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# EDITED TRANSCRIPT

UEIC - Q1 2015 Universal Electronics Inc. Earnings Call

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## CORPORATE PARTICIPANTS

**Becky Herrick** LHA - IR

**Paul Arling** Universal Electronics Inc. - Chairman and CEO

**Bryan Hackworth** Universal Electronics Inc. - SVP and CFO

## CONFERENCE CALL PARTICIPANTS

**Mike Olson** Piper Jaffray & Co. - Analyst

**Jason Ursaner** CJS Securities - Analyst

**Lance James** RBC Global Asset Management – Portfolio Manager

## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to the Universal Electronics first-quarter 2015 conference call. (Operator Instructions) As a reminder, this conference call is being recorded. I would now like to introduce your host for today's conference call, Becky Herrick of LHA. Ma'am, you may begin.

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**Becky Herrick** - LHA - IR

Thank you, Candace, and thank you all for joining us for the Universal Electronics first-quarter 2015 conference call. By now you should have received a copy of the press release. If not please contact LHA at 415-433-3777. This call is being broadcast live over the Internet. A webcast replay will be available for one year at www.UEI.com. Also, any additional updated material nonpublic information that might be discussed during this call will be provided on the Company's website where it will be retained for at least one year. You may also access that information by listening to the webcast replay.

After reading a short Safe Harbor statement, I will turn the call over to management. During the course of this conference call, management may make projections or other forward-looking statements regarding future events and the future financial performance of the Company including the Company's ability to maintain and build its relationship with key customers, the Company's ability to anticipate the needs and wants of its customers, and timing to develop and deliver products that will meet those needs and wants, particularly the more advanced platforms of easy setup and intuitive control; the continued success in winning new customers and growing its market share, the timing of new product rollout orders from the Company's customers as anticipated by management including the XFINITY® voice remote, the TiVo® product, and smartphone software and hardware; the continued trend of the home entertainment industry in providing consumers with more advanced technologies; management's abilities to manage its business to achieve its revenue earnings as guided and other factors described in the Company's filings with the US Securities and Exchange Commission.

The actual results the Company achieves may differ materially from any forward-looking statements due to such risks and uncertainties. Management wishes to caution you that these statements are just projections and actual results or events may differ materially, and the Company undertakes no obligation to revise or update these statements to reflect events or circumstances that may arise after today's date. For further detail on risks, management refers you to the press release mentioned at the onset of the call and the documents the Company files from time to time with the SEC, including the annual report on Form 10-K for the year ended December 31, 2014. These documents contain and identify various factors that could cause actual results to differ materially from those contained in management's projections or forward-looking statements.

Also, the Company references adjusted pro forma or non-GAAP metrics and this call. These adjusted pro forma metrics are provided because management uses them in making financial, operating, and planning decisions and in evaluating the Company's performance.

The Company believes these measures will assist investors in assessing the Company's underlying performance for the periods being reported. Adjusted pro forma metrics exclude amortization expense relating to intangible assets acquired, depreciation expense relating to the increase in fixed assets from cost to fair market value, other employee-related restructuring costs and stock-based compensation. In management's financial remarks, it will reference adjusted pro forma metrics. A full reconciliation of these adjusted pro forma measures versus GAAP is included in the Company's press release that was issued after the close of market today.

On the call today are Chairman and Chief Executive Officer, Paul Arling, who will deliver an overview, and Chief Financial Officer, Bryan Hackworth, who will summarize the financials, and then Paul will return to provide closing remarks. It is now my pleasure to introduce Paul Arling. Please go ahead, Paul.

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**Paul Arling** - Universal Electronics Inc. - Chairman and CEO

Thank you, Becky. Our first-quarter 2015 results were in line with our expectations as net income grew 16% over the first quarter of 2014. Our focus on providing an easier, more intuitive control interface for the consumer has produced a long track record of strong financial performance – one that we are confident will continue into the years ahead. Our strategy for growth has proven successful time and again, and recent trends in the market support our long-term outlook. In short, we believe UEI is better positioned than ever to grow our share of the wireless control market.

One of the key components of our growth strategy is our focus on innovation. Knowing the home entertainment industry is always evolving, we are constantly developing the hardware and software products that anticipate the needs of the changing market. In January, we announced Comcast chose UEI to supply its new XFINITY® voice remote controls. The new remote uses voice commands to help consumers find what they want faster from changing channels to getting recommendations on what to watch and more. This remote is powered by our advanced control technology that enables easy home setup and configuration. Initial shipments to Comcast commenced in the second quarter and are expected to scale throughout the year.

Earlier this week, we announced TiVo® selected UEI to supply remotes to its service provider network throughout the US and Canadian markets. We continue to provide embedded software solutions to more and more of the world's largest consumer electronics companies as smart devices remain a growing opportunity for us. We are building our licensing footprint in the fast-growing mobile phone market in China as many of the leading mobile phone brands have selected our software and hardware technology for their devices. We are now working with some of the top mobile phone manufacturers in the region including Huawei, Lenovo®, and ZTE, who in 2014 all ranked among the top 10 largest smartphone brought brands in the world.

China is now the world's largest smartphone market and provides a sizable long-term opportunity for UEI. We are well-positioned to build current relationships and add new ones as we become the de facto choice for leading mobile phone brands. QuickSet continues to be a strong performer for us and the technology of choice for leading brands of set-top boxes, televisions, game consoles, smartphones, and tablets. Our latest QuickSet® solution, QuickSet 3.0 integrates our Control Plus™ technology and represents the industry's most advanced solution for simplifying setup and everyday use for the consumer.

In addition to providing technologies and solutions for our customers' devices, in many cases we partner with subscription broadcasting and consumer electronics companies on the development of their new next-generation set-top box, television, or other device. This partnership is particularly relevant as these devices become more sophisticated and require the expertise that only UEI can offer. In fact, right now we are seeing a remarkable trend as our customers, particularly in subscription broadcasting, are investing in more advanced platforms aimed at improving user interface for their consumers.

Most notable about this trend is how quickly the transition is taking hold and how many of our customers across North America and Europe are upgrading their devices. Whether it's through creating products that offer faster content delivery, better aesthetics, advanced wireless connectivity protocols, or motion and voice control capabilities, these customers are looking for increasingly sophisticated wireless control solutions to meet the higher expectations of their customers. This trend is obviously beneficial to UEI as we are the de facto solution for providing advanced wireless control solutions. While in the short-term we expect to see below average order volumes from some of our customers as they deplete existing inventories in advance of their new product rollouts, in the second half of 2015 we expect to begin benefiting from this growing trend. This is an exciting evolution in the home entertainment industry, and we are confident the best is yet to come.

With that, I'd like to turn the call over to our CFO, Bryan Hackworth, to discuss our financial results.

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**Bryan Hackworth** - Universal Electronics Inc. - SVP and CFO

Thank you, Paul. As a reminder, our results for the first quarter of 2015, as well as the same period in 2014, will reference adjusted pro forma metrics. First-quarter 2015 net sales were $132.7 million, compared to $129.8 million for the first quarter of 2014. Business category net sales were $121.5 million, compared to the first quarter of 2014 net sales of $118.4 million. Our consumer category net sales were $11.2 million, compared to the first quarter 2014 net sales of $11.4 million.

As a result of the stronger US dollar versus the Euro and British pound, consumer sales were adversely affected by FX translation by $1.3 million. Gross profit for the first quarter was $37.7 million or 28.4% of sales, compared to a gross margin of 28.3% in the first quarter of sales in 2014. Total operating expenses were $28.6 million, compared to $28 million in the first quarter of 2014. Breaking down our operating expenses: R&D expense was $4.3 million, compared to $4.2 million in the first quarter 2014. SG&A expenses were $24.2 million, compared to $23.8 million in the first quarter of 2014.

Operating income was $9.1 million, compared to $8.8 million in the first quarter of 2014. The effective tax rate was 21.1%, compared to 24.1% in the first quarter of 2014. First-quarter 2015 net income was $7.4 million, or $0.46 per diluted share, compared to $6.4 million, or $0.40 per diluted share in the first quarter of 2014.

Next, I'll review our cash flow and balance sheet at March 31, 2015. We ended the quarter with cash and cash equivalents of $97.1 million, compared to $112.5 million at December 31, 2014, which reflects typical seasonality of accounts payable and accrued expenses. During the first quarter, we repurchased approximately 69,000 shares for $4 million representing an average price of approximately $58 per share. Given the positive long-term trends in our industry, our stronger-than-ever market position, and the trading range of our stock, we plan to aggressively buy back our shares over the next three months.

DSOs trended toward more normalized levels of approximately 64 days at March 31, 2015, compared to 59 days a year prior. Net inventory turns were approximately 4 turns at both March 31, 2015, and March 31, 2014.

Now turning to our guidance, it is important to note our second quarter 2015 guidance takes into account that many of our subscription broadcasting customers are preparing to roll out new products that include more advanced features. As a result, during this phase these customers are depleting their existing inventories causing customers to temporarily reduce orders well below normalized levels in the first half of 2015.

The second quarter of 2015 we expect revenue between $143 million and $151 million compared to last year's second-quarter revenue of $146.3 million. EPS for the second quarter is expected to range from $0.63 to $0.73 per diluted share compared to $0.66 recorded for the second quarter of 2014. While there are normal ebbs and flows in our sales figures, the long-term outlook for our business remains unchanged. We continue to expect average annual sales growth of 5% to 10% and average earnings growth of 10% to 20%.

I would now like to turn the call back to Paul.

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**Paul Arling** - Universal Electronics Inc. - Chairman and CEO

Thanks, Bryan. As Bryan stated, our long-term outlook for the business remains strong, and we are more encouraged than ever about our future growth prospects. For nearly 30 years, we have been through many market evolutions, some of which redefined the home entertainment landscape. What has made UEI successful is our ability to anticipate the changing trends in the market and provide our customers with the solutions that address these changes. Whether they are upgrades in wireless connectivity protocols, new methods of functionality such as voice or motion, or the introduction of new more advanced devices such as smartphones, game consoles, over the top devices, and smart TVs, UEI continues to redefine what a remote control is and what a remote control can do.

The era of easy setup and intuitive control of home entertainment sources is upon us. Consumers demand it and it provides an enormous opportunity to those who can provide it to them. We are at the forefront of creating these new ways to simplify the home entertainment experience. We remain focused on deepening the relationships we have built with industry leaders across the globe and, of course, building new ones. And we firmly believe based on all that is happening that the best is yet to come. Stay tuned.

I would like to now open it up for questions. Operator?

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions)

Mike Olson, Piper Jaffray

**Mike Olson** - Piper Jaffray & Co. - Analyst

Thanks. Good afternoon. Just two questions from me -- so it sounds like the opportunity for higher functionality, higher SP remotes is significant. And with Comcast rolling out a next-generation remote with voice recognition and two-way RF and other features, do you expect that they will set a new bar that will push other operators to upgrade their offerings as well? In other words if Comcast is doing this does it mean that everyone else will follow?

**Paul Arling** - Universal Electronics Inc. - Chairman and CEO

Well, the answer to that is yes. I wouldn't necessarily say it's only because of Comcast; I'd like to give some of the other operators more credit than that. I will tell you we already are or have been in development with other operators on next-generation products, some of which aren't announced. Because of customer sensitivity, they haven't announced their products yet. But there are major operators both here in the Americas and in Europe that are working on next-generation products that have similar features to what Comcast has already announced and is beginning to roll out.

**Mike Olson** - Piper Jaffray & Co. - Analyst

Okay. Great. And then I had two numbers questions. So related to the guidance you talk about expect average annual sales growth to be between 5% to 10% and earnings of 10% to 20%. Does that apply to 2015 or is that just kind of an average over a multiyear period? And then the second numbers question is -- you mentioned you plan to aggressively buy back shares over the next few months. Is there any buyback built into your EPS guidance?

**Bryan Hackworth** - Universal Electronics Inc. - SVP and CFO

First question -- it's the latter. It's over a multiyear -- 3 to 5 years, say, when we talk about sales growth -- and not just 2015. So we believe in the trends that we have here. We are confident in our ability to execute, and we think we can grow net sales 5% to 10% and the bottom line 10% to 20%, and we've done this for several years now. In terms of the EPS, we do not have that in the forecast.

**Mike Olson** - Piper Jaffray & Co. - Analyst

Okay. And just to be clear on the guidance, I know you are saying that it's not just specific to 2015 only, but it does include 2015, that that would be your expectation.

**Bryan Hackworth** - Universal Electronics Inc. - SVP and CFO

Absolutely.

**Mike Olson** - Piper Jaffray & Co. - Analyst

Okay. Thank you very much.

**Operator**

Jason Ursaner, CJS Securities.

**Jason Ursaner** - CJS Securities - Analyst

Just following up on that question, wondering if you can talk a little bit more about the ASPs and gross margin on kind of the next-generation-type remotes that you are working on with subscription broadcast companies, just because a lot of the new features -- some of them seem like your technologies, some of it seems like you are integrating technology where maybe the cost structure can change on some of those.

**Paul Arling** - Universal Electronics Inc. - Chairman and CEO

I'll answer that, Jason. This means -- the movement toward the more advanced remote certainly means that they are going to be adding features, the first of which is typically two-way. Traditional remotes have been one way, where they send a signal -- many or most, I think right now all of these next-generation remotes are going two-way RF. What that does is it allows a lot more functionality to be built into the remote for things like sending voice but, importantly, it also provides a carrier or an opportunity for us to build in things that require two-way, like QuickSet.

So the price points on these new remotes are obviously much higher. In some cases they can be two to three times the ASP of what a traditional unit has been. Now in terms of the margins, it all depends on the customer. The largest customers in the world when they commit to buy tens of millions of units are going to receive sharper pricing just like in any business, so the margins on those may be in the lower than might be for a smaller company within the industry.

**Jason Ursaner** - CJS Securities - Analyst

Okay. And just, I guess historically when you've done rollouts of new type of remote products -- are you looking at this, particularly the XFINITY but maybe some of the other ones that are in the pipeline, is it different than some of the previous ones? Just in the past how has it worked in terms of timing for how these customers move to a new platform? Is it by geography? Does it tend to be kind of all at once where they make a switchover? Just wondering any historical precedents there?

**Paul Arling** - Universal Electronics Inc. - Chairman and CEO

It's a good question. In the past with operators, sometimes they would start it on a regional basis and then it would take, sometimes multiple years for the various systems or regions within a company to adopt the new technology, so it could take longer. I would say that's probably changed some, that some of the larger operators do a fairly quick rollout. The bigger issue right now or the bigger opportunity or challenge, depending on how you view it, is that so many of them are working on this. We've never seen -- I've been here almost 20 years. I've never seen a time where there have been more development projects going on for these next-generation products all at once. There [are] a lot of companies looking at improving the UI for their customer, building these next-generation products -- user interface products, both on the set-top box side but obviously the remote is part of that. So that's probably the biggest change. We've seen rollouts before where there would be less than average orders during a transition, but when you have so many customers doing it at once it can create a lot of activity internally. We are handling it really well. Our development is on track for these projects, and we are really excited about what's happening in the industry with all these advanced features giving rolled out with customers.

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**Jason Ursaner** - CJS Securities - Analyst

Okay. And the inventory challenge at customers during the transition, how much inventory do your customers tend to hold? Do you see that as kind of being a one-quarter issue on Q2, or is that going to be more prolonged through the back half?

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**Paul Arling** - Universal Electronics Inc. - Chairman and CEO

Well, I think typically it's three to -- it could be a little bit more than that. Again, it depends on the operator. They have various locations that they ship from, some of which may carry a few months' supply; some may be as much as four. Some don't have much at all so the transition is very quick. So, it does vary by customer, but in some cases it's months where they will order less than they normally would. I'll give you an example. We have customers that might order 30% to 40% of what they normally would during a quarter because what they are doing is some of the regions are already inventory balanced and others they need to work through the inventory that they have in the barn. So it can be a few months' supply.

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**Jason Ursaner** - CJS Securities - Analyst

Okay. And just last question --

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**Paul Arling** - Universal Electronics Inc. - Chairman and CEO

Long term, customers have to buy to their deployments.

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**Jason Ursaner** - CJS Securities - Analyst

Right.

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**Paul Arling** - Universal Electronics Inc. - Chairman and CEO

So, it goes away after a number of months.

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**Jason Ursaner** - CJS Securities - Analyst

Okay. And just last one for me, the connected devices -- I was wondering if maybe you could breakdown growth a little more from licenses on mobile phones, specifically versus other devices within the AV stack, like the smart TVs and set-top boxes that are taking advantage of QuickSet, just because obviously there's a lot of investor interest around the licensed piece versus more of the embedded chips in the AV stack.

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**Paul Arling** - Universal Electronics Inc. - Chairman and CEO

This is where licensing gets difficult because what we are now seeing is that some of our customers are not going to license things like QuickSet. They are instead going to buy a product with it embedded, which makes it more difficult because we don't really separate out on a selling price how much was for the product, how much was for the chip, and how much was for the license of the QuickSet technologies or the cloud-based services. It's usually a system that we sell to customers at a price. So it's getting -- in some cases we are going into the AV space in particular. In mobile, it's a little easier but in AV and the set-top box TV world it can become very difficult to separate those things out.

**Jason Ursaner** - CJS Securities - Analyst

Maybe just more qualitatively though in terms of traction, what are you hearing from customers in terms of user adoption and pull-through from end-user demand for some of the features? Is it equal across the AV stack and mobile? Just how is it going with customers in those two markets?

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**Paul Arling** - Universal Electronics Inc. - Chairman and CEO

I think the features have gone very well with customers. I think on the AV stack may be higher but that's because that's our historic market. And the problem itself is largely an AV problem; it's not a mobile problem. The mobile device becomes a remote control to solve the problem that exists in the AV stack. So the appetite for the feature has been extremely high amongst those that are adopting it in the AV world, consumer electronics and set-top box companies. I have yet to see one that this has been presented to that was an extremely interested in it because the feature is compelling.

I think longer term, though, this brings an interesting opportunity in the mobile space, because you can envision if the devices have QuickSet embedded -- the TV, the set-top box, the AV receiver, etc. then the app becomes even more powerful because you can envision the app being able to set itself up with absolutely no set up by the user at all. As soon as you enter the network, the app gets launched on your new phone and it already knows all the devices you have and has the activities already set up -- watch DirecTV, watch Comcast, watch Apple TV, watch Roku. These buttons could already be predefined on a mobile device. But again, that's with traction of QuickSet on the AV devices -- TV, set-top box, AV receiver.

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**Jason Ursaner** - CJS Securities - Analyst

Okay.

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**Paul Arling** - Universal Electronics Inc. - Chairman and CEO

And we are seeing a lot of interest there and adoption. Over the last number of years this has done nothing but grow, and now we've got the latest version which is even better, which does predefined activity. So, we think this is going to have a lot of traction in the coming years.

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**Jason Ursaner** - CJS Securities - Analyst

Okay. Sounds great. Thanks for taking all my questions.

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**Operator**

(Operator Instructions)

Lance James, RBC Global Asset Management.

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**Lance James** - RBC Global Asset Management - Analyst

Just a couple of questions. First with your sales goal growth of 5% to 10%, obviously this quarter and your guidance for the next quarter is not going to make that. I guess my question is: what tangible items do you have or some confidence that the second half of the year will pick up sales wise?

**Bryan Hackworth** - Universal Electronics Inc. - SVP and CFO

Well, we've already won the bids and the jobs -- the projects. So we are actually shipping -- some of these transitions that Paul mentioned already occurred and some are in process, so it's not as if we have to go out and win them. We have already won the projects. So we have forecasts, and we pretty much know what the levels will be within a reasonable range. The one thing -- because these features are more advanced, they have the two-way RF, they've got the voice control, the ASPs are higher. So as Paul mentioned, on some of these you are looking at two to three times the previous price because of the advanced features. So that should instill confidence and, again, we have the forecasts from the customer that aren't always perfect but they are within a reasonable range.

**Lance James** - RBC Global Asset Management - Analyst

Terrific. The second question would be, your gross margins have pretty much been in that's 27% to 29% range for the past few years. The question would be -- with either the advanced features that you have on a remote control or selling more into these other connected devices, should we anticipate that there is gross margin improvement potential or would more of your margin enhancement come from leveraging your SG&A over a larger revenue base?

**Bryan Hackworth** - Universal Electronics Inc. - SVP and CFO

I think when you are talking about large customers it is going to be the latter. Large customers will get favorable pricing so the gross margin percentage to a large customer would probably be less than say the Company average. But you hit the nail on the head; where we get the benefit is on the leverage of the SG&A where the incremental cost to ship a high-end remote versus a low-end remote is almost nothing, so the variable costs associated with it are minimal so it's going to drive OI percentage up. So that's where the benefit comes in.

**Lance James** - RBC Global Asset Management - Analyst

Terrific. Thanks. Appreciate the info on both sides, and good luck.

**Operator**

(Operator Instructions) Okay. I am showing no further questions. I would like to now turn the call over to Paul Arling. Sir?

**Paul Arling** - Universal Electronics Inc. - Chairman and CEO

Okay. Thank you everybody for joining us today and for your continued support of UEI. I just want to announce we'll be participating in the B. Riley & Co. 16th Annual Investor Conference on May 13 -- next week -- in Hollywood, and we hope to see as many of you there as possible. Thanks very much for participating and your interest and goodbye.

**Operator**

Ladies and gentlemen, this does conclude your conference. You may now disconnect.