UNIVERSAL ELECTRONICS INC
Form 10-Q
November 08, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 0-21044

UNIVERSAL ELECTRONICS INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	33-0204817
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
201 E. Sandpointe Avenue, 8th Floor Santa Ana, California	92707
(Address of Principal Executive Offices)	(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, any Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨	Accelerated filer ý
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No ý
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 14,572,220 shares of Common Stock, par value $0.01 per share, of the registrant were outstanding on November 3, 2016.

UNIVERSAL ELECTRONICS INC.

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

	September 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 48,141	$ 52,966
Restricted cash	4,623	4,623
Accounts receivable, net	134,438	121,801
Inventories, net	124,091	122,366
Prepaid expenses and other current assets	6,741	6,217
Income tax receivable	441	55
Deferred income taxes	7,243	7,296
Total current assets	325,718	315,324
Property, plant, and equipment, net	103,117	90,015
Goodwill	43,162	43,116
Intangible assets, net	29,615	32,926
Deferred income taxes	9,112	8,474
Long-term restricted cash	4,797	—
Other assets	5,065	5,365
Total assets	$ 520,586	$ 495,220
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 102,754	$ 93,843
Line of credit	35,000	50,000
Accrued compensation	32,406	37,452
Accrued sales discounts, rebates and royalties	8,666	7,618
Accrued income taxes	359	4,745
Other accrued expenses	23,288	21,466
Total current liabilities	202,473	215,124
Long-term liabilities:		
Long-term contingent consideration	11,600	11,751
Deferred income taxes	9,972	7,891
Income tax payable	629	629
Other long-term liabilities	6,568	1,917
Total liabilities	231,242	237,312
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; 23,435,769 and 23,176,277 shares issued on September 30, 2016 and December 31, 2015, respectively	234	232
Paid-in capital	246,930	228,269
Treasury stock, at cost, 8,864,299 and 8,824,768 shares on September 30, 2016 and December 31, 2015, respectively	(212,521)	(210,333)
Accumulated other comprehensive income (loss)	(17,657)	(15,799)

Retained earnings	272,358	255,240
Universal Electronics Inc. stockholders' equity	289,344	257,609
Noncontrolling interest	—	299
Total stockholders' equity	289,344	257,908
Total liabilities and stockholders' equity	$ 520,586	$ 495,220

See Notes 4 and 9 for further information concerning our purchases from related party vendors.
The accompanying notes are an integral part of these consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net sales	$169,185	$160,467	$490,829	$440,723
Cost of sales	127,400	117,658	367,941	320,225
Gross profit	41,785	42,809	122,888	120,498
Research and development expenses	4,955	4,134	15,292	12,664
Selling, general and administrative expenses	28,709	29,642	88,465	82,298
Operating income	8,121	9,033	19,131	25,536
Interest income (expense), net	(228)	(16)	(753)	198
Other income (expense), net	335	(558)	1,726	(272)
Income before provision for income taxes	8,228	8,459	20,104	25,462
Provision for income taxes	421	2,185	2,956	5,624
Net income	7,807	6,274	17,148	19,838
Net income (loss) attributable to noncontrolling interest	—	3	30	3
Net income attributable to Universal Electronics Inc.	$7,807	$6,271	$17,118	$19,835
Earnings per share attributable to Universal Electronics Inc.:				
Basic	$0.54	$0.42	$1.19	$1.28
Diluted	$0.53	$0.41	$1.16	$1.25
Shares used in computing earnings per share:				
Basic	14,510	14,966	14,441	15,535
Diluted	14,848	15,230	14,740	15,834

See Notes 4 and 9 for further information concerning our purchases from related party vendors.
The accompanying notes are an integral part of these consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	$7,807	$6,274	$17,148	$19,838
Other comprehensive income (loss):				
Change in foreign currency translation adjustment	(540)	(4,236)	(1,858)	(7,396)
Total comprehensive income (loss)	7,267	2,038	15,290	12,442
Comprehensive income (loss) attributable to noncontrolling interest	—	3	30	3
Comprehensive income (loss) attributable to Universal Electronics Inc.	$7,267	$2,035	$15,260	$12,439

See Notes 4 and 9 for further information concerning our purchases from related party vendors.
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UNIVERSAL ELECTRONICS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2016	2015
Cash provided by (used for) operating activities:		
Net income	$17,148	$19,838
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Depreciation and amortization	18,994	14,459
Provision for doubtful accounts	123	189
Provision for inventory write-downs	2,398	2,258
Deferred income taxes	1,413	(515)
Tax benefit from exercise of stock options and vested restricted stock	2,230	1,023
Excess tax benefit from stock-based compensation	(2,292)	(1,071)
Shares issued for employee benefit plan	763	734
Employee and director stock-based compensation	7,638	5,923
Performance-based warrant stock-based compensation	3,219	—
Changes in operating assets and liabilities:		
Restricted cash	—	(4,623)
Accounts receivable	(11,359)	(17,851)
Inventories	(4,470)	(20,261)
Prepaid expenses and other assets	(86)	426
Accounts payable and accrued expenses	7,699	21,821
Accrued income taxes	(4,737)	180
Net cash provided by (used for) operating activities	38,681	22,530
Cash used for investing activities:		
Acquisition of property, plant, and equipment	(28,914)	(26,376)
Acquisition of intangible assets	(1,373)	(1,877)
Increase in restricted cash	(4,797)	—
Deposit received toward sale of Guangzhou factory	4,797	—
Deconsolidation of Encore Controls LLC	48	—
Acquisition of net assets of Ecolink Intelligent Technology, Inc., net of cash acquired	—	(12,482)
Net cash used for investing activities	(30,239)	(40,735)
Cash provided by (used for) financing activities:		
Borrowings under line of credit	92,987	69,500
Repayments on line of credit	(107,987)	(22,500)
Proceeds from stock options exercised	4,813	1,648
Treasury stock purchased	(2,188)	(78,708)
Excess tax benefit from stock-based compensation	2,292	1,071
Net cash provided by (used for) financing activities	(10,083)	(28,989)
Effect of exchange rate changes on cash	(3,184)	(1,019)
Net increase (decrease) in cash and cash equivalents	(4,825)	(48,213)
Cash and cash equivalents at beginning of year	52,966	112,521
Cash and cash equivalents at end of period	$48,141	$64,308

Supplemental cash flow information:

Income taxes paid	$6,034	$3,922
Interest paid	$926	$68

See Notes 4 and 9 for further information concerning our purchases from related party vendors.
The accompanying notes are an integral part of these consolidated financial statements.

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UNIVERSAL ELECTRONICS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2016
(Unaudited)

Note 1 — Basis of Presentation and Significant Accounting Policies

In the opinion of management, the accompanying consolidated financial statements of Universal Electronics Inc. and its subsidiaries contain all the adjustments necessary for a fair presentation of financial position, results of operations and cash flows for the periods presented. All such adjustments are of a normal recurring nature. 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 ("U.S. GAAP"), have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. As used herein, the terms "Company," "we," "us," and "our" refer to Universal Electronics Inc. and its subsidiaries, unless the context indicates to the contrary.

Our results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Quantitative and Qualitative Disclosures About Market Risk," and the "Financial Statements and Supplementary Data" included in Items 1A, 7, 7A, and 8, respectively, of our Annual Report on Form 10-K for the year ended December 31, 2015.

Estimates, Judgments and Assumptions

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and assumptions, including those related to revenue recognition, allowances for sales returns and doubtful accounts, inventory valuation, our review for impairment of long-lived assets, intangible assets and goodwill, business combinations, income taxes, stock-based compensation expense and performance-based common stock warrants. Actual results may differ from these estimates and assumptions, and they may be adjusted as more information becomes available. Any adjustment may be material.

See Note 2 to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2015 for a summary of our significant accounting policies.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers", which will supersede most existing U.S. GAAP revenue recognition guidance. This new standard requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. In addition, ASU 2014-09 contains expanded disclosure requirements relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. ASU 2014-09 is effective for fiscal periods beginning after December 15, 2016 and permits the use of either the full retrospective or cumulative effect transition method. On July 9, 2015, the FASB postponed the effective date of the new revenue standard by one year; however, early adoption is permitted as of the original effective date. We do not plan to early adopt ASU 2014-09. We have not yet selected a transition method and are evaluating the impact that this new standard will have on our consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, "Customer's Accounting for Fees Paid in a Cloud Computing Arrangement," which amends Accounting Standards Codification ("ASC") 350, "Intangibles - Goodwill and Other". The amendments provide guidance as to whether a cloud computing arrangement includes a software license, and based on that determination, how to account for such arrangements. ASU 2015-05 is effective for fiscal periods beginning after December 15, 2015 and permits the use of either the prospective or retrospective transition method. The adoption of ASU 2015-05 did not have a material impact on our consolidated financial position or results of operations.

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory", which states that inventory should be measured at the lower of cost and net realizable value. Net realizable value is defined as estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. ASU 2015-11 is effective for fiscal periods beginning after December 15, 2016 and must be applied prospectively. Early adoption is permitted. We do not anticipate that the adoption of ASU 2015-11 will have a material impact on our consolidated financial position or results of operations.

In September 2015, the FASB issued ASU 2015-16, "Simplifying the Accounting for Measurement-period Adjustments." This new guidance requires an acquirer in a business combination to recognize adjustments to the provisional amounts that are identified during the measurement period to be reported in the period in which the adjustment amounts are determined. In addition, the effect on earnings of changes in depreciation, amortization and other items as a result of the change to the provisional amounts, calculated as if the accounting had been complete as of the acquisition date, must be recorded in the reporting period in which the adjustment amounts are determined. ASU 2015-16 is effective for fiscal periods beginning after December 15, 2015 and must be applied prospectively. The adoption of ASU 2015-16 did not have a material impact on our consolidated financial position or results of operations.

In November 2015, the FASB issued ASU 2015-17, "Balance Sheet Classification of Deferred Taxes." This new guidance requires all deferred tax assets and liabilities, along with any related valuation allowance, be classified as non-current on the balance sheet. ASU 2015-17 is effective for fiscal periods beginning after December 15, 2016 and may be adopted either prospectively or retrospectively. Early adoption is permitted. We have not yet selected a transition method and are currently evaluating the impact that ASU 2015-17 will have on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases", which changes the accounting for leases and requires expanded disclosures about leasing activities. This new guidance will require lessees to recognize a right of use asset and a lease liability at the commencement date for all leases with terms greater than twelve months. Accounting by lessors is largely unchanged. ASU 2016-02 is effective for fiscal periods beginning after December 15, 2018 and must be adopted using a modified retrospective approach. Early adoption is permitted. We are currently evaluating the impact that ASU 2016-02 will have on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09,"Improvements to Employee Share-Based Payment Accounting", which amends ASC 718, "Compensation - Stock Compensation". ASU 2016-09 is intended to simplify several aspects of the accounting for share-based payment transactions, including income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for fiscal periods beginning after December 15, 2016. Early adoption is permitted. We are currently evaluating the impact that ASU 2016-09 will have on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, "Classification of Certain Cash Receipts and Cash Payments", which amends ASC 230, "Statement of Cash Flows". This new guidance addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice in how certain transactions are classified in the statement of cash flows. ASU 2016-15 is effective for fiscal periods beginning after December 15, 2017 and must be adopted retrospectively. Early adoption is permitted as long as all amendments are adopted in the same period. We are currently evaluating the impact that ASU 2016-15 will have on our consolidated financial statements.

Note 2 — Cash and Cash Equivalents and Restricted Cash

Cash and Cash Equivalents

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

(In thousands)	September 30, 2016	December 31, 2015
United States	$ 3,499	$ 8,458
People's Republic of China ("PRC")	20,613	28,681
Asia (excluding the PRC)	5,486	5,346
Europe	15,289	8,093
South America	3,254	2,388
Total cash and cash equivalents	$ 48,141	$ 52,966

Restricted Cash

In connection with the court order issued on September 4, 2015, we placed $4.6 million of cash into a collateralized surety bond. This bond has certain restrictions for liquidation and has therefore been classified as restricted cash. Refer to Note 10 for further information about this ongoing litigation.

In connection with the pending sale of our Guangzhou factory in the PRC (Note 10), the buyer made a cash deposit of RMB 32 million ($4.8 million) into an escrow account on September 29, 2016. Under the terms of the escrow account, these funds will not be paid to us until the close of the sale. Accordingly, this deposit is presented as long-term restricted cash within our consolidated balance sheet.

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UNIVERSAL ELECTRONICS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2016
(Unaudited)

Note 3 — Accounts Receivable, Net and Revenue Concentrations

Accounts receivable, net were as follows:

(In thousands)	September 30, 2016	December 31, 2015
Trade receivables, gross	$ 131,229	$ 119,090
Allowance for doubtful accounts	(960)	(822)
Allowance for sales returns	(490)	(507)
Net trade receivables	129,779	117,761
Other	4,659	4,040
Accounts receivable, net	$ 134,438	$ 121,801

Allowance for Doubtful Accounts

Changes in the allowance for doubtful accounts were as follows:

(In thousands)	Nine Months Ended September 30,	
	2016	2015
Balance at beginning of period	$822	$616
Additions (reductions) to costs and expenses	123	189
(Write-offs)/Foreign exchange effects	15	(77)
Balance at end of period	$960	$728

Sales Returns

The allowance for sales returns at September 30, 2016 and December 31, 2015 included reserves for items returned prior to period-end that were not completely processed, and therefore had not yet been removed from the allowance for sales returns balance. If these returns had been fully processed, the allowance for sales returns balance would have been approximately $0.3 million and $0.3 million on September 30, 2016 and December 31, 2015, respectively. The value of these returned goods was included in our inventory balance at September 30, 2016 and December 31, 2015.

Significant Customers

Net sales to the following customers totaled more than 10% of our net sales:

	Three Months Ended September 30,			
	2016		2015	
	$ (thousands)	% of Net Sales	$ (thousands)	% of Net Sales
Comcast Corporation	$35,554	21.0 %	$42,675	26.6 %
DIRECTV	19,642	11.6	21,957	13.7

	Nine Months Ended September 30,			
	2016		2015	
	$ (thousands)	% of Net Sales	$ (thousands)	% of Net Sales
Comcast Corporation	$111,529	22.7 %	$88,633	20.1 %
DIRECTV	56,496	11.5	57,447	13.0

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UNIVERSAL ELECTRONICS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2016
(Unaudited)

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

	September 30, 2016		December 31, 2015	
	$ (thousands)	% of Accounts Receivable, Net	$ (thousands)	% of Accounts Receivable, Net
Comcast Corporation	$29,733	22.1 %	$29,404	24.1 %

Note 4 — Inventories, Net and Significant Supplier

Inventories, net were as follows:

(In thousands)	September 30, 2016	December 31, 2015
Raw materials	$ 36,289	$ 29,290
Components	18,362	12,228
Work in process	5,144	5,671
Finished goods	67,954	78,222
Reserve for excess and obsolete inventory	(3,658)	(3,045)
Inventories, net	$ 124,091	$ 122,366

Reserve for Excess and Obsolete Inventory

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

(In thousands)	Nine Months Ended September 30, 2016	2015
Balance at beginning of period	$3,045	$2,539
Additions charged to costs and expenses [1]	2,120	2,012
Sell through [2]	(781)	(774)
Write-offs/Foreign exchange effects	(726)	(1,201)
Balance at end of period	$3,658	$2,576

(1) The additions charged to costs and expenses do not include inventory directly written-off that was scrapped during production totaling $0.3 million and $0.2 million for the nine months ended September 30, 2016 and 2015, respectively. These amounts are production waste and are not included in management's reserve for excess and obsolete inventory.

(2) These amounts represent the reduction in reserves associated with inventory items that were sold during the period.

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UNIVERSAL ELECTRONICS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2016
(Unaudited)

Significant Supplier

We purchase integrated circuits, components and finished goods from multiple sources. Texas Instruments provided $12.4 million, or 13.0%, of total inventory purchases during the three months ended September 30, 2016 and $32.3 million, or 11.9%, of total inventory purchases during the nine months ended September 30, 2016.

Related Party Supplier

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

	Three Months Ended September 30,			
	2016		2015	
	$ (thousands)	% of Total Inventory Purchases	$ (thousands)	% of Total Inventory Purchases
Related party supplier	$1,382	1.5 %	$2,115	2.3 %

	Nine Months Ended September 30,			
	2016		2015	
	$ (thousands)	% of Total Inventory Purchases	$ (thousands)	% of Total Inventory Purchases
Related party supplier	$4,971	1.8 %	$6,566	2.6 %

Total accounts payable to this supplier were as follows:

	September 30, 2016		December 31, 2015	
	$ (thousands)	% of Accounts Payable	$ (thousands)	% of Accounts Payable
Related party supplier	$1,755	1.7 %	$2,361	2.5 %

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

Note 5 — Goodwill and Intangible Assets, Net

Goodwill

Changes in the carrying amount of goodwill were as follows:

(In thousands)	
Balance at December 31, 2015	$43,116
Foreign exchange effects	46
Balance at September 30, 2016	$43,162

Intangible Assets, Net

The components of intangible assets, net were as follows:

	September 30, 2016			December 31, 2015		
(In thousands)	Gross [(1)]	Accumulated Amortization [(1)]	Net	Gross [(1)]	Accumulated Amortization [(1)]	Net
Distribution rights	$322	$ (120)	$202	$312	$ (96)	$216
Patents	11,710	(4,671)	7,039	11,425	(4,737)	6,688
Trademarks and trade names	2,400	(1,245)	1,155	2,401	(1,053)	1,348
Developed and core technology	12,585	(3,564)	9,021	12,587	(2,144)	10,443
Capitalized software development costs	301	(160)	141	167	(97)	70
Customer relationships	27,700	(15,643)	12,057	27,715	(13,554)	14,161
Total intangible assets, net	$55,018	$ (25,403)	$29,615	$54,607	$ (21,681)	$32,926

(1) This table excludes the gross value of fully amortized intangible assets totaling $9.9 million and $9.0 million at September 30, 2016 and December 31, 2015, respectively.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2016	2015	2016	2015
Cost of sales	$21	$31	$63	$100
Selling, general and administrative expenses	1,551	1,187	4,618	3,206
Total amortization expense	$1,572	$1,218	$4,681	$3,306

Estimated future annual amortization expense related to our intangible assets at September 30, 2016, is as follows:

(In thousands)	
2016 (remaining 3 months)	$1,594
2017	6,348
2018	6,313
2019	6,249
2020	5,159
Thereafter	3,952
Total	$29,615

Note 6 — Line of Credit

On September 16, 2016, we extended the term of our Amended and Restated Credit Agreement ("Amended Credit Agreement") with U.S. Bank National Association ("U.S. Bank") to November 1, 2018. The Amended Credit Agreement provides for an $85.0 million line of credit ("Credit Line") that may be used for working capital and other general corporate purposes including acquisitions, share repurchases and capital expenditures. Amounts available for borrowing under the Credit Line are reduced by the balance of any outstanding letters of credit, of which there were $13 thousand at September 30, 2016.

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

Under the Amended Credit Agreement, we may elect to pay interest on the Credit Line based on LIBOR plus an applicable margin (varying from 1.25% to 1.75%) or base rate (based on the prime rate of U.S. Bank or as otherwise specified in the Amended Credit

Agreement) plus an applicable margin (varying from 0.00% to 0.50%). The applicable margins are calculated quarterly and vary based on our cash flow leverage ratio as set forth in the Amended Credit Agreement. The interest rate in effect at September 30, 2016 was 1.77%. There are no commitment fees or unused line fees under the Amended Credit Agreement.

The Amended Credit Agreement includes financial covenants requiring a minimum fixed charge coverage ratio and a maximum cash flow leverage ratio. In addition, the Amended Credit Agreement also contains other customary affirmative and negative covenants and events of default. As of September 30, 2016, we were in compliance with the covenants and conditions of the Amended Credit Agreement.

At September 30, 2016, we had $35.0 million outstanding under the Credit Line. Our total interest expense on borrowings was $0.3 million and $0.1 million during the three months ended September 30, 2016 and 2015, respectively. Our total interest expense on borrowings was $0.9 million and $0.1 million during the nine months ended September 30, 2016 and 2015, respectively.

Note 7 — Income Taxes

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

We recorded income tax expense of $0.4 million and $2.2 million for the three months ended September 30, 2016 and 2015, respectively. Our effective tax rate was 5.1% and 25.8% during the three months ended September 30, 2016 and 2015, respectively. Our effective tax rate was lower in the current year period primarily due to the recording of $1.8 million in tax refunds during the three months ended September 30, 2016, of which $1.4 million related to tax incentives in China for 2015 and $0.4 million related to certain deductible research and development expenses incurred in China during 2015. This impact was partially offset by the recording of a $0.7 million decrease to the carrying value of certain deferred tax assets to reflect the lower statutory tax rate that will be applied as a result of tax incentives at one of our China manufacturing facilities.

We recorded income tax expense of $3.0 million and $5.6 million for the nine months ended September 30, 2016 and 2015, respectively. Our effective tax rate was 14.7% and 22.1% during the nine months ended September 30, 2016 and 2015, respectively. Our effective tax rate was lower in the current year period primarily due to (a) the recording of an additional $1.3 million in tax refunds during the nine months ended September 30, 2016, of which $0.9 million related to tax incentives in China for previous tax years and $0.4 million related to certain deductible research and development expenses incurred in China during 2015; and (b) lower tax rates in certain jurisdictions within China due to local tax incentives. These impacts were partially offset by the recording of a $0.7 million decrease to the carrying value of certain deferred tax assets to reflect the lower statutory tax rate that will be applied as a result of tax incentives at one of our China manufacturing facilities.

At September 30, 2016, we had gross unrecognized tax benefits of $3.7 million, including interest and penalties, of which $2.1 million would affect the annual effective tax rate if these tax benefits are realized. Further, we are unaware of any positions for which it is reasonably possible that the total amount of unrecognized tax benefits will significantly change within the next twelve months. However, based on federal, state and foreign statute expirations in various jurisdictions, we anticipate a decrease in unrecognized tax benefits of approximately $0.1 million within the next twelve months. We have classified uncertain tax positions as non-current income tax liabilities unless expected to be paid within one year.

We have elected to classify interest and penalties as a component of tax expense. Accrued interest and penalties of $0.3 million and $0.2 million at September 30, 2016 and December 31, 2015, respectively, are included in our unrecognized tax benefits.

We file income tax returns in the U.S. federal jurisdiction, and in various state and foreign jurisdictions. On September 30, 2016, the open statutes of limitations in our significant tax jurisdictions were as follows: federal 2013 through 2015, state 2011 through 2015, and foreign 2009 through 2015.

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Note 8 — Accrued Compensation

The components of accrued compensation were as follows:

(In thousands)	September 30, 2016	December 31, 2015
Accrued social insurance [(1)]	$ 18,262	$ 18,923
Accrued salary/wages	6,283	7,549
Accrued vacation/holiday	2,653	2,227
Accrued bonus [(2)]	2,939	5,914
Accrued commission	751	1,084
Accrued medical insurance claims	122	218
Other accrued compensation	1,396	1,537
Total accrued compensation	$ 32,406	$ 37,452

(1) Effective January 1, 2008, the Chinese Labor Contract Law was enacted in the PRC. This law mandated that PRC employers remit the applicable social insurance payments to their local government. Social insurance is comprised of various components such as pension, medical insurance, job injury insurance, unemployment insurance, and a housing assistance fund, and is administered in a manner similar to social security in the United States. This amount represents our estimate of the amounts due to the PRC government for social insurance on September 30, 2016 and December 31, 2015.

(2) Accrued bonus includes an accrual for an extra month of salary ("13th month salary") to be paid to employees in certain geographies where it is the customary business practice. This 13th month salary is paid to these employees if they remain employed with us through December 31st. The total accrued for the 13th month salary was $0.7 million and $0.7 million at September 30, 2016 and December 31, 2015, respectively.

Note 9 — Other Accrued Expenses

The components of other accrued expenses were as follows:

(In thousands)	September 30, 2016	December 31, 2015
Advertising and marketing	$ 238	$ 191
Deferred revenue	1,451	1,434
Duties	803	1,318
Freight and handling fees	2,459	1,942
Product development	390	630
Product warranty claim costs	135	35
Professional fees	1,528	1,714
Property, plant, and equipment	1,350	551
Sales taxes and VAT	2,730	3,170
Third-party commissions	801	585
Tooling [(1)]	1,449	1,173
Unrealized loss on foreign currency exchange contracts	186	1,164
URC settlement accrual (Notes 2 and 10)	6,618	4,629
Utilities	398	278
Other	2,752	2,652
Total other accrued expenses	$ 23,288	$ 21,466

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

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Related Party Vendor
We have obtained certain engineering support services for our India subsidiary from JAP Techno Solutions ("JAP"). The owner of JAP is the spouse of the managing director of our India operations. Total fees paid to JAP for the three and nine months ended September 30, 2015 were $25 thousand and $77 thousand, respectively. No amounts were paid to this vendor during the nine months ended September 30, 2016.
Note 10 — Commitments and Contingencies
Product Warranties
Changes in the liability for product warranty claim costs were as follows:

(In thousands)	Nine Months Ended September 30,	
	2016	2015
Balance at beginning of period	$35	$353
Accruals for warranties issued during the period	100	12
Settlements (in cash or in kind) during the period	—	(329)
Balance at end of period	$135	$36

Restructuring Activities and Sale of Guangzhou Factory
In the first quarter of 2016, we implemented a plan to reduce our manufacturing costs by transitioning manufacturing activities from our southern-most China factory, located in the city of Guangzhou in the Guangdong province, to our other three China factories where labor rates are lower. As a result, we incurred severance costs of $0.1 million and $1.6 million during the three and nine months ended September 30, 2016, which are included within selling, general and administrative expenses. We expect to incur additional severance costs of approximately $10 million as we continue to execute this transition over the next 12-15 months. Because severance costs relate to involuntary terminations, we record the related liability at the communication date. At September 30, 2016, we had $0.1 million of unpaid severance costs included within accrued compensation.
On September 26, 2016, we entered into an agreement to sell our Guangzhou manufacturing facility for RMB 320 million (approximately $48 million). Under the terms of this agreement, we have up to 24 months to cease all operations within the facility. The closing of the sale will be subject to customary due diligence and local regulatory approval and is expected to be completed within approximately 28 months from the execution of the agreement. In accordance with the terms of the agreement, the buyer deposited 10% of the purchase price into an escrow account at agreement inception, which we have presented as long-term restricted cash in our consolidated balance sheet (also refer to Note 2). The remaining balance of the purchase price is to be placed into the escrow account prior to the closing of the sale and will be released to us upon closing.
Litigation

On June 28, 2016, in connection with previously disclosed litigation matters, we entered into a confidential agreement in principal with Universal Remote Control, Inc. (“URC”), Ohsung Electronics Co., Ltd., and Ohsung Electronics USA, Inc. (collectively the “URC Parties”) to settle all litigation matters (including the malicious prosecution litigation described below) between us and the URC Parties. By and during the term of this agreement, we and the URC Parties will dismiss all litigation matters and appeals. While the terms of this agreement in principal are confidential, the $4.6 million surety bond previously placed by us in connection with these litigation matters will be released to URC. Additionally, the URC Parties will receive a limited paid up license to the technologies covered by the patents in this litigation and a limited covenant not to sue with respect to certain of URC's products existing as of the settlement date. We expect to finalize the definitive settlement agreement and other documents in the near future. Thus, during the nine months ended September 30, 2016, we recorded $2.0 million of estimated litigation settlement costs within selling, general and administrative expenses. While we have been negotiating the settlement agreement and other documents, the underlying litigation with respect to the second litigation matter we filed against URC (Universal Electronics Inc. v. Universal Remote Control, Inc., SACV13-00987 JAK (SHx)) has been stayed with a status conference set for November 14, 2016. In addition, on October 17, 2016, the United States Court of Appeals for the Federal Circuit15-1410-CB Universal Electronics, Inc. v. Universal

Remote Control, Inc. "Opinion filed" (8:12-cv-00329-AG-JPR) ruled in our favor denying URC’s appeal of the lower court’s ruling in the first litigation matter we filed against URC in which URC sought to obtain more attorney fees and costs.

On April 28, 2016, URC filed a malicious prosecution lawsuit against us in the Superior Court of California, County of Orange (Universal Remote Control, Inc. v. Universal Electronics Inc., 30-2016-00849239-CU-BT-CJC) seeking additional monetary damages against us in connection with the litigation matters we filed against them. This lawsuit has been stayed while we have been negotiating a settlement of all our disputes (see discussion above). Further, we believe that this action by URC is without merit, and we have denied all of URC’s allegations and should we not settle all of our disputes (including this one), we intend to vigorously defend against this lawsuit.

On or about June 10, 2015, FM Marketing GmbH ("FMH") and Ruwido Austria GmbH ("Ruwido"), filed a Summons in Summary Proceedings in Belgium court against one of our subsidiaries, Universal Electronics BV ("UEBV") and one of its customers, Telenet N.V. ("Telenet"), claiming that one of the products UEBV supplies Telenet violates two design patents and one utility patent owned by FMH and/or Ruwido. By this summons, FMH and Ruwido sought to enjoin Telenet and UEBV from continued distribution and use of the products at issue. After the September 29, 2015 hearing, the Court issued its ruling in our and Telenet’s favor, rejecting FMH and Ruwido’s request entirely. On October 22, 2015, Ruwido filed its notice of appeal in this ruling. The parties have fully briefed the appeal and on February 15, 2016, the appellate court heard oral arguments. While awaiting the appellate court’s ruling, we requested and received permission to submit additional filings in support of our position. As such, the court set a new date for all new filings to be submitted and set a status conference for January 2017. In addition, in September 2015, UEBV filed an Opposition with the European Patent Office seeking to invalidate the one utility patent asserted against UEBV and Telenet by Ruwido. The hearing on this opposition has been set for July 2017. Finally, on or about February 9, 2016, Ruwido filed a writ of summons for proceeding on the merits with respect to asserted patents. UEBV and Telenet have replied, denying all of Ruwido's allegations and we intend to vigorously defend against these claims with the hearing on this matter set for February 2017.

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

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

Note 11 — Treasury Stock

From time to time, our Board of Directors authorizes management to repurchase shares of our issued and outstanding common stock on the open market. Repurchases may be made to manage dilution created by shares issued under our stock incentive plans or whenever we deem a repurchase is a good use of our cash and the price to be paid is at or below a threshold approved by our Board. As of September 30, 2016, we had 375,000 shares available for repurchase on the open market under the Board's authorizations. On November 2, 2016, our Board increased these repurchase authorizations by 125,000 shares bringing the total authorization as of the approval date to