Logitech Q4 Fiscal Year 2014 Financial Results Management's Prepared Remarks (April 23, 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 Q4 and full Fiscal Year 2014 performance. Unless noted otherwise, the growth percentages that follow are in comparison to the same period in the prior year.

OVERVIEW

Q4 sales were $485M, up by 3%, with exchange rates having no impact on a global basis. Non-GAAP operating income was $23M and 4.7% of sales, a 470 basis point improvement. Non-GAAP earnings per share increased to $0.14 compared to $0.01. We generated $94M in cash flow from operations in the quarter, an improvement of $81M.

FY14 sales were $2.12B, up slightly. FY14 non-GAAP operating income was $140M and 6.6% of sales, both more than double the prior year. Cash flow from operations for the last twelve months was $202M, up by 72% or $85M, and our best cash generation performance in four years.

Our sales and profit performance in FY14 exceeded our expectations that we shared at the start of the year and has put us ahead of schedule on our three year turnaround plan.

RETAIL SALES BY PRODUCT CATEGORY

For Q4, our retail sales increased by 3% in USD to $420M. Units decreased by 1%. Our overall retail average selling price (ASP) grew by 4%, driven primarily by a shift to higher price point products in our Growth category. Products included under PC Gaming, Tablet & Other Accessories, and Mobile Speakers have significantly higher average selling prices than our average.

Beginning with this quarter's results, we have classified our retail sales into three high-level categories: Growth, Profit Maximization and Non-Strategic.

GROWTH

Sales in our retail Growth category, which includes PC Gaming, Tablet & Other Accessories, and Mobile Speakers, grew by 48% in Q4.

PC GAMING

PC Gaming sales in Q4 increased by 86%, with units up by 62%. We experienced very strong double-digit growth in all regions. Several gaming products drove this growth, with sales of gaming mice and gaming headsets more than doubling. Mice sales were led by the G500s Laser Gaming Mouse, with strong contributions to the growth in gaming headsets coming from the G430 Surround Sound Gaming Headset.

TABLET & OTHER ACCESSORIES

In Q4, our Tablet & Other Accessories sales declined by 26%, with units up by 73%. The decline in sales reflects a 29% drop in sales of our tablet keyboards, with the decline primarily coming from the Ultrathin Tablet Keyboard Covers for iPad Air and iPad Mini. The decline in sales reflects price adjustments to our current Ultrathin Keyboard Covers as we manage the transition to our newest Ultrathin offerings, which begin shipping later this quarter.

Unit sales of tablet keyboards remained strong, increasing by 31%. This unit growth, combined with the contribution from shipments of our protective cases for the iPad, which we introduced earlier in FY14, are the drivers behind the 73% growth in unit shipments in Tablet & Other Accessories.

MOBILE SPEAKERS

Q4 sales for our Mobile Speakers line, which is made up entirely of wireless speakers, were up by 404%, with unit shipments growing by 220%. The success was driven primarily by our flagship product – UE BOOM, with a strong contribution also from the UE MINI BOOM. Our ASP grew by 58%, reflecting strong sales of the $199 UE BOOM. Mobile Speaker sales increased significantly across our three regions, with the strongest growth in the Americas, where we have also benefitted from increased distribution.

PROFIT MAXIMIZATION

Sales and units in our Profit Maximization category declined by 5%.

POINTING DEVICES

Q4 sales in Pointing Devices decreased by 8%, with units down by 2%. Sales and unit shipments at the low-end were flat, with the decline related to higher price point offerings.

PC KEYBOARDS & DESKTOPS

Q4 sales in PC Keyboards & Desktops decreased by 3%, with units down by 5%. The decrease was primarily in Asia Pacific, with sales relatively flat in the Americas and EMEA. The high-end was the biggest contributor to the decline in sales and units, with both relatively flat in the mid-range and low-end.

AUDIO – PC & WEARABLES

Q4 sales in Audio – PC & Wearables declined by 2%, with units down by 10%. While sales declined in the Americas and Asia Pacific, we achieved double-digit growth in EMEA. The growth in EMEA was driven by sales of PC speakers, but we are not planning for continuation of this growth given the structural decline in the market. Sales of our PC headsets and earphones both declined by double-digits.

VIDEO

Q4 sales in Video fell by 15%, with units down by 19%. While we continue to gain share, the weak sales reflect the ongoing structural decline of the consumer webcam market, which has contracted by roughly 30% over the last year.

REMOTES

In Q4, our Harmony Remotes sales increased by 15%, with units down by 6%. We experienced strong growth in both the Americas and EMEA. The decline in unit shipments reflects our strategic shift away from the low-end, which began early in FY14 and continued throughout the year.

NON-STRATEGIC

OTHER

Other is made up of products that we are in the process of transitioning out of and is subject to change as we continually assess the strategic fit of the products in our portfolio. Unit sales in Q4 declined by 37%, with sales up by 37%. The sales growth was primarily in EMEA and was driven by a variety of products. The increase in ASP reflects end-of-life sales of higher price point products.

RETAIL SALES BY REGION

RETAIL SALES – AMERICAS REGION

Q4 sales in the Americas increased by 4%, with units up by 2%. The sales decline in the Profit Maximization category was more than offset by strong performance in the Growth category, led by Mobile Speakers.

RETAIL SALES – EMEA REGION

Q4 sales in EMEA were up by 4% in USD and by 1% in local currency. Unit shipments declined by 5%. From a country perspective, we experienced strong growth in both Germany and France. Sales were down in emerging markets, particularly Russia and Turkey. The overall sales growth in EMEA was driven primarily by Mobile Speakers and PC Gaming.

RETAIL SALES – ASIA PACIFIC REGION

Sales in Q4 in Asia Pacific were flat in USD and up by 3% in local currency, with units up by 1%. PC Gaming and Mobile Speakers sales both increased by double-digits. Q4 sales in China increased by 6%, driven by strong results in our Growth category, led by PC Gaming.

OEM SALES

Our Q4 OEM sales increased by 8% primarily due to growth in Keyboards & Desktops. While this was our strongest OEM sales performance in several years, we are not planning for continued growth given the weak market conditions for sales of new desktop PCs.

LIFESIZE

LifeSize achieved sales growth in Q4 of 4%. Sales remained stable at roughly $30M per quarter throughout FY14. Q4 was the second consecutive quarter that LifeSize has delivered profitability, driven by lower spending resulting from the comprehensive restructuring and portfolio rationalization implemented earlier in FY14.

GROSS MARGIN

Our Q4 non-GAAP gross margin of 34.2% was down by 60 basis points compared to the prior year and by 20 basis points sequentially. We improved margins compared to the prior year in most of our Profit Maximization lines. The year-over-year and sequential decline were mainly driven by the price adjustments related to the Logitech Ultrathin Keyboard Cover product transition.

OPERATING EXPENSES

Our Q4 non-GAAP operating expenses were $143M, down by $20M, or 12%, 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 29.5% of sales, down by 530 basis points and reflecting improved operating leverage. The increase in G&A spending was driven by variable compensation costs related to our strong operating performance in FY14.

Our Q4 GAAP operating expenses include a restructuring charge for $5.4M. This charge reflects the consolidation of our Silicon Valley campus from two buildings down to one, which will reduce our facility expenses going forward.

OPERATING INCOME

Our non-GAAP operating income in Q4 was $23M. For the full year, non-GAAP operating income more than doubled to $140M, at 6.6% of sales, and put us ahead of schedule on our three year turnaround plan.

TAX RATE

Our GAAP tax provision in Q4 was a benefit of $3.8M, which primarily reflects the favorable impact of statute of limitations expirations. Our non-GAAP tax rate was 13.2% for FY14.

NET INCOME

Non-GAAP net income was $23M in Q4, up by $21M. For the full year, non-GAAP net income more than doubled to $123M, an improvement of $73M.

SHARE COUNT

Our diluted share count in Q4 was 165.8M shares. The increase vs. the prior year was primarily driven by employee stock plans and the impact of the growth in our share price. We have now received all required approvals for our new $250M share repurchase program.

EARNINGS PER SHARE

Non-GAAP earnings per share in Q4 was $0.14, up from $0.01. For the full year, it was $0.76, more than double that of the prior year.

BALANCE SHEET

We generated $94M in cash flow from operations in Q4, the most for a Q4 in the last six years. For the last twelve months, our cash flow from operations was $202M, an increase of $85M and our highest total since FY10. We finished the year with $469M in cash, up by $136M compared to March 2013, and no debt.

We ended Q4 with $230M in inventory. Disciplined inventory management led to a $31M, or 12%, decrease compared to March 2013 and a $28M decrease compared to December 2013. Inventory turns improved to 5.6, up by 0.9 turns.

Our Q4 accounts receivable was $178M, down slightly from the prior year despite the increase in sales. As a result, DSO decreased by 1 day to 33 days, our lowest ever for a Q4.

Accounts payable was $246M, down by $20M with DPO decreasing by 8 days to 69 days.

Our cash conversion cycle in Q4 was 29 days, down by 4 days. The decrease was primarily due to faster inventory turns, which more than offset the decline in accounts payable.

FISCAL YEAR 2015 OUTLOOK

We are confirming our FY15 outlook of $2.16B in sales and $145M 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: our turnaround, the timing of new products, sales growth for certain products, product categories and regions, market share in product categories, product strategies, and Fiscal Year 2015 sales 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 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, 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, 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 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.