

UNIVERSAL ELECTRONICS INC

Form 10-Q

November 09, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended September 30, 2007**

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

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

**Commission File Number: 0-21044**

**UNIVERSAL ELECTRONICS INC.**

**(Exact Name of Registrant as Specified in Its Charter)**

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

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

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

**90630  
(Zip Code)**

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act)

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 14,568,708 shares of Common Stock, par value \$0.01 per share, of the registrant were outstanding on November 7, 2007.

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CONSOLIDATED BALANCE SHEETS**

(In thousands, except share-related data)

(Unaudited)

|                                                | <b>September<br/>30,<br/>2007</b> | <b>December<br/>31,<br/>2006</b> |
|------------------------------------------------|-----------------------------------|----------------------------------|
| <b>ASSETS</b>                                  |                                   |                                  |
| Current assets:                                |                                   |                                  |
| Cash and cash equivalents                      | \$ 84,498                         | \$ 66,075                        |
| Accounts receivable, net                       | 60,602                            | 51,867                           |
| Inventories, net                               | 32,552                            | 26,459                           |
| Prepaid expenses and other current assets      | 2,776                             | 2,722                            |
| Prepaid income taxes                           | 5,303                             |                                  |
| Deferred income taxes                          | 3,019                             | 3,069                            |
| <br>                                           |                                   |                                  |
| Total current assets                           | 188,750                           | 150,192                          |
| Equipment, furniture and fixtures, net         | 6,902                             | 5,899                            |
| Goodwill                                       | 10,805                            | 10,644                           |
| Intangible assets, net                         | 5,783                             | 5,587                            |
| Other assets                                   | 272                               | 221                              |
| Deferred income taxes                          | 5,520                             | 6,065                            |
| <br>                                           |                                   |                                  |
| Total assets                                   | \$ 218,032                        | \$ 178,608                       |
| <br><b>LIABILITIES AND STOCKHOLDERS EQUITY</b> |                                   |                                  |
| Current liabilities:                           |                                   |                                  |
| Accounts payable                               | \$ 32,972                         | \$ 20,153                        |
| Accrued sales discounts/rebates                | 4,918                             | 4,498                            |
| Accrued income taxes                           |                                   | 4,483                            |
| Accrued compensation                           | 4,278                             | 7,430                            |
| Other accrued expenses                         | 7,580                             | 7,449                            |
| <br>                                           |                                   |                                  |
| Total current liabilities                      | 49,748                            | 44,013                           |
| <br>                                           |                                   |                                  |
| Long term liabilities:                         |                                   |                                  |
| Deferred income taxes                          | 128                               | 103                              |
| Accrued income taxes                           | 6,860                             |                                  |
| Other long term liabilities                    | 1,113                             | 275                              |
| <br>                                           |                                   |                                  |
| Total liabilities                              | 57,849                            | 44,391                           |

Commitments and Contingencies

## Stockholders' equity:

Preferred stock, \$0.01 par value, 5,000,000 shares authorized; none issued or outstanding

Common stock, \$0.01 par value, 50,000,000 shares authorized; 18,263,366 and 17,543,235 shares issued at September 30, 2007 and December 31, 2006, respectively

Paid-in capital

Accumulated other comprehensive income

Retained earnings

|                                                                                                                                 |            |            |
|---------------------------------------------------------------------------------------------------------------------------------|------------|------------|
|                                                                                                                                 | 183        | 175        |
|                                                                                                                                 | 109,626    | 94,733     |
|                                                                                                                                 | 9,047      | 2,759      |
|                                                                                                                                 | 82,441     | 68,514     |
|                                                                                                                                 | 201,297    | 166,181    |
| Less cost of common stock in treasury, 3,831,689 and 3,528,827 shares at September 30, 2007 and December 31, 2006, respectively | (41,114)   | (31,964)   |
| Total stockholders' equity                                                                                                      | 160,183    | 134,217    |
| Total liabilities and stockholders' equity                                                                                      | \$ 218,032 | \$ 178,608 |

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

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**UNIVERSAL ELECTRONICS INC.**  
**CONSOLIDATED INCOME STATEMENTS**

(In thousands, except per share amounts)

(Unaudited)

|                                              | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|----------------------------------------------|---------------------------|-------------|--------------------------|-------------|
|                                              | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                                              | <b>2007</b>               | <b>2006</b> | <b>2007</b>              | <b>2006</b> |
| Net sales                                    | \$ 68,961                 | \$ 59,612   | \$ 206,458               | \$ 166,155  |
| Cost of sales                                | 43,224                    | 38,033      | 131,754                  | 106,506     |
| Gross profit                                 | 25,737                    | 21,579      | 74,704                   | 59,649      |
| Research and development expenses            | 2,070                     | 1,809       | 6,661                    | 5,574       |
| Selling, general and administrative expenses | 17,393                    | 15,142      | 49,611                   | 42,274      |
| Operating income                             | 6,274                     | 4,628       | 18,432                   | 11,801      |
| Interest income, net                         | 879                       | 437         | 2,199                    | 1,058       |
| Other income (expense), net                  | 13                        | (30)        | 134                      | (602)       |
| Income before provision for income taxes     | 7,166                     | 5,035       | 20,765                   | 12,257      |
| Provision for income taxes                   | (2,251)                   | (1,502)     | (6,667)                  | (4,169)     |
| Net income                                   | \$ 4,915                  | \$ 3,533    | \$ 14,098                | \$ 8,088    |
| Earnings per share:                          |                           |             |                          |             |
| Basic                                        | \$ 0.34                   | \$ 0.26     | \$ 0.98                  | \$ 0.59     |
| Diluted                                      | \$ 0.32                   | \$ 0.25     | \$ 0.93                  | \$ 0.56     |
| Shares used in computing earnings per share: |                           |             |                          |             |
| Basic                                        | 14,508                    | 13,845      | 14,358                   | 13,763      |
| Diluted                                      | 15,280                    | 14,415      | 15,149                   | 14,336      |

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

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**UNIVERSAL ELECTRONICS INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

|                                                                                   | <b>Nine Months Ended</b> |             |
|-----------------------------------------------------------------------------------|--------------------------|-------------|
|                                                                                   | <b>September 30,</b>     |             |
|                                                                                   | <b>2007</b>              | <b>2006</b> |
| Cash provided by operating activities:                                            |                          |             |
| Net income                                                                        | \$ 14,098                | \$ 8,088    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                          |             |
| Depreciation and amortization                                                     | 3,264                    | 2,903       |
| Provision for doubtful accounts                                                   | 25                       | 46          |
| Provision for inventory write-downs                                               | 1,555                    | 1,222       |
| Provision (benefit) for deferred income taxes                                     | 674                      | (528)       |
| Tax benefit from exercise of stock options                                        | 2,518                    | 562         |
| Excess tax benefit from stock-based compensation                                  | (1,833)                  | (201)       |
| Shares issued for employee benefit plan                                           | 539                      | 421         |
| Stock-based compensation                                                          | 2,583                    | 2,381       |
| Changes in operating assets and liabilities:                                      |                          |             |
| Accounts receivable                                                               | (6,285)                  | (1,136)     |
| Inventories                                                                       | (6,594)                  | (8,411)     |
| Prepaid expenses and other assets                                                 | 24                       | 817         |
| Accounts payable and accrued expenses                                             | 9,650                    | 2,308       |
| Accrued income taxes                                                              | (3,600)                  | 2,585       |
| Net cash provided by operating activities                                         | 16,618                   | 11,057      |
| Cash used for investing activities:                                               |                          |             |
| Acquisition of equipment, furniture and fixtures                                  | (3,025)                  | (2,887)     |
| Acquisition of intangible assets                                                  | (1,137)                  | (820)       |
| Net cash used for investing activities                                            | (4,162)                  | (3,707)     |
| Cash provided by financing activities:                                            |                          |             |
| Proceeds from stock options exercised                                             | 9,535                    | 3,472       |
| Treasury stock purchases                                                          | (9,426)                  | (560)       |
| Excess tax benefit from stock-based compensation                                  | 1,833                    | 201         |
| Net cash provided by financing activities                                         | 1,942                    | 3,113       |
| Effect of exchange rate changes on cash                                           | 4,025                    | 3,230       |
| Net increase in cash and cash equivalents                                         | 18,423                   | 13,693      |

|                                                  |           |           |
|--------------------------------------------------|-----------|-----------|
| Cash and cash equivalents at beginning of period | 66,075    | 43,641    |
| Cash and cash equivalents at end of period       | \$ 84,498 | \$ 57,334 |

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

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

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

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

The results of operations for the three and nine months ended September 30, 2007 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the consolidated financial statements and related notes and Management Discussion and Analysis of Financial Conditions and Results of Operations contained in our Annual Report on Form 10-K for our fiscal year ended December 31, 2006. The financial information presented in the accompanying statements reflects all adjustments that are, in the opinion of management, necessary for a fair presentation of financial position, operations and cash flows for the periods presented. All such adjustments are of a normal recurring nature. As used herein, the terms Company, we, us and our refer to Universal Electronics Inc. and its subsidiaries, unless the context indicates to the contrary.

*Segment Realignment*

In the third quarter of 2006, we integrated the SimpleDevices business segment into our Core Business segment in order to more closely align our financial reporting with our business structure. The segment integration did not impact previously reported consolidated net revenue, income from operations, net income or net earnings per share.

*Estimates and Assumptions*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and judgments that affect the amounts reported in our consolidated financial statements and accompanying notes. Actual results may differ from these estimates and judgments.

*Recent Accounting Pronouncements*

In February 2007, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* ( SFAS 159 ), which permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings (or another performance indicator if the business entity does not report earnings) at each subsequent reporting date. SFAS 159 is effective for the Company beginning January 1, 2008. We are currently evaluating the effect that the adoption of SFAS 159 will have on our consolidated results of operations and financial condition.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP) and expands disclosures about fair value measurements for assets and liabilities. SFAS 157 applies when other accounting pronouncements require or permit assets or liabilities to be measured at fair value. Accordingly, SFAS 157 does not require new fair value measurements. SFAS 157 is effective for the Company beginning January 1, 2008. We are currently evaluating the effect that the adoption of SFAS 157 will have on our consolidated results of operations and financial condition.

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

**Note 2: Stock-Based Compensation**

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123R, *Share Based Payment* ( SFAS 123R ) using the modified-prospective transition method. Stock-based compensation expense is presented in the same income statement line as cash compensation paid to the same employees or directors. During the three months ended September 30, 2007 and 2006, we recorded \$1.1 million and \$0.8 million, respectively, in pre-tax stock-based compensation expense. Included in SG&A stock-based compensation expense is \$227 thousand and \$79 thousand in pre-tax compensation expense related to stock awards granted to outside directors for the three months ended September 30, 2007 and 2006, respectively. The income tax benefit associated with stock-based compensation was \$0.3 million and \$0.2 million for the three months ended September 30, 2007 and 2006, respectively.

During the nine months ended September 30, 2007 and 2006, we recorded \$2.6 million and \$2.4 million, respectively, in pre-tax stock-based compensation expense. Included in SG&A stock-based compensation expense is \$461 thousand and \$242 thousand in pre-tax compensation expense related to stock awards granted to outside directors for the nine months ended September 30, 2007 and 2006, respectively. The income tax benefit associated with stock-based compensation was \$0.7 million and \$0.7 million for the nine months ended September 30, 2007 and 2006, respectively.

Stock-based compensation expense was included in the following:

| <b>(In thousands)</b>               | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|-------------------------------------|---------------------------|-------------|--------------------------|-------------|
|                                     | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                                     | <b>2007</b>               | <b>2006</b> | <b>2007</b>              | <b>2006</b> |
| Cost of sales                       | \$ 9                      | \$ 7        | \$ 22                    | \$ 20       |
| Research and development            | 122                       | 92          | 307                      | 291         |
| Selling, general and administrative | 971                       | 678         | 2,254                    | 2,070       |
| Stock-based compensation expense    | \$ 1,102                  | \$ 777      | \$ 2,583                 | \$ 2,381    |

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

|                                       | <b>Three Months Ended</b>           |             | <b>Nine Months Ended</b>   |             |
|---------------------------------------|-------------------------------------|-------------|----------------------------|-------------|
|                                       | <b>September 30, <sup>(1)</sup></b> |             | <b>September 30,</b>       |             |
|                                       | <b>2007</b>                         | <b>2006</b> | <b>2007 <sup>(1)</sup></b> | <b>2006</b> |
| Weighted average fair value of grants | \$                                  | \$ 7.27     | \$11.73                    | \$ 7.36     |
| Risk-free interest rate               |                                     | 4.74%       | 4.58%                      | 4.74%       |
| Expected volatility                   |                                     | 38.81%      | 39.06%                     | 39.25%      |
| Expected life in years                |                                     | 4.78        | 5.24                       | 4.84        |

(1) The fair value calculation was based on stock options granted during the period. No stock options were granted during the three months

ended  
September 30,  
2007.

Stock option activity as of September 30, 2007 and changes during the nine months ended September 30, 2007 were as follows:

|                                                   | <b>Number<br/>of<br/>Options<br/>(in<br/>thousands)</b> | <b>Weighted-<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual<br/>Term<br/>(in years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(in<br/>thousands)</b> |
|---------------------------------------------------|---------------------------------------------------------|-----------------------------------------------------|------------------------------------------------------------------------------------|-----------------------------------------------------------------|
| Outstanding at December 31, 2006                  | 2,480                                                   | \$ 13.73                                            |                                                                                    |                                                                 |
| Granted                                           | 324                                                     | 27.68                                               |                                                                                    |                                                                 |
| Exercised                                         | (701)                                                   | 13.61                                               |                                                                                    |                                                                 |
| Forfeited/cancelled/ expired                      | (78)                                                    | 14.22                                               |                                                                                    |                                                                 |
| Outstanding at September 30, 2007                 | 2,025                                                   | \$ 15.98                                            | 5.52                                                                               | \$ 33,453                                                       |
| Vested and expected to vest at September 30, 2007 | 1,931                                                   | \$ 15.59                                            | 5.35                                                                               | \$ 32,650                                                       |
| Exercisable at September 30, 2007                 | 1,350                                                   | \$ 13.18                                            | 4.13                                                                               | \$ 26,078                                                       |

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

The aggregate intrinsic value in the table above represents total pre-tax intrinsic value (difference between Universal Electronics Inc.'s average of the high and low trades of the last trading day of the third quarter of 2007 (September 28, 2007) and the option exercise price, multiplied by the number of the in-the-money options) that option holders would have received had all option holders exercised their options on September 28, 2007. This amount changes based on the fair market value of our common stock. The total intrinsic value of options exercised for the three and nine months ended September 30, 2007 was \$2.8 million and \$10.7 million, respectively. The total intrinsic value of options exercised for the three and nine months ended September 30, 2006 was \$0.2 million and \$2.1 million, respectively. As of September 30, 2007, we expect to recognize \$5.0 million of total unrecognized compensation expense related to non-vested employee stock options over a weighted-average life of 2.46 years. Nonvested restricted stock awards as of September 30, 2007 and changes during the nine months ended September 30, 2007 were as follows:

|                                 | <b>Shares<br/>Granted</b> | <b>Weighted-<br/>Average<br/>Grant Date<br/>Fair Value</b> |
|---------------------------------|---------------------------|------------------------------------------------------------|
| Nonvested at December 31, 2006  | 12,500                    | \$ 18.74                                                   |
| Granted                         | 25,000                    | 36.25                                                      |
| Vested                          | (18,750)                  | 24.58                                                      |
| Nonvested at September 30, 2007 | 18,750                    | \$ 36.25                                                   |

As of September 30, 2007, we expect to recognize \$0.7 million of total unrecognized compensation expense related to non-vested restricted stock awards over a weighted-average life of nine months.

**Note 3: Cash and Cash Equivalents**

Cash and cash equivalents include cash accounts and all investments purchased with initial maturities of three months or less. We maintain cash and cash equivalents with various financial institutions. These financial institutions are located in many different geographic regions. We mitigate our exposure to credit risk by placing our cash and cash equivalents with high quality financial institutions. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant risk in its cash and cash equivalents.

At September 30, 2007, we had approximately \$16.3 million and \$68.2 million of cash and cash equivalents in the United States and Europe, respectively. At December 31, 2006, we had approximately \$6.1 million and \$60.0 million of cash and cash equivalents in the United States and Europe, respectively.

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

Accounts receivable consisted of the following at September 30, 2007 and December 31, 2006:

| <b>(In thousands)</b>           | <b>September<br/>30,<br/>2007</b> | <b>December<br/>31,<br/>2006</b> |
|---------------------------------|-----------------------------------|----------------------------------|
| Trade receivable, gross         | \$ 63,749                         | \$ 55,726                        |
| Allowance for doubtful accounts | (2,324)                           | (2,602)                          |
| Allowance for sales returns     | (1,473)                           | (1,894)                          |
| Net trade receivable            | 59,952                            | 51,230                           |
| Other receivables:              |                                   |                                  |
| Note receivable <sup>(1)</sup>  | 208                               | 200                              |

|                          |    |        |    |        |
|--------------------------|----|--------|----|--------|
| Other <sup>(2)</sup>     |    | 442    |    | 437    |
| Accounts receivable, net | \$ | 60,602 | \$ | 51,867 |

(1) In April 1999, we provided a \$200 thousand non-recourse interest bearing secured loan to our chief executive officer, which is due by December 15, 2007. The note and related interest are classified as a current asset.

(2) Other receivables as of September 30, 2007 and December 31, 2006 consisted primarily of a tenant improvement allowance provided by our landlord for the renovation and expansion of our corporate headquarters in Cypress, California. Construction is expected to be completed during the first quarter of 2008. The tenant improvement allowance will be paid upon completion of construction.

headquarters in  
Cypress,  
California.  
Construction is  
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quarter of 2008.  
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**UNIVERSAL ELECTRONICS INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

*Significant Customers*

We had sales to one significant customer that contributed more than 10% of total net sales. Sales made to this customer were \$8.8 million and \$7.0 million, representing 12.8% and 11.7% of our total net sales for the three months ended September 30, 2007 and 2006, respectively. Sales made to this customer during the nine months ended September 30, 2007 and 2006 amounted to \$31.4 million and \$21.1 million, representing 15.2% and 12.7% of total net sales, respectively. Trade receivables with this customer amounted to \$4.0 million and \$3.1 million, or 6.7% and 6.0% of our net trade receivable at September 30, 2007 and December 31, 2006, respectively.

In addition, we had sales to another customer and its sub-contractors that, when combined, totaled \$11.5 million and \$11.4 million, representing 16.7% and 19.2% of total net sales for the three months ended September 30, 2007 and 2006, respectively. Sales made to this customer and its sub-contractors during the nine months ended September 30, 2007 and 2006 amounted to \$34.5 million and \$30.9 million, representing 16.7% and 18.6% of total net sales, respectively. Trade receivables with this customer and its sub-contractors amounted to \$6.4 million and \$6.2 million, or 10.7% and 12.2% of our net trade receivable at September 30, 2007 and December 31, 2006, respectively. The future loss of either of these customers or of any other key customer (in the United States or abroad, for any reason, including the financial weakness or bankruptcy of the customer or our inability to obtain orders or our inability to maintain order volume) would have an adverse effect on our financial condition, results of operations and cash flows.

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

Inventories, which consist of wireless control devices, including universal remote controls, antennas and related component parts, are valued at the lower of cost or market. Cost, which is determined using the first-in, first-out method, includes the purchase of integrated circuits, sub-contractor costs and freight-in. We carry inventory in amounts necessary to satisfy our customers' inventory requirements on a timely basis. Product innovations and technological advances may shorten a given product's life cycle. We continually monitor inventory to control inventory levels and dispose of any excess or obsolete inventories on hand. We write down our inventory for estimated obsolescence or unmarketable inventory, in an amount equal to the difference between the cost of the inventory and its estimated market value based upon our best estimates about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Net inventories consisted of the following at September 30, 2007 and December 31, 2006:

| <b>(In thousands)</b>       | <b>September<br/>30,<br/>2007</b> | <b>December<br/>31,<br/>2006</b> |
|-----------------------------|-----------------------------------|----------------------------------|
| Components                  | \$ 7,542                          | \$ 6,101                         |
| Finished goods              | 27,479                            | 22,537                           |
| Reserve for inventory scrap | (2,469)                           | (2,179)                          |
| Inventory, net              | \$ 32,552                         | \$ 26,459                        |

During the three months ended September 30, 2007 and 2006 inventory write-downs totaled \$0.6 million and \$0.7 million, respectively. During the nine months ended September 30, 2007 and 2006 inventory write-downs totaled \$1.6 million and \$1.2 million, respectively. Inventory write-downs are a normal part of our business and result primarily from product life cycle estimation variances.

*Significant Suppliers*

Most of the components used in our products are available from multiple sources. We have elected to purchase integrated circuits ( IC ), used principally in our wireless control products, from two main sources. Purchases from one supplier amounted to more than 10% of total inventory purchases. Purchases from this major supplier amounted



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

to \$7.9 million and \$3.4 million, representing 18.5% and 8.4% of total inventory purchases for the three months ended September 30, 2007 and 2006, respectively. Purchases made from this supplier during the nine months ended September 30, 2007 and 2006 amounted to \$18.6 million and \$9.1 million, representing 15.6% and 8.7% of total inventory purchases, respectively. Accounts payable with that supplier amounted to \$3.4 million and \$0.8 million, representing 10.4% and 3.9% of total accounts payable at September 30, 2007 and December 31, 2006, respectively. For the three and nine months ended September 30, 2006, a different IC supplier provided more than 10% of total inventory purchases. Purchases from that supplier amounted to \$4.5 million and \$11.6 million, representing 10.9% and 11.1% of total inventory purchases for the three and nine months ended September 30, 2006, respectively. In addition, during the three months ended September 30, 2007, we purchased component and finished good products from two major suppliers. Purchases from these two major suppliers amounted to \$12.4 million and \$8.3 million, representing 29.1% and 19.6%, respectively, of total inventory purchases for the three months ended September 30, 2007. During the three months ended September 30, 2006 purchases from the same two suppliers amounted to \$11.3 million and \$5.5 million, representing 27.5% and 13.5%, respectively, of total inventory purchases. During the nine months ended September 30, 2007 purchases from these two suppliers amounted to \$33.6 million and \$22.7 million, representing 28.2% and 19.0%, respectively, of total inventory purchases. During the same period last year, purchases from these two suppliers amounted to \$30.0 million and \$9.1 million, representing 28.7% and 8.7% of total inventory purchases. For the nine months ended September 30, 2006, one other supplier provided more than 10% of total inventory purchases. Purchases from this supplier amounted to \$11.2 million, representing 10.7%, of total inventory purchases for the nine months ended September 30, 2006, respectively.

Accounts payable with the aforementioned two suppliers of component and finished good products amounted to \$11.0 million and \$6.3 million, representing 33.3% and 19.1%, respectively, of total accounts payable at September 30, 2007. At December 31, 2006, accounts payable with the same two suppliers amounted to \$8.2 million and \$2.0 million, representing 40.4% and 9.8%, respectively, of total accounts payable. No other component and finished goods supplier accounted for inventory purchases exceeding ten percent of the total inventory purchases for the three and nine months ended September 30, 2007 or 2006.

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 purchase inventory on a timely basis from any of these sources. We generally maintain inventories of our integrated chips, which could be used in part to mitigate, but not eliminate, delays resulting from supply interruptions. An extended interruption, a 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 prices of components, would have an adverse effect on our business, results of operations and cash flows.

**Note 6: Income Taxes**

We use the estimated annual effective tax rate to determine our provision for income taxes for interim periods. We recorded income tax expense of \$2.3 million for the three months ended September 30, 2007 compared to \$1.5 million for the same period last year. Our estimated effective tax rate was 31.4% and 29.8% during the three months ended September 30, 2007 and 2006, respectively. The increase in our effective tax rate is due primarily to a higher percentage of pre-tax income being earned in higher tax rate jurisdictions. We recorded income tax expense of \$6.7 million for the nine months ended September 30, 2007 compared to \$4.2 million for the same period last year. Our estimated effective tax rate was 32.1% and 34.0% during the nine months ended September 30, 2007 and 2006, respectively. The decrease in our effective tax rate is due primarily to the re-enactment of the federal research and development tax credit statute which was passed by Congress in the fourth quarter of 2006 as well as the Netherlands statutory tax rate decreasing from 31.5% in 2006 to 25.5% in 2007, offset partially by increased pre-tax income in higher tax rate jurisdictions.

We adopted the provisions of FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes- an interpretation of FASB Statement No. 109* ( FIN 48 ) effective January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109,

*Accounting for Income Taxes*, and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

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In accordance with the adoption of FIN 48, we evaluate our tax positions to determine if it is more likely than not that a tax position is sustainable, based on its technical merits. If a tax position does not meet the more likely than not standard, a full reserve is established against the tax asset or a liability is recorded. Additionally, for a position that is determined to, more likely than not, be sustainable, we measure the benefit at the greatest cumulative probability of being realized and establish a reserve or liability for the balance. A material change in our tax reserves could have a significant impact on our results.

As a result of implementing FIN 48, we recognized a \$0.2 million increase in our liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. We recorded an increase in our unrecognized tax benefits of approximately \$0.1 and \$0.3 million for the three and nine months ended September 30, 2007, respectively. We had unrecognized tax benefits of approximately \$6.8 million as of January 1, 2007, of which \$6.3 million, if recognized, would result in the reduction of our effective tax rate. The open statute of limitations for our significant tax jurisdiction are as follows: federal and state for 2002 through 2006 and non-U.S. for 2001 through 2006. In accordance with FIN 48, we have elected to classify interest and penalties as components of tax expense. Interest and penalties were \$0.6 million at the date of adoption and \$0.9 million as of September 30, 2007 and are included in the unrecognized tax benefits. All unrecognized tax benefits at September 30, 2007 are classified as long term as prescribed by FIN 48 because we do not anticipate payment of cash within one year of the operating cycle.

We do not expect any material changes to the estimated amount of liability associated with our uncertain tax positions within the next twelve months.

**Note 7: Earnings Per Share**

Basic earnings per share are computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares and dilutive potential common shares, which includes the dilutive effect of stock options and restricted stock grants. Dilutive potential common shares for all periods presented are computed utilizing the treasury stock method. In the computation of diluted earnings per common share for the three months ended September 30, 2007 and 2006, 302,250 and 1,147,961 stock options, respectively, were excluded because their inclusion would have been antidilutive. In the computation of diluted earnings per common share for the nine months ended September 30, 2007 and 2006, 204,125 and 1,137,242 stock options, respectively, were excluded because their inclusion would have been antidilutive.

Earnings per share for the three and nine months ended September 30, 2007 and 2006 are calculated below:

| <b>(In thousands, except per-share amounts):</b>      | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|-------------------------------------------------------|---------------------------|-------------|--------------------------|-------------|
|                                                       | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                                                       | <b>2007</b>               | <b>2006</b> | <b>2007</b>              | <b>2006</b> |
| <b>BASIC</b>                                          |                           |             |                          |             |
| Net income                                            | \$ 4,915                  | \$ 3,533    | \$ 14,098                | \$ 8,088    |
| Weighted-average common shares outstanding            | 14,508                    | 13,845      | 14,358                   | 13,763      |
| Basic earnings per share                              | \$ 0.34                   | \$ 0.26     | \$ 0.98                  | \$ 0.59     |
| <b>DILUTED</b>                                        |                           |             |                          |             |
| Net income                                            | \$ 4,915                  | \$ 3,533    | \$ 14,098                | \$ 8,088    |
| Weighted-average common shares outstanding for basic  | 14,508                    | 13,845      | 14,358                   | 13,763      |
| Dilutive effect of stock options and restricted stock | 772                       | 570         | 791                      | 573         |

|                                                               |         |         |         |         |
|---------------------------------------------------------------|---------|---------|---------|---------|
| Weighted-average common shares outstanding on a diluted basis | 15,280  | 14,415  | 15,149  | 14,336  |
| Diluted earnings per share                                    | \$ 0.32 | \$ 0.25 | \$ 0.93 | \$ 0.56 |

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**Note 8: Comprehensive Income**

The components of comprehensive income are listed below:

| <b>(In thousands)</b>                        | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|----------------------------------------------|---------------------------|-------------|--------------------------|-------------|
|                                              | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                                              | <b>2007</b>               | <b>2006</b> | <b>2007</b>              | <b>2006</b> |
| Net Income                                   | \$ 4,915                  | \$ 3,533    | \$ 14,098                | \$ 8,088    |
| Other comprehensive income:                  |                           |             |                          |             |
| Foreign currency translations <sup>(1)</sup> | 4,348                     | (454)       | 6,288                    | 4,951       |
| Comprehensive income:                        | \$ 9,263                  | \$ 3,079    | \$ 20,386                | \$ 13,039   |

(1) The foreign currency translation gains of \$6.3 million and \$5.0 million for the nine months ended September 30, 2007 and 2006, respectively, were due to the weakening of the U.S. dollar versus the Euro. The U.S. dollar/Euro spot rate was 1.42 and 1.32 at September 30, 2007 and December 31, 2006, respectively, and 1.27 and 1.18 at September 30, 2006 and December 31, 2005, respectively.

**Note 9: Other Income (Expense), Net**

**Three Months Ended**                      **Nine Months Ended**

| (In thousands)                                        | September 30, |         | September 30, |          |
|-------------------------------------------------------|---------------|---------|---------------|----------|
|                                                       | 2007          | 2006    | 2007          | 2006     |
| Gain (loss) on foreign currency exchange transactions | \$ 11         | \$ (30) | \$ 122        | \$ (602) |
| Other                                                 | 2             |         | 12            |          |
| Other income (expense), net                           | \$ 13         | \$ (30) | \$ 134        | \$ (602) |

**Note 10: Revolving Credit Line**

Effective August 31, 2006, we amended our original Credit Facility with Comerica, extending our line of credit through August 31, 2009. The amended Credit Facility provides a \$15 million unsecured revolving credit agreement with Comerica for three years expiring on August 31, 2009. Under the Credit Facility, the interest payable is variable and is based on the bank's cost of funds or LIBOR plus a fixed margin of 1.25%. The interest rate in effect as of September 30, 2007 using LIBOR plus a fixed margin of 1.25% was 6.15%. We pay a commitment fee ranging from zero to a maximum rate of 1/4 of 1% per year on the unused portion of the credit line depending on the amount of cash investment retained with Comerica during each quarter. At September 30, 2007, the commitment rate was 0.25%. Under the terms of the Credit Facility, dividend payments are allowed for up to 100% of the prior fiscal year's net income, to be paid within 90 days of year end. We are subject to certain financial covenants related to our net worth, quick ratio and net income. Amounts available for borrowing under the Credit Facility are reduced by the outstanding balance of import letters of credit. As of September 30, 2007, we did not have any amounts outstanding under the Credit Facility or any outstanding import letters of credit. Furthermore, as of September 30, 2007, we were in compliance with all financial covenants required by the Credit Facility. Under the amended Credit Facility we have authority to acquire up to an additional 2.0 million shares of our common stock in the open market. See Note 12 for further discussion.

**Note 11: Other Accrued Expenses**

The components of other accrued expenses are listed below:

| (In thousands)                    | September   | December    |
|-----------------------------------|-------------|-------------|
|                                   | 30,<br>2007 | 31,<br>2006 |
| Accrued freight                   | \$ 1,947    | \$ 1,346    |
| Accrued advertising and marketing | 865         | 558         |
| Accrued sales and VAT taxes       | 753         | 1,444       |
| Deferred income taxes             | 458         | 236         |
| Deferred revenue                  | 239         | 841         |
| Accrued warranties                | 106         | 416         |
| Other                             | 3,212       | 2,608       |
| Total other accrued expenses      | \$ 7,580    | \$ 7,449    |

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**Note 12: Treasury Stock**

During the nine months ended September 30, 2007 and 2006, we repurchased 321,300 and 32,326 shares of our common stock at the cost of \$9.4 million and \$0.6 million, respectively. Repurchased shares are recorded as shares held in treasury at cost. We generally hold shares for future use as management and the Board of Directors deem appropriate, including compensating outside directors of the Company. During the nine months ended September 30, 2007 and 2006, we issued 18,438 and 15,000 shares, respectively, to outside directors for services performed. The fair value of these shares is \$344,817 and \$242,269, respectively. The fair value of non vested shares is determined based on the closing trade price of the Company's shares on the date of grant. Refer to Note 2 for related stock-based compensation expense.

**Note 13: Goodwill and Intangible Assets**

Under the requirements of SFAS 142, *Goodwill and Intangible Assets*, the unit of accounting for goodwill and intangible assets are at a level of reporting referred to as a reporting unit. SFAS 142 defines a reporting unit as either (1) an operating segment, as defined in SFAS 131, *Disclosures about Segments of an Enterprise and Related Information* or (2) one level below an operating segment, referred to as a component. Our domestic and international components are reporting units within our one operating segment Core Business. Goodwill and intangible assets are reviewed for impairment during the fourth quarter of each year. Goodwill is tested at the reporting unit level and intangible assets are tested at the lowest identifiable cash flow level. Goodwill and intangible assets are tested for impairment between annual tests, if an event occurs or circumstances change that would reduce the fair value of a reporting unit below its carrying amount. As of September 30, 2007 management is unaware of any triggering events that would cause the fair value of goodwill or intangible assets to be reduced below the carrying value.

As reported earlier, during the fourth quarter of 2004 we purchased Simple Devices for approximately \$12.8 million in cash, including direct acquisition costs and a potential performance-based payment of our unregistered common stock, if certain future financial objectives were achieved. As a result of the performance-based incentive and other factors, our chief operating decision maker ( CODM ) reviewed SimpleDevices' discrete operating results through the second quarter of 2006. Consequently, SimpleDevices was defined as an operating segment and a reporting unit through the second quarter of 2006.

Effective the end of the second quarter of 2006, we completed our integration of SimpleDevices' technologies with our existing technologies and merged SimpleDevices' sales, engineering and administrative functions into our domestic reporting unit. The performance-based payment related to the acquisition also expired. In addition, commencing in the third quarter of 2006, our CODM no longer reviewed SimpleDevices' financial statements on a stand alone basis. Accordingly, SimpleDevices became part of the domestic reporting unit within our single operating segment in the third quarter of 2006.

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

| <b>(In thousands)</b>        | <b>September<br/>30,<br/>2007</b> | <b>December<br/>31,<br/>2006</b> |
|------------------------------|-----------------------------------|----------------------------------|
| Goodwill                     |                                   |                                  |
| United States                | \$ 8,314                          | \$ 8,314                         |
| International <sup>(1)</sup> | 2,491                             | 2,330                            |
| Total                        | \$ 10,805                         | \$ 10,644                        |

- (1) The difference in international goodwill reported at September 30, 2007, as compared to the goodwill reported at December 31, 2006, was the result of fluctuations in the foreign currency exchange rates used to translate the balance into U.S. dollars.



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

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

|                                         | <b>September 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|-----------------------------------------|-------------------------------|------------------------------|
| Carrying amount:                        |                               |                              |
| Distribution rights (10 years)          | \$ 408                        | \$ 379                       |
| Patents (10 years)                      | 6,140                         | 5,605                        |
| Trademark and trade names (10 years)    | 840                           | 840                          |
| Developed and core technology (5 years) | 1,630                         | 2,410                        |
| Capitalized software (2-5 years)        | 475                           | 898                          |
| Other (5-7 years)                       | 370                           | 370                          |
| <br>Total carrying amount               | <br>\$ 9,863                  | <br>\$ 10,502                |
| Accumulated amortization:               |                               |                              |
| Distribution rights                     | \$ 54                         | \$ 50                        |
| Patents                                 | 2,567                         | 2,221                        |
| Trademark and trade names               | 252                           | 189                          |
| Developed and core technology           | 978                           | 1,475                        |
| Capitalized software                    | 7                             | 813                          |
| Other                                   | 222                           | 167                          |
| <br>Total accumulated amortization      | <br>\$ 4,080                  | <br>\$ 4,915                 |
| Net carrying amount:                    |                               |                              |
| Distribution rights                     | \$ 354                        | \$ 329                       |
| Patents                                 | 3,573                         | 3,384                        |
| Trademark and trade names               | 588                           | 651                          |
| Developed and core technology           | 652                           | 935                          |
| Capitalized software                    | 468                           | 85                           |
| Other                                   | 148                           | 203                          |
| <br>Total net carrying amount           | <br>\$ 5,783                  | <br>\$ 5,587                 |

Amortization expense, including the amortization of capitalized software, which is recorded in cost of sales for the three and nine months ended September, 2007 was approximately \$0.3 million and \$1.0 million, respectively.

Amortization expense for the three and nine months ended September 30, 2006 was approximately \$0.4 million and \$1.1 million, respectively.

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

**(In thousands):**

|                           |          |
|---------------------------|----------|
| 2007 (remaining 3 months) | \$ 352   |
| 2008                      | 1,336    |
| 2009                      | 1,232    |
| 2010                      | 760      |
| 2011                      | 760      |
| Thereafter                | 1,343    |
| Total                     | \$ 5,783 |

**Note 14: Business Segments and Foreign Operations***Industry Segments*

SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*, defines an operating segment, in part, as a component of an enterprise whose operating results are regularly reviewed by the chief operating decision maker ( CODM ). The CODM makes decisions about resources to be allocated to the segment and assesses its performance. Operating segments may be aggregated only to the limited extent permitted by the standard.

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As a result of the performance-based incentive and other factors, management reviewed SimpleDevices' discrete operating results through the second quarter of 2006, and as a result, defined SimpleDevices as a separate segment. Since acquiring SimpleDevices, we have integrated SimpleDevices' technologies with and into our own technology. In addition, we have integrated SimpleDevices' sales, engineering and administrative functions into our own. Accordingly, commencing in the third quarter of 2006, we merged SimpleDevices into our Core Business segment, and now we operate in a single industry segment.

*Foreign Operations*

Our sales to external customers and long-lived tangible assets by geographic area for the three and nine months ended September 30, 2007 and 2006 are as follows:

| <b>(In thousands)</b> | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|-----------------------|---------------------------|-------------|--------------------------|-------------|
|                       | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                       | <b>2007</b>               | <b>2006</b> | <b>2007</b>              | <b>2006</b> |
| Net Sales             |                           |             |                          |             |
| United States         | \$ 35,231                 | \$ 32,294   | \$ 118,053               | \$ 90,369   |
| International:        |                           |             |                          |             |
| Asia                  | 9,840                     | 8,032       | 23,916                   | 22,972      |
| United Kingdom        | 7,480                     | 6,575       | 23,833                   | 16,305      |
| Spain                 | 2,642                     | 1,864       | 5,618                    | 5,885       |
| South Africa          | 2,419                     | 2,964       | 5,013                    | 6,337       |
| Switzerland           | 2,093                     | 105         | 5,070                    | 678         |
| France                | 1,279                     | 1,051       | 2,961                    | 3,406       |
| Germany               | 1,170                     | 1,538       | 3,988                    | 4,731       |
| All Other             | 6,807                     | 5,189       | 18,006                   | 15,472      |
| Total International   | 33,730                    | 27,318      | 88,405                   | 75,786      |
| Total Net Sales       | \$ 68,961                 | \$ 59,612   | \$ 206,458               | \$ 166,155  |

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

Our geographic long-lived asset information is as follows:

| <b>(In thousands)</b>      | <b>September 30,</b> |       | <b>December 31,</b> |       |
|----------------------------|----------------------|-------|---------------------|-------|
|                            | <b>2007</b>          |       | <b>2006</b>         |       |
| Long-lived Tangible Assets |                      |       |                     |       |
| United States              | \$                   | 4,763 | \$                  | 3,921 |
| International              |                      | 2,411 |                     | 2,199 |
| Total                      | \$                   | 7,174 | \$                  | 6,120 |

**Note 15: Derivatives**

Our foreign currency exposures are primarily concentrated in the Euro and British Pound. Depending on the predictability of future receivables, payables and cash flows in each operating currency, we periodically enter into foreign currency exchange contracts with terms normally lasting less than nine months to protect against the adverse effects that exchange-rate fluctuations may have on our foreign currency-denominated receivables, payables, cash

flows and reported income. We do not enter into financial instruments for speculation or trading purposes. These derivatives have not qualified for hedge accounting. The gains and losses on both the derivatives and the foreign currency-denominated balances are recorded as foreign exchange transaction gains or losses and are classified in other income (expense), net. Derivatives are recorded on the balance sheet at fair value. The estimated fair value of derivative financial instruments represents the amount required to enter into similar offsetting contracts with similar remaining maturities based on quoted market prices.

We held foreign currency exchange contracts which resulted in a net pre-tax gain of approximately \$337 thousand for the quarter ended September 30, 2007, compared to a net pre-tax loss of approximately \$101 thousand for the quarter ended September 30, 2006. For the nine months ended September 30, 2007 and 2006, we had a pre-tax gain of approximately \$570 thousand, compared to a net pre-tax loss of \$66 thousand the same period last year. We had

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one foreign currency exchange contract outstanding at September 30, 2007, a forward contract with a notional value of \$9.0 million. We had two foreign currency exchange contracts outstanding at December 31, 2006, known as participating forwards, both with a notional value of \$6.25 million each.

We held a USD/Euro forward contract with a notional value of \$9.0 million and a forward rate of \$1.4114 USD/Euro as of September 30, 2007, due for settlement on October 26, 2007. We held the Euro position on this contract. The fair value of this contract was \$106 thousand at September 30, 2007; and this contract value is included in prepaid expenses and other current assets. At December 31, 2006, we had a loss on participating forward contracts of approximately \$0.6 million, which was included in other accrued expenses.

**Note 16: Guarantees and Product Warranties**

The Company indemnifies its directors and officers to the maximum extent permitted under the laws of the State of Delaware. The Company has purchased directors and officers insurance to insure our individual directors and officers against certain claims, including the payment of claims such as those alleged in Note 17 and attorney's fees and related expenses incurred in connection with the defense of such claim. The amounts and types of coverage have varied from period to period as dictated by market conditions.

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

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

| <b>Description</b>                   | <b>Balance at<br/>Beginning<br/>of<br/>Period</b> | <b>Accruals for<br/>Warranties<br/>Issued<br/>During<br/>the Period</b> | <b>Settlements<br/>(in Cash)<br/>During<br/>the Period</b> | <b>Balance<br/>at<br/>End of<br/>Period</b> |
|--------------------------------------|---------------------------------------------------|-------------------------------------------------------------------------|------------------------------------------------------------|---------------------------------------------|
| Nine Months Ended September 30, 2007 | \$ 416                                            | \$(138) <sup>(1)</sup>                                                  | \$ (172)                                                   | \$ 106                                      |
| Nine Months Ended September 30, 2006 | \$ 414                                            | \$ 245                                                                  | \$ (172)                                                   | \$ 487                                      |

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

**Note 17: Litigation and Contingencies**

*Pending Litigation, Proceedings and Investigations*

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

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

We maintain directors' and officers' liability insurance to insure our individual directors and officers against certain claims, including the payment of claims such as those alleged in the above lawsuits and attorney's fees and related expenses incurred in connection with the defense of such claims.

*Contingency*

During the second quarter of 2007, the Company adopted a Long-Term Incentive Plan (LTIP) that provides a bonus pool for the executive management team contingent on achieving certain performance goals involving sales growth and earnings per diluted share through December 31, 2008. The LTIP commits a maximum of \$12 million in bonus if the highest performance goals are met. Payment is further dependent on the employee's continued employment at the time of payment, which occurs over fiscal years 2009 and 2010, and will be in cash or the Company's stock at the Board of Director's discretion. The participants in the LTIP may elect to defer all the payments. Vesting in the LTIP occurs as payments are due, and management believes that a four-year period is appropriate. The LTIP was effective January 1, 2007. The Company recorded compensation expense of \$250,000 and \$750,000 for the three and nine months ended September 30, 2007, respectively, for the LTIP.

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

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

**Overview**

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

Beginning in 1986 and continuing today, we have compiled an extensive library that covers over 321,000 individual device functions and over 3,200 individual consumer electronic equipment brand names. Our library is regularly updated with new IR codes used in newly introduced video and audio devices. All such IR codes are captured from the original manufacturer's remote control devices or manufacturer's specifications to ensure the accuracy and integrity of the database. We have also developed patented technologies that provide the capability to easily upgrade the memory of the wireless control device by adding IR codes from the library that were not originally included. Since the third quarter of 2006, we have been operating as one business segment. We have ten international subsidiaries established in the Netherlands, Germany, United Kingdom, Argentina, Spain, Italy, Singapore, Hong Kong and France.

Some of our strategic business objectives for 2007 include the following:

- expand our sales and marketing efforts, including increasing our sales force, to subscription broadcasters and OEMs in Asia, Latin America and Europe;

- focus on developing and marketing additional products that are based on the Zigbee, Z-Wave® and other radio frequency technology;

- continue to seek strategic business opportunities that will compliment our business; and

- continue to enhance the Nevo® product line, which first began shipping in October 2005.

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

For further discussion of factors that could impact operating results, see the section below captioned "Factors That Could Affect Future Results."

**Critical Accounting Policies and Estimates**

Management's Discussion and Analysis of Financial Condition and Results of Operations are based upon our consolidated financial statements, which we have prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Senior management has discussed the development, selection and disclosure of these estimates with the Audit Committee of our Board of Directors. Actual results may differ from these estimates under different assumptions or conditions.



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An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably could have been used, or if changes in the estimate that are reasonably likely to occur could materially impact the financial statements. Management believes that, other than the adoption of FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes- an interpretation of FASB Statement No. 109* ( FIN 48 ) and the adoption of FASB Staff Position No. 48-1, *Definition of Settlement in FASB Interpretation No. 48* ( FIN 48-1 ), and adoption of a Long-Term Incentive Plan for our executive employees, there have been no significant changes during the nine months ended September 30, 2007 to the items that we disclosed as our critical accounting policies and estimates in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

**Income Taxes**

In accordance with the adoption of FIN 48 effective January 1, 2007, we evaluate our tax positions to determine if it is more likely than not that a tax position is sustainable, based on its technical merits. If a tax position does not meet the more likely than not standard, a full reserve is established. Additionally, for a position that is determined to, more likely than not, be sustainable, we measure the benefit at the greatest cumulative probability of being realized and establish a reserve for the balance. In May 2007, the FASB published FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48* ( FSP FIN 48-1 ). FSP FIN 48-1 is an amendment to FIN 48. It clarifies how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. FSP FIN 48-1 is effective upon the initial adoption of FIN 48. Accordingly, we adopted FSP FIN 48-1 on January 1, 2007. A material change in our tax reserves could have a significant impact on our results. Refer to Note 6 captioned *Income Taxes* included in the *Notes to the Consolidated Financial Statements* set forth above for additional disclosure regarding adoption of FIN 48.

**Stock-Based Compensation Expense**

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123R, *Share-Based Payment* ( SFAS 123R ) using the modified-prospective transition method. Stock-based compensation expense is presented in the same income statement line as cash compensation paid to the same employees or directors. During the three months ended September 30, 2007 and 2006, we recorded \$1.1 million and \$0.8 million, respectively, in pre-tax stock-based compensation expense. Included in SG&A stock-based compensation expense is \$227 thousand and \$79 thousand in pre-tax compensation expense related to stock awards granted to outside directors for the three months ended September 30, 2007 and 2006, respectively. The income tax benefit associated with stock-based compensation expense was \$0.3 million and \$0.2 million for the three months ended September 30, 2007 and 2006, respectively. During the nine months ended September 30, 2007 and 2006, we recorded \$2.6 million and \$2.4 million, respectively, in pre-tax stock-based compensation expense. Included in SG&A stock-based compensation expense is \$461 thousand and \$242 thousand in pre-tax compensation expense related to stock awards granted to outside directors for the nine months ended September 30, 2007 and 2006, respectively. The income tax benefit associated with stock-based compensation expense was \$0.7 million and \$0.7 million for the nine months ended September 30, 2007 and 2006, respectively.

Stock-based compensation expense was included in the following:

| (In thousands)                      | Three Months Ended |        | Nine Months Ended |          |
|-------------------------------------|--------------------|--------|-------------------|----------|
|                                     | September 30,      |        | September 30,     |          |
|                                     | 2007               | 2006   | 2007              | 2006     |
| Cost of sales                       | \$ 9               | \$ 7   | \$ 22             | \$ 20    |
| Research and development            | 122                | 92     | 307               | 291      |
| Selling, general and administrative | 971                | 678    | 2,254             | 2,070    |
| Stock-based compensation expense    | \$ 1,102           | \$ 777 | \$ 2,583          | \$ 2,381 |

As of September 30, 2007, we expect to recognize \$5.0 million of total unrecognized compensation expense related to non-vested employee stock options over a weighted-average life of 2.46 years.

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We issue restricted stock awards to the outside directors for services performed. Under SFAS No. 123R, compensation expense related to restricted stock awards is based on the fair value of the shares awarded as of the grant date. Compensation expense for the restricted stock awards is recognized on a straight-line basis over the requisite service period of one year. The fair value of nonvested shares is determined based on the closing trade price of the Company's shares on the grant date. During the nine months ended September 30, 2007 and 2006, we issued 18,438 and 15,000 shares, respectively. The fair value of these shares is \$344,817 and \$242,269, respectively.

As of September 30, 2007, we expect to recognize \$0.7 million of total unrecognized compensation expense related to non-vested restricted stock awards over a weighted-average life of nine months.

Determining the appropriate fair value model and calculating the fair value of share-based payment awards requires the utilization of highly subjective assumptions, including the expected life of the share-based payment awards and stock price volatility. Management determined that historical volatility calculated based on our actively traded common stock is a better indicator of expected volatility and future stock price trends than implied volatility. The assumptions used in calculating the fair value of share-based payment awards represent management's best estimates, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the amount of stock-based compensation expense could be significantly different from the amount recorded. If the forfeiture rate decreased by 1%, stock-based compensation expense would have increased by approximately 4.1% and 3.7% for the three and nine months ended September 30, 2007, respectively. During the nine months ended September 30, 2007, we granted 75,250 and 248,750 stock options to executive and non-executive employees, respectively.

Refer to Note 2 captioned "Stock-based Compensation" included in the Notes to the Consolidated Financial Statements set forth above for additional disclosure regarding stock-based compensation expense.

**Long-Term Incentive Plan**

During the second quarter of 2007, the Company adopted a Long-Term Incentive Plan (LTIP) that provides a bonus pool for the executive management team contingent on achieving certain performance goals involving sales growth and earnings per diluted share through December 31, 2008. The LTIP commits a maximum of \$12 million in bonus if the highest performance goals are met. Payment is further dependent on the employee's continued employment at the time of payment, which occurs over fiscal years 2009 and 2010, and will be in cash or the Company's stock at the Board of Director's discretion. The participants in the LTIP may elect to defer all the payments. Vesting in the LTIP occurs as payments are due, and management believes that a four-year period is appropriate. The LTIP was effective January 1, 2007.

On a quarterly basis, Company management reviews the most recent net sales and earnings per diluted share projections for 2007 and 2008 combined to determine the most likely payout of the LTIP as well as the appropriate LTIP accrual as of a respective balance sheet date. The Company recorded compensation expense of \$250,000 and \$750,000 for the three and nine months ended September 30, 2007, respectively, for the LTIP.

**Recent Accounting Pronouncements**

Refer to Note 1 to the Consolidated Financial Statements in Part 1, Item I for a full description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on results of operations and financial condition. Note 1 is incorporated in this discussion by reference.

**Table of Contents****Results of Operations**

The following table sets forth our results of operations expressed as a percentage of net sales for the three and nine months ended September 30, 2007 and 2006:

|                                              | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|----------------------------------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                                              | <b>2007</b>                                 | <b>2006</b> | <b>2007</b>                                | <b>2006</b> |
| Net sales                                    | 100.0%                                      | 100.0%      | 100.0%                                     | 100.0%      |
| Cost of sales                                | 62.7                                        | 63.8        | 63.8                                       | 64.1        |
| Gross profit                                 | 37.3                                        | 36.2        | 36.2                                       | 35.9        |
| Research and development expenses            | 3.0                                         | 3.0         | 3.2                                        | 3.4         |
| Selling, general and administrative expenses | 25.2                                        | 25.4        | 24.0                                       | 25.4        |
| Operating expenses                           | 28.2                                        | 28.4        | 27.2                                       | 28.8        |
| Operating income                             | 9.1                                         | 7.8         | 9.0                                        | 7.1         |
| Interest income, net                         | 1.3                                         | 0.7         | 1.0                                        | 0.7         |
| Other income (expense), net                  | 0.0                                         | (0.1)       | 0.0                                        | (0.4)       |
| Income before income taxes                   | 10.4                                        | 8.4         | 10.0                                       | 7.4         |
| Provision for income taxes                   | (3.3)                                       | (2.5)       | (3.2)                                      | (2.5)       |
| Net income                                   | 7.1%                                        | 5.9%        | 6.8%                                       | 4.9%        |

*Three Months Ended September 30, 2007 versus Three Months Ended September 30, 2006:*

The following table sets forth our net sales by our Business and Consumer lines for the three months ended September 30, 2007 and 2006:

|                 | <b>2007</b>              |                   | <b>2006</b>              |                   |
|-----------------|--------------------------|-------------------|--------------------------|-------------------|
|                 | <b>\$<br/>(millions)</b> | <b>% of total</b> | <b>\$<br/>(millions)</b> | <b>% of total</b> |
| Net sales:      |                          |                   |                          |                   |
| Business        | \$ 55.9                  | 81.0%             | \$ 46.1                  | 77.4%             |
| Consumer        | 13.1                     | 19.0%             | 13.5                     | 22.6%             |
| Total net sales | \$ 69.0                  | 100.0%            | \$ 59.6                  | 100.0%            |

*Overview*

Net sales for the third quarter of 2007 were \$69.0 million, an increase of 16% compared to \$59.6 million for the third quarter of 2006. Net income for the third quarter of 2007 was \$4.9 million or \$0.34 per share (basic) and \$0.32 per share (diluted) compared to \$3.5 million or \$0.26 per share (basic) and \$0.25 per share (diluted) for the third quarter of 2006.

*Consolidated*

Net sales in our Business lines (subscription broadcasting, OEM and computing companies) were approximately 81% of net sales in the third quarter of 2007 compared to approximately 77% in the third quarter of 2006. Net sales in our Business lines for the third quarter of 2007 increased by 21% to \$55.9 million from \$46.1 million in the third quarter of 2006. This increase in sales resulted primarily from an increase in the volume of remote control sales. The increase

in remote control sales volume was attributable to the continued deployment of advanced function set-top boxes by the service operators and market share gains with a few key subscription broadcasting customers. These advanced functions include digital video recording ( DVR ), video-on-demand ( VOD ), and high definition television ( HDTV ). We expect that the deployment of the advanced function set-top boxes by the service operators will continue into the foreseeable future as penetration for each of the functions cited continues to increase.

Net sales in our Consumer lines (*One For All*<sup>®</sup> retail, private label, custom installers and direct import) were approximately 19% of net sales for the third quarter of 2007 compared to approximately 23% for the third quarter of 2006. Net sales in our Consumer lines for the third quarter of 2007 decreased by 3% to \$13.1 million, from \$13.5 million in the third quarter of 2006. Retail sales made in the United States was the key driver of the sales decline in our Consumer lines. These sales were down \$0.7 million. European retail sales increased by \$0.2 million compared to

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2006. The strengthening of both the Euro and the British Pound compared to the U.S. Dollar resulted in an increase in net sales of approximately \$0.7 million. Net of this positive currency effect, Europe retail sales decreased by \$0.5 million.

Gross profit for the third quarter of 2007 was \$25.7 million compared to \$21.6 million for the third quarter of 2006. Gross profit as a percentage of sales for the third quarter of 2007 was 37.3% compared to 36.2% for the same period in the prior year. The increase in gross profit as a percentage of net sales was primarily attributable to a decrease in royalty expense of \$0.4 million, due to lower sales of SKY-branded retail products in Europe. This decrease in royalty expense added 0.9% to the gross profit rate. The gross profit rate was also positively impacted by the strengthening of both the Euro and British Pound compared to the U.S. Dollar, which resulted in an increase in gross profit of approximately \$0.7 million, or an increase in the gross profit rate of 0.6%. A decline in scrap expense of \$0.1 million added 0.2% to the gross profit rate. Partially offsetting these increases was an increase in sub-contract labor expense of \$0.5 million, which reduced the gross profit rate by 0.6%.

Research and development expenses increased 17% from \$1.8 million in the third quarter of 2006 to \$2.1 million in the third quarter of 2007. The increase is primarily related to internal as well as third party costs associated with the continued expansion of the Nevo<sup>®</sup> platform and the development of products for sale in our subscription broadcasting, retail and OEM channels.

Selling, general and administrative expenses increased 15% from \$15.1 million in the third quarter of 2006 to \$17.4 million in the third quarter of 2007. Payroll and benefits increased by \$0.9 million due to new hires and merit increases; employee bonus expense increased by \$0.9 million; the strengthening of both the Euro and British Pound compared to the U.S. Dollar resulted in an increase of \$0.5 million; stock-based compensation and long-term incentive compensation increased by \$0.4 million; and additional advertising expense resulted in an increase of \$0.3 million. These increases were partially offset by the capitalization of internal software development costs of \$0.3 million and a decrease in tradeshow expense of \$0.4 million.

In the third quarter of 2007, we recorded \$0.9 million of interest income compared to \$0.4 million in the third quarter of 2006. This increase is due to higher money market rates and a higher average cash balance.

We recorded income tax expense of \$2.3 million in the third quarter of 2007 compared to \$1.5 million in the third quarter of 2006. Our effective tax rate was 31.4% in the third quarter of 2007 compared to 29.8% in the third quarter of 2006. The increase in our effective tax rate is due primarily to a higher percentage of pre-tax income being earned in higher tax rate jurisdictions.

*Nine Months Ended September 30, 2007 versus Nine Months Ended September 30, 2006:*

The following table sets forth our net sales by our Business and Consumer lines for the nine months ended September 30, 2007 and 2006:

|                 | 2007             |            | 2006             |            |
|-----------------|------------------|------------|------------------|------------|
|                 | \$<br>(millions) | % of total | \$<br>(millions) | % of total |
| Net sales:      |                  |            |                  |            |
| Business        | \$ 166.7         | 80.7%      | \$ 129.3         | 77.8%      |
| Consumer        | 39.8             | 19.3%      | 36.9             | 22.2%      |
| Total net sales | \$ 206.5         | 100.0%     | \$ 166.2         | 100.0%     |

*Overview*

Net sales for the nine months ended September 30, 2007 were \$206.5 million, an increase of 24% compared to \$166.2 million for the nine months ended September 30, 2006. Net income for the nine months ended September 30, 2007 was \$14.1 million or \$0.98 per share (basic) and \$0.93 per share (diluted) compared to \$8.1 million or \$0.59 per share (basic) and \$0.56 per share (diluted) for the nine months ended September 30, 2006.

**Table of Contents***Consolidated*

Net sales in our Business lines (subscription broadcasting, OEM and computing companies) were approximately 81% of net sales for the nine months ended September 30, 2007 compared to 78% for the nine months ended September 30, 2006. Net sales in our Business lines for the nine months ended September 30, 2007 increased by 29% to \$166.7 million from \$129.3 million for the same period last year. This increase in sales resulted primarily from an increase in the volume of remote control sales. The increase in remote control sales volume was attributable to the continued deployment of advanced function set-top boxes by the service operators and market share gains with a few key subscription broadcasting customers. These advanced functions include digital video recording ( DVR ), video-on-demand ( VOD ) and high definition television ( HDTV ). We expect the deployment of the advanced function set-top boxes by the service operators to continue into the foreseeable future as penetration for each of these functions continues to increase. As a result, we expect Business category revenue to range between \$215.6 and \$218.6 million for the full year 2007.

Net sales in our Consumer lines (*One For All*<sup>®</sup> retail, private label, custom installers and direct import) were approximately 19% of net sales for the nine months ended September 30, 2007 compared to 22% for the nine months ended September 30, 2006. Net sales in our Consumer lines for the nine months ended September 30, 2007 increased by 8% to \$39.8 million from \$36.9 million for the same period last year. The increase in sales resulted primarily from an increase in European retail sales, which were up 10% to \$30.5 million in the nine months ended September 30, 2007 from \$27.6 million during the same period last year. This increase was primarily attributable to increased sales in the UK, as well as the strengthening of both the Euro and British Pound compared to the U.S. Dollar. The impact of the stronger currencies resulted in an increase in net sales of approximately \$2.5 million. Net of this positive currency effect, European retail sales increased \$0.4 million. The increase in our consumer lines was also driven by our expanding presence in the CEDIA market. CEDIA sales increased by \$2.1 million from 2006. Partially offsetting these increases was a decline in retail sales made outside of both Europe and the United States, as these sales were down \$1.0 million. We encountered difficult selling conditions, primarily in Latin America. United States direct import licensing and product revenues for 2007 decreased by \$0.6 million or 42% to \$0.8 million in 2007 from \$1.4 million in 2006, due primarily to a decline in Kameleon sales in North America. Private Label sales were also down by \$0.4 million, from \$2.8 million to \$2.4 million. We expect Consumer category revenue to range between \$60.3 and \$63.3 million for the full year 2007, with a higher percentage of retail sales occurring in the fourth quarter, which is consistent with prior years.

Gross profit for the nine months ended September 30, 2007 was \$74.7 million compared to \$59.6 million for the nine months ended September 30, 2006. Gross profit as a percentage of net sales for the nine months ended September 30, 2007 was 36.2% compared to 35.9% for the same period last year. The gross profit rate was positively impacted by the strengthening of both the Euro and British Pound compared to the U.S. Dollar, which resulted in an increase of approximately \$2.3 million in gross profit, or an increase of 0.7% in the gross profit rate. A decrease in royalty expense of \$0.9 million, due to lower sales of SKY-branded retail product in Europe, increased the gross profit rate by 0.7%, and a decline in warranty expense of \$0.4 million due to lower negotiated pricing added 0.2% to the gross profit rate. Partially offsetting these increases in the gross profit rate was an increase in freight and handling expense of \$2.6 million, which reduced the gross profit rate by 1.0%. The increase in freight expense is due primarily to an increase in the percentage of units shipped by air; air freight is significantly more costly than ocean freight. An increase in sub-contract labor expense of \$0.8 million reduced the gross profit rate by 0.2%.

Research and development expenses increased 20% from \$5.6 million in the nine months ended September 30, 2006 to \$6.7 million in the nine months ended September 30, 2007. The increase is primarily related to internal as well as third party costs associated with the continued expansion of the Nevo<sup>®</sup> platform and the development of products for sale in our subscription broadcasting, retail and OEM channels. We expect research and development expenses to remain near current levels in the fourth quarter of 2007.

Selling, general and administrative expenses increased 17% from \$42.3 million in the nine months ended September 30, 2006 to \$49.6 million in the nine months ended September 30, 2007. Payroll and benefits increased by \$2.5 million due to new hires and merit increases; the strengthening of both the Euro and British Pound compared to the U.S. Dollar resulted in an increase of \$1.6 million; long-term incentive compensation increased by \$0.8 million;

delivery and freight increased \$0.6 million; additional travel resulted in an increase of \$0.4 million; advertising



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expense increased \$0.4 million; director's fees and expenses increased by \$0.3 million; telecommunications expense increased \$0.2 million; rent increased \$0.2 million and all other expenses increased \$0.3 million. We expect that selling, general and administrative expenses will range between \$67.2 and \$67.8 million for the full year 2007. In the nine months ended September 30, 2007, we recorded \$2.2 million of net interest income compared to \$1.1 million during the nine months ended September 30, 2006. This increase was due to higher money market rates and a higher average cash balance in Europe. We expect this trend to continue through the remainder of 2007. We recorded income tax expense of \$6.7 million for the nine months ended September 30, 2007 compared to \$4.2 million for the nine months ended September 30, 2006. Our effective tax rate was 32.1% during the nine months ended September 30, 2007 compared to 34.0% during the nine months ended September 30, 2006. The decrease in our effective tax rate is due primarily to the re-enactment of the federal research and development tax credit statute which was passed by Congress in the fourth quarter of 2006 as well as the Netherlands' statutory tax rate decreasing from 31.5% in 2006 to 25.5% in 2007, offset partially by increased pre-tax income in higher tax rate jurisdictions. We estimate that our effective tax rate will approximate 32.5% for the full year 2007.

**Liquidity and Capital Resources***Financial Condition (Sources and Uses of Cash)*

|                                           | <b>Nine months<br/>ended<br/>September 30,<br/>2007</b> | <b>Increase<br/><br/>(decrease)</b> | <b>Nine months<br/>ended<br/>September 30,<br/>2006</b> |
|-------------------------------------------|---------------------------------------------------------|-------------------------------------|---------------------------------------------------------|
| Net cash provided by operating activities | \$ 16,618                                               | \$ 5,561                            | \$ 11,057                                               |
| Net cash used for investing activities    | (4,162)                                                 | (455)                               | (3,707)                                                 |
| Net cash provided by financing activities | 1,942                                                   | (1,171)                             | 3,113                                                   |
| Effect of exchange rate changes on cash   | 4,025                                                   | 795                                 | 3,230                                                   |

  

|                           | <b>September 30,<br/>2007</b> | <b>Increase</b> | <b>December 31,<br/>2006</b> |
|---------------------------|-------------------------------|-----------------|------------------------------|
| Cash and cash equivalents | \$ 84,498                     | \$18,423        | \$ 66,075                    |
| Working capital           | 139,002                       | 32,823          | 106,179                      |

*Net cash provided by operating activities* for the first nine months of 2007 was \$16.6 million as compared to \$11.1 million for the first nine months of 2006. The increase in cash provided by operating activities was primarily driven by an increase in net sales and net income in the first nine months of 2007 compared to 2006 of 24% and 74%, respectively, offset partially by a corresponding increase in accounts receivable. Days sales outstanding has increased from approximately 68 days at September 30, 2006 to approximately 79 days at September 30, 2007 due primarily to certain large customers unofficially extending their payment terms. We expect our days sales outstanding to resume to a range of approximately 70 days to 75 days. We have extended our payment terms with certain vendors resulting in our payables cycle increasing from approximately 49 days at September 30, 2006 to approximately 61 days at September 30, 2007.

*Net cash used for investing activities* for the first nine months of 2007 was \$4.2 million compared to \$3.7 million for the first nine months of 2006. The increase is primarily due to the purchase of additional tooling equipment in 2007, which is required to support our current and future growth.

In order to accommodate the growth of our company, we are currently renovating and expanding our corporate headquarters. The renovation and expansion are expected to be completed during the first quarter of 2008. The total cost of this renovation is estimated to be approximately \$1.0 million and will be financed by our cash flow from operations as well as a \$0.4 million tenant improvement allowance. In addition, we plan to make a significant investment to upgrade our information systems, which we expect to cost approximately \$1.0 million. The upgrade of our information systems commenced in the second quarter of 2007 and we expect it to be completed in 2008.

*Net cash provided by financing activities* for the first nine months of 2007 was \$1.9 million as compared to cash provided by financing activities of \$3.1 million for the first nine months of 2006. The decrease in cash provided by

financing activities was primarily due to an increase in stock repurchases in 2007 compared to 2006. We purchased 321,300 shares of our common stock during the nine months ended September 30, 2007 for \$9.4 million compared to 32,326 shares purchased during the first nine months of 2006 for \$0.6 million.

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We hold repurchased shares as treasury stock and they are available for reissue. Presently, except for using a small number of these treasury shares to compensate our outside board members, we have no plans to distribute these shares. However, we may change these plans, if necessary, to fulfill our on-going business objectives. Under our amended Credit Facility with Comerica Bank, we have authority to acquire up to an additional 2.0 million shares of our common stock in the open market. As of September 30, 2007, 1,582,100 shares were available for purchase under the Credit Facility. During the remainder of 2007 we may continue to purchase shares of our common stock if we believe conditions are favorable or to manage the dilutive effect of stock option exercises.

The increase in stock repurchases in 2007 compared to 2006 was partially offset by an increase in proceeds from stock option exercises in 2007. Proceeds from stock option exercises were \$9.5 million and \$3.5 million during the first nine months of 2007 and 2006, respectively. In addition, the excess tax benefit related to stock-based compensation was \$1.8 million and \$0.2 million for the nine months ended September 30, 2007 and September 30, 2006, respectively.

*Contractual Obligations*

At September 30, 2007 our contractual obligations were \$22.5 million compared to \$26.9 million as previously reported on our Annual Report on Form 10-K. Purchase obligations primarily consist of an agreement with a specific vendor to purchase approximately 80% of our integrated circuits through October 16, 2008 from this vendor. Included in our contractual obligations are future obligations on existing operating leases.

*Liquidity*

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

Our cash balances are held in the United States and Europe. At September 30, 2007, we had approximately \$16.3 million and \$68.2 million of cash and cash equivalents in the United States and Europe, respectively. At December 31, 2006, we had approximately \$6.1 million and \$60.0 million of cash and cash equivalents in the United States and Europe, respectively.

We have a \$15 million unsecured revolving credit agreement ( Credit Facility ) with Comerica Bank, which expires on August 31, 2009. Under the Credit Facility, the interest payable is variable and is based on the bank's cost of funds or LIBOR plus a fixed margin of 1.25%. The interest rate in effect as of September 30, 2007 using LIBOR plus a fixed margin of 1.25% was 6.15%. We pay a commitment fee ranging from zero to a maximum rate of 1/4 of 1% per year on the unused portion of the credit line depending on the amount of cash investment retained with Comerica during each quarter. Under the terms of the Credit Facility, dividend payments are allowed for up to 100% of the prior fiscal year's net income, to be paid within 90 days of this period's year end. We are subject to certain financial covenants related to our net worth, quick ratio, and net income. Amounts available for borrowing under the Credit Facility are reduced by the outstanding balance of import letters of credit. As of September 30, 2007, we did not have any amounts outstanding under the Credit Facility or any outstanding import letters of credit. Furthermore, as of September 30, 2007, we were in compliance with all financial covenants required by the Credit Facility.

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

*Off Balance Sheet Arrangements*

We do not participate in any off balance sheet arrangements.

**Table of Contents****Factors That May Affect Financial Condition and Future Results***Forward Looking Statements*

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

While we believe that the forward looking statements made in this report are based on reasonable assumptions, the actual outcome of such statements is subject to a number of risks and uncertainties, including the failure of our markets to continue growing and expanding in the manner we anticipated; the failure of our customers to grow and expand as we anticipated; the effects of natural or other events beyond our control, including the effect of a war or terrorist activities on us or the economy; the economic environment's effect on us and our customers; the growth of, acceptance of and demand for our products and technologies in various markets and geographical regions, including cable, satellite, consumer electronics, retail and interactive TV and home automation, not materializing as we believe; our inability to add profitable complementary products which are accepted by the marketplace; our inability to continue to maintain our operating costs at acceptable levels through our cost containment efforts; our inability to realize tax benefits from various tax projects initiated from time to time; our inability to maintain the strength of our balance sheet; our inability to continue selling our products or licensing our technologies at higher or profitable margins; the failure of various markets and industries to grow or emerge as rapidly or as successfully as we believe; the lack of continued growth of our technologies and product lines addressing the market for digital media; our inability to obtain orders or maintain our order volume with new and existing customers; the possible dilutive effect our stock option program may have on our earnings per share and stock price; our inability to continue to obtain adequate quantities of component parts or secure adequate factory production capacity on a timely basis; the effect the value of the Euro and other foreign currencies relative to the U.S. dollar could have on our financial results; and other factors that may be listed from time to time in our press releases and filings with the SEC.

**Outlook**

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

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

Throughout 2007, we will continue development of our Nevo® technology, an embedded solution that transforms an electronic display into a sophisticated and easy-to-use wireless home control and automation device. New Nevo®



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

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

We will continue developing software and firmware solutions that can enable devices such as TVs, set-top boxes, stereos, automotive audio systems and other consumer electronic products to wirelessly connect and interact with home networks and interactive services to deliver digital entertainment and information. This smart device category is emerging, and in the remainder of 2007 we look to continue to build relationships with our customers in this category. Throughout 2007, we will continue to evaluate acceptable acquisition targets and strategic partnership opportunities in our core business lines as well as in the networked home marketplace. We caution, however, that no assurance can be made that any suitable acquisition target or partnership opportunity will be identified and, if identified, that a transaction can be consummated. Moreover, if consummated, no assurance can be made that any such acquisition or partnership will profitably add to our operations.

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

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

On August 31, 2006, we amended our credit facility to extend for an additional three years, expiring on August 31, 2009. The interest payable under our revolving Credit Facility with our bank is variable and based on either (i) the bank's cost of funds or (ii) the LIBOR rate plus a fixed margin of 1.25%; the rate is affected by changes in market interest rates. At September 30, 2007, we had no borrowings on our credit facility. The interest rate in effect on the credit facility as of September 30, 2007 using the LIBOR Rate option plus a fixed margin of 1.25% was 6.15%.

At September 30, 2007 we had wholly owned subsidiaries in The Netherlands, United Kingdom, Germany, France, Argentina, Spain, Hong Kong, Singapore and Italy. Sales from these operations are typically denominated in local currencies including Euros, British Pounds and Argentine Pesos, thereby creating exposure to changes in exchange rates. Changes in local currency exchange rates relative to the U.S. Dollar and, in some cases, to each other, may positively or negatively affect our sales, gross margins and net income. From time to time, we enter into foreign currency exchange agreements to manage our exposure arising from fluctuating exchange rates that affect cash flows and our reported income. Contract terms for the foreign currency exchange agreements normally last less than nine months. We do not enter into any derivative transactions for speculative purposes.

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

The sensitivity of earnings and cash flows to the variability in exchange rates is assessed by applying an approximate range of potential rate fluctuations to our assets, obligations and projected results of operations denominated in foreign currency. Based on our overall foreign currency rate exposure at September 30, 2007, we believe that movements in foreign currency rates could have a material affect on our financial position. We estimate

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that if the exchange rates for the Euro and the British Pound relative to the U.S. Dollar fluctuate 10% from September 30, 2007, net income and cash flows in the fourth quarter of 2007 would fluctuate by approximately \$0.6 million and \$8.6 million, respectively.

**ITEM 4. CONTROLS AND PROCEDURES**

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

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

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

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

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

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

We maintain directors' and officers' liability insurance to insure our individual directors and officers against certain claims, including the payment of claims such as those alleged in the above lawsuits and attorney's fees and related expenses incurred in connection with the defense of such claims.

**Table of Contents****ITEM 1A. RISK FACTORS***Potential for Litigation*

As is typical in our industry and for 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, against those of our customers to whom we owe indemnification, 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 they 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.

For additional and more comprehensive discussion of risk factors, see Risk Factors in Part 1, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, which is incorporated herein by reference.

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

During the quarter ended September 30, 2007, we did not sell any equity securities that were not registered under the Securities Act of 1934.

We have authority under the Credit Facility to acquire up to 2.0 million shares of our common stock in market purchases. Between August 31, 2006, the date of amendment of the Credit Facility, and September 30, 2007, we purchased 417,900 shares of our common stock leaving 1,582,100 remaining shares authorized for purchase under the Credit Facility. We repurchased 250,000 shares during the quarter ended September 30, 2007, and we may continue to repurchase shares of our common stock during the remainder of the year, if we believe conditions are favorable, or to manage dilution created by shares issued under the employee stock plans. Purchase information for the third quarter of 2007 is set forth by month in the following table:

| <b>Period</b>                          | <b>Total<br/>Number<br/>of Shares<br/>Purchased</b> | <b>Average<br/>Price<br/>Paid<br/>per Share</b> | <b>Total Number<br/>of<br/>Shares<br/>Purchased as<br/>Part of<br/>Publicly<br/>Announced<br/>Plans or<br/>Programs</b> | <b>Maximum<br/>Number of<br/>Shares that<br/>May Yet<br/>Be Purchased<br/>Under the Plans<br/>or<br/>Programs</b> |
|----------------------------------------|-----------------------------------------------------|-------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------|
| July 1, 2007 – July 31, 2007           |                                                     |                                                 | N/A                                                                                                                     | N/A                                                                                                               |
| August 1, 2007 – August 31, 2007       | 77,700                                              | 28.06                                           | N/A                                                                                                                     | N/A                                                                                                               |
| September 1, 2007 – September 30, 2007 | 172,300                                             | 28.05                                           | N/A                                                                                                                     | N/A                                                                                                               |
| Total Q3 2007                          | 250,000                                             | 28.05                                           | N/A                                                                                                                     | N/A                                                                                                               |

**ITEM 6. EXHIBITS**

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





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**SIGNATURE**

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

Date: November 9, 2007

Universal Electronics Inc.

/s/ Bryan Hackworth  
Bryan Hackworth  
Chief Financial Officer  
(principal financial officer  
and principal accounting officer)  
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**EXHIBIT INDEX**

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