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UEIC - Q2 2016 Universal Electronics Inc Earnings Call

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Steven Frankel *Dougherty & Company - Analyst*

Greg Burns *Sidoti & Company, LLC - Analyst*

Edison Chu *G2 Investment Partners - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Universal Electronics Inc. earnings conference call. (Operator Instructions). Also, as a reminder, this conference call is being recorded. I would now like to turn the call over to your host, Kirsten Chapman. You may begin.

Kirsten Chapman - LHA, Inc. - IR

Thank you, [Julam]. This is Kirsten Chapman of LHA and thank you all for joining us today for the UEI second-quarter 2016 financial results conference call. By now you should have 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. A webcast replay will be available for one year at uei.com. You may also access that information by listening to the webcast replay.

In addition, any additional updated material nonpublic information that may be discussed during this call will be provided on the Company's website where it will also be retained for at least one year. After reading a short Safe Harbor statement I will turn the call over to management.

During the course of this call management may make projections or other forward-looking statements regarding future events and future financial performance of the Company including: the Company's ability to maintain and build its relationships with key customers; the Company's ability to anticipate the needs and wants of its customers and timely develop and deliver products and technologies that will meet those needs and wants including two-way RF technologies, voice control, the click technologies, home security, home automation, wireless sensors and other technologies identified on this call; the significant percentage of its revenues attributable to a limited number of customers and particularly the sales growth and benefits of the Company's relationship with Comcast; the timing of new product rollout orders from the Company's orders as anticipated by management; the continued trend of industry in providing consumers with more advanced technologies; the Company's expansion into the home security space; management's ability to manage its business to achieve its revenue margins and earnings as guided; the continued ability to identify and execute on opportunities that maximize shareholder value; 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 from those projected. The Company undertakes no obligation to revise or update any statements to reflect events or circumstances that may arise after today's call.

For further detail on risks, management refers you to the press release mentioned at the onset of this 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, 2015 and the periodic reports filed



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

In management's financial remarks adjusted pro forma metrics will be referenced. Management provides adjusted performance metrics because it 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 performance for the periods being reported. A full description and reconciliation of the adjusted pro forma measures versus GAAP are included in the Company's press release issued today.

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

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

Thank you, Kirsten, and thank you all for joining us today. Our second-quarter 2016 result reflects solid year-over-year growth. Net sales grew 17% over the same quarter last year and we maintained a strong bottom-line with EPS of \$0.77 representing 15% growth over last year.

Our subscription broadcasting business continued to perform well as our customers around the world ramp up new product introductions featuring our advanced AV control software and hardware solutions. As we outlined earlier this year, we are or will soon be supplying our advanced remote control technology to customers representing more than 110 million subscribers or nearly 20% of the entire world's subscriber base over the next few years.

Comcast rollout of its XR-11 Voice Remote to its subscriber base continues to grow. Cox Communications, the first X1 platform syndicator, began shipments of their platform in the second quarter of this year. And we anticipate other syndication partners to begin their product rollouts later this year and into 2017.

Beginning in the second half of 2016 we will be introducing new eco-link home security, monitoring and control solutions. This new suite of intelligent sensing technology combines with our home entertainment control innovations to provide customers a more complete smart home solution.

We announced in March that we signed an agreement with UTC Fire & Security to make Ecolink security sensors available through all of its Interlogix sales channels. Products will begin shipping in the third quarter and we expect our growth in this industry will accelerate in the second half of the year and into 2017.

There is significant opportunity to leverage our traditional customer base and our expertise in wireless control protocols to establish a strong market position in home security. The synergies in delivering monitored security and set-top box video entertainment by service providers is a growing trend. And UEI is at the forefront of helping to deliver on this emerging service.

Our ability to facilitate ease of use and simple functionality ensures our leadership position in wireless control technologies as the industry trends towards more sophisticated products and solutions. For example, our QuickSet suite continues to set the benchmark for a phenomenal user experience in home entertainment as evidenced by the solid product reviews of the Samsung KS9000 series Smart TV.

We are continuing to implement our QuickSet solutions across all of our business lines in regions around the world. In our Asia-Pacific region we continue to win new projects and expand our share in new product categories such as lighting control, thermostat controllers and other smart home control applications. While we are gaining traction with product introductions we are still at the early stages of this trend.

We have a very healthy pipeline of over 90 active development projects today and we see a continued migration from many of our customers to more fully featured remotes over the next 12 to 18 months. As they are in various phases of the development lifecycle customers across the world will be rolling out new platforms in the coming months and throughout 2017 providing UEI with both near and long-term growth.



With that I would now like to have Bryan Hackworth, our CFO, take you through the financial results.

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

Thanks, Paul. As a reminder, our results for the second quarter of 2016 [and both] the same period in 2015 will reference adjusted pro forma metrics.

Second-quarter net sales were \$172.2 million, an increase of approximately 17% compared to \$147.6 million for the second quarter of 2015.

Business category net sales contributed the majority of the growth increasing approximately 18% from \$135.5 million in the second quarter of 2015 to \$159.7 million in the second quarter of 2016. This growth was derived not just from Comcast which began deploying their advanced platform in the second quarter of 2015, but also from a handful of additional customers that made the same strategic decision.

Consumer category revenue, despite a stronger US dollar versus the British pound, grew modestly to \$12.5 million from \$12.1 million in the prior year quarter. Gross margins were 26.1% compared to 27.5%. Operating expenses were \$30.3 million compared to \$27 million.

R&D expense of \$5 million is an increase of 26% compared to \$4 million in the second quarter of 2015, reflecting our continuing investments into new products and technologies including the smart home market.

SG&A expense was \$25.3 million compared to \$23.1 million. Operating income was \$14.7 million compared to \$13.5 million. The effective tax rate was 25.2% compared to 21.5%. Net income was \$11.3 million or \$0.77 per diluted share compared to \$10.7 million or \$0.67 per diluted share in the prior year period.

For the first six months of 2016 net sales were \$323.7 million compared to \$280.3 million in the same period last year. Gross margins of 25.9% compared to 27.9%. Operating expenses are \$59.8 million compared to \$55.6 million in the six months of last year.

Operating income was \$24 million compared to \$22.6 million. Net income was \$18.5 million or \$1.26 per diluted share compared to \$18.2 million or \$1.13 per diluted share in the first six months of last year.

Next I will review our cash flow and balance sheet at June 30, 2016. We ended the quarter with cash and cash equivalents of \$49.4 million compared to \$53 million at December 31, 2015. DSOs were approximately 70 days at June 30, 2016 compared to 63 days a year prior. Net inventory turns were approximately 4.3 turns at June 30, 2016 compared to 4.1 turns a year prior.

Now turning to our guidance. For the third quarter 2016 we expect net sales to range between \$169 million and \$177 million, an increase of 5% to 10% compared to \$160.5 million in the third quarter of 2015. EPS for the third quarter is expected to range from \$0.87 to \$0.97, an increase of 12% to 24% compared to \$0.78 in the third quarter of [2015]. I would now like to return the call back to Paul.

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

Thanks, Bryan. I'd like to take a moment to reflect on what we have accomplished to date and, more importantly, share our perspective on how well-positioned we are for an even more exciting future.

UEI has established a remarkable track record of growth in sales and earnings over the last decade by executing on its strategy of making your home systems, historically home entertainment systems, easier and more intuitive to operate.

The list of customers across the globe that have entrusted us to do this: Comcast, DIRECTV, EchoStar, DISH, Cox, Charter, Sony, Samsung, Panasonic, Sky, Liberty, Vodafone, Microsoft and many, many other industry leaders are a testament to the quality of solutions we provide. We have truly changed what a remote control is and what it is capable of doing.



Yesterday the term smart TV was a misnomer and smart devices came to be defined as smartphones and tablets. These prior concepts and definitions are evolving as today's home entertainment devices are truly becoming smart through the use of apps that make doing things easier.

Today the home entertainment industry is going through a vast transformation. Leading home entertainment device makers are striving to make their devices easier to set up and use every day and service providers are creating simplified solutions for accessing an ever increasing array of entertainment options. This is where UEI excels.

We have invested over the last 20 years to become the best home control provider in the world and have separated ourselves from competition by using technology to solve the everyday challenges of our customers and ultimately the consumer.

By providing the intelligence inside TVs, set-top boxes, universal remotes, home security sensors and more, UEI enables the wireless control of and interoperability between virtually any device in the home.

Our innovations continue to provide solutions for the control of devices and content that prioritize ease-of-use in set up while incorporating state-of-the-art technology such as voice control.

We continue to have a very positive outlook for the Company and we look forward to keeping you updated on our progress in the months and years ahead. Stay tuned. I would now like to open it up for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Steven Frankel.

Steven Frankel - Dougherty & Company - Analyst

Maybe just start with -- last quarter but it was very helpful how you outlined the number of new customers you have ramping. Did any of those new customers commence shipments in Q2?

Paul Arling - Universal Electronics Inc. - Chairman & CEO

Yes, a few of them did. And of course as the coming weeks and months than over the next year progress we -- as I said on this call, we have right now just over 90 active projects going on across the world, Asia-Pacific, Europe, here in the Americas.

So there is a lot of activity regarding new products, new solutions, new technologies, some are embedded chips, some are full products. So it is a wide array of things, but again, they all fall under that same theme of connected home projects, advanced remote technologies, etc.

So really the same message as last time. Last time we talked about the greater than 110 million subscribers -- companies representing greater than 110 million subscribers. It has resulted in now 90 projects. So, yes, in the coming weeks we will ship a few more projects and, again, it is an ongoing thing -- week-to-week, month-to-month, quarter-to-quarter.

Steven Frankel - Dougherty & Company - Analyst

Given all that, I would've anticipated another quarter of solid double-digit revenue growth. But you are guiding to something less than 10% at the midpoint. How much of that is a function of lapping some tough compares from Comcast? Or does the change in the pound have some kind of influence on that number as well? Maybe give us a sense of why you are guiding the way you are guiding.



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

Yes, the pound has a minimal effect for us. Someone said that Comcast was in -- they launched last year, Steven, in Q2, about midway. And so, for Q3 this is the first quarter that we are going to have it in [base] for the full quarter. So that makes the comp more difficult.

But despite that I mean Comcast did \$42 million in sales last year in Q3. Despite that we are still growing 5% to 10% and we are anticipating that in the third quarter, which is really driven by what Paul just mentioned is all new customers coming on board and transitioning from the lower end platform to the higher end platform. So, I think it is all growth considering that Comcast is in the base.

Steven Frankel - *Dougherty & Company - Analyst*

And what was Comcast and DIRECTV as a percentage of revenue in the quarter?

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

Comcast was 21.3% and DIRECTV was 11.7%.

Steven Frankel - *Dougherty & Company - Analyst*

Okay. And maybe an Ecolink update. Did you ship Ecolink products to a subscription broadcaster in the quarter or is that coming later this year?

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

No, that will be in the second half of this year -- this quarter and into Q4 and into next year.

Steven Frankel - *Dougherty & Company - Analyst*

All right, that is all for now and I will get back in the queue. Thank you.

Operator

Greg Burns, Sidoti.

Greg Burns - *Sidoti & Company, LLC - Analyst*

I see DISH launched their voice remote, can you confirm whether or not you are shipping that -- that is your technology or your remote that they are using?

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

Well, we don't speak about the specific products at DISH, but obviously DISH is a major customer of ours, they are not a reported 10% customer. But they are in our top list of customers. So we are deploying with some of their next-generation products, yes.



Greg Burns - *Sidoti & Company, LLC - Analyst*

Okay. And when we look at the different service providers that are rolling out these next-generation products, are they all created equal? And I mean that by like you have got a certain amount of incremental ASP from Comcast X1, the XR-11 remote versus like a legacy remote. What differentiates Comcast next-gen remote versus maybe someone else's?

I mean is there like a tiering of features that make the value of the new remote go higher? Can you just give us a sense of what might differentiate one customer from the other? Or are they all kind of equal, you get a similar type of bump in ASP?

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

Well, yes, the ASPs typically are higher -- some of them are a multiple of what the prior product was. And again, it is all dependent on what they were deploying before.

Some customers may have deployed in the past a relatively de-featured product which would make the next-generation product the significantly higher ASP. Other customers were already doing a radiofrequency product so the ASP game may not be quite as big.

I think we estimate that it is roughly at least 2X in terms of the uptick. And it is both (inaudible) logical and in some cases it is the look and feel of the product. A lot of customers have opted for zero gap tools where the product doesn't have a gap in the case and laser etched well advanced keypad than they have done in the past.

So, there is look and feel enhancements as well as technological advancements. They have added voice so there is microphones in the product, two-way RF. So there is a lot of new features in these products.

Some customers have chosen ZigBee or a flavor of the ZigBee, RF4CE for their two [RF]. Other customers in other regions of the world are using Bluetooth. But again, all of those are two-way RF products capability of things like voice and other applications.

So yes, but this is a general trend across the world. It is not just happening here, it has happened here first and there are now a lot of companies here who are either in the midst of deploying or developing or planning for those next-generation products, but it is happening in other parts of the world, Japan, Korea, Europe, etc. So this appears to be a trend that has legs for the coming years.

Greg Burns - *Sidoti & Company, LLC - Analyst*

Okay and it appears the guidance implies a little sequential improvement in gross margin. I think maybe a little bit less than what the consensus numbers were maybe looking for. But could you just talk about the gross margin compression that you expect? Over what time period do you expect to maybe get back to that 28 to kind of 30 range in terms of gross margin?

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

Yes, we don't give specific guidance on gross margins we just give guidance on top line/bottom line. But I will say this, and we've said it before, that as the smart customers transition and they start to ramp, that should help our gross margin rate. Because they typically won't get the pricing that a real large customer will.

I mean it is good news and bad news for us in that sometimes when you are selling to large customers and they are buying large quantities it puts downward pressure on the gross margin rate and we have seen that.



Even -- and what I consider a large customer it's -- from a public accounting perspective it's 10% customers. But you still have customers that are less than 10% but are still I consider significant. So if I were to look at our top five customers right now comparing Q2 over Q2 the sales have gone up relatively significantly, which is good news for us. The bad news is it puts downward pressure on the gross margin rate.

But as Paul mentioned, Ecolink is going to start shipping in the back half of the year. Their average gross margin is higher than the Company's average, so that should help. So I don't want to put a timeline on it, but I think there are some positive trends that should help the margin rate.

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

And the other thing I want to say about these implementations is that you can imagine that when you have got dozens of players in a time probably 50 to 100 players across the world doing these next-generation implementations, some of them will start slowly. Some of them will develop the product, put it through testing.

They've got a lot of technology in this next-generation platform that they didn't have before. But if we use at least the initial sample of people who have done this, if they start off a little bit slowly then they monitor the progress. They see how engaged the customers are, how much it is lowering churn. How high -- how much people are engaging with the platform and doing more video on demand or other things.

They look out the economic benefit they are getting. And if the early sample that we have seen is any indication, what happens is the operator will start slowly. But when they see the positive impact of what they are doing they then get more aggressive in deployment because they see the very positive impact it's having on their customers and on their financial results.

So, if the early sample is any indication into the back half of this year, but more importantly into 2017, 2018 and 2019, in the coming years we should see quite a transformation of the industry where the operators all will begin moving to these types of platforms and then launching them more aggressively as they see the positive impact of the platforms they are launching.

Greg Burns - *Sidoti & Company, LLC - Analyst*

Thank you.

Operator

(Operator Instructions). Edison Chu, G2 Investment Partners.

Edison Chu - *G2 Investment Partners - Analyst*

Congratulations on the quarter. Just last year you had a number of projects ramp in the fourth quarter that allowed you to buck your historical seasonal trend where you guys grew in the fourth quarter versus your typical decline.

Do you have -- with Ecolink projects ramping up here in the second half and into December, do you have any visibility about what that fourth-quarter directionally might look like?

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

Yes, Edison, it is Bryan. We just give one quarter out. Right now we are giving the Q3 guidance and then I will speak to Q4 in a few months.



Edison Chu - *G2 Investment Partners - Analyst*

Okay. And longer-term as some of the new Ecolink projects ramp would you expect the gross margin trend for the Company overall to start improving or is the visibility difficult because you still have larger customers ramping up on new advanced remote controls which might still offset that Ecolink gross margin improvement?

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

Yes, it is a good question, Edison. Mix is obviously extremely important. It is certainly true what you said that the security products that we ship typically will carry a slightly higher margin than our average. So, to the extent that they make up a higher percentage of the mix it will have an upward lift on our margins.

However, if we have our two largest customers buy record amounts, that pulls it down a little bit. So this is one of the reasons why we don't like to provide long-term margin guidance because we could have extremely successful quarters with some of our largest customers and that would be good news from an earnings standpoint, but it would affect the margins negatively. Right? So these mix effects obviously can swing over a 6-month or 12-month period.

But, it is certainly true that as medium to smaller size customers, if your top two or five customers have now affected the rest of the end of the industry and the medium to small size customers are moving to these next-generation remotes, typically the smaller customers will carry a slightly higher margin than the larger customers and safety and security products carry higher margins than average. To the extent those things make up a higher percentage of the mix it begins to make the margins move up.

Edison Chu - *G2 Investment Partners - Analyst*

Okay, great. Understood. Thank you very much, guys.

Operator

Thank you. I show no further questions in queue at this time. I would like to turn the call over to your host, Mr. Paul Arling.

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

Okay, thank you all for joining us today and for your continued interest in our Company. Over the next few months we will be participating in a number of tradeshow including IFA September 2 in Berlin, IBC September 9 in Amsterdam; and Cable-Tec Expo September 26 through 29 in Philadelphia.

We will also be participating in the 2016 Deutsche Bank Technology Conference on September 13 in Las Vegas and the Credit Suisse small- and mid-cap conference on September 15 in New York. So we are going to be on planes a lot this quarter. We hope to see you at one or all of these events if you can make it to all of them. Thank you very much for being with us today and goodbye.

Operator

Thank you, ladies and gentlemen, for attending today's conference. This concludes the program; you may all disconnect. Good day.



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