ELECTRONIC SYSTEMS TECHNOLOGY INC
Form 10-Q
November 19, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **September 30, 2012**

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

From ________________ to ________________

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

(Exact name of registrant as specified in its charter)

Washington	**000-27793**	**91-1238077**
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

415 N. Quay St. Bldg B1 Kennewick WA	**99336**
(Address of principal executive offices)	(Zip Code)

(509) 735-9092

(Registrant's telephone number, including area code)

N/A

(Former name, former address & former fiscal year, if changed since last report

Indicate by check mark whether the registrant (1) has filed all documents and reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filings for the past 90 days. YES x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every 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 x 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.

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

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

Yes ¨ No x

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of November 1, 2012, the number of the Company's shares of common stock par value $0.001 outstanding was 5,158,667.

1

FORM 10-Q

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

BALANCE SHEETS

(as prepared by Management)

	September 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Current assets		
Cash and cash equivalents	$ 728,446	$ 1,227,490
Short term certificate of deposit investments	1,407,000	1,033,000
Accounts receivable, net of allowance for uncollectables	160,840	104,166
Inventories	521,528	471,314
Federal income tax receivable	11,909	47,663
Prepaid expenses	59,035	29,694
Deferred income tax asset	56,100	54,000
Total current assets	2,944,858	2,967,327
Property & equipment, net of depreciation	45,836	54,358
Vendor deposits	35,980	1,675
Total assets	$ 3,026,674	$ 3,023,360
LIABILITIES & STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 58,921	$ 16,104
Accrued liabilities	37,558	34,707
Refundable deposits	48,094	49,303
Total current liabilities	144,573	100,114
Deferred income tax liability	6,200	7,800
Total liabilities	150,773	107,914

Stockholders equity				
Common stock, $0.001 par value 50,000,000 shares authorized				
5,158,667 shares issued and outstanding		5,159		5,159
Additional paid-in capital		1,003,903		1,001,648
Retained earnings		1,866,839		1,908,639
Total stockholders equity		2,875,901		2,915,446
Total liabilities and stockholders equity	$	3,026,674	$	3,023,360

(See "Notes to Financial Statements")

3

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

STATEMENTS OF OPERATIONS

(as prepared by Management)

(Unaudited)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Revenue:				
Sales	$ 551,205	$ 487,161	$ 1,460,944	$ 1,332,765
Cost of sales	233,796	234,236	654,155	598,708
Gross Profit	317,409	252,925	806,789	734,057
Operating expenses				
General and administrative	66,419	64,999	220,147	220,663
Research and development	55,210	70,600	203,248	207,025
Marketing	110,049	123,946	353,792	407,824
Customer service	28,756	26,438	92,313	84,593
Total operating expense	260,434	285,983	869,500	920,105
Operating income (loss)	56,975	(33,058)	(62,711)	(186,048)
Other income				
Uncollectible amounts recovered	--	--	--	4,166
Interest income	1,830	2,177	5,302	7,536
Total other income	1,830	2,177	5,302	11,702
Income (loss) before income tax	58,805	(30,881)	(57,409)	(174,346)
(Provision) benefit for income tax	(22,090)	10,800	15,609	48,700
Net income (loss)	$ 36,715	$ (20,081)	$ (41,800)	$ (125,646)
Basic and diluted earnings (loss) per share	$ 0.01	$ (0.00)	$ (0.01)	$ (0.02)
Weighted average shares used in computing net income (loss) per share:				
Basic and diluted	5,158,667	5,158,667	5,158,667	5,158,667

(See "Notes to Financial Statements")

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

STATEMENTS OF CASH FLOWS

(as prepared by Management)

(Unaudited)

	Nine Months Ended September 30, 2012	2011
Cash flows provided (used) in operating activities:		
Net income (loss)	$ (41,800)	$ (125,646)
Noncash items included in income:		
Depreciation	11,401	16,250
Deferred income tax	(3,700)	9,300
Share based compensation	2,255	2,565
Change in:		
Accounts receivable net	(56,674)	17,199
Inventory	(50,214)	(52,454)
Prepaid expenses	(29,341)	(25,754)
Vendor deposits	(34,305)	(40,193)
Federal income taxes receivable	35,754	(58,000)
Accounts payable and accrued liabilities	45,668	(23,258)
Refundable deposits	(1,209)	165
Accrued federal income taxes	--	(77,171)
Net cash flows provided (used) in operating activities	(122,165)	(316,804)
Cash flows provided (used) in investing activities:		
Certificates of deposit redeemed (purchased)	(374,000)	171,000
Additions to property and equipment	(2,879)	(32,059)
Net cash flows provided (used) in investing activities	(376,879)	138,941
Cash flows provided (used) in financing activities:		
Cash distribution to shareholders	--	(51,587)

Net cash flows provided (used) in financing activities	--	(91,780)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(499,044)	(269,643)
Cash and cash equivalents at beginning of period	1,227,490	1,133,720
Cash and cash equivalents at ending of period	$ 728,446	$ 864,077

(See "Notes to Financial Statements)

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

NOTES TO FINANCIAL STATEMENTS

(as prepared by Management)

(Unaudited)

NOTE 1 - BASIS OF PRESENTATION

The financial statements of Electronic Systems Technology, Inc. (the Company), presented in this Form 10-Q are unaudited and reflect, in the opinion of Management, a fair presentation of operations for the three and nine month periods ended September 30, 2012 and September 30, 2011. All adjustments of a normal recurring nature and necessary for a fair presentation of the results for the periods covered have been made. Certain information and footnote disclosure normally included in financial statements prepared in accordance with generally accepted accounting principals have been condensed or omitted pursuant to the applicable rules and regulations of the Securities and Exchange Commission. In preparation of the financial statements, certain amounts and balances have been restated from previously filed reports to conform to the format of this quarterly presentation. These financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2011, as filed with Securities and Exchange Commission.

The results of operations for the three and nine month periods ended September 30, 2012, are not necessarily indicative of the results expected for the full fiscal year or for any other fiscal period.

NOTE 2 - INVENTORIES

Inventories are stated at lower of direct cost or market with cost determined using the FIFO (first in, first out) method. Inventories consist of the following:

	September 30, 2012	December 31, 2011
Parts	$301,605	$228,012
Work in progress	104,154	74,992
Finished goods	115,769	168,310

Total Inventory	$521,528	$471,314

NOTE 3 EARNINGS (LOSS) PER SHARE (EPS)

Basic EPS excludes dilution and is computed by dividing income (loss) available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects potential dilution occurring if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. At September 30, 2012 the Company had 610,000 outstanding stock options that could have a dilutive effect on future periods.

NOTE 4 - STOCK OPTIONS

As of September 30, 2012, the Company had outstanding stock options, which have been granted periodically to individual employees and directors with no less than three years of continuous tenure with the Company. On February 10, 2012, additional stock options to purchase shares of the Company's common stock were granted to individual employees and directors with no less than three years continuous tenure. The options granted on February 10, 2012 totaled 220,000 shares under option and have an exercise price of $0.37 per share.

The options granted on February 10, 2012 may be exercised any time during the period from February 10, 2012 through February 9, 2015. The Company's Form 8-K filed February 3, 2012, is incorporated herein by reference. All outstanding stock options must be exercised within 90 days after termination of employment.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

NOTES TO FINANCIAL STATEMENTS

(as prepared by Management)

(Unaudited)

NOTE 4 - STOCK OPTIONS, Continued:

The fair value of each option award is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in:

	2012	2011
Dividend yield	2.70%	0.00%
Expected volatility	68%	74%
Risk-free interest rate	0.36%	1.40%
Expected term (in years)	3	3
Estimated Fair Value per Option Granted	$0.145	$0.21

The Company uses historical data to estimate option exercise rates. The option exercise rate for option grants in 2011 through 2005 was 7.07%.

A summary of option activity during the nine months ended September 30, 2012, is as follows:

	Number Outstanding	Weighted-Average Exercise Price Per Share
Outstanding at December 31, 2011	590,000	$0.40
Granted	220,000	0.37
Exercised	--	--
Canceled	(200,000)	0.32
Outstanding at September 30, 2012	610,000	$ 0.43

NOTE 5 - RELATED PARTY TRANSACTIONS

For the three and nine-month period ended September 30, 2012 services in the amount of $18,330 and $71,883 respectively were contracted with Manufacturing Services, Inc., of which the current owner, Michael S. Brown and the former owner, Melvin H. Brown, are both currently members of the Board of Directors of Electronic Systems Technology Inc.

NOTE 6   SEGMENT REPORTING

Segment information is prepared on the same basis that the Company's management reviews financial information for operational decision making purposes. The Company has two reportable segments, domestic and foreign, based on the geographic location of the customers. Both segments sell radio modem products (requiring an FCC license or license free Ethernet products), related accessories for radio modem products for industrial automation projects, and mobile data computer products. The foreign segment sells the Company's products and services outside the United States.

During the quarter ended September 30, 2012, Domestic customers represented approximately 77% of total sales. Foreign customers represented approximately 23% of total sales. Sales to one customer, accounted for more than 10% of the Company s sales revenues for the quarter ended September 30, 2012. No other sales to a single customer comprised 10% or more of the Company's sales revenues for the quarter ended September 30, 2012. Revenues from foreign countries consisted primarily of revenues from Peru, Croatia, Columbia and Mexico.

During the first nine months of 2012, Domestic customers represented approximately 77% of total net revenues. Foreign customers represented approximately 23% of total net revenues. No single customer comprised more than 10% of sales revenues for the first nine months of 2012. Revenues from foreign countries during the nine months of 2012 consist primarily of revenues from product sales to Mexico, Columbia, Canada and Peru.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

NOTES TO FINANCIAL STATEMENTS

(as prepared by Management)

(Unaudited)

NOTE 6 SEGMENT REPORTING, Continued:

Management evaluates performance based on net revenues and operating expenses. Administrative functions such as finance and information systems are centralized. Where applicable, portions of the administrative function expenses are allocated between the operating segments. The operating segments share the same manufacturing and distributing facilities. Costs of operating the manufacturing plant, equipment, inventory, and accounts receivable are allocated directly to each segment.

Summary financial information for the three reportable segments for the third quarter and the first nine months of 2012 and 2011 is as follows:

	Domestic	Foreign	Unallocated Corporate	Total
Three months ended September 30, 2012				
Total sales	$423,307	$127,898	$ -	$551,205
Total other income	1,830	-	-	1,830
Earnings (loss) before tax	73,744	51,481	(66,420)	58,805
Depreciation	3,471	-	364	3,385
Identifiable assets	696,461	48,315	2,281,898	3,026,674
Net capital expenditures	433	-	2,446	2,879
Three months ended September 30, 2011				
Total sales	$357,895	$129,266	$ -	$487,161
Total other income	2,177	-	-	2,177
Earnings (loss) before tax	(11,619)	45,737	(64,999)	(30,881)
Depreciation	5,105	-	600	5,705
Identifiable assets	581,460	66	2,418,472	2,999,998

Net capital expenditures	2,160	-	-	2,160
Nine months ended September 30, 2012				
Total sales	$1,122,889	$338,055	$ -	$1,460,944
Total other income	5,302	-	-	5,302
Earnings (loss) before tax	65,403	97,335	(220,147)	(57,409)
Depreciation	10,412	-	989	11,401
Identifiable assets	696,461	48,315	2,281,898	3,026,674
Net capital expenditures	433	-	2,446	2,879
Nine months ended September 30, 2011				
Total sales	$843,719	$489,046	$ -	$1,332,765
Total other income	7,536	-	4,166	11,702
Earnings (loss) before tax	(141,875)	188,192	(220,663)	(174,346)
Depreciation	14,478	-	1,772	16,250
Identifiable assets	581,460	66	2,418,472	2,999,998
Net capital expenditures	32,059	-	-	32,059

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

Management s discussion and analysis is intended to be read in conjunction with the company s unaudited financial statements and the integral notes thereto for the quarter ending September 30, 2012. The following statements may be forward looking in nature and actual results may differ materially.

A.

RESULTS OF OPERATIONS

REVENUES:

Total revenues from the sale of the Company s ESTeem wireless modem systems, accessories, and services increased to $551,205 for the third quarter of 2012 as compared to $487,161 in the third quarter of 2011. As of September 30, 2012, year to date sales increased to $1,460,944 as compared to $1,332,765 as of September 30, 2011. Management believes the increase in quarterly and year to date sales revenues is due to increased orders received for all domestic market segments including industrial automation. Management believes the continued fragile economic recovery in the United States has resulted in delayed or canceled funding of projects involving the Company s products, however Q3 results show a modest improvement of the macro economic conditions that impact the core business. Management believes the fragile economic situation in the United States will continue to make sales revenues difficult to predict and prone to potential fluctuation.

The Company's revenues have historically fluctuated from quarter to quarter due to timing factors such as customer order placement and product shipments to customers, as well as customer buying trends, and changes in the general economic environment. The procurement process regarding plant and project automation, or project development, which usually surrounds the decision to purchase ESTeem products, can be lengthy. This procurement process may involve bid activities unrelated to the ESTeem products, such as additional systems and subcontract work, as well as capital budget considerations on the part of the customer. Because of the complexity of this procurement process, forecasts in regard to the Company's revenues become difficult to predict.

A percentage breakdown of EST's Domestic and Export Sales, for the third quarter of 2012 and 2011 are as follows:

	For the third quarter of	
	2012	2011
Domestic Sales	77%	73%
Export Sales	23%	27%

OPERATING SEGMENTS

Segment information is prepared on the same basis that the Company s Management reviews financial information for operational decision-making purposes. The Company s operating segment information is contained in Financial Statements, Notes to Financial Statements, Note 6 Segment Reporting .

Domestic Revenues

During the quarter ended September 30, 2012, the Company s domestic operations represented 77% of the Company s total net revenues. Domestic operations sell ESTeem modem products, accessories and service primarily through domestic resellers, as well as directly to end users of the Company s products. Domestic sales revenues increased to $423,307 for the quarter ended September 30, 2012, compared to $357,895 for the quarter ended September 30, 2011.

Industrial Networking Solutions a domestic customer comprised more than 10% of the Company's sales revenues for the quarter ended September 30, 2012.

Domestic segment operating income was $73,744 for the quarter ended September 30, 2012 as compared with a segment operating loss of $11,619 for the same quarter of 2011, due to increased sales revenues and flat expenses for the segment during the third quarter of 2012.

For the nine-month period ended September 30, 2012, the Company s domestic operations represented 77% of the Company s total net revenues. Year to date domestic sales revenues increased to $1,122,889 as of September 30, 2012, compared to $843,719 for the same period of 2011. Management believes the increase in quarterly sales revenues is due to improved macro economic conditions for its domestic customer base Management believes the continued fragile economic recovery in the United States will continue to make sales revenues difficult to predict and prone to potential fluctuation.

The domestic segment recorded operating income of $65,403 for the nine month period ended September 30, 2012 as compared with a segment an operating loss of $141,875 for the same period of 2011. The increase in profitability is due to increased sales revenues and managed expenses for the segment during the first nine months of 2012.

Foreign Revenues

The Company s foreign operating segment represented 23% of the Company s total sales for the quarter ended September 30, 2012. The foreign operating segment is based wholly in the United States and maintains no assets outside of the United States. The foreign operating segment sells ESTeem modem products, accessories and service primarily through foreign resellers, as well as directly to end use customers of the Company s products located outside the United States.

During the quarter ended September 30, 2012, the Company had $127,898 in foreign export sales, amounting to 23% of total sales of the Company for the quarter, compared with foreign export sales of $129,266 for the same quarter of 2011. Management believes the slight decrease in foreign sales revenues is due to reduced demand for industrial automation projects using the Company s products in Latin America. Revenues from foreign countries consisted primarily of revenues from Peru, Croatia, Colombia and Mexico. Products purchased by foreign customers were used primarily in industrial automation applications. No one foreign customer accounted for 10% of the Company s sales revenues for the quarter ended September 30, 2012.

Operating income for the foreign segment increased to $51,481 for the quarter ended September 30, 2012 as compared with an operating income of $45,737 for the same period of 2011 due to managed expenses for flat sales revenues for the segment.

For the nine-month period ended September 30, 2012, the Company had $338,055 in foreign export sales, amounting to 23% of total net revenues of the Company for the period, compared with foreign export sales of $489,046 for the same period of 2011. We believe the year to date decrease in foreign sales revenues is due to decreased orders for industrial automation and communication backbone applications in the Peru, Colombia, Morocco, Mexico and Canada, caused by continued stagnant economic conditions. Management believes the majority of foreign export sales are the result of the Company s Latin American sales staff, EST foreign reseller activity, and the Company s internet website presence.

Year to date foreign segment operating income decreased to $97,335 for the period ended September 30, 2012 as compared with a segment operating income of $188,192 for the same period of 2011, due to decreased year to date sales revenues.

Unallocated Corporate

Unallocated corporate expenses relate to functions, such as accounting, corporate management and administration that support but are not attributable to the Company s domestic or foreign operating segments, including salaries, wages and other expenses related to the performance of these support functions. Unallocated corporate expenses increased during the quarter ended September 30, 2012 to $66,419 as compared with $64,999 for the same quarter of 2011, and represented expense to total sales revenue percentages of 12% and 13% for the third quarters of 2012 and 2011, respectively.

Year to date unallocated corporate expenses increased for the period ended September 30, 2012 to $220,147 as compared with $220,663 for the same period of 2011 and represented expense to total sales revenue percentages of 15% and 17% for the first nine months of 2012 and 2011, respectively.

BACKLOG:

The Company had minimal backlog as of September 30, 2012. Customers generally place orders on an as needed basis . Shipment for most of the Company s products is generally made within 1 to 15 working days after receipt of customer orders, with the exception of ongoing, scheduled projects, and custom designed equipment.

COST OF SALES:

Cost of sales percentages of gross sales for the third quarters of 2012 and 2011 were 42% and 48%, respectively. The cost of sales decrease for the third quarter of 2012 is the result the product mix for items sold during the quarter having a mor favorable profit margin.

OPERATING EXPENSES:

Operating expenses for the third quarter of 2012 decreased $25,549 when compared with the third quarter of 2011. The following is a delineation of operating expenses:

For the quarter ended:	September 30,	September 30,	
	2012	2011	Increase(Decrease)
General and Administrative	$ 66,419	$ 64,999	$ 1,420
Research and Development	55,210	70,600	(15,390)
Marketing	110,049	123,946	(13,897)
Customer Service	28,756	26,438	2,318
Total Operating Expenses	$ 260,434	$ 285,983	$ (25,549)

GENERAL AND ADMINISTRATIVE:

During the third quarter of 2012 General and Administrative expenses increased $1,420 when compared with the third quarter of 2011 due to increased department wages.

RESEARCH AND DEVELOPMENT:

During the third quarter of 2012, Research and Development expenses decreased $15,390 when compared with the third quarter of 2011. The decrease is due to decreased subcontracted engineering expertise and research and development related wages when compared with the same period of 2011.

MARKETING:

Marketing expenses decreased $13,897, during the third quarter of 2012 when compared with the third quarter of 2011 due to decreased marketing related wages, trade show and travel expenses.

CUSTOMER SERVICE:

Customer service expenses for the third quarter of 2012 increased $2,318, when compared with the third quarter of 2011 due to a increased amount of engineering and customer support services being billed directly to customers.

INTEREST AND INVESTMENT INCOME:

The Company earned $1,830 in investment and interest income for the quarter ended September 30, 2012. Sources of this income were money market accounts and certificates of deposit.

NET INCOME (LOSS):

The Company recorded net income of $36,715 for the third quarter of 2012, compared to a net loss of $20,081 for the third quarter of 2011. The increased in profitability is the result of increased sales revenues and decreased expenses during the third quarter of 2012 when compared with the third quarter of 2011. Year to date, the Company has a net loss of $41,800 for the nine months ended September 30, 2012, compared with a net loss of $125,646 for the same period of 2011. The increase in the Company s year to date profitability is the result of increased sales revenues and decreased expenses during the first nine months of 2012 when compared with the same period of 2011.

B. Financial Condition, Liquidity and Capital Resources

The Corporation's current asset to current liabilities ratio at September 30, 2012 was 20.0:1 compared to 29.1:1 at December 31, 2011. At September 30, 2012, the Company had cash and cash equivalent holdings of $728,446 as compared to cash and cash equivalent holdings of $1,227,490 at December 31, 2011. The Company had certificates of deposit investments in the amount of $1,407,000 as of September 30, 2012 as compared to $1,033,000 as of December 31, 2011, due to timing differences in certificate of deposit maturities and cash requirements of the Company.

Accounts receivable, net increased to $160,840 as of September 30, 2012, from December 31, 2011 levels of $104,166, due to sales revenues and collections timing differences. Inventory increased to $521,528 at September 30, 2012, from December 31, 2011 levels of $471,314, due to increased product sales during the first nine months of 2012. The Company's fixed assets, net of depreciation, decreased to $45,836 as of September 30, 2012, from December 31, 2011 levels of $54,358 due capital expenditures of $2,879 for research related test equipment and by depreciation of $11,401. Prepaid expenses increased to $59,035 as of September 30, 2012 from December 31, 2011 amounts of $29,694 due to recent renewal of annual insurance policies, Netsuite network services, and prepaid tradeshow and travel expenses. For the quarter ending September 30, 2012 the Company paid deposits to vendors providing long lead time, off-shore inventory in the amount of $35,980, which is included in vendor deposits on the Company s balance sheets.

Since January 1, 2005, the Company has contracted with Netsuite Inc. to provide the Company s customer relationship management and accounting software and related network infrastructure services. The prepaid Netsuite Inc. services as of September 30, 2012 are reflected in prepaid expenses on the Company s balance sheet in the amount of $26,807.

As of September 30, 2012, the Company s trade accounts payable balance was $58,921 as compared with $16,104 at December 31, 2011, and reflects amounts owed for purchases of inventory items and contracted services. Accrued liabilities as of September 30, 2012 were $37,558, compared with $34,707 at December 31, 2011, and reflect items such as accrued vacation benefits, and quarterly payroll and excise tax liabilities. Federal income tax receivable as of September 30, 2012 decreased to $11,909 compared with federal income tax receivable of $47,663 at December 31, 2011 due to increased profitability during the first nine months of 2012.

It is Management s opinion the Company s cash, cash equivalent reserves, and working capital at September 30, 2012 are sufficient to satisfy requirements for operations, capital expenditures, and other expenditures as may arise in the short term.

FORWARD LOOKING STATEMENTS: The above discussion may contain forward looking statements that involve a number of risks and uncertainties. In addition to the factors discussed above, among other factors that could cause actual results to differ materially are the following: competitive factors such as rival wireless architectures and price pressures; availability of third party component products at reasonable prices; inventory risks due to shifts in market demand and/or price erosion of purchased components; change in product mix, and risk factors that are listed in the Company s reports and registration statements filed with the Securities and Exchange Commission.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There is no established market for trading the common stock of the Company. The market for the Company s common stock is limited, and as such shareholders may have difficulty reselling their shares when desired or at attractive market prices. Our Common Stock is not regularly quoted in the automated quotation system of a registered securities system or association. The Common Stock is quoted on the OTC Markets Group Qdiv>

(1) The Underlying Return excludes any cash dividend payments.
(2) The “total return” is the number, expressed as a percentage, that results from comparing the payment at maturity per $10 principal amount Security to the purchase price of $10 per Security.

8

What Are the Tax Consequences of the Securities?

U.S. Federal Income Tax Consequences

Set forth below, together with the discussion of U.S. federal income tax in the accompanying product prospectus supplement, prospectus supplement, and prospectus, is a summary of the material U.S. federal income tax consequences relating to an investment in the Securities. The following summary supplements and to the extent inconsistent with supersedes the discussion under the section entitled “Supplemental Discussion of U.S. Federal Income Tax Consequences” in the accompanying product prospectus supplement, the section entitled “Certain Income Tax Consequences” in the accompanying prospectus supplement, and the section entitled “Tax Consequences” in the accompanying prospectus, which you should carefully review prior to investing in the Securities.

In the opinion of our counsel, Morrison & Foerster LLP, it would generally be reasonable to treat a security with terms described herein as a pre-paid cash-settled derivative contract in respect of the Underlying for U.S. federal income tax purposes, and the terms of the Securities require a holder and us (in the absence of a change in law or an administrative or judicial ruling to the contrary) to treat the Securities for all tax purposes in accordance with such characterization. If the Securities are so treated, subject to the discussion in the accompanying product prospectus supplement concerning the potential application of the “constructive ownership” rules under Section 1260 of the Code, a holder should generally recognize capital gain or loss upon the sale or maturity of the Securities in an amount equal to the difference between the amount a holder receives at such time and the holder’s tax basis in the Securities. Capital gain recognized by an individual U.S. holder is generally taxed at preferential rates where the property is held for more than one year and is generally taxed at ordinary income rates where the property is held for one year or less. The deductibility of capital losses is subject to limitations.

Alternative tax treatments are also possible and the Internal Revenue Service might assert that a treatment other than that described above is more appropriate. In addition, the Internal Revenue Service has released a notice that may affect the taxation of holders of the Securities. According to the notice, the Internal Revenue Service and the Treasury Department are actively considering whether the holder of an instrument such as the Securities should be required to accrue ordinary income on a current basis. It is not possible to determine what guidance they will ultimately issue, if any. It is possible, however, that under such guidance, holders of the Securities will ultimately be required to accrue income currently and this could be applied on a retroactive basis. The Internal Revenue Service and the Treasury Department are also considering other relevant issues, including whether additional gain or loss from such instruments should be treated as ordinary or capital and whether the special "constructive ownership rules" of Section 1260 of the Internal Revenue Code might be applied to such instruments. Holders are urged to consult their tax advisors concerning the significance, and the potential impact, of the above considerations.

Individual holders that own “specified foreign financial assets” may be required to include certain information with respect to such assets with their U.S. federal income tax return. You are urged to consult your own tax advisor regarding such requirements with respect to the Securities.

A “dividend equivalent” payment is treated as a dividend from sources within the United States and such payments generally would be subject to a 30% U.S. withholding tax if paid to a non-U.S. holder. Under U.S. Treasury Department regulations, payments (including deemed payments) with respect to equity-linked instruments (“ELIs”) that are “specified ELIs” may be treated as dividend equivalents if such specified ELIs reference an interest in an “underlying security,” which is generally any interest in an entity taxable as a corporation for U.S. federal income tax purposes if a payment with respect to such interest could give rise to a U.S. source dividend. However, the IRS has issued guidance that states that the U.S. Treasury Department and the IRS intend to amend the effective dates of the U.S. Treasury Department regulations to provide that withholding on dividend equivalent payments will not apply to specified ELIs that are not delta-one instruments and that are issued before January 1, 2018. Based on our determination that the Securities are not delta-one instruments, non-U.S. holders should not be subject to withholding on dividend equivalent payments, if any, under the Securities. However, it is possible that the Securities could be treated as deemed reissued for U.S. federal income tax purposes upon the occurrence of certain events affecting the Underlying or the Securities, and following such occurrence the Securities could be treated as subject to withholding on dividend equivalent payments. Non-U.S. holders that enter, or have entered, into other transactions in respect of the Underlying or the Securities should consult their tax advisors as to the application of the dividend equivalent withholding tax in the context of the Securities and their other transactions. If any payments are treated as dividend equivalents subject to withholding, we (or the applicable paying agent) would be entitled to withhold taxes without being required to pay

any additional amounts with respect to amounts so withheld.
Please see the discussion under the section entitled “Supplemental Discussion of U.S. Federal Income Tax Consequences” in the accompanying product prospectus supplement for a further discussion of the U.S. federal income tax consequences of an investment in the Securities.
Canadian Federal Income Tax Consequences
For a discussion of the material Canadian federal income tax consequences relating to an investment in the Securities, please see the section entitled “Tax Consequences—Canadian Taxation” in the accompanying prospectus, which you should carefully review prior to investing in the Securities.

9

The iShares® MSCI EAFE ETF

iShares® consists of numerous separate investment portfolios (the "iShares® Funds"), including the Underlying. The Underlying seeks investment results that correspond generally to the price and yield performance, before fees and expenses, of its underlying index. The Underlying typically earns income dividends from securities included in the underlying index. These amounts, net of expenses and taxes (if applicable), are passed along to the Underlying's shareholders as "ordinary income." In addition, the Underlying realizes capital gains or losses whenever it sells securities. Net long-term capital gains are distributed to shareholders as "capital gain distributions." However, because the Securities are linked only to the share price of the Underlying, you will not be entitled to receive income, dividend, or capital gain distributions from the Underlying or any equivalent payments.

Information provided to or filed with the SEC by iShares® under the Securities Exchange Act of 1934 and the Investment Company Act of 1940 can be located at the SEC's facilities or through the SEC's website by reference to SEC file numbers 033-97598 and 811-09102, respectively. We have not independently verified the accuracy or completeness of the information or reports prepared by iShares®.

The selection of the Underlying is not a recommendation to buy or sell the shares of the Underlying. Neither we nor any of our affiliates make any representation to you as to the performance of the shares of the Underlying.

"iShares®" and BlackRock® are registered trademarks of BlackRock®. BlackRock® has licensed certain trademarks and trade names of BlackRock® for our use. The Securities are not sponsored, endorsed, sold, or promoted by BlackRock®, or by any of the iShares® Funds. Neither BlackRock® nor the iShares® Funds make any representations or warranties to the owners of the Securities or any member of the public regarding the advisability of investing in the Securities. Neither BlackRock® nor the iShares® Funds shall have any obligation or liability in connection with the registration, operation, marketing, trading, or sale of the Securities or in connection with our use of information about the iShares® Funds.

The iShares® MSCI EAFE ETF

The EFA seeks investment results that correspond generally to the price and yield performance, before fees and expenses, of the MSCI EAFE Index. The MSCI EAFE Index is intended to measure equity market performance in developed market countries, excluding the U.S. and Canada. The shares of this Fund trade on the NYSE Arca under the symbol "EFA."

The MSCI EAFE Index

We have derived all information contained in this document regarding the MSCI EAFE Index, including, without limitation, its make-up, method of calculation and changes in its components, from publicly available information. The MSCI EAFE Index is a stock index calculated, published and disseminated daily by MSCI, a majority-owned subsidiary of Morgan Stanley, through numerous data vendors, on the MSCI website and in real time on Bloomberg Financial Markets and Reuters Limited. Neither MSCI nor Morgan Stanley has any obligation to continue to calculate and publish, and may discontinue calculation and publication of the MSCI EAFE Index.

The MSCI EAFE Index is a free float-adjusted market capitalization index with a base date of December 31, 1969 and an initial value of 100. The MSCI EAFE Index is calculated daily in U.S. dollars and published in real time every 60 seconds during market trading hours. The MSCI EAFE Index currently consists of the following 21 developed countries: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, The Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. The MSCI EAFE Index is comprised of companies in both the Large Cap Index and Mid Cap Index, as discussed in the section "—Defining Market Capitalization Size Segments for Each Market" below. The MSCI EAFE Index is part of the MSCI Regional Equity Indices series and is an MSCI Global Investable Market Index, which is a family within the MSCI International Equity Indices.

General – MSCI Indices

MSCI provides global equity indices intended to measure equity performance in international markets and the MSCI International Equity Indices are designed to serve as global equity performance benchmarks. In constructing these indices, MSCI applies its index construction and maintenance methodology across developed, emerging, and frontier markets.

MSCI enhanced the methodology used in its MSCI International Equity Indices. The MSCI Standard and MSCI Small Cap Indices, along with the other MSCI equity indices based on them, transitioned to the global investable market indices methodology described below. The transition was completed at the end of May 2008. The Enhanced MSCI

Standard Indices are composed of the MSCI Large Cap and Mid Cap Indices. The MSCI Global Small Cap Index transitioned to the MSCI Small Cap Index resulting from the Global Investable Market Indices methodology and contains no overlap with constituents of the transitioned MSCI Standard Indices. Together, the relevant MSCI Large Cap, Mid Cap, and Small Cap Indices will make up the MSCI investable market index for each country, composite, sector, and style index that MSCI offers.

Constructing the MSCI Global Investable Market Indices. MSCI undertakes an index construction process, which involves:

- defining the equity universe;
- determining the market investable equity universe for each market;
- determining market capitalization size segments for each market;
- applying index continuity rules for the MSCI Standard Index;
- creating style segments within each size segment within each market; and
- classifying securities under the Global Industry Classification Standard (the “GICS”).

Defining the Equity Universe. The equity universe is defined by:

- Identifying Eligible Equity Securities: the equity universe initially looks at securities listed in any of the countries in the MSCI Global Index Series, which will be classified as either Developed Markets (“DM”) or Emerging Markets (“EM”). All listed equity securities, including Real Estate Investment Trusts, are eligible for inclusion in the equity universe. Conversely, mutual funds, ETFs, equity derivatives and most investment trusts are not eligible for inclusion in the equity universe.
- Classifying Eligible Securities into the Appropriate Country: each company and its securities (i.e., share classes) are classified in only one country.

Effective with the November 2015 semi-annual index review, companies traded outside of their country of classification (i.e., “foreign listed companies”) became eligible for inclusion in the MSCI Country Investable Market Indexes along with the applicable MSCI Global Index. In order for a MSCI Country Investable Market Index to be eligible to include foreign listed companies, it must meet the Foreign Listing Materiality Requirement. To meet the Foreign Listing Materiality Requirement, the aggregate market capitalization of all securities represented by foreign listings should represent at least (i) 5% of the free float-adjusted market capitalization of the relevant MSCI Country Investable Market Index and (ii) 0.05% of the free-float adjusted market capitalization of the MSCI ACWI Investable Market Index.

Determining the Market Investable Equity Universes. A market investable equity universe for a market is derived by applying investability screens to individual companies and securities in the equity universe that are classified in that market. A market is equivalent to a single country, except in DM Europe, where all DM countries in Europe are aggregated into a single market for index construction purposes. Subsequently, individual DM Europe country indices within the MSCI Europe Index are derived from the constituents of the MSCI Europe Index under the global investable market indices methodology.

The investability screens used to determine the investable equity universe in each market are as follows:

- Equity Universe Minimum Size Requirement: this investability screen is applied at the company level. In order to be included in a market investable equity universe, a company must have the required minimum full market capitalization.
- Equity Universe Minimum Free Float–Adjusted Market Capitalization Requirement: this investability screen is applied at the individual security level. To be eligible for inclusion in a market investable equity universe, a security must have a free float–adjusted market capitalization equal to or higher than 50% of the equity universe minimum size requirement.
- DM and EM Minimum Liquidity Requirement: This investability screen is applied at the individual security level. To be eligible for inclusion in a market investable equity universe, a security must have adequate liquidity. The twelve-month and three-month Annual Traded Value Ratio (“ATVR”), a measure that screens out extreme daily trading volumes and takes into account the free float–adjusted market capitalization size of securities, together with the three-month frequency of trading are used to measure liquidity. A minimum liquidity level of 20% of three- and twelve-month ATVR and 90% of three-month frequency of trading over the last four consecutive quarters are required for inclusion of a security in a market investable equity universe of a DM, and a minimum liquidity level of 15% of three- and twelve-month ATVR and 80% of three-month frequency of trading over the last four consecutive quarters are required for inclusion of a security in a market investable equity universe of an EM.
- Global Minimum Foreign Inclusion Factor Requirement: this investability screen is applied at the individual security level. To be eligible for inclusion in a market investable equity universe, a security’s Foreign Inclusion Factor (“FIF”) must reach a certain threshold. The FIF of a security is defined as the proportion of shares outstanding that is available for purchase in the public equity markets by international investors. This proportion accounts for the available free float of and/or the foreign ownership limits applicable to a specific security (or company). In general, a security must have an FIF equal to or larger than 0.15 to be eligible for inclusion in a market investable equity universe.
- Minimum Length of Trading Requirement: this investability screen is applied at the individual security level. For an initial public offering (“IPO”) to be eligible for inclusion in a market investable equity universe, the new issue must have started trading at least three months before the implementation of a semi–annual index review (as described below). This requirement is applicable to small new issues in all markets. Large IPOs are not subject to the minimum length of trading requirement and may be included in a market investable equity universe and the Standard Index outside of a Quarterly or Semi–Annual Index Review.
- Minimum Foreign Room Requirement: this investability screen is applied at the individual security level. For a security that is subject to a foreign ownership limit to be eligible for inclusion in a market investable equity universe, the proportion of shares still available to foreign investors relative to the maximum allowed (referred to as “foreign room”) must be at least 15%.

Defining Market Capitalization Size Segments for Each Market. Once a market investable equity universe is defined, it is segmented into the following size–based indices:

- Investable Market Index (Large + Mid + Small);
- Standard Index (Large + Mid);
- Large Cap Index;
- Mid Cap Index; or
- Small Cap Index.

Creating the size segment indices in each market involves the following steps:

- defining the market coverage target range for each size segment;

- determining the global minimum size range for each size segment;
- determining the market size segment cutoffs and associated segment number of companies;
- assigning companies to the size segments; and
- applying final size−segment investability requirements.

Index Continuity Rules for the Standard Indices. In order to achieve index continuity, as well as to provide some basic level of diversification within a market index, and notwithstanding the effect of other index construction rules described in this section, a minimum number of five constituents will be maintained for a DM Standard Index and a minimum number of three constituents will be maintained for an EM Standard Index.

Creating Style Indices within Each Size Segment. All securities in the investable equity universe are classified into value or growth segments using the MSCI Global Value and Growth methodology.

Classifying Securities under the Global Industry Classification Standard. All securities in the global investable equity universe are assigned to the industry that best describes their business activities. To this end, MSCI has designed, in conjunction with S&P Dow Jones Indexes, the GICS. Under the GICS, each company is assigned to one sub−industry according to its principal business activity. Therefore, a company can belong to only one industry grouping at each of the four levels of the GICS.

Index Maintenance

The MSCI Global Investable Market Indices are maintained with the objective of reflecting the evolution of the underlying equity markets and segments on a timely basis, while seeking to achieve index continuity, continuous investability of constituents and replicability of the indices, index stability and low index turnover. In particular, index maintenance involves:

(i) Semi−Annual Index Reviews (“SAIRs”) in May and November of the Size Segment and Global Value and Growth Indices which include:

11

- updating the indices on the basis of a fully refreshed equity universe;
- taking buffer rules into consideration for migration of securities across size and style segments; and
- updating FIFs and Number of Shares (“NOS”).

(ii) Quarterly Index Reviews in February and August of the Size Segment Indices aimed at:

- including significant new eligible securities (such as IPOs that were not eligible for earlier inclusion) in the index;
- allowing for significant moves of companies within the Size Segment Indices, using wider buffers than in the SAIR; and
- reflecting the impact of significant market events on FIFs and updating NOS.

(iii) Ongoing Event–Related Changes: changes of this type are generally implemented in the indices as they occur. Significantly large IPOs are included in the indices after the close of the company’s tenth day of trading.

None of us, the dealer or any of our other affiliates accepts any responsibility for the calculation, maintenance, or publication of, or for any error, omission, or disruption in, the index or any successor to the index.

Historical Information

The following table sets forth the quarterly high, low and period-end closing prices of the Underlying, as reported by Bloomberg. The historical performance of the Underlying should not be taken as an indication of its future performance. We cannot give you assurance that the performance of the Underlying will result in the return of any of your initial investment.

Quarter Begin	Quarter End	Quarterly Closing High ($)	Quarterly Closing Low ($)	Quarterly Period-End Close ($)
1/1/2008	3/31/2008	78.35	68.34	71.90
4/1/2008	6/30/2008	78.52	68.08	68.67
7/1/2008	9/30/2008	68.00	53.08	56.30
10/1/2008	12/31/2008	55.88	35.73	44.86
1/1/2009	3/31/2009	45.44	31.70	37.59
4/1/2009	6/30/2009	49.04	38.57	45.81
7/1/2009	9/30/2009	55.81	44.01	54.68
10/1/2009	12/31/2009	57.28	52.66	55.28
1/1/2010	3/31/2010	57.96	50.45	56.00
4/1/2010	6/30/2010	58.03	46.29	46.51
7/1/2010	9/30/2010	55.42	47.09	54.92
10/1/2010	12/31/2010	59.46	54.25	58.23
1/1/2011	3/31/2011	61.91	55.31	60.09
4/1/2011	6/30/2011	63.87	57.10	60.14
7/1/2011	9/30/2011	60.80	46.66	47.75
10/1/2011	12/31/2011	55.57	46.45	49.53
1/1/2012	3/31/2012	55.80	49.15	54.90
4/1/2012	6/30/2012	55.51	46.55	49.96
7/1/2012	9/30/2012	55.15	47.62	53.00
10/1/2012	12/31/2012	56.88	51.96	56.82
1/2/2013	3/31/2013	59.89	56.90	58.98
4/1/2013	6/30/2013	63.53	57.03	57.38
7/1/2013	9/30/2013	65.05	57.55	63.79
10/1/2013	12/31/2013	67.06	62.71	67.06
1/2/2014	3/31/2014	68.03	62.31	67.17
4/1/2014	6/30/2014	70.67	66.26	68.37
7/1/2014	9/30/2014	69.25	64.12	64.12
10/1/2014	12/31/2014	64.51	59.53	60.84
1/2/2015	3/31/2015	65.99	58.48	64.17
4/1/2015	6/30/2015	68.42	63.49	63.49
7/1/2015	9/30/2015	65.46	56.25	57.32
10/1/2015	12/31/2015	62.06	57.50	58.75
1/1/2016	3/31/2016	57.80	51.38	57.13

4/1/2016	6/30/2016	59.87	52.64	55.81
7/1/2016	9/30/2016	59.86	54.44	59.13
10/1/2016	12/31/2016	59.20	56.20	57.73
1/1/2017	3/6/2017*	60.97	58.09	60.74

* This free writing prospectus includes information for the first calendar quarter of 2017 only for the period from January 1, 2017 through March 6, 2017. Accordingly, the "Quarterly Closing High," "Quarterly Closing Low" and "Quarterly Period-End Close" data indicated are for this shortened period only and do not reflect complete data for the first calendar quarter of 2017.

12

The graph below illustrates the performance of the Underlying from January 1, 2008 to March 6, 2017, assuming an Initial Underlying Price of $60.74, which was its closing price on March 6, 2017, and a Downside Threshold equal to 90% of the Initial Underlying Price (the actual Initial Underlying Price and Downside Threshold will be determined on the Trade Date).

n Downside Threshold = 90% of the Initial Underlying Price

HISTORIC PERFORMANCE IS NOT AN INDICATION OF FUTURE PERFORMANCE.

Source: Bloomberg L.P. We have not independently verified the accuracy or completeness of the information obtained from Bloomberg Financial Markets

13

Supplemental Plan of Distribution (Conflicts of Interest)

We have agreed to indemnify UBS and RBCCM against liabilities under the Securities Act of 1933, as amended, or to contribute payments that UBS and RBCCM may be required to make relating to these liabilities as described in the prospectus supplement and the prospectus. We will agree that UBS may sell all or a part of the Securities that it will purchase from us to investors at the price to public listed on the cover hereof, or its affiliates at the price indicated on the cover of the pricing supplement, the document that will be filed under Rule 424(b)(2) containing the final pricing terms of the Securities.

UBS may allow a concession not in excess of the underwriting discount set forth on the cover of the pricing supplement to its affiliates for distribution of the Securities.

Subject to regulatory constraints and market conditions, RBCCM intends to offer to purchase the Securities in the secondary market, but it is not required to do so.

We or our affiliates may enter into swap agreements or related hedge transactions with one of our other affiliates or unaffiliated counterparties in connection with the sale of the Securities and RBCCM and/or an affiliate may earn additional income as a result of payments pursuant to the swap or related hedge transactions. See “Use of Proceeds and Hedging” beginning on page PS-13 of the accompanying product prospectus supplement no. UBS-EQUITY-1.

The value of the Securities shown on your account statement may be based on RBCCM’s estimate of the value of the Securities if RBCCM or another of our affiliates were to make a market in the Securities (which it is not obligated to do). That estimate will be based upon the price that RBCCM may pay for the Securities in light of then prevailing market conditions, our creditworthiness and transaction costs. If so specified in the pricing supplement related to the Securities, for a period of approximately five months after the issue date of the Securities, the value of the Securities that may be shown on your account statement may be higher than RBCCM’s estimated value of the Securities at that time. This is because the estimated value of the Securities will not include the underwriting discount and our hedging costs and profits; however, the value of the Securities shown on your account statement during that period may be a higher amount, potentially reflecting the addition of the underwriting discount and our estimated costs and profits from hedging the Securities. Any such excess is expected to decrease over time until the end of this period. After this period, if RBCCM repurchases your Securities, it expects to do so at prices that reflect their estimated value. This period may be reduced at RBCCM’s discretion based on a variety of factors, including but not limited to, the amount of the Securities that we repurchase and our negotiated arrangements from time to time with UBS.

For additional information as to the relationship between us and RBCCM, please see the section “Plan of Distribution—Conflicts of Interest” in the prospectus dated January 8, 2016.

Structuring the Securities

The Securities are our debt securities, the return on which is linked to the performance of the Underlying. As is the case for all of our debt securities, including our structured notes, the economic terms of the Securities reflect our actual or perceived creditworthiness at the time of pricing. In addition, because structured notes result in increased operational, funding and liability management costs to us, we typically borrow the funds under these Securities at a rate that is more favorable to us than the rate that we might pay for a conventional fixed or floating rate debt security of comparable maturity. Using this relatively lower implied borrowing rate rather than the secondary market rate is a factor that is likely to result in a higher initial estimated value of the Securities at the time their terms are set than if the secondary market rate was used. Unlike the estimated value included on the cover of this document or in the final pricing supplement relating to the Securities, any value of the Securities determined for purposes of a secondary market transaction may be based on a different borrowing rate, which may result in a lower value for the Securities than if our initial internal borrowing rate were used.

In order to satisfy our payment obligations under the Securities, we may choose to enter into certain hedging arrangements (which may include call options, put options or other derivatives) on the issue date with RBCCM or one of our other subsidiaries. The terms of these hedging arrangements take into account a number of factors, including our creditworthiness, interest rate movements, the volatility of the Underlying, and the tenor of the Securities. The economic terms of the Securities and their initial estimated value depend in part on the terms of these hedging arrangements.

The lower implied borrowing rate is a factor that reduces the economic terms of the Securities to you. The initial offering price of the Securities also reflects the underwriting commission and our estimated hedging costs. These factors result in the initial estimated value for the Securities on the Trade Date being less than their public offering price. See “Key Risks—The Initial Estimated Value of the Securities Will Be Less than the Price to the Public” above.

Terms Incorporated in Master Note

The terms appearing above under the caption “Indicative Terms of the Securities” and the provisions in the accompanying product prospectus supplement no. UBS-EQUITY-1 dated January 4, 2017 under the caption “General Terms of the Securities,” are incorporated into the master note issued to DTC, the registered holder of the Securities.

14