017		
(In thousands)	Gross [1]	Accumulated Amortization [1]	Net	Gross [1]	Accumulated Amortization [1]	Net
Distribution rights	$333	$ (182)	$151	$344	$ (165)	$179
Patents	14,194	(5,502)	8,692	13,250	(5,310)	7,940
Trademarks and trade names	2,786	(1,823)	963	2,786	(1,594)	1,192
Developed and core technology	12,560	(7,583)	4,977	12,560	(6,071)	6,489
Capitalized software development costs	249	(131)	118	142	(77)	65
Customer relationships	32,534	(21,855)	10,679	32,534	(19,395)	13,139
Order backlog	—	—	—	150	(113)	37
Total intangible assets, net	$62,656	$ (37,076)	$25,580	$61,766	$ (32,725)	$29,041

(1) This table excludes the gross value of fully amortized intangible assets totaling $6.8 million and $6.0 million at September 30, 2018 and December 31, 2017, respectively.

Amortization expense is recorded in selling, general and administrative expenses, except amortization expense related to capitalized software development costs and order backlog, which are recorded in cost of sales. Amortization expense by income statement caption was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2018	2017	2018	2017
Cost of sales	$18	$54	$91	$128
Selling, general and administrative expenses	1,770	1,715	5,275	5,032
Total amortization expense	$1,788	$1,769	$5,366	$5,160

Estimated future annual amortization expense related to our intangible assets at September 30, 2018, was as follows:

(In thousands)	
2018 (remaining 3 months)	$1,778
2019	7,018
2020	5,883
2021	2,325
2022	2,216
Thereafter	6,360
Total	$25,580

Note 6 — Line of Credit

Our Second Amended and Restated Credit Agreement ("Second Amended Credit Agreement") with U.S. Bank National Association ("U.S. Bank") and Wells Fargo Bank, National Association provides for a $170.0 million revolving line of credit ("Credit Line") that expires on November 1, 2019. The Credit Line may be used for working capital and other general corporate purposes including acquisitions, share repurchases and capital expenditures. Amounts available for borrowing under the Credit Line are reduced by the balance of any outstanding letters of credit. There were no outstanding letters of credit at September 30, 2018.

All obligations under the Credit Line are secured by substantially all of our U.S. personal property and tangible and intangible assets as well as 65% of our ownership interest in Enson Assets Limited, our wholly-owned subsidiary which controls our manufacturing factories in the PRC.

Under the Second Amended Credit Agreement, we may elect to pay interest on the Credit Line based on LIBOR plus an applicable margin (varying from 1.25% to 1.75%) or base rate (based on the prime rate of U.S. Bank or as otherwise specified in the Second Amended Credit Agreement) plus an applicable margin (varying from 0.00% to 0.50%). The applicable margins are calculated quarterly and vary based on our cash flow leverage ratio as set forth in the Second Amended Credit Agreement. The interest rate in effect at September 30, 2018 was 3.97%. There are no commitment fees or unused line fees under the Second Amended Credit Agreement.

The Second Amended Credit Agreement includes financial covenants requiring a minimum fixed charge coverage ratio and a maximum cash flow leverage ratio. In addition, the Second Amended Credit Agreement contains other customary affirmative and negative covenants and events of default. As of September 30, 2018, we were in compliance with the covenants and conditions of the Second Amended Credit Agreement.

At September 30, 2018, we had $103.5 million outstanding under the Credit Line. Our total interest expense on borrowings was $1.2 million and $0.8 million during the three months ended September 30, 2018 and 2017, respectively. Our total interest expense on borrowings was $3.7 million and $1.8 million during the nine months ended September 30, 2018 and 2017, respectively.

Note 7 — Income Taxes

We utilize our estimated annual effective tax rate to determine our provision for income taxes for interim periods. The income tax provision is computed by taking the estimated annual effective rate and multiplying it by the year-to-date pre-tax book income.

We recorded income tax expense of $0.3 million and $1.8 million for the three months ended September 30, 2018 and 2017, respectively, and our effective tax rate was 24.5% and 51.4% for the three months ended September 30, 2018 and 2017, respectively. The decrease in our effective tax rate was primarily due to certain transactions in China during

the three months ended September 30, 2017 being nondeductible as a result of the pending sale of our Guangzhou factory.
During the nine months ended September 30, 2018 and 2017, we recorded income tax expense of $2.2 million and $2.9 million, respectively, and our effective tax rate was 8.8% and 31.1% during the nine months ended September 30, 2018 and 2017, respectively. The decrease in our effective tax rate was primarily a result of the tax rate applicable to the gain recognized on the sale of our

Guangzhou factory being lower than our blended consolidated tax rate. Additionally, during the nine months ended September 30, 2017, certain transactions in China were nondeductible as a result of the pending sale of our Guangzhou factory.

The Tax Cuts and Jobs Act (the "Tax Act") was enacted on December 22, 2017. The Tax Act reduces the U.S. federal corporate income tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign sourced earnings. We are applying the guidance in SAB 118 when accounting for the enactment-date effects of the Tax Act. At September 30, 2018, we have not completed our accounting for all of the tax effects of the Tax Act. Additionally, we have made a reasonable estimate of other effects. During the three and nine month periods ended September 30, 2018, we recognized no adjustments to the provisional amounts recorded at December 31, 2017. We are awaiting further guidance from the U.S. federal and state regulatory bodies with regards to the final accounting and reporting of these items in the jurisdictions where we file tax returns. In all cases, we will continue to make and refine our calculations as additional analysis is completed. Our estimates may also be affected as we gain a more thorough understanding of tax law. These changes could be material to income tax expense.

Additionally, we have provided provisional amounts for the legislative provisions that are effective as of January 1, 2018, including, but not limited to, the creation of the base erosion anti-abuse tax ("BEAT"), a new minimum tax, a new provision designed to tax global intangible low-taxed income ("Global Minimum Tax" or "GMT"), a new limitation on deductible interest expense, and limitations on the use of net operating losses. Our accounting for these elements of the Tax Act is incomplete; however, we were able to make reasonable estimates and therefore recorded provisional adjustments. Similar to the above elements, we are in the process of collecting and preparing necessary data, and interpreting guidance as issued by the U.S. Treasury Department, Internal Revenue Service, FASB, and other federal and state standard-setting regulatory bodies. However, we continue to gather additional information to complete our accounting for these items and expect to complete the accounting within the prescribed measurement period. Given the complexity of the GMT provisions, we are still evaluating the effects of the GMT provisions and have not yet determined our accounting policy. At September 30, 2018, we are still evaluating the GMT provisions and our analysis of future taxable income that is subject to GMT, we have included GMT related to current year operations only in our estimated annual effective tax rate and have not provided additional GMT on deferred items.

At September 30, 2018, we had gross unrecognized tax benefits of $4.6 million, including interest and penalties, of which approximately $4.3 million, if not for the state Research and Experimentation income tax credit valuation allowance, would affect the annual effective tax rate if these tax benefits are realized. Further, we are unaware of any positions for which it is reasonably possible that the total amount of unrecognized tax benefits will significantly change within the next twelve months. Based on federal, state and foreign statute expirations in various jurisdictions, we do not anticipate any decrease in unrecognized tax benefits within the next twelve months. We have classified uncertain tax positions as non-current income tax liabilities unless expected to be paid within one year.

We have elected to classify interest and penalties as a component of tax expense. Accrued interest and penalties of $0.6 million and $0.5 million at September 30, 2018 and December 31, 2017, respectively, are included in our unrecognized tax benefits.

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Note 8 — Accrued Compensation
The components of accrued compensation were as follows:

(In thousands)	September 30, 2018	December 31, 2017
Accrued social insurance [(1)]	$ 17,216	$ 17,727
Accrued salary/wages	8,309	7,910
Accrued vacation/holiday	2,830	2,769
Accrued bonus [(2)]	1,724	2,329
Accrued commission	935	1,089
Other accrued compensation	1,206	2,675
Total accrued compensation	$ 32,220	$ 34,499

(1) PRC employers are required by law to remit the applicable social insurance payments to their local government. Social insurance is comprised of various components such as pension, medical insurance, job industry insurance, unemployment insurance, and a housing assistance fund, and is administered in a manner similar to social security in the United States. This amount represents our estimate of the amounts due to the PRC government for social insurance on September 30, 2018 and December 31, 2017.

(2) Accrued bonus includes an accrual for an extra month of salary ("13th month salary") to be paid to employees in certain geographies where it is the customary business practice. This 13th month salary is paid to these employees if they remain employed with us through December 31st. The total accrued for the 13th month salary was $0.1 million and $0.7 million at September 30, 2018 and December 31, 2017, respectively.

Note 9 — Other Accrued Liabilities
The components of other accrued liabilities were as follows:

(In thousands)	September 30, 2018	December 31, 2017
Deposit for sale of Guangzhou factory	$ —	$ 4,901
Duties	1,039	1,184
Freight and handling fees	2,757	1,983
Professional fees	1,488	1,578
Property, plant and equipment	366	2,151
Sales taxes and VAT	998	2,955
Short-term contingent consideration	3,730	3,800
Tooling [(1)]	2,171	1,843
Other	7,350	8,324
Total other accrued liabilities	$ 19,899	$ 28,719

(1) The tooling accrual balance relates to unearned revenue for tooling that will be sold to customers.

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Note 10 — Commitments and Contingencies
Product Warranties
Changes in the liability for product warranty claim costs were as follows:

(In thousands)	Nine Months Ended September 30, 2018	2017
Balance at beginning of period	$339	$134
Accruals for warranties issued during the period	787	169
Settlements (in cash or in kind) during the period	(850)	(85)
Balance at end of period	$276	$218

Restructuring Activities and Sale of Guangzhou Factory
In the first quarter of 2016, we implemented a plan to transition manufacturing activities from our southern-most China factory, located in the city of Guangzhou in the Guangdong province, to our other China factories. As a result, we incurred severance costs of $0.4 million and $6.1 million during the three and nine months ended September 30, 2017, respectively, which are included within operating expenses. All operations ceased in our Guangzhou factory in the third quarter of 2017 and the transition to the other China factories was completed by the end of 2017. Since all operations at our Guangzhou manufacturing facility ceased as of the end of July 2017, the related building and land lease assets were classified as assets held for sale in our consolidated balance sheet at December 31, 2017.

On September 26, 2016, we entered into an agreement to sell our Guangzhou manufacturing facility for RMB 320 million. In accordance with the terms of the agreement, the buyer deposited 10% of the purchase price into an escrow account upon the execution of the agreement, which we presented as restricted cash in our consolidated balance sheet at December 31, 2017 (also refer to Note 2). In April 2018, we and the buyer mutually agreed to terminate the sale. The mutually agreed termination took effect immediately with no incremental penalty or costs to either party. In connection with this termination, the deposit was returned to the buyer.

On April 23, 2018, we entered into a new agreement to sell our Guangzhou manufacturing facility to a second buyer for RMB 339 million (approximately $51.4 million based on exchange rates in effect at the time of closing). On April 26, 2018, the second buyer paid to us a deposit of RMB 34 million (approximately $5.1 million based on exchange rates in effect at the time of closing), which under the terms of the agreement was nonrefundable. Upon receipt by the Governmental Agency of the second buyer’s application of approval of transfer, the second buyer was to pay to us RMB 237 million (approximately $35.8 million based on exchange rates in effect at the time of closing). Additionally, within two days after the second payment was made to us, the second buyer was to deposit the remaining consideration of RMB 68 million (approximately $10.3 million based on exchange rates in effect at the time of closing) into escrow, which was to be released to us upon the closing of the sale. Per the terms of the agreement, the sale was to be completed no later than June 30, 2018. On June 26, 2018, all conditions to closing were satisfied and the sale was completed, resulting in a pre-tax gain of $37.0 million ($32.1 million, net of income taxes).
Litigation
On or about June 10, 2015, FM Marketing GmbH ("FMH") and Ruwido Austria GmbH ("Ruwido"), filed a Summons in Summary Proceedings in Belgium court against one of our subsidiaries, Universal Electronics BV ("UEBV") and one of its customers, Telenet N.V. ("Telenet"), claiming that one of the products UEBV supplied to Telenet violates two design patents and one utility patent owned by FMH and/or Ruwido. By this summons, FMH and Ruwido sought

to enjoin Telenet and UEBV from continued distribution and use of the product at issue. After the September 29, 2015 hearing, the court issued its ruling in our and Telenet’s favor, rejecting FMH and Ruwido’s request entirely. On October 22, 2015, Ruwido filed its notice of appeal in this ruling. The parties have fully briefed and argued before the appellate court and we are awaiting the appellate court’s ruling. In addition, on or about February 9, 2016, Ruwido filed a writ of summons for proceeding on the merits with respect to the asserted patents. UEBV and Telenet have replied, denying all of Ruwido's allegations and in June 2017, a hearing was held before the trial court. During this hearing, Ruwido sought to have a second product which we are currently selling to Telenet included in this case. In September 2017, the Court ruled in our favor that our current product cannot be made part of this case. The Court also refused to rule on whether the original product (which we are no longer selling) infringes the Ruwido patent, instead deciding to wait until the European Patent Office has ruled on our Opposition (see below). Finally, the Court ruled that our original product (which we are no longer selling) infringes certain of Ruwido’s design rights, but stayed any decision of compensation and/or damages until all aspects of the case have been decided. We have filed an appeal as to the Court's ruling of infringement, and submission by the parties were due to the Court during the second quarter of 2018 with a hearing expected to take place in late 2018. Subsequent to the Court's ruling that a second product could not be added to the first case on the merits, Ruwido filed a separate case on the merits with respect to this second product, claiming that it too infringes the same patent at issue in the first suit. We have denied these claims. According to the Court's trial schedule, briefs from both parties will be due during the second half of 2018 and early 2019 with a trial date set for January 2019. In September 2015, UEBV filed an Opposition with the European Patent Office seeking to invalidate the one utility patent asserted against UEBV and Telenet by Ruwido. The hearing on this opposition was held in July 2017. During this hearing the panel requested additional information. We have assembled this additional information and the final hearing has been scheduled for January 29, 2019. On September 5, 2017, Ruwido and FMH filed a patent infringement case on the merits against UEBV and Telenet in the Netherlands alleging the same claims of infringement as in the Belgium Courts (see above). We have denied these claims and filed a counterclaim seeking to invalidate the Ruwido patent. A November 30, 2018 hearing date has been set by the Court.

On September 5, 2018, we filed a lawsuit against Roku, Inc. ("Roku") in the United States District Court, Central District of California (Universal Electronics Inc. v. Roku, Inc.) alleging that Roku is infringing nine patents that are in four patent families related to remote control set-up and touchscreen remotes. We have alleged that this complaint relates to multiple Roku streaming players and components therefore and certain universal control devices, including but not limited, the Roku App, Roku TV, Roku Ultra, Roku Express, Roku Streaming Stick, Roku Ultra, Roku Premiere, Roku 4, Roku 3, Roku 2, Roku Enhanced Remote and any other Roku product that provides for the remote control of an external device such as a TV, audiovisual receiver, sound bar or Roku TV Wireless Speakers. Roku has not yet answered our complaint.

There are no other material pending legal proceedings to which we or any of our subsidiaries is a party or of which our respective property is the subject. However, as is typical in our industry and to the nature and kind of business in which we are engaged, from time to time, various claims, charges and litigation are asserted or commenced by third parties against us or by us against third parties arising from or related to product liability, infringement of patent or other intellectual property rights, breach of warranty, contractual relations, or employee relations. The amounts claimed may be substantial but may not bear any reasonable relationship to the merits of the claims or the extent of any real risk of court awards assessed against us or in our favor. However, no assurances can be made as to the outcome of any of these matters, nor can we estimate the range of potential losses to us. In our opinion, final judgments, if any, which might be rendered against us in potential or pending litigation would not have a material adverse effect on our consolidated financial condition, results of operations, or cash flows. Moreover, we believe that our products do not infringe any third parties' patents or other intellectual property rights.

We maintain directors' and officers' liability insurance which insures our individual directors and officers against certain claims, as well as attorney's fees and related expenses incurred in connection with the defense of such claims.

Note 11 — Treasury Stock

From time to time, our Board of Directors authorizes management to repurchase shares of our issued and outstanding common stock on the open market. On July 26, 2018, our Board approved a repurchase plan authorizing the repurchase of up to $5.0 million of our common stock. As of September 30, 2018, we had $3.3 million of authorized repurchases remaining under the Board's authorizations. On October 30, 2018, our Board approved an adjustment to the amount of common stock that we could purchase under our existing repurchase plan to an amount not to exceed $5.0 million of our common stock. We may utilize various methods to effect the repurchases, which could include open market repurchases, negotiated block transactions, accelerated share repurchases or open market solicitations for shares, some of which may be effected through Rule 10b5-1 plans. The timing and amount of future repurchases, if any, will depend upon several factors, including market and business conditions, and such repurchases may be discontinued at any time.

Repurchased shares of our common stock were as follows:

	Nine Months Ended September 30,	
(In thousands)	2018	2017
Shares repurchased	374	330
Cost of shares repurchased	$12,564	$20,217

Repurchased shares are recorded as shares held in treasury at cost. We hold these shares for future use as management and the Board of Directors deem appropriate.

Note 12 — Foreign Operations

Foreign Operations

Our net sales to external customers by geographic area were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2018	2017	2018	2017
United States	$84,756	$85,762	$243,801	$253,259
Asia (excluding PRC)	36,888	26,113	91,755	77,679
People's Republic of China	28,108	23,437	68,852	61,015
Europe	18,785	18,877	58,245	56,041
Latin America	6,411	13,567	23,077	44,593
Other	7,769	7,896	24,208	22,051
Total net sales	$182,717	$175,652	$509,938	$514,638

Specific identification of the customer billing location was the basis used for attributing revenues from external customers to geographic areas.

Long-lived tangible assets by geographic area were as follows:

(In thousands)	September 30, 2018	December 31, 2017
United States	$ 14,765	$ 14,674
People's Republic of China	85,808	96,984
All other countries	4,787	3,870
Total long-lived tangible assets	$ 105,360	$ 115,528

Note 13 — Stock-Based Compensation

Stock-based compensation expense for each employee and director is presented in the same statement of operations caption as their cash compensation. Stock-based compensation expense by statement of operations caption and the related income tax benefit were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2018	2017	2018	2017
Cost of sales	$ 21	$ 19	$ 61	$ 53
Research and development expenses	200	149	556	412
Selling, general and administrative expenses:				
Employees	1,671			