Logitech Q3 Fiscal Year 2014 Financial Results Management's Prepared Remarks (January 22, 2014)

Logitech is posting a copy of these prepared remarks, its press release and accompanying slides to its investor website. These prepared remarks will not be read on the call. We refer both to GAAP and to non-GAAP financial measures herein. For full GAAP to non-GAAP reconciliation information and cautionary information regarding the use of non-GAAP measures, please refer to "Supplemental Financial Information" in our earnings press release or "Financial Statements only" posted to our website under "Quarterly Results" at http://ir.logitech.com. The live webcast or replay of the question and answer session is also available on our website.

COMPANY COMMENTARY

Following is a summary of the company's comments on key areas impacting Q3 Fiscal Year 2014 performance. Unless noted otherwise, the growth percentages that follow are in comparison to same period prior year.

OVERVIEW

Q3 sales were $628M, up 2% with exchange rates having no impact on a global basis. Non-GAAP operating income was $67M and 10.7% of sales, a 400 basis point improvement. Non-GAAP earnings per share increased by 84% to $0.35. We generated $94M in cash flow from operations in the quarter. Our performance in Q3 confirms that we are on track in our turnaround.

RETAIL SALES BY PRODUCT CATEGORY

For Q3, our retail sales increased by 4% in USD to $563M. Units decreased by 1%. Combined, our retail growth categories delivered 62% sales growth. Our overall retail average selling price (ASP) grew by 5% in Q3 and by 6% year-to-date. Our ASP continues to benefit from the strong growth in two relatively high ASP categories, Tablet & Other Accessories and Audio - Wearables and Wireless.

TABLET & OTHER ACCESSORIES

In Q3, our sales grew by 95%, with units more than doubling. Sales growth was equally strong across all three of our retail regions. Sales of our tablet keyboard covers grew by 67%, led by the Ultrathin Keyboard Cover and the Ultrathin Keyboard Folio for iPad Air. Growth in the category also benefitted from sales of our protective cases for iPad.

AUDIO – WEARABLES & WIRELESS

For Q3, sales increased by 79% and units grew by 27%. Our average selling price in the category grew by 41% as a result of our strategic shift to higher price points over the course of the last year. Sales more than doubled in both the Americas and EMEA. Sales of our mobile speakers grew by 131%, with units up by 96%. This growth was driven primarily by strong demand for UE BOOM, which was our best-selling product across all retail categories in the quarter. The sales growth in our Audio - Wearables & Wireless category was partially offset by a decline in sales of our earphones and headphones, which, as we have previously noted, we have deemphasized.

PC GAMING

Q3 sales in the PC Gaming category increased by 25%, with units up by 27%. Sales increased in all regions, led by Asia Pacific. We achieved strong growth in sales and units for both gaming headsets and gaming mice. Sales growth in the category also benefitted from sales of our G27 Racing Wheel.

PC KEYBOARDS & DESKTOPS

Q3 sales decreased by 2%, with units down 6%. The decrease in sales and units was primarily related to low-end, stand-alone corded keyboards. Sales and units of cordless keyboards as well as keyboard and mouse combos grew by single digits. Sales of our Wireless Touch Keyboard K400 grew significantly.

POINTING DEVICES

In Q3, our sales decreased by 8%, with units down by 5%. The decline was experienced in both the high-end and low-end of the category and across all regions. Sales and units were up by single digits in the mid-range, with a strong contribution from the Logitech Wireless Mouse M560, a new ambidextrous mouse designed for use with Windows 8.

VIDEO

Q3 sales in Video fell by 9%, with units down by 20%. The decline in the Video category was primarily related to weak sales of low-end consumer webcams and reflects our systematic shift away from lower price points in the consumer webcam category. Sales and units more than doubled in the high-end of the category, largely due to strong sales of webcams targeted at Unified Communications applications.

PC AUDIO

Q3 sales in our PC Audio category declined by 12%, with units down by 8%. Sales fell across our three retail regions. The decline in sales was primarily driven by PC Speakers, with sales of PC Headsets essentially flat.

REMOTES

Our Q3 Harmony Remotes sales decreased by 13%, with units growing by 10%. The decline in sales primarily reflects the rationalization of our product portfolio over the last year to drive increased profitability. Our remotes portfolio today is streamlined and more profitable than it was in Q3 of the prior year.

RETAIL – OTHER

This category includes a variety of products that we already have transitioned out of, or intend to transition out of, by the end of Fiscal Year 2014 and is subject to change as we continually assess the strategic fit of the products in our portfolio. Sales declined by 68% to $7M, with units down by 56%. Sales of speaker docks declined by roughly $8M.

RETAIL SALES BY REGION

RETAIL SALES – ASIA PACIFIC REGION

Q3 sales in Asia Pacific increased by 9% in USD and by 13% in local currency. Units were up by 3%. The increase was driven by Tablet & Other Accessories and PC Gaming, with sales doubling in both categories. Q3 sales in China increased by 8%, with double-digit growth in PC Keyboards & Desktops and PC Gaming.

RETAIL SALES – AMERICAS REGION

Q3 sales and units in the Americas increased by 8%. It was a very strong quarter for sales in the Audio - Wearables & Wireless category, with sales more than doubling and mobile speaker sales nearly tripling. Tablet & Other Accessories sales grew by 81%, and PC Gaming grew by 20%.

RETAIL SALES – EMEA REGION

Q3 sales in EMEA were down by 3% in USD and by 6% in local currency, while units decreased by 11%. From a country perspective, the decline primarily reflected weakness in Russia and France. Germany delivered low single digit growth. The decline in the region's sales was primarily related to declines in PC Audio and Pointing Devices as well as the categories that we are in the process of exiting (reported under Retail – Other). Sales more than doubled in both Tablets & Other Accessories and Audio - Wearables & Wireless.

OEM SALES

Our OEM sales performance compared to the prior year has been stable throughout Fiscal 2014, with Q3 down by just 2% despite the weak market conditions for sales of new desktop PCs. The drop was primarily due to a decline in the Pointing Devices category. We achieved strong growth in Keyboards & Desktops.

LIFESIZE SALES

Our Q3 sales of $30M demonstrate a stable top line that has been essentially unchanged for the last four quarters. Despite the 19% decline in sales in Q3, LifeSize returned to profitability one quarter sooner than expected due to portfolio rationalization and lower spending resulting from the comprehensive restructuring implemented earlier in the year.

GROSS MARGIN

Our Q3 non-GAAP gross margin of 34.4% was down by 40 basis points and by 170 basis points sequentially. The primary factor in both the year-over-year and sequential declines was shifts in the product mix. We had very strong growth in the Tablet & Other Accessories and Audio - Wearables & Wireless categories combined with sales declines in the majority of our PC-related categories. The product-mix-related margin decline was partially offset by the benefit from cost reductions initiatives across most of our product categories.

OPERATING EXPENSES

Our Q3 non-GAAP operating expenses were $149M, down by $24M, or 14%, and down by $6M sequentially. This decline includes savings resulting from the restructuring actions and the ongoing rationalization of infrastructure and marketing activities. Non-GAAP operating expenses were 23.7% of sales, down by 440 basis points and reflecting improved operating leverage. The increase in G&A spending was driven by variable compensation costs.

OPERATING INCOME

Non-GAAP operating income in Q3 was $67M, growing by 63%, or $26M. Non-GAAP operating margin was 10.7%, up by 400 basis points.

INTEREST EXPENSE

Interest expense in Q3 was $1M due to our decision to terminate our unutilized $250M Senior Revolving Credit Facility, which resulted in a charge for unamortized, pre-paid fees.

TAX RATE

Our non-GAAP tax rate was 14.2% in Q3 and 14.7% year-to-date.

EARNINGS PER SHARE

Non-GAAP earnings per share in Q3 increased by 84%, or $0.16, to $0.35.

BALANCE SHEET

We generated $94M in cash flow from operations in Q3. On a year-to-date basis, our cash flow from operations was $108M, closely aligned with our non-GAAP operating profit of $117M. Our quarter-ending cash position was $380M, up by $58M compared to December 2012 and by $85M compared to September 2013.

We ended Q3 with $258M in inventory. Disciplined inventory management led to a $19M, or 7%, decrease compared to December 2012 and a $35M decrease compared to September 2013. Inventory turns improved to 6.4, up by 0.6 turns.

Our Q3 accounts receivable was $313M, up by $48M. The increase was due to sales growth, sales linearity within the quarter, and selective reductions in early payment discounts. As a result, DSO increased by 6 days to 45 days.

Accounts payable was $329M, down by $11M with DPO decreasing by 4 days to 71 days due to our continued focus on managing DPO at a reasonable level.

Our cash conversion cycle in Q3 was 29 days, up by 4 days. The increase was due to the increase in accounts receivable and the decline in accounts payable, which were partially offset by faster inventory turns.

FISCAL YEAR 2014 OUTLOOK

Based on our Q3 performance, we have raised our full-year outlook for Fiscal Year 2014. We now expect sales of just under $2.1 billion, compared to the previously expected $2.0 billion, and non-GAAP operating income in the range of $120 million to $125 million, compared to the previously expected $100 million.

ANALYST & INVESTOR DAY

Our next analyst and investor day is scheduled for March 6 in New York.

FORWARD LOOKING STATEMENTS

These remarks contain forward-looking statements within the meaning of the federal securities laws, including, without limitation, statements regarding: our turnaround, products and product categories which we intend to deemphasize or out of which we intend to transition and the timing of those transitions, shifts in our product portfolio and product price points, sales execution in Germany, growth and market conditions in certain product categories, cost reductions, operating leverage, and Fiscal Year 2014 revenue and operating income. The forward-looking statements in these remarks involve risks and uncertainties that could cause Logitech's actual results and events to differ materially from those anticipated in these forward-looking statements, including, without limitation: if our product offerings, marketing activities and investment prioritization decisions do not result in the sales, profitability or profitability growth we expect, or when we expect it; the demand of our customers and our consumers for our products and our ability to accurately forecast it; if we fail to innovate and develop new products in a timely and cost-effective manner for our new and existing product categories; if we do not successfully execute on our growth opportunities in our new product categories and sales in emerging market geographies; if sales of PC peripherals in mature markets are less than we expect; the effect of pricing, product, marketing and other initiatives by our competitors; if our products and marketing strategies fail to separate our products from competitors' products; if our restructurings fail to produce the intended performance and cost savings results; if there is a deterioration of business and economic conditions in one or more of our sales regions or operating segments, or significant fluctuations in exchange rates. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in Logitech's periodic filings with the Securities and Exchange Commission, including our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2013 and our Amended Annual Report on Form 10-K/A for the fiscal year ended March 31, 2013, available at www.sec.gov, under the caption Risk Factors and elsewhere. Logitech does not undertake any obligation to update any forward-looking statements to reflect new information or events or circumstances occurring after the date of these remarks.

USE OF NON-GAAP FINANCIAL INFORMATION

To facilitate comparisons to Logitech's historical results, Logitech has included non-GAAP adjusted measures which exclude share-based compensation expense, amortization of other intangible assets, restructuring charges (credits), other restructuring-related charges, investment impairment (recovery) and other items detailed under "Supplemental Financial Information" in our earnings press release or "Financial Statements only" posted to our website under "Quarterly Results" at http://ir.logitech.com. Logitech believes this information, used together with the GAAP financial information, will help investors to evaluate its current period performance and trends in its business.

CHANNEL INVENTORY DATA

Estimates the inventory levels of our products held by or in-transit to our retailer and distributor customers. Includes data compiled by Logitech from data supplied by our customers, and our estimates of inventory in transit to our customers. Customers supplying data vary by geographic region and from period to period, but typically represent a majority of our retail sales. Data and our estimates are subject to limitations and possible error sources and may not be an entirely accurate indicator of actual customer channel inventory. Limitations and possible error sources include the following:

- Data supplied by our customers may not be indicative of inventory held by our customers as a whole
- Reliability of the data depends on accuracy and timeliness of information supplied to us by our customers, and the processes by which they collect their data are largely outside our control
- In the U.S., Canada, and to a lesser extent Asia Pacific, and a still lesser extent, EMEA, data is based on Point of Sale (POS) electronic data. Where POS data is not available, the data is collected largely through manual processes, including the exchange of spreadsheets or other non-automated methods of data transmission, which are subject to typical human errors, including errors in data entry, transmission and interpretation
- Our interpretation of the data, and our estimates of in-transit inventory, may be subject to errors in assumptions, calculations or other errors.