

## Logitech Q2 Fiscal Year 2015 Preliminary Financial Results Management's Prepared Remarks (October 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.

As previously disclosed, Logitech's Audit Committee, with the assistance of independent advisors, was conducting an independent investigation of certain accounting matters related to the Company's previously issued financial statements. The investigation is now closed. With the investigation closed, Logitech is performing the necessary work to complete and file its Annual Report for Fiscal Year 2014, Annual Report on Form 10-K for Fiscal Year 2014 and Quarterly Reports on Form 10-Q for the first and second quarters of Fiscal Year 2015. The Company intends to file these reports as soon as possible to regain compliance with Nasdaq and SIX Swiss Exchange listing requirements.

Last month, Logitech announced the restatement of its financial statements for Fiscal Years 2011 and 2012 and for the first quarter of Fiscal Year 2012, related to inventory valuation reserves for the Company's discontinued Revue product. In connection with the restatement, there will be other immaterial corrections to the financial statements for Fiscal Years 2010 and 2013, as well as the first and second quarters of Fiscal Year 2014. None of these other corrections are material to the respective years or to the interim period.

Preliminary financial information for the second quarter of Fiscal Year 2015 was compiled by the Company and has not yet been reviewed by the Company's independent registered public accounting firm. The financial information for the first and

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second quarters of Fiscal Year 2015 may be subject to adjustment based on changes in reserves and estimates resulting from subsequent events and other information available through the filing date of the Company's Quarterly Report on Form 10-Q for the second quarter of Fiscal Year 2015. Accordingly, the preliminary results for the first and second quarters of Fiscal Year 2015 and the results for the corresponding period of Fiscal Year 2014 contained in these prepared remarks may be subject to potentially material adjustment. Complete financial information for the first and second quarters of Fiscal Year 2015, including balance sheet and cash flow statement, will be provided when the Company files its Quarterly Reports on Form 10-Q.

### **COMPANY COMMENTARY**

Following is a summary of the company's comments on key areas impacting preliminary Q2 Fiscal Year 2015 performance. The growth percentages that follow are in comparison to same period of the prior year.

### **OVERVIEW**

Q2 sales were flat at \$530M, with retail sales, excluding the Other/Non-strategic category, growing for the sixth consecutive quarter. The impact from exchange rates on a global basis was immaterial in Q2 compared to the prior year. Non-GAAP operating income was better than expected at \$59M and 11.1% of sales, a 410 basis point improvement and the highest for a Q2 in the last six years. Non-GAAP earnings per share grew by over 50% to \$0.31. Through continued strong working capital management, we generated approximately \$33M in cash flow from operations in the quarter, an improvement of \$18M. For the last twelve months, we generated approximately \$250M in cash flow from operations, doubling compared to the prior period.

## **RETAIL SALES BY PRODUCT CATEGORY**

For Q2, our retail sales increased by 2% in USD to \$473M and by 4% excluding the Other/Non-Strategic category. Unit shipments were flat. Our overall retail average selling price (ASP) increased by 2%.

We classify our retail sales into three high-level groupings: Growth, Profit Maximization and Other/Non-Strategic.

### **GROWTH**

Our retail Growth category, which includes PC Gaming, Mobile Speakers, and Tablet & Other Accessories, delivered 27% sales growth in Q2, with units up by 31%.

#### **PC GAMING**

Q2 sales in our PC Gaming category increased by 10%, with units up by 11%. Despite supply constraints for critical components for gaming mice and keyboards, our sales growth was driven by double-digit gains in gaming mice and headsets, with keyboards up by single digits. Mice sales were up more than 20%, primarily driven by our new G502 Tunable Gaming Mouse. Sales of our PC Gaming products grew strongly in both the Americas and EMEA, reflecting an improved product portfolio that positions us well for continued growth during the remainder of the year.

#### **MOBILE SPEAKERS**

Sales and units in Q2 in our Mobile Speaker category, which is made up entirely of wireless speakers, more than doubled for the sixth consecutive quarter. The strong performance in this category continues to be driven primarily by UE BOOM, which was our best-selling product in Q2 across all categories, with sales and units up by more than three times. Mobile Speaker sales increased significantly across our three regions due to great products and expanded distribution, with sales in the Americas nearly tripling.

#### TABLET & OTHER ACCESSORIES

In Q2, sales in our Tablet & Other Accessories category declined 19%, with units up 15%. The reduction in sales reflects the combination of a declining market for iPad shipments as well as our continued reduction in channel inventory in anticipation of the new iPad launches. We were pleased with the sales contribution from our new tablet keyboard cases for the Samsung platform, such as the Ultrathin Keyboard Folio for the Samsung Galaxy Tab 4. The growth in unit shipments was primarily driven by our protective cases for the iPad.

#### **PROFIT MAXIMIZATION**

Sales in our Profit Maximization category decreased by 2%, with units down by 3%.

#### POINTING DEVICES

In Q2, our Pointing Devices sales decreased by 2%, with units down by 1%. Sales and units were up in the mid-range of the category. We achieved both sales and unit growth in the category in our Asia Pacific region.

#### PC KEYBOARDS & DESKTOPS

Q2 sales in our PC Keyboards & Desktops category were flat, with units up by 2%. Sales in the Americas and EMEA were up by single digits. Sales of our keyboard and mouse combos grew by 10%, led by the Wireless Combo MK270 and the Desktop MK120. We were pleased with the initial demand for the Bluetooth Multi-Device K480 Keyboard, a new offering that we began shipping late in the quarter.

#### AUDIO – PC & WEARABLES

Q2 sales in our Audio category declined by 17%, with units down by 14%. The primary driver of the decline was weak sales of PC speakers in EMEA, reflecting weakness in emerging markets and a category that appears to be in structural decline as music consumption continues to migrate to mobile platforms, which benefits products such as our UE Bluetooth mobile speakers.

## VIDEO

Q2 sales in Video increased by 3%, with units down by 17%. Sales of consumer webcams declined by 18%, consistent with the ongoing structural decline of the consumer webcam market. Sales of our video collaboration offerings targeted at small and midsize conference rooms more than doubled, offsetting the decline in webcams. The primary contributor to this growth, as well as to the 24% increase in the average selling price for the Video category, was the Logitech ConferenceCam CC3000e, a mobile video conferencing solution that delivers 1080p HD video and enterprise-quality audio for under \$1,000.

## REMOTES

In Q2, our Harmony Remotes sales increased by 41%, with units up by 56%, and with strong sales growth in all regions as we supply our newly launched products ahead of the holiday selling season. A key driver of the growth was the Harmony Ultimate Home, which includes both a color touch-screen remote and the Harmony Home Hub, enabling integration and control of compatible home automation devices and up to 15 home entertainment devices.

## **OTHER/NON-STRATEGIC**

This category is made up of products that we have discontinued, and is subject to change as we continually assess the strategic fit of the products in our portfolio. As planned, sales and units declined steeply in Q2, with sales of less than \$1M compared to more than \$10M last year.

## **RETAIL SALES BY REGION**

### RETAIL SALES – AMERICAS REGION

Q2 sales in the Americas grew by 10%, with units up by 11%. The increase in sales was primarily driven by strong performance in the Growth category, with Mobile Speakers sales nearly tripling and PC Gaming sales up by over 30%.

#### RETAIL SALES – EMEA REGION

Q2 sales in EMEA were down by 5% in both USD and in local currency. Unit shipments declined by 10%. Sales of our Mobile Speakers nearly doubled in the quarter and we achieved double-digit growth in PC Gaming and in Remotes.

#### RETAIL SALES – ASIA PACIFIC REGION

Sales in Q2 in Asia Pacific were down by 1% in both USD and in local currency, with units flat. While we experienced sales weakness in several emerging market countries in the region, that decline was offset by 10%+ growth in mature market countries. We achieved a single-digit increase in the Growth category, with a strong performance from Mobile Speakers.

#### OEM SALES

Our Q2 OEM sales decreased by 24%, primarily due to weak mice sales that were only partially offset by growth in Keyboards & Desktops. The decline in mice sales was expected, as we elected not to participate in lower margin opportunities with several customers.

#### LIFESIZE

Lifesize sales declined by 4% in Q2 but were up by 10% sequentially. Lifesize is in the early stages of transitioning its product portfolio to the recently announced Lifesize Cloud, a software-as-a-service (SaaS) offering that is off to a promising start and provides an affordable, simple and scalable video conferencing solution with little to no need for IT involvement. The overall decline in sales reflects the combination of this short-term portfolio transition and weak market conditions for video conferencing endpoints. Lifesize returned to profitability on a non-GAAP basis in the quarter.

## **GROSS MARGIN**

Our Q2 non-GAAP gross margin reached a record high of 38.8%, up by 270 basis points. The increase primarily reflects the combination of a significant improvement in both our Profit Maximization category and in Mobile Speakers, driven largely by product cost reductions and economies of scale, and to a lesser degree a favorable shift in product mix. We do not expect to sustain this margin level as we progress through the second half of Fiscal 2015.

About one percentage point of this improvement is due to the unusual situation of our books still being open for Q4 of Fiscal 2014 and Q1 of Fiscal 2015, which has resulted in changes that impact our Q2 Fiscal 2015 results.

## **OPERATING EXPENSES**

Demonstrating continued discipline in managing our spending, our Q2 non-GAAP operating expenses were \$147M, down by \$7M, or 5%. This was the sixth consecutive quarter of year-over-year reductions, a trend that we do not expect to sustain during the 2<sup>nd</sup> half of Fiscal 2015 as we plan to selectively invest to drive sales growth. The decline, which was partially offset by new investments to drive future growth, includes savings resulting from last year's restructuring actions and the rationalization of infrastructure and indirect procurement activities. Non-GAAP operating expenses were 27.8% of sales, down by 130 basis points. Note that our non-GAAP operating expenses in Q2 of the current year exclude \$8M in G&A costs related to the recently closed Audit Committee investigation.

## **OPERATING INCOME**

Our non-GAAP operating income in Q2 was \$59M, an improvement of \$22M, significantly outpacing the growth in sales. Our non-GAAP operating margin reached 11.1%, up by 410 basis points and the highest for a Q2 in the last six years.

## **OTHER EXPENSE**

Other expense was \$0.9M in Q2 compared to expense of \$0.2M. The increased expense was primarily driven by unfavorable movements in currency exchange rates during Q2 of the current year.

## **NET INCOME**

Non-GAAP net income was \$51M in Q2, up by \$20M and benefitting from our 12.5% non-GAAP effective tax rate.

## **EARNINGS PER SHARE**

Non-GAAP earnings per share in Q2 increased by more than 50% to \$0.31, up from \$0.20.

## **CASH**

Increased efficiency in working capital management led to the generation of approximately \$33M in cash flow from operations in the quarter, the most for a Q2 in the last five years. For the last twelve months, our cash flow from operations was approximately \$250M, doubling compared to the prior twelve months. Our quarter-ending cash position was \$500M, up by \$205M compared to Q2 of the prior year and reaching the highest level for a Q2 in six years.

Our cash conversion cycle in Q2 was 28 days, our best ever for a Q2, with the 14 day improvement over the prior year driven primarily by our inventory efficiency initiatives.

## **SHARE COUNT & REPURCHASES**

Our diluted share count in Q2 was 166.1M shares. We have a \$250M share repurchase plan that will be available for opportunistic usage once our SEC filings are current.

## **FISCAL YEAR 2015 OUTLOOK**

We are confirming our outlook for Fiscal 2015 of approximately \$2.16B in sales, assuming relatively stable currency exchange rates, and approximately \$170M in non-GAAP operating income.

## **FORWARD LOOKING STATEMENTS**

These remarks contain forward-looking statements within the meaning of the federal securities laws, including, without limitation, statements regarding: the Company's product portfolio, category growth and decline, share buybacks, Fiscal Year 2015 sales, gross margin, operating expenses and operating income, exchange rates in the second half of Fiscal Year 2015, the timing of filing periodic reports with the Securities and Exchange Commission and the SIX Swiss Exchange to regain compliance with the Company's listing requirements, and the impact and materiality of the restatement on and other corrections to the Company's financial statements. 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: the results of the Audit Committee's investigation and the completion of the additional work related to the Company's Fiscal Year 2014 Annual Report, Fiscal Year 2014 Annual Report on Form 10-K, and Fiscal Year 2015 First and Second Quarter Quarterly Reports on Form 10-Q; any adjustments resulting from the review of the preliminary financial results for the first and second quarter of Fiscal Year 2015 by the Company's independent registered public accounting firm or from the review of subsequent events, including reserves and estimates, through the dates of filing the Fiscal Year 2014 Annual Report on Form 10-K and the Fiscal Year 2015 First and Second Quarter Quarterly Reports on Form 10-Q; if there is a delay in completing the Fiscal Year 2014 audit of financial statements and internal controls or the First and Second Quarter of Fiscal Year 2015 accounting reviews; 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

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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 or our growth opportunities are more limited than we expect; 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, and our reaction to them, on our sales, gross margins and profitability; if our products and marketing strategies fail to separate our products from competitors' products; if we do not fully realize our goals to lower our costs and improve our operating leverage; 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; the effect of changes to our effective income tax 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 December 31, 2013 and our Amended Annual Report on Form 10-K/A for the fiscal year ended March 31, 2013, available at [www.sec.gov](http://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), benefit from (provision for) income taxes, one-time special charges 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. With respect to our outlook for non-GAAP operating income, most of these excluded amounts pertain to events that have not yet occurred and are not currently possible to estimate with a reasonable degree of accuracy. Therefore, no reconciliation to the GAAP amounts has been provided for Fiscal Year 2015.

#### 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.