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Logitech International SA (LOGI)

Q2 2018 Earnings Call

CORPORATE PARTICIPANTS

Benjamin Lu, CFA

Vice President-Investor Relations, Logitech International SA

Vincent Pilette

Chief Financial Officer, Logitech International SA

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

OTHER PARTICIPANTS

Jörn Iffert

Analyst, UBS AG

Jürgen Wagner

Analyst, MainFirst Bank AG

Asiya Merchant

Analyst, Citigroup Global Markets, Inc.

Paul Coster

Analyst, JPMorgan Securities LLC

Tavis C. McCourt

Analyst, Raymond James & Associates, Inc.

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

Ananda Baruah

Analyst, Loop Capital Markets LLC

Günther Hollfelder

Analyst, Baader Bank AG

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Sharon, and I will be your conference operator today. At this time, I would like to welcome everyone to the Logitech Second Quarter Fiscal 2018 Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

Ben Lu, Head of Investor Relations, you may begin your conference.

Benjamin Lu, CFA

Vice President-Investor Relations, Logitech International SA

Thanks, Sharon. Welcome to the Logitech conference call to discuss the company's financial results for the second quarter of fiscal year 2018. The press release, our prepared remarks and slides, as well as a live webcast of this call are available online at the Investor Relations page of our website, logitech.com.

During the course of this call, we may make forward-looking statements, including forward-looking statements with respect to future operating results that are being made under the Safe Harbor of the Securities Litigation Reform Act of 1995. The forward-looking statements involve risks and uncertainties and actual results could differ materially as noted in our quarterly and other filings with the SEC. The company undertakes no obligation to update or revise any forward-looking statements as a result of new developments or otherwise.

Please note that today's call will include results reported on both a GAAP and a non-GAAP basis. Non-GAAP reporting is provided to help you better understand our business. However, non-GAAP financial results are not

meant to be considered in isolation from or as a substitute for or superior to GAAP results. Non-GAAP measures have inherent limitations and should be used only in conjunction with Logitech's consolidated financial statements prepared in accordance with GAAP. Our press release and slides provide a reconciliation between GAAP and non-GAAP numbers and are posted on our Investor Relations website. We encourage listeners to review these items.

Unless noted otherwise, comparisons between periods are year-over-year and in constant currency. This call is being recorded and will be available for replay on the Investor Relations page of the Logitech website.

Joining us today are Bracken Darrell, President and Chief Executive Officer; and Vincent Pilette, Chief Financial Officer.

I'll now turn the call over to Bracken.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Thanks, Ben, and thanks to all of you for joining us. This quarter, we grew our sales and operating profits double-digits and the first-half sales and profits were up 12%. I have to say, there were so many areas for improvement that we could have gotten much more from our performance, but to some extent that's always true.

Overall, as we've been doing for the past few years, we're simply executing our strategy, investing in existing categories and capabilities, and systematically expanding into new ones, most recently in console gaming headsets. You've heard me say many times that we're going to build a multi-category, multi-brand design company, and it's still early on that road.

Vincent and I spent our first couple of years here right-sizing cost structure, improving our operational discipline and creating a foothold in new product categories like Bluetooth speakers and video collaboration. We redistributed our engineering resources and reduced unnecessary overhead as we focused on better and different products.

Today, I am far more excited about all the market opportunities that we can capture ahead of us than ever. Whether it's the structural growth in gaming, the widening innovation we're driving in music or the opportunities generated by new cloud platforms in the home and elsewhere, it's just an amazing time.

This quarter, we introduced a stream of cool products across our categories. I hope everyone saw our announcement last week of the Ultimate Ears BLAST and MEGABLAST. These are the two newest additions to our family of portable speakers. They build on the success of BOOM and MEGABOOM by adding Wi-Fi and integrating native Alexa voice control. Not only can they double as home Wi-Fi speakers, but they're also mobile. So you can continue to listening to your music on the go. And with far-field mics built-in, you can play your music simply by saying, Alexa, play some Van Morrison. That was [indiscernible] (00:03:53) as well as asking Alexa to check the weather and a host of other cool things. There really is no other [ph] speaker (00:04:00) in the market like it today, which has Wi-Fi, Bluetooth and Alexa built-in.

Let me talk about one of the newest members of our family, Jaybird. I am super-excited about the portfolio of products we're building now. FREEDOM 2 is really an outstanding upgrade of the original version. X3 is our best seller. And we just introduced RUN, our first truly wireless product and it's awesome. RUN is so good that I know if you try, you'll love it like I do. In my book, there is no better fit and comfort. The acoustics are very good and all

that in a small size. Jaybird RUN might just inspire you to get out and run. And we are just beginning to hit our stride with what we're doing in Jaybird.

And if you look at our original core, there are still important and cool innovations we can do there that can affect the way we create, work and live. We introduced the best and most advanced keyboard in the company's history this quarter, our new flagship Logitech CRAFT. This has become my personal keyboard, and I am addicted. It replaced the K780, which was my previous favorite. CRAFT includes a creative dial that offers a whole new way to work. You just turn the dial and adjust image brightness, contrast or saturation in Adobe Photoshop [ph] or (00:05:15) and I know a lot of the finance folks will like this, you can create and adjust charts in Excel just by turning the dial. It's made for creativity and productivity and it's an entirely new experience used in harmony with the mouse.

As a company, we institutionally love products and because it's what we've done for 35-plus years, we also love the users who especially love a product. Nowhere has that been more true than the trackball, that odd pointing device with a little ball on top. We've been wanting to do something special for those trackball loyal users for years, and this quarter we released our first wireless trackball in almost a decade, the MX ERGO. Users love it. [ph] Back then I'm looking across the table at (00:05:55) is a huge fan and he's smiling as I'm talking about the trackball. And the reviews from customers [indiscernible] (00:06:02) have also been very good and journalists have given excellent reviews as well. So it's off to a terrific start.

Now let me give you a quick rundown on each product category. Our gaming business continued to deliver strong momentum as we've had in the past several quarters. Sales rose 42% in this quarter with a strong performance from all three regions and across all the different gaming product lines.

Our strong performance here is driven of course by great products and innovations like POWERPLAY. POWERPLAY is the wireless charging pad that gives infinite battery life for your wireless gaming mouse while you play. I just can't think of a better application of wireless charging. It's for the gamer who requires complete freedom of movement, but zero risk of battery die. No trade-offs. We're not the only ones impressed. Just this week Popular Science named it one of the best innovations of the year along with a Nintendo Switch. They called it the magically charging mouse.

I'm also so excited to have ASTRO now as part of the gaming family. We just announced our latest mainstream console gaming headset, the A20 for \$149. This builds on the more affordable A10 headset that ASTRO launched back in June. We aren't just expanding ASTRO's portfolio though. We're also expanding its global distribution, and I'm looking forward to the additional opportunities that ASTRO is going to bring ahead.

Video Collaboration had another very impressive quarter, with sales up 59% to a record quarterly high of \$46 million. We continue to invest in our go-to-market capabilities here, and create great products like MeetUp. It took us over three years to reach the \$100 million annual sales run rate milestone back in December 2015, and just a year and a half later, our annual sales run rate is approaching \$200 million. Stay tuned.

Our Smart Home group delivered another strong performance. [ph] We've been referring from the integration of Alexa here too, and Google system (00:07:53) in the Harmony Hub line of products. And we view the Smart Home market as a set of long-term opportunities for us. We're still early in the rollout of our latest Circle 2 security camera, but remain excited about the long-term prospects for this nascent market as well.

Mobile Speakers fell 8% this quarter as we prepare for the ramp of our new line up, as mentioned earlier. At the same time, our pint-sized WONDERBOOM entered the market powerfully. [ph] It's in unqualified yet (00:08:23)

and I can't wait to see what BLAST and MEGABLAST do. Audio-PC & Wearable sales were flat in Q2. As we stated last quarter, we're positioning the Jaybird portfolio for long-term growth. And as [ph] a runner (00:08:35) myself, I'm super excited about where we're going.

Our PC peripheral products performed consistently well, taking advantage of the large and stable PC installed base. Sales were up 1% overall. Pointing Devices and Keyboards & Combos were flattish, while PC Webcams grew 12%. Tablet & Other Accessories' sales were up 50%, making second quarter in a row very strong double-digit growth. Is this a new trend? Still too early to say. What I do know is that when we come out with innovative new tablet keyboard offerings, we deliver growth.

Now, I pass the call over to Vincent.

Vincent Pilette

Chief Financial Officer, Logitech International SA

Thanks, Bracken. We posted another consistent quarter of double-digit growth, better than expected, with net sales up 11% in constant currency and non-GAAP operating income up 12%. ASTRO, which was fully integrated in September, only marginally contributed to our sales growth this quarter, less than 1 point. With ASTRO now fully integrated and a range of great new products across almost all of our categories, we have the best portfolio we've ever had to deliver on our growth ambitions. As you know, our long-term financial model is based on high single-digit top-line growth, with gross margin in the range of 35% to 37%.

In Q2, our non-GAAP gross margin reached 36.6%, down 40 basis points year-over-year, but still near the high-end of our target range. Currency was somewhat neutral in the quarter, while product cost savings allowed us to invest in promotions and other costs related to numerous new products across all of our categories. Gross margin was also impacted by the transition to a new third-party distribution center in the Americas to support our growth. We experienced significant challenges in the transition, operating procedures and in ramping fulfillment in Q2 and early Q3. The challenge is that this third-party distribution center are adding additional cost in this period.

Looking ahead, we are fully committed to managing the business within our annual gross margin range of 35% to 37%, while investing into operational capabilities and investing for sustainable growth opportunities, whether they are OpEx or gross margin-related. In Q2, our non-GAAP operating expenses rose 11% to \$159 million and were 25% of sales, in line with our mid-term target of OpEx to sales ratio of 25%. Excluding ASTRO Gaming, our operating expenses would have increased 9%.

Our sales and marketing and R&D expenses increased 14% and 10%, respectively, while at the same time, we continued to drive leveraging our G&A spending down 40 basis points to 3.4% of sales. Cash flow from operations was \$68 million in Q2, as we invested in our working capital ahead of the holiday season. As we had mentioned last [ph] quarter (00:11:34), our cash flow seasonality this year is very similar to what we saw back in fiscal year 2016. You should expect to see our second half cash flow from operations improve compared to the first half, [ph] such that (00:11:47) that our full year cash flows should be approximately one-time our non-GAAP operating income.

As a reminder, our first priority for the use of cash is investing in our business, which also comes in the form of [ph] tuck-in (00:11:59) acquisition followed by a growing dividend and finally opportunistic buyback. In the [ph] quarter (00:12:06), we spent \$85 million to acquire ASTRO Gaming. We paid out \$104 million in dividend, up from the \$93 million that we paid last fiscal year and we repurchased \$10 million worth of stock.

And with those details, Bracken, I'll turn it back to you.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Thank you, Vincent. Through the first half, we are operating at the high end of our range for the year, which gives me the strong confidence in our ability to deliver our previous guidance. Our biggest seasonal quarter is right ahead of us and we have a good line-up and good momentum. I'm proud of what our team has created, both in terms of innovative new products and enhanced capabilities. We're maintaining our fiscal year 2018 sales guidance growth of 10% to 12% in constant currency and non-GAAP operating income of \$260 million to \$270 million.

And with that, Vincent and I are now ready for your questions. Operator, please queue them up.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions]

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Great.

A

Operator: Your first question comes from Jörn Iffert from UBS. Your line is open.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Hi, Jörn.

A

Vincent Pilette

Chief Financial Officer, Logitech International SA

Hey.

A

Jörn Iffert

Analyst, UBS AG

Yeah. Hi, and thanks for taking my questions.

Q

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Thank you.

A

Jörn Iffert

Analyst, UBS AG

And may I quickly start this sell-through in Americas. It was plus-3%, I think one of the weakest sell-through we have seen in the last couple of quarters, if I remember correctly. And [ph] what's your name, (00:13:27) any particular product range here, which was contributing to this weakness?

Q

Second question would be on gross profit margin. Can you please specify what was the impact from the third-party distribution center and setup? And what are you expecting on the gross profit margin for the second half versus the first half, because if I remember correctly, in July, you said, I mean, there will be investment front-loaded in fiscal year 2018. It would be very good to know what is roughly the gross profit margin or action going into the second half.

And my last question is on wireless speaker. I understand there was some clean-up, but could you share with us the sell-through data for Q2 2018? Thanks a lot.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Okay. So let me take [indiscernible] (00:14:15) the first few questions. I'm sure Bracken is going to [ph] complete some of the data (00:14:17) I'm going to give you. So, yeah, sell-through for those who have looked at our slides on our website, in Americas, it's up 3% versus our sell-in of 10%. Some of the sell-in data include some of the education channel that is not comprising to the sell-through.

Sell-through is the best proxy we have for sell-out. It was marginally impacted by the transition of the distribution center and how the products moved through our channel to [ph] peer channels (00:14:46). Overall, we feel pretty good about going into the holiday season. When we managed the business, we mainly managed on weeks-on-hand and where we're positioned versus the demand. And our [ph] overall channel feels (00:15:01) right in the middle of our target range compared to the demand we see going into Q3. So we feel reasonably confident from that position.

Remember also we give that data as an indicator. There is not always an exactly match between selling and sell-through depending on the size and timing of the product moving into the channel. Overall for the company, we are up 11% sell-in, up 13% in sell-out and feel good also on the global position as well as [indiscernible] (00:15:31). That's for sell-through.

On the gross margin side, [ph] definitely (00:15:37) the gross margin was impacted by two things, as we mentioned; the higher level of promotion as we transition to new product cycle and then the incremental cost from the distribution center. I'm not going to [ph] size (00:15:51) any one of those events. There is plenty of different dimension impacting gross margin. Seasonally going into the second half, as you know, Jörn, Q3 is normally a declining quarter-over-quarter gross margin quarter. So Q3 being a lower gross margin quarter, but we will be within our target range of 35% to 37%. We normally do not guide by either quarter or at the gross margin level, but within the range feels a right indicator.

And then, there was another comment around [ph] Mobile Speaker I think. And overall – (00:16:26) part of the sell-through, of course, data that you saw was part of promoting our mobile Bluetooth speaker as we prepare for new products. And so, the ASP was impacted by the higher level of promotion you saw.

Jörn Iffert

Analyst, UBS AG

Q

So may I ask then sell-through of the wireless speaker was also negative in Q2 2018?

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Yes, it was. It was. Sell-through was also negative in Americas and EMEA, it was positive in AP. And as you know, we launched both MEGABLAST and BLAST mainly in the U.S. and then in a few countries in Europe.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Exactly.

Jörn Iffert

Analyst, UBS AG

Q

All right. Thanks very much.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Yep.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Thank you, Jörn.

Operator: Your next question comes from Asiya Merchant from Citigroup. Your line is open.

[indiscernible] (00:17:19)

Asiya Merchant

Analyst, Citigroup Global Markets, Inc.

Q

Hi, Bracken, hi, Vincent. How are you?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Perfect.

Asiya Merchant

Analyst, Citigroup Global Markets, Inc.

Q

Great. Can you just talk a little bit now that your ASTRO acquisition is complete and Gaming is already doing so well, kind of what our expectations are for the second half? I know you guys have a great line-up, but relative to expectations that were set at your Analyst Day earlier in the year, how should we think about the Gaming segment going forward? And I have a follow-up question on gross margin.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Okay. Well, of course, we don't guide by category or by quarter, but I would say overall we continue to feel very, very good about Gaming. Every segment had strong growth and it's really just a strong market and we're performing well within that market across the board and around the world. I would say in the second half, we expect more of the same and I think I wouldn't give exact numbers, but I [ph] would be (00:18:05) surprised, we didn't have good strong growth in gaming through the back half.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

And, Asia, just to give you a little more color, right. So we talked at our Analyst Day [ph] in gaming in (00:18:13) actually across all of our categories of the three ways to grow right, positioning our product on structurally growing markets, gaining share in those markets, and then adding adjacency. You can see that perfect framework in gaming when all three levers are delivering and maybe are delivering versus our expectation.

Asiya Merchant

Analyst, Citigroup Global Markets, Inc.

Q

That's great. And then, on the gross margin, Vincent, I guess, we talked at the Analyst Day, you guys talked about your design for cost initiatives and how that's going to – while it's in the range, kind of the implication was that we should be seeing positive margins that obviously you guys invest in the business. So can you talk a little bit about where you've been able to further expand your design for cost initiatives relative to what you guys talked about at the Analyst Day, which products have now been impacted, how much more runway is there and [ph] to feel (00:19:03) confident about the gross margin range that you guys are guiding for?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Yeah, well, I wouldn't be really specific – and, Vincent, you can add anything you want. Well, I wouldn't be really specific on the individual products. If you zoom out a second, every time we launch a new product our goal is to have equal or better gross margins. Roughly 80% of the time and, right, this year, 80% of those [ph] were – that's exactly we're (00:19:23) doing, which would be up versus the past for sure. New categories that we're launching with the same principle above the company average and we're doing that very consistently now. And I think we'll continue to do that going forward.

Asiya Merchant

Analyst, Citigroup Global Markets, Inc.

Q

Okay. Thank you.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Thank you.

Operator: Your next question comes from Tavis McCourt from Raymond James. Your line is open.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Hi, Tavis.

Tavis C. McCourt

Analyst, Raymond James & Associates, Inc.

Q

Hey, guys. Hey, how are you doing, Bracken?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Perfect.

Tavis C. McCourt

Analyst, Raymond James & Associates, Inc.

Q

Couple of questions. I guess you don't want to talk about the exact cost impact, but I guess qualitatively, can you tell us what exactly you're doing with this distribution center in the U.S.? Is that kind of an extra layer of inventory? [ph] Is it your DC or is that your third-parties were (00:20:03) just moving physical locations? Just give us some sense of how temporary this may be.

And then, on the cash flow, Vincent, from your guidance I suspect, you expect inventory returns and DSOs to kind of return to normal by the end of the year. I think that would still get cash flow from operations this year below where it was in 2017. Should we think of this year as kind of a good run rate or was last year kind of a better run rate for the business? I haven't had a chance to look at all the puts and takes on working capital changes.

And then, Bracken, a product question for you. Sorry, Vincent. I'll hop off.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Sure. [ph] It's no good (00:20:48).

Tavis C. McCourt

Analyst, Raymond James & Associates, Inc.

Q

So in the Home segment, it feels like – I know you guys don't want to call one or two quarters a trend, but feels like it's getting some momentum and I think this is a category a few years ago you had potentially looked to exit. And so, I'm wondering within there I think you've got the Harmony brand, the Circle brand. Are there other products within there and kind of what are your growth ambitions with that Smart Home segment specifically?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Okay.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Good. Let me take quickly the financial questions, and Bracken will answer the product question. So on the distribution center, it's really a response to our growth. As you know, we've been on an accelerating path of growth in the U.S. for the last four years and we needed to have a bigger facility. It's a third-party logistics provider and it's basically moving into more flexible and bigger facilities.

The extra layer [ph] of cost (00:21:51) came in many different areas. The first one, of course, is we kept all distribution in parallel to manage the transition timeframe. It also came in the form of logistics we were handling and had some operational change in the transition we had to [ph] air freight more than our over-budget (00:22:11). We continue this process as we go into Q3, which is the biggest quarter, as you know. So for Q2 and Q3, those incremental costs would be in the P&L. I would expect that to regulate going into Q4. So it's kind of a one-time item [ph] over due course (00:22:28).

In term of the cash flow, those are approximate number. We normally don't guide cash flow, but we give a directional thing. As you know, our inventory, as we mentioned, has been growing here ahead of the holidays.

More than half of the gross is really product linked to the new product we've introduced on a year-over-year basis. So definitely incremental in term of overall – going into the holidays. I would expect that of course to sell-through as we said, and so working capital and days of inventory to regulate post-Q3.

The only one-time item in cash flow that we have is linked to the fact that this year at the beginning of Q1, we mentioned it in Q1 [ph] call (00:23:15), we paid the last year annual compensation plan, which [ph] moved (00:23:19) from a six months' view to annual view. So there was a one-time catch-up with higher cash flow in Q1, because we moved to an annual [ph] plan thing (00:23:20) for last fiscal year. That is the only item that changes year-over-year, and so we feel confident to say approximately one-time non-GAAP operating income is a good proxy for cash flow.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

[indiscernible] (00:23:35) to answer your question about the Home, I think we now have really three significant things happening in Home. We've got Harmony, as you mentioned, which is now integrated not only with Alexa, but with Google Home. We've got Circle 2, which we just launched last quarter. So it's still ramping. And as of last week, we'll have Bluetooth speakers that can operate not only on-the-go, but also as Wi-Fi speakers inside the home. So we have those three different products that position us interestingly for the Home.

And going forward, we're always looking at new things, Tavis. We never stop experimenting. We've already experimented some products in the Home. I would say overall, if I step back and maybe many of you will agree with this, I think the Home as a marketplace has actually grown slower than I think most people thought. We've been a little careful not to go too crazy there, but we continue to be developing and experimenting in a lot of different places in the Home and we're going to try to participate in every place that makes sense for us. So, yes, I am optimistic about the Home going forward. No, I wasn't four years ago, when I tried to sell Harmony, but I'm excited about it now, and I think it's a good long-term play for us.

Tavis C. McCourt

Analyst, Raymond James & Associates, Inc.

Q

Great. Thanks very much for the details.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Thank you.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Thank you.

Operator: Your next question comes from Ananda Baruah from Loop Capital. Your line is open.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Hey, Ananda.

Vincent Pilette

Chief Financial Officer, Logitech International SA

Hi, Ananda.

A

Ananda Baruah

Analyst, Loop Capital Markets LLC

Hey. Hey, guys. Good morning. How are you?

Q

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Good.

A

Ananda Baruah

Analyst, Loop Capital Markets LLC

Awesome. Yeah, congrats on a solid quarter, kind of pretty much all around. A few for me if I could. Bracken, you sound like you have a lot of enthusiasm across the board on the portfolio and you've spoken pretty energetically about sort of new product offerings that have recently come to market. You talked pretty energetically about [ph] mobile speaker refresh (00:25:27) that's upcoming and the way that's landing with me is you're actually – well, it's sounds like you're excited about, this is my term, incremental momentum across your growth businesses. I guess the first thing. Is that an accurate interpretation on my thought?

Q

And then, as we think about, I know you're not going to give guidance and that's totally, totally, totally fine, but as we think about heading into just 2018, the different aspects of your business that you think will be the more important drivers, could you sort of walk, at least give us some kind of text there [ph] in however (00:26:06) you're comfortable doing that? And then I have a follow-up. Thanks.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Okay. Why don't I take [indiscernible] (00:26:17) why don't I take them in reverse order. Yeah, I really do feel like we have the best product lineup since I've been here and we've been continually fueling that. The cool thing about the lineup now is we got really, really exciting new launches that have happened within the last two quarters across really every category. So it's a super exciting time.

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The incremental momentum, I'll put in quotation marks, I'm not sure how to react exactly except to say we have very good momentum now. So if you look at our Video Collaboration business, it grew almost 60% this quarter and Gaming grew 42%. Those are two of our growth categories. And we just launched our new Bluetooth speakers that are not only Bluetooth speakers, but they're also Wi-Fi and we have Alexa built-in. So we have a lot of cool things going on right now. I mean, I don't know how to gauge that relative to last year, the year before or something like that, but all I know is we're taking on more difficult challenges from a product standpoint. We're consistently executing I think very strong products in the marketplace and it does position us really well not just for this year, but for the long-term. And you can bet, we're going to do the same thing next year.

Vincent Pilette

Chief Financial Officer, Logitech International SA

And if I can just add, Ananda, on the momentum thing. I don't know about our own incremental momentum, but I can tell you and I shared that at the Analyst Day, we definitely have incremental set of opportunities as we

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progress into the different markets we are in, and at this point in time, it's more difficult to decide which project not to do then, which project to do. We definitely feel really, really good about the opportunities the company faces in the long-term.

Ananda Baruah

Analyst, Loop Capital Markets LLC

Q

That's awesome. That's super helpful context, guys. And then, as a follow-up, just with regard to distribution center business, sounds like you're saying, kind of March quarter is the quarter where – this is my term, but say, just net headwind or net drag sort of resolves itself. Will there be cost and revenue opportunities when you get through that? It sounds like there definitely are some sort of cost opportunities, but we had a rev benefit from that as well. It sounds [ph] like there may be a mice (00:28:23).

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Yeah, I think – in fact, the reason I mentioned it is because there's the incremental cost. We've had some operational issues, and it's much more in terms of moving product through the channel on time. We feel pretty good of where we finish Q2 [ph] if you want, not leaving (00:28:36) much more revenue on the table from a selling perspective.

Now, as Jörn mentioned, sell-through was a little bit low in the U.S., and there was some impact through that progression of the products through the channels. The main reason I mentioned is because it will be incremental cost in – there's been in Q2, and then there will be in Q3 as we run [ph] two (00:29:06) distribution center in parallel to address the demand in Q3.

Ananda Baruah

Analyst, Loop Capital Markets LLC

Q

Got it. Got it. And then just a quick follow-up on the gross margin. So it sounds like you guys observed some headwind to gross margin. Gross margin is obviously strong. Is that accurate? So said another way, if you weren't doing some of the things you were doing, will the gross margin potentially have been even stronger, and I think you sort of beat [ph] street expectations, my expectations as well this quarter since then. So are you [ph] really (00:29:40) pushing right up at the high end of the gross margin range already on an organic basis?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

I don't know. I [ph] can't understand the way (00:29:46) you guys look at the result we put. It looks all easy and now you're saying you're facing headwind. Every quarter, every day, every week we face headwind and then we work our way through and say, okay, how do we continue to build a better product cost through our overall structure, how we create room and how we compete, et cetera. We know we have a lot of levers in our gross margin, and I don't want to focus too much on Q2 specifically. We are operating at the high end of our range. We feel good about our long-term range and where we are today within that range.

Ananda Baruah

Analyst, Loop Capital Markets LLC

Q

Awesome. Appreciate it. Thanks a lot, guys. Congrats. Thanks a lot.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Thank you very much. Thanks.

A

Operator: Your next question comes from Jürgen Wagner from MainFirst Bank. Your line is open.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Hi, there.

A

Jürgen Wagner

Analyst, MainFirst Bank AG

Yeah, hi. Thank you for taking the question. Actually on Jaybird, you mentioned that you are positive on the positioning. What was the revenue run rate in the quarter?

Q

Vincent Pilette

Chief Financial Officer, Logitech International SA

So we [ph] don't speak overall (00:30:48) Jaybird by itself. It's, as you know, in the Wearable category and we posted all the numbers on our website, but we don't call out Jaybird specifically.

A

Jürgen Wagner

Analyst, MainFirst Bank AG

And second question, FX exposure, has that changed recently? And what is your hedging policy?

Q

Vincent Pilette

Chief Financial Officer, Logitech International SA

Yes, so in the quarter – it's a question I have not received yet, but I'm sure I will in one-on-one. So the currency in the euro was beneficial or favorable to us, if you want. Now that has to be balanced with the fact that other currencies were unfavorable. Chinese currency, Japanese currency, the pound, all moved the other way than the euro. All in one, when we hedge for four months looking forward, as you know and mix and overall currency globally, the currency didn't have any material impact on the current quarter.

A

Jürgen Wagner

Analyst, MainFirst Bank AG

Okay. Thank you.

Q

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Thank you.

A

Operator: Your next question comes from Paul Coster from JPMorgan. Your line is open.

Paul Coster

Analyst, JPMorgan Securities LLC

Q

Yeah. Thanks for taking my question. We saw something of a surge in growth for keyboards, the device in 2016 really and through the beginning of 2017. It now seems to have moderated to what, I think many of us, would have thought was the normal growth rate. Can you just maybe explain what's happened there and whether what we're now seeing in the sort of low-single-digit growth is what we should expect moving forward?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Keyboards is an interesting category. People definitely haven't slowed down using keyboard. And so, our business, I think has been more driven by the products that we've launched into that market than the market itself. If we innovate enough, I'm convinced we can continue to have growth in keyboards, and we just launched that CRAFT keyboard, Paul, which I don't know if you've seen it yet, but it's really cool. And we're going to keep doing things in the keyboard market.

We're even in a world where, if I look out years from now, even in a world where you've got [ph] AR or AR (00:32:58) in particular, I imagine keyboard to still be pretty significant player. That's probably a few years out before you're going to see that. So, yeah, I mean, I think the keyboard market is alive and well. And the installed base is really stable. So I think at the end of the day, as long as the installed base stay stable, I think we're going to have a pretty good keyboard business, and we're going to keep innovating in it. We've got cool things in the oven all the time.

Paul Coster

Analyst, JPMorgan Securities LLC

Q

Maybe just a little bit deeper into that then. I mean, you saw double-digit growth for three quarters last fiscal year in that category. Are you saying that that's just a function of the product cycle and it's quite feasible? You would come back to that kind of growth at some point in the future as well?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

I'd be still hesitant to ever say that we hit double-digit growth in the [ph] keyboard market as an expectation set (00:33:46). But I do think, a lot of that growth was driven by an emphasis we put on multi-device keyboards, more and more people are using multiple things in those keyboards, and that was a really good innovation. I think we'll have good innovations going forward. Well, how much will we get out of that, how much growth we get out? It's really hard for me to say, but I think just structurally with a PC installed base that's very healthy and it doesn't look like it's trending downward or drastically at all or even much. I think [ph] that our opportunity in (00:34:18) keyboards will continue to be good.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

And, Paul, if I can add a few things. So at the Analyst Day in March, we did tell everyone that in the keyboard, we saw double-digit the year before. We probably will not see that this year. And depending on, as you mentioned, product cycle, product innovation, timing of those NPIs, some of those category can move up and down. We always look at the PC peripheral and initially [ph] where we position it (00:34:41) when we came into the company, but so far we think we have accounted for low-single-digit growth rate opportunity in that category.

Some categories can perform better. Webcam was up 12%. I would not advise you to model double-digit growth rate for ever in Webcam, but you never know. We can always come up with new product and find those opportunities. Overall, PC peripheral low-single-digits, we've been pretty good around that target range.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

It's so nice, Paul. I have a question about keyboards on the call.

Operator: Your next question comes from Michael Foeth from Vontobel. Your line is open.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Hi, Michael.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Hi, Michael.

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

Q

Yes. Hi. How are you?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Perfect.

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

Q

Two questions from my side regarding Jaybird as well. In terms of last quarter, I thought that you were sort of disappointed in the U.S. with the performance and my question is what have you done to reposition Jaybird, not in terms – obviously, we've seen new products, but in terms of distribution channels and how long do you think will it take before this really takes off, because I think there's pretty high potential and everybody finds it a really cool product, but it doesn't seem to be accelerating yet? So that will be the first question about the positioning of Jaybird and how you sell it.

And the second one is, if you could give us an update on your Spotlight Presenter? Any significant contribution in the quarter and is it accelerating or has it sort of lost momentum again? Thank you.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Yeah. So I'll take a few quantitative answers and then Bracken can also comment. On the Jaybird side, what we said on the call last quarter is that we are really re-evaluating the approach with Jaybird from both a product portfolio and a distribution perspective to position it for long-term success. So it's not an acquisition that we decided to say, hey, let's go and launch it broadly in every mass distribution environment and push it through.

We were really focusing on the brand, positioning the brand wide and aligning all of the different value vectors along that brand. So we're in the process of that and you saw RUN launch and you can easily extrapolate how we're positioning the brand and what we're doing from product portfolio all the way to distribution. I don't think we

want to be much more specific than that. It's very exciting brand, very exciting set of products that use the [ph] RUN all the time to run (00:37:22) and I really love it and I'm sure many, many of our customers do too.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

And before we go to the next one, I'll add to that. I think when we bought Jaybird, we really saw an opportunity to do something different than what was really being done in the market with a platform that is really interesting. And so, we're super-excited about the long-term potential there and we're holding ourselves back from trying to squeeze all the juice out of that lemon in a short-term basis and really build it structurally for long-term growth. And so, no, I don't think we're done yet on really thinking through and changing the distribution footprint and the product portfolio until you see more as we go ahead.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

So in term of Spotlight, it's still my favorite [ph] presents (00:38:08) to my CFO colleagues to help them improve their presentation skills. It's a fantastic product. As you know, it has software applications loaded and we can improve the functionality through software upgrades. I think it's really showing up capabilities to take small subcategories and [ph] going to (00:38:29) evolve them and position them for growth. It grew double-digit in the quarter and has been doing so since the launch.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Yeah, and I think that's one – the nice thing about that, it's a very small category. So we're not going to go spend a tremendous amount of marketing money to advertise or something. But the cool thing about it is every time you present it in a group of people, you just do the advertising. So it's getting more and more traction in more and more places and we still think it's the best thing out there for presenting and it'll keep growing.

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

Q

Okay. Thank you. Maybe if I can just add a question here.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Sure.

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

Q

I mean, you're very successful with the video conferencing products and those sell, I guess, essentially to companies, right, to businesses. So how can you leverage that sort of sales to businesses and try to get more mice into the business world, get more of the Spotlight product into the business world eventually, also keyboards? I don't know if I'm sitting in the only company, which has like super outdated mice and keyboards, but I guess I'm not. So can you leverage your video conferencing contacts to the other categories?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Potentially, I mean, I think as you probably see, we already have a pretty decent share of mice and keyboards to go into companies, but we don't have as big and strong a selling effort into those markets as we would have [ph] sound Video Collaboration (00:40:06) as you said. It's a much more indirect sale for us.

So maybe there's a long-term potential there to mice and keyboard offerings in the businesses using Video Collaboration, but right now we're just super-excited about the Video Collaboration business. We think it has so much runway ahead of it and we'd be making a mistake if we try to put too many things on its back. It's got big shoulders by itself to carry a long-term growth for us and we're going to really stay focused there.

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

Q

Understood. Thank you.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Thanks Michael.

Operator: [Operator Instructions] Your next question comes from Guenther Hollfelder from Baader-Helvea. Your line open.

Günther Hollfelder

Analyst, Baader Bank AG

Q

Yeah. Thank you. It's Günther Hollfelder of Baader-Helvea . Hello, hi. I had a follow-up on the currency impact. Looking at the second half [indiscernible] (00:40:57) tailwind in terms of sales, and if you could comment also on the impact on profitability at the current exchange rate? Thanks.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Yeah, yeah. So let me do that quickly. I don't want to start to speculate where the currency will be for the remaining two quarters, as you know, we are definitely hedged on [ph] four months rolling (00:41:25). So for Q3, feel pretty good and then we'll see where we are in Q4.

We plan conservatively and we know all of the levers in the overall P&L. If you keep at current exchange rate and they will not move, here you would expect a couple of points delta between overall sales in U.S. dollars versus constant currency depending of course on the mix. As you know, EMEA is growing at mid-single-digit, while China, for example, is growing double-digit much more, and so the mix has a big role as well. And I don't want to start speculating on that.

In term of the flow through in the P&L, we are hedged [ph] for four months (00:42:08). So we kind of have the impact this quarter of the cost of hedging. If [ph] currency (00:42:13) does not move, we should see some benefit going into Q3. If it moves, as it has done versus the average of the last quarter, then we'll have another cost of hedging to offset that. In the long run, so when you pass the volatility or the short-term volatility, we definitely have a benefit into the P&L from a currency perspective if it stays where it is.

Günther Hollfelder

Analyst, Baader Bank AG

Q

Okay. And I had one question on your sales strategy approach going to the holiday season, and particularly in the U.S. and also in Europe. Do you expect [ph] quieter (00:42:56) significant change in terms of the share of online sales this holiday season compared to last year? And have you positioned yourself accordingly?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Yeah, we've consistently seen online sales like you'd expect. Online sales have grown every year. In the Americas or in the U.S., for example, I think it's grown about – I was looking at this [indiscernible] (00:43:21) the other day across multiple categories. It's grown about 1 point a year for the last 8 or 10 years. So now in our categories, it'd be up to between 32%, 33% and 35%. In China, our online sales are bumping up against 65% to 70%. In Europe, it would be lower than either one of those, but still coming up strongly and not too far away from the U.S. now. And we expect that to continue. So we're putting more and more emphasis on our online go-to-market, and that's going to continue forever until they finally stabilize.

Günther Hollfelder

Analyst, Baader Bank AG

Q

Okay. But the trend in the U.S. in terms of online sales, you expect it's pretty much in line, let's say, with the growth compared to last year's, there's no special impact or significant acceleration or anything?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

No, I don't think there's a special acceleration, but online has been outgrowing offline for every year for as long as I've been here and before that and that will continue.

Günther Hollfelder

Analyst, Baader Bank AG

Q

Okay. Great. Many thanks.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

All right. Thank you.

Operator: Next question comes from Jörn Iffert from UBS. Please go ahead.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Hi, Jörn.

Jörn Iffert

Analyst, UBS AG

Q

I'm sorry. Sorry to [ph] enter, but (00:44:39) I'm back here. Just a follow-up.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Nice to have you back, [ph] Jörn Iffert (00:44:43).

Jörn Iffert

Analyst, UBS AG

Q

Thanks. Just a follow-up question please on the gross profit margin. And as Vincent already has indicated that usually Q3 is down versus Q2 on the gross profit margin. And this [ph] hasn't (00:44:56) been the case, I think, in the last two years. What exactly should be the case right now? I mean, you have some benefits coming from [ph] FX (00:45:02) on top, the mix seems quite favorable. It's high gross profit margin, Video Collaboration growing strongly. So what exactly is the reason? Why it should be down in Q3 versus Q2 as this has not been the case in the last two years? [ph] It is (00:45:14) just the statement to be conservative or how shall we read it?

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

No, I think you have a lot of new products here that have introduced. There is cost of new products, there is promotion of the [ph] old lines (00:45:25), you have the normal holidays and the holiday promotions, the effect of Black Friday in Americas. That have the same impact in Europe. So all of those dynamic, if you want, create normally a low gross margin in Q3, and that is offset by the FX, if it stays where it is, which would be beneficial. And then, of course, as a third driver for us, we have this transition of the [ph] DC (00:45:53), which may marginally impact margin in Q3 as well.

Jörn Iffert

Analyst, UBS AG

Q

Okay. Though it has to be seen, the cost...

[indiscernible] (00:45:59)

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Just so other investors and analysts [ph] don't think wrong (00:46:03). Overall, we [ph] communicate (00:46:04) to manage within our range of 35% to 37%. It's all built into our overall guidance and we feel very good about where we are going into the quarter.

Jörn Iffert

Analyst, UBS AG

Q

All right. Thank you.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Thank you.

Operator: At this time, I will turn the call over to the presenters.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Okay, well, we're halfway through the year. As Vincent said, and I've said a couple of times in this call, I feel extremely good about the product line going into our biggest quarter of the year. So look forward to talking to you guys in January.

Operator: This concludes today's conference call. You may now disconnect.

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