



**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended **June 30, 2008**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number: **0-21044**

**UNIVERSAL ELECTRONICS INC.**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**  
(State or Other Jurisdiction  
of Incorporation or Organization)

**33-0204817**  
(I.R.S. Employer  
Identification No.)

**6101 Gateway Drive**  
**Cypress, California**  
(Address of Principal Executive Offices)

**90630**  
(Zip Code)

**Registrant's Telephone Number, Including Area Code: (714) 820-1000**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller reporting company  
(do not check if smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act) Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 13,916,624 shares of Common Stock, par value \$0.01 per share, of the registrant were outstanding on August 5, 2008.

UNIVERSAL ELECTRONICS INC.

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**PART I. FINANCIAL INFORMATION****ITEM 1. Consolidated Financial Statements**

**UNIVERSAL ELECTRONICS INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share-related data)  
(Unaudited)

|  | June 30,<br>2008  | December 31,<br>2007 |
|--|-------------------|----------------------|
| <b>ASSETS</b>  |                   |                      |
| Current assets:  |                   |                      |
| Cash and cash equivalents  | \$ 88,215         | \$ 86,610            |
| Accounts receivable, net   | 58,464            | 60,146               |
| Inventories, net   | 42,650            | 34,906               |
| Prepaid expenses and other current assets  | 3,072             | 1,874                |
| Deferred income taxes  | 2,876             | 2,871                |
| Total current assets   | 195,277           | 186,407              |
| Equipment, furniture and fixtures, net   | 9,008             | 7,558                |
| Goodwill   | 11,043            | 10,863               |
| Intangible assets, net   | 5,537             | 5,700                |
| Other assets   | 394               | 369                  |
| Deferred income taxes  | 6,645             | 6,388                |
| Total assets   | <u>\$ 227,904</u> | <u>\$ 217,285</u>    |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                   |                      |
| Current liabilities:   |                   |                      |
| Accounts payable   | \$ 40,829         | \$ 29,382            |
| Accrued sales discounts, rebates and royalties   | 4,446             | 4,671                |
| Accrued income taxes   | 2,631             | 1,720                |
| Accrued compensation   | 3,568             | 3,737                |
| Other accrued expenses   | 5,921             | 6,567                |
| Total current liabilities  | 57,395            | 46,077               |
| Long-term liabilities:   |                   |                      |
| Deferred income taxes  | 148               | 127                  |
| Income tax payable   | 1,506             | 1,506                |
| Other long-term liabilities  | 1,263             | 1,333                |
| Total liabilities  | 60,312            | 49,043               |
| Commitments and Contingencies  |                   |                      |
| Stockholders' equity:  |                   |                      |
| Preferred stock, \$0.01 par value, 5,000,000 shares authorized; none issued or outstanding   | —                 | —                    |
| Common stock, \$0.01 par value, 50,000,000 shares authorized; 18,615,390 and 18,547,019 shares issued at June 30, 2008 and December 31, 2007, respectively | 186               | 185                  |
| Paid-in capital  | 117,559           | 114,441              |
| Accumulated other comprehensive income   | 18,804            | 11,221               |
| Retained earnings  | 94,476            | 88,508               |
|  | 231,025           | 214,355              |
| Less cost of common stock in treasury, 4,718,093 and 3,975,439 shares at June 30, 2008 and December 31, 2007, respectively                                 | (63,433)          | (46,113)             |
| Total stockholders' equity   | 167,592           | 168,242              |
| Total liabilities and stockholders' equity   | <u>\$ 227,904</u> | <u>\$ 217,285</u>    |

The accompanying notes are an integral part of these financial statements.

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

|  | Three Months Ended<br>June 30, |                 | Six Months Ended<br>June 30, |                 |
|--|--------------------------------|-----------------|------------------------------|-----------------|
|  | 2008                           | 2007            | 2008                         | 2007            |
| Net sales                                    | \$ 70,684                      | \$ 71,478       | \$ 131,875                   | \$ 137,497      |
| Cost of sales                                | 46,472                         | 46,852          | 85,928                       | 88,530          |
| Gross profit                                 | 24,212                         | 24,626          | 45,947                       | 48,967          |
| Research and development expenses            | 2,121                          | 2,269           | 4,317                        | 4,591           |
| Selling, general and administrative expenses | 17,734                         | 16,385          | 34,590                       | 32,218          |
| Operating income                             | 4,357                          | 5,972           | 7,040                        | 12,158          |
| Interest income, net                         | 893                            | 732             | 1,790                        | 1,320           |
| Other (expense) income, net                  | (2)                            | 27              | 180                          | 121             |
| Income before provision for income taxes     | 5,248                          | 6,731           | 9,010                        | 13,599          |
| Provision for income taxes                   | (1,753)                        | (2,185)         | (3,042)                      | (4,416)         |
| Net income                                   | <u>\$ 3,495</u>                | <u>\$ 4,546</u> | <u>\$ 5,968</u>              | <u>\$ 9,183</u> |
| Earnings per share:                          |                                |                 |                              |                 |
| Basic  | <u>\$ 0.25</u>                 | <u>\$ 0.31</u>  | <u>\$ 0.42</u>               | <u>\$ 0.64</u>  |
| Diluted                                      | <u>\$ 0.24</u>                 | <u>\$ 0.30</u>  | <u>\$ 0.40</u>               | <u>\$ 0.61</u>  |
| Shares used in computing earnings per share: |                                |                 |                              |                 |
| Basic  | <u>14,033</u>                  | <u>14,437</u>   | <u>14,256</u>                | <u>14,282</u>   |
| Diluted                                      | <u>14,547</u>                  | <u>15,262</u>   | <u>14,755</u>                | <u>15,084</u>   |

The accompanying notes are an integral part of these financial statements.

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

|   | Six Months Ended<br>June 30, |                  |
|---|------------------------------|------------------|
|   | 2008                         | 2007             |
| Cash provided by operating activities:  |                              |                  |
| Net income  | \$ 5,968                     | \$ 9,183         |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |                  |
| Depreciation and amortization   | 2,892                        | 2,160            |
| Provision for doubtful accounts   | 64                           | 10               |
| Provision for inventory write-downs   | 973                          | 952              |
| Provision (benefit) for deferred income taxes                                     | (171)                        | 853              |
| Tax benefit from exercise of stock options  | 171                          | 1,960            |
| Excess tax benefit from stock-based compensation                                  | (134)                        | (1,091)          |
| Shares issued for employee benefit plan   | 282                          | 394              |
| Stock-based compensation  | 2,311                        | 1,481            |
| Changes in operating assets and liabilities:                                      |                              |                  |
| Accounts receivable   | 4,173                        | (7,103)          |
| Inventories   | (7,462)                      | (1,419)          |
| Prepaid expenses and other assets   | (1,112)                      | (586)            |
| Accounts payable and accrued expenses   | 8,795                        | 1,566            |
| Accrued income taxes  | 639                          | (3,476)          |
| Net cash provided by operating activities   | <u>17,389</u>                | <u>4,884</u>     |
| Cash used for investing activities:   |                              |                  |
| Acquisition of equipment, furniture and fixtures                                  | (3,457)                      | (2,050)          |
| Acquisition of intangible assets  | (505)                        | (635)            |
| Net cash used for investing activities  | <u>(3,962)</u>               | <u>(2,685)</u>   |
| Cash (used for) provided by financing activities:                                 |                              |                  |
| Proceeds from stock options exercised   | 525                          | 8,037            |
| Treasury stock purchased  | (17,489)                     | (2,413)          |
| Excess tax benefit from stock-based compensation                                  | 134                          | 1,091            |
| Net cash (used for) provided by financing activities                              | <u>(16,830)</u>              | <u>6,715</u>     |
| Effect of exchange rate changes on cash   | 5,008                        | 1,450            |
| Net increase in cash and cash equivalents   | 1,605                        | 10,364           |
| Cash and cash equivalents at beginning of period                                  | 86,610                       | 66,075           |
| Cash and cash equivalents at end of period  | <u>\$ 88,215</u>             | <u>\$ 76,439</u> |

The accompanying notes are an integral part of these financial statements.

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

**Note 1: Basis of Presentation and Significant Accounting Policies**

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements. Certain information and footnote disclosures normally included in financial statements, which are prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission.

The results of operations for the three and six months ended June 30, 2008 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the consolidated financial statements and related notes and "Management Discussion and Analysis of Financial Conditions and Results of Operations" contained in our Annual Report on Form 10-K for our fiscal year ended December 31, 2007. The financial information presented in the accompanying statements reflects all adjustments that are, in the opinion of management, necessary for a fair presentation of financial position, operations and cash flows for the periods presented. All such adjustments are of a normal recurring nature. As used herein, the terms "Company", "we", "us" and "our" refer to Universal Electronics Inc. and its subsidiaries, unless the context indicates to the contrary.

*Estimates and Assumptions*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and judgments, including those related to revenue recognition, allowance for sales returns and doubtful accounts, warranties, inventory valuation, our review for impairment of long-lived assets, intangible assets and goodwill, income taxes and stock-based compensation expense. Actual results may differ from these judgments and estimates, and they may be adjusted as more information becomes available. Any adjustment could be significant.

*Revenue Recognition*

We recognize revenue on the sale of products when delivery has occurred, there is persuasive evidence of an arrangement, the sales price is fixed or determinable and collectibility is reasonably assured. We record a provision for estimated sales returns on product sales in the same period as the related revenues are recorded. These estimates are based on historical sales returns, analysis of credit memo data and other known factors. The provision recorded for estimated sales returns and allowances is deducted from gross sales to arrive at net sales in the period the related revenue is recorded.

We accrue for discounts and rebates on product sales in the same period as the related revenues are recorded based on historical experience. Changes in such accruals may be required if future rebates and incentives differ from our estimates. Rebates and incentives are recognized as a reduction of sales if distributed in cash or customer account credits. Rebates and incentives are recognized as cost of sales if we provide products or services for payment.

Sales allowances reduce gross accounts receivable to arrive at accounts receivable, net in the same period the related receivable is recorded. We have no obligations after delivery of our products other than the associated warranties (see Note 15). We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make payments for products sold or services rendered. The allowance for doubtful accounts is based on a variety of factors, including historical experience, length of time receivables are past due, current economic trends and changes in customer payment behavior. Also, we record specific provisions for individual accounts when we become aware of a customer's inability to meet its financial obligations to us, such as in the case of bankruptcy filings or deterioration in the customer's operating results or financial position. If circumstances related to a customer change, our estimates of the recoverability of the receivables would be further adjusted, either upward or downward.

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

We generate service revenue, which is paid monthly, as a result of providing consumer support programs to some of our customers through our call centers. These service revenues are recognized when services are performed, persuasive evidence of an arrangement exists, the sales price is fixed or determinable, and collectibility is reasonably assured.

We may from time to time initiate the sale or license of certain intellectual property, including patented technologies, trademarks, or a particular database of infrared codes. When a fixed upfront fee is received in exchange for the conveyance of a patent, trademark, or database delivered that represents the culmination of the earnings process we record revenue when delivery has occurred, persuasive evidence of an arrangement exists, the sales price is fixed or determinable and collectibility is reasonably assured. We record license revenue when our customers ship products incorporating our intellectual property, persuasive evidence of an arrangement exists, the sales price is fixed or determinable, and collectibility is reasonably assured.

When a sales arrangement contains multiple elements, such as software products, licenses and/or services, we allocate revenue to each element based on its relative fair value. The fair values for the multiple elements are determined based on vendor specific objective evidence ("VSOE"), or the price charged when the element is sold separately. The residual method is utilized when VSOE exists for all the undelivered elements, but not for the delivered element. This is performed by allocating revenue to the undelivered elements (that have VSOE) and the residual revenue to the delivered elements. When the fair value for an undelivered element cannot be determined, we defer revenue for the delivered elements until the undelivered element is delivered. We limit the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services or subject to customer-specified return or refund privileges.

We account for revenue under software licensing arrangements involving significant production, modification or customization of software in accordance with SOP 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts". We recognize revenue and profit as work progresses on long-term, fixed price contracts using the percentage-of-completion method. When applying the percentage-of-completion method, we rely on estimates of total expected contract revenue and labor hours which are provided by our project managers. We follow this method because reasonably dependable estimates of the revenue and labor applicable to various stages of a contract can be made. Recognized revenue and profit are subject to revisions as the contract progresses to completion. Revisions to revenue and profit estimates are charged to income in the period in which the facts that give rise to the revision become known, and losses are accrued when identified.

In accordance with EITF Issue 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)" ("EITF 06-3"), we present all non-income government-assessed taxes (sales, use and value added taxes) collected from our customers and remitted to governmental agencies on a net basis (excluded from revenue) in our financial statements. The government-assessed taxes are recorded in other accrued expenses until they are remitted to the government agency.

*Recent Accounting Pronouncements*

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles in the United States of America ("GAAP"), and expands disclosures about fair value measurements for assets and liabilities. SFAS 157 applies when other accounting pronouncements require or permit assets or liabilities to be measured at fair value. Accordingly, SFAS 157 does not require new fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position for SFAS 157 ("FSP FAS 157-1") to amend SFAS 157 to exclude SFAS 13, "Accounting for Leases", and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under SFAS 13. However, this scope exception does not apply to assets acquired and liabilities assumed in a business combination that are required to be measured at fair value under SFAS 141, "Business Combinations", or SFAS 141R, "Business Combinations", regardless of whether those assets and liabilities are related to leases. Additionally in February 2008 the FASB issued FASB Staff Position for SFAS 157 ("FSP FAS 157-2"), which delays the



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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

effective date of SFAS 157 for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in an entity's financial statements on a recurring basis (at least annually) until fiscal years beginning after November 15, 2008. We adopted the provisions of SFAS 157 in the first quarter of 2008, except for those items within scope of FSP FAS 157-2, which we will adopt in the first quarter of 2009. We will apply the provisions as necessary (i.e. annual year-end impairment review of goodwill and intangible assets). As a result, the adoption of SFAS 157 had no impact on our consolidated results of operations and financial condition during the six months ended June 30, 2008.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115" ("SFAS 159"). SFAS 159 expands the use of fair value accounting but does not affect existing standards that require assets or liabilities to be carried at fair value. Under SFAS 159, a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees and issued debt. Other eligible items include firm commitments for financial instruments that otherwise would not be recognized at inception and non-cash warranty obligations where a warrantor is permitted to pay a third party to provide the warranty goods or services. If the use of fair value is elected, any upfront costs and fees related to the item must be recognized in earnings and cannot be deferred, such as debt issuance costs. The fair value election is irrevocable and generally made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings. Subsequent to the adoption of SFAS 159, changes in fair value are recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007 and was adopted by us in the first quarter of 2008. The adoption of SFAS 159 had no impact on our consolidated results of operations and financial condition during the six months ended June 30, 2008.

In June 2007, the FASB ratified EITF 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities" ("EITF 07-3"). EITF 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and recognized as an expense as the goods are delivered or the related services are performed. EITF 07-3 is effective, on a prospective basis, for fiscal years beginning after December 15, 2007 and was adopted by us in the first quarter of 2008. We did not have any arrangements with advance payments and therefore the adoption of EITF 07-3 did not have a material effect on our consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS 141R"). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective as of the beginning of an entity's fiscal year that begins after December 15, 2008, and will be adopted by us in the first quarter of fiscal 2009. We do not believe that the adoption of Statement 141R will have a material effect on our financial statements; however, the effect is dependent upon whether we make any future acquisitions and the specifics of those acquisitions.

In December 2007, the FASB ratified EITF 07-1, "Accounting for Collaborative Arrangements Related to the Development and Commercialization of Intellectual Property" ("EITF 07-1"). EITF 07-1 defines collaborative arrangements and establishes disclosure requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. EITF 07-1 is effective as of the beginning of an entity's fiscal year that begins after December 15, 2008 and should be applied retrospectively to all prior periods presented for all collaborative arrangements existing as of the effective date. EITF 07-1 is effective for us beginning January 1, 2009. Currently, we do not have any collaborative arrangements; therefore, we do not believe that the adoption of EITF 07-1 will have an impact on our consolidated results of operations and financial condition.

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

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements: an amendment of ARB No. 51” (“SFAS 160”). SFAS 160 changes the accounting for, and the financial statement presentation of, noncontrolling equity interests in a consolidated subsidiary. SFAS 160 replaces the existing minority-interest provisions of Accounting Research Bulletin 51 (“ARB 51”), “Consolidated Financial Statements,” by defining a new term—noncontrolling interests—to replace what were previously called minority interests. The new standard establishes noncontrolling interests as a component of the equity of a consolidated entity. The underlying principle of the new standard is that both the controlling interest and the noncontrolling interests are part of the equity of a single economic entity: the consolidated reporting entity. Classifying noncontrolling interests as a component of consolidated equity is a change from the current practice of treating minority interests as a mezzanine item between liabilities and equity or as a liability. The change affects both the accounting and financial reporting for noncontrolling interests in a consolidated subsidiary. SFAS 160 includes reporting requirements intended to clearly identify and differentiate the interests of the parent and the interests of the noncontrolling owners. The reporting requirements are required to be applied retrospectively. SFAS 160 is effective for fiscal years and interim periods within those fiscal years beginning on or after December 15, 2008. Early adoption is prohibited. We currently do not believe that the adoption of SFAS 160 will have a significant effect on our financial statements as we do not have any noncontrolling equity interests of a consolidated subsidiary.

In March 2008, the FASB issued SFAS No. 161, “Disclosures About Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133” (“SFAS 161”). SFAS 161 amends and expands the disclosure requirements of SFAS 133, “Accounting for Derivative Instruments and Hedging Activities,” to provide improved transparency into the uses and financial statement impact of derivative instruments and hedging activities. We will be required to provide enhanced disclosures about how and why we use derivative instruments, how they are accounted for, and how they affect our financial performance. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS 161 encourages, but does not require, comparative disclosures for earlier periods at initial adoption. SFAS 161 is effective for us beginning December 31, 2008. We are currently assessing the impact that SFAS 161 will have on our consolidated results of operations and financial condition.

In April 2008, the FASB issued FASB Staff Position No. FAS 142-3 “Determination of the Useful Life of Intangible Assets” (“FSP FAS 142-3”). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, “Goodwill and Other Intangible Assets.” The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under FASB Statement No. 141 (revised 2007), “Business Combinations”, and other U.S. GAAP. FSP FAS 142-3 is effective for fiscal years and interim periods within those fiscal years beginning on or after December 15, 2008. The guidance for determining the useful life of a recognized intangible asset in paragraphs 7–11 of this FSP shall be applied prospectively to intangible assets acquired after the effective date. The disclosure requirements in paragraphs 13–15 shall be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. Early adoption is prohibited. FSP FAS 142-3 is effective for us beginning January 1, 2009. We are currently assessing the impact that FSP FAS 142-3 will have on our consolidated results of operations and financial condition.

In May 2008, the FASB issued SFAS No. 162, “The Hierarchy of Generally Accepted Accounting Principles” (“SFAS 162”). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (the GAAP hierarchy). Statement 162 will become effective 60 days following the SEC’s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, “The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles.” We do not expect the adoption of SFAS 162 to have a material effect on our consolidated results of operations and financial condition.

In June 2008, the FASB issued FASB Staff Position on EITF 03-6, “Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities” (“FSP EITF 03-6-1”). FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and,

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

therefore, need to be included in the earnings allocation in computing earning per share under FASB Statement No. 128, "Earnings per Share". EITF 03-6-1 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008 and should be applied retrospectively to all prior periods. Early adoption is prohibited. FSP EITF 03-6-1 is effective for us beginning January 1, 2009. We do not expect the adoption of FSP EITF 03-6-1 to have a material effect on our consolidated results of operations and financial condition.

**Note 2: Stock-Based Compensation**

We follow the fair value recognition provisions of SFAS No. 123R, "Share-Based Payment" ("SFAS 123R") using the modified-prospective transition method. Stock-based compensation expense is presented in the same income statement caption as cash compensation paid to the same employees or directors. During the three months ended June 30, 2008 and 2007, we recorded \$1.1 million and \$0.8 million, respectively in pre-tax stock-based compensation expense. Included in selling, general and administrative ("SG&A") stock-based compensation expense is \$206 thousand and \$117 thousand in pre-tax compensation expense for the three months ended June 30, 2008 and 2007, respectively, related to stock awards granted to outside directors.

During the six months ended June 30, 2008 and 2007, we recorded \$2.3 million and \$1.5 million, respectively in pre-tax stock-based compensation expense. Included in selling, general and administrative ("SG&A") stock-based compensation expense is \$387 thousand and \$234 thousand in pre-tax compensation expense for the six months ended June 30, 2008 and 2007, respectively, related to stock awards granted to outside directors.

Additionally, during the first quarter of 2008, as part of the annual review cycle, the Compensation Committee of the Board of Directors granted 115,926 shares of restricted stock to our executives under the 2006 Stock Incentive Plan. The awards were granted as part of a long-term incentive compensation plan to assist us in meeting our performance and retention objectives. Each executive grant is subject to a three-year vesting period. In accordance with SFAS 123R, compensation expense related to restricted stock awards is based on the fair value of the shares awarded as of the grant date. The fair value of non-vested shares is determined based on the average of the high and low trade prices of our Company's shares on the grant date. For the three and six months ended June 30, 2008, the stock-based compensation expense related to this award was \$228 thousand and \$456 thousand, respectively, and is included in SG&A.

The income tax benefit under SFAS 123R from the recognition of stock-based compensation for the three and six months ended June 30, 2008 was \$0.2 million and \$0.5 million, respectively. The income tax benefit under SFAS 123R from the recognition of stock-based compensation for the three and six months ended June 30, 2007 was \$0.2 million and \$0.4 million, respectively.

Stock-based compensation expense was included in the following:

| (In thousands)                                       | Three Months Ended<br>June 30, |               | Six Months Ended<br>June 30, |                 |
|--|--------------------------------|---------------|------------------------------|-----------------|
|  | 2008                           | 2007          | 2008                         | 2007            |
| Cost of sales  | \$ 5                           | \$ 7          | \$ 9                         | \$ 13           |
| Research and development                             | 106                            | 106           | 205                          | 185             |
| Selling, general and administrative                  | 1,021                          | 692           | 2,097                        | 1,283           |
| Stock-based compensation expense before income taxes | <u>\$ 1,132</u>                | <u>\$ 805</u> | <u>\$ 2,311</u>              | <u>\$ 1,481</u> |

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We estimate the fair value of share-based payment awards using the Black-Scholes option pricing model with the following assumptions and weighted average fair values:

|                                       | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|---------------------------------------|--------------------------------|----------|------------------------------|----------|
|                                       | 2008 (1)                       | 2007 (1) | 2008 (1)                     | 2007 (1) |
| Weighted average fair value of grants | \$10.57                        | \$11.86  | \$ 9.07                      | \$11.73  |
| Risk-free interest rate               | 3.03%                          | 4.58%    | 2.74%                        | 4.58%    |
| Expected volatility                   | 41.42%                         | 38.83%   | 40.84%                       | 39.06%   |
| Expected life in years                | 4.72                           | 5.24     | 4.74                         | 5.24     |

(1) The fair value calculation was based on stock options granted during the period.

Stock option activity as of June 30, 2008 and changes for the six months ended June 30, 2008 were as follows:

|  | Number of<br>Options<br>(in thousands) | Weighted-<br>Average<br>Exercise<br>Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term<br>(in years) | Aggregate<br>Intrinsic Value<br>(in thousands) |
|--|--|---|--|--|
| Outstanding at December 31, 2007             | 1,739                                  | \$16.83                                   |  |  |
| Granted                                      | 139                                    | 23.46                                     |  |  |
| Exercised                                    | (48)                                   | 11.00                                     |  | \$ 675   |
| Forfeited/ cancelled/ expired                | (21)                                   | 26.05                                     |  |  |
| Outstanding at June 30, 2008                 | <u>1,809</u>                           | \$17.39                                   | 5.45   | \$8,764  |
| Vested and expected to vest at June 30, 2008 | 1,761                                  | \$16.75                                   | 5.21   | \$8,775  |
| Exercisable at June 30, 2008                 | 1,306                                  | \$14.99                                   | 4.28   | \$8,252  |

The aggregate intrinsic value in the table above represents total pre-tax intrinsic value (difference between Universal Electronics Inc.'s average of the high and low trades of the last trading day of the second quarter of 2008 (June 30, 2008) and the option exercise price, multiplied by the number of the in-the-money options) that option holders would have received had all option holders exercised their options on June 30, 2008. This amount changes based on the fair market value of our common stock. The total intrinsic value of options exercised for the three and six months ended June 30, 2008 was \$0.5 million and \$0.7 million, respectively. The total intrinsic value of options exercised for the three and six months ended June 30, 2007 was \$4.7 million and \$7.9 million, respectively.

As of June 30, 2008, we expect to recognize \$4.0 million of total unrecognized compensation expense related to non-vested employee stock options over a weighted-average life of 2.2 years.

Non-vested restricted stock awards as of June 30, 2008 and changes during the six months ended June 30, 2008 were as follows:

|                                 | Shares<br>Granted<br>(in thousands) | Weighted-<br>Average<br>Grant Date<br>Fair Value |
|---------------------------------|-------------------------------------|--|
| Non-vested at December 31, 2007 | 10                                  | \$36.25  |
| Granted                         | 117                                 | 23.62  |
| Vested                          | (30)                                | 27.86  |
| Forfeited                       | —                                   | —  |
| Non-vested at June 30, 2008     | <u>97</u>                           | \$23.59  |

As of June 30, 2008, we expect to recognize \$2.3 million in unrecognized compensation expense related to non-vested restricted stock awards over a weighted-average life of 2.5 years.

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**Note 3: Cash and Cash Equivalents**

Cash and cash equivalents include cash accounts and all investments purchased with initial maturities of three months or less. We maintain cash and cash equivalents with various financial institutions. These financial institutions are located in many different geographic regions. We mitigate our exposure to credit risk by placing our cash and cash equivalents with high quality financial institutions.

At June 30, 2008, we had approximately \$7.2 million and \$81.0 million of cash and cash equivalents in the United States and Europe, respectively. At December 31, 2007, we had approximately \$12.2 million and \$74.4 million of cash and cash equivalents in the United States and Europe, respectively.

**Note 4: Accounts Receivable and Revenue Concentrations**

Accounts receivable consisted of the following:

| <b>(In thousands)</b>           | <b>June 30,<br/>2008</b> | <b>December 31,<br/>2007</b> |
|---------------------------------|--------------------------|------------------------------|
| Trade receivable, gross         | \$ 62,813                | \$ 63,528                    |
| Allowance for doubtful accounts | (2,362)                  | (2,330)                      |
| Allowance for sales returns     | (2,411)                  | (1,482)                      |
| Net trade receivable            | 58,040                   | 59,716                       |
| Other receivables (1)           | 424                      | 430                          |
| Accounts receivable, net        | <u>\$ 58,464</u>         | <u>\$ 60,146</u>             |

(1) Other receivables as of June 30, 2008 and December 31, 2007 consisted primarily of a tenant improvement allowance provided by our landlord for the renovation and expansion of our corporate headquarters in Cypress, California. Construction was completed during the first quarter of 2008. We expect the tenant improvement allowance to be collected in the third quarter of 2008.

*Significant Customers*

We had sales to one significant customer and its sub-contractors that, when combined, totaled \$13.8 million and \$12.1 million, accounting for 19.5% and 17.0% of net sales, for the three months ended June 30, 2008 and 2007, respectively. Sales made to this customer during the six months ended June 30, 2008 and 2007 amounted to \$23.1 million and \$23.0 million, representing 17.5% and 16.7% of total net sales, respectively. Trade receivables with this customer and its sub-contractors amounted to \$7.8 million and \$7.9 million, or 13.3% and 13.3% of our net trade receivable at June 30, 2008 and December 31, 2007, respectively.

For the three and six months ended June 30, 2007, we had sales to another customer that contributed more than 10% of total net sales. Sales made to this customer were \$12.4 million and \$22.5 million, representing 17.4% and 16.4%, respectively, of our total net sales for the three and six months ended June 30, 2007. Trade receivables with this customer amounted to \$2.3 million, or 3.8% of our net trade receivable at December 31, 2007.

The loss of these customers or any key customer, either in the United States or abroad, due to the financial weakness or bankruptcy of any such customer or our inability to obtain orders or maintain our order volume with our major customers, may have a material adverse effect on our financial condition, results of operations and cash flows.

**Note 5: Inventories and Significant Suppliers***Inventories*

Inventories, which consist of wireless control devices, including universal remote controls, antennas and related component parts, are valued at the lower of cost or market. Cost, which is determined using the first-in, first-out method includes the purchase of integrated circuits, sub-contractor costs and freight-in. We carry inventory in amounts necessary to satisfy our customers' inventory requirements on a timely basis.

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Product innovations and technological advances may shorten a given product's life cycle. We continually monitor inventory to control inventory levels and dispose of any excess or obsolete inventories on hand. We write down our inventory for estimated obsolescence or unmarketable inventory, in an amount equal to the difference between the cost of the inventory and its estimated market value based upon our best estimates about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Net inventories consisted of the following:

| <b>(In thousands)</b>       | <b>June 30,<br/>2008</b> | <b>December 31,<br/>2007</b> |
|-----------------------------|--------------------------|------------------------------|
| Components                  | \$ 10,559                | \$ 6,750                     |
| Finished goods              | 33,738                   | 29,982                       |
| Reserve for inventory scrap | (1,647)                  | (1,826)                      |
| Inventory, net              | <u>\$ 42,650</u>         | <u>\$ 34,906</u>             |

During the three months ended June 30, 2008 and 2007, inventory write-downs totaled \$0.7 million and \$0.5 million, respectively. During the six months ended June 30, 2008 and 2007, inventory write-downs totaled \$1.0 million and \$1.0 million, respectively. Inventory write-downs are a normal part of our business and result primarily from product life cycle estimation variances.

#### *Significant Suppliers*

Most of the components used in our products are available from multiple sources. We have elected to purchase integrated circuits ("IC"), used principally in our wireless control products, from two main sources. Purchases from one supplier amounted to more than 10% of total inventory purchases. Purchases from this major supplier amounted to \$7.2 million and \$5.5 million, representing 15.7% and 13.3% of total inventory purchases for the three months ended June 30, 2008 and 2007, respectively. Purchases from this major supplier amounted to \$13.8 million and \$10.7 million, representing 16.4% and 14.0% of total inventory purchases for the six months ended June 30, 2008 and 2007, respectively. Accounts payable with that supplier amounted to \$3.4 million and \$3.2 million, representing 8.2% and 9.7% of total accounts payable at June 30, 2008 and December 31, 2007, respectively.

In addition, during the three months ended June 30, 2008, we purchased component and finished good products from two major suppliers. Purchases from these two major suppliers amounted to \$12.9 million and \$6.4 million, representing 28.3% and 14.1%, respectively, of total inventory purchases for the three months ended June 30, 2008. During the three months ended June 30, 2007 purchases from the same two suppliers amounted to \$11.5 million and \$9.1 million, representing 27.9% and 21.8%, respectively, of total inventory purchases. During the six months ended June 30, 2008 purchases from these two major suppliers amounted to \$24.8 million and \$13.0 million, representing 29.4% and 15.5%, respectively, of total inventory purchases. During the same period last year, purchases from the same two suppliers amounted to \$21.3 million and \$14.3 million, representing 27.7% and 18.7%, respectively, of total inventory purchases. Accounts payable with these suppliers of component and finished good products amounted to \$13.1 million and \$7.2 million, representing 32.2% and 17.6%, respectively, of total accounts payable at June 30, 2008. At December 31, 2007, accounts payable with the same suppliers amounted to \$10.8 million and \$6.3 million, representing 32.6% and 19.1%, respectively, of total accounts payable.

For the three and six months ended June 30, 2007, one other supplier provided more than 10% of total inventory purchases. Purchases from this supplier amounted to \$4.6 million and 8.4 million, representing 11.1% and 11.0%, respectively, of total inventory purchases for the three and six months ended June 30, 2007.

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We have identified alternative sources of supply for these integrated circuits, components, and finished goods; however, there can be no assurance that we will be able to continue to obtain these inventory purchases on a timely basis. We generally maintain inventories of our integrated chips, which could be used in part to mitigate, but not eliminate, delays resulting from supply interruptions. An extended interruption, shortage or termination in the supply of any of the components used in our products, or a reduction in their quality or reliability, or a significant increase in prices of components, would have an adverse effect on our business, results of operations and cash flows.

**Note 6: Income Taxes**

We use the estimated annual effective tax rate to determine our provision for income taxes for interim periods. We recorded income tax expense of \$1.8 million for the three months ended June 30, 2008 compared to \$2.2 million for the same period last year. Our estimated effective tax rate was 33.4% and 32.5% during the three months ended June 30, 2008 and 2007, respectively. We recorded income tax expense of \$3.0 million for the six months ended June 30, 2008 compared to \$4.4 million for the same period last year. Our estimated effective tax rate was 33.8% and 32.5% during the six months ended June 30, 2008 and 2007, respectively. The increase in our effective tax rate is due primarily to the federal research and development tax credit statute which expired at the end of 2007.

Effective January 1, 2007, we adopted the provisions of FASB Interpretation 48, "Accounting for Uncertainty in Income Taxes- an interpretation of FASB Statement No. 109" ("FIN 48"). As a result of the implementation of FIN 48, we recognized a \$0.2 million increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. We also recognized a decrease of \$0.3 million in other comprehensive income related to foreign currency translation as of December 31, 2007. At June 30, 2008, we had gross unrecognized tax benefits of approximately \$9.2 million, including interest and penalties, of which approximately \$7.6 million of this amount would affect the annual effective tax rate, if these tax benefits are realized. Further, we are unaware of any positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase within the next twelve months. However, based on federal, state and foreign statute expirations in various jurisdictions, we anticipate a decrease in unrecognized tax benefits of approximately \$0.7 million within the next twelve months.

In accordance with FIN 48, we have elected to classify interest and penalties as components of tax expense. Accrued interest and penalties were \$1.0 million at December 31, 2007 and \$1.2 million at June 30, 2008 and are included in the unrecognized tax benefits.

We file income tax returns in the U.S. federal jurisdiction, various states and foreign jurisdictions. As of June 30, 2008, the open statute of limitations for our significant tax jurisdictions are as follows: federal for 2004 through 2007, state for 2003 through 2007 and non-U.S. for 2001 through 2007. Approximately \$5.1 million of gross unrecognized tax benefits at June 30, 2008 are classified as short term in accrued income taxes as prescribed by FIN 48 because we anticipate payment of cash within the next twelve months. The accrued income taxes are net of a U.S. income tax receivable of approximately \$0.7 million. This unrecognized tax benefit relates to a foreign currency loss claimed on our Netherlands tax return for the years ended 2002 and 2003. We are currently under audit by the Dutch tax authorities and we expect this issue to be resolved within the next twelve months. The majority of the remaining gross unrecognized tax benefits is attributable to U.S. income taxes and is classified as long-term income taxes payable.

**Note 7: Earnings Per Share**

Basic earnings per share are computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares and dilutive potential common shares, which includes the dilutive effect of stock options and restricted stock grants. Dilutive potential common shares for all periods presented are computed utilizing the treasury stock method. In the computation of diluted earnings per common share for the three months ended June 30, 2008 and 2007, we have excluded 413,916 and 305,750 stock options, respectively, with exercise prices greater than the average market price of the underlying common stock, because their inclusion would have been antidilutive. In the computation of diluted earnings per common share for the six months ended June 30, 2008 and 2007, we have excluded 385,308 and 155,063 stock options, respectively, with exercise prices greater than the average market price of the underlying common stock, because their inclusion would have been antidilutive.



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Earnings per share for the three and six months ended June 30, 2008 and 2007 are calculated as follows:

| (In thousands, except per-share amounts)                      | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|---|--------------------------------|----------|------------------------------|----------|
|   | 2008                           | 2007     | 2008                         | 2007     |
| <b>BASIC</b>  |                                |          |                              |          |
| Net income  | \$ 3,495                       | \$ 4,546 | \$ 5,968                     | \$ 9,183 |
| Weighted-average common shares outstanding                    | 14,033                         | 14,437   | 14,256                       | 14,282   |
| Basic earnings per share                                      | \$ 0.25                        | \$ 0.31  | \$ 0.42                      | \$ 0.64  |
| <b>DILUTED</b>  |                                |          |                              |          |
| Net income  | \$ 3,495                       | \$ 4,546 | \$ 5,968                     | \$ 9,183 |
| Weighted-average common shares outstanding for basic          | 14,033                         | 14,437   | 14,256                       | 14,282   |
| Dilutive effect of stock options and restricted stock         | 514                            | 825      | 499                          | 802      |
| Weighted-average common shares outstanding on a diluted basis | 14,547                         | 15,262   | 14,755                       | 15,084   |
| Diluted earnings per share                                    | \$ 0.24                        | \$ 0.30  | \$ 0.40                      | \$ 0.61  |

**Note 8: Comprehensive Income**

The components of comprehensive income are listed below:

| (In thousands)                     | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |           |
|------------------------------------|--------------------------------|----------|------------------------------|-----------|
|                                    | 2008                           | 2007     | 2008                         | 2007      |
| Net income                         | \$ 3,495                       | \$ 4,546 | \$ 5,968                     | \$ 9,183  |
| Other comprehensive (loss) income: |                                |          |                              |           |
| Foreign currency translations (1)  | (263)                          | 1,168    | 7,583                        | 1,940     |
| Comprehensive income:              | \$ 3,232                       | \$ 5,714 | \$ 13,551                    | \$ 11,123 |

(1) The foreign currency translation gains of \$7.6 million and \$1.9 million for the six months ended June 30, 2008 and 2007, respectively, were due to the weakening of the U.S. dollar against the Euro. The U.S. dollar/Euro spot rate was 1.58 and 1.46 at June 30, 2008 and December 31, 2007, respectively, and 1.35 and 1.32 at June 30, 2007 and December 31, 2006, respectively.

**Note 9: Revolving Credit Line**

We have a \$15 million unsecured revolving credit agreement ("Credit Facility") with Comerica Bank, which expires on August 31, 2009. Under the Credit Facility, the interest payable is variable and is based on the bank's cost of funds or LIBOR plus a fixed margin of 1.25%. The interest rate in effect as of June 30, 2008 using LIBOR plus a fixed margin of 1.25% was 4.56%. We pay a commitment fee ranging from zero to a maximum rate of 1/4 of 1% per year on the unused portion of the credit line depending on the amount of cash investment retained with Comerica during each quarter. At June 30, 2008, the commitment fee rate was 0.25%. Under the terms of the Credit Facility, dividend payments are allowed for up to 100% of the prior fiscal year's net income, to be paid within 90 days of this period's year end. We are subject to certain financial covenants related to our net worth, quick ratio and net income. Amounts available for borrowing under the Credit Facility are reduced by the outstanding balance of import letters of credit. As of June 30, 2008, we did not have any amounts outstanding under the Credit Facility or any outstanding import letters of credit. The available balance on the line of credit was \$15 million as of June 30, 2008. Furthermore, as of June 30, 2008, we were in compliance with all financial covenants required by the Credit Facility.

Under our Credit Facility, we have authority to acquire up to an additional 2.0 million shares of our common stock in the open market. From August 31, 2006 through June 30, 2008, we have purchased 1,321,804 shares of our common stock, leaving 678,196 shares available for purchase under the Credit Facility.



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**Note 10: Other Accrued Expenses**

The components of other accrued expenses are listed below:

| (In thousands)                    | June 30,<br>2008 | December 31,<br>2007 |
|-----------------------------------|------------------|----------------------|
| Accrued freight                   | \$ 701           | \$ 1,435             |
| Accrued professional fees         | 723              | 580                  |
| Accrued advertising and marketing | 769              | 735                  |
| Deferred income taxes             | 428              | 511                  |
| Accrued third-party commissions   | 476              | 204                  |
| Accrued sales and VAT taxes       | 176              | 499                  |
| Other                             | 2,648            | 2,603                |
| Total other accrued expenses      | <u>\$ 5,921</u>  | <u>\$ 6,567</u>      |

**Note 11: Treasury Stock**

During the six months ended June 30, 2008 and 2007, we repurchased 753,904 and 71,300 shares of our common stock at a cost of \$17.5 million and \$2.4 million, respectively. Repurchased shares are recorded as shares held in treasury at cost. We generally hold shares for future use as management and the Board of Directors deem appropriate, including compensating outside directors and executives of the Company. During the six months ended June 30, 2008 and 2007, we issued 11,250 and 12,188 shares, respectively, to outside directors for services performed (see Note 2).

**Note 12: Goodwill and Intangible Assets**

Under the requirements of SFAS 142, "Goodwill and Intangible Assets", the unit of accounting for goodwill is at a level of reporting referred to as a "reporting unit." SFAS 142 defines a reporting unit as either (1) an operating segment — as defined in SFAS 131, "Disclosures about Segments of an Enterprise and Related Information" or (2) one level below an operating segment — referred to as a component. Our domestic and international components are "reporting units" within our one operating segment "Core Business." Goodwill is reviewed for impairment as of December 31st of each year. Goodwill of a reporting unit is tested for impairment between annual tests, if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

Goodwill for the domestic operations was generated from the acquisition of a remote control company in 1998 and the acquisition of a software and firmware solutions company, SimpleDevices, in 2004. Goodwill for international operations resulted from the acquisition of remote control distributors in the UK in 1998, Spain in 1999 and France in 2000.

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Domestic and international goodwill are as follows:

| (In thousands)    | June 30,<br>2008 | December 31,<br>2007 |
|-------------------|------------------|----------------------|
| Goodwill          |                  |                      |
| United States     | \$ 8,314         | \$ 8,314             |
| International (1) | 2,729            | 2,549                |
| Total             | <u>\$ 11,043</u> | <u>\$ 10,863</u>     |

(1) The difference in international goodwill reported at June 30, 2008, as compared to the goodwill reported at December 31, 2007, was the result of fluctuations in the foreign currency exchange rates used to translate the balance into U.S. dollars.

Besides goodwill, our intangible assets consist principally of distribution rights, patents, trademarks, purchased technologies and capitalized software development costs. Capitalized amounts related to patents represent external legal costs for the application and maintenance of patents. Intangible assets are amortized using the straight-line method over their estimated period of benefit, ranging from one to ten years.

Information regarding our other intangible assets is as follows (in thousands):

|   | June 30, 2008 (1) | December 31, 2007 (1) |
|---|-------------------|-----------------------|
| Carrying amount:                        |                   |                       |
| Distribution rights (10 years)          | \$ 452            | \$ 419                |
| Patents (10 years)                      | 6,774             | 6,335                 |
| Trademark and trade names (10 years)    | 840               | 840                   |
| Developed and core technology (5 years) | 1,630             | 1,630                 |
| Capitalized software (1-2 years)        | 513               | 499                   |
| Other (5-7 years)                       | 370               | 370                   |
| Total carrying amount                   | <u>\$ 10,579</u>  | <u>\$ 10,093</u>      |
| Accumulated amortization:               |                   |                       |
| Distribution rights                     | \$ 60             | \$ 56                 |
| Patents                                 | 2,987             | 2,695                 |
| Trademark and trade names               | 315               | 273                   |
| Developed and core technology           | 1,223             | 1,060                 |
| Capitalized software                    | 179               | 68                    |
| Other                                   | 278               | 241                   |
| Total accumulated amortization          | <u>\$ 5,042</u>   | <u>\$ 4,393</u>       |
| Net carrying amount:                    |                   |                       |
| Distribution rights                     | \$ 392            | \$ 363                |
| Patents                                 | 3,787             | 3,640                 |
| Trademark and trade names               | 525               | 567                   |
| Developed and core technology           | 407               | 570                   |
| Capitalized software                    | 334               | 431                   |
| Other                                   | 92                | 129                   |
| Total net carrying amount               | <u>\$ 5,537</u>   | <u>\$ 5,700</u>       |

(1) This table excludes fully amortized intangible assets of \$5.5 million as of June 30, 2008 and December 31, 2007.

Amortization expense, including the amortization of capitalized software development, which is recorded in cost of sales, for the three and six months ended June 30, 2008 was approximately \$0.3 million and \$0.7 million, respectively. Amortization expense for the three and six months ended June 30, 2007 was approximately \$0.4 million and \$0.7 million, respectively.

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Estimated amortization expense for existing intangible assets for each of the five succeeding years ending December 31 and thereafter are as follows:

| (In thousands)            |                 |
|---------------------------|-----------------|
| 2008 (remaining 6 months) | \$ 697          |
| 2009                      | 1,235           |
| 2010                      | 744             |
| 2011                      | 737             |
| 2012                      | 737             |
| Thereafter                | 1,387           |
| Total                     | <u>\$ 5,537</u> |

**Note 13: Business Segment and Foreign Operations**

*Business Segment*

SFAS 131, "Disclosures about Segments of an Enterprise and Related Information," defines an operating segment, in part, as a component of an enterprise whose operating results are regularly reviewed by the chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance. Operating segments may be aggregated only to the limited extent permitted by the standard. We currently operate in one business segment "Core Business".

*Foreign Operations*

Our sales to external customers and long-lived tangible assets by geographic area are as follows:

| (In thousands)      | Three Months Ended |                  | Six Months Ended  |                   |
|---------------------|--------------------|------------------|-------------------|-------------------|
|                     | 2008               | June 30,<br>2007 | 2008              | June 30,<br>2007  |
| Net Sales           |                    |                  |                   |                   |
| United States       | \$ 37,453          | \$ 43,143        | \$ 69,812         | \$ 82,822         |
| International:      |                    |                  |                   |                   |
| Asia                | 13,988             | 8,462            | 24,694            | 14,076            |
| United Kingdom      | 5,134              | 7,087            | 10,742            | 16,353            |
| Spain               | 2,119              | 1,567            | 4,846             | 2,976             |
| Germany             | 1,453              | 1,214            | 3,573             | 2,818             |
| France              | 1,362              | 774              | 2,731             | 1,682             |
| South Africa        | 1,318              | 1,643            | 2,172             | 2,594             |
| Australia           | 1,727              | 226              | 2,604             | 753               |
| Switzerland         | 96                 | 1,638            | 652               | 2,977             |
| All Other           | 6,034              | 5,724            | 10,049            | 10,446            |
| Total International | <u>33,231</u>      | <u>28,335</u>    | <u>62,063</u>     | <u>54,675</u>     |
| Total Net Sales     | <u>\$ 70,684</u>   | <u>\$ 71,478</u> | <u>\$ 131,875</u> | <u>\$ 137,497</u> |

Specific identification of the customer location was the basis used for attributing revenues from external customers to individual countries.

Our geographic long-lived asset information is as follows:

| (In thousands)             | June 30, 2008   | December 31, 2007 |
|----------------------------|-----------------|-------------------|
| Long-lived Tangible Assets |                 |                   |
| United States              | \$ 6,237        | \$ 5,238          |
| International              | 3,165           | 2,689             |
| Total                      | <u>\$ 9,402</u> | <u>\$ 7,927</u>   |

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

**Note 14: Derivatives**

Our foreign currency exposures are primarily concentrated in the Euro and British Pound. Depending on the predictability of future receivables, payables and cash flows in each operating currency, we periodically enter into foreign currency exchange contracts with terms normally lasting less than nine months to protect against the adverse effects that exchange-rate fluctuations may have on our foreign currency-denominated receivables, payables, cash flows and reported income. We do not enter into financial instruments for speculation or trading purposes. These derivatives have not qualified for hedge accounting. The gains and losses on both the derivatives and the foreign currency-denominated balances are recorded as foreign exchange transaction gains or losses and are classified in other (expense) income, net. Derivatives are recorded on the balance sheet at fair value. The estimated fair value of derivative financial instruments represents the amount required to enter into similar offsetting contracts with similar remaining maturities based on quoted market prices.

We held foreign currency exchange contracts which resulted in a net pre-tax loss of approximately \$101 thousand for the three months ended June 30, 2008 and a net pre-tax gain of approximately \$51 thousand for the three months ended June 30, 2007. For the six months ended June 30, 2008 and 2007, we had a pre-tax gain of approximately \$533 thousand and \$233 thousand, respectively. We had two foreign currency exchange contracts outstanding at June 30, 2008. These are forward contracts with the notional values of \$7.0 million and \$2.0 million. At December 31, 2007 we had one foreign currency exchange contract outstanding, a forward contract with a notional value of \$5.0 million, which settled on January 25, 2008. The fair value of the outstanding forward contract as of December 31, 2007 was \$11 thousand, which was included in prepaid expenses and other current assets.

We held one US dollar/ Euro forward contract with a notional value of \$7.0 million and a forward rate of \$1.5766 US dollar/ Euro, respectively as of June 30, 2008. We also held one GBP/ Euro forward contract with a notional value \$2.0 million and a forward rate of £ 0.7966 GBP/ Euro as of June 30, 2008. We held the Euro position on these contracts, which are both due for settlement on July 25, 2008. The aggregate loss on these contracts as of June 30, 2008 was \$29 thousand and is included in other accrued expenses.

**Note 15: Contingencies**

*Indemnities*

We indemnify our directors and officers to the maximum extent permitted under the laws of the State of Delaware and we have entered into Indemnification Agreements with each of our directors and executive officers. In addition, we purchased directors and officers' insurance to insure our individual directors and officers against certain claims and attorney's fees and related expenses incurred in connection with the defense of such claim. The amounts and types of coverage may vary from period to period as dictated by market conditions. Management is not aware of any matters that require indemnification of its officers or directors.

*Product Warranties*

We warrant our products against defects in materials and workmanship arising during normal use. We service warranty claims directly through our customer service department or contracted third-party warranty repair facilities. Our warranty period ranges up to three years. We provide for estimated product warranty expenses, which are included in cost of sales, as we sell the related products. Since warranty expense is a forecast primarily based on historical claims experience, actual claim costs may differ from the amounts provided.

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

Changes in the liability for product warranties are presented below (in thousands):

| <u>Description</u>                            | <u>Balance at<br/>Beginning of<br/>Period</u> | <u>Accruals for<br/>Warranties<br/>Issued During<br/>the Period</u> | <u>Settlements<br/>(in Cash or in<br/>Kind) During<br/>the Period</u> | <u>Balance at<br/>End of<br/>Period</u> |
|---|---|---|---|---|
| Six Months Ended June 30, 2008 <sup>(1)</sup> | \$ 178  | —   | \$ (86)   | \$ 92                                   |
| Six Months Ended June 30, 2007 <sup>(1)</sup> | \$ 416  | \$(146)   | \$(170)   | \$ 100                                  |

(1) In the second quarter of 2007, we renegotiated pricing terms with our third party warranty repair vendor which resulted in lower warranty costs per unit. As a result, our warranty accrual was reduced to reflect the lower pricing.

#### *Litigation*

In 2002, one of our subsidiaries (One For All S.A.S.) brought an action against a former distributor of the subsidiary's products seeking a recovery of accounts receivable. The distributor filed a counterclaim against our subsidiary seeking payment for amounts allegedly owed for administrative and other services rendered by the distributor for our subsidiary. In January 2005, the parties agreed to include in that action all claims between the distributor and two of our other subsidiaries, Universal Electronics BV and One For All Iberia SL. As a result, the single action covers all claims and counterclaims between the various parties. The parties further agreed that, before any judgment is paid, all disputes between the various parties would be concluded. These additional claims involve nonpayment for products and damages resulting from the alleged wrongful termination of agency agreements. On March 15, 2005, the court in one of the litigation matters brought by the distributor against one of our subsidiaries, rendered judgment against our subsidiary and awarded damages and costs to the distributor in the amount of approximately \$102,000. The amount of this judgment was charged to operations during the second quarter of 2005 and has been paid. With respect to the remaining matters before the court, we are awaiting the expert to finalize and file his pre-trial report with the court and when completed, we will respond. Management is unable to estimate the likelihood of an unfavorable outcome, and the amount of loss, if any, in the case of an unfavorable outcome.

On February 7, 2008, we filed suit against Gibson Audio, a Division of Gibson Guitar Corp., Gibson Guitar Corp., and Gibson Musical Instruments, Inc. seeking payment of the remaining balance of a minimum royalty fee due us under a software agreement. On March 10, 2008 the Gibson companies answered our complaint with a general denial of all of our allegations. Also, the Gibson companies counterclaimed that we breached various aspects of the software agreement and that they are seeking unspecified damages. We disagree vigorously with their denials of liability and with their counterclaims and will continue to pursue this matter. As we are in the early stages of discovery, we are unable to estimate the likely outcome of this matter and the amount, if any, of recovery of the balance due us at this time.

There are no other material pending legal proceedings, other than litigation that is incidental to the ordinary course of our business, to which we or any of our subsidiaries is a party or of which our respective property is the subject. We do not believe that any of the claims made against us in any of the pending matters have merit and we intend to vigorously defend ourselves against them.

#### *Long-Term Incentive Plan*

During the second quarter of 2007, we adopted a Long-Term Incentive Plan ("LTIP"), effective January 1, 2007, that provides a bonus pool for the executive management team contingent on achieving certain performance goals for the two-year period commencing on January 1, 2007 and ending on December 31, 2008, involving sales growth and earnings per diluted share. Vesting in the bonus pool will occur in eight equal quarterly increments commencing with the quarter ending March 31, 2009 and will continue as long as the participant remains an employee of our company. Payment of the vested portion of the bonus pool will occur on the vesting date, unless the participant elects to defer such payment, and will be made in cash, our common stock, or a combination of cash and stock (at our company's discretion). Our Board of Directors believes that a four-year performance and vesting time period is appropriate. The LTIP commits a maximum of \$12 million in bonus if the highest performance goals are met. During the first quarter of 2008, due to lower net sales projections for 2008, we lowered our annual LTIP accrual from \$1.0 million at December 31, 2007 to \$0.8 million at March 31, 2008 resulting in a \$175 thousand benefit to pre-tax income. The LTIP accrual is approximately \$1.0 million at June 30, 2008 and is included in other long-term liabilities.

## ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the Consolidated Financial Statements and the related notes that appear elsewhere in this document.

### Overview

We have developed a broad line of pre-programmed universal wireless control products and audio-video accessories that are marketed to enhance home entertainment systems. Our channels of distribution include international retail, U.S. retail, private label, OEMs, cable and satellite service providers, CEDIA (Custom Electronic Design and Installation Association) and companies in the computing industry. We believe that our universal remote control database contains device codes that are capable of controlling virtually all infrared remote ("IR") controlled TVs, VCRs, DVD players, cable converters, CD players, audio components and satellite receivers, as well as most other infrared remote controlled devices worldwide.

Beginning in 1986 and continuing today, we have compiled an extensive library that covers over 355,000 individual device functions and over 3,400 individual consumer electronic equipment brand names. Our library is regularly updated with new IR codes used in newly introduced video and audio devices. All such IR codes are captured from the original manufacturer's remote control devices or manufacturer's specifications to ensure the accuracy and integrity of the database. We have also developed patented technologies that provide the capability to easily upgrade the memory of the wireless control device by adding IR codes from the library that were not originally included.

Since the third quarter of 2006, we have been operating as one business segment. We have eleven operating subsidiaries located in Argentina, France, two in Germany, Hong Kong, India, Italy, the Netherlands, Singapore, Spain, and the United Kingdom.

To recap our results for the first six months of 2008:

- revenue declined year-over-year in the first six months of 2008 by 4.1%, from \$137.5 million in the first six months of 2007 to \$131.9 million in the first six months of 2008, and net income was \$6.0 million, or \$0.40 per diluted share in the first six months of 2008, compared to \$9.2 million, or \$0.61 per diluted share in the first six months of 2007;
- we repurchased 753,904 shares of common stock for \$17.5 million, at an average price of \$23.20 per share;

Our business objectives for the remainder of 2008 include the following:

- increase our share with existing customers;
- acquire new customers in historically strong regions;
- continue our expansion into new regions, Asia in particular;
- continue to develop industry-leading technologies and products; and
- continue to evaluate potential merger and acquisition opportunities that may enhance our business.

We intend for the following discussion of our financial condition and results of operations to provide information that will assist in understanding our consolidated financial statements, the changes in certain key items in those financial statements from period to period, and the primary factors that accounted for those changes, as well as how certain accounting principles, policies and estimates affect our consolidated financial statements.

## Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and judgments, including those related to revenue recognition, allowance for sales returns and doubtful accounts, warranties, inventory valuation, business combination purchase price allocations, our review for impairment of long-lived assets, intangible assets and goodwill, income taxes and stock-based compensation expense. Actual results may differ from these judgments and estimates, and they may be adjusted as more information becomes available. Any adjustment could be significant.

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably could have been used, or if changes in the estimate that are reasonably likely to occur could materially impact the financial statements. For further information regarding critical accounting policies and estimates, other than stock-based compensation discussed below, refer to Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in our Annual Report on Form 10-K for our fiscal year ended December 31, 2007.

## Stock-Based Compensation

We follow the fair value recognition provisions of SFAS No. 123R, "Share Based Payment" ("SFAS 123R") using the modified-prospective transition method. Stock-based compensation expense is presented in the same income statement line as cash compensation paid to the same employees or directors. During the three months ended June 30, 2008 and 2007, we recorded \$1.1 million and \$0.8 million, respectively, of pre-tax stock-based compensation expense. During the six months ended June 30, 2008 and 2007, we recorded \$2.3 million and \$1.5 million, respectively, of pre-tax stock-based compensation expense.

Stock-based compensation expense was included in the following:

| (In thousands)                                       | Three Months Ended<br>June 30, |               | Six Months Ended<br>June 30, |                 |
|--|--------------------------------|---------------|------------------------------|-----------------|
|  | 2008                           | 2007          | 2008                         | 2007            |
| Cost of sales  | \$ 5                           | \$ 7          | \$ 9                         | \$ 13           |
| Research and development                             | 106                            | 106           | 205                          | 185             |
| Selling, general and administrative                  | 1,021                          | 692           | 2,097                        | 1,283           |
| Stock-based compensation expense before income taxes | <u>\$ 1,132</u>                | <u>\$ 805</u> | <u>\$ 2,311</u>              | <u>\$ 1,481</u> |

As of June 30, 2008, we expect to recognize \$4.0 million of total unrecognized compensation expense related to non-vested stock options over a weighted-average life of 2.2 years.

Included in SG&A stock-based compensation expense is \$206 thousand and \$117 thousand in pre-tax compensation expense for the three months ended June 30, 2008 and 2007, respectively, related to stock awards granted to outside directors. Included in SG&A stock-based compensation expense is \$387 thousand and \$234 thousand in pre-tax compensation expense for the six months ended June 30, 2008 and 2007, respectively, related to stock awards granted to outside directors. We issue restricted stock awards to the outside directors for services performed. Compensation expense for the restricted stock awards is recognized on a straight-line basis over the requisite service period of one year.

Additionally, in the first quarter of 2008 during the annual review cycle, the Compensation Committee granted our executives 115,926 shares of restricted stock under the 2006 Stock Incentive Plan. The awards were granted as part of long-term incentive compensation to assist us in meeting our performance and retention objectives. Each executive grant is subject to a three-year vesting period. For the three and six months ended June 30, 2008, the stock-based compensation expense related to this award was \$228 thousand and \$456 thousand, respectively, and is included in SG&A.

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Under SFAS 123R, compensation expense related to restricted stock awards granted to outside directors and executives is based on the fair value of the shares awarded as of the grant date. The fair value of non-vested shares is determined based on the average of the high and low trade prices of our company's shares on the grant date.

As of June 30, 2008, we expect to recognize \$2.3 million in unrecognized compensation expense related to non-vested restricted stock awards over a weighted-average life of 2.5 years.

Determining the appropriate fair value model and calculating the fair value of share-based payment awards requires the utilization of highly subjective assumptions, including the expected life of the share-based payment awards and stock price volatility. Management determined that historical volatility calculated based on our actively traded common stock is a better indicator of expected volatility and future stock price trends than implied volatility. The assumptions used in calculating the fair value of share-based payment awards represent management's best estimates, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest.

We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions used to determine stock-based compensation expense. However, if actual results are not consistent with our estimates and assumptions we may be exposed to material stock-based compensation expense. Refer to Note 2 captioned "Stock-based Compensation" included in the "Notes to the Consolidated Financial Statements" set forth above for additional disclosure regarding stock-based compensation expense.

## Results of Operations

The following table sets forth our results of operations expressed as a percentage of net sales for the three and six months ended June 30, 2008 and 2007:

|  | Three Months Ended June 30, |       | Six Months Ended June 30, |       |
|--|-----------------------------|-------|---------------------------|-------|
|  | 2008                        | 2007  | 2008                      | 2007  |
| Net sales                                    | 100%                        | 100%  | 100%                      | 100%  |
| Cost of sales                                | 65.7                        | 65.5  | 65.2                      | 64.4  |
| Gross profit                                 | 34.3                        | 34.5  | 34.8                      | 35.6  |
| Research and development expenses            | 3.0                         | 3.2   | 3.3                       | 3.3   |
| Selling, general and administrative expenses | 25.1                        | 22.9  | 26.2                      | 23.5  |
| Operating expenses                           | 28.1                        | 26.1  | 29.5                      | 26.8  |
| Operating income                             | 6.2                         | 8.4   | 5.3                       | 8.8   |
| Interest income, net                         | 1.2                         | 1.0   | 1.4                       | 1.0   |
| Other income (expense), net                  | 0.0                         | 0.0   | 0.1                       | 0.1   |
| Income before income taxes                   | 7.4                         | 9.4   | 6.8                       | 9.9   |
| Provision for income taxes                   | (2.5)                       | (3.1) | (2.3)                     | (3.2) |
| Net income                                   | 4.9%                        | 6.3%  | 4.5%                      | 6.7%  |

*Three Months Ended June 30, 2008 versus Three Months Ended June 30, 2007:*

The following table sets forth our net sales by our Business and Consumer lines for the three months ended June 30, 2008 and 2007:

|                 | 2008           |               | 2007           |               |
|-----------------|----------------|---------------|----------------|---------------|
|                 | \$ (millions)  | % of total    | \$ (millions)  | % of total    |
| Net sales:      |                |               |                |               |
| Business        | \$ 56.8        | 80.3%         | \$ 60.5        | 84.6%         |
| Consumer        | 13.9           | 19.7%         | 11.0           | 15.4%         |
| Total net sales | <u>\$ 70.7</u> | <u>100.0%</u> | <u>\$ 71.5</u> | <u>100.0%</u> |



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### Overview

Net sales for the second quarter of 2008 were \$70.7 million, a decrease of 1% compared to \$71.5 million for the second quarter of 2007. Net income for the second quarter of 2008 was \$3.5 million or \$0.25 per share (basic) and \$0.24 per share (diluted) compared to \$4.5 million or \$0.31 per share (basic) and \$0.30 per share (diluted) for the second quarter of 2007.

### Consolidated

Net sales in our Business lines (subscription broadcasting, OEM and computing companies) were approximately 80% of net sales in the second quarter of 2008 compared to approximately 85% in the second quarter of 2007. Net sales in our Business line for the second quarter of 2008 decreased by 6% to \$56.8 million from \$60.5 million in the second quarter of 2007. This decrease in sales resulted primarily from a decrease in the volume of remote control sales with our subscription broadcasting customers. Sales in the second quarter of 2007 were favorably impacted by the mid-year Open Cable Application Platform (“OCAP”) compliance deadline, as some of our key customers ordered additional product ahead of the deadline. In spite of the difficult comparison with the second quarter of 2007, the roll out of advanced functions such as digital video recording (“DVR”), video-on-demand (“VOD”), and high definition television (“HDTV”) continues. We expect that the deployment of the advanced function set-top boxes by the service operators will continue into the foreseeable future as penetration for each of the functions cited continues to increase. We expect Business category revenue to range between \$234 million and \$244 million for the full year 2008.

Net sales in our Consumer lines (*One For All*® retail, private label, custom installers and direct import) were approximately 20% of net sales for the second quarter of 2008 compared to approximately 15% for the second quarter of 2007. Net sales in our Consumer lines for the second quarter of 2008 increased by 26.5% to \$13.9 million, from \$11.0 million in the second quarter of 2007. CEDIA sales increased by \$1.8 million compared to the second quarter of 2007, primarily due to the launch of a new Nevo product that occurred in the second quarter of 2008. International retail sales increased by \$1.7 million compared to the second quarter of 2007, mainly due to increased distribution in the UK market. International retail sales were favorably impacted by the strengthening of both the Euro and the British Pound compared to the U.S. Dollar, which resulted in an increase in net sales of approximately \$0.5 million. Net of this positive currency effect, international retail sales increased by \$1.2 million. Partially offsetting these increases were private label sales, which decreased \$0.6 million, to \$0.4 million in the second quarter of 2008 from \$1.0 million in the second quarter of 2007. This was due to a decline in the volume of remote control sales to our private label partners. We expect Consumer category revenue to range between \$67 million and \$77 million for the full year 2008.

Gross profit for the second quarter of 2008 was \$24.2 million compared to \$24.6 million for the second quarter of 2007. Gross profit as a percent of sales for the second quarter of 2008 was 34.3% compared to 34.5% for the same period in the prior year. The decrease in gross profit as a percentage of net sales was primarily attributable to product mix within our business lines, partially offset by a shift in mix towards our higher-margin consumer lines, which generally have a higher gross profit rate as compared to our other sales. This change in mix resulted in a 1.4% decrease in the gross profit rate. Included in this mix calculation is an increase in royalty revenue of \$1.0 million which favorably impacted the gross margin rate by 1.0%. Partially offsetting the decrease in the gross profit rate was a reduction of \$1.0 million of freight, handling and duty expense, which increased the gross profit rate by 1.3%. In the second quarter of 2008, there was a decrease in the percentage of units shipped by air compared to the second quarter of 2007.

Research and development expenses decreased 6% from \$2.3 million in the second quarter of 2007 to \$2.1 million in the second quarter of 2008. The decrease is due to the completion of the latest development phase for the Nevo® platform that took place in late 2007. We expect research and development expenses to remain near current levels for the remaining quarters of 2008.

Selling, general and administrative expenses increased 8% from \$16.4 million in the second quarter of 2007 to \$17.7 million in the second quarter of 2008. The strengthening of both the Euro and British Pound compared to the U.S. Dollar resulted in an increase of \$1.2 million, stock-based compensation increased by \$0.3 million due to grants that

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occurred in the first quarter of 2008, sales commissions increased by \$0.3 million, payroll and benefits increased by \$0.2 million, and depreciation increased by \$0.2 million. These increases were partially offset by lower delivery and freight expense, which decreased by \$0.4 million, long-term incentive plan expense, which decreased by \$0.3 million, and travel, which decreased by \$0.3 million. We expect that selling, general and administrative expenses to range between \$68 million and \$72 million for the full year 2008.

In the second quarter of 2008, we recorded \$0.9 million of net interest income compared to \$0.7 million in the second quarter of 2007. This increase is due to higher money market rates and a higher average cash balance. We expect net interest income to range between \$3.3 million and \$3.8 million for the full year 2008.

We recorded income tax expense of \$1.8 million in the second quarter of 2008 compared to \$2.2 million in the second quarter of 2007. Our effective tax rate was 33.4% in the second quarter of 2008 compared to 32.5% in the second quarter of 2007. The increase in our effective tax rate is due primarily to the expiration of the federal research and development tax credit statute, which occurred on December 31, 2007. We estimate that our effective tax rate will range between 33% and 35% for the full year 2008.

### *Six Months Ended June 30, 2008 versus Six Months Ended June 30, 2007:*

The following table sets forth our net sales by our Business and Consumer lines for the six months ended June 30, 2008 and 2007:

|                 | 2008            |               | 2007            |               |
|-----------------|-----------------|---------------|-----------------|---------------|
|                 | \$ (millions)   | % of total    | \$ (millions)   | % of total    |
| Net sales:      |                 |               |                 |               |
| Business        | \$ 105.1        | 79.7%         | \$ 110.7        | 80.5%         |
| Consumer        | 26.8            | 20.3%         | 26.8            | 19.5%         |
| Total net sales | <u>\$ 131.9</u> | <u>100.0%</u> | <u>\$ 137.5</u> | <u>100.0%</u> |

### *Overview*

Net sales for the six months ended June 30, 2008 were \$131.9 million, a decrease of 4% compared to \$137.5 million for the six months ended June 30, 2007. Net income for the six months ended June 30, 2008 was \$6.0 million or \$0.42 per share (basic) and \$0.40 per share (diluted) compared to \$9.2 million or \$0.64 per share (basic) and \$0.61 per share (diluted) for the six months ended June 30, 2007.

### *Consolidated*

Net sales in our Business lines (subscription broadcasting, OEM and computing companies) were approximately 80% of net sales for the six months ended June 30, 2008 compared to approximately 81% for the six months ended June 30, 2007. Net sales in our Business lines for the six months ended June 30, 2008 decreased by 5% to \$105.1 million from \$110.7 million for the same period last year. This decrease in sales resulted primarily from a decrease in the volume of remote control sales with our subscription broadcasting customers. Sales in the first half of 2007 were favorably impacted by the mid-year Open Cable Application Platform ("OCAP") compliance deadline, as some of our key customers ordered additional product ahead of the deadline. In spite of the difficult comparison with the first half of 2007, the roll out of advanced functions such as digital video recording ("DVR"), video-on-demand ("VOD"), and high definition television ("HDTV") continues. We expect the deployment of the advanced function set-top boxes by the service operators to continue into the foreseeable future as penetration for each of these functions continues to increase. We expect Business category revenue to range between \$234 million and \$244 million for the full year 2008.

Net sales in our Consumer lines (*One For All*® retail, private label, custom installers and direct import) were approximately 20% of net sales for the six months ended June 30, 2008 compared to approximately 19% for the six months ended June 30, 2007. Net sales in our Consumer lines for the six months ended June 30, 2008 and 2007 were flat at \$26.8 million for both periods. International retail sales increased 5% to \$22.1 million for the six months ended June 30, 2008 from \$21.1 million for the six months ended June 30, 2007. This increase was primarily attributable to the strengthening of both the Euro and British Pound compared to the U.S. Dollar. The impact of the stronger currencies resulted in an increase in net sales of approximately \$1.1 million. Net of this positive currency

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effect, international retail sales were relatively flat. There were decreases in private label sales, which decreased \$0.6 million, to \$1.0 million in the first six months of 2008 from \$1.6 million in the first six months of 2007. This was due to a decline in the volume of remote control sales to our private label partners. United States direct import licensing and product revenues for the first six months of 2008 decreased by \$0.3 million or 37% to \$0.4 million in 2008 from \$0.7 million in 2007, due to a decline in Kameleon sales in North America and the expiration of a license agreement. We expect Consumer category revenue to range between \$67 million and \$77 million for the full year 2008.

Gross profit for the six months ended June 30, 2008 was \$45.9 million compared to \$49.0 million for the six months ended June 30, 2007. Gross profit as a percentage of net sales for the six months ended June 30, 2008 was 34.8% compared to 35.6% for the six months ended June 30, 2007. The decrease in gross profit as a percentage of net sales was primarily attributable to product mix within our business lines, partially offset by a shift in mix towards our higher-margin consumer lines, which generally have a higher gross profit rate as compared to our other sales. This change in mix resulted in a 2.4% decrease in the gross profit rate. Included in this mix calculation is an increase in royalty revenue of \$1.9 million which favorably impacted the gross margin rate by 0.9%. Partially offsetting the decrease in the gross profit rate was a reduction of \$1.6 million of freight, handling and duty expense, which increased the gross profit rate by 1.1%. In the first half of 2008, there was a decrease in the percentage of units shipped by air compared to the first half of 2007. Royalty expense decreased by \$0.7 million, resulting from lower sales of SKY-branded retail products, which added 0.5% to the gross profit rate.

Research and development expenses decreased 6% from \$4.6 million in the six months ended June 30, 2007 to \$4.3 million in the six months ended June 30, 2008. The decrease is due to the completion of the latest development phase for the Nevo<sup>®</sup> platform that took place in late 2007. We expect research and development expenses to remain near current levels for the remaining quarters of 2008.

Selling, general and administrative expenses increased 7% from \$32.2 million in the six months ended June 30, 2007 to \$34.6 million in the six months ended June 30, 2008. The strengthening of both the Euro and British Pound compared to the U.S. Dollar resulted in an increase of \$2.2 million, and stock-based compensation increased by \$0.8 million due to grants that occurred in the first quarter of 2008. These increases were partially offset by long-term incentive plan expense, which decreased by \$0.5 million. We expect that selling, general and administrative expenses to range between \$68 million and \$72 million for the full year 2008.

In the six months ended June 30, 2008, we recorded \$1.8 million of net interest income compared to \$1.3 million during the six months ended June 30, 2007. This increase was due to higher money market rates and a higher average cash balance in Europe. We expect net interest income to range between \$3.3 million and \$3.8 million for the full year 2008.

For the six months ended June 30, 2008, net other income was \$0.2 million as compared to \$0.1 million for the six months ended June 30, 2007. Approximately \$0.2 million of net other income in the six months ended June 30, 2008 was the result of a foreign exchange gain, compared to a foreign exchange gain of \$0.1 million for the six months ended June 30, 2007, net of gains/losses on foreign currency forward contracts.

We recorded income tax expense of \$3.0 million for the six months ended June 30, 2008 compared to \$4.4 million for the six months ended June 30, 2007. Our effective tax rate was 33.8% during the six months ended June 30, 2008 compared to 32.5% during the six months ended June 30, 2007. The increase in our effective tax rate is due primarily to the expiration of the federal research and development tax credit statute, which occurred on December 31, 2007. We estimate that our effective tax rate will range between 33% and 35% for the full year 2008.

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### Liquidity and Capital Resources

#### Financial Condition (Sources and Uses of Cash):

| (In thousands)                                       | Six months ended<br>June 30, 2008 | (Decrease)/<br>Increase in cash | Six months ended<br>June 30, 2007 |
|--|-----------------------------------|---------------------------------|-----------------------------------|
| Net cash provided by operating activities            | \$ 17,389                         | \$ 12,505                       | \$ 4,884                          |
| Net cash used for investing activities               | (3,962)                           | (1,277)                         | (2,685)                           |
| Net cash (used for) provided by financing activities | (16,830)                          | (23,545)                        | 6,715                             |
| Effect of exchange rate changes on cash              | 5,008                             | 3,558                           | 1,450                             |
|  | <u>June 30, 2008</u>              | <u>Increase/(Decrease)</u>      | <u>December 31, 2007</u>          |
| Cash and cash equivalents                            | \$ 88,215                         | \$ 1,605                        | \$ 86,610                         |
| Working capital                                      | 137,882                           | (2,448)                         | 140,330                           |

*Net cash provided by operating activities* for the first six months of 2008 was \$17.4 million as compared to \$4.9 million in the first six months of 2007. The increase in cash provided by operating activities was primarily driven by a comparative improvement in our days sales outstanding from the first six months of 2007 to the first six months of 2008. During the first six months of 2007, days sales outstanding increased from 67 days at December 31, 2006 to 75 days at June 30, 2007 compared to an improvement in days sales outstanding from 82 days at December 31, 2007 to 74 days at June 30, 2008. In addition, in an effort to improve our cash conversion cycle, we have extended the payment cycle to various vendors.

Partially offsetting the aforementioned improvement in our cash conversion cycle is a decrease in our inventory turns from 7.1 turns in the second quarter of 2007 to 4.4 turns in the second quarter of 2008. Inventory levels are higher at June 30, 2008 compared to June 30, 2007 as we are building product in advance of the two upcoming strong volume quarters.

*Net cash used for investing activities* for the first six months of 2008 was \$4.0 million as compared to \$2.7 million for the first six months of 2007. The increase in cash used for investing activities was primarily due to an increase in leasehold improvements and acquisition of furniture and fixtures related to the renovation of our corporate headquarters. During the first quarter of 2007, we began to renovate and expand our corporate headquarters. Construction was completed during the first quarter of 2008. The total cost of this renovation was approximately \$2.0 million, which was financed through our current operations, and a \$0.4 million tenant improvement allowance to be collected from the landlord in the third quarter of 2008.

We also plan to make a significant investment to upgrade our information systems, which we expect to cost approximately \$1.0 million. The strategic planning for the upgrade of our information systems commenced in 2007 and we expect implementation to be completed in 2009. In addition, in order to support our future sales growth, we expect annual purchases of tooling equipment to increase throughout the years.

*Net cash used for financing activities* for the first six months of 2008 was \$16.8 million as compared to cash provided by financing activities of \$6.7 million for the first six months of 2007. The increase in cash used for financing activities was primarily due to the repurchase of 753,904 shares of our common stock for a total cost of \$17.5 million in the first six months of 2008. During the first six months of 2007, we repurchased 71,300 shares of our common stock for a total cost of \$2.4 million. We hold repurchased shares as treasury stock and they are available for reissue. Presently, except for using a small number of these treasury shares to compensate our outside board members, we have no plans to distribute these shares. However, we may change these plans if necessary to fulfill our on-going business objectives.

In addition, proceeds from stock exercises were \$0.5 million during the first six months of 2008 compared to \$8.0 million in the first six months of 2007.

Effective August 31, 2006, we amended our original Credit Facility with Comerica, extending our line of credit through August 31, 2009. Under the amended Credit Facility, we have authority to acquire up to an additional 2.0 million shares of our common stock in the open market. From August 31, 2006, through June 30, 2008, we purchased 1,321,804 shares of our common stock, leaving 678,196 shares available for purchase under the Credit Facility. During 2008 we may continue to purchase shares of our common stock if we believe conditions are favorable and to offset the dilutive effect of stock option exercises.

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### *Contractual Obligations*

At June 30, 2008 our contractual obligations were \$36.0 million compared to \$25.6 million as reported on our Annual Report on Form 10-K as of December 31, 2007. The following table summarizes our contractual obligations at June 30, 2008 and the effect these obligations are expected to have on our liquidity and cash flow in future periods.

| (in thousands)                      | Payments Due by Period |                     |                  |                 |                  |
|-------------------------------------|------------------------|---------------------|------------------|-----------------|------------------|
|                                     | Total                  | Less than<br>1 year | 1 - 3<br>Years   | 4 - 5<br>years  | After<br>5 years |
| <b>Contractual obligations:</b>     |                        |                     |                  |                 |                  |
| Operating lease obligations         | \$ 6,136               | \$ 1,870            | \$ 3,720         | \$ 546          | \$ —             |
| Purchase obligations <sup>(1)</sup> | 29,901                 | 9,661               | 14,720           | 5,520           | —                |
| Total contractual obligations       | <u>\$ 36,037</u>       | <u>\$ 11,531</u>    | <u>\$ 18,440</u> | <u>\$ 6,066</u> | <u>\$ —</u>      |

(1) Purchase obligations include payments due under two vendor agreements to purchase minimum quantities of inventory.

### *Liquidity*

We generally use cash provided by operations as our primary source of liquidity, since internally generated cash flows are typically sufficient to support business operations, capital expenditures and discretionary share repurchases. We are able to supplement this near term liquidity, if necessary, with our Credit Facility, as discussed below.

Historically, our working capital needs have typically been greatest during the third and fourth quarters when accounts receivable and inventories increase in connection with the fourth quarter holiday selling season. At June 30 2008, we had \$137.9 million of working capital as compared to \$140.3 million at December 31, 2007.

Our cash balances are held in the United States and Europe. At June 30, 2008, we had approximately \$7.2 million and \$81.0 million of cash and cash equivalents in the United States and Europe, respectively.

We have a \$15 million unsecured revolving credit agreement (“Credit Facility”) with Comerica Bank, which expires on August 31, 2009. Under the Credit Facility, the interest payable is variable and is based on the bank’s cost of funds or the LIBOR rate plus a fixed margin of 1.25%. The interest rate in effect as of June 30, 2008 using the LIBOR Rate option plus a fixed margin of 1.25% was 4.56%. We pay a commitment fee ranging from zero to a maximum rate of 1/4 of 1% per year on the unused portion of the credit line depending on the amount of cash investment retained with Comerica during each quarter. Under the terms of the Credit Facility, dividend payments are allowed for up to 100% of the prior fiscal year’s net income, to be paid within 90 days of this period’s year end. We are subject to certain financial covenants related to our net worth, quick ratio, and net income. Amounts available for borrowing under the Credit Facility are reduced by the outstanding balance of import letters of credit. As of June 30, 2008, we did not have any amounts outstanding under the Credit Facility or any outstanding import letters of credit. As of June 30, 2008, we had available \$15 million on the line of credit. Furthermore we were in compliance with all financial covenants required by the Credit Facility as of June 30, 2008.

It is our policy to carefully monitor the state of our business, cash requirements and capital structure. As previously mentioned, we believe that cash generated from our operations and funds available from our borrowing facility will be sufficient to fund current business operations and anticipated growth at least over the next twelve months; however, there can be no assurance that such funds will be adequate for that purpose.

### *Off Balance Sheet Arrangements*

We do not participate in any off balance sheet arrangements.

*Recent Accounting Pronouncements*

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements” (“SFAS 157”), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (“GAAP”), and expands disclosures about fair value measurements for assets and liabilities. SFAS 157 applies when other accounting pronouncements require or permit assets or liabilities to be measured at fair value. Accordingly, SFAS 157 does not require new fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position for SFAS 157 (“FSP FAS 157-1”) to amend SFAS 157 to exclude SFAS 13, “Accounting for Leases”, and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under SFAS 13. However, this scope exception does not apply to assets acquired and liabilities assumed in a business combination that are required to be measured at fair value under SFAS 141, “Business Combinations”, or SFAS 141R, “Business Combinations”, regardless of whether those assets and liabilities are related to leases. Additionally in February 2008 the FASB issued FASB Staff Position for SFAS 157 (“FSP FAS 157-2”), which delays the effective date of SFAS 157 for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in an entity’s financial statements on a recurring basis (at least annually) until fiscal years beginning after November 15, 2008. We adopted the provisions of SFAS 157 in the first quarter of 2008, except for those items within scope of FSP FAS 157-2, which we will adopt in the first quarter of 2009. We will apply the provisions as necessary (i.e. annual year-end impairment review of goodwill and intangible assets). As a result, the adoption of SFAS 157 had no impact on our consolidated results of operations and financial condition during the six months ended June 30, 2008.

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115” (“SFAS 159”). SFAS 159 expands the use of fair value accounting but does not affect existing standards that require assets or liabilities to be carried at fair value. Under SFAS 159, a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees and issued debt. Other eligible items include firm commitments for financial instruments that otherwise would not be recognized at inception and non-cash warranty obligations where a warrantor is permitted to pay a third party to provide the warranty goods or services. If the use of fair value is elected, any upfront costs and fees related to the item must be recognized in earnings and cannot be deferred, such as debt issuance costs. The fair value election is irrevocable and generally made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings. Subsequent to the adoption of SFAS 159, changes in fair value are recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007 and was adopted by us in the first quarter of 2008. The adoption of SFAS 159 had no impact on our consolidated results of operations and financial condition during the six months ended June 30, 2008.

In June 2007, the FASB ratified EITF 07-3, “Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities” (“EITF 07-3”). EITF 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and recognized as an expense as the goods are delivered or the related services are performed. EITF 07-3 is effective, on a prospective basis, for fiscal years beginning after December 15, 2007 and was adopted by us in the first quarter of 2008. The adoption of EITF 07-3 did not have a material effect on our consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), “Business Combinations” (“SFAS 141R”). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective as of the beginning of an entity’s fiscal year that begins after December 15, 2008, and will be adopted by us in the first quarter of fiscal 2009. We do not believe that the adoption of Statement 141R will have a material effect on our financial statements; however, the effect is dependent upon whether we make any future acquisitions and the specifics of those acquisitions.

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In December 2007, the FASB ratified EITF 07-1, “Accounting for Collaborative Arrangements Related to the Development and Commercialization of Intellectual Property” (“EITF 07-1”). EITF 07-1 defines collaborative arrangements and establishes disclosure requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. EITF 07-1 is effective as of the beginning of an entity’s fiscal year that begins after December 15, 2008 and should be applied retrospectively to all prior periods presented for all collaborative arrangements existing as of the effective date. EITF 07-1 is effective for us beginning January 1, 2009. Currently, we do not have any collaborative arrangements; therefore, we do not believe that the adoption of EITF 07-1 will have an impact on our consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements: an amendment of ARB No. 51” (“SFAS 160”). SFAS 160 changes the accounting for, and the financial statement presentation of, noncontrolling equity interests in a consolidated subsidiary. SFAS 160 replaces the existing minority-interest provisions of Accounting Research Bulletin 51 (“ARB 51”), “Consolidated Financial Statements,” by defining a new term—noncontrolling interests—to replace what were previously called minority interests. The new standard establishes noncontrolling interests as a component of the equity of a consolidated entity. The underlying principle of the new standard is that both the controlling interest and the noncontrolling interests are part of the equity of a single economic entity: the consolidated reporting entity. Classifying noncontrolling interests as a component of consolidated equity is a change from the current practice of treating minority interests as a mezzanine item between liabilities and equity or as a liability. The change affects both the accounting and financial reporting for noncontrolling interests in a consolidated subsidiary. SFAS 160 includes reporting requirements intended to clearly identify and differentiate the interests of the parent and the interests of the noncontrolling owners. The reporting requirements are required to be applied retrospectively. SFAS 160 is effective for fiscal years and interim periods within those fiscal years beginning on or after December 15, 2008. Early adoption is prohibited. We currently do not believe that the adoption of SFAS 160 will have a significant effect on our financial statements as we do not have any noncontrolling equity interests of a consolidated subsidiary.

In March 2008, the FASB issued SFAS No. 161, “Disclosures About Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133” (“SFAS 161”). SFAS 161 amends and expands the disclosure requirements of SFAS 133, “Accounting for Derivative Instruments and Hedging Activities,” to provide improved transparency into the uses and financial statement impact of derivative instruments and hedging activities. We will be required to provide enhanced disclosures about how and why we use derivative instruments, how they are accounted for, and how they affect our financial performance. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS 161 encourages, but does not require, comparative disclosures for earlier periods at initial adoption. SFAS 161 is effective for us beginning December 31, 2008. We are currently assessing the impact that SFAS 161 will have on our consolidated results of operations and financial condition.

In April 2008, the FASB issued FASB Staff Position No. FAS 142-3 “Determination of the Useful Life of Intangible Assets” (“FSP FAS 142-3”). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, “Goodwill and Other Intangible Assets.” The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under FASB Statement No. 141 (revised 2007), “Business Combinations”, and other U.S. GAAP. FSP FAS 142-3 is effective for fiscal years and interim periods within those fiscal years beginning on or after December 15, 2008. The guidance for determining the useful life of a recognized intangible asset in paragraphs 7–11 of this FSP shall be applied prospectively to intangible assets acquired after the effective date. The disclosure requirements in paragraphs 13–15 shall be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. Early adoption is prohibited. FSP FAS 142-3 is effective for us beginning January 1, 2009. We are currently assessing the impact that FSP FAS 142-3 will have on our consolidated results of operations and financial condition.

In May 2008, the FASB issued SFAS No. 162, “The Hierarchy of Generally Accepted Accounting Principles” (“SFAS 162”). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (the GAAP hierarchy). Statement 162 will become effective 60 days following the SEC’s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, “The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles.” We do not expect the adoption of SFAS 162 to have a material effect on our consolidated results of operations and financial condition.



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In June 2008, the FASB issued FASB Staff Position on EITF 03-6, “Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities” (“FSP EITF 03-6-1”). FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under FASB Statement No. 128, “Earnings per Share”. EITF 03-6-1 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008 and should be applied retrospectively to all prior periods. Early adoption is prohibited. FSP EITF 03-6-1 is effective for us beginning January 1, 2009. We do not expect the adoption of FSP EITF 03-6-1 to have a material effect on our consolidated results of operations and financial condition.

### **Factors That May Affect Financial Condition and Future Results**

#### *Forward Looking Statements*

We caution that the following important factors, among others (including but not limited to factors discussed below or above in “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” as well as those factors discussed in our 2007 Annual Report on Form 10-K, or in our other reports filed from time to time with the Securities and Exchange Commission), could affect our actual results and could contribute to or cause our actual consolidated results to differ materially from those expressed in any of our forward-looking statements. The factors included here are not exhaustive. Further, any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for management to predict all such factors, nor can we assess the impact of each such factor on the business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Therefore, forward-looking statements should not be relied upon as a prediction of actual future results.

While we believe that the forward looking statements made in this report are based on reasonable assumptions, the actual outcome of such statements is subject to a number of risks and uncertainties, including the failure of our markets to continue growing and expanding in the manner we anticipated; the failure of our customers to grow and expand as we anticipated; the effects of natural or other events beyond our control, including the effect a war or terrorist activities may have on us or the economy; the economic environment’s effect on us or our customers; the growth of, acceptance of and the demand for our products and technologies in various markets and geographical regions, including cable, satellite, consumer electronics, retail, digital media/ technology, CEDIA, interactive TV, automotive, and cellular industries not materializing or growing as we believed; our inability to add profitable complementary products which are accepted by the marketplace; our inability to continue to maintain our operating costs at acceptable levels through our cost containment efforts; our inability to realize tax benefits from various tax projects initiated from time to time; our inability to maintain the strength of our balance sheet; our inability to continue selling our products or licensing our technologies at higher or profitable margins; our inability to obtain orders or maintain our order volume with new and existing customers; the possible dilutive effect our stock option and other stock-based compensation programs may have on our earnings per share and stock price; our inability to continue to obtain adequate quantities of component parts or secure adequate factory production capacity on a timely basis; and other factors listed from time to time in our press releases and filings with the Securities and Exchange Commission.

### **Outlook**

Our focus is to build technology and products that make the consumer’s interaction with devices and content within the home easier and more enjoyable. The pace of change in the home is increasing. The growth of new devices, such as DVD players, PVR/DVR technologies, HDTV and home theater solutions, to name only a few, has transformed control of the home entertainment center into a complex challenge for the consumer. The more recent introduction and projected growth of digital media technologies in the consumer’s life will further increase this complexity. We have set out to create the interface for the connected home, building a bridge between the home devices of today and the networked home of the future. We intend to invest in new products and technology, particularly in the connected home space, which will expand our business beyond the control of devices to the control of and access to content, such as digital media, to enrich the entertainment experience.



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We will continue enhancing our leadership position in our core business by developing custom products for our subscription broadcasting, OEM, retail and computing customers, growing our capture expertise in infrared technology and radio frequency standards, adding to our portfolio of patented or patent pending technologies and developing new platform products. We are also developing new ways to enhance remote controls and other accessory products.

We are continuing to seek ways to use our technology to make the set-up and use of control products, and the access to and control of digital entertainment within the home entertainment network, easier and more affordable. In addition, we are working on product line extensions to our One For All® branded products which include digital antennas, signal boosters, and other A/V accessories.

We are also seeking ways to increase our customer base worldwide, particularly in the areas of subscription broadcasting, OEM and One For All® retail. We will continue to work on strengthening existing relationships by working with customers to understand how to make the consumer interaction with products and services within the home easier and more enjoyable. We intend to invest in new products and technology to meet our customer needs now and into the future.

We will continue developing software and firmware solutions that can enable devices such as TVs, set-top boxes, stereos, automotive audio systems and other consumer electronic products to wirelessly connect and interact with home networks and interactive services to deliver digital entertainment and information. This “smart device” category is emerging, and in the remainder of 2008 we look to continue to build relationships with our customers in this category.

Throughout 2008, we will continue to evaluate acceptable acquisition targets and strategic partnership opportunities in our core business lines as well as in the networked home marketplace. We caution, however, that no assurance can be made that any suitable acquisition target or partnership opportunity will be identified and, if identified, that a transaction can be consummated. Moreover, if consummated, no assurance can be made that any such acquisition or partnership will profitably add to our operations.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to various market risks, including interest rate and foreign currency exchange rate fluctuations. We have established policies, procedures and internal processes governing our management of these risks and the use of financial instruments to mitigate our risk exposure.

On August 31, 2006, we amended our credit facility to extend for an additional three years, expiring on August 31, 2009. The interest payable under our revolving Credit Facility with our bank is variable and based on either (i) the bank’s cost of funds or (ii) the LIBOR rate plus a fixed margin of 1.25%; the rate is affected by changes in market interest rates. At June 30, 2008, we had no borrowings on our credit facility. The interest rate in effect on the credit facility as of June 30, 2008 using the LIBOR Rate option plus a fixed margin of 1.25% was 4.56%.

At June 30, 2008 we had wholly owned subsidiaries in the Netherlands, United Kingdom, Germany, France, Argentina, Spain, Italy, Singapore, Hong Kong and India. Sales from these operations are typically denominated in local currencies such as the Euro and the British Pound, thereby creating exposure to changes in exchange rates. Changes in local currency exchange rates relative to the U.S. Dollar and, in some cases, to each other, may positively or negatively affect our sales, gross margins and net income. From time to time, we enter into foreign currency exchange agreements to manage our exposure arising from fluctuating exchange rates that affect cash flows and our reported income. Contract terms for the foreign currency exchange agreements normally last less than nine months. We do not enter into any derivative transactions for speculative purposes.

The value of our net balance sheet positions held in foreign currency can also be impacted by fluctuating exchange rates, as can the value of the income generated by our European subsidiaries. It is difficult to estimate the impact of fluctuations on reported income, as it depends on the opening and closing rates, the average net balance sheet positions held in a foreign currency and the amount of income generated in local currency. We routinely forecast what these balance sheet positions and income generated in local currency may be, and we take steps to minimize exposure as we deem appropriate.

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The sensitivity of earnings and cash flows to the variability in exchange rates is assessed by applying an approximate range of potential rate fluctuations to our assets, obligations and projected results of operations denominated in foreign currency. Based on our overall foreign currency rate exposure at June 30, 2008, we believe that movements in foreign currency rates could have a material affect on our financial position. We estimate that if the exchange rates for the Euro and the British Pound relative to the U.S. Dollar fluctuate 10% from June 30, 2008, net income and cash flows in the third quarter of 2008 would fluctuate by approximately \$0.2 million and \$9.6 million, respectively.

### **ITEM 4. CONTROLS AND PROCEDURES**

Exchange Act Rule 13a-15(d) defines “disclosure controls and procedures” to mean controls and procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission’s rules and forms. The definition further states that disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that the information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

An evaluation was performed under the supervision and with the participation of our management, including our principal executive and principal financial officers, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our principal executive and principal financial officers have concluded that our disclosure controls and procedures were effective, as of the end of the period covered by this report, to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

There were no changes in our internal control over financial reporting that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

In 2002, one of our subsidiaries (One For All S.A.S.) brought an action against a former distributor of the subsidiary’s products seeking a recovery of accounts receivable. The distributor filed a counterclaim against our subsidiary seeking payment for amounts allegedly owed for administrative and other services rendered by the distributor for our subsidiary. In January 2005, the parties agreed to include in that action all claims between the distributor and two of our other subsidiaries, Universal Electronics BV and One For All Iberia SL. As a result, the single action covers all claims and counterclaims between the various parties. The parties further agreed that, before any judgment is paid, all disputes between the various parties would be concluded. These additional claims involve nonpayment for products and damages resulting from the alleged wrongful termination of agency agreements. On March 15, 2005, the court in one of the litigation matters brought by the distributor against one of our subsidiaries, rendered judgment against our subsidiary and awarded damages and costs to the distributor in the amount of approximately \$102,000. The amount of this judgment was charged to operations during the second quarter of 2005 and has been paid. With respect to the remaining matters before the court, we are awaiting the expert to finalize and file his pre-trial report with the court and when completed, we will respond. Management is unable to estimate the likelihood of an unfavorable outcome, and the amount of loss, if any, in the case of an unfavorable outcome.

On February 7, 2008, we filed suit against Gibson Audio, a Division of Gibson Guitar Corp., Gibson Guitar Corp., and Gibson Musical Instruments, Inc. seeking payment of the remaining balance of a minimum royalty fee due us under a software agreement. On March 10, 2008 the Gibson companies answered our complaint with a general

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denial of all of our allegations. Also, as is typical, the Gibson companies counterclaimed that we breached various aspects of the software agreement and that they are seeking unspecified damages. We disagree vigorously with their denials of liability and with their counterclaims and will continue to pursue this matter. As we are in the early stages of discovery, we are unable to estimate the likely outcome of this matter and the amount, if any, of recovery of the balance due us at this time.

There are no other material pending legal proceedings, other than litigation incidental to the ordinary course of our business, to which we or any of our subsidiaries is a party or of which our respective property is the subject. We do not believe that any of the claims made against us in any of the pending matters has merit and we intend to vigorously defend ourselves against each claim.

We maintain directors' and officers' liability insurance to insure our individual directors and officers against certain claims and attorney's fees and related expenses incurred in connection with the defense of such claims.

### ITEM 1A. RISK FACTORS

For risk factors, see "Risk Factors" in Part 1, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2007, which is incorporated herein by reference.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the quarter ended June 30, 2008, we did not sell any equity securities that were not registered under the Securities Act of 1933.

We have authority under the Credit Facility to acquire up to 2.0 million shares of our common stock in market purchases. Between August 31, 2006, the date of amendment of the Credit Facility, and June 30, 2008, we purchased 1,321,804 shares of our common stock leaving 678,196 remaining shares authorized for purchase under the Credit Facility. We repurchased 253,904 shares during the quarter ended June 30, 2008, and we may continue to repurchase shares of our common stock during the remainder of the year, if we believe conditions are favorable, or to manage dilution created by shares issued under the employee stock plans. Purchase information for the second quarter of 2008 is set forth by month in the following table:

| <u>Period</u>                  | <u>Total Number of Shares Purchased</u> | <u>Average Price Paid per Share</u> | <u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u> | <u>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs</u> |
|--------------------------------|---|-------------------------------------|---|---|
| April 1, 2008 – April 30, 2008 | 3,904                                   | \$24.21                             | N/A   | N/A   |
| May 1, 2008 – May 31, 2008     | 206,500                                 | 23.50                               | N/A   | N/A   |
| June 1, 2008 – June 30, 2008   | 43,500                                  | 24.97                               | N/A   | N/A   |
| Total Q2 2008                  | <u>253,904</u>                          | \$23.76                             | <u>N/A</u>  | <u>N/A</u>  |

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**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

We held our Annual Meeting on June 12, 2008. The terms of all of our directors expired at the meeting. All of the directors nominated were re-elected by the stockholders for the term indicated. In addition, the stockholders ratified the appointment of our independent registered public accounting firm.

Results of the voting were as follows:

*Election of Directors:*

| <b>Nominee</b>       | <b>Term Expiring in</b> | <b>In Favor</b> | <b>Withheld</b> |
|----------------------|-------------------------|-----------------|-----------------|
| Paul D. Arling       | 2009                    | 13,282,757      | 300,709         |
| Satjiv S. Chahil     | 2010                    | 13,422,870      | 160,596         |
| William C. Mulligan  | 2010                    | 13,174,917      | 408,549         |
| J. C. Sparkman       | 2010                    | 13,418,285      | 165,181         |
| Gregory P. Stapleton | 2010                    | 13,409,220      | 174,246         |
| Edward K. Zinser     | 2010                    | 13,422,170      | 161,296         |

*Ratification of the appointment of Grant Thornton, as our independent registered public accounting firm for the year ending December 31, 2008:*

| <b>In Favor</b> | <b>Opposed</b> | <b>Abstain</b> |
|-----------------|----------------|----------------|
| 13,574,583      | 4,885          | 3,998          |

**ITEM 6. EXHIBITS**

- 31.1 Rule 13a-14(a) Certifications of Paul D. Arling, Chief Executive Officer (principal executive officer) of Universal Electronics Inc.
- 31.2 Rule 13a-14(a) Certifications of Bryan Hackworth, Chief Financial Officer (principal financial officer and principal accounting officer) of Universal Electronics Inc.
- 32 Section 1350 Certifications of Paul D. Arling, Chief Executive Officer (principal executive officer) of Universal Electronics Inc., and Bryan Hackworth, Chief Financial Officer (principal financial officer and principal accounting officer) of Universal Electronics Inc. pursuant to 18 U.S.C. Section 1350

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 8, 2008

Universal Electronics Inc.

/s/ Bryan Hackworth

Bryan Hackworth  
Chief Financial Officer  
(principal financial officer and  
principal accounting officer)

**EXHIBIT INDEX**

| <b>Exhibit No</b> | <b>Description</b>  |
|-------------------|---|
| 31.1              | Rule 13a-14(a) Certifications of Paul D. Arling, Chief Executive Officer (principal executive officer) of Universal Electronics Inc.  |
| 31.2              | Rule 13a-14(a) Certifications of Bryan M. Hackworth, Chief Financial Officer (principal financial officer and principal accounting officer) of Universal Electronics Inc.   |
| 32                | Section 1350 Certifications of Paul D. Arling, Chief Executive Officer (principal executive officer) of Universal Electronics Inc., and Bryan M. Hackworth, Chief Financial Officer (principal financial officer and principal accounting officer) of Universal Electronics Inc. pursuant to 18 U.S.C. Section 1350 |

Rule 13a-14(a) Certifications

I, Paul D. Arling, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Universal Electronics Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2008

/s/ Paul D. Arling

Paul D. Arling

Chief Executive Officer

(principal executive officer)



I, Bryan M. Hackworth, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Universal Electronics Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2008

/s/ Bryan M. Hackworth

Bryan M. Hackworth

Chief Financial Officer

(principal financial officer

and principal accounting officer)

## SECTION 1350 CERTIFICATIONS

Pursuant to 18 U.S.C. Section 1350, each of the undersigned officers of Universal Electronics Inc. (the "Company"), hereby certifies that the (i) Company's Form 10-Q for the fiscal quarter ended June 30, 2008 (the "Report") fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 8, 2008

By: /s/ Paul D. Arling  
Chief Executive Officer  
(principal executive officer)

By: /s/ Bryan M. Hackworth  
Chief Financial Officer  
(principal financial officer and  
principal accounting officer)

A signed original of this written statement has been provided to Universal Electronics Inc. and will be retained by it and furnished to the Securities and Exchange Commission or its staff upon request.