

UNIVERSAL ELECTRONICS INC

Form 10-Q

August 09, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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FORM 10-Q

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(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, 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

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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, 8<sup>th</sup> Floor

Santa Ana, California

(Address of Principal Executive Offices)

92707

(Zip Code)

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

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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 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 ☒ 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 ☐ (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 ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 15,282,389 shares of Common Stock, par value \$0.01 per share, of the registrant were outstanding on August 1, 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)

|  | June 30, 2013 | December 31,<br>2012 |
|--|---------------|----------------------|
| <b>ASSETS</b>  |               |                      |
| Current assets:  |               |                      |
| Cash and cash equivalents  | \$49,745      | \$44,593             |
| Accounts receivable, net   | 89,432        | 91,048               |
| Inventories, net   | 100,050       | 84,381               |
| Prepaid expenses and other current assets  | 3,654         | 3,661                |
| Income tax receivable  | 6             | 270                  |
| Deferred income taxes  | 5,175         | 5,210                |
| Total current assets   | 248,062       | 229,163              |
| Property, plant, and equipment, net  | 76,337        | 77,706               |
| Goodwill   | 30,876        | 30,890               |
| Intangible assets, net   | 28,312        | 29,835               |
| Other assets   | 5,195         | 5,361                |
| Deferred income taxes  | 6,516         | 6,369                |
| Total assets   | \$395,298     | \$379,324            |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |               |                      |
| Current liabilities:   |               |                      |
| Accounts payable   | \$65,947      | \$59,831             |
| Line of credit   | —             | —                    |
| Accrued compensation   | 33,005        | 33,398               |
| Accrued sales discounts, rebates and royalties   | 6,179         | 8,093                |
| Accrued income taxes   | 3,253         | 3,668                |
| Deferred income taxes  | 45            | 41                   |
| Other accrued expenses   | 9,758         | 10,644               |
| Total current liabilities  | 118,187       | 115,675              |
| Long-term liabilities:   |               |                      |
| Deferred income taxes  | 10,654        | 10,687               |
| Income tax payable   | 525           | 525                  |
| Other long-term liabilities  | 2,055         | 1,787                |
| Total liabilities  | 131,421       | 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; 21,839,302 and 21,491,398 shares issued on June 30, 2013 and December 31, 2012, respectively | 218           | 215                  |
| Paid-in capital  | 187,744       | 180,607              |
| Accumulated other comprehensive income (loss)  | 576           | 1,052                |
| Retained earnings  | 179,356       | 170,569              |
|  | 367,894       | 352,443              |
|  | (104,017)     | (101,793)            |

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Less cost of common stock in treasury, 6,619,048 and 6,516,382 shares on June 30, 2013 and December 31, 2012, respectively

|  |           |           |
|--|-----------|-----------|
| Total stockholders' equity                 | 263,877   | 250,650   |
| Total liabilities and stockholders' equity | \$395,298 | \$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.

Table of ContentsUNIVERSAL ELECTRONICS INC.  
CONSOLIDATED INCOME STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

|  | Three Months Ended June 30, |           | Six Months Ended June 30, |           |
|--|-----------------------------|-----------|---------------------------|-----------|
|  | 2013                        | 2012      | 2013                      | 2012      |
| Net sales                                    | \$136,109                   | \$116,704 | \$250,831                 | \$220,436 |
| Cost of sales                                | 98,273                      | 83,734    | 180,446                   | 159,139   |
| Gross profit                                 | 37,836                      | 32,970    | 70,385                    | 61,297    |
| Research and development expenses            | 4,040                       | 3,424     | 8,281                     | 6,887     |
| Selling, general and administrative expenses | 23,820                      | 23,080    | 48,233                    | 45,632    |
| Operating income                             | 9,976                       | 6,466     | 13,871                    | 8,778     |
| Interest income (expense), net               | 4                           | (51       | ) 13                      | (88       |
| Other income (expense), net                  | (1,630                      | ) (126    | ) (2,180                  | ) (450    |
| Income before provision for income taxes     | 8,350                       | 6,289     | 11,704                    | 8,240     |
| Provision for income taxes                   | 2,509                       | 1,136     | 2,917                     | 1,455     |
| Net income                                   | \$5,841                     | \$5,153   | \$8,787                   | \$6,785   |
| Earnings per share:                          |                             |           |                           |           |
| Basic  | \$0.39                      | \$0.35    | \$0.58                    | \$0.46    |
| Diluted                                      | \$0.38                      | \$0.34    | \$0.57                    | \$0.45    |
| Shares used in computing earnings per share: |                             |           |                           |           |
| Basic  | 15,098                      | 14,933    | 15,032                    | 14,904    |
| Diluted                                      | 15,419                      | 15,048    | 15,322                    | 15,080    |

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 June<br>30, |          | Six Months Ended June 30, |          |
|---|--------------------------------|----------|---------------------------|----------|
|   | 2013                           | 2012     | 2013                      | 2012     |
| Net income  | \$5,841                        | \$5,153  | \$8,787                   | \$6,785  |
| Other comprehensive income (loss):                |                                |          |                           |          |
| Change in foreign currency translation adjustment | 650                            | (2,421 ) | (476 )                    | (1,493 ) |
| Comprehensive income                              | \$6,491                        | \$2,732  | \$8,311                   | \$5,292  |

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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CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

|  | Six Months Ended June 30, |            |
|--|---------------------------|------------|
|  | 2013                      | 2012       |
| Cash provided by (used for) operating activities:  |                           |            |
| Net income   | \$8,787                   | \$6,785    |
| Adjustments to reconcile net income to net cash provided by (used for) operating activities: |                           |            |
| Depreciation and amortization  | 8,788                     | 8,525      |
| Provision for doubtful accounts  | 48                        | 37         |
| Provision for inventory write-downs  | 1,130                     | 1,623      |
| Deferred income taxes  | (111)                     | ) 6        |
| Tax benefit from exercise of stock options and vested restricted stock                       | 399                       | (72)       |
| Excess tax benefit from stock-based compensation   | (366)                     | ) (30)     |
| Shares issued for employee benefit plan  | 446                       | 468        |
| Stock-based compensation   | 2,561                     | 2,337      |
| Changes in operating assets and liabilities:   |                           |            |
| Accounts receivable  | 638                       | (4,678)    |
| Inventories  | (16,996)                  | ) 10,630   |
| Prepaid expenses and other assets  | 143                       | (711)      |
| Accounts payable and accrued expenses  | 2,647                     | (13,523)   |
| Accrued income and other taxes   | (168)                     | ) (2,796)  |
| Net cash provided by (used for) operating activities   | 7,946                     | 8,601      |
| Cash used for investing activities:  |                           |            |
| Acquisition of property, plant, and equipment  | (4,655)                   | ) (4,261)  |
| Acquisition of intangible assets   | (654)                     | ) (430)    |
| Net cash used for investing activities   | (5,309)                   | ) (4,691)  |
| Cash provided by (used for) financing activities:  |                           |            |
| Issuance of debt   | 19,500                    | 8,000      |
| Payment of debt  | (19,500)                  | ) (11,400) |
| Proceeds from stock options exercised  | 3,946                     | 1,386      |
| Treasury stock purchased   | (2,435)                   | ) (486)    |
| Excess tax benefit from stock-based compensation   | 366                       | 30         |
| Net cash provided by (used for) financing activities   | 1,877                     | (2,470)    |
| Effect of exchange rate changes on cash  | 638                       | (124)      |
| Net increase (decrease) in cash and cash equivalents   | 5,152                     | 1,316      |
| Cash and cash equivalents at beginning of year   | 44,593                    | 29,372     |
| Cash and cash equivalents at end of period   | \$49,745                  | \$30,688   |
| Supplemental Cash Flow Information:  |                           |            |
| Income taxes paid  | \$2,420                   | \$5,354    |
| Interest paid  | \$43                      | \$176      |

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

JUNE 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 six months ended June 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

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UNIVERSAL ELECTRONICS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2013

(Unaudited)

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)                  | June 30,<br>2013 | December 31,<br>2012 |
|---------------------------------|------------------|----------------------|
| United States                   | \$14,208         | \$2,741              |
| Asia                            | 25,758           | 27,317               |
| Europe                          | 6,079            | 9,361                |
| Cayman Islands                  | 1                | 1                    |
| South America                   | 3,699            | 5,173                |
| Total cash and cash equivalents | \$49,745         | \$44,593             |

## Note 3 — Accounts Receivable, Net and Revenue Concentrations

Accounts receivable, net were as follows:

| (In thousands)                  | June 30,<br>2013 | December 31,<br>2012 |
|---------------------------------|------------------|----------------------|
| Trade receivables, gross        | \$87,664         | \$90,056             |
| Allowance for doubtful accounts | (325)            | (322)                |
| Allowance for sales returns     | (588)            | (996)                |
| Net trade receivables           | 86,751           | 88,738               |
| Other                           | 2,681            | 2,310                |
| Accounts receivable, net        | \$89,432         | \$91,048             |

Allowance for Doubtful Accounts

Changes in the allowance for doubtful accounts were as follows:

| (In thousands)<br>Description            | Balance at<br>Beginning of<br>Period | Additions<br>to Costs and<br>Expenses | (Write-offs)/<br>FX Effects | Balance at<br>End of<br>Period |
|--|--------------------------------------|---------------------------------------|-----------------------------|--------------------------------|
| Valuation account for trade receivables: |                                      |                                       |                             |                                |
| Six months ended June 30, 2013           | \$322                                | 48                                    | (45)                        | \$325                          |
| Six months ended June 30, 2012           | \$1,021                              | 37                                    | (7)                         | \$1,051                        |

## Sales Returns

The allowance for sales returns at June 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 \$0.3 million and \$0.6 million on June 30, 2013 and December 31, 2012, respectively. The value of these returned goods was included in our inventory balance at June 30, 2013 and December 31, 2012.

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UNIVERSAL ELECTRONICS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2013

(Unaudited)

## Significant Customer

Net sales to the following significant customer that totaled more than 10% of our net sales were as follows:

|         | Three Months Ended June 30, |                | 2012           |                |
|---------|-----------------------------|----------------|----------------|----------------|
|         | 2013                        |                |                |                |
|         | \$ (thousands)              | % of Net Sales | \$ (thousands) | % of Net Sales |
| DIRECTV | \$22,137                    | 16.3           | % \$19,215     | 16.5           |

|         | Six Months Ended June 30, |                | 2012           |                |
|---------|---------------------------|----------------|----------------|----------------|
|         | 2013                      |                |                |                |
|         | \$ (thousands)            | % of Net Sales | \$ (thousands) | % of Net Sales |
| DIRECTV | \$42,984                  | 17.1           | % \$35,426     | 16.1           |

Trade receivables associated with the significant customer activity disclosed above were as follows:

|         | June 30, 2013  |                               | December 31, 2012 |                               |
|---------|----------------|-------------------------------|-------------------|-------------------------------|
|         | \$ (thousands) | % of Accounts Receivable, Net | \$ (thousands)    | % of Accounts Receivable, Net |
| DIRECTV | \$10,360       | 11.6                          | % \$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.

## Note 4 — Inventories, Net and Significant Suppliers

Inventories, net were as follows:

| (In thousands)                            | June 30, 2013 | December 31, 2012 |
|---|---------------|-------------------|
| Raw materials                             | \$23,683      | \$17,438          |
| Components                                | 16,733        | 20,978            |
| Work in process                           | 3,250         | 1,050             |
| Finished goods                            | 58,306        | 46,939            |
| Reserve for excess and obsolete inventory | (1,922)       | (2,024)           |
| Inventories, net                          | \$100,050     | \$84,381          |

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UNIVERSAL ELECTRONICS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2013

(Unaudited)

## Reserve for Excess and Obsolete Inventory

Changes in the reserve for excess and obsolete inventory were as follows:

| (In thousands)<br>Description              | Balance at<br>Beginning<br>of Period | Additions<br>Charged to<br>Costs and<br>Expenses<br>(1) | Sell<br>Through <sup>(2)</sup> | Write-offs/FX<br>Effects | Balance<br>at End<br>of Period |
|--|--------------------------------------|---|--------------------------------|--------------------------|--------------------------------|
| Reserve for excess and obsolete inventory: |                                      |   |                                |                          |                                |
| Six months ended June 30, 2013             | \$2,024                              | \$1,022   | \$(219)                        | ) \$(905)                | ) \$1,922                      |
| Six months ended June 30, 2012             | \$3,447                              | \$1,386   | \$(558)                        | ) \$(1,238)              | ) \$3,037                      |

The additions charged to costs and expenses do not include inventory directly written-off that was scrapped during production totaling \$0.1 million and \$0.2 million for the six months ended June 30, 2013 and 2012, respectively. (1) These amounts are production waste and are not included in management's reserve for excess and obsolete inventory.

This column represents the reversal of reserves associated with inventory items that were sold during the period.

(2) 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 June 30, |   | 2012           |   |   |
|---------|-----------------------------|---|----------------|---|---|
|         | 2013                        | % of<br>Total<br>Inventory<br>Purchases | \$ (thousands) | % of<br>Total<br>Inventory<br>Purchases |   |
| Samsung | \$—                         | —                                       | \$5,719        | 10.0                                    | % |
|         | Six Months Ended June 30,   |   | 2012           |   |   |
|         | 2013                        | % of<br>Total<br>Inventory<br>Purchases | \$ (thousands) | % of<br>Total<br>Inventory<br>Purchases |   |
| Samsung | \$—                         | —                                       | \$10,935       | 10.2                                    | % |
| Samjin  | \$—                         | —                                       | \$11,193       | 10.4                                    | % |

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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UNIVERSAL ELECTRONICS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2013

(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 June 30,<br>2013 |                                      | 2012           |                                      |   |
|----------------------|-------------------------------------|--------------------------------------|----------------|--------------------------------------|---|
|                      | \$ (thousands)                      | % of Total<br>Inventory<br>Purchases | \$ (thousands) | % of Total<br>Inventory<br>Purchases |   |
| Related party vendor | \$2,469                             | 3.0                                  | % \$2,152      | 3.8                                  | % |
|                      | Six Months Ended June 30,<br>2013   |                                      | 2012           |                                      |   |
|                      | \$ (thousands)                      | % of Total<br>Inventory<br>Purchases | \$ (thousands) | % of Total<br>Inventory<br>Purchases |   |
| Related party vendor | \$4,685                             | 3.2                                  | % \$3,507      | 3.3                                  | % |

The total accounts payable to this vendor were the following:

|                      | June 30, 2013  |                          | December 31, 2012 |                          |   |
|----------------------|----------------|--------------------------|-------------------|--------------------------|---|
|                      | \$ (thousands) | % of Accounts<br>Payable | \$ (thousands)    | % of Accounts<br>Payable |   |
| Related party vendor | \$1,476        | 2.2                      | % \$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             | (14      | ) |
| Balance at June 30, 2013     | \$30,876 |   |



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UNIVERSAL ELECTRONICS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2013

(Unaudited)

## Intangible Assets, Net

The components of intangible assets, net were as follows:

| (In thousands)                         | June 30, 2013 |                             |          | December 31, 2012 |                             |          |
|--|---------------|-----------------------------|----------|-------------------|-----------------------------|----------|
|  | Gross         | Accumulated<br>Amortization | Net      | Gross             | Accumulated<br>Amortization | Net      |
| Carrying amount <sup>(1)</sup> :       |               |                             |          |                   |                             |          |
| Distribution rights                    | \$373         | \$(50 )                     | \$323    | \$378             | \$(50 )                     | \$328    |
| Patents                                | 8,541         | (4,097 )                    | 4,444    | 8,113             | (3,847 )                    | 4,266    |
| Trademark and trade names              | 2,840         | (1,268 )                    | 1,572    | 2,841             | (1,127 )                    | 1,714    |
| Developed and core technology          | 3,505         | (1,022 )                    | 2,483    | 3,507             | (906 )                      | 2,601    |
| Capitalized software development costs | 327           | (119 )                      | 208      | 1,276             | (913 )                      | 363      |
| Customer relationships                 | 26,400        | (7,118 )                    | 19,282   | 26,415            | (5,852 )                    | 20,563   |
| Total carrying amount                  | \$41,986      | \$(13,674 )                 | \$28,312 | \$42,530          | \$(12,695 )                 | \$29,835 |

(1) This table excludes the gross value of fully amortized intangible assets totaling \$6.3 million and \$9.1 million on June 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:

| (In thousands)                      | Three Months Ended June 30, |         | Six Months Ended June 30, |         |
|-------------------------------------|-----------------------------|---------|---------------------------|---------|
|                                     | 2013                        | 2012    | 2013                      | 2012    |
| Cost of sales                       | \$51                        | \$76    | \$143                     | \$157   |
| Selling, general and administrative | 973                         | 962     | 1,945                     | 1,920   |
| Total amortization expense          | \$1,024                     | \$1,038 | \$2,088                   | \$2,077 |

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

| (In thousands)            |          |
|---------------------------|----------|
| 2013 (remaining 6 months) | \$2,048  |
| 2014                      | 4,053    |
| 2015                      | 3,888    |
| 2016                      | 3,871    |
| 2017                      | 3,842    |
| Thereafter                | 10,610   |
| Total                     | \$28,312 |

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 six months ended June 30, 2013 and 2012.

We disposed of three patents and one trademark with an immaterial aggregate carrying amount during the six months ended June 30, 2013. We disposed of eleven patents with an immaterial aggregate carrying amount during the six

months ended June 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

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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 June 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 June 30, 2013, we were in compliance with the covenants and conditions of the Amended Credit Agreement.

Our total interest expense on borrowings was \$16 thousand and \$0.1 million during the three months ended June 30, 2013 and 2012, respectively. Our total interest expense on borrowings was \$49 thousand and \$0.2 million during the six months ended June 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 \$2.5 million and \$1.1 million for the three months ended June 30, 2013 and 2012, respectively. Our effective tax rate was 30.0% and 18.1% during the three months ended June 30, 2013 and 2012, respectively. The increase in our effective tax rate was due to the following: 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; a greater percentage of income earned in higher tax rate jurisdictions in 2013 compared to 2012; and the reversal of \$0.3 million of unrecognized tax benefits in the second quarter of 2012 which were originally recorded in 2007, 2010 and 2011.

We recorded income tax expense of \$2.9 million and \$1.5 million for the six months ended June 30, 2013 and 2012, respectively. Our effective tax rate was 24.9% and 17.7% during the six months ended June 30, 2013 and 2012, respectively. The increase in our effective tax rate was due to the following: 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; a greater percentage of income earned in higher tax rate jurisdictions in 2013 compared to 2012; and the reversal of \$0.5 million of unrecognized tax benefits in 2012 which were originally recorded in 2007 through 2011.

On June 30, 2013, we had gross unrecognized tax benefits of approximately \$5.5 million, including interest and penalties, of which approximately \$5.0 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 \$0.5 million and \$0.1 million on June 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 June 30, 2013, the open statutes of limitations in our significant tax jurisdictions were as follows: federal 2009 through 2012, state 2008 through 2012, and non-U.S. 2006 through 2012. On June 30, 2013, of our gross unrecognized tax benefits of \$5.5 million, which included \$0.5 million of interest and penalties, \$3.6 million are classified as current and \$1.9 million are classified as long term.

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## Note 8 — Accrued Compensation

The components of accrued compensation are listed below:

| (In thousands)                          | June 30, 2013 | December 31, 2012 |
|---|---------------|-------------------|
| Accrued social insurance <sup>(1)</sup> | \$20,135      | \$19,842          |
| Accrued salary/wages                    | 5,393         | 4,862             |
| Accrued vacation/holiday                | 2,202         | 2,048             |
| Accrued bonus <sup>(2)</sup>            | 3,076         | 4,181             |
| Accrued commission                      | 470           | 478               |
| Accrued medical insurance claims        | 669           | 643               |
| Other accrued compensation              | 1,060         | 1,344             |
| Total accrued compensation              | \$33,005      | \$33,398          |

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 June 30, 2013 and December 31, 2012.

Accrued bonus includes an accrual for an extra month of salary ("13<sup>th</sup> month salary") to be paid to employees in certain geographies where it is the customary business practice. This 13<sup>th</sup> month salary is paid to these employees if they remain employed with us through December 31st. The total accrued for the 13<sup>th</sup> month salary was \$0.4 million and \$0.5 million at June 30, 2013 and December 31, 2012, respectively.

## Note 9 — Other Accrued Expenses

The components of other accrued expenses are listed below:

| (In thousands)               | June 30, 2013 | December 31, 2012 |
|------------------------------|---------------|-------------------|
| Advertising and marketing    | \$478         | \$501             |
| Duties                       | 819           | 584               |
| Freight                      | 1,458         | 1,666             |
| Product development          | 381           | 569               |
| Product warranty claim costs | 279           | 404               |
| Professional fees            | 806           | 1,234             |
| Sales taxes and VAT          | 671           | 1,979             |
| Third-party commissions      | 677           | 337               |
| Tooling <sup>(1)</sup>       | 638           | 221               |
| Utilities                    | 356           | 316               |
| Other                        | 3,195         | 2,833             |
| Total other accrued expenses | \$9,758       | \$10,644          |

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



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## Note 10 — Commitments and Contingencies

## Product Warranties

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

| (In thousands)<br>Description             | Balance at<br>Beginning<br>of Period | Accruals<br>for<br>Warranties<br>Issued<br>During the<br>Period | Settlements<br>(in Cash or<br>in Kind)<br>During the<br>Period | Balance<br>at End<br>of Period |
|---|--------------------------------------|---|--|--------------------------------|
| Reserve for product warranty claim costs: |                                      |   |  |                                |
| Six months ended June 30, 2013            | \$404                                | \$375   | \$(500 )   | \$279                          |
| Six months ended June 30, 2012            | \$6                                  | \$—   | \$—  | \$6                            |

## Litigation

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. We are presently determining whether or not to appeal this decision, but 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. URC has not yet responded to this complaint.

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 June 30, 2013 and December 31, 2012 based on its latest actuarial



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report. The India Plan has an independent external manager that advises us of the appropriate funding contribution requirements to which we comply. At June 30, 2013, approximately 38 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 June 30, 2013 and December 31, 2012 for the India Plan was not material. During the six months ended June 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:

| (In thousands, except share data) | Six Months Ended June 30, |        |
|-----------------------------------|---------------------------|--------|
|                                   | 2013                      | 2012   |
| Shares repurchased                | 117,666                   | 27,980 |
| Cost of shares repurchased        | \$2,435                   | \$486  |

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 six months ended June 30, 2013 and 2012, we issued 15,000 and 22,500 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 June 30, 2013, we had 968,905 shares available for repurchase under the Board's authorizations.

## 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:

| (In thousands)             | Three Months Ended June 30, |           | Six Months Ended June 30, |           |
|----------------------------|-----------------------------|-----------|---------------------------|-----------|
|                            | 2013                        | 2012      | 2013                      | 2012      |
| Net sales:                 |                             |           |                           |           |
| United States              | \$47,979                    | \$40,129  | \$92,747                  | \$74,349  |
| Asia (excluding PRC)       | 29,575                      | 32,857    | 51,735                    | 61,519    |
| People's Republic of China | 24,803                      | 19,287    | 41,624                    | 34,709    |
| Europe                     | 17,992                      | 14,982    | 33,521                    | 28,134    |
| Latin America              | 8,887                       | 5,109     | 16,710                    | 12,141    |
| Other                      | 6,873                       | 4,340     | 14,494                    | 9,584     |
| Total net sales            | \$136,109                   | \$116,704 | \$250,831                 | \$220,436 |

Specific identification of the customer billing location was the basis used for attributing revenues from external customers to geographic areas.

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Long-lived tangible assets were as follows:

| (In thousands)              | June 30, 2013 | December 31, 2012 |
|-----------------------------|---------------|-------------------|
| Long-lived tangible assets: |               |                   |
| United States               | \$5,242       | \$5,541           |
| People's Republic of China  | 73,015        | 73,804            |
| All other countries         | 3,275         | 3,722             |
| Total                       | \$81,532      | \$83,067          |

## 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:

| (In thousands)                         | Three Months Ended June 30, |         | Six Months Ended June 30, |         |
|--|-----------------------------|---------|---------------------------|---------|
|  | 2013                        | 2012    | 2013                      | 2012    |
| Research and development               | \$55                        | \$45    | \$112                     | \$115   |
| Selling, general and administrative:   |                             |         |                           |         |
| Employees                              | 1,149                       | 890     | 2,258                     | 1,812   |
| Outside directors                      | 96                          | 205     | 191                       | 410     |
| Total stock-based compensation expense | \$1,300                     | \$1,140 | \$2,561                   | \$2,337 |
| Income tax benefit                     | \$415                       | \$360   | \$804                     | \$767   |

## Stock Options

Stock option activity was as follows:

|   | Number of Options<br>(in 000's) | Weighted-Average<br>Exercise Price | Weighted-Average<br>Remaining Contractual<br>Terms<br>(in years) | Aggregate<br>Intrinsic<br>Value<br>(in 000's) |
|---|---------------------------------|------------------------------------|--|---|
| Outstanding at December 31, 2012                            | 1,412                           | \$ 20.56                           |  |   |
| Granted   | 201                             | 19.68                              |  |   |
| Exercised   | (273)                           | ) 14.44                            |  | \$2,703                                       |
| Forfeited/canceled/expired                                  | (7)                             | ) 28.08                            |  |   |
| Outstanding at June 30, 2013 <sup>(1)</sup>                 | 1,333                           | \$ 21.64                           | 5.72   | \$8,799                                       |
| Vested and expected to vest at June 30, 2013 <sup>(1)</sup> | 1,329                           | \$ 21.65                           | 5.70   | \$8,763                                       |
| Exercisable on June 30, 2013 <sup>(1)</sup>                 | 989                             | \$ 21.89                           | 4.60   | \$6,279                                       |

The aggregate intrinsic value represents the total pre-tax value (the difference between our closing stock price on the last trading day of the second 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 June 30, 2013. This amount will change based on the fair market value of our stock.



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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 June 30, |      | Six Months Ended June 30, |         |   |
|--|-----------------------------|------|---------------------------|---------|---|
|  | 2013                        | 2012 | 2013                      | 2012    |   |
| Weighted average fair value of grants <sup>(1)</sup> | \$10.04                     | \$—  | \$9.26                    | \$9.65  |   |
| Risk-free interest rate                              | 0.73                        | % —  | 0.95                      | % 0.86  | % |
| Expected volatility                                  | 52.38                       | % —  | 53.39                     | % 55.25 | % |
| Expected life in years                               | 5.20                        | —    | 5.20                      | 5.14    |   |

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

As of June 30, 2013, we expect to recognize \$3.0 million of total unrecognized pre-tax stock-based compensation expense related to non-vested stock options over a remaining weighted-average life of 2.1 years.

**Restricted Stock**

Non-vested restricted stock award activity was as follows:

|                                 | Shares Granted<br>(in 000's) | Weighted-Average<br>Grant Date Fair<br>Value |
|---------------------------------|------------------------------|--|
| Non-vested at December 31, 2012 | 270                          | \$18.72                                      |
| Granted                         | 80                           | 19.25  |
| Vested                          | (72)                         | ) 20.74                                      |
| Forfeited                       | —                            | —  |
| Non-vested at June 30, 2013     | 278                          | 18.34  |

As of June 30, 2013, we expect to recognize \$4.1 million of total unrecognized pre-tax stock-based compensation expense related to non-vested restricted stock awards over a weighted-average life of 1.8 years.

**Note 14 — Other Income (Expense), Net**

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

| (In thousands)  | Three Months Ended June 30, |          | Six Months Ended June 30, |          |   |
|---|-----------------------------|----------|---------------------------|----------|---|
|   | 2013                        | 2012     | 2013                      | 2012     |   |
| Net gain (loss) on foreign currency exchange contracts <sup>(1)</sup> | \$(57                       | ) \$(254 | ) \$(255                  | ) \$(214 | ) |
| Net gain (loss) on foreign currency exchange transactions             | (1,596                      | ) 111    | (1,949                    | ) (339   | ) |
| Other income  | 23                          | 17       | 24                        | 103      |   |
| Other income (expense), net   | \$(1,630                    | ) \$(126 | ) \$(2,180                | ) \$(450 | ) |

(1) This represents the gains and (losses) incurred on foreign currency hedging derivatives (see Note 16 for further details).

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Note 15 — Earnings Per Share

Earnings per share was calculated as follows:

|  | Three Months Ended June 30, | Six Months Ended June 30, |
|--|-----------------------------|---------------------------|
| (In thousands, except per-share amounts) |                             |                           |