UNIVERSAL ELECTRONICS INC
Form 10-Q
November 08, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

OR

¨ 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.)
201 E. Sandpointe Avenue, 8th Floor Santa Ana, California (Address of Principal Executive Offices)	92707 (Zip Code)

Registrant's telephone number, including area code: (714) 918-9500

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 ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, any Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý 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 ý
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 15,552,256 shares of Common Stock, par value $0.01 per share, of the registrant were outstanding on November 5, 2013.

UNIVERSAL ELECTRONICS INC.

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PART I. FINANCIAL INFORMATION
ITEM 1. Consolidated Financial Statements (Unaudited)
UNIVERSAL ELECTRONICS INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share-related data)
(Unaudited)

	September 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$44,602	$44,593
Accounts receivable, net	103,466	91,048
Inventories, net	103,579	84,381
Prepaid expenses and other current assets	3,573	3,661
Income tax receivable	12	270
Deferred income taxes	5,102	5,210
Total current assets	260,334	229,163
Property, plant, and equipment, net	76,662	77,706
Goodwill	30,961	30,890
Intangible assets, net	27,632	29,835
Other assets	5,096	5,361
Deferred income taxes	6,252	6,369
Total assets	$406,937	$379,324
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$57,153	$59,831
Line of credit	—	—
Accrued compensation	35,529	33,398
Accrued sales discounts, rebates and royalties	7,165	8,093
Accrued income taxes	2,756	3,668
Deferred income taxes	56	41
Other accrued expenses	10,550	10,644
Total current liabilities	113,209	115,675
Long-term liabilities:		
Deferred income taxes	10,549	10,687
Income tax payable	525	525
Other long-term liabilities	2,082	1,787
Total liabilities	126,365	128,674
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; 22,133,206 and 21,491,398 shares issued on September 30, 2013 and December 31, 2012, respectively	221	215
Paid-in capital	194,360	180,607
Accumulated other comprehensive income (loss)	2,641	1,052
Retained earnings	187,979	170,569
	385,201	352,443

Less cost of common stock in treasury, 6,634,641 and 6,516,382 shares on September 30, 2013 and December 31, 2012, respectively	(104,629)	(101,793)
Total stockholders' equity	280,572	250,650
Total liabilities and stockholders' equity	$406,937	$379,324

See Note 4 for further information concerning our purchases from a related party vendor.
The accompanying notes are an integral part of these consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net sales	$142,389	$124,871	$393,220	$345,307
Cost of sales	101,940	88,433	282,386	247,572
Gross profit	40,449	36,438	110,834	97,735
Research and development expenses	4,182	3,521	12,463	10,408
Selling, general and administrative expenses	25,796	23,383	74,029	69,015
Operating income	10,471	9,534	24,342	18,312
Interest income (expense), net	47	(24)	60	(112)
Other income (expense), net	(717)	(65)	(2,897)	(515)
Income before provision for income taxes	9,801	9,445	21,505	17,685
Provision for income taxes	1,178	2,595	4,095	4,050
Net income	$8,623	$6,850	$17,410	$13,635
Earnings per share:				
Basic	$0.56	$0.46	$1.15	$0.91
Diluted	$0.55	$0.45	$1.13	$0.90
Shares used in computing earnings per share:				
Basic	15,324	14,984	15,129	14,931
Diluted	15,743	15,099	15,462	15,087

See Note 4 for further information concerning our purchases from a related party vendor.
The accompanying notes are an integral part of these consolidated financial statements.

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UNIVERSAL ELECTRONICS INC.
CONSOLIDATED COMPREHENSIVE INCOME STATEMENTS
(In thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income	$8,623	$6,850	$17,410	$13,635
Other comprehensive income (loss):				
Change in foreign currency translation adjustment	2,065	498	1,589	(995)
Comprehensive income	$10,688	$7,348	$18,999	$12,640

See Note 4 for further information concerning our purchases from a related party vendor.
The accompanying notes are an integral part of these consolidated financial statements.

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

	Nine Months Ended September 30,	
	2013	2012
Cash provided by (used for) operating activities:		
Net income	$17,410	$13,635
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Depreciation and amortization	13,387	12,948
Provision for doubtful accounts	140	72
Provision for inventory write-downs	1,988	2,148
Deferred income taxes	127	146
Tax benefit from exercise of stock options and vested restricted stock	1,040	(160)
Excess tax benefit from stock-based compensation	(1,011)	(49)
Shares issued for employee benefit plan	598	620
Stock-based compensation	3,950	3,447
Changes in operating assets and liabilities:		
Accounts receivable	(12,734)	(10,876)
Inventories	(20,701)	15,758
Prepaid expenses and other assets	352	(282)
Accounts payable and accrued expenses	(3,015)	(8,335)
Accrued income and other taxes	(729)	(1,428)
Net cash provided by (used for) operating activities	802	27,644
Cash used for investing activities:		
Acquisition of property, plant, and equipment	(7,978)	(6,525)
Acquisition of intangible assets	(978)	(802)
Net cash used for investing activities	(8,956)	(7,327)
Cash provided by (used for) financing activities:		
Issuance of debt	19,500	12,000
Payment of debt	(19,500)	(21,600)
Proceeds from stock options exercised	8,487	1,425
Treasury stock purchased	(3,153)	(619)
Excess tax benefit from stock-based compensation	1,011	49
Net cash provided by (used for) financing activities	6,345	(8,745)
Effect of exchange rate changes on cash	1,818	272
Net increase (decrease) in cash and cash equivalents	9	11,844
Cash and cash equivalents at beginning of year	44,593	29,372
Cash and cash equivalents at end of period	$44,602	$41,216
Supplemental Cash Flow Information:		
Income taxes paid	$3,319	$6,494
Interest paid	$44	$245

See Note 4 for further information concerning our purchases from a related party vendor.
The accompanying notes are an integral part of these consolidated financial statements.

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UNIVERSAL ELECTRONICS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013
(Unaudited)

Note 1 — Basis of Presentation and Significant Accounting Policies

In the opinion of management, the accompanying consolidated financial statements of Universal Electronics Inc. and its wholly-owned subsidiaries contain all the adjustments necessary for a fair presentation of financial position, results of operations and cash flows for the periods presented. All such adjustments are of a normal recurring nature and certain reclassifications have been made to prior year amounts in order to conform to the current year presentation. 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. 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.

Our results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the "Risk Factors," "Management Discussion and Analysis of Financial Condition and Results of Operations," "Quantitative and Qualitative Disclosures About Market Risk," and the "Financial Statements and Supplementary Data" and notes thereto included in Items 1A, 7, 7A, and 8, respectively, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Estimates, Judgments 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, judgments and assumptions 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, judgments and assumptions, including those related to revenue recognition, allowances for sales returns and doubtful accounts, warranties, inventory valuation, business combination purchase price allocations, impairment of long-lived assets, intangible assets and goodwill, income taxes and stock-based compensation expense. Actual results may differ from our expectations. Based on our evaluation, our estimates, judgments and assumptions may be adjusted as more information becomes available. Any adjustment may be material.

See Note 2 to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2012 for a summary of our significant accounting policies.

Recent Accounting Pronouncements

In December 2011, the FASB issued Accounting Standards Update ("ASU") 2011-11, "Disclosures about Offsetting Assets and Liabilities." The amendments in ASU 2011-11 require an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. In January 2013, the FASB issued ASU 2013-01, "Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities," which limits the scope of ASU 2011-11 to derivatives, repurchase agreements and securities lending transactions. This guidance became effective on January 1, 2013 with retrospective application required. The adoption of this guidance did not have a material impact on our consolidated financial statements.

In February 2013, the FASB issued ASU 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income," which updates ASU 2011-05, "Comprehensive Income." This standard requires the presentation in a single location, either in a note or parenthetically on the face of the financial statements, of the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line items affected by the reclassification. We adopted this guidance effective January 1, 2013. The adoption of this guidance did not have a material impact on our consolidated financial statements.

In July 2013, the FASB issued ASU 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists." This standard requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The adoption of ASU 2013-11 is not expected to have a material impact on our consolidated results of operations or financial position.

Note 2 — Cash and Cash Equivalents

Cash and cash equivalents were held in the following geographic regions:

(In thousands)	September 30, 2013	December 31, 2012
United States	$15,850	$2,741
Asia	19,113	27,317
Europe	6,615	9,361
Cayman Islands	8	1
South America	3,016	5,173
Total cash and cash equivalents	$44,602	$44,593

Note 3 — Accounts Receivable, Net and Revenue Concentrations

Accounts receivable, net were as follows:

(In thousands)	September 30, 2013	December 31, 2012
Trade receivables, gross	$99,708	$90,056
Allowance for doubtful accounts	(425)	(322)
Allowance for sales returns	(535)	(996)
Net trade receivables	98,748	88,738
Other	4,718	2,310
Accounts receivable, net	$103,466	$91,048

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UNIVERSAL ELECTRONICS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013
(Unaudited)

Allowance for Doubtful Accounts
Changes in the allowance for doubtful accounts were as follows:

(In thousands)	Nine Months Ended September 30,	
	2013	2012
Balance at beginning of period	$322	$1,021
Additions to costs and expenses	140	72
(Write-offs)/FX effects	(37)	(775)
Balance at end of period	$425	$318

Sales Returns
The allowance for sales returns at September 30, 2013 and December 31, 2012 included reserves for items returned prior to period-end that were not completely processed, and therefore had not yet been removed from the allowance for sales returns balance. If these returns had been fully processed, the allowance for sales returns balance would have been approximately $0.4 million and $0.6 million on September 30, 2013 and December 31, 2012, respectively. The value of these returned goods was included in our inventory balance at September 30, 2013 and December 31, 2012.
Significant Customer
Net sales to the following significant customer that totaled more than 10% of our net sales were as follows:

	Three Months Ended September 30,			
	2013		2012	
	$ (thousands)	% of Net Sales	$ (thousands)	% of Net Sales
DIRECTV	$21,667	15.2%	$23,691	19.0%

	Nine Months Ended September 30,			
	2013		2012	
	$ (thousands)	% of Net Sales	$ (thousands)	% of Net Sales
DIRECTV	$64,651	16.4%	$59,117	17.1%

Trade receivables associated with a significant customer that totaled more than 10% of our accounts receivable, net were as follows:

	September 30, 2013		December 31, 2012	
	$ (thousands)	% of Accounts Receivable, Net	$ (thousands)	% of Accounts Receivable, Net
DIRECTV	$—	—%	$9,277	10.2%

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

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UNIVERSAL ELECTRONICS INC.
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(Unaudited)

Note 4 — Inventories, Net and Significant Suppliers
Inventories, net were as follows:

(In thousands)	September 30, 2013	December 31, 2012
Raw materials	$20,831	$17,438
Components	19,949	20,978
Work in process	2,771	1,050
Finished goods	62,022	46,939
Reserve for excess and obsolete inventory	(1,994)	(2,024)
Inventories, net	$103,579	$84,381

Reserve for Excess and Obsolete Inventory
Changes in the reserve for excess and obsolete inventory were as follows:

(In thousands)	Nine Months Ended September 30, 2013	2012
Balance at beginning of period	$2,024	$3,447
Additions charged to costs and expenses [1]	1,838	1,891
Sell through [2]	(240)	(1,124)
Write-offs/FX effects	(1,628)	(1,907)
Balance at end of period	$1,994	$2,307

(1) The additions charged to costs and expenses do not include inventory directly written-off that was scrapped during production totaling $0.2 million and $0.3 million for the nine months ended September 30, 2013 and 2012, respectively. These amounts are production waste and are not included in management's reserve for excess and obsolete inventory.

(2) These amounts represent the reversal of reserves associated with inventory items that were sold during the period. Sell through is the result of differences between our judgment concerning the saleability of inventory items during the excess and obsolete inventory review process and our subsequent experience.

Significant Suppliers
We purchase integrated circuits, components and finished goods from multiple sources. We had purchases from the following significant suppliers that totaled more than 10% of our total inventory purchases as follows:

	Three Months Ended September 30, 2013		2012	
	$ (thousands)	% of Total Inventory Purchases	$ (thousands)	% of Total Inventory Purchases
Maxim	$8,699	11.2 %	—	—
Wuxi Funide Digital	$7,781	10.0 %	—	—

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 maintain inventories of our integrated circuits, which may be utilized 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, a reduction in their quality or reliability, or a significant increase in the prices of components, would have an adverse effect on our operating results, financial condition and cash flows.

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(Unaudited)

Related Party Vendor
We purchase certain printed circuit board assemblies from a related party vendor. The vendor is considered a related party for financial reporting purposes because our Senior Vice President of Manufacturing owns 40% of this vendor. Inventory purchases from this vendor were as follows:

	Three Months Ended September 30,					
	2013			2012		
	$ (thousands)	% of Total Inventory Purchases		$ (thousands)	% of Total Inventory Purchases	
Related party vendor	$2,395	3.1	%	$2,471	4.3	%

	Nine Months Ended September 30,					
	2013			2012		
	$ (thousands)	% of Total Inventory Purchases		$ (thousands)	% of Total Inventory Purchases	
Related party vendor	$7,079	3.2	%	$5,978	3.6	%

The total accounts payable to this vendor were the following:

	September 30, 2013			December 31, 2012		
	$ (thousands)	% of Accounts Payable		$ (thousands)	% of Accounts Payable	
Related party vendor	$1,619	2.8	%	$1,815	3.0	%

Our payable terms and pricing with this vendor are consistent with the terms offered by other vendors in the ordinary course of business. The accounting policies that we apply to our transactions with our related party vendor are consistent with those applied in transactions with independent third parties. Corporate management routinely monitors purchases from our related party vendor to ensure these purchases remain consistent with our business objectives.

Note 5 — Goodwill and Intangible Assets, Net

Goodwill

Goodwill and changes in the carrying amount of goodwill were as follows:

(In thousands)	
Balance at December 31, 2012	$30,890
Foreign currency	71
Balance at September 30, 2013	$30,961

UNIVERSAL ELECTRONICS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013
(Unaudited)

Intangible Assets, Net

The components of intangible assets, net were as follows:

	September 30, 2013			December 31, 2012		
(In thousands)	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Carrying amount [1]:						
Distribution rights	$389	$(52)	$337	$378	$(50)	$328
Patents	8,695	(4,175)	4,520	8,113	(3,847)	4,266
Trademark and trade names	2,840	(1,339)	1,501	2,841	(1,127)	1,714
Developed and core technology	3,505	(1,080)	2,425	3,507	(906)	2,601
Capitalized software development costs	297	(98)	199	1,276	(913)	363
Customer relationships	26,403	(7,753)	18,650	26,415	(5,852)	20,563
Total carrying amount	$42,129	$(14,497)	$27,632	$42,530	$(12,695)	$29,835

(1) This table excludes the gross value of fully amortized intangible assets totaling $6.5 million and $9.1 million on September 30, 2013 and December 31, 2012, respectively.

Amortization expense is recorded in selling, general and administrative expenses, except amortization expense related to capitalized software development costs which is recorded in cost of sales. Amortization expense by income statement caption was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2013	2012	2013	2012
Cost of sales	$34	$73	$177	$231
Selling, general and administrative	986	971	2,930	2,890
Total amortization expense	$1,020	$1,044	$3,107	$3,121

Estimated future amortization expense related to our intangible assets at September 30, 2013, is as follows:

(In thousands)	
2013 (remaining 3 months)	$1,021
2014	4,053
2015	3,890
2016	3,858
2017	3,830
Thereafter	10,980
Total	$27,632

Impairment charges are recorded in selling, general and administrative expenses as a component of amortization expense, except impairment charges related to capitalized software development costs which are recorded in cost of sales. We recorded immaterial impairment charges related to our intangible assets for the three and nine months ended September 30, 2013 and 2012.

We disposed of nine patents and twelve trademarks with an immaterial aggregate carrying amount during the nine months ended September 30, 2013. We disposed of thirteen patents with an immaterial aggregate carrying amount during the nine months ended September 30, 2012. These assets no longer held any probable future economic benefits and thus were written-off.

Note 6 — Line of Credit

On October 2, 2012, we entered into an Amended and Restated Credit Agreement ("Amended Credit Agreement") with U.S. Bank National Association ("U.S. Bank") which provides for a $55.0 million line of credit ("Credit Line") that may be used for working capital and other general corporate purposes including acquisitions, share repurchases and capital expenditures. The Amended Credit Agreement expires on November 1, 2014. Amounts available for borrowing under the Credit Line are reduced by the balance of any outstanding letters of credit, of which there were $13 thousand at September 30, 2013.

All obligations under the Credit Line are secured by substantially all of our U.S. personal property and tangible and intangible assets as well as 65% of our ownership interest in Enson Assets Limited, our wholly-owned subsidiary which controls our manufacturing factories in the People's Republic of China ("PRC").

Under the Amended Credit Agreement, we may elect to pay interest on the Credit Line based on LIBOR plus an applicable margin (varying from 1.25% to 1.75%) or base rate (based on the prime rate of U.S. Bank or as otherwise specified in the Amended Credit Agreement) plus an applicable margin (varying from -0.25% to +0.25%). The applicable margins are calculated quarterly and vary based on our leverage ratio as set forth in the Amended Credit Agreement. There are no commitment fees or unused line fees under the Amended Credit Agreement.

The Amended Credit Agreement includes financial covenants requiring a minimum fixed charge coverage ratio, a maximum leverage ratio and minimum liquidity levels. In addition, the Amended Credit Agreement also contains other customary affirmative and negative covenants and events of default. As of September 30, 2013, we were in compliance with the covenants and conditions of the Amended Credit Agreement.

Our total interest expense on borrowings was $0.1 million during the three months ended September 30, 2012. Our total interest expense on borrowings was $23 thousand and $0.2 million during the nine months ended September 30, 2013 and 2012, respectively.

Note 7 — Income Taxes

We utilize our estimated annual effective tax rate to determine our provision for income taxes for interim periods. The income tax provision is computed by taking the estimated annual effective tax rate and multiplying it by the year-to-date pre-tax book income.

We recorded income tax expense of $1.2 million and $2.6 million for the three months ended September 30, 2013 and 2012, respectively. Our effective tax rate was 12.0% and 27.5% during the three months ended September 30, 2013 and 2012, respectively. The decrease in our effective tax rate was due primarily to a shift of income from higher tax rate jurisdictions to lower tax rate jurisdictions driven largely by a tax benefit on certain income earned in Hong Kong.

We recorded income tax expense of $4.1 million and $4.1 million for the nine months ended September 30, 2013 and 2012, respectively. Our effective tax rate was 19.0% and 22.9% during the nine months ended September 30, 2013 and 2012, respectively. The decrease in our effective tax rate was due primarily to a shift of income from higher tax rate jurisdictions to lower tax rate jurisdictions driven largely by a tax benefit on certain income earned in Hong Kong. Partially offsetting this benefit was the recording of approximately $0.4 million of additional tax reserves in the second quarter of 2013 resulting from a tax audit in Hong Kong for years preceding our acquisition of Enson Assets Limited and the reversal of $0.5 million of unrecognized tax benefits in 2012 which were originally recorded in 2007 through 2011.

On September 30, 2013, we had gross unrecognized tax benefits of approximately $3.4 million, including interest and penalties, of which approximately $2.9 million 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 amount 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 $0.1 million within the next twelve months.

We have elected to classify interest and penalties as a component of tax expense. Accrued interest and penalties of $0.1 million and $0.1 million on September 30, 2013 and December 31, 2012, respectively, are included in our unrecognized tax benefits.

We file income tax returns in the U.S. federal jurisdiction, and in various state and foreign jurisdictions. On September 30, 2013, the open statutes of limitations in our significant tax jurisdictions were as follows: federal 2010 through 2012, state 2008 through 2012, and non-U.S. 2006 through 2012. On September 30, 2013, of our gross unrecognized tax benefits of $3.4 million, which included $0.1 million of interest and penalties, $1.5 million are classified as current and $1.9 million are classified as long term.

UNIVERSAL ELECTRONICS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2013
(Unaudited)

Note 8 — Accrued Compensation
The components of accrued compensation are listed below:

(In thousands)	September 30, 2013	December 31, 2012
Accrued social insurance (1)	$20,325	$19,842
Accrued salary/wages	5,856	4,862
Accrued vacation/holiday	2,127	2,048
Accrued bonus (2)	4,838	4,181
Accrued commission	755	478
Accrued medical insurance claims	576	643
Other accrued compensation	1,052	1,344
Total accrued compensation	$35,529	$33,398

(1) Effective January 1, 2008, the Chinese Labor Contract Law was enacted in the PRC. This law mandated that PRC employers remit the applicable social insurance payments to their local government. Social insurance is comprised of various components such as pension, medical insurance, job injury insurance, unemployment insurance, and a housing assistance fund, and is administered in a manner similar to social security in the United States. This amount represents our estimate of the amounts due to the PRC government for social insurance on September 30, 2013 and December 31, 2012.

(2) Accrued bonus includes an accrual for an extra month of salary ("13th month salary") to be paid to employees in certain geographies where it is the customary business practice. This 13th month salary is paid to these employees if they remain employed with us through December 31st. The total accrued for the 13th month salary was $0.5 million and $0.5 million at September 30, 2013 and December 31, 2012, respectively.

Note 9 — Other Accrued Expenses
The components of other accrued expenses are listed below:

(In thousands)	September 30, 2013	December 31, 2012
Advertising and marketing	$402	$501
Duties	855	584
Freight	1,575	1,666
Product development	522	569
Product warranty claim costs	—	404
Professional fees	954	1,234
Sales taxes and VAT	1,017	1,979
Third-party commissions	632	337
Tooling (1)	754	221
Utilities	386	316
Other	3,453	2,833
Total other accrued expenses	$10,550	$10,644

(1) The tooling accrual balance relates to unearned revenue for tooling that will be sold to customers.

Note 10 — Commitments and Contingencies

Product Warranties

Changes in the reserve for product warranty claim costs were as follows:

(In thousands)	Nine Months Ended September 30, 2013	2012
Balance at beginning of period	$404	$6
Accruals for warranties issued during the period	375	—
Settlements (in cash or in kind) during the period	(779)	—
Balance at end of period	$—	$6

Litigation

On July 15, 2011, we filed a lawsuit against Logitech, Inc., Logitech International S.A. and Logitech Europe S.A. in the United States District Court, Central District of California (Universal Electronics Inc. v. Logitech, Inc., Logitech International S.A. and Logitech Europe S.A., SACV 11-1056-JVS(ANx)) alleging that the Logitech companies were infringing seventeen of our patents related to remote control technology. We alleged that this complaint related to multiple Logitech remote control products and were seeking monetary relief for the infringement, including enhanced damages due to the willfulness of the Logitech companies' actions, injunctive relief to enjoin the Logitech companies from further infringing, including contributory infringement and/or inducing infringement, and attorney's fees. In its answer, filed on November 3, 2011, the Logitech companies generally denied all of our allegations of infringement and counterclaimed that we were infringing five of their patents. On November 24, 2011, we answered the Logitech companies' counterclaims, generally denying all of their allegations of infringement. On September 26, 2012, the Logitech companies and the Company entered into a long-term, confidential Settlement and License Agreement with an effective date of July 1, 2012 (the "Agreement"). During the term of the Agreement, the Logitech companies and the Company dismissed all lawsuits and, among other things, the Logitech companies will pay royalties to the Company to license the technologies covered by our patents in this suit. Additionally, the Logitech companies agreed to pay the Company $2.0 million for past royalties for the period covering July 1, 2010 through June 30, 2012. Due to the historical and ongoing relationship with the Logitech companies, this amount was included in net sales for the three- and nine-month periods ended September 30, 2012.

On March 2, 2012, we filed a lawsuit against Universal Remote Control, Inc. ("URC") in the United States District Court, Central District of California (Universal Electronics Inc. v. Universal Remote Control, Inc., SACV12-0039 AG (JPRx)) alleging that URC is infringing, directly and indirectly, four of our patents related to remote control technology. We have alleged that this complaint relates to multiple URC remote control products, including the URC model numbers UR5U-9000L, WR7 and other remote controls with different model names or numbers, but with substantially the same designs, features, and functionalities. We are seeking monetary relief for the infringement, including enhanced damages due to the willfulness of URC's actions, injunctive relief to enjoin URC from further infringing, including contributory infringement and/or inducing infringement, and attorney's fees. URC has denied infringing our patents. On January 29, 2013, the Court held its "Markman" hearing and on February 1, 2013, the Court issued its ruling that four of the 24 claims we have asserted against URC were invalid, effectively removing one of the four patents alleged by us to be infringed by URC from this litigation. In our estimation this ruling does not materially affect our position in this litigation. In all other respects, this litigation is continuing as scheduled with discovery continuing.

On June 28, 2013, we filed a second lawsuit against URC, also in the United States District Court, Central District of California (Universal Electronics Inc. v. Universal Remote Control, Inc., SACV13-00987 JAK (SHx)). In this second lawsuit, we are alleging that URC is infringing, directly and indirectly, nine additional patents that we own related to remote control technology. As in the first lawsuit, in this second lawsuit we have alleged that this complaint relates to multiple URC remote control products. We are seeking monetary relief for infringement, including enhanced damages due to the willfulness of URC's actions, injunctive relief to enjoin URC from further infringing, including contributory infringement and/or inducing infringement, and attorney's fees. In mid-July 2013, URC filed a Notice of Related Cases seeking to transfer this lawsuit to the same Judge and Magistrate hearing the lawsuit we filed against URC on March 2, 2012 and we did not object to this Notice. Consequently, this lawsuit was transferred. In all other respects this litigation is continuing as scheduled with URC answering this compliant with a denial of infringement, asserting affirmative defenses, and seeking a ruling that URC has not infringed our patents, that our patents are invalid and unenforceable, that the patents have been licensed to URC, and an award of attorneys’ fees and costs. Discovery is underway.

On September 23, 2013, we filed a lawsuit against Peel Technologies, Inc. (“Peel”) in the United States District Court, Central District of California (Universal Electronics Inc. v. Peel Technologies, Inc., SACV13-01484 GAF (RNBx)) alleging that Peel is infringing, directly and indirectly, five of our patents related to remote control technology. We have alleged that this complaint relates to software and hardware used in connection with remote control devices, including Peel’s software products called “TV App” (sometimes referred to as “Sense TV”), “WatchOn App” and “Peel Smart Remote App,” and a product called “Peel Universal Remote” consisting of a Peel “Fruit” hardware device and a software component for use with the iOS operating system. We are seeking monetary relief for the infringement, including enhanced damages due to the willfulness of Peel’s actions, injunctive relief to enjoin Peel from further infringing, including contributory infringement and/or inducing infringement, and attorney’s fees. Peel has not yet answered our compliant.

There are no other material pending legal proceedings to which we or any of our subsidiaries is a party or of which our respective property is the subject. However, as is typical in our industry and to the nature and kind of business in which we are engaged, from time to time, various claims, charges and litigation are asserted or commenced by third parties against us or by us against third parties arising from or related to product liability, infringement of patent or other intellectual property rights, breach of warranty, contractual relations, or employee relations. The amounts claimed may be substantial but may not bear any reasonable relationship to the merits of the claims or the extent of any real risk of court awards assessed against us or in our favor. However, no assurances can be made as to the outcome of any of these matters, nor can we estimate the range of potential losses to us. In our opinion, final judgments, if any, which might be rendered against us in potential or pending litigation would not have a material adverse effect on our financial condition, results of operations, or cash flows. Moreover, we believe that our products do not infringe any third parties' patents or other intellectual property rights.

We maintain directors' and officers' liability insurance which insures our individual directors and officers against certain claims, as well as attorney's fees and related expenses incurred in connection with the defense of such claims.

Defined Benefit Plan

Our subsidiary in India maintains a defined benefit pension plan ("India Plan") for local employees, which is consistent with local statutes and practices. The pension plan was adequately funded on September 30, 2013 and December 31, 2012 based on its latest actuarial report. The India Plan has an independent external manager that advises us of the appropriate funding contribution requirements to which we comply. At September 30, 2013, approximately 37 percent of our India subsidiary employees had qualified for eligibility. An individual must be employed by our India subsidiary for a minimum of 5 years before becoming eligible. Upon the termination, resignation or retirement of an eligible employee, we are liable to pay the employee an amount equal to 15 days salary for each full year of service completed. The total amount of liability outstanding at September 30, 2013 and December 31, 2012 for the India Plan was not material. During the nine months ended September 30, 2013 and 2012, the net periodic benefit costs were also not material.

Note 11 — Treasury Stock

Repurchased shares of our common stock were as follows:

	Nine Months Ended September 30,	
(In thousands, except share data)	2013	2012
Shares repurchased	140,759	37,267
Cost of shares repurchased	$3,153	$619

Repurchased shares are recorded as shares held in treasury at cost. We hold these shares for future use as management and the Board of Directors deem appropriate, which has included compensating our outside directors. During the nine months ended September 30, 2013 and 2012, we issued 22,500 and 30,000 shares from treasury, respectively, to outside directors for services performed (see Note 13).

From time to time, our Board of Directors authorizes management to repurchase shares of our issued and outstanding common stock. Repurchases may be made to manage dilution created by shares issued under our stock incentive plans or whenever we deem a repurchase is a good use of our cash and the price to be paid is at or below a threshold approved by our Board. As of September 30, 2013, we had 945,812 shares available for repurchase under the Board's authorizations.

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Note 12 — Business Segment and Foreign Operations
Reportable Segment
An operating segment, in part, is 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 a limited extent. Our chief operating decision maker, the Chief Executive Officer, reviews financial information presented on a consolidated basis, accompanied by disaggregated information about revenues for purposes of making operating decisions and assessing financial performance. Accordingly, we only have a single operating and reportable segment.
Foreign Operations
Our net sales to external customers by geographic area were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2013	2012	2013	2012
Net sales:				
United States	$53,310	$49,015	$146,057	$123,364
Asia (excluding PRC)	28,521	27,752	80,256	89,271
People's Republic of China	27,913	21,031	69,537	55,740
Europe	16,686	14,049	50,207	42,183
Latin America	9,617	7,926	26,327	20,067
Other	6,342	5,098	20,836	14,682
Total net sales	$142,389	$124,871	$393,220	$345,307

Specific identification of the customer billing location was the basis used for attributing revenues from external customers to geographic areas.
Long-lived tangible assets were as follows:

(In thousands)	September 30, 2013	December 31, 2012
Long-lived tangible assets:		
United States	$4,786	$5,541
People's Republic of China	73,751	73,804
All other countries	3,221	3,722
Total	$81,758	$83,067

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Note 13 — Stock-Based Compensation
Stock-based compensation expense for each employee and director is presented in the same income statement caption as their cash compensation. Stock-based compensation expense by income statement caption and the related income tax benefit were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2013	2012	2013	2012
Research and development	$54	$52	$166	$167
Selling, general and administrative:				
Employees	1,120	949	3,378	2,761
Outside directors	215	109	406	519
Total stock-based compensation expense	$1,389	$1,110	$3,950	$3,447
Income tax benefit	$451	$358	$1,255	$1,125

Stock Options

Stock option activity was as follows:

	Number of Options (in 000's)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Terms (in years)	Aggregate Intrinsic Value (in 000's)
Outstanding at December 31, 2012	1,412	$ 20.56		
Granted	201	19.68		
Exercised	(499)	17.00		$5,564
Forfeited/canceled/expired	(7)	28.08		
Outstanding at September 30, 2013 [1]	1,107	$ 21.96	5.95	$15,584
Vested and expected to vest at September 30, 2013 [1]	1,103	$ 21.96	5.94	$15,519
Exercisable on September 30, 2013 [1]	811	$ 22.39	4.93	$11,068

(1) The aggregate intrinsic value represents the total pre-tax value (the difference between our closing stock price on the last trading day of the third quarter of 2013 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had they all exercised their options on September 30, 2013. This amount will change based on the fair market value of our stock.

The assumptions we utilized in the Black-Scholes option pricing model and the resulting weighted average fair value of stock option grants were the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Weighted average fair value of grants [1]	$—	$7.17	$9.26	$9.57
Risk-free interest rate	— %	0.72 %	0.95 %	0.86 %
Expected volatility	— %	54.44 %	53.39 %	55.22 %
Expected life in years	0.00	5.34	5.20	5.15

(1) The weighted average fair value of grants was calculated utilizing the stock options granted during each respective period.

As of September 30, 2013, we expect to recognize $2.5 million of total unrecognized pre-tax stock-based compensation expense related to non-vested stock options over a remaining weighted-average life of 1.9 years.

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Restricted Stock

Non-vested restricted stock award activity was as follows:

	Shares Granted (in 000's)	Weighted-Average Grant Date Fair Value
Non-vested at December 31, 2012	270	$18.72
Granted	110	21.84
Vested	(143)	19.52
Forfeited	—	—
Non-vested at September 30, 2013	237	$19.67

As of September 30, 2013, we expect to recognize $4.0 million of total unrecognized pre-tax stock-based compensation expense related to non-vested restricted stock awards over a weighted-average life of 1.5 years.

Note 14 — Other Income (Expense), Net

Other income (expense), net consisted of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2013	2012	2013	2012
Net gain (loss) on foreign currency exchange contracts [1]	$299	$96	$44	$(118)
Net gain (loss) on foreign currency exchange transactions	(1,084)	(266)	(3,033)	(604)
Other income	68	105	92	207
Other income (expense), net	$(717)	$(65)	$(2,897)	$(515)

[1] This represents the gains and (losses) incurred on foreign currency hedging derivatives (see Note 16).

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Note 15 — Earnings Per Share
Earnings per share was calculated as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands, except per-share amounts)	2013	2012	2013	2012
BASIC				
Net income	$8,623	$6,850	$17,410	$13,635
Weighted-average common shares outstanding	15,324	14,984	15,129	14,931
Basic earnings per share	$0.56	$0.46	$1.15	