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Universal Electronics, Inc. (UEIC)

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MANAGEMENT DISCUSSION SECTION

Greg J. Burns

Analyst, Sidoti & Co. LLC

All right. Right. So I'm Greg Burns, the analyst at Sidoti, covering sorry, covering Universal Electronics. Really happy to have Paul Arling, the company's CEO presenting here for us this afternoon. So I'm going to hand it off to Paul and then I'll hop back in at the end and we can go through some Q&A if there's time.

So with that, take it away, Paul.

Paul D. Arling

Chairman & Chief Executive Officer, Universal Electronics, Inc.

Okay. Thank you. First, I'll start off. I'm going to make some forward-looking statements. You're probably hoping I will. There are a lot of risks involved in these forward-looking statements. Please visit our SEC disclosures for a more detailed explanation of those risks. We're the global leader in wireless universal control solutions for home entertainment and smart home devices. Essentially, we build control systems or control solutions for most of the major brands in the world, which we'll get to in a few minutes. Particularly in home entertainment, but also now more and more in smart home applications. This is our long term financial performance chart. While last year was difficult on sales, we have shown over the last 18 years, I guess this represents a 10% compound annual growth and our earnings have been approximately 13% in growth over these last 18 years.

While there have been ups and downs, we obviously have shown a strong long term track record of growth in both sales and earnings, with last year being our highest earnings EPS year ever. So we're really proud of that, both the long term and even the short term accomplishments we had last year. At a glance, we're the market share leader particularly in home entertainment, lead – working with the leading companies home entertainment working with the leading companies in the world. We focus on technology and product innovation, the industry – with the industry leading QuickSet software which again is embedded in many televisions today, the major brands in the world as well as in most of the major operators on the home entertainment sides of products. We have global scale, our R&D teams really across the world, we've – we manufacture in multiple areas of the world as many of you followed us for a while. No, we now are producing a fair amount of our product in Mexico due to the US tariffs, but we've made those changes successfully and profitably. We have a Fortune 100 customer base

which again we'll get to in a few minutes and obviously a strong financial performance as we demonstrated on the last slide.

Well, our channels are made up of again home entertainment, the ones represented in red here are what we would define as home entertainment, video service providers, consumer electronics, and retail. That makes up just over three quarters of our sales today, but increasing – increasingly we have a smart home channels which are represented here and black, security and automation and climate control are the major portions of that. But we also are in home appliances and hospitality your home away from home. So the applications we're building for most of the channels we have also would apply to hospitality because again it's your home away from home.

Here are some of the companies we – I won't go through all of these names with some of the companies that we power major companies in the industries we serve. Most of the major video service providers across the world are working with us either utilizing our technology or our products for their implementations. The three leading market share brands in television in the world, Samsung, LG and Sony are all embedding our QuickSet technology in their products and their TVs. Strong presence in retail, security, climate control which is a growing portion of business for us. So the leading brands in the world are using UEI technology our products. An important point for everybody to remember the average American spends almost five hours per day watching television. You probably do not. Maybe you do. But if you watch less than that that means somebody is watching more. If you watch three hours somebody else is watching seven hours. This is a the most common activity in the home today. And again we power this. Most Americans are watching both traditional and streaming services as you can see from this there's a couple of points to make.

Almost two thirds of people or about two thirds of people are watching both, which brings about an opportunity for what we call hybrid systems, systems that combine the TV live TV shows you like to watch things like sports and reality shows which are like sports. And you watch them on linear TV, but then you go binge watch of your favorite show on some service Netflix, Prime, Hulu name your favorite service. So this is what most Americans are doing today. I think another important point to make from this though is that streaming appears to be getting close to saturation as far as household penetration. That doesn't mean more services can come, but household penetration looks to be holding steady at just over 80% over the last couple of years. But importantly we're building the hybrid systems that serve these dual households people who are streaming and watching live TV. Entertainment and control has changed dramatically in the last number of years more content than ever requires better and a little more seamless ways to find or search for things which lead to a greater demand for voice remotes. When you have thousands or tens of thousands or in fact millions of options it becomes very difficult to do it other than to do things like press a button and say I want to watch the name your favorite show and it simply appears on the screen or name a channel and it tunes to that channel. This is becoming very popular in the implementations we're doing. And Internet connectivity and two way communication creates smart control opportunity, a lot of the things we're doing today are enabled by IP and IP driven systems, auto configuration of your system is something that's been enabled over the last number of years that we're doing, you simply bring the product home, plug it in, connect everything together and our software takes over and completely configures your system and gives you complete control over that system through that software with no work on your own part.

Set-top boxes with advanced [ph] TDOS is projected to grow significantly over the next five years. So again these hybrid boxes are becoming the more the norm and every major operator either has introduced one or is planning to introduce one. Smart entertainment growth is driven by streaming advanced set-top box again growth here between 2019 and 2023 is more than doubling. Smart media players obviously grow fair and smart TV shipments are growing also substantially. 69% of US households have at least one smart home device. The major applications that we're targeting here are contact and motion sensors, smart thermostats and garage sensors. These are – these markets add up to about \$4 billion, and as I said earlier this accounts for just over 20% of our

sales today. So we're still relatively small but we see a good growth trajectory for these types of applications. And maybe they're interchanged with the AV system because as I mentioned earlier the average person is spending five hours a day in the US watching television. What better place to control your smartphone than from the AV experience. Our vision is basically to be the most knowledgeable company on the planet about entertainment, smart devices and services that people have in their home. We believe we're already achieving this, but you're never done and we continue to have this vision of our company to be just that. We're doing this in software and services, wireless connectivity which are larger parts of our business than ever before. But we also sell products for home entertainment and the connected home. We are actually doing over 100 billion cloud transactions annually with these IP based products. So it's very common in the home today to have these connected products powered by UEI technology.

Some new products we introduced this year and the replacement for CES, we did this virtually, the Comfort Family of connected thermostats. HVAC is actually a very good portion of our smart home business with leading companies in the world. And we're developing new products there. The Comfort Family, QuickSet Widget and the Virtual Agent are also new. If you want more information on these of course you could look at the replay which I think if it's not posted now will be soon from our Investor Day last Friday where we actually demonstrate these technologies and give a more detailed explanation of them. In Q4 alone we won some new – there were some new wins for us. Virgin provided a voice-enabled remote for their new Virgin TVs 360 platform. Apple was also announced they're launching an Apple TV. We've launched an Apple TV remote control for MVPDs. This is a product specifically made for hybrid systems again for streaming as well as watching your linear TV experience and a uniquely designed remote Siri-based Siri-powered that can also control your live TV experience. And also a big win for us with liberty, one of the largest operators in the world to provide another voice enabled remote for their 4K box. We are achieving profitability records last year while difficult on the sales front due to COVID operators that had non self-install platforms shrank. Our Q4 sales were less than the prior year but our gross margins have expanded significantly. In 2020 they were over 30%, 30.8% to be exact versus 26.7% in the year before. Again this is due to more licensing particularly in the CE business, consumer electronics business as well as a richer mix with customers. And we also are – have improved our operating margin by being smarter about our expense management, investing more in R&D and less in SG&A for growth in the future. And our balance sheet is strengthened. We ended last year with a net positive cash balance of \$57 million cash with down – our debt down to \$20 million at year-end.

We repaid \$48 million of that debt during 2020. We've also been buying our stock. We don't think the market has represented always the true value of our company. The intrinsic value is not equal to the market value. And when those two numbers diverge from each other greatly we become a opportunistic buyer, because we think it's a good a high return method of utilizing that cash. So we've become a buyer of the stock.

In summary, we are growing the home entertainment channels through these hybrid systems and leveraging our long-term customer relationships, upgrading customers to these advanced products. We've been diversifying into the connected home successfully mainly in safety and security in HVAC, but many applications of the smart home. We've been shifting to higher margin sales which shows in our numbers and again delivering consistent growth. We target 5% to 10% sales growth over our long-term. Our long term goal is 5% to 10% in sales and 10% to 20% in earnings long-term. That's my presentation and we can now open it up for questions.

QUESTION AND ANSWER SECTION

Q

Great thanks. So if anyone has any questions listening in you can type them in through the Q&A function through Zoom. If not I'll kick it off here Paul. So we think about your traditional home entertainment market subscription broadcast satellite market. Can you just talk about the risk of cord cutting there and where you still see growth opportunities in that market?

A

Yeah, sure. Well cord cutting can affect our business. I think it's important to remember, consumers – the consumer market really isn't about cord cutting or anything else like that. As I've described earlier, people still want to watch live television. Some of the most popular shows on TV are either sports during the fall, the number one show every week is football on Sunday night. Sports are still a major part of TV viewing, whether it's streaming, live, no matter how it's delivered, live television is important to users, to customers. They want to see their sporting events.

Some of the most popular shows on TV are also reality shows. Again, many in this audience today may not watch them, but they're some of the highest rated shows on TV are reality shows, which are largely like sports. There's a competition usually someone gets eliminated, somebody loses this week or wins this week depending on the show. These – this is what we refer to as perishable content, things that you'd need to watch live or near live because nobody as I like to say nobody watches the Super Bowl on Monday. These are types of events that you need to watch live. But in addition to that people also want to binge watch their favorite show through whatever service it is they enjoy, Disney+ or Netflix or name your favorite service.

What the future holds is that both traditional players in the industry as well as potentially new players aren't and the successful ones are going to be the ones that combine those two things into one easy-to-user platform. And that's what you're seeing the market place. Comcast has done this successfully. They have a great platform, through which people can launch their Linear or Live TV their sports you want to watch right now BBMCaa or a baseball game. You want to watch that tonight. And then when it's over, you go binge watch something on your favorite service. I think that's what the future is. We're less concerned about who's going to provide it. We think there's going to be competition on that front. We happen to think that the incumbents in the industry are doing a good job and will increasingly do a better job of providing those platforms. But there will be new platforms things like the Apple TV, targeted for MVPDs that we think will achieve success because they provide exactly what I just described. A combination of the Linear TV in that case provided by the traditional player, the cable and the MVPD itself through an app and then you get all the other apps you want to watch. So I think that's the more important point. And we power most of these platforms, these hybrid platforms that combine linear with over the top.

Q

Okay. We'll come back to that. But I guess the two components I think about in the traditional home entertainment market are this upgrade cycle that's occurring and then you gaining more exposure with these over the top these

streaming platforms. So can you just talk about where we are? What is that upgrade cycle? What it means to you in terms of the revenue incremental revenue and where we are in terms of that upgrade cycle?

A

Sure. Yeah it's still relatively early in the upgrade cycle although it's been going on for a few years now. There is still a lot of projected growth just by outside data sources in these advanced platforms. Over the next five years, it's expected to double in terms of the number of subscribers, number of subscribers in terms of the number of subscribers number of subscribers that will have availability of and will adopt one of these advanced platforms and I think one of things that I kind of want to get through is everybody tries to simplify the world and they view this as a battle between one thing or the other without realizing that a traditional player in this industry actually is streaming. So, it – but saying that there's these streaming these dark agents of streaming and then there's these the traditional player. It's not really that simple that there are traditional players who are building streaming platforms that provide what I described earlier, linear plus SVOD AVOD-type services. And they put it into one easy-to-use interface. So, I think that's what you're going to increasingly see is that there will be new players that will enter and bring those solutions, but there's also traditional players that are working on becoming more of a streaming company and when they do that they'll succeed – and they'll succeed because they're giving the consumer exactly what they want which is again tonight I want to watch the Chicago White Sox play baseball and then when the game's over I want to go binge watch some show on a service. And I want to be able to do that easily on one interface that will give me all of that within it and I think that is the trend and you're going to see more of that for both traditional players or others that are either new to the industry. They're big companies, but they're new to this industry. And there's going to be a need for that. Smaller players in the industry are going to need.

help, because the large companies can build their own platform. But the medium-size companies will probably need help and there is plenty of that out there with companies like with Google they've built Android platforms that we power. Apple, who's building a great platform that combines those things. TiVo is out there. They are also winning some business with this new generation of product. Comcast has done it themselves. They've syndicated their platform. I think there's a lot of options for the medium size to smaller players. But they're all going to move in this direction because that's what the consumer wants.

Q

Okay. Just so everyone understands. So when we talk about like this advanced platform remote upgrade cycle we're talking about voice enabled to a IP connected remotes and that have two times the ASP of a typical traditional remote. So that's kind of driving this like – it's not a cannibalization, but there's rerating of your existing customer base to a higher ASP device over time.

A

I forgot. Yeah. And I'm sorry. That's an important point. These products are typically much more sophisticated than that which came before them. The older platforms could be powered by universal remote that was infrared only, because you could turn your TV on, you could change the volume and you could change the channel. That was essentially – there was more to it than that, you could bring up the guide. But there was more to it than that. But put simply that's what those products were able to do. Newer products are much more sophisticated because they're going to need to carry voice. They're going to need to be two way. The consumers want them to be self-

configurable, the operators now want them to be self-configurable, not just because it's less expensive because they could ship you the box and you could set it up yourself. But the pandemic has driven this home even more, because having somebody come into your home to install has become difficult or uncomfortable. Well, with a QuickSet enabled product you wouldn't need to do that. You could simply mail somebody the product or have them pick it up and then they could bring it home and set it up themselves. These products are much more sophisticated than that which came before them and therefore they typically are more expensive, in fact often two times as expensive. So as this begins to roll forward the products are more sophisticated. We're the specialist in making them; number one, by far in the world that making these advanced products and the market is expanding due to the ASP increase.

Q

Okay. And then you mentioned a bunch of these streaming over the top platforms that you're now providing remote or control technology for the Apple TV, Android, flexi Comcast. There's a question from the audience about Roku. What is your current relationship with Roku? And has their success been a net positive or negative for you?

A

Well, yeah, we're actually engaged in a few legal matters with Roku. They were a customer at one point, but we currently are not working with them. And we are engaged in I think it's three separate lawsuits, two in district court and one ITC case. So not currently working with them. And we'll keep people updated on the status of those legal matters as they move forward.

Q

Okay. Now switching over to the other the connected home, smart home opportunity. I think that's probably in my view like an underappreciated like aspect of how the business is evolving at this point. So you mentioned it little over 20% of revenue at this point. So you mentioned like a little over 20% of the revenues coming from there. Just roll out a bunch of new products going after that market. I think more aggressively whether it's technology building blocks and your own products you're building. So can you just talk about what the opportunity is there in that market for UEI with some of these new product or new foundational technologies you've rolled out as well as some of the new products that you're bringing to market?

A

Sure, yeah. We've been doing these smart home products for some time now. And I think we're what we've learned and we have this learning from the home entertainment market is that most people relate to smart home through products that have come out early. So things like [ph] Ness or other products which are great products and they introduced the concept to consumers. We saw the same thing in home control. We were the originator many years ago of the first universal remotes that would operate all of your devices in your AV stack, your TV, your set-top box et cetera all with one device. And it started in the aftermarket on the consumer side. So you would go buy these products and they would control – you'd set them up and they would control everything. What we saw happened next though was that if you fast forward to today probably 95 plus percent of these home control products – sorry home entertainment control products are distributed through the TV companies, the subscription broadcasters in other words they're embedded. These technologies are embedded in the original

product itself. We think the same thing is beginning to happen in home control in HVAC and other products because as new systems come out rather than having to add this feature later it could be embedded in the original unit. Now it does take longer because your HVAC system – I hate to break this to anybody out there but if you have one in your home today they typically last about 15 to 20 years. Eventually they break and you'll probably either have to have it fixed or replaced. It is our view that in the future when you have it replaced just like top and in-home entertainment these smart home applications will be built into the product when you buy it, this is what we're starting to do with major companies in the HVAC industry including the largest in the world 00:26:26 Daikin was a large one of our top 10 customers. They are beginning to make and have been making for a while. Smart products split systems typically which are common here in the US and they're making them smarter and better than ever able to be remotely controlled, able to be IP controlled, we think that's the trend. And we're working with those companies to make that happen.

Q

Okay. And then at your Analyst Day you had an example of 00:27:02 with the LG and it's just turning to using QuickSet the new QuickSet to kind of turn the TV into the hub for the home.

A

Yeah.

Q

Which I think is interesting. Can you just talk about that opportunity to maybe blend what you've been doing on the home entertainment side of control with home automation?

A

Sure. Yeah. We've – it's a further expansion of QuickSet, QuickSet began by configuring your home entertainment devices. So you bring this TV home, you plug in your Direct TV box your Comcast box whatever box you're using. Say you have a streamer Apple TV streamer and you have an Xbox. You plug them in, it identifies them, discovers them, identifies them configures them and then makes the controller that ships with that unit control them. So it does everything automatically. We've extended that now to home control devices. So if you were to have a lighting system or HVAC system or really any of these home control devices, it'll do the same thing. It will discover them, identify them, configure them and then allow control of them through the interface on the LG TV that we showed at Investor Day. So it's just an expansion of really the same concept but much wider better for the whole home. It's now not just about home entertainment, it's about control of the entire home through that device.

Q

Okay. And then you talked about the smart thermostats and then you also have a product Nevo Butler, which is kind of a smart speak white label smart speaker. So do you have customers for these products and any timetable on when they will start to roll those out?

A

Yeah. We do. Nevo Butler is something that we are currently working with a customer on launch plans for that product. So that is soon sometime during probably the front half of 2021, but sometime this year. We're working with somebody on launch of that product.

Q

Okay. And then the timetable on the smart thermostats is that being adopted or is that something that you have customers lined up or what's the status there?

A

Yeah. We are currently talking with some major players in the industry who have great interest in that. It's not as close to launch as the butler right now, but you know it's progressing.

Q

Okay. All right. It looks like we're at the end of our time slot here. So I just want to thank 00:29:54

[Abrupt End]

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