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UEIC - Q3 2015 Universal Electronics Inc Earnings Call

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CONFERENCE CALL PARTICIPANTS

Becky Herrick *LHA - IR*

Steven Frankel *Dougherty & Company - Analyst*

Les Sulewski *Sidoti & Company - Analyst*

PRESENTATION

Operator

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

Becky Herrick - LHA - IR

Thanks, Eric, and thank you all for joining us for the Universal Electronics third-quarter 2015 conference call. By now you should've received a copy of the press release. If you have not, please contact LHA at 415-433-3777. This call is being broadcast live over the Internet at 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'll 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 in the future financial performance of the Company including the benefits anticipated by the Company due to the continuation expansion of benefits the company has experienced and anticipates due to licensing of the Company's technologies and patents such as the Company's Smart device and QuickSet technologies.

The continued adoption the continued adoption, selection and acceptance of the company's technologies and products by the world's largest companies in the home entertainment industries such as Comcast's XFINITY product. The successful integration of the (inaudible) assets of this besides, significant percentage of the Company's revenues attributable to a limited number of customers. The timely development, delivery and market acceptance of products and technologies such as home security, home automation, wireless sensors and other smart home and security technologies. The continued innovation of next generation solutions that are accepted by the Company's customers and end-users. Management's continued ability to identify and execute on opportunities that maximize shareholder value including the effects repurchasing the company shares have on the Company's stock value. The continued sale and earnings growth has experienced in the past, management's ability to identify and execute upon growing trends in markets, management's ability to manage its cash and cash equivalents and achieving its revenue and earnings is 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 statement 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 risk, management refers you to the press release mentioned at the onset of this call and the documents the company files time to time with the SEC including the annual report on Form 10-K for the year ended December 31, 2014 and the periodic and quarterly reports filed since then.

These documents along with risks identified earlier contain and identify various factors that could cause actual results to differ materially from those contained in management's projection or forward-looking statements.

In management's financial remarks, it will reference adjusted pro forma metrics. A full description and reconciliation of these adjusted pro forma measures versus GAAP is included in the company's press release issued after the close of market today. Adjusted pro forma metrics are provided because management uses them in making financial, operating in planning decisions and in evaluating the Company's performance.

The Company believes these measures will assist investors and 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 resulting from acquisitions, increase in inventories from cost to fair market value resulting from acquisitions, a court ordered award to a defendant in a lawsuit or a portion of its legal fees, stock-based compensation and other employee-related restructuring costs.

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

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

Thank you, Becky, and thank you all for joining us today. For the third quarter of 2015, we reported net sales of \$160.5 million reflecting a 9% growth over the same quarter last year. And EPS was within guidance at \$0.78.

The world is changing as consumers need for more advanced functionality is paired with an increasing desire for simplification. New home entertainment platforms in development are cloud connected and paired with advanced two-way remote controls. These platforms are changing the way that home entertainment is controlled and consumed.

They also provide an opportunity to add new home control or home safety and security services desired by consumers. This provides an enormous opportunity for us as this is right where UEI excels. For years, we have helped our customers provide devices and technologies that substantially increase functionality while remaining simple to set up and use every day.

A good example of this is Comcast who chose UEI to supply its new XFINITY voice remote-control, which uses voice commands as well as traditional manual operations to control functions such as changing channels in volume and it incorporates our advanced control technology to enable easy home set up and configuration.

We are beginning to see the positive impact of this and other new product rollouts in Q4 and anticipate it will continue to build into 2016 as customers continue to ramp into their new product releases.

We remain on plan with the integration of Ecolink intelligent technology. The acquisition we announced on August 6.

Ecolink is a leading provider of wireless securities, sensing and home automation products and services. According to data from ABI research, the global market for home, safety and security sensors and connected devices is projected to more than double over the next four years.

From \$1.4 billion in 2015 to \$4 billion in 2019. We are currently working on several new products in this emerging and rapidly expanding industry which we expect introduce with our industry partners throughout 2016.



As we introduce our innovative products and technologies into new markets, we are also expanding our presence within our existing markets with new and current customers. Our embedded software solutions continue to be adopted by more of the world's largest home entertainment companies.

We expect to launch several advanced remote control solutions as well as home safety and security products with major industry players in the next few quarters. We will provide details as these programs roll out.

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

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

Thank you, Paul. As a reminder our results for the third quarter and first nine months of 2015 as well as the same periods in 2014 will reference adjusted pro forma metrics. Third-quarter 2015 net sales were \$160.5 million compared to \$147.8 million for the third quarter of 2014.

Third-quarter sales were less than expected mainly due to a couple of customers delaying their shipments leading to advanced platforms. We expect these shipments to commence in the fourth quarter.

Business category net sales were \$148.6 million compared to \$135.2 million. Consumer category net sales were \$11.9 million compared to \$12.6 million. As a result of the stronger US dollar versus the euro and British pound, consumer sales were adversely affected by \$1.3 million. Gross profit was \$43.1 million or 26.9% of sales compared to the gross margin of 30.7% in the third quarter of 2014. The decrease in our gross margin rate is due primarily to a higher percentage of our sales being made to large customers who receive favorable pricing as a result of higher volumes.

We've also experienced a decrease in shipment royalty revenue as there were a number of new product introductions in the prior-year. One was a significant brand name.

Total operating expenses were \$25.9 million and compared to \$28.9 million in the third quarter 2014. Breaking down our operating expenses, R&D expense was \$4 million compared to \$4.2 million in the third quarter of 2014. SG&A expenses decreased from \$24.8 million to \$21.9 million primarily as a result of lower incentive compensation.

Operating income was \$17.2 million compared to \$16.4 million in the third quarter 2014. The effective tax rate was 29% compared to 18.8%. Net income for the third quarter of 2015 was \$11.8 million or \$0.78 per diluted share compared to \$12.9 million or \$0.80 per diluted share in the third quarter of 2014.

In the nine months ended September 30, 2015 compared to the same period in 2014, net sales were \$440.7 million compared to \$423.9 million. Gross margin was 27.5% compared to 29.7%. Total operating expenses were \$81.5 million compared to \$86.3 million. Operating income was \$39.8 million compared to \$39.7 million. Net income was \$30 million or \$1.89 per diluted share compared to \$29.8 million or \$1.85 per diluted share in the prior-year period.

Next, I'll review our cash flow and balance sheet at September 30, 2015. We ended the quarter with cash and cash equivalents of \$64.3 million compared to \$112.5 million at December 31, 2014. During the third quarter, we completed the acquisition of Ecolink which resulted in the cash outflow of \$12.5 million net of cash acquired.

During the third quarter, we repurchased approximately 945,000 shares for \$44.4 million representing an average price of approximately \$47 per share. At the current price, we expect to continue to buyback our shares over the next few months as the promising trends in our industry in our growing market position supports our positive long-term outlook.

DSO's were approximately 63 days at September 30, 2015 compared to 65 days the year prior. Net inventory transfer approximately 4.2 turns at September 30, 2015 compared to 4.5 turns the year prior. Now turning to our guidance. It's important to note the implementation of next generation IP connected two-way platforms are upon us. And we couldn't be more excited about the short and long-term prospects for our business.

Our fourth-quarter guidance reflects the continued transition of our customer base to higher-end platforms as will begin shipping remotes of more advanced features to three additional customers in the fourth quarter. Because of this transition, the seasonality of our business in 2015 is different than in the past as our fourth quarter is expected to not only be the largest quarter of the year but also in our Company's history.

For the fourth quarter of 2015 we expect revenue between \$159 million and \$167 million compared to last year's fourth quarter revenue of \$138.4 million. EPS for the fourth quarter is expected to range from \$0.79 to \$0.89 per diluted share compared to \$0.70 recorded for the fourth quarter of 2014.

Based on the after mentioned positive trends in our industry, we are reaffirming our long-term financial outlook. We expect average annual sales growth of 5% to 10% and average earnings growth of 10% to 20% over the next five years.

I'd now like to turn the call back to Paul.

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

Thank you, Bryan. There's an important acceleration coming to our business and I'd like to take a minute to discuss where the business has come from and where we think it is going.

Almost 20 years ago when this current team started to take hold, UEI sold basic universal remotes and had approximately a 3% market share in United States. Perhaps the first large inflection point for UEI came when the digital to analog conversion took place. Our customers identified that they needed to take control of other devices in the home entertainment stock and if the service tech shave minutes often in field visit and the remote worked perfectly with the devices that the consumer already had in place, their service costs could be lowered and customer satisfaction could be increased.

UEI led this transition by building the best device technology in the world.

Jumping forward to today the greatest testament to the technology leadership position we have built this the market share we enjoy. We have the majority share of control technology in the US and by far the leading share of our market worldwide.

Today another powerful inflection point is now making itself available to UEI and we are ideally positioned to capitalize on it. The technology of today includes cloud connected TV, set-top boxes and over-the-top devices that are smarter than ever.

These devices are being linked to the remote control to perform automated setup and every day ease-of-use features that have never been possible before. These remote control systems are not just a dream or interesting idea. Some have already been introduced, some are about to be introduced and some are in development for introduction next year with many of the leading names in home entertainment worldwide.

In addition, these cloud connected to a platforms have also opened up for us to sell other products to support new home control and home security services that our customers have been planning. This movement towards smarter more advanced remote control systems has begun and represent an enormous market and financial opportunity for us at UEI in the coming years.

Frankly, these ideas are not new to us as we contemplated this day many years ago. But the technology is now available and the consumers appetite for these new products and services combine for a powerful opportunity today. Our unmatched world leading technologies, intellectual property and products have us ideally positioned to excel as this inevitable transition to the smart home takes place.

We are more excited than ever before about the future prospects of our Company. Stay tuned.

I'd like to now open it up for questions. Eric?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Steven Frankel, Dougherty.

Steven Frankel - Dougherty & Company - Analyst

Good afternoon, let me just start with a couple of housekeeping items and then a more strategic question. So what was Comcast's percent of revenue in the quarter?

Bryan Hackworth - Universal Electronics Inc. - SVP and CFO

Comcast was -- they were at 26.6% of sales.

Steven Frankel - Dougherty & Company - Analyst

And were there any other customers over 10%?

Bryan Hackworth - Universal Electronics Inc. - SVP and CFO

There was. DirecTV was also a 10% customer. They were at 13.7%.

Steven Frankel - Dougherty & Company - Analyst

Okay and what tax rate should we assume or is assumed in your fourth-quarter guidance?

Bryan Hackworth - Universal Electronics Inc. - SVP and CFO

I'd add -- I'd probably put low to mid-20s. Right now the R&D tax credit hasn't passed yet so the tax rate runs little higher than (inaudible) finalized it last year.

Steven Frankel - Dougherty & Company - Analyst

Okay and then the advanced remote customer that slipped out of this quarter, how do you have confidence that they will ship in Q4? Have they already begun shipments?

Bryan Hackworth - Universal Electronics Inc. - SVP and CFO

Well, we communicate with them daily, so it's something that we our salespeople they work with their team in terms of their purchasing departments. So we are in constant contact with them. And from our understanding they are going to ship in Q4. So I think our confidence level is high in that regard.



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

The one thing Steve, set-top boxes are much more complex than in the past. So the fact that these customers delayed shipment by month or two isn't -- we don't like it but I can't say it's a complete surprise when you're dealing with the -- they used to be old analog boxes and now you've got two-way RF, you've got IP connections, you've got voice control. They are much more complex. So again we are not happy a got delayed a little bit but in the grand scheme of things from a long-term perspective it's very minor.

Steven Frankel - *Dougherty & Company - Analyst*

Okay and for Paul, could you maybe give us an idea of the go link opportunity for you? What kind of revenue contribution might we expect kind of short run in 2016 and then longer-term how big of an opportunity is this for you out of that \$4 billion pie?

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

Well, I'm not willing to give you the exact figure or guidance for next year but what I'll say is this. As we said in the prepared remarks that the platforms that are being put into your home today our IP connected or cloud connected so they are connected to the Internet. They all have built-in two-way RF capabilities.

So this architecture makes a perfect host for these other products, these other services door sensors, window sensors. You know protection against fire and other types of safety and security products potentially home control products. All the protocol necessary to bring such services will already be in place. And basically justified on the back of the video business.

So anyway, these platforms are out there. We see this is a big opportunity. It's important to note as we did in the prepared remarks, we're not talking about a market that doesn't currently exist and that we hope will develop. The market for these products, these home safety and security products is already \$1 billion almost \$1.5 billion a year and it's projected to more than double over the next four years probably on the basis of some of the smart platforms that are coming out.

Our customers have been talking to us about this for some time. They obviously realize that the architecture they have put in place will lead to a small incremental investment necessary to bring this type of service revenue to them. We've talked to current industry players in the home safety and security business and we have some unique innovative product that we think can make a real difference there.

So we do think that we have -- we can carve out a real good market position in this new market which is about \$1.5 billion going to almost \$3 billion. So that would tell you how big this could potentially be. Do your market share statistics, take 10% of that market and you've got a very large number.

Steven Frankel - *Dougherty & Company - Analyst*

And I think you've said before that there are contracts in place today for 2016 delivery of new products, right? So it's not like you're just going out and knocking on doors today trying to get started.

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

No, those doors have already been knocked on and we already have projects that are ready. Well, not ready for deployment yet but are in development for deployment early next year.



Steven Frankel - *Dougherty & Company - Analyst*

Great, thank you, Paul.

Operator

(Operator Instructions) Les Sulewski, Sidoti & Company.

Les Sulewski - *Sidoti & Company - Analyst*

Bryan, if I can ask you on the shipment delay. If it wasn't for that issue, with the revenue on the top line and third-quarter be somewhere within that previous guidance that you gave?

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

It would have, yes.

Les Sulewski - *Sidoti & Company - Analyst*

Okay and then I guess when we talked about on the previous quarter, we had revenue probably somewhere in line with what the third quarter would have been. Do you think though the guidance for 4Q is a little bit light and does it include the shipment that your expecting to deliver in the next quarter?

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

Yes, I want to say I think Q4's revenue guidance is light. It's where I think it's going to -- where we are going to be. We think it's going to be between and \$159 million and \$167 million, which amounts to 15% to 20% growth over the prior year. So we expect strong growth for all the reasons that we mentioned in the prepared remarks but it's what -- it's the range I think were going to fall within.

Les Sulewski - *Sidoti & Company - Analyst*

That's helpful. Perhaps kind of a big picture maybe, Paul, maybe you can take this one. Can you kind of go over what you are seeing by each geography region? Specifically in the fiber side?

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

Sure, I would say that particularly for these advanced platforms the two-way or cloud connected boxes with two-way protocol, that is probably clustered mostly in North America and Western Europe but I would say it's either in development, being ready to be introduced and in a couple of cases will be introduced or has been introduced in the near term.

So this is not something that is isolated to just two players. We've counted almost 2 dozen now that are again at various stages of development on this type of platform. So this is becoming a trend or a movement rather than just an isolated incident.

We think that you know the world is changing in the area of home entertainment and so, we're pretty excited about this. We're going to see some platforms launch in Q4 but we have many more beyond that that we see happening next year and probably the year after that.



Les Sulewski - *Sidoti & Company - Analyst*

Maybe you can also mention what are you seeing on the OEM side of the business?

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

Well, OEM is going strong. On that you'll see some things that will change early next year mainly because they are on typically on an annual product cycle so TVs, AV receivers and other OEM type consumer electronics devices are typically designed once a year. They are being designed now through this past summer through the end of this year to be introduced early next year.

So, you'll see changes and we'll talk more about that as next year progresses. The platform for this year though are already designed. So there won't be an impetus this year other than the sale of products that we are currently in.

Les Sulewski - *Sidoti & Company - Analyst*

Thanks for that additional color. I guess last one on the royalty revenue, you mentioned an increase, an uptick there. Can you provide little bit more detail on that?

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

No, no, I said the royalties were lower in Q3 of 2015 versus last Q3. They've actually gone down.

Les Sulewski - *Sidoti & Company - Analyst*

Okay, I apologize on that. Any commentary on that one then?

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

Yes, it's just we had some product introductions so we had some strong -- we had a surge in licensing revenue for a while. We sell into the TV market and some of our customers have lost a little bit of market share. So it's resulted in an adverse effect on our royalty revenue but we've been able to compensate for it. And with the transition of the lower end platform to the higher end platform, which is really driving the growth rate now for us.

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

And we have a much more diverse list of customers this year than ever before, so there's a higher count of customers. Unfortunately though compared to last year there were two major programs that were relatively new. One which was brand-new with a major name that has diminished. So that's what caused royalty to come down a little bit Q3.

This was not a surprise though. This is really what caused any difference but we knew that before the quarter started.

Les Sulewski - *Sidoti & Company - Analyst*

Got it, thank you, gentlemen.

Operator

Steven Frankel, Dougherty.

Steven Frankel - Dougherty & Company - Analyst

Bryan, just a quick follow-up. What was Comcast in the year ago quarter? Was it over 10% of revenue?

Bryan Hackworth - Universal Electronics Inc. - SVP and CFO

I believe they were, Steve. I'd have to go back and look to see exactly what it was. But I think they were in the low teens but I'd have to go back and double check.

Steven Frankel - Dougherty & Company - Analyst

Okay. I think that's it for me. Thank you.

Operator

Thank you and I'm showing no further questions in the queue. I would now like to turn the call back over to Paul Arling for any closing remarks.

Paul Arling - Universal Electronics Inc. - Chairman and CEO

Okay, thank you all for joining us today and for your continued interest in UEI. Coming up early next year as always we'll be exhibiting at the consumer electronics show or otherwise known as CES in Las Vegas from January 6 through the 9. And we'll be participating in the Needham 18th annual growth conference in New York health the next week January 12 through the 14. Hope to see some or all of you there. Thanks very much, goodbye.

Operator

Ladies and gentlemen thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone have a great day.

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